ANANDRATHI

India I Equities

Technology

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

25 July 2022

Persistent Systems

Building up on client profiles, margins surprise: Buy

Rating: **Buy**
Target Price: Rs.4,290
Share Price: Rs.3,600

Persistent had a steady quarter growing 5.3% q/q (organic) and the EBIT margin improving 27bps. It integrated two months of Media Agility and is now not looking at acquisitions as management focuses on integration. TCV touched $394m, up 61% y/y and net new TCV was up 56% y/y, reflecting no concerns on the macro side. Management intends to maintain the growth momentum with an upward margin bias, though Q2 will have a wage-hike impact. Hiring was strong and attrition eased a bit. No meaningful estimate change, but we lower our TP to Rs.4,290 (29x FY24, earlier Rs.4,980), reflecting the present volatile situation.

Remarkably better client metrics, TCV hits another high. Persistent delivered another strong quarter; revenue touched $241.5m, up 11% q/q incl. acquisitions, and is likely to breach $1bn in Q2. Client mining notably improved; four clients in the $20m+ bucket and five added in $5m+ in the last four quarters. It has 130 clients total in $1m+, up from 83 in FY21. On TCV, its book-to-bill was 1.6 (TTM average: 1.6), ACV was up 39% y/y, suggesting continued growth.

EBIT margins surprise, more tailwinds ahead. Persistent delivered 14.3% EBIT margins for Q1, up 18bps y/y, notably after absorbing overheads on account of acquisitions and higher talent costs over the last 12 months. Wage hikes are due in Q2 and the gross impact is ~250bps but management is confident of delivering eh same margins in FY23 as in FY22.

High capex, receivables transient. Persistent had hugh capex in FY22 (~7% of revenue vs past 2.1% average) to support headcount growth. In Q1, it opened an office in Gurgaon, keeping expenses high, but expects a drop from Q2. In FY23, though, expenses may be high. On receivables, acquisitions are being integrated; hence, some slippage was there in Q1, expected to self-correct through the year. No change in payment terms.

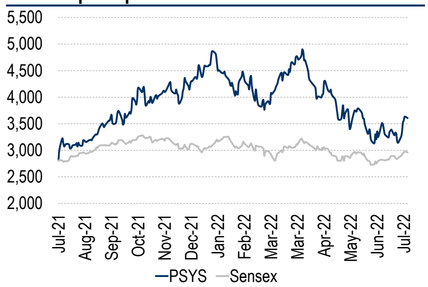
Maintaining a Buy. There is no meaningful change in estimates. The revised target of Rs.4,290 (from Rs.4,980 earlier), 29x FY24 EPS, reflects the present volatile situation and is in line with peers. The slight discount is on account of the lower FCF profiles in FY22 and FY23, largely offset by high growth. **Risks:** Slowdown in the US, M&A integration-related.

Key data	PSYS IN / PERS.BO
52-week high / low	Rs.4988 / 2974
Sensex / Nifty	55766 / 16631
3-m average volume	$14.6m
Market cap	Rs.276bn / $3456.8m
Shares outstanding	76m

Shareholding pattern (%)	Jun'22	Mar'22	Dec'21
Promoters	31.3	31.3	31.3
- of which, Pledged	-	-	-
Free float	68.7	68.7	68.7
- Foreign institutions	20.5	20.0	19.9
- Domestic institutions	25.9	26.8	26.9
- Public	22.4	22.0	21.9

Estimates revision (%)	FY23e	FY24e
Sales ($)	0.2	(0.1)
EBITDA	1.5	1.3
PAT	1.2	0.7

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY20	FY21	FY22	FY23e	FY24e
Sales (Rs m)	35,658	41,879	57,107	80,849	96,543
Net profit (Rs m)	3,403	4,507	6,904	9,155	10,986
EPS (Rs)	44.5	59.0	90.3	123.3	148.0
P/E (x)	81.2	61.3	40.0	30.2	25.1
EV / EBITDA (x)	53.4	38.5	27.3	19.0	15.4
P/BV (x)	11.6	9.9	8.2	6.9	5.9
RoE (%)	14.4	17.4	22.4	24.9	25.5
RoCE (%)	11.6	15.9	21.3	25.4	26.5
Dividend yield (%)	1.1	0.4	0.7	1.2	1.6
Net debt / equity (x)	-0.4	-0.6	-0.3	-0.2	-0.2

Source: Company, Anand Rathi Research

Mohit Jain
Research Analyst

Krishna Thakker
Research Associate

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Revenues (US$m)	**501.6**	**566.1**	**765.6**	**1,036.2**	**1,236.2**
Growth (%)	**4.3**	**12.9**	**35.2**	**35.4**	**19.3**
Net revenues (Rs m)	35,658	41,879	57,107	80,849	96,543
Employee & Direct Costs	23,494	27,650	37,895	54,498	66,025
Gross Profit	12,164	14,229	19,213	26,351	30,518
Gross Margin %	34.11	33.98	33.64	32.59	31.61
SG&A	7,234	7,398	9,557	12,514	13,431
EBITDA	**4,930**	**6,830**	**9,655**	**13,837**	**17,087**
EBITDA margins (%)	13.8	16.3	16.9	17.1	17.7
- Depreciation	1,660	1,756	1,660	2,637	3,392
Other income	1,254	1,020	1,248	1,035	987
Interest Exp					
PBT	4,523	6,094	9,243	12,234	14,681
Effective tax rate (%)	25	26	25	25	25
+ Associates/(Minorities)					
Net Income	3,403	4,507	6,904	9,155	10,986
WANS	76	76	76	74	74
FDEPS (Rs/share)	44.5	59.0	90.3	123.3	148.0

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	764	764	764	764	764
Net worth	23,858	27,957	33,682	39,744	46,470
Total debt (including Pref)	46	44	4,326	3,028	2,120
Minority interest					
DTL/(Asset)	-960	-1,038	-1,123	-1,123	-1,123
Capital employed	**22,944**	**26,963**	**36,885**	**41,650**	**47,467**
Net tangible assets	2,791	3,254	4,276	5,202	5,140
Net Intangible assets	1,435	1,230	8,270	15,554	17,419
Goodwill	89	86	2,790	2,790	2,790
CWIP (tangible and intangible)	303	122	1,071	1,071	1,071
Investments (Strategic)	4,621	3,621	3,878	3,878	3,878
Investments (Financial)	5,165	6,375	4,347	1,304	2,608
Current Assets (ex Cash) Incl LT a	10,985	11,121	19,242	21,568	24,212
Cash	4,572	9,809	9,144	7,783	8,426
Current Liabilities (ex ST Loan/Cu	7,018	8,654	16,133	17,500	18,077
Working capital	3,967	2,467	3,110	4,069	6,134
Capital deployed	**22,944**	**26,963**	**36,885**	**41,650**	**47,467**
Contingent Liabilities	247	506	869	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	4,523	6,094	9,243	12,234	14,681
+ Non-cash items	1,402	1,269	1,981	1,769	2,638
Operating profit before WC chang	5,925	7,363	11,224	14,003	17,319
- Incr./(decr.) in WC	1,369	-1,578	4,062	959	2,065
Others incuding taxes	-1,328	-1,582	1,288	-3,079	-3,695
Operating cash-flow	3,228	7,359	8,450	9,964	11,558
- Capex (tangible + Intangible)	746	1,251	3,808	4,432	2,216
Free cash-flow	2,482	6,108	4,642	5,532	9,342
Acquisitions	435	448	6,154	6,415	2,981
- Dividend (including buyback & ta	2,978	1,070	1,987	3,093	4,261
+ Equity raised	-	-	-	-	-
+ Debt raised	38	4	4,279	-1,298	-908
- Fin Investments	1,797	-634	-1,992	-3,043	1,304
- Misc. Items (CFI + CFF)	-538	-9	3,437	-868	-755
Net cash-flow	-2,152	5,237	-665	-1,362	643

