

Persistent Systems | BUY

Confidence booster for FY23

Persistent reported an overall 11.1% QoQ USD revenue growth (5.6% organic) with solid growth in the services business(+13.5% QoQ). Growth leverage and currency gains drove a 30 bps QoQ improvement in EBIT margins to 14.3% , ahead of estimates despite continued investments in hiring. Persistent continued the hiring spree as it added 3k+ employees (+16% QoQ). Record order bookings with TCV of USD 394 mn (+9% QoQ,+61% YoY) and strong hiring momentum provide confidence in near term growth trajectory notwithstanding the underlying macro concerns. Persistent remains on track to replicate growth outperformance through FY23 after emerging as growth leader through FY20-22. Persistent also remains confident of maintaining operating margins within a narrow range in FY23 aided by growth leverage and revenue mix notwithstanding industry wide supply side pressures and resumption of certain operating expenses. We fine tune our estimates and retain BUY with a revised TP of INR 4,200(V/s INR 4,320 earlier), based on a revised 28x June'24E EPS (V/s 29x earlier, at par with Tier I leader TCS.

- Strong operating performance yet again:** Persistent reported a 11.1% QoQ growth in revenues to USD 241.1 mn (this included ~5.6% organic growth). YoY growth has improved every single quarter since 1QFY21. Growth was aided by strong show in Services (+13.5% QoQ) even as the IP revenues declined by 13% QoQ. EBIT margins improved by 30 bps sequentially to 14.3% aided by growth leverage and currency gains despite continued investments in hiring, higher amortisation charge and the seasonal increase in travel/visa expenses . **We note that Persistent (along with Coforge) may be the only companies to show improvement in YoY margins in 1QFY23.** Company continued the hiring momentum adding 3k+ employees at the net level (+16% QoQ) which included ~1,950 freshers as well as ~550 people from the MediaAgility acquisition. In addition the company reported record order bookings TCV of USD 394 mn (up both QoQ and YoY) with solid book/bill ratio. Reported LTM attrition cooled off a bit aided by strong hiring with company expecting more moderation through the course of FY23.
- Hiring momentum and bookings provides confidence in near term growth trajectory:** Record order bookings as well as solid hiring (additional hiring of ~1,350 freshers in 2QFY23) provides confidence in near term growth visibility notwithstanding increasing street concerns from macro. Persistent suggests that it is continuously engaging with clients and partnering them in both revenue maximisation and cost optimisation initiatives. While it remains watchful, it suggests that the demand environment and pipeline/deal wins remain strong which should sustain growth visibility in the near term. While Persistent implements wage increments in 2QFY23, it expects to limit the margins within a narrow range for FY23 as a whole aided by growth mix and pricing strength notwithstanding industry wide resumption of travel/facility expenses.
- Growth leadership on track; maintain BUY:** Persistent's 1QFY23 results provide confidence that the company is on track to sustain the growth leadership in FY23 similar to the trend seen through FY20-22. We fine tune our FY22-25E with slight adjustments



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Recommendation and Price Target

| | |
|----------------------------|-------|
| Current Reco. | BUY |
| Previous Reco. | BUY |
| Current Price Target (12M) | 4,200 |
| Upside/(Downside) | 15.6% |
| Previous Price Target | 4,320 |
| Change | -2.8% |

Key Data – PSYS IN

| | |
|--------------------------|---------------------|
| Current Market Price | INR3,633 |
| Market cap (bn) | INR277.6/US\$3.5 |
| Free Float | 55% |
| Shares in issue (mn) | 76.5 |
| Diluted share (mn) | 76.4 |
| 3-mon avg daily val (mn) | INR1,098.0/US\$13.7 |
| 52-week range | 4,988/2,813 |
| Sensex/Nifty | 56,072/16,719 |
| INR/US\$ | 79.9 |

Price Performance

| % | 1M | 6M | 12M |
|-----------|------|-------|------|
| Absolute | 12.9 | -15.5 | 28.4 |
| Relative* | 6.2 | -12.9 | 21.3 |

