

TCV up 20% QoQ; Top client recovery likely to help sustain growth momentum

About the stock: Persistent Systems (Persistent) offers cloud, data, product & design led services to BFSI, healthcare & hi-tech verticals.

- Persistent had a strong year (FY22) with revenue growth of 35.2% in dollar terms, out of which organic growth was 32.8%
- Net debt free and healthy double digit return ratio (with RoCE of 20%)

Q3FY23 Results: Persistent reported steady revenue growth in Q3FY23.

- Revenue grew 3.5% QoQ in CC terms and 3.4% QoQ dollar terms
- EBIT margins improved ~80 bps QoQ to 15.4%
- Reported TCV was US\$440.2 mn, up 19.7% QoQ & 31.7% YoY

What should investors do? Persistent's share price has grown by ~5.5x over the past five years (from ~₹ 770 in January 2018 to ~₹ 4,258 levels in January 2023).

- We maintain our **BUY** rating on the stock

Target Price and Valuation: We value Persistent at ₹ 4,920 i.e. 26x P/E on FY25E.

Key triggers for future price performance:

- The company has achieved US\$1 bn revenue on a quarterly annualised basis and is now aiming at US\$2 bn annual revenue in the medium term
- Persistent acquired five companies in FY22, building capabilities in payments, cloud, etc. It is not shying away from acquisitions in coming years as well
- Strong deal win momentum will help improve its revenue growth. We expect dollar revenue to grow at 24.2% CAGR in FY22-25E along with EBIT margin expansion of ~180 bps to 15.6% over FY22-25E

Alternate Stock Idea: Apart from Persistent, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 1,730



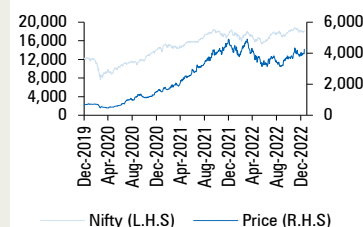
Particulars

Particular	Amount
Market Cap (₹ Crore)	30,724
Total Debt (₹ Crore)	600
Cash & Invests (₹ Crore)	1,349
EV (₹ Crore)	29,975
52 week H/L	4954 / 3092
Equity capital	76.4
Face value	10.0

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	31	31	31	31
FII	20	20	20	20
DII	27	27	26	26
Public	22	22	22	23

Price Chart



Recent event & key risks

- Won highest ever TCV of US\$440.2 mn in Q3
- Key Risk:** (i) Lower-than-expected revenue growth, (ii) Lower-than-expected margins

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Key Financial Summary

(₹ Crore)	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	4,188	5,711	14.7%	8,188	9,594	10,951	24.2%
EBITDA	683	958	16.1%	1,517	1,807	2,084	29.6%
EBITDA Margins (%)	16.3	16.8		18.5	18.8	19.0	
Net Profit	451	690	18.0%	1,064	1,259	1,441	27.8%
EPS (₹)	59.0	90.3		139.2	164.7	188.5	
P/E (x)	72.2	47.1		31.5	25.8	22.6	
RoCE (%)	21.6	23.1		29.9	30.9	30.5	
RoE (%)	16.1	20.5		26.9	26.8	25.9	