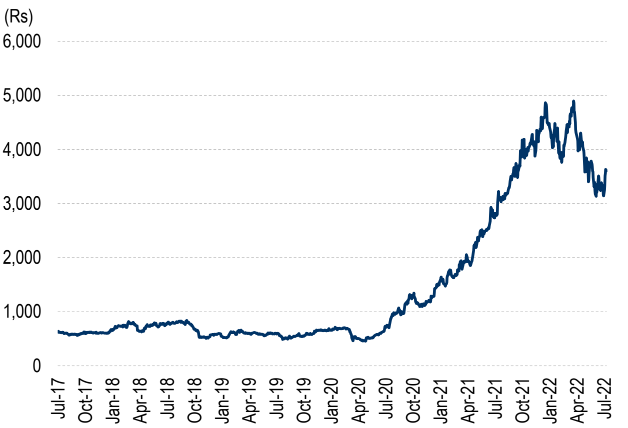
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	81.2	61.3	40.0	30.2	25.1
EV/EBITDA (x)	53.4	38.5	27.3	19.0	15.4
EV/sales (x)	7.3	6.0	4.5	3.2	2.7
P/B (x)	11.6	9.9	8.2	6.9	5.9
RoE (%)	14.4	17.4	22.4	24.9	25.5
RoCE (%) - After tax	11.6	15.9	21.3	25.4	26.5
RoIC (%) - After tax	25.3	39.0	35.9	29.2	29.1
DPS (Rs per share)	39.0	14.0	26.0	41.7	57.4
Dividend yield (%)	1.1	0.4	0.7	1.2	1.6
Dividend payout (%) - Inc. DDT	87.5	23.7	28.8	33.8	38.8
Net debt/equity (x)	-0.4	-0.6	-0.3	-0.2	-0.2
Receivables (days)	82	69	81	82	82
Inventory (days)					
Payables (days)	27	28	33	30	28
CFO:PAT%	94.9	163.3	122.4	108.8	105.2
FCF:PAT% - includ M&A payout	59.8	124.9	-22.6	-9.6	57.9

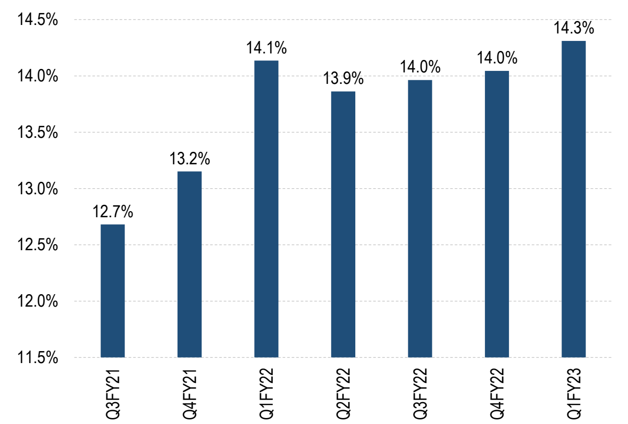
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBIT margins



Source: Company, Anand Rathi Research

Result Highlights

Q1 FY23 Results at a Glance

Fig 7 – Segment-wise results

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q/Q	Y/Y
Revenue ($ m)	167	182	199	217	242	11.1%	44.8%
Growth Y/Y %	27.3%	34.0%	33.0%	35.9%	31.4%		
Industry Y/Y % (est.)	20%	22%	21%	19%	17%		
Revenue (Rs m)	12,299	13,512	14,917	16,379	18,781	14.7%	52.7%
Effec. exchange rate	73.7	74.1	74.9	75.4	77.8	3.2%	5.5%
TCV($ m)	244.8	282.5	334.3	361.0	394.0	9.1%	60.9%
TCV(LTM)	1,018.3	1,075.8	1,108.1	1,222.6	1,371.8	12.2%	34.7%
Y/Y %	31%	26%	11%	46%	61%		
TCV:Rev.	1.5	1.5	1.7	1.7	1.6		
Employees (EoP)	14,904	15,879	16,989	18,599	21,638	16.3%	45.2%
Rev. prod. ($ '000/employee)	11.7	11.8	12.1	12.2	12.0	-1.7%	2.8%
Utilisation % (IT Services)	80.1%	82.8%	83.0%	80.6%	79.5%	-110 bps	-60 bps
Attrition %	16.6%	23.6%	26.9%	26.6%	24.8%	-180 bps	820 bps
CoR (excl. D&A)	(8,173)	(8,982)	(9,880)	(10,859)	(12,433)	14.5%	52.1%
As % of revenue	-66%	-66%	-66%	-66%	-66%	10 bps	25 bps
SG&A	(2,037)	(2,287)	(2,526)	(2,707)	(3,015)	11.4%	48.0%
As % of revenue.	-17%	-17%	-17%	-17%	-16%	48 bps	51 bps
EBITDA	2,089	2,244	2,511	2,812	3,333	18.5%	59.6%
EBITDA margins %	17.0%	16.6%	16.8%	17.2%	17.7%	58 bps	76 bps
EBIT	1,739	1,873	2,083	2,300	2,688	16.8%	54.6%
EBIT margins %	14.1%	13.9%	14.0%	14.0%	14.3%	27 bps	18 bps
Industry margins % (est.)	16.4%	17.2%	17.9%	17.3%	15.9%	-136 bps	-47 bps
Other income (excl. forex)	183	293	251	251	89	-64.5%	-51.3%
Non-recurring / Forex	109	10	30	120	42	-65.2%	-61.7%
Interest expenses							
PBT	2,031	2,176	2,364	2,672	2,819	5.5%	39%
PBT margins %	16.5%	16.1%	15.8%	16.3%	15.0%	-130 bps	-150 bps
Taxes	(518)	(559)	(600)	(662)	(703)	6.1%	36%
ETR %	-26%	-26%	-25%	-25%	-25%	-15 bps	59 bps
Associates / Minority							
Net income	1,512	1,618	1,764	2,010	2,116	5.3%	40%
Net margins %	12.3%	12.0%	11.8%	12.3%	11.3%	-100 bps	-103 bps
Industry net margins %	13.4%	13.5%	13.3%	13.7%	11.9%	-186 bps	-153 bps
EPS (Rs)	19.8	21.2	23.1	26.3	28.5	8.4%	44%

