21 October 2022

Persistent Systems

Growth resilience and margin surprise in Q2: Buy

Rating: **Buy**
Target Price: Rs.4,410
Share Price: Rs.3,695

Persistent was resilient in key metrics despite the top client sliding 21% q/q as it reported 5% q/q (organic) company growth. Tailwinds came from the IP-led business, which surprised, absorbing almost half of the fall. The EBIT margin rose 27bps q/q, absorbing 230bps of the wage-hike impact and was 72bps higher y/y. TCV touched $368m, up 30% y/y and net new TCV was up 53% y/y; no slowdown yet. Management intends to maintain growth; margins would improve as supply challenges seem to be behind. We revise estimates ~10% driven by TCVs and margins. Target increased to Rs.4,410 (23x FY25, earlier Rs.4,290).

Resilient growth despite steep drops in top client, TCV sustains. Persistent had $256m revenue, up 6% q/q incl. acquisitions, after absorbing a steep decline in the top client. TCVs suggest continued growth ahead, leading to our revised FY24 estimate. Book-to-bill was 1.4 (TTM average: 1.6), above peers. Most assignments are annually renewed (average tenure ~1.5 years); hence, Q2 ACV took the hit for ramp-downs, and still grew 3% q/q, 35% y/y. On the positive side, top-client concentration shrank to 9%.

Wage hikes behind, margin tailwinds ahead. The Q2 EBIT margin was 14.6%, up 27bps q/q, 72bps y/y, as high-margin IP revenue has started growing again after a while. The company doesn't expect similar growth in IP but expects them to grow. On the services business, supply cost pressures seem to be past and rupee depreciation tailwinds are blowing. Hence, we expect better margins.

High H1 capex and receivables. Persistent in running on high capex with FY22 (~7% of revenue) and FY23 (~6%) to support headcount growth. Capex has come off the Q1 high but is still on the higher side. On receivables, DSOs (incl. unbilled) have risen, leading to less cash generated (H1 at 88% vs 3-yr avg 127%). No change in payment terms reported.

Maintaining a Buy. We raise our estimates ~10% on the good Q2 performance. We also introduce FY25e and roll forward our valuation with a revised target of Rs.4,410, suggesting 19% potential. The revised target is based on 23x FY25e. **Risks:** Slowdown in the US, M&A integration-related.

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	41,879	57,107	84,394	105,048	125,827
Net profit (Rs m)	4,507	6,904	9,930	12,250	14,633
EPS (Rs)	59.0	90.3	129.9	160.3	191.5
P/E (x)	62.9	41.0	28.5	23.1	19.4
EV / EBITDA (x)	39.6	28.0	17.6	14.0	11.9
P/BV (x)	10.1	8.4	7.0	5.9	5.1
RoE (%)	17.4	22.4	26.9	27.8	28.2
RoCE (%)	15.9	21.3	28.6	30.1	30.6
Dividend yield (%)	0.4	0.7	1.2	1.7	2.3
Net debt / equity (x)	-0.6	-0.3	-0.1	-0.1	-0.2

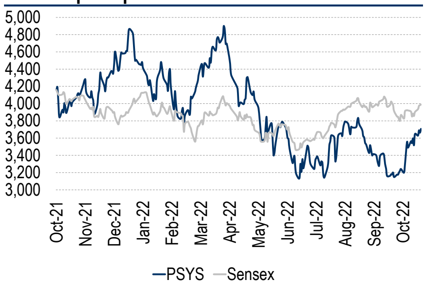
Source: Company, Anand Rathi Research

Key data	PSYS IN / PERS.BO
52-week high / low	Rs4988 / 3092
Sensex / Nifty	59203 / 17564
3-m average volume	$17.1m
Market cap	Rs283bn / $3423.1m
Shares outstanding	76m

Shareholding pattern (%)	Jun'22	Mar'22	Dec'21
Promoters	31.3	31.3	31.3
- *of which, Pledged*	-	-	-
Free float	68.7	68.7	68.7
- Foreign institutions	20.5	20.0	19.9
- Domestic institutions	25.9	26.8	26.9
- Public	22.4	22.0	21.9

Estimates revision (%)	FY23e	FY24e
Sales ($)	0.6	3.0
EBITDA	8.2	10.7
PAT	5.8	9.5

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Revenues (US$m)	**566.1**	**765.6**	**1,042.4**	**1,269.5**	**1,520.6**
Growth (%)	**12.9**	**35.2**	**36.2**	**21.8**	**19.8**
Net revenues (Rs m)	41,879	57,107	84,394	105,048	125,827
Employee & Direct Costs	27,650	37,895	55,722	70,182	84,621
Gross Profit	14,229	19,213	28,672	34,866	41,206
Gross Margin %	33.98	33.64	33.97	33.19	32.75
SG&A	7,398	9,557	13,298	15,627	18,478
EBITDA	**6,830**	**9,655**	**15,373**	**19,239**	**22,728**
EBITDA margins (%)	16.3	16.9	18.2	18.3	18.1
- Depreciation	1,756	1,660	2,753	3,572	3,945
Other income	1,020	1,248	646	701	772
Interest Exp					
PBT	6,094	9,243	13,266	16,368	19,554
Effective tax rate (%)	26	25	25	25	25
+ Associates/(Minorities)					
Net Income	4,507	6,904	9,930	12,250	14,633
WANS	76	76	76	76	76
FDEPS (Rs/share)	59.0	90.3	129.9	160.3	191.5

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	764	764	764	764	764
Net worth	27,957	33,682	40,257	47,757	55,983
Total debt (including Pref)	44	4,326	3,028	2,120	-
Minority interest					
DTL/(Asset)	-1,038	-1,123	-1,123	-1,123	-1,123
Capital employed	**26,963**	**36,885**	**42,163**	**48,753**	**54,860**
Net tangible assets	3,254	4,276	5,339	5,275	5,129
Net Intangible assets	1,230	8,270	16,120	18,275	18,080
Goodwill	86	2,790	2,790	2,790	2,790
CWIP (tangible and intangible)	122	1,071	1,071	1,071	1,071
Investments (Strategic)	3,621	3,878	3,878	3,878	3,878
Investments (Financial)	6,375	4,347	1,304	2,608	5,216
Current Assets (ex Cash) Incl LT a	11,121	19,242	23,141	27,085	32,193
Cash	9,809	9,144	6,184	6,336	6,147
Current Liabilities (ex ST Loan/Cu	8,654	16,133	17,665	18,566	19,643
Working capital	2,467	3,110	5,476	8,519	12,550
Capital deployed	**26,963**	**36,885**	**42,163**	**48,753**	**54,860**
Contingent Liabilities	506	869	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT	6,094	9,243	13,266	16,368	19,554
+ Non-cash items	1,269	1,981	2,145	3,104	3,406
Operating profit before WC chang	7,363	11,224	15,411	19,472	22,961
- Incr./(decr.) in WC	-1,578	4,062	2,367	3,043	4,031
Others incuding taxes	-1,582	1,288	-3,336	-4,118	-4,921
Operating cash-flow	7,359	8,450	9,708	12,311	14,009
- Capex (tangible + Intangible)	1,251	3,808	5,010	2,505	2,505
Free cash-flow	6,108	4,642	4,698	9,806	11,504
Acquisitions	448	6,154	6,656	3,158	1,098
- Dividend (including buyback & ta	1,070	1,987	3,354	4,751	6,407
+ Equity raised	-	-	-	-	-
+ Debt raised	4	4,279	-1,298	-908	-2,120
- Fin Investments	-634	-1,992	-3,043	1,304	2,608
- Misc. Items (CFI + CFF)	-9	3,437	-608	-468	-539
Net cash-flow	5,237	-665	-2,960	152	-190