* To the BSE Sensex

Financial Summary

| Y/E March | FY21A | FY22A | FY23E | FY24E | FY25E |
|------------------------|--------|--------|--------|--------|----------|
| Net Sales | 41,879 | 57,107 | 81,015 | 95,455 | 1,11,709 |
| Sales Growth (%) | 17.4 | 36.4 | 41.9 | 17.8 | 17.0 |
| EBITDA | 6,830 | 9,582 | 13,740 | 16,860 | 19,463 |
| EBITDA Margin (%) | 16.3 | 16.8 | 17.0 | 17.7 | 17.4 |
| Adjusted Net Profit | 4,507 | 6,904 | 8,840 | 11,123 | 12,823 |
| Diluted EPS (INR) | 59.0 | 90.3 | 115.7 | 145.5 | 167.8 |
| Diluted EPS Growth (%) | 32.5 | 53.2 | 28.0 | 25.8 | 15.3 |
| ROIC (%) | 42.3 | 43.3 | 37.1 | 40.9 | 46.7 |
| ROE (%) | 17.4 | 22.4 | 24.3 | 26.3 | 25.9 |
| P/E (x) | 61.6 | 40.2 | 31.4 | 25.0 | 21.7 |
| P/B (x) | 9.9 | 8.2 | 7.1 | 6.1 | 5.2 |
| EV/EBITDA (x) | 37.5 | 27.3 | 19.1 | 15.2 | 12.8 |
| Dividend Yield (%) | 0.6 | 0.9 | 1.3 | 1.6 | 1.8 |

Source: Company data, JM Financial. Note: Valuations as of 22/Jul/2022

JM Financial Research is also available on:
Bloomberg - JMFR <GO>,
Thomson Publisher & Reuters,
S&P Capital IQ, FactSet and Visible Alpha

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to estimates and maintain BUY with a revised TP of INR 4,200 based on 28x June'24E EPS (V/s 29x earlier), in line with our target P/E multiple for Tier I leader TCS. We have backed a strong EPS upgrade cycle for Persistent through the last couple of years which has fuelled strong re-rating for the name and at the top of the Tier II peers. However given heightened expectations, the room for positive surprises and further upgrades remains limited. That said, Persistent's performance is keeping the faith alive on superior growth performance with stable margins. PSYS remains our top pick amongst Tier II techs.