Source: Company, Anand Rathi Research

Fig 8 – Quarterly result

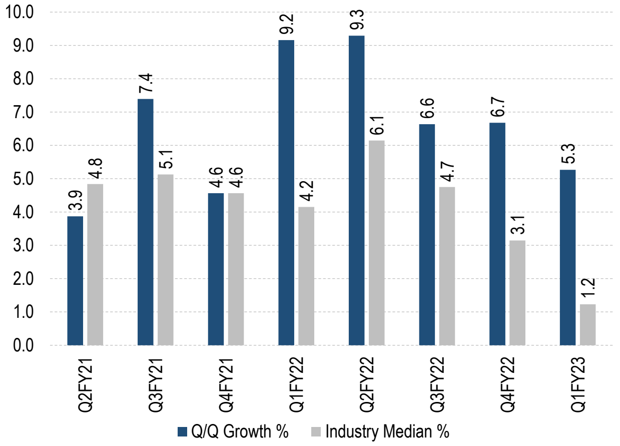
Year-end: Mar (Rs m)	Q1FY23	% chg. Q/Q	% chg. Y/Y	Q1 as % of FY23	FY22	FY22 % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	242	11.1	44.8	23	766	35.2	35.4
Sales	18,781	14.7	52.7	23	57,107	36.4	41.6
EBITDA	3,333	18.5	59.6	24	9,655	41.4	43.3
EBITDA margin (%)	17.7	58bps	76bps	-	16.9	60bps	21bps
EBIT	2,688	16.8	54.6	24	7,995	57.5	40.1
EBIT margin (%)	14.3	27bps	18bps	-	14.0	188bps	-15bps
PBT	2,819	5.5	38.8	23	9,243	51.7	32.4
Tax	(703)	6.1	35.6	23	(2,339)	47.3	31.7
Tax rate (%)	(24.9)	-15bps	59bps	-	(25.3)	75bps	14bps
Net income	2,116	5.3	39.9	23	6,904	53.2	32.6

Source: Company, Anand Rathi Research *Note: FY22 numbers include acquisitions made, hence not comparable*

Steady Q1, ahead of Industry and peers

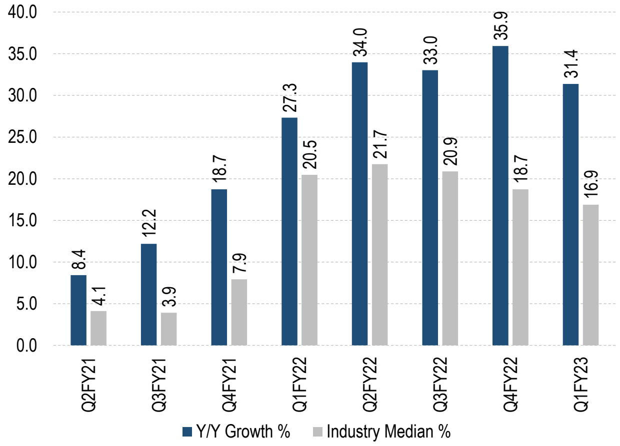
Persistent had a steady Q1, comfortably beating industry organic growth rates. In Q1 FY22, it grew 11% sequentially (after including acquisitions) and has been at par or above the industry median growth for the seven quarters after Q2 FY21. Q1 organic revenue growth was 5.3% q/q, 31% y/y, in dollars. The company added $4.6m, two months from MediaAgility, and another $8.2m from DataGlove (full three-month consolidation now). In Services (its core business), it delivered 7% q/q growth (org).
From a y/y perspective, it delivered 45% (31% organic) revenue growth, beating midcap IT companies. It has been ahead of industry growth for the last eight quarters, suggesting a healthy mix of deals and ramp-ups, something also visible in client buckets.

Fig 9 – Grew faster than the industry



Source: Company, Anand Rathi Research

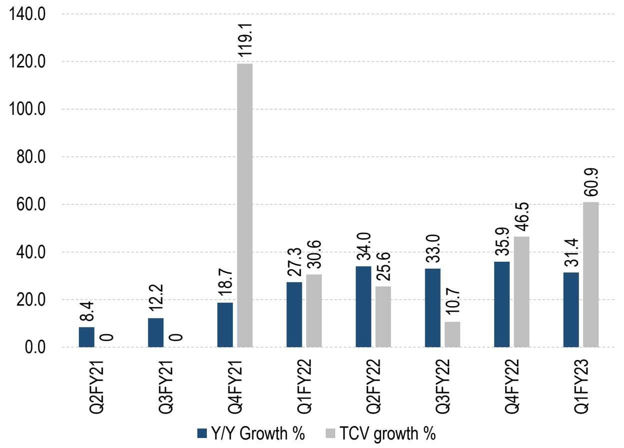
Fig 10 – Consistently growing faster than the industry



Source: Company, Anand Rathi Research Note:

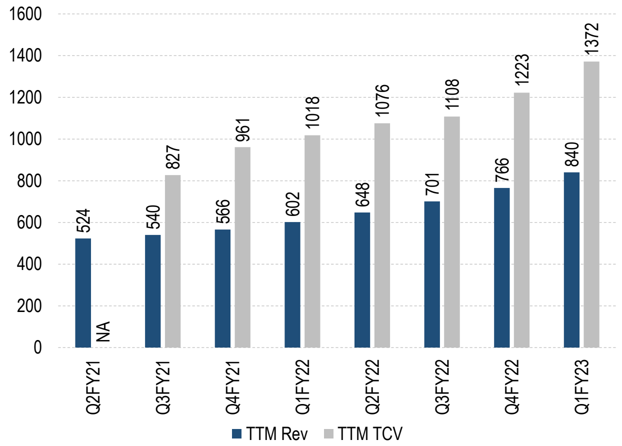
In TCV, it had a good quarter with Q1 at $394m (up 9% q/q, 61% y/y), compared to Q4's $361m TCV. A few key deals won include one from a leading European software company, its largest ($50m+ over seven years) in the European region and from a leading health-tech company. Q1 deal wins offer strong growth assurance in FY23 as the book-to-bill is high. Demand is strong and the order backlog is increasing, per management.

Fig 11 – TCV grows faster than revenue



Source: Company, Anand Rathi Research Note:

Fig 12 – TTM TCV ahead of TTM revenues.



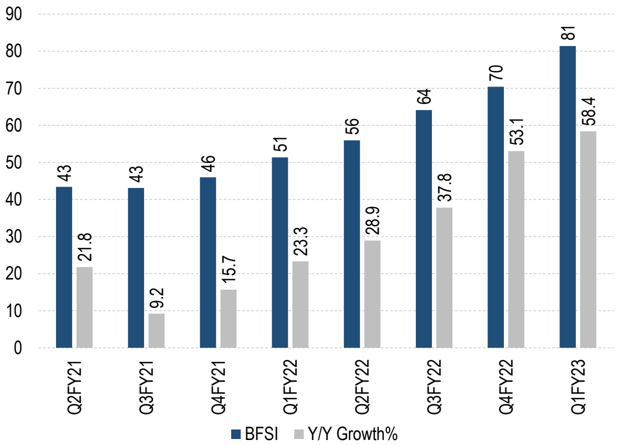
Source: Company, Anand Rathi Research Note:

Strong growth across verticals

Persistent, from a vertical-exposure perspective, operates in three verticals: Hi-tech (46% of revenue), BFSI (34%) and Healthcare (20%). Interestingly, BFSI is the largest for Indian IT where PSYS is trying to establish itself as a strong challenger (~$326m revenue p.a., at the Q1 run rate). A few large US banks are its clients and it is expanding its base in India in this vertical. In Q1, BFSI growth accelerated 58% y/y. This vertical was aided by acquisitions over the last few quarters.

