Q2FY25
Persistent Systems Ltd

Result update

23rd Oct 2024

Persistent Systems Ltd.

Elevated valuation overshadows strong Q2FY25 earnings

CMP*	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 5,719	**INR 5,441**	**(4.9%)**	**INR 8,07,560**	**REDUCE**	**Internet Software & Services**

Result Highlights:

- We expect a Revenue/PAT growth at a CAGR of 17.0%/21.0% for FY24-FY26E, respectively, and to witness a revenue/PAT growth of 16.6%/21.8% for FY24-FY27E. Accordingly, we project FY26E EPS of INR 102.7 and assign a P/E multiple of 53x, driven by recent ACV wins, improving discretionary spendings supported by margin expansion due to lower SG&A expenses. Consequently, we arrive at a TP of INR 5,441 (previously: INR 4,798).
- **Historically Revenue/PAT growth of PSYS from FY21-FY24 has been 32.9%/34.4%, exceeding our forecasted growth rates, which typically would suggest a lower P/E multiple. However, over the past six months, the stock has surged close to 61.0%, leading to stretched valuations. 1Yr Forward P/E of PSYS now trades at a record high of 65.6x, compared to a 3Yr average of 32.2x. At the current market price, we believe the risk-reward profile has turned unfavorable with the risks of a potential correction in multiple outweighs the potential upside. Accordingly, we are downgrading the shares of Persistent Systems Ltd to "REDUCE" from "HOLD".**

MARKET DATA

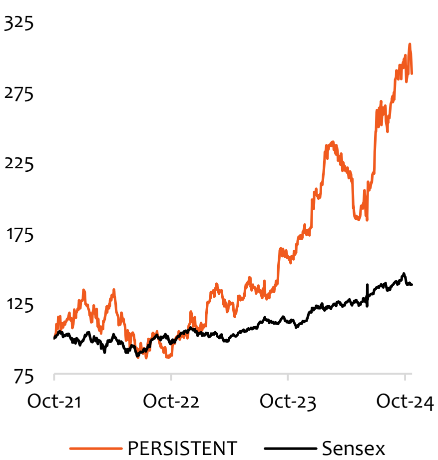
Shares outs (Mn)	155.8
Mkt Cap (INR Mn)	8,07,560
52 Wk H/L (INR)	5,690/1,420
Volume Avg (3m K)	419
Face Value (INR)	5.0
Bloomberg Code	PSYS IN

KEY FINANCIALS

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Revenue	83,506	98,216	116,442	134,479	155,813
EBIT	12,472	13,663	16,226	20,296	25,157
PAT	9,211	10,935	12,904	15,680	19,389
OPM (%)	14.9%	13.9%	13.9%	15.1%	16.1%
NPM (%)	11.0%	11.1%	11.1%	11.7%	12.4%

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



Healthcare & BFSI propel strong revenue growth in Q2FY25

- PSYS revenue for Q2FY25 stood at INR 28,972 Mn, up 20.1% YoY (+5.8% QoQ).
- The revenue growth was led by robust growth in the BFSI vertical, up 17.0% YoY (+8.1% QoQ), Healthcare & Lifesciences up 73.2% YoY (+10.3% QoQ), driven by significant deal wins.
- Software, Hi-Tech, and emerging industries saw a muted growth of 1.0% YoY (+1.4% QoQ).
- EBIT of INR 4,062 Mn rose by 22.8% YoY (+5.8% QoQ), surpassing our projections. EBIT margin improved by 31bps YoY (-1bps QoQ) to 14.0%.
- PAT jumped to INR 3,250 Mn up 23.4% YoY (+6.1% QoQ), beating our estimates driven by robust growth in BFSI and Healthcare vertical; PAT margins stood at 11.2% improved by 30 bps YoY (+2bps QoQ).
- In terms of regions, North America grew by 23.3% YoY (+6.6% QoQ), India grew by 13.9% YoY (-0.6% QoQ), RoW grew by 20.1% (-0.4% QoQ), due to lower base.
- Europe region remained flat YoY (-0.1% YoY/7.2% QoQ). The flattish growth in Europe is attributed to reduced salesforce related activity in the region.

PSYS holds margin steady with strategic offsets in Q2FY25

- EBIT Margin has remained flat sequentially to 14.0% (+31bps YoY)
- Sequential tailwinds affecting margin were wage hike (-210bps), absence of policy rationalization benefits (-130bps), Fresh issuance of ESOPs (-60bps), and a lower earn-off credit (-60bps).
- Sequential headwinds supporting margin growth were improvement in utilization rate (+120bps), reduction in subcontractor cost (+70bps), lower resale business (+50bps), pricing & right-shore (+130bps), currency movement (+30bps), absence of H-1B visa cost, (+60bps).