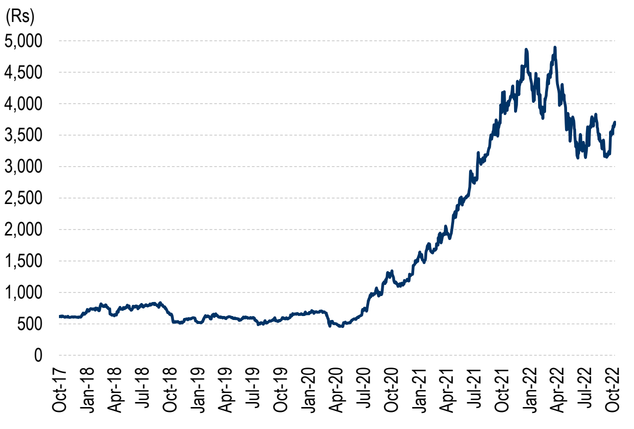
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	62.9	41.0	28.5	23.1	19.4
EV/EBITDA (x)	39.6	28.0	17.6	14.0	11.9
EV/sales (x)	6.4	4.8	3.3	2.6	2.2
P/B (x)	10.1	8.4	7.0	5.9	5.1
RoE (%)	17.4	22.4	26.9	27.8	28.2
RoCE (%) - After tax	15.9	21.3	28.6	30.1	30.6
RoIC (%) - After tax	39.0	35.9	31.8	30.9	33.2
DPS (Rs per share)	14.0	26.0	43.9	62.2	83.8
Dividend yield (%)	0.4	0.7	1.2	1.7	2.3
Dividend payout (%) - Inc. DDT	23.7	28.8	33.8	38.8	43.8
Net debt/equity (x)	-0.6	-0.3	-0.1	-0.1	-0.2
Receivables (days)	69	81	85	85	85
Inventory (days)					
Payables (days)	28	33	30	28	27
CFO:PAT%	163.3	122.4	97.8	100.5	95.7
FCF:PAT% - includ M&A payout	124.9	-22.6	-19.7	54.3	71.1

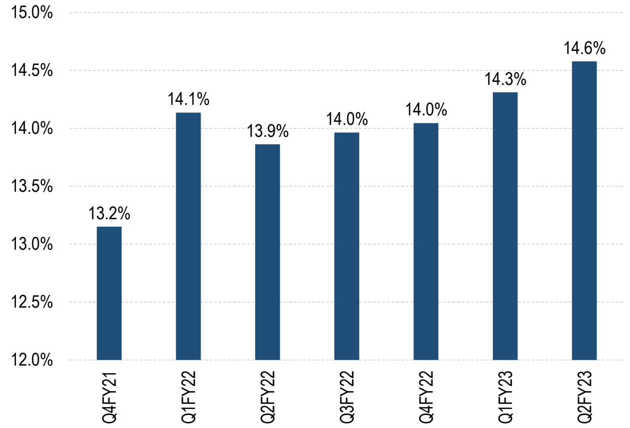
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBIT margins



Source: Company, Anand Rathi Research

Result Highlights

Q2 FY23 Results at a Glance

Fig 7 – Segment-wise results

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q/Q	Y/Y
Revenue ($ m)	182	199	217	242	256	5.8%	40.2%
Growth Y/Y %	34.0%	33.0%	35.9%	28.5%	26.3%		
Industry Y/Y % (est.)	22%	21%	20%	16%	13%		
Revenue (Rs m)	13,512	14,917	16,379	18,781	20,486	9.1%	51.6%
Effec. exchange rate	74.1	74.9	75.4	77.8	80.2	3.1%	8.2%
TCV($ m)	282.5	334.3	361.0	394.0	367.8	-6.6%	30.2%
TCV(LTM)	1,075.8	1,108.1	1,222.6	1,371.8	1,457.1	6.2%	35.4%
Y/Y %	26%	11%	46%	61%	30%		
TCV:Rev.	1.5	1.7	1.7	1.6	1.4		
Employees (EoP)	15,879	16,989	18,599	21,638	22,476	3.9%	41.5%
Rev. prod. ($ '000/employee)	11.8	12.1	12.2	12.0	11.6	-3.5%	-2.2%
Utilisation % (IT Services)	82.8%	83.0%	80.6%	79.5%	79.9%	40 bps	-290 bps
Attrition %	23.6%	26.9%	26.6%	24.8%	23.7%	-110 bps	10 bps
CoR (excl. D&A)	(8,982)	(9,880)	(10,859)	(12,433)	(13,628)	9.6%	51.7%
As % of revenue	-66%	-66%	-66%	-66%	-67%	-32 bps	-5 bps
SG&A	(2,287)	(2,526)	(2,707)	(3,015)	(3,178)	5.4%	39.0%
As % of revenue.	-17%	-17%	-17%	-16%	-16%	54 bps	141 bps
EBITDA	2,244	2,511	2,812	3,333	3,680	10.4%	64.0%
EBITDA margins %	16.6%	16.8%	17.2%	17.7%	18.0%	22 bps	135 bps
EBIT	1,873	2,083	2,300	2,688	2,987	11.1%	59.4%
EBIT margins %	13.9%	14.0%	14.0%	14.3%	14.6%	27 bps	72 bps
Industry margins % (est.)	17.2%	17.9%	17.3%	16.4%	15.7%	-76 bps	-157 bps
Other income (excl. forex)	293	251	251	89	61	-31.8%	-79.2%
Non-recurring / Forex	10	30	120	42	(91)	NM	NM
Interest expenses							
PBT	2,176	2,364	2,672	2,819	2,956	4.9%	36%
PBT margins %	16.1%	15.8%	16.3%	15.0%	14.4%	-58 bps	-168 bps
Taxes	(559)	(600)	(662)	(703)	(756)	7.6%	35%
ETR %	-26%	-25%	-25%	-25%	-26%	-64 bps	10 bps
Associates / Minority							
Net income	1,618	1,764	2,010	2,116	2,200	4.0%	36%
Net margins %	12.0%	11.8%	12.3%	11.3%	10.7%	-53 bps	-123 bps
Industry net margins %	13.9%	14.0%	14.3%	12.5%	11.8%	-62 bps	-209 bps
EPS (Rs)	21.2	23.1	26.3	27.7	28.8	4.0%	36%