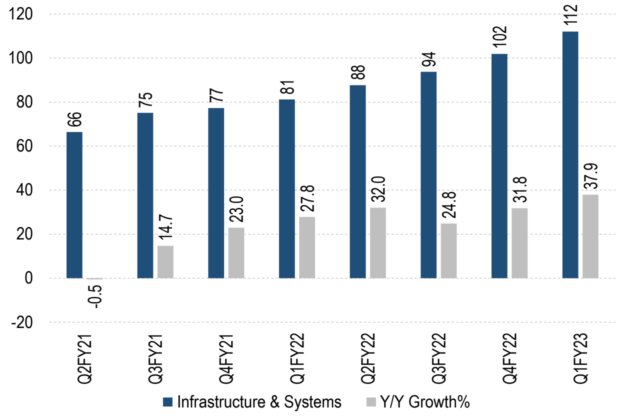
The other two are high-growth verticals for Indian IT. PSYS's Hi-tech vertical grew 38% y/y in Q1 and the outlook continues to be good, despite the ongoing US-related concerns. This vertical was further aided by the Data Glove acquisition integrated for the full quarter. PSYS' top client declined sequentially for the second consecutive quarter while the y/y growth was flattish. Excl. the top client, Hi-tech grew 58% y/y.

Fig 13 – Strong BFSI growth



Source: Company, Anand Rathi Research Note: Q3FY22 growth is organic (est.)

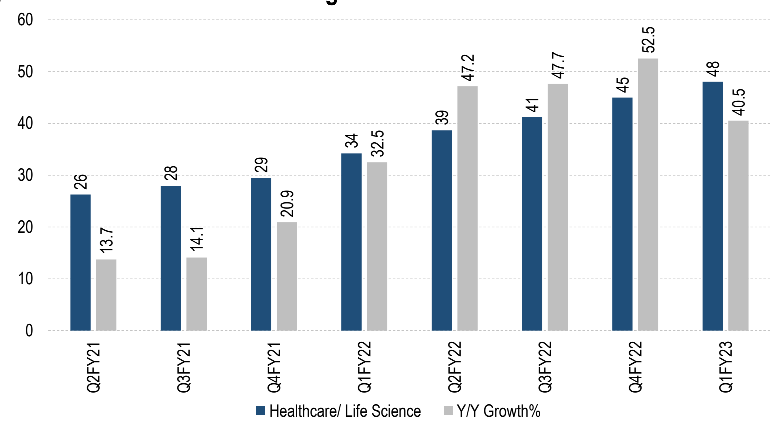
Fig 14 – Software, Hi-tech, Emerging Industries verticals growing well



Source: Company, Anand Rathi Research Note:

In Healthcare & Life Sciences, Persistent has been delivering good growth for the past few quarters. In line with its performance, Q1 was strong (up 7% q/q, 41% y/y). This vertical is expected to continue to grow fast.

Fig 15 – Healthcare to continue to grow fast



Source: Company, Anand Rathi Research Note:

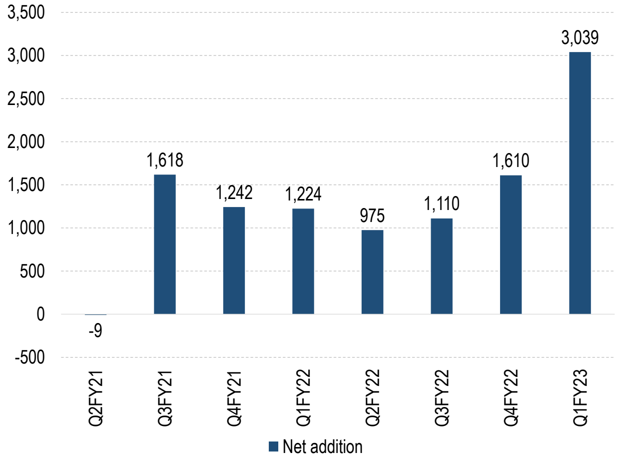
Margin improves q/q and y/y; productivity steady

Persistent added 3,039 employees (500 from MediaAgility) in Q1 (6,734 in LTM), leading to utilisation moving to 79.5% in Q1 FY23 from 80.1% a year ago. Sequentially, it came down from 80.6%. In Q1, 1,950 freshers were added (to be deployed in 3-6 months) and the company plans to add 1,350 freshers in Q2. Wage hikes are due on 1st Jul and to have a gross impact of ~250-300bps.

As of Q1, it increased its technical headcount by 46%, compelling the company to buy another facility in Gurgaon in Q1. The Q1 EBIT margin expanded 27bps q/q, 18bps y/y, despite supply-side challenges, travel & visa costs, and amortization, offset by currency.

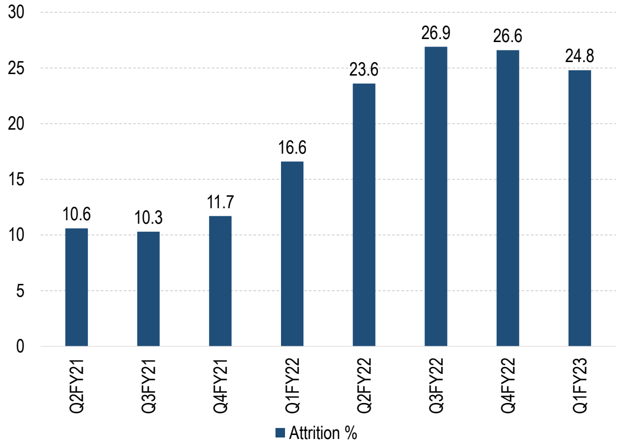
Attrition, on the other hand, was 24.8% (down from its four-year high in Q3). The higher Services revenue and favourable currency movement aided margins and offset the higher cost of operations caused by attrition.

