Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Persistent Systems Ltd

Decent Q3; Maintain Buy

IT & ITES	Sharekhan code: PERSISTENT
Reco/View: Buy ↔	CMP: Rs. 4,258 / Price Target: Rs. 5,010 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↓	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 20.8

Updated Oct 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 32,538 cr
52-week high/low:	Rs. 4,950/3092
NSE volume: (No of shares)	3.5 lakh
BSE code:	533179
NSE code:	PERSISTENT
Free float: (No of shares)	5.3 cr

Shareholding (%)

Promoters	31.3
FII	20.3
DII	26.4
Others	22.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.5	16.2	27.9	-0.2
Relative to Sensex	9.0	13.2	16.8	-1.5

Sharekhan Research, Bloomberg

Summary

- Persistent Systems reported decent constant currency revenue growth, up 3.5% q-o-q, broadly in line with consensus estimates at $264.4million led by consistent growth in IP led and Services revenues. EBIT Margin at 15.4 %, improved by ~80 bps q-o-q led by currency benefits and easing of supply side pressure offset by headwinds from furloughs, seasonality and an increase in travel and facilities cost.
- Company reported strong deal wins for Q3FY23 with TCV of deal wins at $440million, up 20% q-o-q and Book-to-Bill ratio at 1.7x. New business TCV reported for the quarter was $239, up 5% q-o-q while Total ACV stood at $326.3 million, up 20% q-o-q.
- The management indicated that decline in revenue from top client has bottomed out and that the company expects revenue growth of at least over 30% for FY23. The management also stated that the company is well placed to maintain the quarterly deal win run-rate at above $400 million going ahead.
- Despite strong bookings and sustained acceleration in deal wins, the near-term outlook for FY2024E looks uncertain due to persisting global headwinds with gradual recovery coming in the next few quarters. However, we believe the structural growth story for Indian IT sector is intact and hence we maintain a Buy rating on Persistent Systems with revised PT of 5010 (to reflect the rollover of target multiple to FY25E EPS).

Persistent Systems Limited reported revenue of $264.4 million in Q3FY23, up 3.4% on q-o-q and up 32.8% y-o-y. Revenue in constant currency terms which was up 3.5% on q-o-q basis was broadly in-line with consensus estimated but missed our estimates by ~50 bps. EBIT Margin at 15.4 %, improved by ~80 bps q-o-q led by currency benefits and easing of supply side pressure offset by headwinds from furloughs, seasonality and an increase in travel and facilities cost. In terms of geographies, North America growth moderated by 1.5% q-o-q while Europe, India and Rest of the World (ROW) grew strongly by 12.2%/10.6% and 3.4% q-o-q, respectively. Growth moderated for all verticals with Software, Healthcare & Lifescience and BFSI verticals showing a 4.1%/2.9%/2.8% q-o-q in revenue, respectively. Attrition at 21.6% moderated 210 Bps q-o-q. However, utilisation at 77.6% fell 230 Bps q-o-q. Net employee Additions were 122 taking total headcount to 22,598. The management indicated that the decline in revenues from top clients has bottomed out and that the company expects revenue growth of at least 30%+ for FY23. The management also cited their aspiration of improving margin by 100-200bps in 2-3 years. Persistent Systems announced an Interim dividend of Rs 28 per share. Management stated that the deal win rate has been consistently strong since past several quarters and mentioned that the company is well placed to maintain deal win quarterly run rate greater than $400 million going ahead. Despite strong bookings and sustained acceleration in deal wins, the near-term outlook for FY2024E looks uncertain due to persisting global headwinds with gradual recovery coming in the next few quarters. However, we believe that the structural growth story for Indian IT sector is intact and hence we maintain Buy on Persistent Systems with revised PT of 5010 (to reflect the rollover of target multiple to FY25E EPS). At CMP, the stock trades at 32.9x/28.5x and 25.5x its FY23E/FY24E and FY25E EPS, respectively.