Source: Company, Anand Rathi Research Note: Y/Y organic growth is estimated to be 26.3%

Fig 8 – Quarterly result

Year-end: Mar (Rs m)	Q2FY23	% chg. Q/Q	% chg. Y/Y	H1 as % of FY23	FY22	FY22 % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	256	5.8	40.2	48	766	35.2	36.2
Sales	20,486	9.1	51.6	47	57,107	36.4	47.8
EBITDA	3,680	10.4	64.0	46	9,655	41.4	59.2
EBITDA margin (%)	18.0	22bps	135bps	-	16.9	60bps	131bps
EBIT	2,987	11.1	59.4	45	7,995	57.5	57.8
EBIT margin (%)	14.6	27bps	72bps	-	14.0	188bps	95bps
PBT	2,956	4.9	35.8	44	9,243	51.7	43.5
Tax	(756)	7.6	35.3	44	(2,339)	47.3	42.6
Tax rate (%)	(25.6)	-64bps	10bps	-	(25.3)	75bps	16bps
Net income	2,200	4.0	36.0	43	6,904	53.2	43.8

Source: Company, Anand Rathi Research Note: FY22 numbers include acquisitions made, hence not comparable

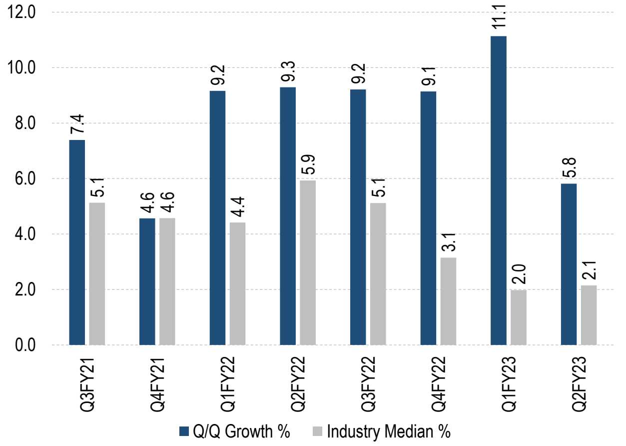
Growth shows resilience

Persistent had a good Q2, comfortably surpassing the industry growth rate. In Q2 FY22, it grew 5.8% sequentially (incl. acquisitions) and has been at par or above the industry median growth for the last eight quarters. Q2 organic revenue growth was 4.8% q/q, 26.3% y/y, in dollars. MediaAgility was integrated for the full quarter. In Services (its core business), it delivered 3.9% q/q growth (org). The notable part in Q2 was the fact that it delivered this growth after absorbing the steep decline in the top client. We are not sure of any other mid-size IT services company which has shown such resilience in a tough environment.

From a y/y perspective, it delivered 26.3% organic (40% incl. inorganic) revenue growth, outstripping midcap IT companies. It has been ahead of industry growth for the last eight quarters, suggesting a healthy mix of deals and ramp-ups, something also visible in client buckets.

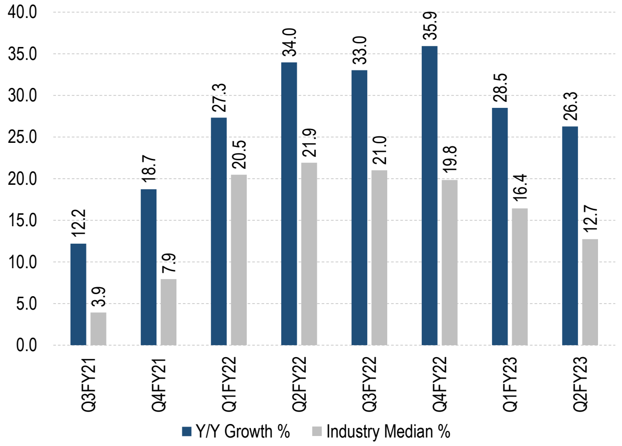
This perfomance was on the 6-8% revenue leakage (between revenues and TCVs) due to ramp-up delays and to fulfilment issues at the company's end.

Fig 9 – Grew faster than the industry



Source: Company, Anand Rathi Research

Fig 10 – Consistently growing faster than the industry

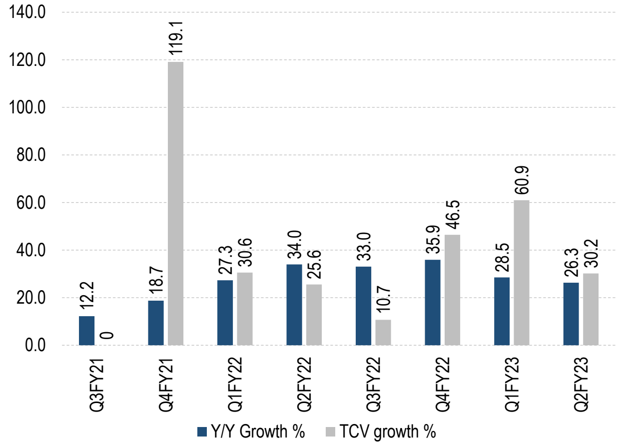


Source: Company, Anand Rathi Research Note:

In TCV, it had a good quarter with Q2 at $368m (up 30% y/y). A few key deals won include one from a leading European enterprise software company, of $80m (the largest in Q2), spread over five years. Q2 deal wins offer strong growth assurance in FY23 as book-to-bill is high. Management also said it is not seeing much delays in deal closures and that cost take-out deals have increased in the last few quarters. The enterpirse software space is seeing strong deal closures.

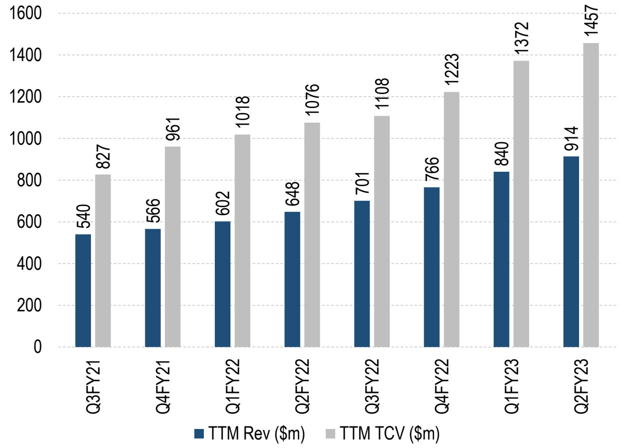
On a TTM basis, revnues grew faster (41% y/y) than TCV (35% y/y); both have been growing over 30% y/y on average for the last four quarters.

Fig 11 – Revenue grows faster than TCV



Source: Company, Anand Rathi Research Note:

Fig 12 – TTM TCV ahead of TTM revenues.



