Stock Update

Company Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Persistent Systems Ltd

Consistent Performer; maintain Buy

IT & ITES	Sharekhan code: PERSISTENT
Reco/View: Buy ↔	CMP: **Rs. 5,368** / Price Target: **Rs. 6,000** ↑

↑ 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 19.32

Updated Aug 07, 2023

Low Risk

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

Source: Morningstar

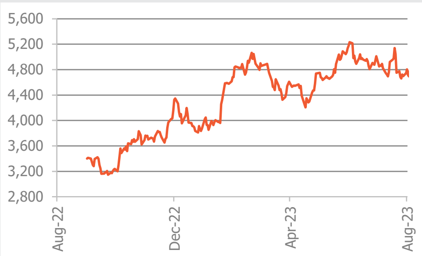
Company details

Market cap:	Rs. 41,296 cr
52-week high/low:	Rs. 5,389 / 3,092
NSE volume: (No of shares)	3.5 lakh
BSE code:	533179
NSE code:	PERSISTENT
Free float: (No of shares)	5.3 cr

Shareholding (%)

Promoters	31.1
FII	20.5
DII	28.0
Others	20.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.1	4.5	12.0	57.8
Relative to Sensex	15.7	1.0	2.0	47.5

Sharekhan Research, Bloomberg

Summary

- We maintain Buy rating on Persistent Systems Limited (Persistent) with a revised PT of Rs. 6,000, as we believe the company can continue to consistently perform, aided by resilient Hi-tech vertical, robust deal wins, and a strong deal pipeline. At CMP, the stock trades at 27.6/23.8x its FY25/26E EPS.
- Growth across Hi-tech continues to lead due to resilience from the largely non-discretionary product engineering segment. Further, incremental deal wins over the past several quarters have aided in increasing the company's market share in the product engineering segment.
- While BFSI and Healthcare& Lifesciences are expected to witness slowdown for couple of quarters, positive signs of stabilising client engagement are emerging.
- The company has sufficient margin levers to partly offset the margin impact due to wage hike in Q2 and has reiterated its aspiration to achieve 200-300 bps margin improvement over the next 2-3 years.

Persistent Systems Limited (Persistent) has been consistently delivering industry-leading revenue growth with CQGR of 3.8% in CC over Q1FY23- Q1FY24 (Tier1 peers CQGR of 0.5% in CC) despite challenging macro environment aided by strong order book and resilient Hi-tech vertical. Deal wins continue to be robust with average order booking of $400 million and average new business TCV of $237 million over Q1FY23-Q1FY24. Book-to-Bill of 1.3x provides decent revenue visibility going ahead. Among verticals, the Hi-tech vertical has shown greater resilience, registering a CQGR of ~5% over Q1FY23-Q1FY24, higher than the BFSI and Healthcare & Lifesciences vertical which have grown at CQGRs of ~3.7% and 2.2%, respectively. Over the last few quarters, the company has achieved decent improvement in utilisation, offshore-onsite mix, and moderation in attrition. Management had expressed that it has enough levers in place to improve margins by 200-300 bps over the next 2-3 years. We believe Persistent can continue to consistently perform, aided by resilient Hi-tech vertical, robust deal wins, and strong deal pipeline. Hence, we maintain Buy rating on Persistent with a revised price target (PT) of Rs. 6,000. At CMP, the stock trades at 27.6/23.8x its FY25/26E EPS.

- **Resilient Hi-tech Vertical:** The Hi-tech vertical (contributing to ~48% of revenue), has shown greater resilience, registering a CQGR of ~5% over Q1FY23-Q1FY24, higher than BFSI and Healthcare vertical which have reported CQGRs of ~3.7% and 2.2%, respectively. The vertical, which largely provides product engineering services to its clients, is more insulated from the uncertain environment as it caters to core portion in product engineering rather than discretionary. Thus, it has been able to tide efficiently over the challenging environment unlike most of its peers, where the Hi-tech vertical has been weak due to cuts in discretionary spending.
- **Green shoots despite uncertain environment:** BFSI segment continues to witness challenges due to slower decision making, increasing deal scrutiny, and deferring projects resulting in conversion issues, which are expected to continue for a couple of quarters. However, Hi-tech vertical has been more resilient and has continued to deliver stronger performance among verticals. While the vertical has been resilient, incremental deal wins ($50mn during the last six quarters) have continued to flow over the past several quarters, thus enabling the company to increase its market share in the product engineering segment. Some deal closures have been pushed out to the second quarter, although they are not substantial. However, there are positive signs of stabilising client engagements with recovery expected in the coming quarters. Quarterly results of some of the hyperscalers are also encouraging.
- **Sufficient Margin Levers available for achieving aspirational margins:** Wage hike in Q2 is expected to lead to margin contraction of 200-225 bps. However, the company is confident that it has enough margin levers such as utilisation, offshore-onshore mix, employee pyramid etc. to contain the contraction to 100-125 bps. Further, management has reiterated the aspiration of margin expansion of 200-300 bps over the next 2-3 years basis the availability of margin levers.