Key positives

- TCV of deal wins at $440million, up 20% q-o-q and Book-to-Bill rebounding to 1.7x
- LTM Attrition rate in Q3FY23 fell sharply by 210 bps to 21.6% on a q-o-q basis.

Key negatives

- Blended utilization rates at 77.6% deteriorated by ~230 bps q-o-q.
- Net headcount addition of 122 employees is the lowest in the last nine quarters.

Management Commentary

- The management indicated that decline in revenue from top client has bottomed out and that the company expects FY23 revenue growth of at least 30%+. The management also cited their aspiration of improving margin by 100-200 bps in 2-3 years.
- Management stated that the deal win rate has been consistently strong since past several quarters and mentioned that the company is well placed to maintain deal win quarterly run-rate greater than $400 million going ahead.

Revision in estimates – We have fine-tuned our estimates for FY23/24/25 owing to macro-overhang and INR-USD reset.

Our Call

Valuation – Decent Q3, Maintain Buy: Despite strong bookings and sustained acceleration in deal wins, the near-term outlook for FY2024E looks uncertain due to persisting global headwinds with gradual recovery coming in the next few quarters. However, we believe the structural growth story for the Indian IT sector is intact and hence we maintain a Buy on Persistent Systems with revised PT of 5010 (to reflect the rollover of target multiple to FY25E EPS). At CMP, the stock trades at 32.9x/28.5x and 25.5x its FY23E/FY24E and FY25E EPS, respectively.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spends.

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	5,710.7	8,311.4	9,651.2	11,248.3
OPM (%)	16.8	18.3	17.9	17.4
Adjusted PAT	690.4	964.4	1,115.0	1,245.8
% YoY growth	53.2	39.7	15.6	11.7
Adjusted EPS (Rs.)	90.3	129.3	149.5	167.0
P/E (x)	47.1	32.9	28.5	25.5
P/B (x)	9.7	8.2	7.0	6.0
EV/EBITDA (x)	35.2	21.6	18.5	15.9
RoNW (%)	22.4	26.3	25.9	24.8
RoCE (%)	26.0	28.8	29.4	28.8