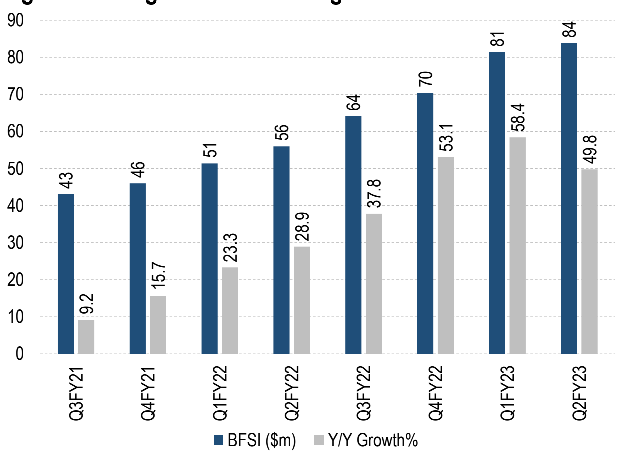
Source: Company, Anand Rathi Research Note:

Hi-tech was strong while BFSI moderated

Persistent, from a vertical-exposure perspective, operates in three verticals: hi-tech (48% of revenue), BFSI (33%) and healthcare (20%). Interestingly, BFSI is the largest for Indian IT where PSYS is trying to establish itself as a strong challenger (~$335m revenue p.a., at the Q2 run rate). A few large US banks are its clients and it is expanding its base in India in this vertical. In Q2, BFSI growth decelerated to just 3% q/q. Management expects some recovery ahead based on deal wins in Q2. This vertical was aided by acquisitions in the last few quarters.

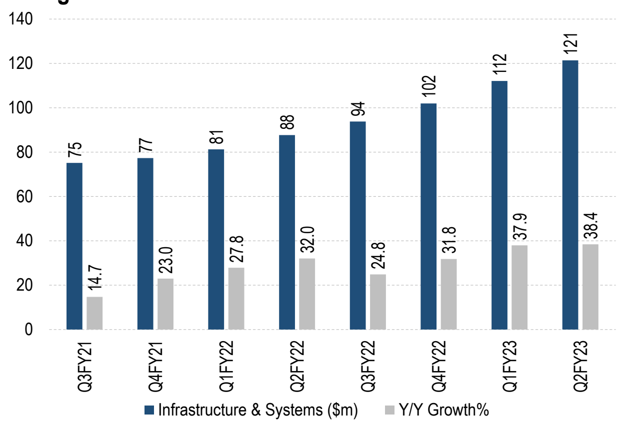
The hi-tech vertical grew 38% y/y in Q2 and the company closed a large deal ($80m+) here in Q2. This vertical has been doing very well for the company, averaging over 30% y/y growth in the last seven quarters. This vertical was further aided by the MediaAgility acquisition integrated for the full quarter. The top client was down 21% q/q, 28% y/y, declining sequentially for the third straight quarter. Excl. the top client, hi-tech grew 74% y/y, with the acquisitions.

Fig 13 – BFSI growth moderating



Source: Company, Anand Rathi Research Note: Q3FY22 growth is organic (est.)

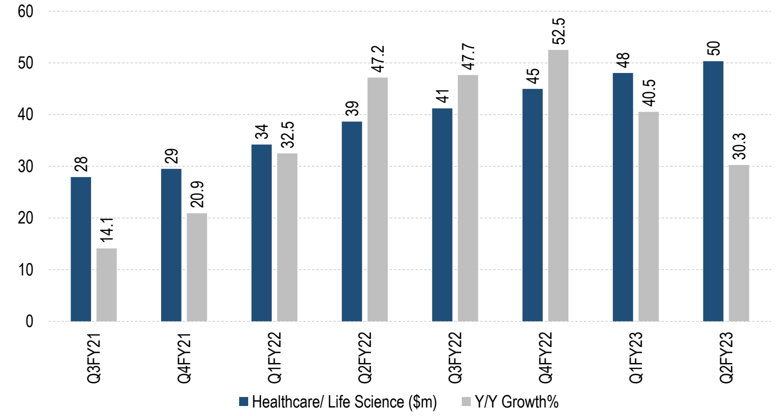
Fig 14 – Software, hi-tech emerging industries growth strong



Source: Company, Anand Rathi Research Note:

In healthcare and lifesciences, Persistent has been delivering good growth for quite some quarters now. In line with its performance, Q2 was strong (up 5% q/q, 30% y/y). This vertical is expected to continue to do well.

Fig 15 – Healthcare to continue to grow fast



Source: Company, Anand Rathi Research Note:

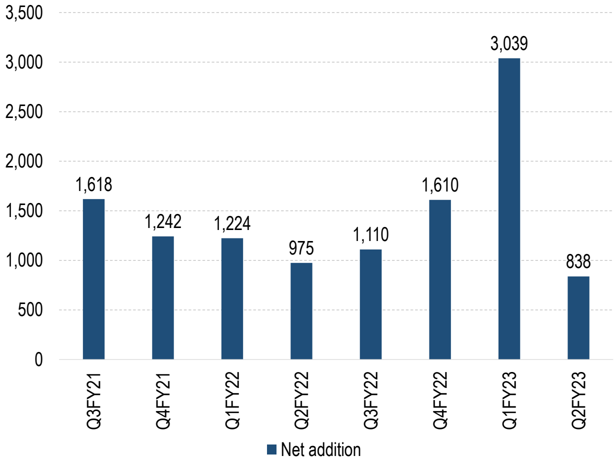
Margin improves q/q and y/y; productivity steady

Persistent added 838 employees (mainly freshers) in Q2 (6,596 in LTM), leading to utilisation moving to 79.9% in Q2 FY23 from 82.8% a year ago. Sequentially, it moved up slightly from 79.5%. In H1, 3,000 freshers (1,950 in Q1) were added and the the company disclosed that they are done with its fresher hiring for the year. Wage hikes are effective 1st Jul and had a gross impact of 230bps on margins.

The Q2 EBIT margin expanded 27bps q/q, 72bps y/y, despite the impact from wage hikes, provision for doubtful debts and CSR. Margins were largely cushioned by the greater contribution from IP-led and depreciating currency. This quarter also saw lower travel costs (absence of visa costs, which were booked in Q1) and sub-contracting costs.

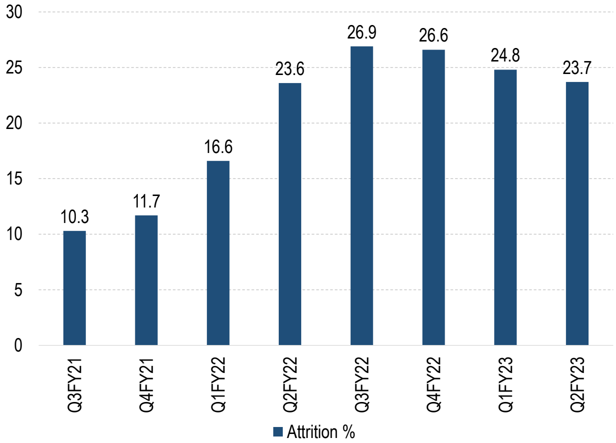
Attrition, on the other hand, was 23.7% (moving downward for the third quarter in a row). The company expects attiriton to further moderate in H2.