Fig 16 – Net addition strong



Source: Company, Anand Rathi Research

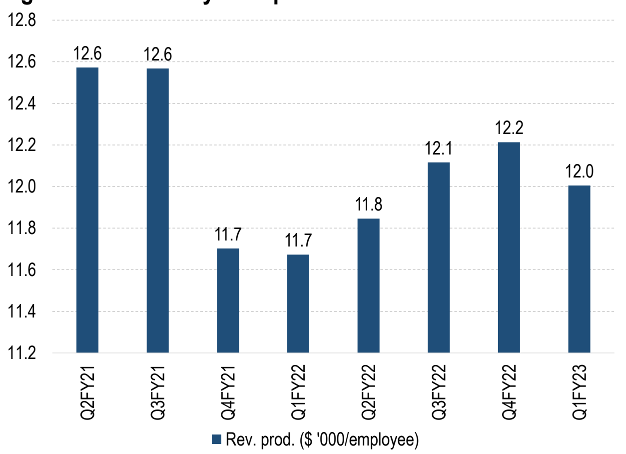
Fig 17 – Attrition starts to taper



Source: Company, Anand Rathi Research Note: Excluding freshers, attrition was 26.3% in Q1FY23

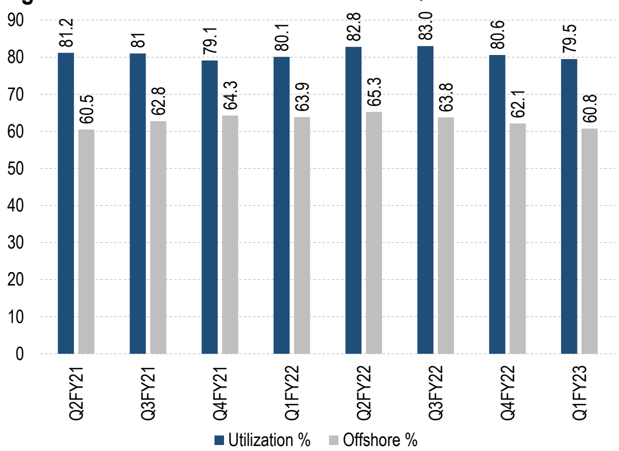
From an employee-productivity perspective, PSYS is ~5% lower than the recent highs but we expect it to be steady ahead. From a y/y perspective, productivity has improved 3%. PSYS currently has better productivity in Europe and, hence, in quarters (like Q4) when growth in Europe turns out to be strong, productivity also moves up. On the other hand, in Q1, cross-currency headwinds lead to lower productivity. Besides, given relatively lower utilisation and higher offshore, productivity is likely to be range-bound.

Fig 18 – Productivity to improve ahead



Source: Company, Anand Rathi Research Note:

Fig 19 – Utilisation and Offshore fall in Q1



Source: Company, Anand Rathi Research Note:

The recent drop in offshore is on account of acquisitions which were largely onsite. As the company grows and acquisitions get integrated, we expect offshore to regain its previous highs.

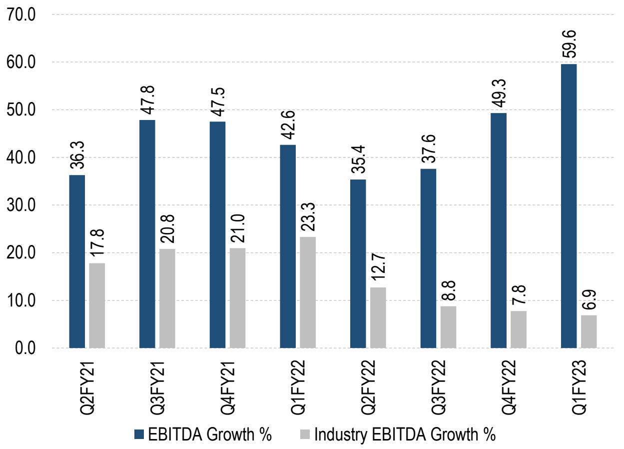
Healthy EBIDTA / NI growth

PSYS delivered 60% y/y EBITDA growth in Q1 FY23, way ahead of the industry. Y/Y, its margins expanded 76bps to 17.7%. FY23 margins would see headwinds in the form of wage hikes (to be higher than in FY22), and from acquisitions and high attrition. However, the worst of these three variables appear to be behind by Q2 after which there will be expansion opportunities. The company is confident of defending FY22 margins of 14%. Margin levers include utilisation, sub-contracting costs (travel opening up), and fresher intake. H2 FY23 should also see synergy revenue, which would also be a lever.

Despite supply-side challenges, the EBITDA margin expanded in Q1. The company had a 90bp currency benefit in Q1. It is negotiating with some clients for better billing rates and has already increased rates with some renewal contracts. This would be another, and the strongest, lever for margin expansion ahead. Despite all the challenges, it has done well in terms of margins, and its EBITDA growth is still way above the industry average.

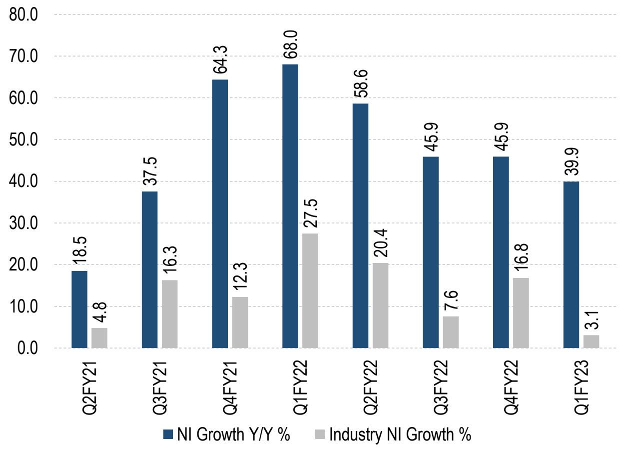
NI grew 40% in Q1 while the NI margin contracted 100bps q/q, 103bps y/y. This was largely due to lower other income (down 65% q/q, 51% y/y) and forex gains (down 65% q/q, 62% y/y).

Fig 20 – EBITDA growth, higher than that of the industry



Source: Company, Anand Rathi Research

Fig 21 – NI growth continues to be higher than industry



Source: Company, Anand Rathi Research Note:

In terms of client metrics, Persistent has scaled up well in $5m+ clients with LTM addition of five (on a base of 21 to reach 26 by Q1 FY23). This is in line with management commentary of efforts in client mining. Further, the maximum success came in the $1m+ clients, which increased by 28 in the last 12 months to 130 in Q1. The count includes clients added through acquisitions over the period.

Conference Call Highlights

Q1 FY23 Concall takeaways

- Demand is strong and management is not seeing any delays from clients.
- Persistent recorded 11.1% q/q growth: organic 5.6%, inorganic 5.5%
- Did not lose any revenue in Q1 due to budget constraints from clients but lost revenue due to staffing and delay in ramp-ups.
- Royalty revenue was slow in IP-led. The top-client was down due to the IP-led contract.
- BFSI – Mortgage exposure is insignificant (not impacted by mortgage slowdown). RedHat growth rate slower than that of the company and insignificant.
- Won a seven-year deal of $50m+ from a leading European software company. This is its largest deal in the Europe.
- Won a five-year deal from a leading health-tech company. This is one of the larger deals it won in Healthcare.
- New contracts are coming in at higher prices though the company also increased rates with some renewal contracts.
- Rationalising the tail is on the cards, management is waiting to either scale up with current clients or let them find a new provider.
- The EBIT margin was hit by supply-side challenges, travel & visa costs, and amortization, aided by currency (90bps) and receivables collected.
- Visa costs were $1.1m and project-related travel costs were $0.2m (this will not recur in Q2)
- Amortization was higher due to acquisitions. Media Agility was integrated for two months and DataGlove was integrated for the full quarter. Persistent has already started seeing wins with new acquisitions.
- Q2 wage hike impact to be ~250-300bps (a bit higher than prior years), should be able to absorb some of it. Margin levers include utilisation, sub-contractor costs (travel opening up), and fresher intake. H2 FY23 should also see synergy revenue, which would also be a lever.
- 1,950 fresh graduates were added in Q1, to be deployed within 3-6 months. The company plans to add 1,350 fresh graduates in Q2. Freshers are considered for utilisation calculation three months after being onboarded.
- Sales and business development headcount up due to acquisitions.
- Attrition to moderate ahead
- DSO higher due to some spillover in the first week of Jul. Unbilled up due to Media Agility.
- Focus on integration of acquisitions made, not looking for acquisitions for the next 3-6 months.
- Capex up due to hardware (for freshers), office requirements (Gurgaon) and Q1 also has higher software capex. Capex to come down in FY23.