Source: Company; Sharekhan estimates

Key Highlights

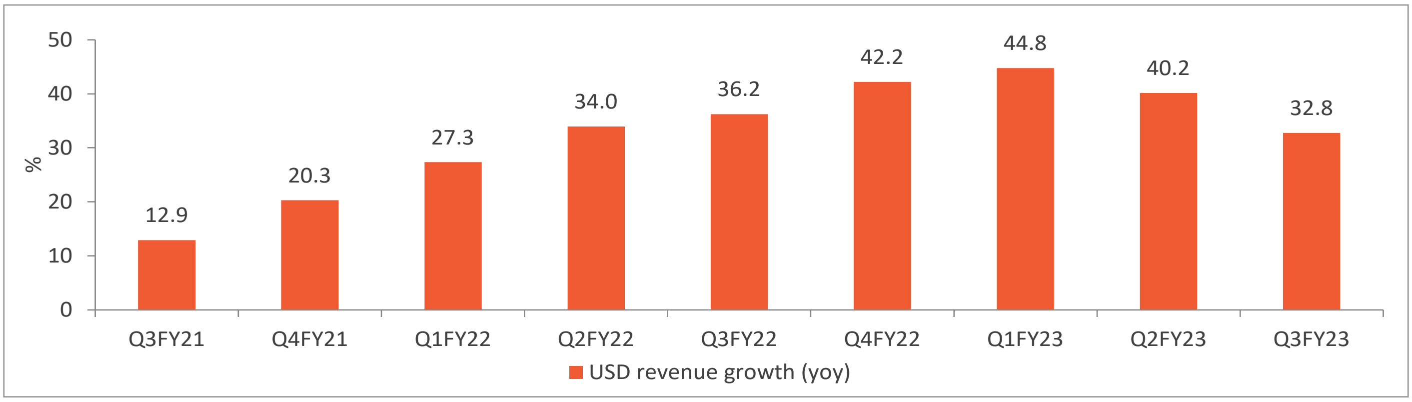
- **Strong order intake provides growth visibility:** Total order booking stood at $440 million for Q3FY2023, up 20% q-o-q. This translates into a book-to-bill ratio of 1.7x. New business deal TCVs improved 5% q-o-q to $239 million. Total deal ACV remained improved sequentially by 20% to $326.3 million. New business deal ACVs improved by 5% q-o-q to $143.8 million.
- **Growth momentum continues to fall:** Growth momentum continued to fall for all verticals with Software, Healthcare & Life Science and BFSI growing 4.1%/2.9%/2.8% q-o-q and 34.7%/25.7% and 34.4% y-o-y respectively.
- **Growth Moderation continues in US:** Moderation in growth in the North America business continued which grew by 1.5% in Q2Y2023 compared to 6.1% growth in Q2FY2023, while business growth rebounded in Europe growing 12.2% q-o-q. India business reported revenue growth of 10.6% q-o-q. Rest of world (RoW) business had a revenue growth of 3.4% q-o-q.
- **Softness in Top Accounts:** Revenue from the top clients fell 12% q-o-q. Revenue from the top-5 clients fell by 5% q-o-q, while revenues from top-10 clients fell by 1.4% q-o-q. Revenues from the top 2-5 clients decelerated by 1.7% q-o-q. Revenue from the top-20 clients grew 2.2% q-o-q, while revenue from the non-top-20 clients grew by 4.6% q-o-q.
- **Client addition:** Three clients were added under the $30 million+ bucket in Q3FY23.
- **Higher utilisation, attrition rate moderates:** Utilisation during the quarter deteriorated by 230 bps q-o-q to 77.6% in Q3FY2023. Offshoring revenue mix declined marginally to 57.3% in Q3FY2023. Attrition rate moderated by 210 bps to 21.6% in Q3FY2023 compared to 23.7% in Q2FY2023.
- **Net headcount additions falls:** Net employee Additions were 122 taking total headcount to 22598, versus net addition of 838/1110 employees in Q2FY2023/Q3FY2022.
- **Strong cash generation; DSO constant:** The company had cash and investments of Rs. 1674.6 crore as of December 31, 2022, versus Rs. 1,896.4 crore as of Dec 31, 2021. DSO increased by 7 days sequentially to 67.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	YoY (%)	QoQ (%)
Revenues In USD (mn)	**264.4**	**199.1**	**255.6**	**32.8**	**3.4**
Revenues In INR	**2,169.4**	**1,491.7**	**2,048.6**	**45.4**	**5.9**
Direct Costs	1,436.0	988.0	1,362.8	45.3	5.4
SG&A	331.8	252.6	317.8	31.4	4.4
EBITDA	**401.6**	**251.1**	**368.0**	**59.9**	**9.1**
Depreciation & amortization	68.4	42.8	69.3	59.8	-1.4
EBIT	**333.2**	**208.3**	**298.7**	**60.0**	**11.6**
Forex gain/(loss)	10.5	3.0	-9.1	252.5	-215.4
Other Income	8.7	25.1	6.1	-65.4	43.1
PBT	**352.4**	**236.4**	**295.6**	**49.1**	**19.2**
Tax Provision	84.8	60.0	75.6	41.3	12.2
PAT	**267.6**	**176.4**	**220.0**	**51.7**	**21.6**
Minority interest	0.0	0.0	0.0		
Net profit	**238.0**	**176.4**	**220.0**	**34.9**	**8.2**
Exceptional items (IL&FS)	**-29.7**	**0.0**	**0.0**		
Adjusted net profit	**267.6**	**176.4**	**220.0**	**51.7**	**21.6**
EPS (Rs)	31.9	23.1	29.6	38.2	7.7
Margin (%)					
EBITDA	18.5	16.8	18.0	168	55
EBIT	15.4	14.0	14.6	140	78
NPM	12.3	11.8	10.7	51	160
Tax rate	24.1	25.4	25.6	-132	-150