Fig 16 – Net addition slow; chiefly freshers hired in Q2



Source: Company, Anand Rathi Research

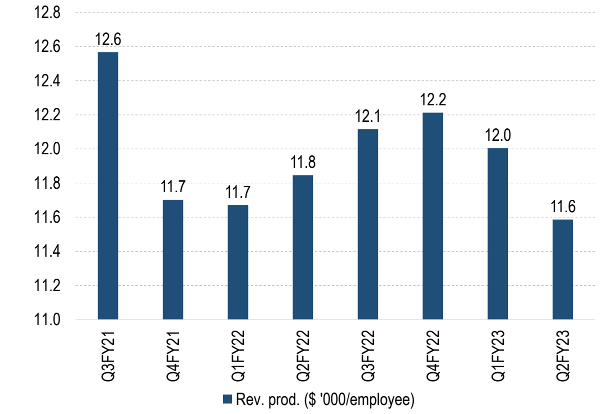
Fig 17 – Attrition moving downward



Source: Company, Anand Rathi Research Note: Excluding freshers, attrition was 26.3% in Q1FY23

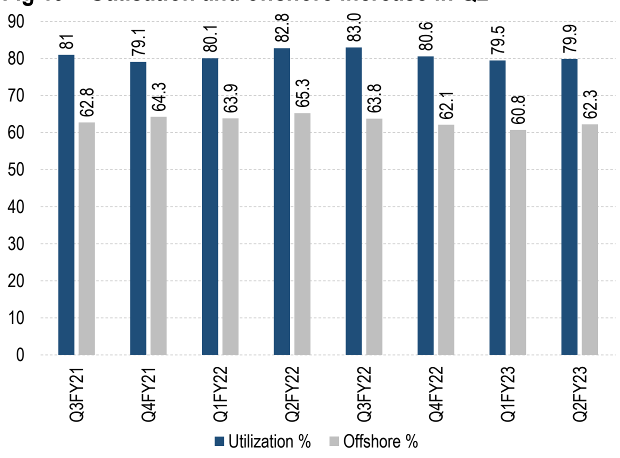
From an employee-productivity perspective, PSYS is ~8% lower than the recent highs and also slightly lower than the last seven quarters (average 11.9%). The fluctuation is due to integration of various acquisitions over the past year at different times. Besides, it also reflects downward pressure on onsite billing rates as the company is moving to near-shore delivery. From a y/y perspective, productivity is down 2%. PSYS now has better productivity in Europe and, hence, in quarters (like Q2) when growth in Europe turns out to be soft, productivity also moves down.

Fig 18 – Productivity fluctuations reflect M&A integration and decline in onsite billing rates



Source: Company, Anand Rathi Research Note:

Fig 19 – Utilisation and offshore increase in Q2



Source: Company, Anand Rathi Research Note:

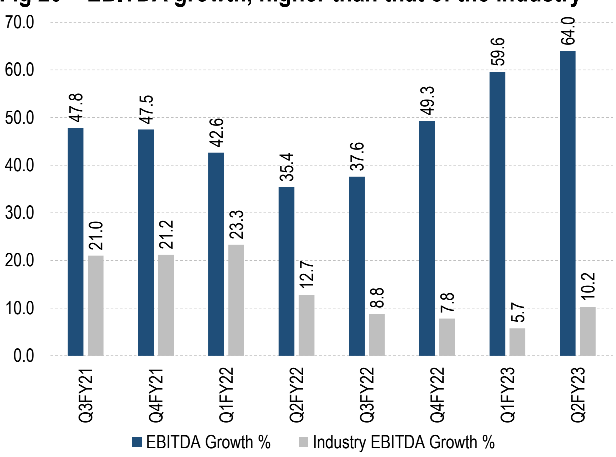
Healthy EBIDTA / NI growth

PSYS delivered 64% y/y EBITDA growth in Q2 FY23, way ahead of the industry. Y/y, margins expanded 135bps to 18%. Margins in FY23 would be better than in FY22 despite headwinds in the form of wage hikes (higher than in FY22), and from acquisitions and high attrition. The worst of these three variables, however, appear to be behind. The company is confident of defending margins at current levels and sees some improvement in H2. Margin levers include higher utilisation, lower sub-contracting costs and more fresher intake, all tailwinds. H2 FY23 should also see synergy revenue, which would also be a lever for margins/operating leverage.

In Q2, the company saw margins impacted by the wage hike (230bps), provision for doubtful debts (20bps) and CSR (10bps), cushioned by IP-led (80bs), currency (90bps) and operating leverage benefits from more services revenue. Despite all the challenges, it has done well in margins, and its EBITDA growth is still above the industry average.

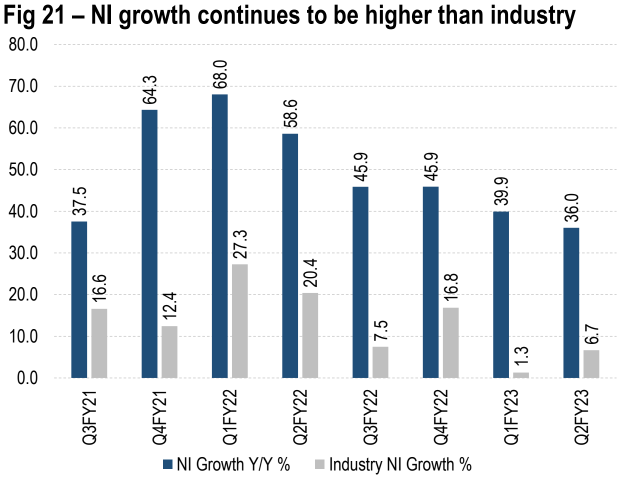
NI grew 36% in Q2 while the NI margin contracted 53bps q/q, 123bps y/y. This was largely due to lower other income (down 32% q/q, 79% y/y) and forex loss (forex gains in Q1 FY23 and Q2 FY22). Further, ETR moved up sequentially to 25.6%, from 24.9%, and was flatish y/y.

Fig 20 – EBITDA growth, higher than that of the industry



Source: Company, Anand Rathi Research

Fig 21 – NI growth continues to be higher than industry



Source: Company, Anand Rathi Research Note:

In terms of client metrics, Persistent has scaled up well in $5m+ clients and $10m+ clients with LTM addition of respectively eight (on a base of 22 to reach 28 by Q2 FY23) and three (on a base of nine to reach 12 by Q1 FY23). This is in line with management commentary of efforts in client mining. Further, the maximum success came in the $1m+ clients, which increased by 40 in the last 12 months to 146 in Q2. The count includes clients added through acquisitions over the period.