Key takeaways of recent quarter & conference call highlights

- The company reported revenue growth of 3.5% to US\$264.4 million (mn). In CC terms, growth was 3.5% QoQ. Persistent indicated that revenue growth in the quarter was impacted due to the seasonal furloughs in Q3. In rupee terms, the company reported revenue of ₹ 2,169.4 crore, up 5.9% QoQ
- Geography wise, North America (77% of the mix) reported muted growth of 1.5% QoQ while Europe & India reported strong growth of 12.2% & 10.7% QoQ, respectively. The company indicated that North America region growth was muted due to a decline in top customer's revenue and impact of furlough
- Vertical wise the company reported broad-based growth albeit at a slower pace compared to previous quarters with hi-tech, BFSI & lifescience reporting growth of 4.1%, 2.8% & 2.9%, respectively
- EBIT margin of the company improved 80 bps QoQ to 15.4%. The company indicated that margin improvement was due to the tailwind of currency benefit (60 bps) and higher IP revenues mitigated by the headwind of impact of furloughs along with higher travel & facility expenses
- The company indicated that growth for the quarter was impacted by lower growth in top two clients. As far as the top client is concerned, Persistent indicated that it did some contract restructuring with this client a few quarters back wherein it has changed a five-year contract with this client from revenue sharing to T&M on account of declining profitability in the deal. The planned ramp down from the client in Q2 had an impact on Q3 revenues as well. Persistent also indicated that due to restructuring, impact in the few quarters was to the tune of US\$24-24 mn spread across quarters, resulting in the top client mix coming down from 25% to 7.4% now. The company believes that due to its 18-year association with this company as well as the client's stable performance in the recent past, the client spending is likely resume again. Persistent expects revenue from the top client to see an upward trend, going forward. As far as top two client is concerned, where the company has been associated since 2011 across multiple services and multiple geographies, revenue growth was impacted due to client specific furloughs. The company expects revenue recovery from this client from Q4 onwards. Persistent also said it continues to work on the client concentration optimisation strategy
- The company during the quarter won its highest ever TCV of US\$440.2 mn, up 19.7% QoQ & 31.7% YoY. It also reported ACV of US\$326.3 mn, up 20.3% QoQ & 12% YoY
- Persistent continues to aspire to reach quarterly annualised revenues of US\$2 billion (bn), going ahead, without specifying any timeline and also indicated that it did not see any difficulty in growing at least 3-4% on a sequential basis, going ahead. The company also said that vendor consolidation, large deals, recovery from top two clients and acquisition would be building blocks for this revenue aspiration
- The company indicated that since integration of all its acquisitions is now complete, which is now helping it to participate in the large deal pipeline, it has started looking for any inorganic opportunity available in the market. Persistent is also seeing vendor consolidation opportunities in the market. It won a large deal of TCV US\$70 mn spread across three years with one of the largest retail player in the US wherein part of the work of the deal is being moved from one of its peers there while part of the work is due to niche vendor opting out
- On the demand outlook, the company indicated that it is seeing some headwinds in terms of reprioritising work by a few of its clients especially on the cloud transformation deals instead of cutting down the spending. Enterprises globally trying to conserve cash in terms of challenges of inflation and uncertainties on geopolitical risks while companies are looking to shift as much as work in offshore mode where Persistent stands to benefit. As a thumb rule, if US\$100 were spent by clients, they are currently looking to spend US\$85, saving 15% of the cost. Hence, cost optimisation deals are also coming in large numbers

Persistent - ESG Disclosure Score*

Score	FY20	FY21	FY22
Environmental	26.4	34.3	32.9
Social	26.4	24.8	25.4
Governance	76.1	76.1	76.1
Overall ESG Score	43.0	45.1	44.8

Source: Bloomberg, ICICI Direct Research, *Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures

- The company mentioned that Europe growth for the quarter was strong due to large deals it won in the previous quarters. Large deal wins over the last few quarters were to the tune of TCV of US\$100mn+. Persistent also indicated that it has been investing to strengthen the sales team in the last few quarters and it has been yielding results. It has also seen leadership changes there recently. The company mentioned that it is watchful on this geography over the next few quarters due to the war situation but hopeful of continued strong growth, going forward, even above company average
- Persistent indicated it had been pursuing price hike with continuous dialogue with its customers and received satisfactory price hikes during that period. The company indicated it is unlikely to pursue a price hike for the next six to 12 months as the environment is not favourable for the same
- The company's net addition during the quarter was 122 taking the total employee strength to 22,598
- Persistent mentioned that subcontracting costs for it normally varies in the range of 12-14% of sales. The company mentioned that it was high in this quarter due to unavailability of company people for projects on account of furloughs. Persistent also mentioned that it still faces challenges from people movement (even within US region) despite market opening. Hence, it has to continue deploying subcontractors. Hence, it does not think it (moderation of subcontractor costs) is one of the margin levers. The company outlined the following levers for margin expansions: a) continued strong revenue growth, ii) fresher deployment, iii) client mining, sale of more services to the same client, iv) continue to win large deals. Persistent also made it clear that it is not compromising growth for margin and growth remains a top priority
- The company hired 3200 freshers in the last many quarters, has already given offers to 1200 freshers and confirmed 100% adherence of the same. Persistent has been investing in training & development of talent resulting in pyramid optimisation aiding margin expansion. The company indicated that it is looking for 200-300 bps margin improvement over the next two to three years. Persistent also mentioned that attrition is moderating and that trend is likely to continue, going forward. The company indicated that net additions are likely to see some uptick on account of its office opening in some places in Bengaluru, Indore and London. It is planning to open a few more offices in Jaipur, Kochi and New Jersey. The company also indicated that it continues to provide flexible working model for its employees
- The company's LTM attrition declined 210 bps QoQ to 21.6%. This is the fourth successive quarter of attrition moderation marking the decline of 530 bps from the peak of 26.9% reported in Q3FY22. It also indicated that attrition is expected to decline further as the hiring environment across sectors is easing. The company's utilisation declined 230 bps QoQ to 77.6% while blended utilisation excluding freshers was at 83.3%
- The company declared an interim dividend of ₹ 28 per share and informed that the record date for determining eligible shareholders for payment of dividend will be January 27
- The company said it had appointed Rajesh Gharpure as the Chief Delivery Officer for Services business. He is an industry veteran with over 27 year of experience in Finance, Consulting, Digital Transformation, Global delivery & Operations with L&T, LTI and LTIMindtree