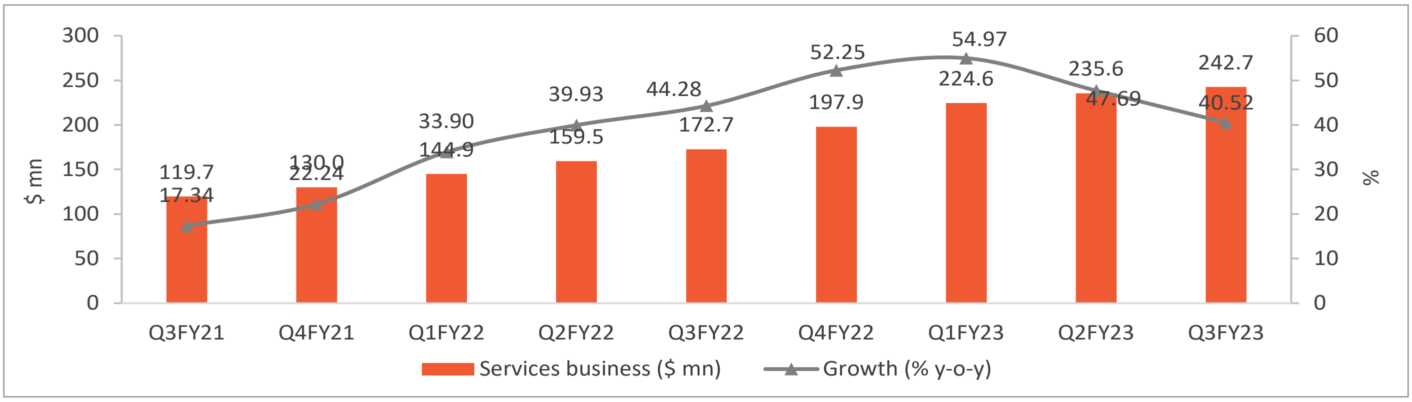
Source: Company, Sharekhan Research

USD revenue growth trend (y-o-y)



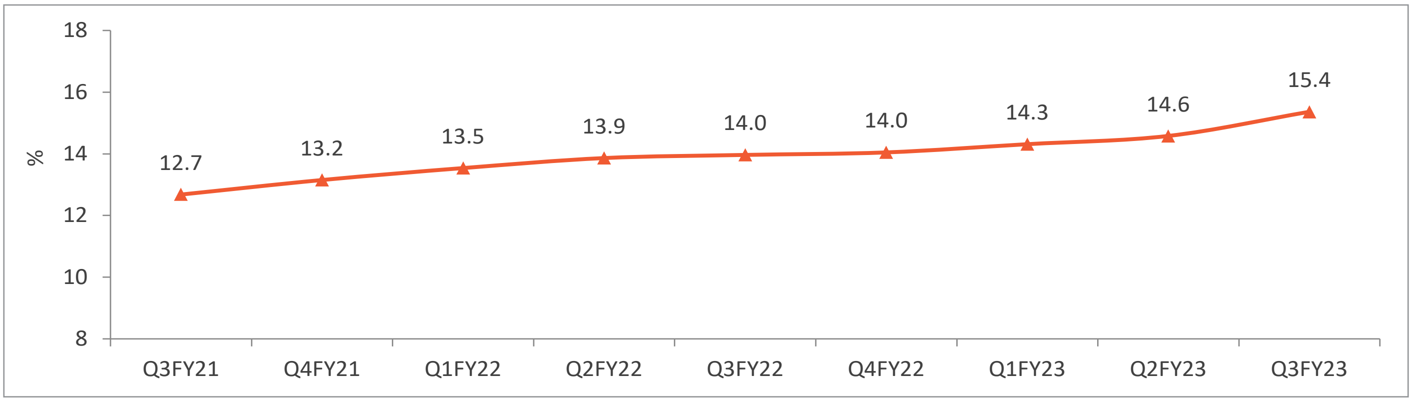
Source: Company, Sharekhan Research

Service business growth trend (y-o-y)



