Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Persistent Systems Ltd

Good Quarter, margins commentary disappoints

IT & ITES	Sharekhan code: PERSISTENT
Reco/View: Buy ↔	CMP: **Rs. 3,511**
	Price Target: **Rs. 4,150** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Persistent reported revenue of $310.9 million, up 3.4% q-o-q in constant currency (CC) terms, in line with our estimate of $311.2 million, led by growth in Healthcare and BFSI.
- EBIT margin was flat at 14.5% but missed our estimates of 14.8%, owing to a one-time transition cost along with lower utilization, higher sub-contractor cost, and higher travel cost, offset by a reduction in earnout liability in one of its acquisitions.
- Management has stated its goal is to maintain top-quartile growth, while maintaining margins at the current level for FY25, disappoints street expectations.
- We have cut our estimates for FY25/26E by 8%/10%, owing to lower margins estimates. The 10% correction in the stock post Q4 numbers makes risk reward favourable. We maintain Buy on the stock with a revised TP of Rs 4,150. At the CMP, the stock trades at 39.8/32.1x its FY25/FY26E EPS.

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	=	↔	=

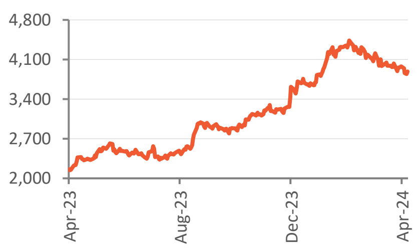
Company details

Market cap:	Rs. 54,081 cr
52-week high/low:	Rs. 4,490 / 2,113
NSE volume: (No of shares)	4.1 lakh
BSE code:	533179
NSE code:	PERSISTENT
Free float: (No of shares)	5.3 cr

Shareholding (%)

Promoters	31.0
FII	25.0
DII	25.9
Others	17.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-11.9	-11.4	18.9	63.3
Relative to Sensex	-13.0	-14.5	6.3	39.9

Sharekhan Research, Bloomberg

Persistent Systems Limited (PSL) reported revenue of $310.9 million, up 3.4% in constant currency (CC) terms, in line with our estimate of $311.2 million, led by Healthcare and Lifesciences and BFSI vertical, which was partially offset by weakness in Software, Hi-tech, and Emerging industries. Revenue in rupee terms stood at Rs. 2,590.5 crore, up 3.7% q-o-q and 14.9% y-o-y. EBIT margin was flat at 14.5% but missed our estimate of 14.8%, owing to ramp up of a large vendor consolidation deal, which included a one-time transition cost along with lower utilisation, higher subcontractor cost, and higher travel cost, which was compensated by a reduction in earnout liability concerning one of the acquisitions. The total TCV stood at $447.7 million, down 14% q-o-q/up 6% y-o-y. Book-to-bill stood at 1.4x. New business TCVs stood at $302 million up 9% q-o-q/21% y-o-y. Net headcount additions increased by 514, taking the overall headcount to 23,850, while LTM attrition moderated further to 11.5% from 11.9%, down 40 bps q-o-q. Utilisation declined 150bps q-o-q to 80% from 81.5%. PSL has been consistently delivering industry-leading performance since the past several quarters and is well placed to lead the growth trajectory in FY25/FY26, given the strong order book, consistent addition of new logos, and robust capabilities. Management has stated its goal is to maintain top-quartile growth, while maintaining margins at the current level for FY25. Though management has reaffirmed its commitment towards improving EBIT margin by 200-300bps over the next two to three years, its commentary on maintaining EBIT margin at the current level for FY25 owing to investments in building sales and marketing capacity as well as building next-gen technology assets, including in the AI domain is likely to place upper bounds on the profitability. Hence, we maintain BUY on the stock with a revised target price (TP) of Rs. 4,150. At the CMP, the stock trades at 39.8/32.1x its FY25/FY26E EPS.

Key positives

- New business TCVs stood at $302 million, up 9%q-o-q/ 21% y-o-y.
- LTM attrition moderated to 11.5% from 11.9%, down 40bps q-o-q.
- Net headcount additions increased 514, taking the overall headcount to 23,850.

Key negatives

- Utilisation declined 150bps q-o-q to 80% from 81.5%.
- Subcontractor costs grew ~19% q-o-q to Rs. 364.5 crore.