Exhibit 1. PSYS – 1QFY23 and FY23 snapshot

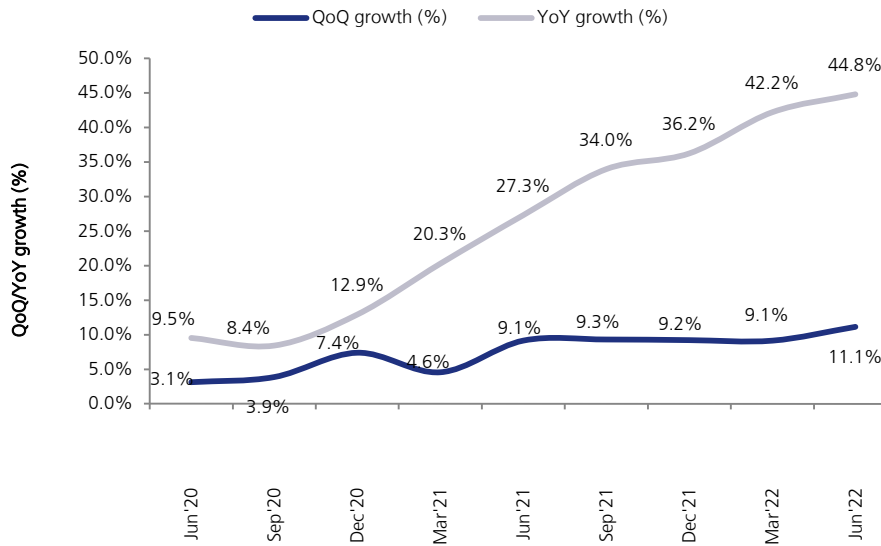
| INR mn, unless specified | 1QFY22 | 2QFY22 | 3QFY22 | 4QFY22 | 1QFY23 | YoY (%) | QoQ (%) | FY22TD | FY23TD | YoY (%) |
|--------------------------|--------|--------|--------|--------|--------|--------------|--------------|--------|--------|--------------|
| Revenue (US \$ Mn) | 167 | 182 | 199 | 217 | 242 | 44.8 | 11.1 | 167 | 242 | 44.8 |
| Revenue Rs. Mn | 12,299 | 13,512 | 14,917 | 16,379 | 18,781 | 52.7 | 14.7 | 12,299 | 18,781 | 52.7 |
| Operating Expenditure | 10,284 | 11,269 | 12,406 | 13,567 | 15,448 | 50.2 | 13.9 | 10,284 | 15,448 | 50.2 |
| Cost of revenues | 8,173 | 8,982 | 9,880 | 10,859 | 12,433 | 52.1 | 14.5 | 8,173 | 12,433 | 52.1 |
| as % of sales | 66.5 | 66.5 | 66.2 | 66.3 | 66.2 | | | | | |
| SG&A expenses | 2,111 | 2,287 | 2,526 | 2,707 | 3,015 | 42.8 | 11.4 | 2,111 | 3,015 | 42.8 |
| as % of sales | 17.2 | 16.9 | 16.9 | 16.5 | 16.1 | | | | | |
| EBITDA | 2,015 | 2,244 | 2,511 | 2,812 | 3,333 | 65.4 | 18.5 | 2,015 | 3,333 | 65.4 |
| Depreciation | 350 | 371 | 428 | 511 | 645 | | | 350 | 645 | |
| EBIT | 1,665 | 1,873 | 2,083 | 2,300 | 2,688 | 61.4 | 16.8 | 1,665 | 2,688 | 61.4 |
| Other Income | 365 | 303 | 281 | 371 | 131 | | | 365 | 131 | |
| PBT | 2,031 | 2,176 | 2,364 | 2,672 | 2,819 | 38.8 | 5.5 | 2,031 | 2,819 | 38.8 |
| Total Tax | 518 | 559 | 600 | 662 | 703 | | | 518 | 703 | |
| Adjusted PAT | 1,512 | 1,618 | 1,764 | 2,010 | 2,116 | 39.9 | 5.3 | 1,512 | 2,116 | 39.9 |
| APAT after MI | 1,512 | 1,618 | 1,764 | 2,010 | 2,116 | 39.9 | 5.3 | 1,512 | 2,116 | 39.9 |
| Reported EPS | 19.8 | 21.2 | 23.1 | 26.3 | 27.7 | 40.0 | 5.3 | 19.8 | 27.7 | 40.0 |
| Margins (%) | | | | | | (bps) | (bps) | | | (bps) |
| EBIDTA | 16.4 | 16.6 | 16.8 | 17.2 | 17.7 | 136 | 58 | 16.4 | 17.7 | 136 |
| EBIT | 13.5 | 13.9 | 14.0 | 14.0 | 14.3 | 77 | 27 | 13.5 | 14.3 | 77 |
| EBT | 16.5 | 16.1 | 15.8 | 16.3 | 15.0 | (150) | (130) | 16.5 | 15.0 | (150) |
| PAT | 12.3 | 12.0 | 11.8 | 12.3 | 11.3 | (103) | (100) | 12.3 | 11.3 | (103) |
| Effective Tax rate | 25.5 | 25.7 | 25.4 | 24.8 | 24.9 | (59) | 15 | 25.5 | 24.9 | (59) |