Exhibit 1: P&L

	Q3FY23	Q3FY22	YoY (%)	Q2FY23	loQ (%)	Comments
Revenue (USD mn)	264.4	199.1	32.8	255.6	3.5	Revenue growth impacted by decline in revenue of top 2 clients and seasonal furlough impact
Revenue	2,169.4	1,491.7	45.4	2,048.6	5.9	
Employee expenses	1,419.3	982.5	44.5	1,349.5	5.2	
Gross Margin	750.0	509.3	47.3	699.1	7.3	
Gross margin (%)	34.6	34.1	44 bps	34.1	45 bps	
Other expenses	348.5	258.2	35.0	331.2	5.2	
EBITDA	401.6	251.1	59.9	368.0	9.1	
EBITDA Margin (%)	18.5	16.8	168 bps	18.0	55 bps	
Depreciation & amortisatio	68.4	42.8	59.8	69.3	-1.4	
EBIT	333.2	208.3	60.0	298.7	11.6	
EBIT Margin (%)	15.4	14.0	140 bps	14.6	78 bps	Margin grew due to tailwind of currency benefit & higher IP revenue mitigated by headwinds of higher travel expense, higher facility expense & impact of furlough
Other income	19.2	28.1	-31.6	-3.1	-730.2	Other income higher due to forex gain in Q3 compared to forex loss in Q2
PBT	352.4	236.4	49.1	295.6	19.2	
Tax paid	84.8	60.0	41.3	75.6	12.2	
PAT	238.0	176.4	34.9	220.0	8.2	

Source: Company, ICICI Direct Research

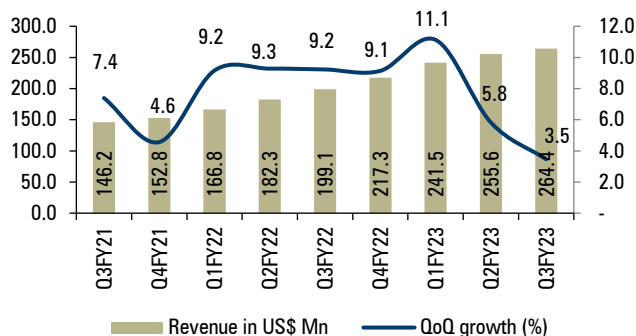
Exhibit 2: Change in estimates

	FY23E			FY24E			FY25E			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	8,188	8,188	0.0	9,705	9,594	-1.1	10,808	10,951	1.3	
EBIT	1,149	1,239	7.8	1,391	1,480	6.4	1,581	1,712	8.3	
EBIT Margin (%)	14.0	15.1	110 bps	14.3	15.4	110 bps	14.6	15.6	100 bps	Margins increased on management focus on margin improvement
PAT	954	1,064	11.5	1,147	1,259	9.8	1,288	1,441	11.9	
EPS (₹)	125	139	11.5	150	165	9.8	168	189	11.9	