Our Call

Valuation – Maintain Buy with revised PT of Rs 6,000: Despite the uncertain environment, Persistent has been consistently delivering industry-leading revenue growth, aided by strong deal wins and steady growth across its key Hi-tech vertical. We expect 17% / 22% sales and PAT CAGR over FY23-26E. Hence, we maintain Buy rating on Persistent with a revised PT of Rs. 6,000 (the increase in PT reflects rollover of the valuation multiple to Sep25 earnings estimates). At CMP, the stock trades at 27.6/23.8x its FY25/26E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. Contagion effect of banking crisis, macro headwinds and possible recession in the US that may moderate the pace of technology spends.

Valuation Rs cr

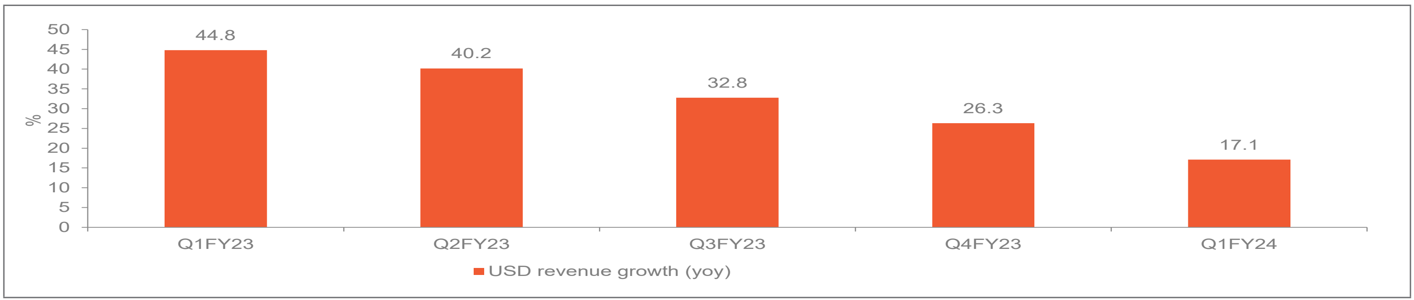
Particulars	FY23	FY24E	FY25E	FY26E
Revenue	8,350.6	9,860.1	11,622.0	13,500.0
OPM (%)	18.2	18.9	19.8	20.2
Adjusted PAT	950.7	1,213.0	1,495.7	1,736.1
YoY growth (%)	37.7	27.6	23.3	16.1
Adjusted EPS (Rs.)	127.2	157.7	194.5	225.8
P/E (x)	42.2	34.0	27.6	23.8
P/B (x)	10.3	8.7	7.3	6.1
EV/EBITDA (x)	28.1	22.1	17.4	15.8
RoNW (%)	25.9	28.0	29.0	28.2
RoCE (%)	27.8	30.4	32.8	32.7

Source: Company; Sharekhan estimates

Resilient Hitech vertical key to consistent performance

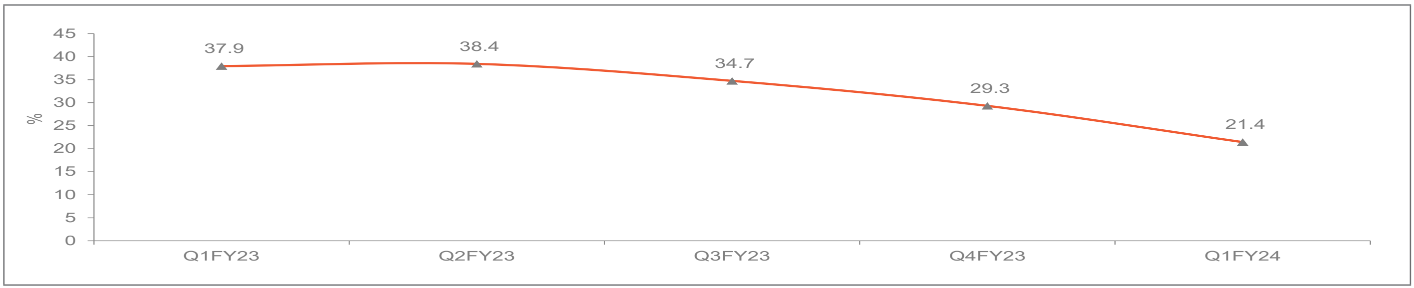
Despite macro headwinds since the past several quarters, Persistent has been consistently delivering industry-leading revenue growth with a CQGR of 3.8% in CC over Q1FY23- Q1FY24 (Tier-1 peers' CQGR of 0.5% in CC) aided by a strong order book and resilient Hi-tech vertical. Deal wins continue to be robust with average order booking of $400 million and average new Business TCV of $ 237 million over Q1FY23-Q1FY24. The Hi-tech vertical has shown greater resilience, registering a CQGR of ~5% over Q1FY23-Q1FY24, higher than the BFSI and Healthcare vertical, which have reported a CQGR of ~3.7% and 2.2%, respectively. While the vertical has been resilient, incremental deal wins ($50mn during the last six quarters) have continued to flow over the past several quarters, thus enabling the company to increase its market share in the product engineering segment.