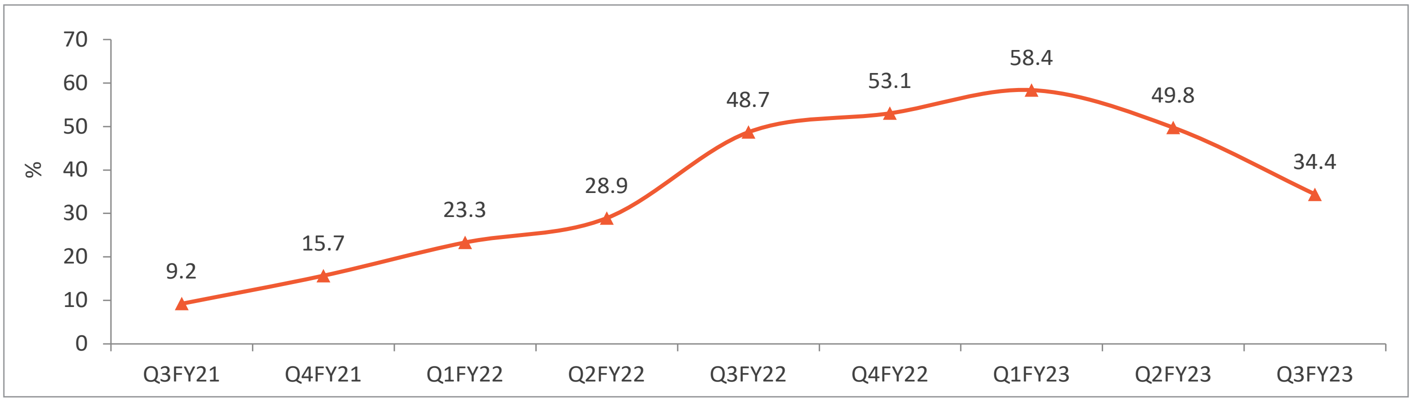
Source: Company, Sharekhan Research

EBIT margin trend (%)



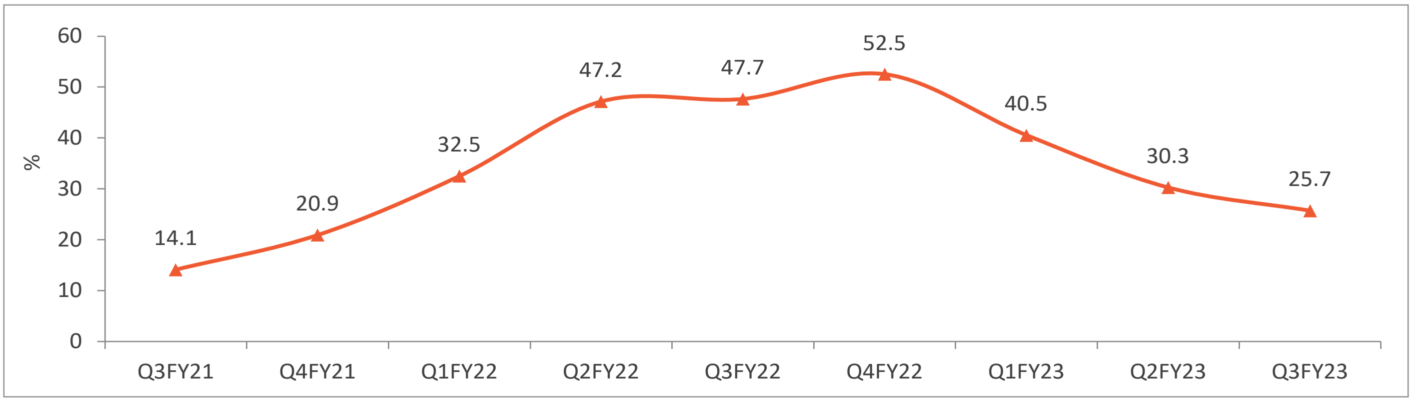
Source: Company, Sharekhan Research

BFSI revenue growth trend (y-o-y)