Source: Company, ICICI Direct Research

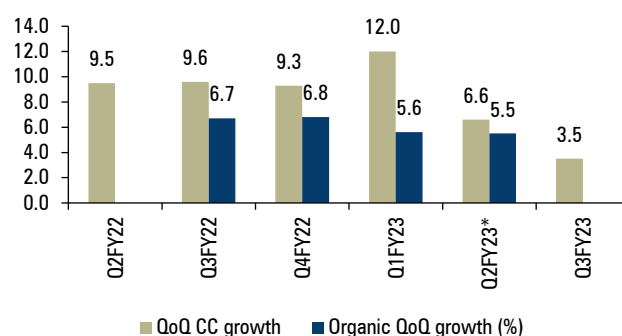
Key Metrics

Exhibit 3: Top 2 clients, furloughs impact revenue growth



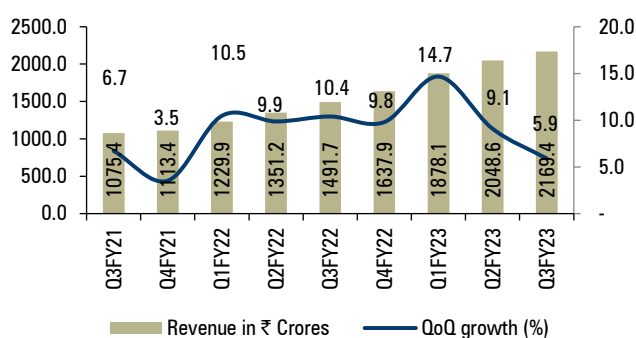
Source: Company, ICICI Direct Research

Exhibit 4: CC growth trend



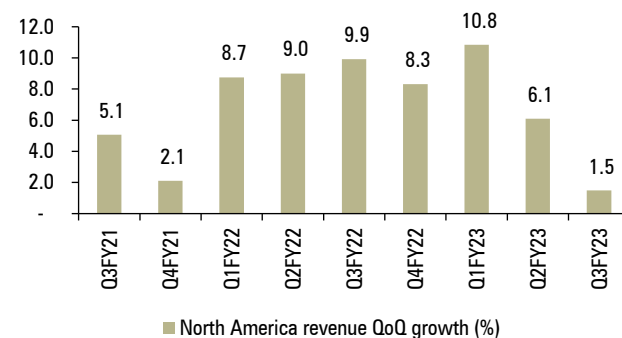
Source: Company, ICICI Direct Research, * Organic QoQ growth - Q2FY23 growth in CC terms while other period growth in dollar terms