Management Commentary

- During the next 12 months, given the challenging macro environment, the goal is to maintain top-quartile growth while maintaining margins at the current level.
- The company is focusing on growth this year and expects Healthcare to lead the growth on account of the robust pipeline.
- The pecking order for growth among verticals in FY25 is Healthcare, followed by BFSI and Hi-tech.
- The company is committed towards improving its EBIT margin by 200-300 bps over the next two to three years.
- Hi-tech is facing headwinds owing to enterprise customers as they face challenges in their business. Management expects the pressure to continue for the next few quarters.
- AI is opening up significant opportunities in two broad areas – AI for product engineering and AI for the enterprises.

Revision in estimates – We have revised our estimates to factor in Q4FY24 performance and FY25 revenue and margin outlook.

Our Call

Valuation – Maintain BUY with a revised PT of Rs. 4,150: PSL has been consistently delivering industry-leading performance since the past several quarters and is well placed to lead the growth trajectory in FY25/FY26, given the strong order book, consistent addition of new logos, and strong capabilities. We expect Sales/PAT CAGR at 17.8%/20.6% over FY24-FY26E. Though management has reaffirmed its commitment towards improving EBIT margin by 200-300 bps over the next two to three years, its commentary on maintaining EBIT margin at the current level for FY25 owing to investments in building sales and marketing capacity as well as building next-gen technology assets, including the AI domain is likely to place upper bounds on the profitability. We have cut our estimates for FY25/FY26E by 8%/10% owing to lower margins estimates. The 10% correction in the stock post Q4 numbers, makes risk reward favourable. We maintain BUY on the stock with a revised TP of Rs. 4,150. At the CMP, the stock trades at 39.8/32.1x its FY25/FY26E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of the banking crisis, macro headwinds, and recession in the U.S. can moderate the pace of technology spends.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24	FY25E	FY26E
Revenue	5,710.7	8,350.6	9,821.6	11,510.3	13,618.6
OPM (%)	16.8	18.2	17.6	17.7	18.8
Adjusted PAT	690.4	950.7	1,142.1	1,340.5	1,661.2
YoY growth (%)	53.2	37.7	20.1	17.4	23.9
Adjusted EPS (Rs.)	45.2	63.6	75.1	88.1	109.2
P/E (x)	77.7	55.2	46.8	39.8	32.1
P/B (x)	8.0	6.8	5.5	4.7	4.0
EV/EBITDA (x)	29.0	18.3	15.9	12.7	11.0
RoNW (%)	22.4	25.9	25.6	25.0	26.4
RoCE (%)	26.0	27.8	28.7	30.2	32.9