MARKET INFO

SENSEX	80,082
NIFTY	24,436

SHARE HOLDING PATTERN (%)

Particulars (%)	Sep-24	Jun-24	Mar-24
Promoters	30.7	31.0	31.0
FIIs	23.3	22.6	25.0
DIIs	27.4	28.2	25.9
Others	18.6	18.2	18.1
Total	100.0	100.0	100.0

17.0%

Revenue CAGR between FY24 and FY26E

21.0%

Adj. PAT CAGR between FY24 and FY26E

*Based on the Today's closing
Note: All the market data is as of Today's closing

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Persistent Systems Ltd.

Key Concall Highlights:

Strong order Book and client engagement growth in Q2FY25

- The total contract value (TCV) for the quarter reached USD 529.0 Mn, up 10.4% YoY (+14.3% QoQ), with USD 389.8 Mn of TCV from new bookings.
- The annual contract value (ACV) portion of this TCV was USD 348.3 Mn up 10.3% YoY (+3.3% QoQ), with USD 218.6 Mn contributed by ACV from new bookings.
- PSYS saw robust YoY growth across its client base, with top 5 customer revenue increased by 31.5%, top 10 customer rose by 24.6%, top 20 customer revenue increased by 22.1%.

PSYS expands digital solutions with strategic acquisitions and AI enhancements

- The company recently announced its plan to acquire Arrka, a Pune-based company focused on data privacy management.
- The acquisition of Arrka will enhance Persistent's offerings by helping customers manage data privacy risks and comply with various legal and regulatory requirements globally.
- The acquisition will also significantly bolster Persistent's AI, governance, and cybersecurity capabilities.
- The company is integrating Arrka's expertise with its SASVA and iAURA platforms to provide enhanced data privacy features.
- This acquisition complements existing AI offerings, addressing the growing need for trustworthy and ethical digital solutions.
- Following Q1FY25 announcement, the company has fully integrated Starfish.
- PSYS enhancing their contact center portfolio with AI-enabled administration and workflow assistance and expect to report some early deal wins from this portfolio by the end of Q3FY25E.

Adopts cautious workforce strategy amid soft labor market

- The company is adopting a cautious approach in a soft labor market, with no immediate plans to build a bench or hire ahead.
- PSYS does not anticipate significant changes to labor practices, aside from traditional seasonal furloughs in financial services and hi-tech sectors.
- To increase revenue per employee, the company is shifting to a platform-driven services model that utilizes AI for enhanced customer value.
- Furlough expectations are consistent with last year, with decisions finalized in November and December.

Launches SASVA 2.0 and expands product development initiatives

- The company has launched SASVA 2.0, an AI-driven platform that enhances software engineering services throughout the product development lifecycle. This platform offers comprehensive assessments to identify productivity gains, accelerate time-to-market, and reduce costs, while facilitating intelligent backlog management and roadmap planning.
- Persistent has partnered with a leading full-stack observability provider to enhance product and data engineering capabilities.
- Additionally, the company is supporting a financial analytics firm in speeding up its flagship product roadmap and collaborating with hyperscalers to develop connectors for GenAI offerings.
- A new global technology center is being established for a U.S.-based cybersecurity client to expedite their product roadmap.
- Furthermore, Persistent is assisting a U.S. precision medicine firm in transitioning its R&D center to India, ensuring a smooth, cost-effective process without disrupting customer deliverables. This focus on AI-driven platforms supports the company's goal of becoming a platform-driven services organization.

Employee base reduced and attrition inched up

- For Q2FY25, the employee headcount reduced by 282 employees to 23,237 (net addition of 395 employees YoY), with attrition rate inched up 10bps sequentially to 12.0% (Q2FY24 – 13.5%).