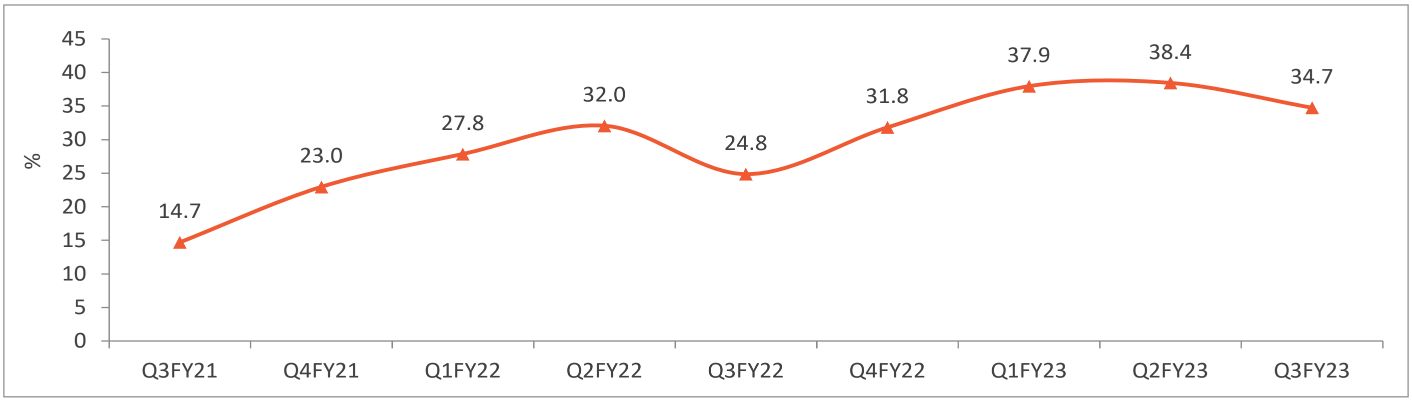
Source: Company, Sharekhan Research

Healthcare and life sciences revenue growth trend (y-o-y)



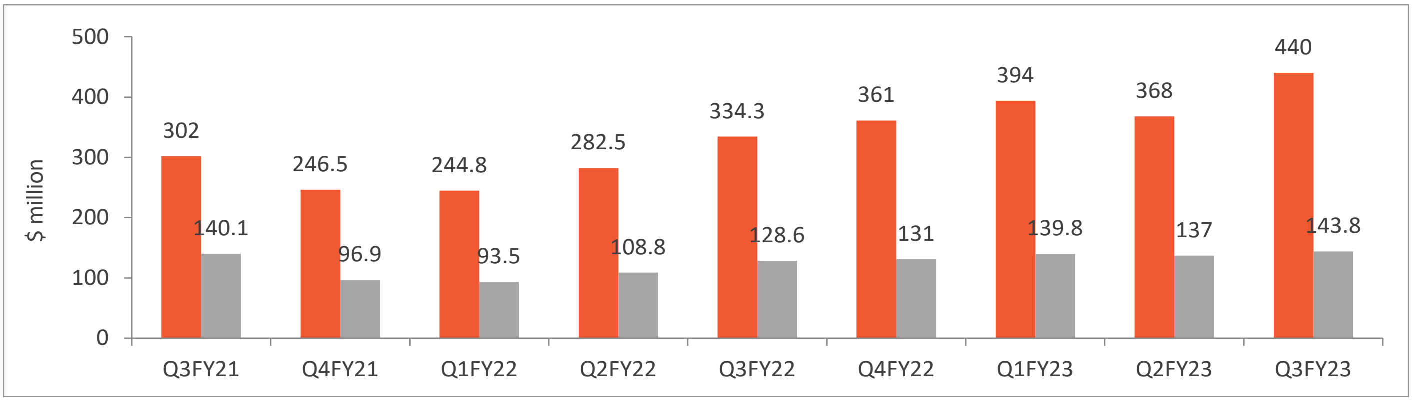
Source: Company, Sharekhan Research

Software and hi-tech revenue growth trend (y-o-y)