Source: Company; Sharekhan estimates

Key Highlights

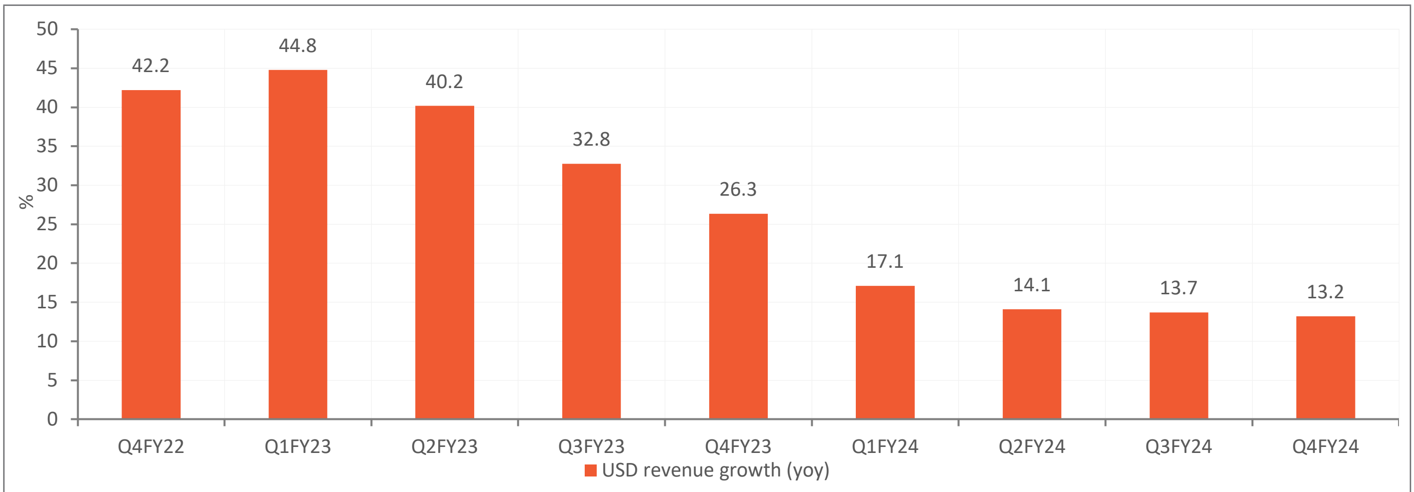
- **Revenue growth:** PSL reported $310.9 million in revenue, up 3.4% in constant currency (CC) terms, in-line with our estimate of $311.2 million. USD revenue grew 3.4% q-o-q /13.2% y-o-y, while revenue in rupee terms stood at Rs. 2,590.5 crore, up 3.7% q-o-q and 14.9% y-o-y. Sequential growth was led by the Healthcare & Lifesciences and BFSI verticals, which was partially offset by weakness in Software, Hi-tech, and Emerging Industries. For FY24, reported revenue stood at $1186.05 million, up 14.5% y-o-y.
- **EBIT margin:** EBIT margin was flat at 14.5%, missing our estimate of 14.8% owing to ramp up of a large vendor consolidation deal, which included a one-time transition cost along with lower utilisation, higher subcontractor cost and higher travel cost, which was compensated by a reduction in earnout liability with respect to one of the acquisitions. EBIT for FY24 stood at 14.4% compared to 14.9% in FY23.
- **Order bookings:** The total TCVs for Q4FY24 stood at $447.7 million, down 14% q-o-q/up 6%y-o-y. Book-to-bill stood at 1.4x. New business TCVs stood at $302 million, up 9% q-o-q/21% y-o-y. New annual contract value stood at $184.5 million, up 1% q-o-q/10% y-o-y, while new business ACV stood at $182.9, down 1% q-o-q/up 27% y-o-y, respectively. For FY24, TCV and ACV stood at $1828.7 million and $1296.7 million, respectively, while new TCV and new ACV stood at $1,129.7 million and $695.7 million, respectively.
- **Sequential growth across verticals:** Sequential revenue growth was led by Health and Lifesciences and BFSI, which grew 14.8 %/1.8% q-o-q, respectively. Software, hi-tech, and emerging industries declined 0.7% q-o-q.
- **Growth across geographies:** In terms of geographies, North America/India and ROW grew 4%/4.5% q-o-q and 47.8% q-o-q, respectively, while Europe declined 9.3% q-o-q.
- **Top clients:** Revenue from the top client declined 11% q-o-q owing to planned partial ramp down of a large five-year deal as per the contract. Revenue from the top-5 clients, top-10 clients, top-20 clients, and top-50 clients grew 7.9%, 5.3%, 2.8%, and 4.3% q-o-q, respectively.
- **Client addition:** The company added one client each in its $30mn+ and $5mn+ revenue category on a sequential basis, while the number of clients declined by two in the $20mn+ revenue category. The company added two clients in the $10 million+ revenue category.
- **Headcount and attrition:** Net additions grew by 514, taking the total headcount to 23,850. LTM attrition moderated further by 40bps to 11.5% in Q4FY24 from 11.9% in Q3FY24. However, utilisation declined 150bps to 80% in Q4FY24 from 81.5% in Q3FY24.
- **Cash generation and DSO:** Cash and investments stood at Rs. 1,860.9 crore at the end of Q4FY24 from Rs. 1,847.2 crore at the end of Q3FY24. DSO improved to 63 in Q4FY24 from 66 in Q3FY24.