Conference Call Highlights

Q2 FY23 Concall takeaways

- Sequential organic growth was 4.8% (5.5% cc); Media Agility was integrated for the full quarter
- IP-led growth was driven by the Accelerite portfolio.
- Revenue leakage of 6-8% happens due to ramp-up delays and to fulfillment issues at the company's end.
- Financial services exposure mainly in the US and India (chiefly NBFC and financial services organisations) and the company does not have much exposure to the mortgage part.
- Salesforce practice is $130m (annual run rate), part of the work is project oriented, part managed services. Significant work here is longer term contracts.
- Won an $80m deal (largest in Q2) spread over five years from a leading European enterprise software company
- Strong deal wins and closures in enterprise software. Not many delays in deal closures, and the pipeline is good. Cost take-out deals have increased in the last few quarters.
- Acquisitions are in the final stage of integration and the company has already started winning deals through them.
- Top client won't see material impact in Q3 and Q4.
- No client-specific issues but clients are talking about being more prudent about long-term spends.
- Margins hit by wage hike (230bps), provision for doubtful debts (20bps) and CSR (10bps), cushioned by IP-led (80bps), currency (90bps) and margin from higher services revenue. This quarter also saw lower travel costs (visa filing cost absent) and lower sub contracting costs.
- Wage hike was effective 1st July and covered all employees.
- D&A higher due to Media Agility being integrated for the full quarter.
- Most hiring in Q2 was of freshers (3,000 joined in H1, and the company has completed fresher hiring for the year. A small portion has already become billable.
- TTM attrition to continue to moderate in H2.
- OCF affected by performance bonus, insurance and fresher addition (payout on account of licenses).
- Management to get active in M&A (considering M&A in Europe) in a few months, as current-acquisition integration is done.

Business Outlook

- Endeavor to grow 4-6% sequentially intact.
- Confident of margins holding at levels now, provided the dollar is not volatile.
- ETR to be at Q2 levels for the rest of the year.

Q1 FY23 Concall takeaways

- Demand is strong and management is not seeing any delays from clients.
- Persistent recorded 11.1% q/q growth: organic 5.6%, inorganic 5.5%
- Did not lose any revenue in Q1 due to budget constraints from clients but lost revenue due to staffing and delay in ramp-ups.
- Royalty revenue was slow in IP-led. The top-client was down due to the IP-led contract.
- BFSI – Mortgage exposure is insignificant (not impacted by mortgage slowdown). RedHat growth rate slower than that of the company and insignificant.
- Won a seven-year deal of $50m+ from a leading European software company. This is its largest deal in the Europe.
- Won a five-year deal from a leading health-tech company. This is one of the larger deals it won in Healthcare.
- New contracts are coming in at higher prices though the company also increased rates with some renewal contracts.
- Rationalising the tail is on the cards, management is waiting to either scale up with current clients or let them find a new provider.
- The EBIT margin was hit by supply-side challenges, travel & visa costs, and amortization, aided by currency (90bps) and receivables collected.
- Visa costs were $1.1m and project-related travel costs were $0.2m (this will not recur in Q2)
- Amortization was higher due to acquisitions. Media Agility was integrated for two months and DataGlove was integrated for the full quarter. Persistent has already started seeing wins with new acquisitions.
- Q2 wage hike impact to be ~250-300bps (a bit higher than prior years), should be able to absorb some of it. Margin levers include utilisation, sub-contractor costs (travel opening up), and fresher intake. H2 FY23 should also see synergy revenue, which would also be a lever.
- 1,950 fresh graduates were added in Q1, to be deployed within 3-6 months. The company plans to add 1,350 fresh graduates in Q2. Freshers are considered for utilisation calculation three months after being onboarded.
- Sales and business development headcount up due to acquisitions.
- Attrition to moderate ahead
- DSO higher due to some spillover in the first week of Jul. Unbilled up due to Media Agility.
- Focus on integration of acquisitions made, not looking for acquisitions for the next 3-6 months.
- Capex up due to hardware (for freshers), office requirements (Gurgaon) and Q1 also has higher software capex. Capex to come down in FY23.
- To achieve $1bn run rate in the next few quarters.
- FY23 margins to be around FY22 levels.

Q4 FY22 Concall takeaways

- Q4 organic revenue growth was 6.8% q/q, 36% y/y, in dollar terms. The company had $4.7m further revenue from all three acquisitions in Q4. This was after absorbing a $4m drop in revenue from the top client due to a restructuring of their contract.
- FY22 organic growth was 32.8%.
- IP-led revenue was down due to restructuring of a deal with the top customer. The revenue-share deal is now a T&M one.
- The BFSI and Hi-tech (mainly Data Glove) verticals were aided by acquisitions in Q4.
- Offshore linear revenue grew 11.5% due to 9.8% volume growth and a 1.5% billing-rate increase.
- Onsite linear revenue grew 20.1% due to 17.6% volume growth and a 2.1% billing-rate increase.
- SCI and Shree Partners were fully integrated while Data Glove was integrated for a month. The Media Agility acquisition is expected to be closed in 1-2 weeks.
- TCV data shared do not include acquisitions' TCV.
- Deal highlights. $10m+ deal signed in payments with the help of SCI. Shree Partners not only aided in vendor consolidation but has also helped PSYS close two large multi-year deals and are triple digit on a TCV basis.
- Despite headwinds from D&A, one-time cost in M&A (30bps), supply side challenges and higher CSR, EBIT was flat. The company had a currency benefit of 30bps.
- Margins were down in BFSI due to increase in onsite revenue
- SCI and Shree at similar levels if margins compared to the company
- FY23 margins to see headwinds in the form of wage hikes (to be higher than in FY22), a 70-80bp headwind from acquisitions and high attrition. The company is confident of defending the 14% EBIT margins and is looking to raise prices with some clients.
- The billing rate in Europe is higher than that of the US.
- Of the net headcount addition in Q4, 30-40% were freshers and 700 employees were added from Data Glove. Wage hikes are due on 1st Jul.
- Utilisation was down in Q4 due to capacity building and fresher intake
- The company expects TTM attrition to be high as demand is robust, but expect it to come down over FY23
- Receivables were higher due to billing toward the quarter's end, not due to change in payment terms
- DSO was 59 days vs 58 in Q3
- Total payout for acquisitions (excl. MediaAgility) would be $220m, of which $150m was upfront, the rest in liabilities/earn-outs.
- Management is not seeing any weakness in the ISV market despite inflation and geopolitical tension

- Debt taken of $25m for SCI and $35m for Data Glove. The cost of debt is Libor+155bps. The tenure is three years and is an amortizing structure.
- The company will pause acquisitions for 1-2 quarters and concentrate on integration.
- CMT is an emerging vertical with a $50m run rate.
- The company is looking at $1bn revenue in 4-6 quarters.
- It is confident of defending a 14% EBIT margin.