Exhibit 5: Rupee revenue grows 5.9% in Q3



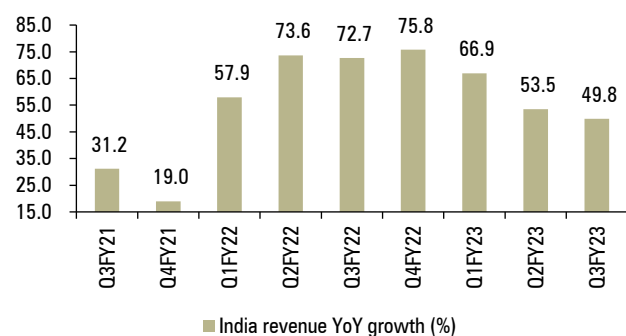
Source: Company, ICICI Direct Research

Exhibit 6: NA impacted by furloughs & top client decline



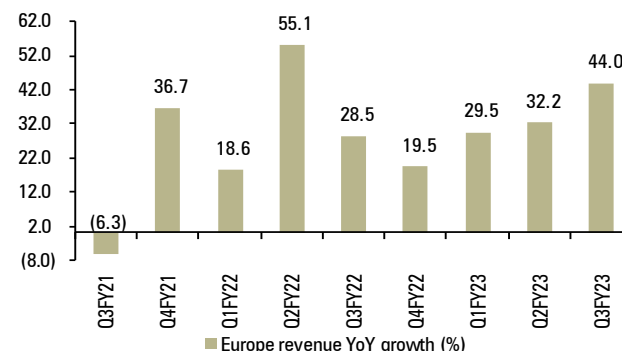
Source: Company, ICICI Direct Research

Exhibit 7: India region grows steadily



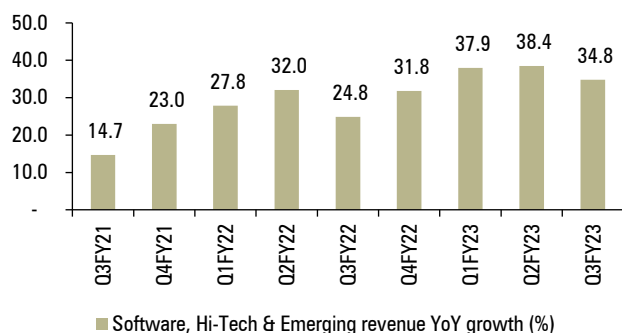
Source: Company, ICICI Direct Research

Exhibit 8: Strong TCV aiding growth in Europe



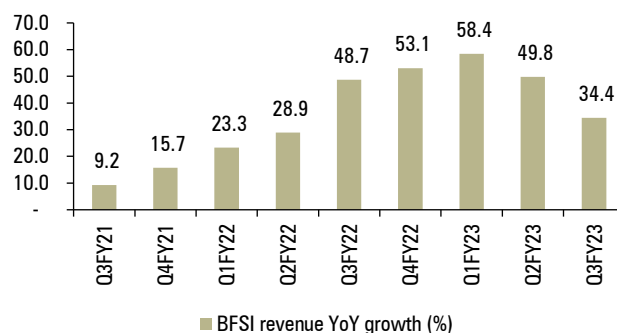
Source: Company, ICICI Direct Research

Exhibit 9: Hi-Tech vertical YoY growth steady



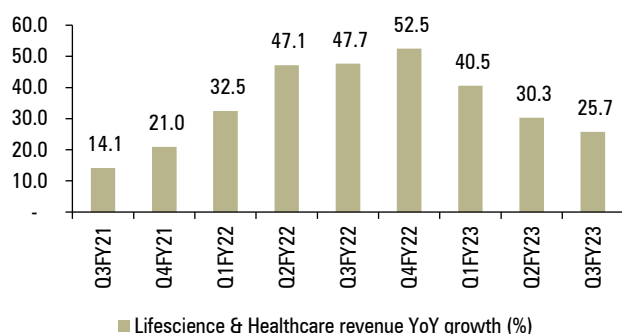
Source: Company, ICICI Direct Research

Exhibit 10: BFSI vertical sees some moderation



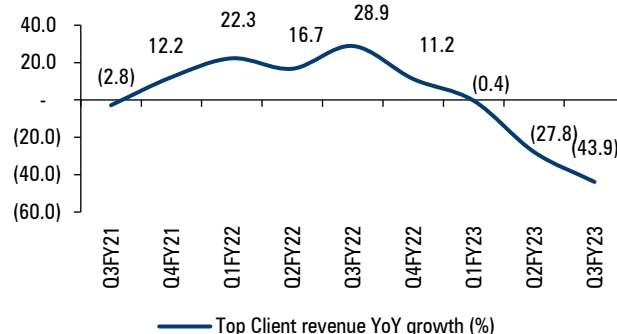
Source: Company, ICICI Direct Research

Exhibit 11: As does lifescience & healthcare



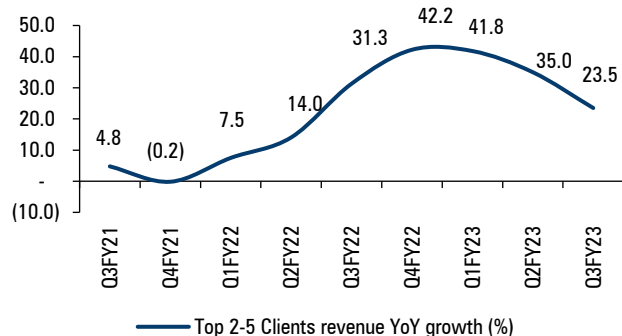
Source: Company, ICICI Direct Research

Exhibit 12: Contract restructuring led decline continues



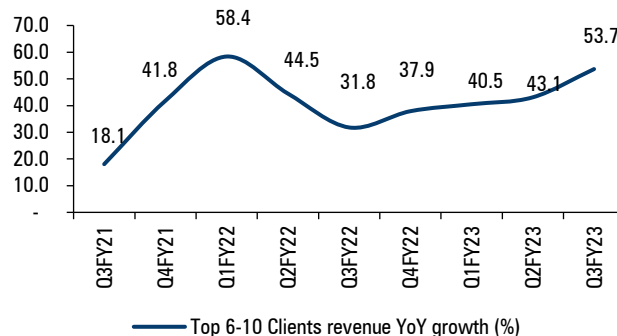
Source: Company, ICICI Direct Research

Exhibit 13: Top 2 client sees furlough impact



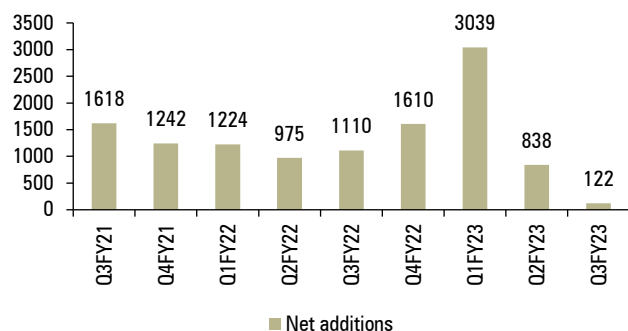
Source: Company, ICICI Direct Research

Exhibit 14: While Top 6-10 showing recovery



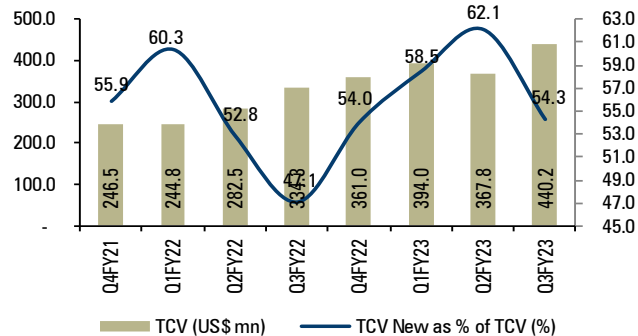
Source: Company, ICICI Direct Research

Exhibit 15: Net additions lower



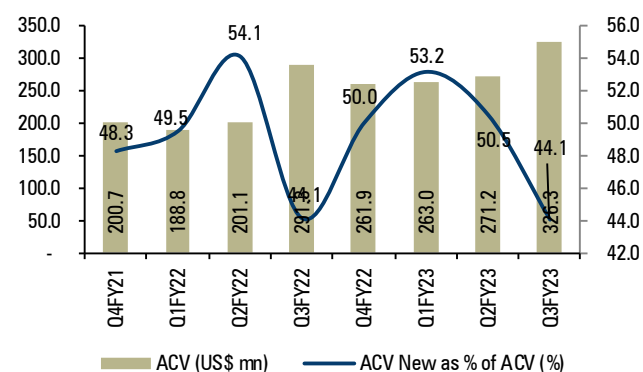
Source: Company, ICICI Direct Research