Results (Consolidated) Rs cr

Particulars	Q4FY24	Q4FY23	Q3FY24	Y-o-Y (%)	Q-o-Q (%)
Revenue in USD (mn)	**310.9**	**274.6**	**300.6**	**13.2**	**3.4**
Revenue in INR	**2,590.5**	**2,254.5**	**2,498.2**	**14.9**	**3.7**
Direct Costs	1,728.6	1,489.4	1,653.9	16.1	4.5
SG&A	407.5	348.8	402.5	16.8	1.3
EBITDA	**454.4**	**416.3**	**441.8**	**9.1**	**2.8**
Depreciation and amortisation	79.9	69.7	78.7	14.6	1.5
EBIT	**374.4**	**346.6**	**363.1**	**8.0**	**3.1**
Forex gain/(loss)	-1.6	-18.9	8.1	-91.8	-119.2
Other Income	22.6	12.9	18.1	75.1	24.8
PBT	**395.5**	**340.6**	**389.3**	**16.1**	**1.6**
Tax Provision	80.2	89.1	103.2	-10.0	-22.3
PAT	**315.3**	**251.5**	**286.1**	**25.4**	**10.2**
Minority interest	0.0	0.0	0.0		
Net profit	**315.3**	**251.5**	**286.1**	**25.4**	**10.2**
Adjusted net profit	**315.3**	**251.5**	**286.1**	**25.4**	**10.2**
EPS (Rs.)	20.7	33.7	37.8	-38.4	-45.2
Margin (%)					
EBITDA	**17.5**	**18.5**	**17.7**	**-93**	**-15**
EBIT	14.5	15.4	14.5	-92	-8
NPM	12.2	11.2	11.5	102	72
Tax rate	20.3	26.2	26.5	-588	-623

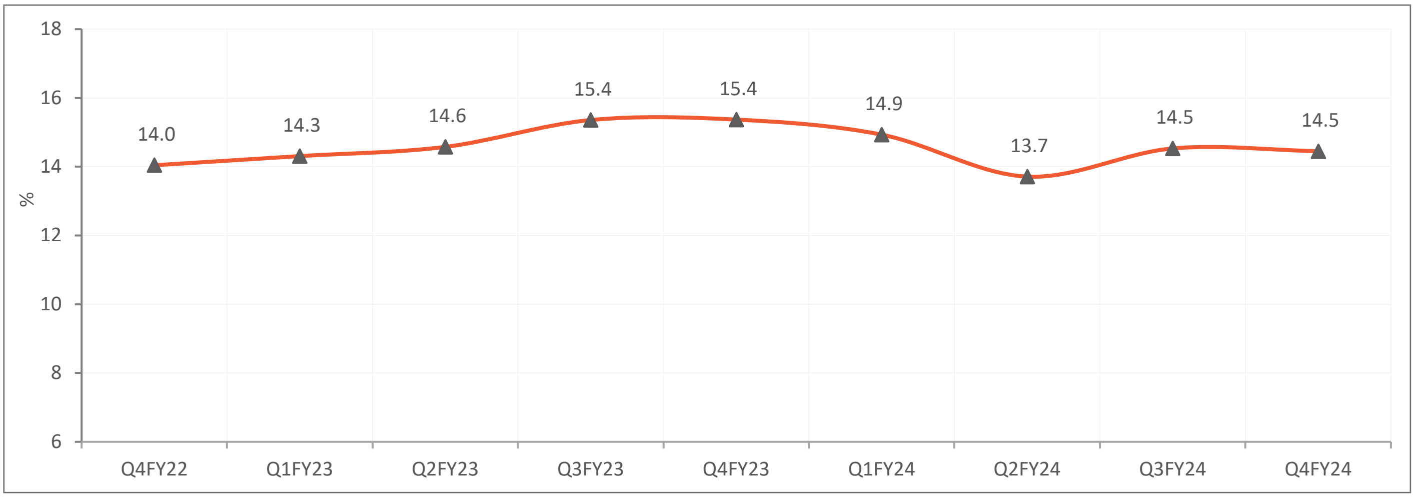
Source: Company; Sharekhan Research

USD revenue growth trend (y-o-y)