Q3 FY22 Concall takeaways

- Q3 organic growth was 6.7% q/q, 33.4% y/y
- SCI's revenue was consolidated for almost the entire quarter, Shree Partners was consolidated for about half the quarter. SCI's revenue for the quarter was $3.7m and Shree Partners revenue was ~$800,000.
- The ESOP plan had a margin impact of 75bps. The higher Services revenue, better IP-led revenue and favourable currency movements aided margins by 50bps, and the focus on utilization helped offset the higher cost of operations caused by attrition. EBIDTA improved 20bps to 16.8%, against 16.6% the previous quarter.
- 1,110 employees added including 258 from the Shree Partners and SCI acquisitions. Fresh graduates constituted ~one fourth of the organic net addition. Looking at hiring 3,000 freshers in FY23.
- Annualized attrition has started to soften, though it remains high. 12-month attrition is likely to be the higher side for at least another couple of quarters. It would then moderate due to the base effect and on account of the new batch of freshers who will join, thereby expanding the supply for industry overall
- Avani Davda was added to Persistent's Board of Directors. Kuljesh Puri joined as an SVP for IBM Alliance and Emerging Verticals. Ajay Kumar joined as SVP for Partner Ecosystems, which includes sourcing advisory, private equity and similar channels. Vijay Iyer joined as Sales VP for digital transformation. PSYS also on-boarded its first member to the Persistent Advisor Network, Werner Boeing, a former CIO of Roche Diagnostics.
- Depreciation and amortization was higher on account of the new acquisitions. On a full-quarter basis, the amortization impact would be ~40bps, then moderate as revenue grows.
- DSO was 58 days, against 55 in the previous quarter, the increase being primarily due to higher IP invoicing in the last month of the quarter and some collections spilling over to the first week of Jan
- PSYS is a significant player in the Salesforce ecosystem in India and has expanded it footprint in Indian domestic financial services. The company expects this to be steady in terms of growth.
- PSYS has a healthy pipeline in the Salesforce market in Europe as well as the non-Salesforce market. In the next few quarters, it is expected to see a positive trajectory from a growth perspective for Europe.
- Kuljesh Puri hired as SVP for IBM Alliance and Emerging Verticals. Emerging Verticals has a decent portion of Communications, Media and Technology revenue in it and it is doing well. As it grows more over

time, the company will start announcing it as a separate vertical, but does not expect this in FY23.

- Management aims to be a billion dollar-plus organization over the next 4-8 quarters

Q2 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth after a long time.
- Growth in Q2 was led by Healthcare and Life sciences, followed by BFSI and Hi-tech.
- Returned to normal wage hike (Jul) and Q2 saw the full impact (230bps gross), cushioned by growth and utilisation.
- ESOP plan introduced, which covers 80% of employees, in addition to their packages. ESOP scheme to have an impact of 70-80bps on margins; over time this should be offset.
- Acquisition of SCI and Shree Partners in September; no cost or revenue from these two in Q2. The company is evaluating more tuck-in M&As.
- On the IP business, it is working on optimizing margins and has converted a long-standing contract to a T&M one, which should boost margins and not have any seasonality. This will see some additional resources being released and re-deployed to Services or having more billability. In both the scenarios, margins should improve.
- The drop in the billing rate onsite was due to lower revenue from Europe (essentially due to seasonality) and an increase in revenue from Mexico which typically comes at a lower rate than the US.
- SG&A was higher due to more recruitment expenses although revenue growth aided in covering this. We expect operating leverage ahead.
- Supply-side challenges and attrition would pressure margins but the company expects to navigate these challenges.
- DSO was 55 days compared to 54 in Q1.
- It won a deal with a third-party insurance administrator (an existing customer). The TCV exceeds $50m over five years.
- In Healthcare, it won two deals with a contract-research organization and a leading US healthcare provider among other deals
- In Hi-tech the company was chosen by an employee engagement solutions organization and leading tax preparation and financial technology provider amongst other deals
- Management has plans to go bigger in the US, Canada and Mexico for near-shore delivery. This will help it build a more global delivery model.
- Management is seeing a healthy demand environment. TCV is a good representation of revenue ahead.
- Deals are a good mix of short-medium term and medium term.
- Expect 83-84% utilization.
- No further impact from impairments.
- IP business to be stable for some time and decline over a long tail, steep declines behind the company now.

- Acquisitions to have an impact of 30-40bps over two quarters on EBIT but should be manageable. At the gross margin level, acquisitions are accretive.
- Travel expense had a 10-15bp impact in Q2; if travel continues to open up, it expects this to increase 15bps each quarter.
- Its Europe business was hit by attrition in Q2, or it would have seen growth otherwise. In the medium term, this should move to 10-15% of revenue.
- The IP business has healthy margins; higher than the company average
- Goal of a $1bn run rate to be achieved in 6-8 quarters. This will mostly be through organic growth but some inorganic growth like that in Q2 could be added. Looking for capability acquisitions in cloud, data, security or salesforce.
- Q2 margins sustainable; expect margins of 16-17%.
- Margins to improve 100-150bps over the next 8-10 quarters

Factsheet

Fig 22 – Revenue split

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Effort-Led	87.5	86.7	91.1	93.0	92.2
IP-Led	12.5	13.3	8.9	7.0	7.8

Source: Company, Anand Rathi Research

Fig 23 – Revenue-split, by region

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
North America	78.7	79.2	78.6	78.4	78.6
Europe	8.8	8.3	8.4	8.5	8.3
Asia-Pacific	12.5	12.5	13.0	13.1	13.1

Source: Company, Anand Rathi Research

Fig 24 – Revenue-split, by industry

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
BFSI	31	32	32	34	33
Healthcare	21	21	21	20	20
Infrastructure & Systems	48	47	47	46	48

Source: Company, Anand Rathi Research

Fig 25 – Client profiles (LTM)

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Client profiling					
Top 1	16.9	17.5	14.0	11.7	8.7
Top 5	35.8	36.1	32.5	30.8	26.9
Top 10	45.4	45.0	42.1	40.7	36.7
<$1m+	490	511	560	605	621
$1m+	106	114	118	130	146
$5m+	22	24	25	26	30
Active Clients (effort based)	596	625	678	735	767

Source: Company, Anand Rathi Research

Fig 26 – Workforce

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Employee Movement					
Technical(EOP)	14,657	15,721	17,283	20,144	20,941
Net Adds (Qtr)	824	1,064	1,562	2,861	797
Net Adds (LTM)	4,656	4,188	4,577	6,311	6,284
Utilization %	82.8	83.0	80.6	79.5	79.9
Attrition %	23.6	26.9	26.6	24.8	23.7
Sales(EOP)	296	294	317	367	387
Net Adds (Qtr)	(12)	(2)	23	50	20
Net Adds (LTM)	28	17	44	59	91