Exhibit 16: TCV wins highest in Q3, New TCV healthy



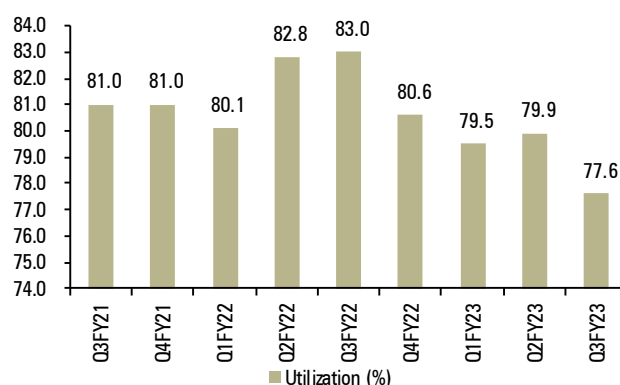
Source: Company, ICICI Direct Research

Exhibit 17: ACV trend



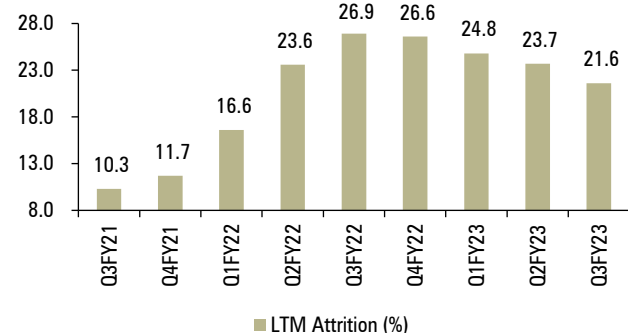
Source: Company, ICICI Direct Research

Exhibit 18: Utilisation to improve after fresher deployment



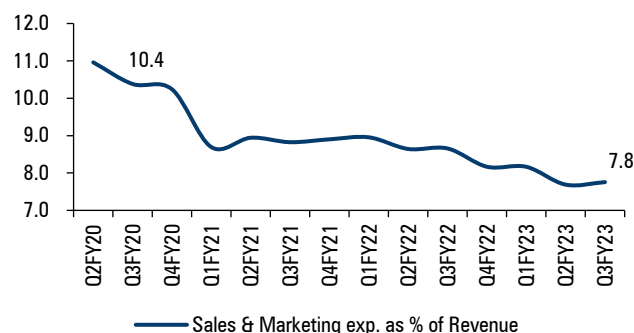
Source: Company, ICICI Direct Research

Exhibit 19: LTM attrition moderating consistently



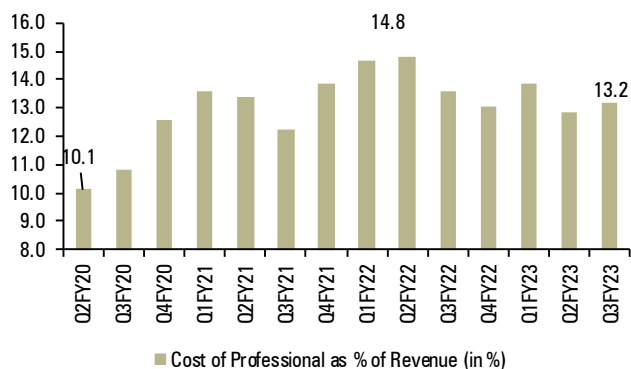
Source: Company, ICICI Direct Research

Exhibit 20: S&M expenses continue to moderate



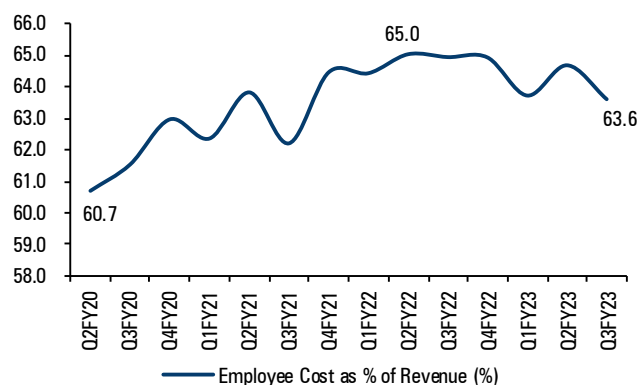
Source: Company, ICICI Direct Research

Exhibit 21: Sub costs likely remain elevated



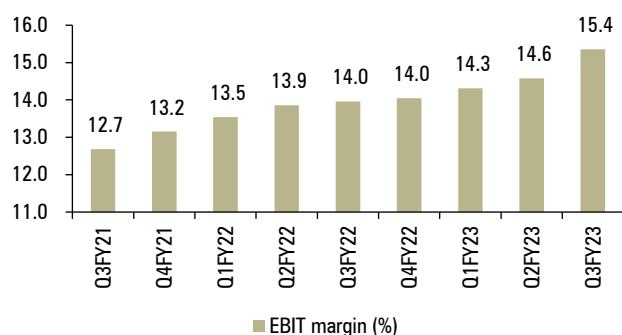
Source: Company, ICICI Direct Research

Exhibit 22: Ease of supply pushing employee cost down



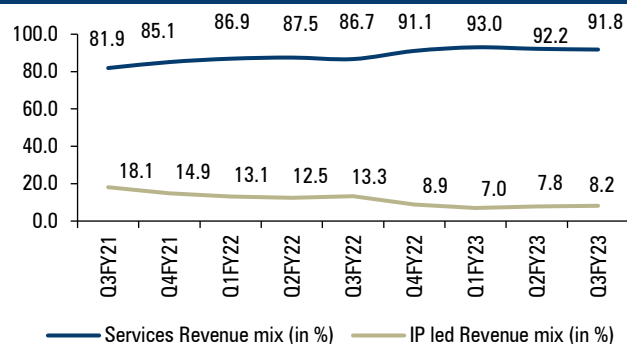
Source: Company, ICICI Direct Research

Exhibit 23: Aiding margin expansion



Source: Company, ICICI Direct Research

Exhibit 24: Revenue mix trend skewed toward services



Source: Company, ICICI Direct Research

Financial summary

Exhibit 25: Profit and loss statement ₹ crore

Particulars	FY22	FY23E	FY24E	FY25E
Total Revenues	5,711	8,188	9,594	10,951
Growth (%)	36.4	43.4	17.2	14.1
Employee & Subcon costs	3,763	5,281	6,140	6,987
Total Operating Expenditure	4,753	6,671	7,787	8,867
EBITDA	958	1,517	1,807	2,084
Growth (%)	40.3	58.4	19.1	15.4