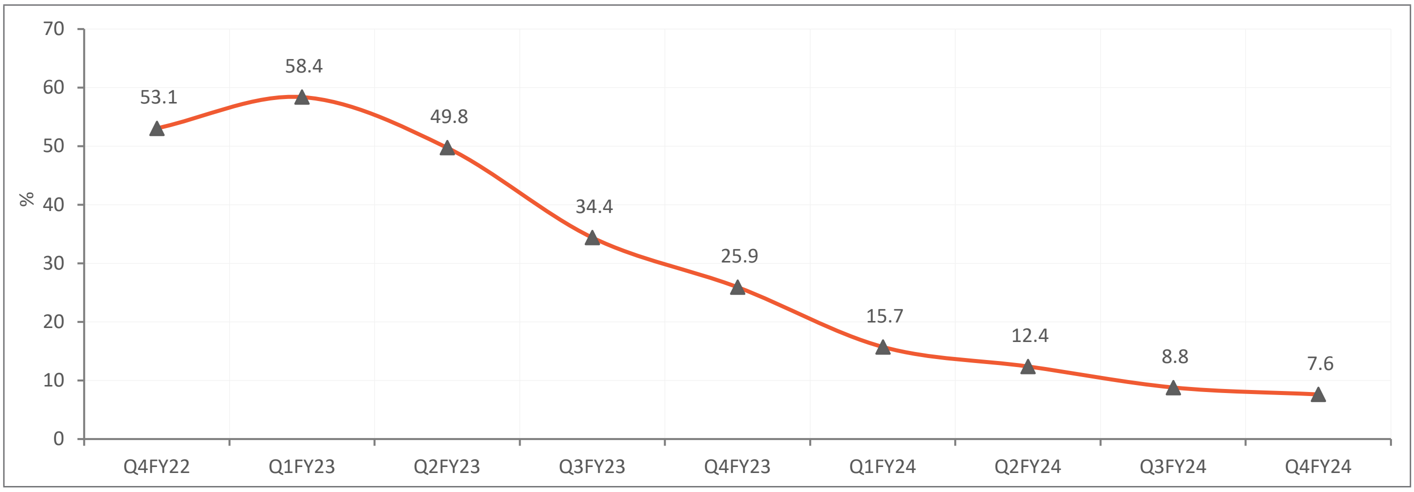
Source: Sharekhan Research

EBIT margin trend (%)



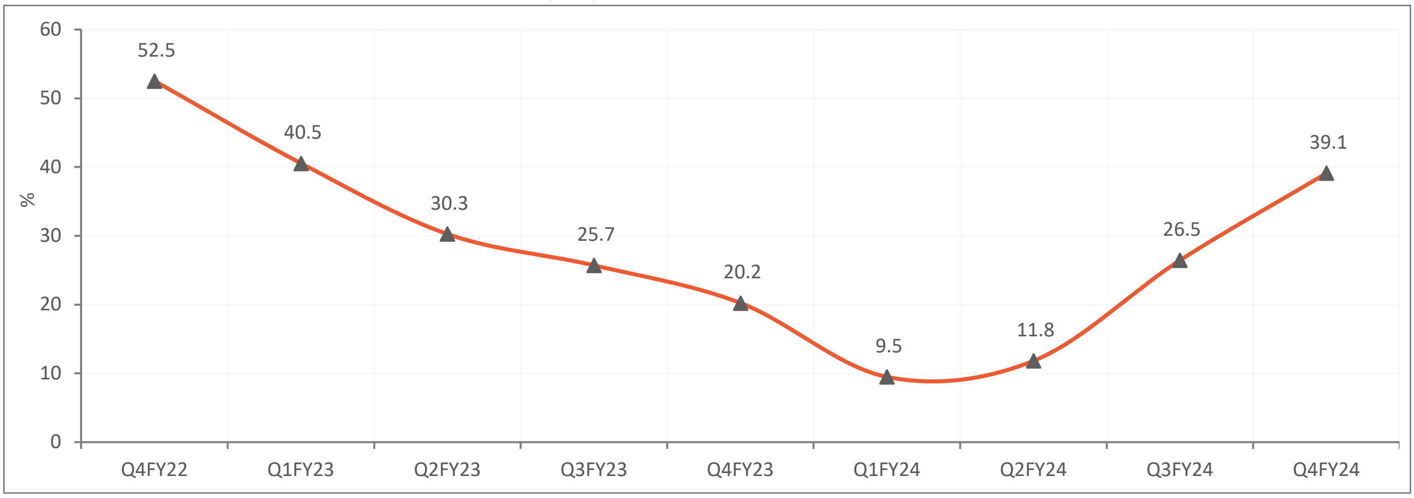
Source: Sharekhan Research

BFSI revenue growth trend (y-o-y)