Business Outlook

- To achieve $1bn run rate in the next few quarters.
- FY23 margins to be around FY22 levels.

Q4 FY22 Concall takeaways

- Q4 organic revenue growth was 6.8% q/q, 36% y/y, in dollar terms. The company had $4.7m further revenue from all three acquisitions in Q4. This was after absorbing a $4m drop in revenue from the top client due to a restructuring of their contract.
- FY22 organic growth was 32.8%.
- IP-led revenue was down due to restructuring of a deal with the top customer. The revenue-share deal is now a T&M one.
- The BFSI and Hi-tech (mainly Data Glove) verticals were aided by acquisitions in Q4.
- Offshore linear revenue grew 11.5% due to 9.8% volume growth and a 1.5% billing-rate increase.
- Onsite linear revenue grew 20.1% due to 17.6% volume growth and a 2.1% billing-rate increase.
- SCI and Shree Partners were fully integrated while Data Glove was integrated for a month. The Media Agility acquisition is expected to be closed in 1-2 weeks.
- TCV data shared do not include acquisitions' TCV.
- Deal highlights. $10m+ deal signed in payments with the help of SCI. Shree Partners not only aided in vendor consolidation but has also helped PSYS close two large multi-year deals and are triple digit on a TCV basis.
- Despite headwinds from D&A, one-time cost in M&A (30bps), supply side challenges and higher CSR, EBIT was flat. The company had a currency benefit of 30bps.
- Margins were down in BFSI due to increase in onsite revenue
- SCI and Shree at similar levels if margins compared to the company
- FY23 margins to see headwinds in the form of wage hikes (to be higher than in FY22), a 70-80bp headwind from acquisitions and high attrition. The company is confident of defending the 14% EBIT margins and is looking to raise prices with some clients.
- The billing rate in Europe is higher than that of the US.
- Of the net headcount addition in Q4, 30-40% were freshers and 700 employees were added from Data Glove. Wage hikes are due on 1st Jul.
- Utilisation was down in Q4 due to capacity building and fresher intake
- The company expects TTM attrition to be high as demand is robust, but expect it to come down over FY23
- Receivables were higher due to billing toward the quarter's end, not due to change in payment terms
- DSO was 59 days vs 58 in Q3

- Total payout for acquisitions (excl. MediaAgility) would be $220m, of which $150m was upfront, the rest in liabilities/earn-outs.
- Management is not seeing any weakness in the ISV market despite inflation and geopolitical tension
- Debt taken of $25m for SCI and $35m for Data Glove. The cost of debt is Libor+155bps. The tenure is three years and is an amortizing structure.
- The company will pause acquisitions for 1-2 quarters and concentrate on integration.
- CMT is an emerging vertical with a $50m run rate.
- The company is looking at $1bn revenue in 4-6 quarters.
- It is confident of defending a 14% EBIT margin.

Q3 FY22 Concall takeaways

- Q3 organic growth was 6.7% q/q, 33.4% y/y
- SCI's revenue was consolidated for almost the entire quarter, Shree Partners was consolidated for about half the quarter. SCI's revenue for the quarter was $3.7m and Shree Partners revenue was ~$800,000.
- The ESOP plan had a margin impact of 75bps. The higher Services revenue, better IP-led revenue and favourable currency movements aided margins by 50bps, and the focus on utilization helped offset the higher cost of operations caused by attrition. EBIDTA improved 20bps to 16.8%, against 16.6% the previous quarter.
- 1,110 employees added including 258 from the Shree Partners and SCI acquisitions. Fresh graduates constituted ~one fourth of the organic net addition. Looking at hiring 3,000 freshers in FY23.
- Annualized attrition has started to soften, though it remains high. 12-month attrition is likely to be the higher side for at least another couple of quarters. It would then moderate due to the base effect and on account of the new batch of freshers who will join, thereby expanding the supply for industry overall
- Avani Davda was added to Persistent's Board of Directors. Kuljesh Puri joined as an SVP for IBM Alliance and Emerging Verticals. Ajay Kumar joined as SVP for Partner Ecosystems, which includes sourcing advisory, private equity and similar channels. Vijay Iyer joined as Sales VP for digital transformation. PSYS also on-boarded its first member to the Persistent Advisor Network, Werner Boeing, a former CIO of Roche Diagnostics.
- Depreciation and amortization was higher on account of the new acquisitions. On a full-quarter basis, the amortization impact would be ~40bps, then moderate as revenue grows.
- DSO was 58 days, against 55 in the previous quarter, the increase being primarily due to higher IP invoicing in the last month of the quarter and some collections spilling over to the first week of Jan
- PSYS is a significant player in the Salesforce ecosystem in India and has expanded it footprint in Indian domestic financial services. The company expects this to be steady in terms of growth.

- PSYS has a healthy pipeline in the Salesforce market in Europe as well as the non-Salesforce market. In the next few quarters, it is expected to see a positive trajectory from a growth perspective for Europe.
- Kuljesh Puri hired as SVP for IBM Alliance and Emerging Verticals. Emerging Verticals has a decent portion of Communications, Media and Technology revenue in it and it is doing well. As it grows more over time, the company will start announcing it as a separate vertical, but does not expect this in FY23.
- Management aims to be a billion dollar-plus organization over the next 4-8 quarters

Q2 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth after a long time.
- Growth in Q2 was led by Healthcare and Life sciences, followed by BFSI and Hi-tech.
- Returned to normal wage hike (Jul) and Q2 saw the full impact (230bps gross), cushioned by growth and utilisation.
- ESOP plan introduced, which covers 80% of employees, in addition to their packages. ESOP scheme to have an impact of 70-80bps on margins; over time this should be offset.
- Acquisition of SCI and Shree Partners in September; no cost or revenue from these two in Q2. The company is evaluating more tuck-in M&As.
- On the IP business, it is working on optimizing margins and has converted a long-standing contract to a T&M one, which should boost margins and not have any seasonality. This will see some additional resources being released and re-deployed to Services or having more billability. In both the scenarios, margins should improve.
- The drop in the billing rate onsite was due to lower revenue from Europe (essentially due to seasonality) and an increase in revenue from Mexico which typically comes at a lower rate than the US.
- SG&A was higher due to more recruitment expenses although revenue growth aided in covering this. We expect operating leverage ahead.
- Supply-side challenges and attrition would pressure margins but the company expects to navigate these challenges.
- DSO was 55 days compared to 54 in Q1.
- It won a deal with a third-party insurance administrator (an existing customer). The TCV exceeds $50m over five years.
- In Healthcare, it won two deals with a contract-research organization and a leading US healthcare provider among other deals
- In Hi-tech the company was chosen by an employee engagement solutions organization and leading tax preparation and financial technology provider amongst other deals
- Management has plans to go bigger in the US, Canada and Mexico for near-shore delivery. This will help it build a more global delivery model.
- Management is seeing a healthy demand environment. TCV is a good representation of revenue ahead.
- Deals are a good mix of short-medium term and medium term.