Depreciation & Amortization	166	278	326	372
Other Income	132	140	176	184
Interest	-	-	-	-
PBT before Excp Items	924	1,379	1,656	1,896
Growth (%)	51.7	49.2	20.1	14.4
Tax	234	345	398	455
PAT before Excp Items	690	1,034	1,259	1,441
Exceptional items	-	30	-	-
PAT before MI	690	1,064	1,259	1,441
Minority Int & Pft. frm asso	-	-	-	-
PAT	690	1,064	1,259	1,441
Growth (%)	53.2	54.1	18.3	14.4
EPS	90	139	165	189
EPS (Growth %)	53.2	54.1	18.3	14.4

Source: Company, ICICI Direct Research

Exhibit 26: Cash flow statement ₹ crore

	FY22	FY23E	FY24E	FY25E
PBT	924	1,379	1,656	1,896
Depreciation & Amortization	166	278	326	372
WC changes	(41)	12	(16)	(15)
Other non cash adju.	32	(110)	(176)	(184)
CF from operations	845	1,215	1,393	1,614
Capital expenditure	(996)	(270)	(317)	(361)
Δ in investments	(53)	-	-	-
Other investing cash flow	72	140	176	184
CF from investing Activities	(977)	(130)	(141)	(177)
Issue of equity	-	-	-	-
Δ in debt funds	428	-	-	-
Dividends paid	(199)	(412)	(516)	(591)
Other financing cash flow	(47)	(30)	(30)	(30)
CF from Financial Activities	182	(442)	(546)	(621)
Δ in cash and cash bank balance	50	643	707	816
Effect of exchange rate changes	-	-	-	-
Opening cash	981	914	1,557	2,264
Cash c/f to balance sheet	914	1,557	2,264	3,080

Source: Company, ICICI Direct Research

Exhibit 27: Balance sheet ₹ crore

	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity	76	76	76	76
Reserves & Surplus	3,292	3,885	4,627	5,477