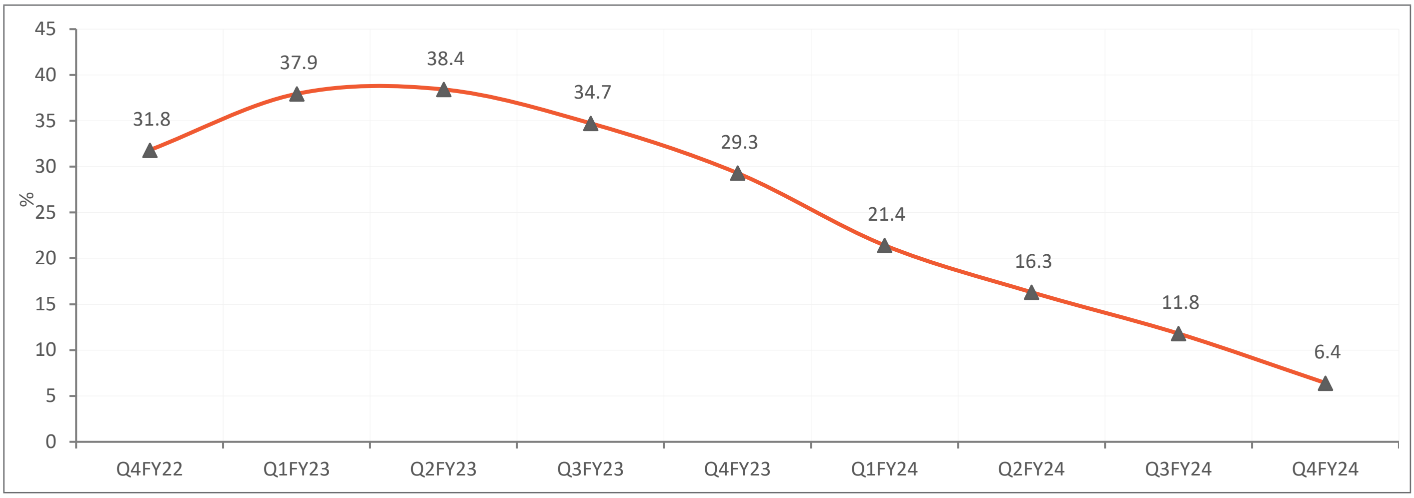
Source: Sharekhan Research

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



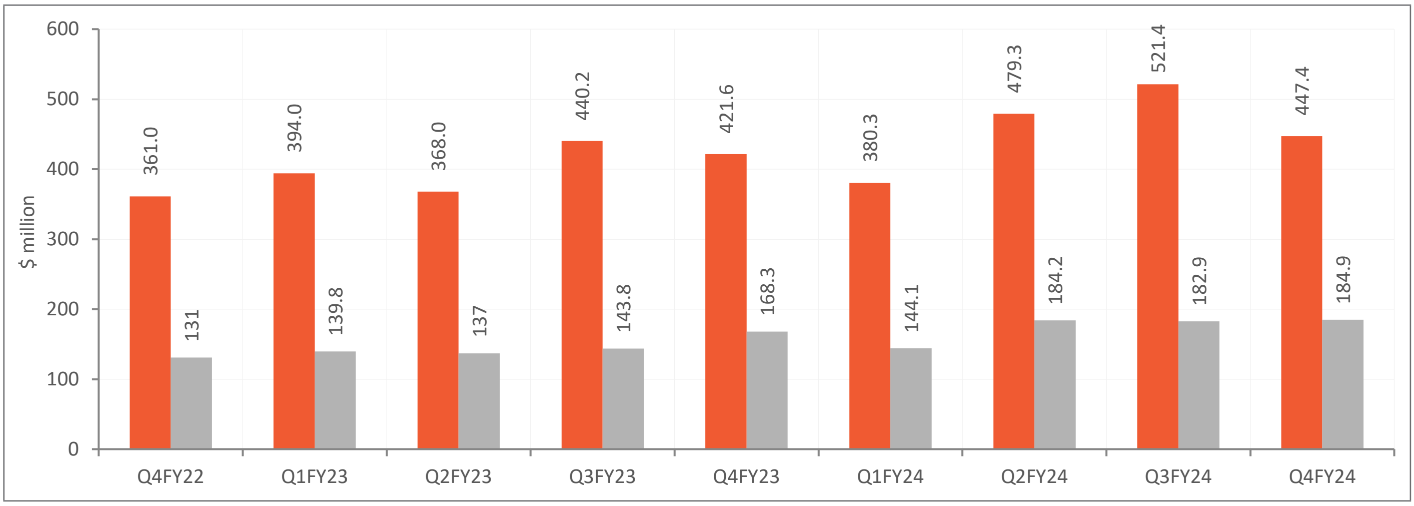
Source: Sharekhan Research

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



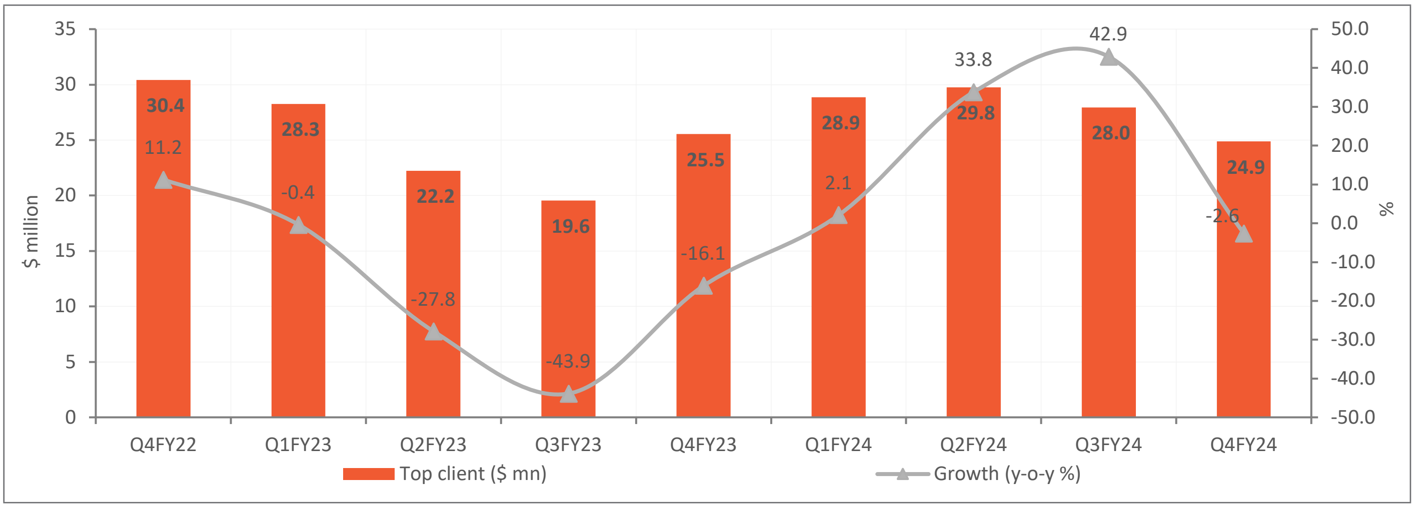
Source: Sharekhan Research

Total deal TCV and new business ACV trend



Source: Sharekhan Research

Top client ($ mn) and growth (%)



Source: Sharekhan Research

Outlook and Valuation

■ Sector View – Macro headwinds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25, aided by lower base coupled with easing sector headwinds. Although the IT sector has already outperformed Nifty last year, we expect the overall outperformance in CY24 to be driven by receding headwinds and better earnings visibility.