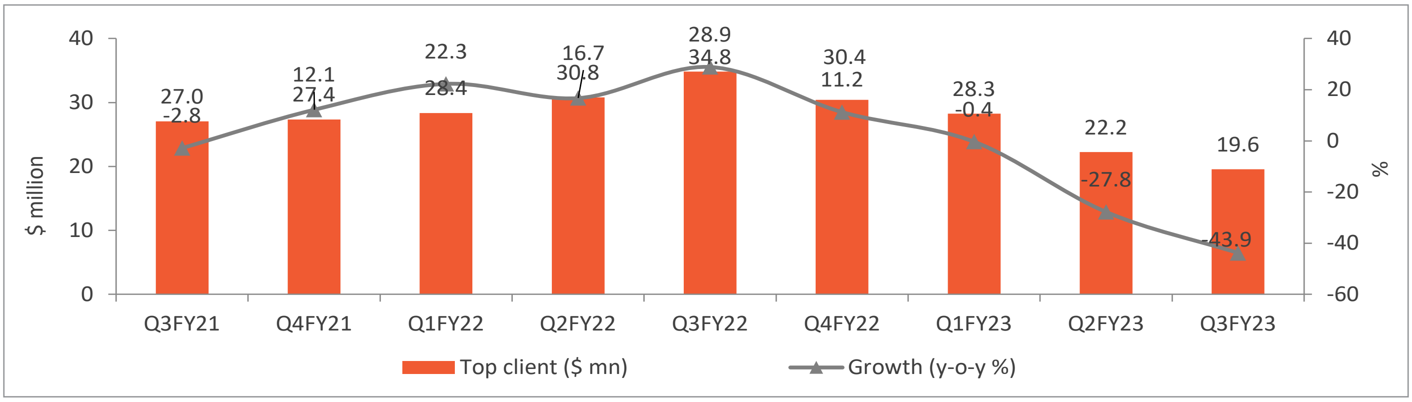
Source: Company, Sharekhan Research

Total deal TCV and new business ACV trend



Source: Company, Sharekhan Research

Top client ($ mn) and growth (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

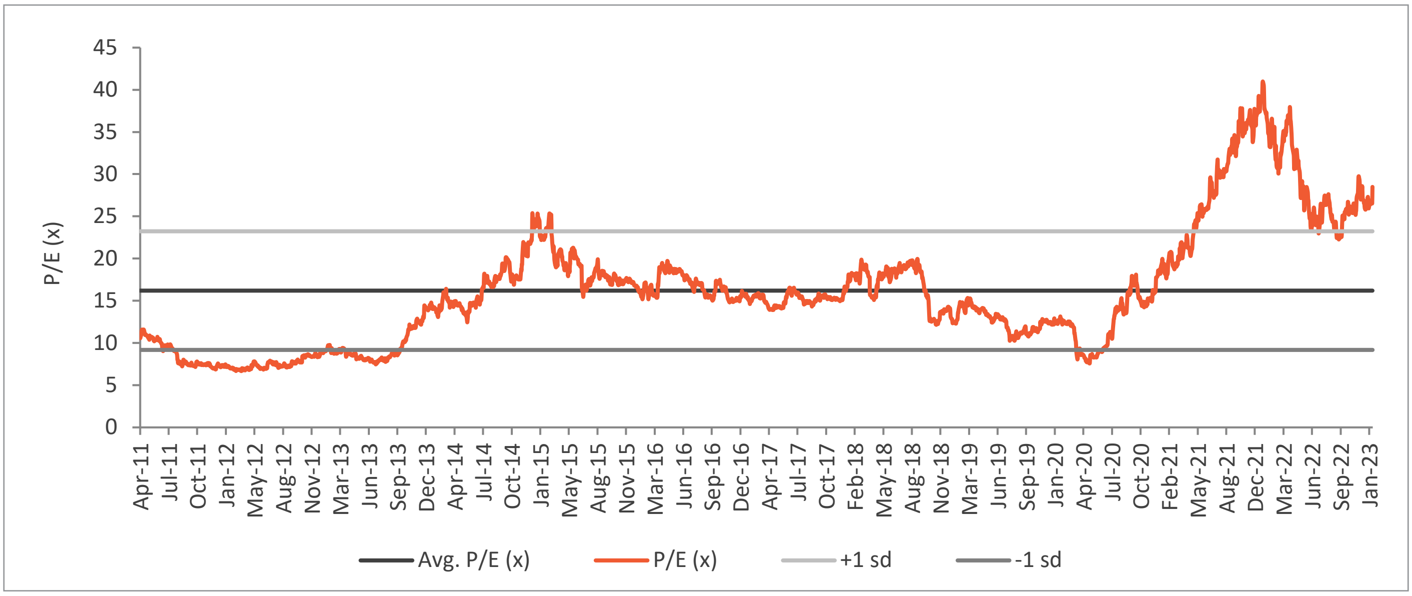
■ Company outlook - Well positioned to capture immense growth opportunity