- Expect 83-84% utilization.
- No further impact from impairments.
- IP business to be stable for some time and decline over a long tail, steep declines behind the company now.
- Acquisitions to have an impact of 30-40bps over two quarters on EBIT but should be manageable. At the gross margin level, acquisitions are accretive.
- Travel expense had a 10-15bp impact in Q2; if travel continues to open up, it expects this to increase 15bps each quarter.
- Its Europe business was hit by attrition in Q2, or it would have seen growth otherwise. In the medium term, this should move to 10-15% of revenue.
- The IP business has healthy margins; higher than the company average
- Goal of a $1bn run rate to be achieved in 6-8 quarters. This will mostly be through organic growth but some inorganic growth like that in Q2 could be added. Looking for capability acquisitions in cloud, data, security or salesforce.
- Q2 margins sustainable; expect margins of 16-17%.
- Margins to improve 100-150bps over the next 8-10 quarters

Q1 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth in the history of the company. Growth was broad based in Q1. Sureline Systems was integrated during the quarter but was small.
- Attrition is an area of focus and measures are in place to bring it down. These measures are better employee engagement, flexible work hours, intake of fresh graduates and upskilling of employees. FY22 returned to a normal wage-hike cycle; hence, wage hikes were given in July.
- H1 B visas had an impact of 50bps on margins in Q1 FY22. Gross margin down due to seasonality. Reported G&A for the quarter includes impairment in one of the start-up investments, resulting in a ~60bp impact.
- Capiot contributed a further $0.5m q/q
- Wage hike to impact margins by 250-275bps at the gross level; expect levers to absorb most of it; the net impact should not be more than 75-100bps (net impact) in Q2.
- Sub-contracting costs to go down as travel opens up.
- As soon as Covid-19 restrictions are lifted, expect near shore centers and more presence onsite. It is a lever ahead.
- Added 400 freshers in Q1; for the year looking at adding 2,000. Overall headcount to continue to increase.
- Europe growth will not see volatility as it moved to net accounting on the reseller-revenues part of the business.

  Evaluating 3-4 tuck-in acquisitions; hope to announce something in Q2.

Factsheet

Fig 22 – Revenue split

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Effort-Led	86.9	87.5	86.7	91.1	93.0
IP-Led	13.1	12.5	13.3	8.9	7.0

Source: Company, Anand Rathi Research

Fig 23 – Revenue-split, by region

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
North America	78.9	78.7	79.2	78.6	78.4
Europe	9.5	8.8	8.3	8.4	8.5
Asia-Pacific	11.6	12.5	12.5	13.0	13.1

Source: Company, Anand Rathi Research

Fig 24 – Revenue-split, by industry

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
BFSI	31	31	32	32	34
Healthcare	21	21	21	21	20
Infrastructure & Systems	49	48	47	47	46

Source: Company, Anand Rathi Research

Fig 25 – Client profiles (LTM)

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Client profiling					
Top 1	17.0	16.9	17.5	14.0	11.7
Top 5	36.5	35.8	36.1	32.5	30.8
Top 10	46.7	45.4	45.0	42.1	40.7
Active Clients (effort based)	568	596	625	678	735

Source: Company, Anand Rathi Research

Fig 26 – Client buckets

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
$1m+	76.0	84.0	90.0	93.0	104.0
$5m+	12.0	13.0	14.0	15.0	15.0
$10m+	5.0	5.0	6.0	6.0	7.0
$20m+	2.0	2.0	2.0	2.0	1.0
$30m+	2.0	2.0	2.0	2.0	3.0

Source: Company, Anand Rathi Research

Fig 27 – Workforce

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Employee Movement					
Technical(EOP)	13,833	14,657	15,721	17,283	20,144
Net Adds (Qtr)	1,127	824	1,064	1,562	2,861
Net Adds (LTM)	3,806	4,656	4,188	4,577	6,311
Utilization %	80.1	82.8	83.0	80.6	79.5
Attrition %	16.6	23.6	26.9	26.6	24.8
Sales(EOP)	308	296	294	317	367
Net Adds (Qtr)	35	(12)	(2)	23	50
Net Adds (LTM)	34	28	17	44	59

Source: Company, Anand Rathi Research

Fig 28 – Revenue-split, by delivery type and billing rates

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Delivery Type(%)					
On-site	36.1	34.7	36.2	37.9	39.2
Offshore	63.9	65.3	63.8	62.1	60.8
Reported Billing Rates ($ /hr)					
On-site	90.9	88.5	85.8	87.6	87.8
Offshore	22.9	23.0	22.7	23.1	23.5

Source: Company, Anand Rathi Research

Fig 29 – Key areas and horizontals growth (%)

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Key Area-wise Growth (Y/Y)					
North America	24.9	27.2	33.1	41.1	43.9
Europe	18.6	55.1	28.5	19.5	29.5
Asia-Pacific	57.1	76.3	68.6	71.2	63.5
Segment Growth (Y/Y)					
Effort-Led	33.9	39.9	40.4	44.9	35.9
IP-Led	(3.9)	3.2	(0.1)	13.5	7.0
Growth, by vertical (Y/Y)					
BFSI	23.3	28.9	37.8	53.1	58.4
Healthcare	32.5	47.2	47.7	52.5	40.5
Infrastructure & Systems	27.8	32.0	24.8	31.8	37.9

Source: Company, Anand Rathi Research Note: Effort-Led Q3FY22 growth is organic (est.)

Fig 30 – TCV Data

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Net New TCV $ m	148	149	158	195	230
Total TCV	245	283	334	361	394

Source: Company, Anand Rathi Research

Valuations

We lower our target to Rs4,290 (Rs4,980 previously), which translates to 29x FY24e EPS. At the ruling price, the stock trades at 25x FY24e P/E and 15x FY24e EV/EBITDA. FY21 grew 13%, with practically no impact from the pandemic; hence, growth in FY22 is more than meets the eye. Revenue was $766m in FY22, and is expected to hit $1,036m by FY23 incl. the three acquisitions. The EBIT margin is expected to be ~14%; we expect 13.9% in FY23 and 14.2% in FY24.

IP sales were down 4% in FY22 (in Q1 FY23, down 13% q/q but up 7% y/y) and we expect slow growth as management focus has shifted to building Services. The company's reliance on its top client came down to 16.3% in FY22 (11.7% in Q1 FY23) from 22% in FY20. For the last two quarters the top client has declined sequentially (down 7% q/q in Q1 FY23). Besides, the company has now added clients and capabilities in the Microsoft ecosystem, which will offer further medium-term growth opportunities.

We value the stock based on a target P/E of 29x FY24e EPS, slightly lower than LTIMindtree, on the very strong growth execution but also a shade lower on account of weak average FCF generation in FY22, FY23 and FY24.