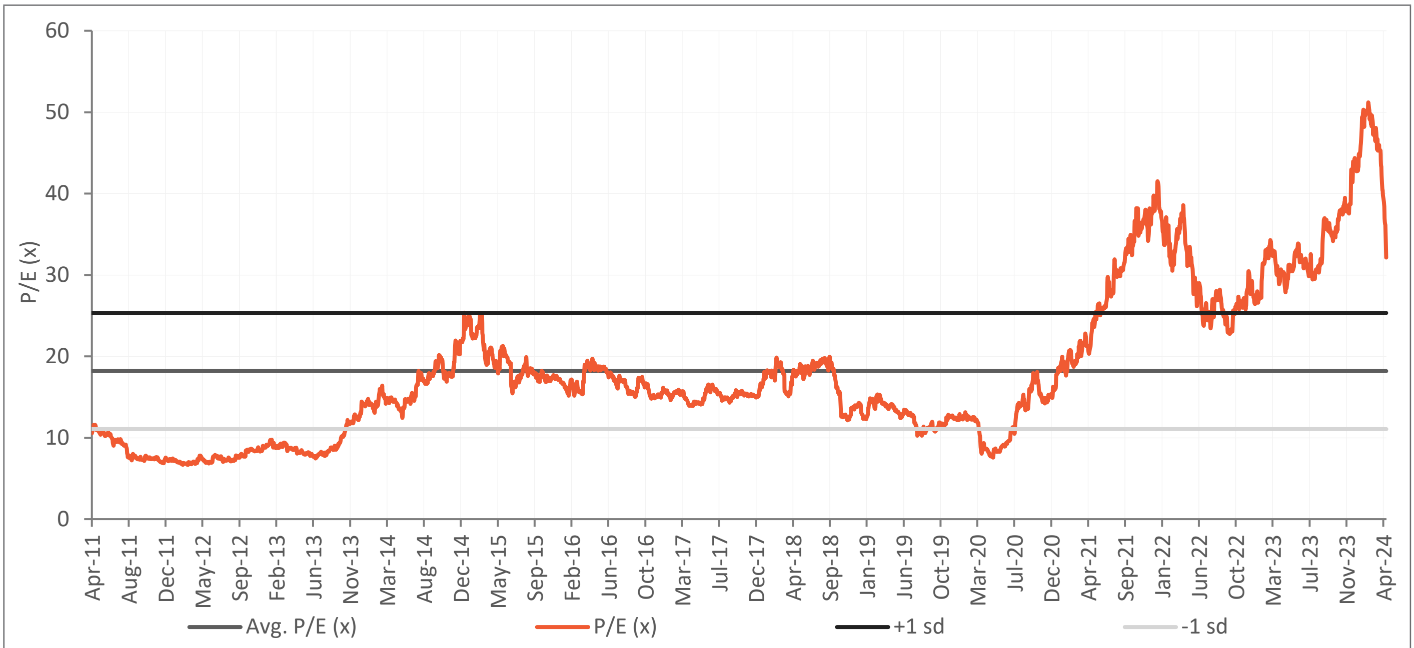
■ Company Outlook – Well-positioned to capture the immense growth opportunity

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. Management remains optimistic about delivering industry-leading revenue growth in FY24 on account of broad-based demand across verticals, robust deal bookings, 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 – Maintain Buy with revised PT of Rs. 4,150

PSL has been consistently delivering industry-leading performance since the past several quarters and is well placed to lead the growth trajectory in FY25/FY26, given the strong order book, consistent addition of new logos, and strong capabilities. We expect Sales/PAT CAGR at 17.8%/20.6% over FY24-FY26E. Though management has reaffirmed its commitment towards improving EBIT margin by 200-300 bps over the next two to three years, its commentary on maintaining EBIT margin at the current level for FY25 owing to investments in building sales and marketing capacity as well as building next-gen technology assets, including the AI domain is likely to place upper bounds on the profitability. We have cut our estimates for FY25/FY26E by 8%/10% owing to lower margins estimates. The 10% correction in the stock post Q4 numbers, makes risk reward favourable. We maintain BUY on the stock with a revised TP of Rs. 4,150. At the CMP, the stock trades at 39.8/32.1x its FY25/FY26E EPS.

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 and 2) Contagion effect of banking crisis, macro headwinds, and recession in the U.S., can 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	KOTAK MAHINDRA TRUSTEE CO	4.97
2	Kotak Mahindra Asset Management Co	3.14
3	Axis Asset Management Co Ltd/India	2.94
4	Motilal Oswal Asset Management Co	2.79
5	Vanguard Group Inc/The	2.73
6	HDFC Asset Management Co Ltd	2.67
7	BlackRock Inc	2.44
8	Nippon Life India Asset Management	1.46
9	FundRock Management Co SA	1.39
10	FMR LLC	1.30

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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