Source: Company, Anand Rathi Research

Fig 27 – Revenue-split, by delivery type and billing rates

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Delivery Type(%)					
On-site	34.7	36.2	37.9	39.2	37.7
Offshore	65.3	63.8	62.1	60.8	62.3
Reported Billing Rates ($ /hr)					
On-site	88.5	85.8	87.6	87.8	86.5
Offshore	23.0	22.7	23.1	23.5	24.1

Source: Company, Anand Rathi Research

Fig 28 – Key areas and horizontals growth (%)

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Key Area-wise Growth (Y/Y)					
North America	27.2	33.1	41.1	43.9	40.0
Europe	55.1	28.5	19.5	29.5	32.2
Asia-Pacific	76.3	68.6	71.2	63.5	46.9
Segment Growth (Y/Y)					
Effort-Led	39.9	40.4	44.9	35.9	29.6
IP-Led	3.2	(0.1)	13.5	7.0	16.1
Growth, by vertical (Y/Y)					
BFSI	28.9	37.8	53.1	58.4	49.8
Healthcare	47.2	47.7	52.5	40.5	30.3
Infrastructure & Systems	32.0	24.8	31.8	37.9	38.4

Source: Company, Anand Rathi Research Note: Effort-Led and IP-Led Q2FY23 growth is organic (est.)

Fig 29 – TCV data

	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Net New TCV $ m	149	158	195	230	228
Total TCV	283	334	361	394	368

Source: Company, Anand Rathi Research

Valuations

We introduce FY25e and roll forward our valuation to FY25. We raise our target to Rs4,410 (Rs4,290 previously), which translates to 23x FY25e EPS. At the ruling price, the stock quotes at 19x FY25e P/E and 12x FY25e EV/ EBITDA. FY21 grew 13%, with practically no impact from the pandemic; hence, FY22 growth is more than meets the eye. Revenue was $766m in FY22, and is expected to hit $1,042m by FY23 incl. the three acquisitions. The EBIT margin ahead is expected to be ~15%, compared to 14% in FY22.

IP sales were down 4% in FY22 (in Q2 FY23, up 18% q/q, 16% y/y, driven by the Accelerite portfolio) and the sales momentum here seems to be building up gradually with commentary also turning positive (from end-of-life earlier). The reliance on its top client fell to 16.3% in FY22 (8.7% in Q2 FY23) from 22% in FY20. For the last three quarters the top client has slid sequentially (down 21% q/q in Q2 FY23). Besides, the company has added clients and capabilities in the Microsoft ecosystem, which would offer further medium-term growth opportunities.

We value the stock based on a target P/E of 23x FY25e EPS, slightly lower than LTIMindtree, on the very strong growth execution but also a shade lower on account of weak average FCF generation in FY22, FY23 and FY24.

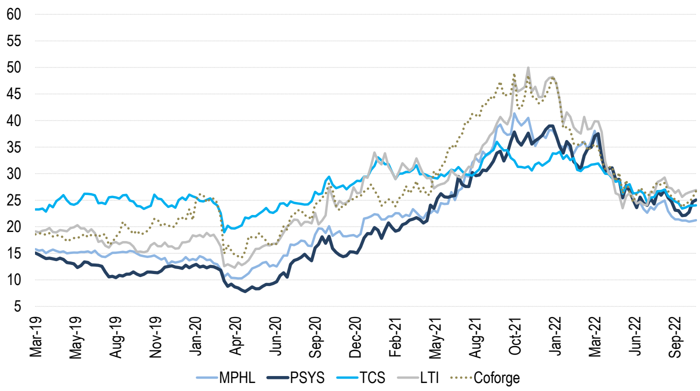
The target multiple reflects the focus on building BFSI faster, bulking up from inorganic initiatives as well. We also note its shrinking exposure to the top client (thus, reducing volatility) and its improving execution and track record in growth built in the last two years. Constraints related to its evolving client metrics will further ease as the company scales up many client relations to large deals (as is evident from its client count of six in the $20m+ bucket).

Fig 30 – Change in estimates

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	1,042	1,036	0.6	1,270	1,233	3.0
Revenues	84,394	82,096	2.8	105,048	98,253	6.9
EBITDA	15,373	14,211	8.2	19,239	17,377	10.7
EBITDA margins %	18.2%	17.3%	91 bps	18.3%	17.7%	63 bps
EBIT	12,620	11,570	9.1	15,667	13,974	12.1
EBIT margins %	15.0%	14.1%	86 bps	14.9%	14.2%	69 bps
PBT	13,266	12,547	5.7	16,368	14,954	9.5
Net profit	9,930	9,388	5.8	12,250	11,190	9.5

Source: Anand Rathi Research

Fig 31 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Slowdown in the US, M&A integration-related.

Appendix

Analyst Certification

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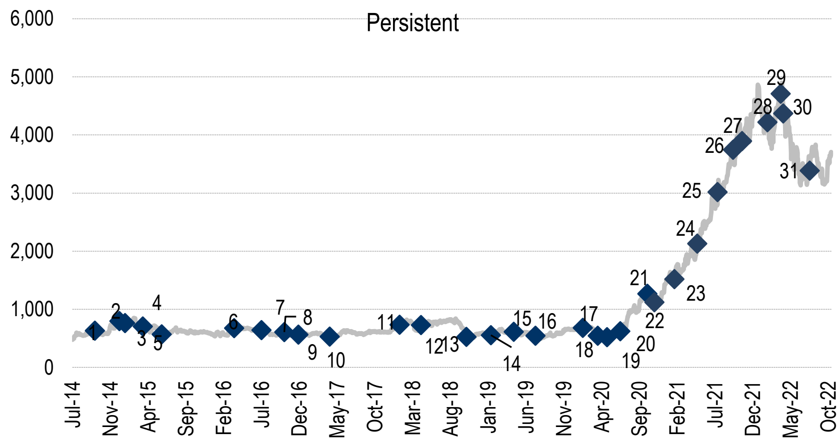

	Date	Rating	TP (Rs)	Share Price (Rs)
16	26-Jul-19	**Hold**	630	552
17	31-Jan-20	**Sell**	690	704
18	31-Mar-20	**Buy**	670	704
19	7-May-20	**Buy**	630	503
20	29-Jun-20	**Hold**	680	627
21	15-Oct-20	**Sell**	940	1,369
22	27-Oct-20	**Sell**	960	1,187
23	1-Feb-21	**Sell**	1,270	1,526
24	2-May-21	**Hold**	2,050	2,038
25	26-Jul-21	**Hold**	3,290	3,040
26	1-Oct-21	**Buy**	4,275	3,716
27	28-Oct-21	**Buy**	4,650	4,007
28	14-Feb-22	**Hold**	4,640	4,200
29	16-Mar-22	**Hold**	4,640	4,314
30	29-Apr-22	**Hold**	4,980	4,288
31	25-Jul-22	**Buy**	4,290	3,600

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