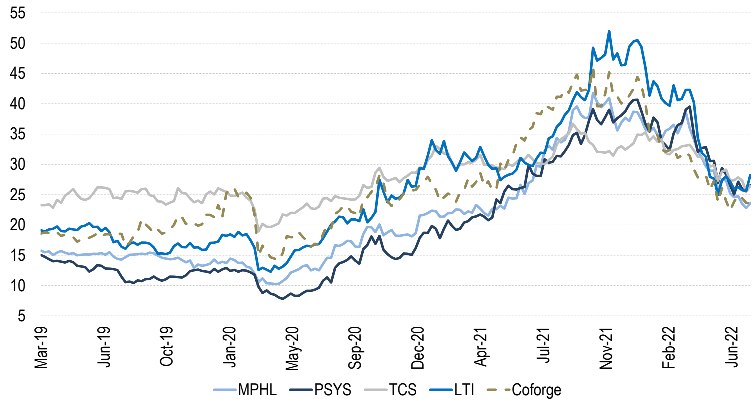
The target multiple reflects Persistent's focus on building BFSI faster, bulking up from inorganic initiatives as well. We also note its shrinking exposure to the top client (thereby, reducing volatility) and its improving execution and track record in growth built over the last two years. The constraints related to its evolving client metrics will further ease as the company scales up many client relations to large deals (as evident from its client count of four in the $20m+ bucket).

Fig 31 – Change in estimates

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	1,036	1,034	0.2	1,236	1,237	(0.1)
Revenues	80,849	79,753	1.4	96,543	95,437	1.2
EBITDA	13,837	13,633	1.5	17,087	16,872	1.3
EBITDA margins %	17.1%	17.1%	2 bps	17.7%	17.7%	2 bps
EBIT	11,199	10,870	3.0	13,694	13,435	1.9
EBIT margins %	13.9%	13.6%	22 bps	14.2%	14.1%	11 bps
PBT	12,234	12,118	1.0	14,681	14,604	0.5
Net profit	9,155	9,051	1.2	10,986	10,907	0.7

Source: Anand Rathi Research

Fig 32 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Slowdown in the US, M&A integration-related.

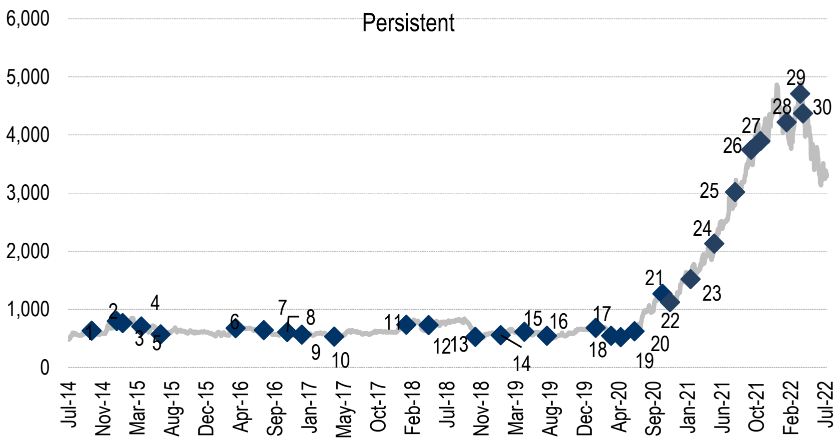
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 25 July 2022)



	Date	Rating	TP (Rs)	Share Price (Rs)
15	30-Apr-19	**Hold**	700	565
16	26-Jul-19	**Hold**	630	552
17	31-Jan-20	**Sell**	690	704
18	31-Mar-20	**Buy**	670	704
19	7-May-20	**Buy**	630	503
20	29-Jun-20	**Hold**	680	627
21	15-Oct-20	**Sell**	940	1,369
22	27-Oct-20	**Sell**	960	1,187
23	1-Feb-21	**Sell**	1,270	1,526
24	2-May-21	**Hold**	2,050	2,038
25	26-Jul-21	**Hold**	3,290	3,040
26	1-Oct-21	**Buy**	4,275	3,716
27	28-Oct-21	**Buy**	4,650	4,007
28	14-Feb-22	**Hold**	4,640	4,200
29	16-Mar-22	**Hold**	4,640	4,314
30	29-Apr-22	**Hold**	4,980	4,288

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)	**Buy**	**Hold**	**Sell**
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

Anand Rathi Share and Stock Brokers Ltd. (hereinafter refer as ARSSBL) (Research Entity, SEBI Regn No. INH000000834, Date of Regn. 29/06/2015) is a subsidiary of the Anand Rathi Financial Services Ltd. ARSSBL is a corporate trading and clearing member of Bombay Stock Exchange Ltd, National Stock Exchange of India Ltd. (NSEIL), Multi Stock Exchange of India Ltd (MCX-SX), and also depository participant with National Securities Depository Ltd (NSDL) and Central Depository Services Ltd. ARSSBL is engaged into the business of Stock Broking, Depository Participant, Mutual Fund distributor.

The research analysts, strategists, or research associates principally responsible for the preparation of Anand Rathi research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

General Disclaimer: This Research Report (hereinafter called "Report") is meant solely for use by the recipient and is not for circulation. This Report does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purpose of purchase or sale of any security, derivatives or any other security through ARSSBL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security (ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by ARSSBL to be reliable. ARSSBL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of ARSSBL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report. The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. ARSSBL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment.

Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report. Research Report may differ between ARSSBL's RAs and/ or ARSSBL's associate companies on account of differences in research methodology, personal judgment and difference in time horizons for which recommendations are made. User should keep this risk in mind and not hold ARSSBL, its employees and associates responsible for any losses, damages of any type whatsoever.

ARSSBL and its associates or employees may; (a) from time to time, have long or short positions in, and buy or sell the investments in/ security of company (ies) mentioned herein or (b) be engaged in any other transaction involving such investments/ securities of company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) these and other activities of ARSSBL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall ARSSBL and its associates or employees or any third party involved in, or related to computing or compiling the information have any liability for any damages of any kind.

Details of Associates of ARSSBL and Brief History of Disciplinary action by regulatory authorities & its associates are available on our website i.e. www.rathionline.com

Disclaimers in respect of jurisdiction: This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ARSSBL to any registration or licensing requirement within such jurisdiction(s). No action has been or will be taken by ARSSBL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. ARSSBL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to ARSSBL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

Statements on ownership and material conflicts of interest, compensation - ARSSBL and Associates

Answers to the Best of the knowledge and belief of ARSSBL/ its Associates/ Research Analyst who is preparing this report

Research analyst or research entity or his associate or his relative has any financial interest in the subject company and the nature of such financial interest.	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company	No
ARSSBL/its Associates/ Research Analyst/ his Relative have any other material conflict of interest at the time of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have managed or co-managed public offering of securities for the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation or other benefits from the subject company or third party in connection with the research report	No
ARSSBL/its Associates/ Research Analyst/ his Relative have served as an officer, director or employee of the subject company.	No
ARSSBL/its Associates/ Research Analyst/ his Relative has been engaged in market making activity for the subject company.	No

Additional information on recommended securities/instruments is available on request.

ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.