Source: Company, JM Financial

Management commentary: Key takeaways

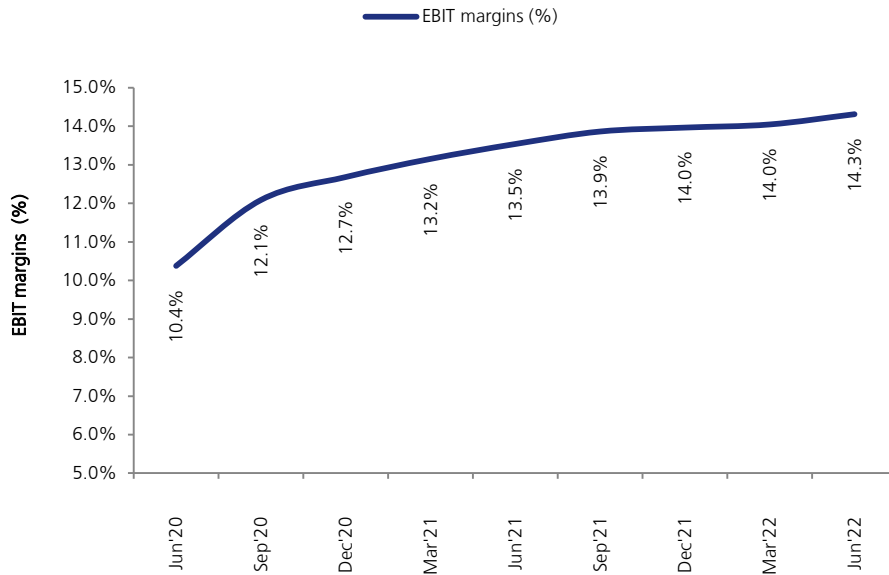
- **Growth outlook:** Persistent saw a 11.1% QoQ (5.6% organic) USD revenue growth in the quarter. This included full impact of the Data glove and 2 month of MediaAgility. Services continued to grow strong while IP Led revenue saw a dip due to lower royalty revenue. Management reiterated a strong demand environment and a robust pipeline. Despite a weak macro setup the company has not seen any delays or budget cuts in tech spends from their clients.
- **Headcount increase:** Persistent added 3,039 net employees during 1QFY23 which included 545 employees from acquisitions. Fresher addition is an important lever to manage margin and company added 1,950 freshers in 1QFY23 and expects to hire another 1,350 freshers in Q2. LTM attrition moderated in the quarter and management expects it to gradually go down in the coming quarters.
- **Margin performance:** Persistent reported 14.3% EBIT margins in 1QFY23, up 30 bps up QoQ. This was achieved despite the impact of higher amortization cost due to acquisitions and some M&A related expenses. Next quarter company expects headwinds of 250-300 bps to margin from wage increases which they plan to offset using levers like increased utilization, increased fresher hiring, managing sub con costs, and operating leverage.
- **Other comments:** Current focus is on integrating the acquisitions already done by the company before taking additional inorganic bets at least for 6-9 months. Company is able to take price increase in new contracts as well as some of the existing contracts coming for renewal. Company will be rationalizing its long tail down the line. ESOP cost will be lower in the second half of the year impacting margins positively.

Exhibit 2. Company reported 11.1% QoQ growth in 1QFY23 partly aided by recent acquisitions



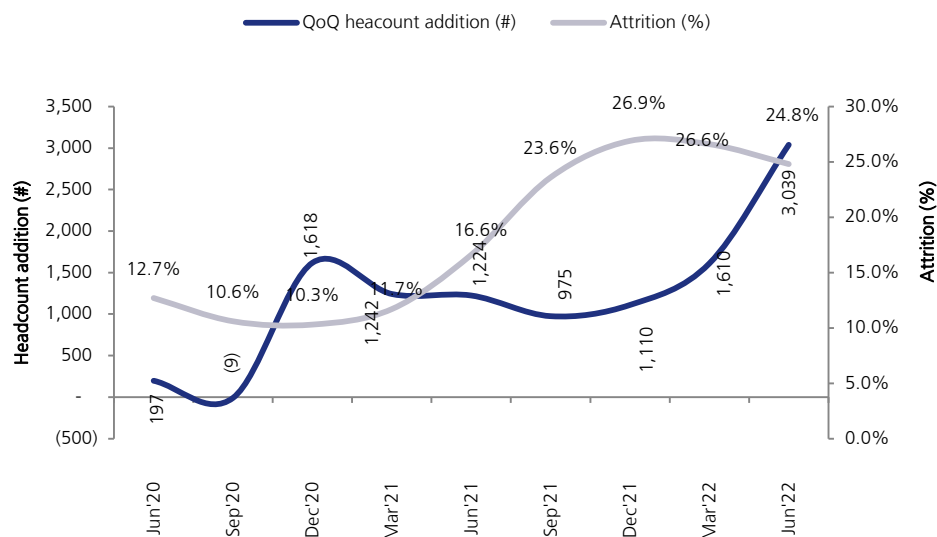
Source: Company, JM Financial

Exhibit 3. EBIT margins improved 30bps QoQ at 14.3% in 1QFY23 despite supply challenges



Source: Company, JM Financial

Exhibit 4. Headcount addition continues to be healthy while attrition sees tad moderation