As PSL is an early identifier of digital trends and has strong product development capabilities, we believe the company is well placed to capture a significant chunk of spends in digital technologies by clients going ahead. The management remains optimistic to deliver industry-leading revenue growth in FY2023 on account of broad-based demand across verticals, robust deal intake, new logo additions and incremental revenue from the acquired entities. We believe the company's leadership position in outsourced product development (OPD), elongated client relationships, and being an end-to-end service provider would help PSL to make the most of the opportunity.

■ Valuation - Decent Q3, Maintain Buy

Despite strong bookings and sustained acceleration in deal wins, the near-term outlook for FY2024E looks uncertain due to persisting global headwinds with gradual recovery coming in the next few quarters. However, we believe the structural growth story for the Indian IT sector is intact and hence we maintain a Buy on Persistent Systems with revised PT of 5010 (to reflect the rollover of target multiple to FY25E EPS). At CMP, the stock trades at 32.9x/28.5x and 25.5x its FY23E/FY24E and FY25E EPS, respectively.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1990, PSL is a global software company specialising in product and technology services. The company has proven expertise, strong presence in newer technologies, and strength to improve its IP base. PSL focuses on developing IoT products and platforms, as it sees significant traction from industrial machinery, SmartCity, healthcare, and smart agriculture verticals. PSL has been focusing on product development, establishing processes to build distributed agile teams, and partnering with the world's leading product companies to build software contributing across the entire product lifecycle. The company derives revenue from North America, Europe, and RoW.

Investment theme

Large corporates have been allocating higher budgets towards digital transformation initiatives and IT spends are moving from ISV to the enterprise model. PSL has restructured its business and aligned its sales resources to capitalise the benefits from clients' digital transformation journey. The alliance with IBM and investments in new-age technologies (IoT, Blockchain, artificial learning, and machine learning) are expected to help the company capture opportunities from these spends.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

Dr. Anand Deshpande	Founder, Chairman and MD
Sandeep Kalra	President: Technology Services
Sunil Sapre	Chief Financial Officer (CFO)
Mark Simpson	President, IBM Alliance

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Trustee	5.01
2	Kotak Mahindra Asset Management Company Limited	4.71
3	Axis Asset Management Company Limited	3.28
4	HDFC Asset Management Company Limited	3.25
5	Vanguard Group Inc	2.41
6	FundRock Management Co SA	1.81
7	L&T Mutual Fund Trustee Ltd	1.71
8	Nippon Life India Asset Management	1.51
9	Dimensional Fund Advisors	1.43
10	Blackrock Inc	1.06

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.