USD revenue growth trend (y-o-y)



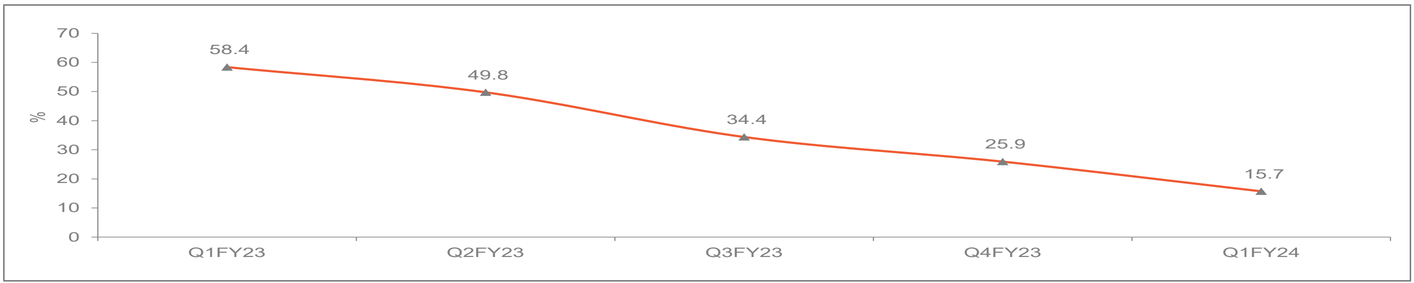
Source: Company; Sharekhan Research

Hi-tech revenue growth trend (y-o-y)



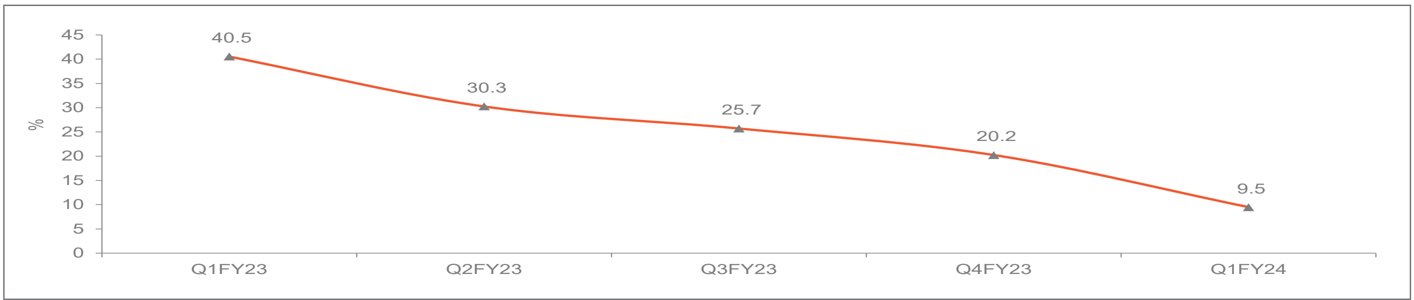
Source: Company; Sharekhan Research

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

Outlook and Valuation

■ **Sector Outlook – Persisting multiple global headwinds turning outlook for FY24E uncertain:** Owing to multiple global headwinds, the outlook for FY2024E 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 Persistent 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. Management remains optimistic to deliver industry-leading revenue growth in FY2023 on account of broad-based demand across verticals, robust deal booking, 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 Persistent to make the most of the opportunity.

■ **Valuation – Maintain Buy with revised PT of Rs 6,000:** Despite the uncertain environment, Persistent has been consistently delivering industry-leading revenue growth, aided by strong deal wins and steady growth across its key Hi-tech vertical. We expect 17% / 22% sales and PAT CAGR over FY23-26E. Hence, we maintain Buy rating on Persistent with a revised PT of Rs. 6,000 (the increase in PT reflects rollover of the valuation multiple to Sep25 earnings estimates). At CMP, the stock trades at 27.6/23.8x its FY25/26E EPS.

One-year forward P/E (x) band

Source: Company; Sharekhan Research

About the company

Incorporated in 1990, Persistent 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. The company focuses on developing IoT products and platforms, as it sees significant traction from industrial machinery, SmartCity, healthcare, and smart agriculture verticals. The company 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. Persistent 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

Rupee appreciation and/or adverse cross-currency movements. Contagion effect of banking crisis, macro headwinds and possible recession in the US that may moderate the pace of technology spends.

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 CO	5.0
2	Kotak Mahindra Asset Management Co	4.4
3	Axis Asset Management Co Ltd/India	3.8
4	HDFC Asset Management Co Ltd	3.2
5	Vanguard Group Inc/The	2.5
6	PSPL ESOP MANAGEMENT TRUST	2.4
7	Motilal Oswal Asset Management Co	2.3
8	Nippon Life India Asset Management	1.5
9	FundRock Management Co SA	1.4
10	BlackRock Inc	1.1

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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