Networth	3,368	3,961	4,704	5,554
Minority Interest	-	-	-	-
Long term Liabilities & provisions	625	647	656	663
Source of funds	3,993	4,608	5,359	6,217
Assets				
Net fixed assets	539	567	596	624
Net intangible assets	823	816	808	799
Goodwill	279	279	279	279
Other non current assets	552	552	552	552
Investments	388	388	388	388
Debtors	948	1,122	1,314	1,500
Current Investments	435	435	435	435
Cash & Cash equivalents	914	1,557	2,264	3,080
Other current assets	536	599	644	687
Trade payables	430	538	631	720
Current liabilities	991	1,108	1,229	1,346
Application of funds	3,993	4,609	5,360	6,217

Source: Company, ICICI Direct Research

Exhibit 28: Key ratios ₹ crore

(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
EPS	90.3	135.3	164.7	188.5
Cash Per Share	119.7	203.7	296.2	402.9
BV	440.7	518.3	615.5	726.7
DPS	31.0	44.7	56.1	64.2
Operating Ratios (%)				
EBITDA Margin	16.8	18.5	18.8	19.0
PBT Margin	16.2	16.8	17.3	17.3
PAT Margin	12.1	13.0	13.1	13.2
Turnover Ratios				
Debtor days	61	50	50	50
Creditor days	27	24	24	24
Return Ratios (%)				
RoE	20.5	26.9	26.8	25.9
RoCE	23.1	29.9	30.9	30.5
RoIC	10.3	20.4	33.0	59.1
Valuation Ratios (x)				
P/E	47.1	31.5	25.8	22.6
EV / EBITDA	33.3	20.2	16.6	14.0
Market Cap / Sales	5.7	4.0	3.4	3.0
Solvency Ratios				
Current Ratio	1.0	1.0	1.1	1.1
Quick Ratio	1.0	1.0	1.1	1.1

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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