Valuation and view:

PSYS earnings for Q2FY25 exceeded our expectations with revenue meeting our projections. The revenue growth was led by robust performance in Healthcare & Life Science and BFSI vertical. The total bookings for Q2FY25 stood at USD 529.0 Mn, up 10.3% YoY. The company also bagged new deals in Healthcare and BFSI. Based on the recent developments, new deal wins, robust growth in Healthcare & BFSI sector, and strong pipeline, **we have slightly reduced our FY26E EPS by -1.5% from INR 104.3 to INR 102.7 on account of slight moderation in other income and assign P/E multiple of 53x, (previously 46.0x), to arrive at a TP of INR 5,441 (previously: INR 4,798).**

PSYS's has delivered a Revenue/PAT growth of 32.9%/34.4% from FY21-FY24, exceeding our forecasted revenue/PAT growth of 16.6%/21.8% for FY24-FY27E. This lower projected growth typically suggest a reduced P/E multiple. However, in the last six months the stock has surged to 61.0%, driven by optimism around improved discretionary spending supported by recent deal wins, resulting in elevated valuations. The 1Yr Forward P/E of PSYS now stands at a record high of 65.6x, compared to a 3Yr average of 32.2x. Given these elevated valuation multiples, we believe the current multiples do not adequately reflect future growth prospects and raise concerns about sustainability. Therefore, we are downgrading our rating on PSYS from "HOLD" to "REDUCE."

Persistent Systems Ltd.

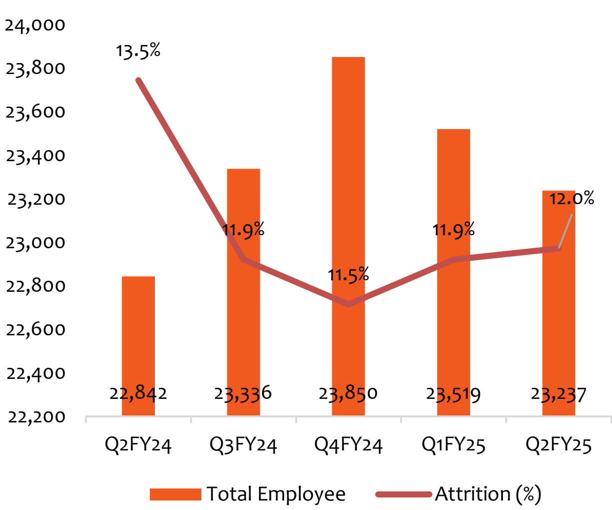
RESULT SNAPSHOT

Particulars (INR Mn)	Q2FY25	Q1FY25	Q2FY24	QoQ	YoY
Sales	**28,972**	**27,372**	**24,117**	**5.8%**	**20.1%**
Total Expenditure	24,164	22,820	20,065		
Employee Benefit Expenses	17,253	15,735	15,344		
Cost of Professionals	4,256	4,217	2,416		
Other Expenses	2,655	2,868	2,306		
EBITDA	**4,807**	**4,552**	**4,052**		
EBITDA Margin (%)	**16.6%**	**16.6%**	**16.8%**		
Depreciation and Amortization expense	745	712	744		
EBIT	**4,062**	**3,840**	**3,308**	**5.8%**	**22.8%**
EBIT Margin (%)	**14.0%**	**14.0%**	**13.7%**	**-1bps**	**31bps**
Finance Costs	182	141	123		
Other Income	465	306	373		
Exceptional items	0	0	0		
Profit before tax	**4,345**	**4,005**	**3,558**		
Tax expense	1,095	941	925		
Net profit	**3,250**	**3,064**	**2,633**	**6.1%**	**23.4%**
Net profit margin (%)	**11.2%**	**11.2%**	**10.9%**	**2bps**	**30bps**
EPS	21.0	19.9	17.1		

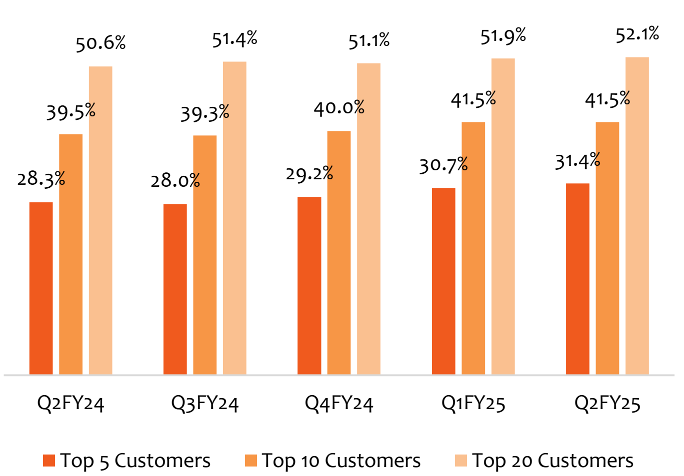
Source: Company, KRChoksey Research

Quarterly Trends

Employee base reduced by 282 sequentially



Revenue contribution increasing from top 5 and top 20 customers



Source: Company, KRChoksey Research

Persistent Systems Ltd.

KEY FINANCIALS

Exhibit 1: Profit & Loss Statement

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Revenue	83,506	98,216	116,442	134,479	155,813
Total Operating expenses	68,315	81,459	97,127	110,968	127,307
EBITDA	**15,191**	**16,757**	**19,315**	**23,511**	**28,506**
Depreciation	2,719	3,094	3,089	3,216	3,350
EBIT	**12,472**	**13,663**	**16,226**	**20,296**	**25,157**
Finance Cost	**770**	**467**	**523**	**586**	**648**
Other income, net	706	1,280	1,493	1,479	1,714
Pre-tax Income	**12,409**	**14,476**	**17,196**	**21,189**	**26,222**
Income tax expense	3,198	3,541	4,203	5,191	6,440
Net profit	**9,211**	**10,935**	**12,992**	**15,998**	**19,783**
Diluted EPS (INR)	60.3	71.1	83.4	102.7	126.9
Shares in Mn	153	154	156	156	156

Exhibit 3: Cash Flow Statement

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
CFFO	9,558	12,213	11,840	15,936	19,158
CFFI	-4,213	-4,695	-9,183	-4,519	-4,974
CFFF	-4,079	-5,937	-6,460	-7,940	-9,777
Net Inc/Dec	1,266	1,581	-3,803	3,478	4,407
Opening Balance	2,978	4,631	6,585	2,781	6,259
Adjustments	387	373	0	0	0
Closing Balance	4,631	6,585	2,781	6,259	10,666

Exhibit 4: Key Ratios

Key Ratios	FY23	FY24	FY25E	FY26E	FY27E
EBIT Margin (%)	14.9%	13.9%	13.9%	15.1%	16.1%
Tax rate (%)	25.8%	24.5%	24.4%	24.5%	24.6%
Net Profit Margin (%)	11.0%	11.1%	11.2%	11.9%	12.7%
RoE (%)	24.9%	26.1%	27.3%	28.1%	29.4%
RoCE (%)	25.5%	26.6%	27.9%	28.7%	29.9%
Current ratio	3.5	3.7	3.3	3.4	3.5
EPS (INR)	60.3	71.1	83.4	102.7	126.9

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Equity					
Equity Capital	764	770	770	770	770
Other Equity	38,887	48,807	55,760	64,322	74,910
Total Equity	**39,651**	**49,577**	**56,530**	**65,093**	**75,680**
Non-Current Liabilities					
Long Term Borrowings	2,058	99	99	99	99
Other Long-term Liabilities	4,521	1,671	2,111	2,361	2,611
Long Term Provisions	373	547	591	638	689
Total Non-Current Liabilities	**6,951**	**2,317**	**2,801**	**3,098**	**3,399**
Current Liabilities					
Borrowings	2,926	2,804	2,865	2,929	2,995
Trade Paybles	5,689	8,139	9,716	11,303	13,135
Other current liabilities	11,514	10,899	12,359	14,043	15,988
Total Current Liabilities	**20,129**	**21,842**	**24,941**	**28,275**	**32,118**
Total Liabilities	**66,731**	**73,736**	**84,272**	**96,465**	**111,197**
Non-Current Assets					
PPE	4,860	4,420	4,639	5,244	6,321
Right of use of Assets	2,198	2,307	2,446	2,592	2,748
Intangible Assets	9,171	4,575	11,097	12,207	13,428
Goodwill	7,184	10,913	10,913	10,913	10,913
Other current assets	8,851	10,290	10,996	11,917	12,801
Total Non-Current Assets	**32,265**	**32,504**	**40,091**	**42,873**	**46,211**
Trade Receivables	15,253	16,761	21,269	24,564	28,461
Cash and Bank	9,033	10,229	6,385	9,845	14,251
Oher current assets	10,180	14,242	16,527	19,183	22,274
Total Current Assets	**34,466**	**41,232**	**44,181**	**53,592**	**64,986**
Total Assets	**66,731**	**73,736**	**84,272**	**96,465**	**111,197**

Source: Company, KRChoksey Research

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Persistent Systems Ltd.

Persistent Systems Ltd.			
Date	CMP (INR)	TP (INR)	Recommendation
23-Oct-24	5,719	5,441	REDUCE
23-Jul-24	4,759	4,798	HOLD
24-Apr-24	3,466	3,857	ACCUMULATE
23-Jan-24	4,127	4,204	HOLD
02-Nov-23	3,113	3,308	ACCUMULATE

Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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