Source: Company, JM Financial

Exhibit 5. Persistent – Changes in estimates

| INR mn, except EPS and margin (%) | FY23E | | | FY24E | | | FY25E | | |
|-----------------------------------|--------|--------|----------|--------|--------|----------|----------|----------|----------|
| | Old | New | % change | Old | New | % change | Old | New | % change |
| Revenues (USD mn) | 1,048 | 1,047 | -0.1% | 1,245 | 1,240 | -0.5% | 1,447 | 1,451 | 0.3% |
| YoY growth, % | 36.9 | 36.8 | | 18.8 | 18.4 | | 16.2 | 17.0 | |
| Revenues | 80,691 | 81,015 | 0.4% | 95,896 | 95,455 | -0.5% | 1,11,408 | 1,11,709 | 0.3% |
| EBIT | 10,895 | 11,023 | 1.2% | 14,075 | 13,993 | -0.6% | 16,357 | 16,358 | 0.0% |
| EBIT margin, % | 13.5 | 13.6 | | 14.7 | 14.7 | | 14.7 | 14.6 | |
| Net profits | 8,743 | 8,840 | 1.1% | 11,106 | 11,123 | 0.1% | 12,817 | 12,823 | 0.0% |
| EPS (INR) | 114.4 | 115.7 | 1.1% | 145.3 | 145.5 | 0.1% | 167.7 | 167.8 | 0.0% |

Source: JM Financial.

Financial Tables (Consolidated)

| Income Statement | | (INR mn) | | | | |
|-----------------------------|---------------|---------------|---------------|---------------|-----------------|--|
| Y/E March | FY21A | FY22A | FY23E | FY24E | FY25E | |
| Net Sales | 41,879 | 57,107 | 81,015 | 95,455 | 1,11,709 | |
| Sales Growth | 17.4% | 36.4% | 41.9% | 17.8% | 17.0% | |
| Other Operating Income | 0 | 0 | 0 | 0 | 0 | |
| Total Revenue | 41,879 | 57,107 | 81,015 | 95,455 | 1,11,709 | |
| Cost of Goods Sold/Op. Exp | 27,650 | 37,895 | 54,349 | 63,878 | 75,692 | |
| Personnel Cost | 0 | 0 | 0 | 0 | 0 | |
| Other Expenses | 7,398 | 9,631 | 12,926 | 14,716 | 16,554 | |
| EBITDA | 6,830 | 9,582 | 13,740 | 16,860 | 19,463 | |
| EBITDA Margin | 16.3% | 16.8% | 17.0% | 17.7% | 17.4% | |
| EBITDA Growth | 38.6% | 40.3% | 43.4% | 22.7% | 15.4% | |
| Depn. & Amort. | 1,756 | 1,660 | 2,716 | 2,867 | 3,104 | |
| EBIT | 5,075 | 7,922 | 11,023 | 13,993 | 16,358 | |
| Other Income | 986 | 1,052 | 727 | 825 | 825 | |
| Finance Cost | 0 | 0 | 90 | 120 | 120 | |
| PBT before Excep. & Forex | 6,061 | 8,973 | 11,660 | 14,698 | 17,064 | |
| Excep. & Forex Inc./Loss(-) | 34 | 269 | 124 | 132 | 33 | |
| PBT | 6,094 | 9,243 | 11,784 | 14,830 | 17,097 | |
| Taxes | 1,588 | 2,339 | 2,944 | 3,708 | 4,274 | |
| Extraordinary Inc./Loss(-) | 0 | 0 | 0 | 0 | 0 | |
| Assoc. Profit/Min. Int.(-) | 0 | 0 | 0 | 0 | 0 | |
| Reported Net Profit | 4,507 | 6,904 | 8,840 | 11,123 | 12,823 | |
| Adjusted Net Profit | 4,507 | 6,904 | 8,840 | 11,123 | 12,823 | |
| Net Margin | 10.8% | 12.1% | 10.9% | 11.7% | 11.5% | |
| Diluted Share Cap. (mn) | 76.4 | 76.4 | 76.4 | 76.4 | 76.4 | |
| Diluted EPS (INR) | 59.0 | 90.3 | 115.7 | 145.5 | 167.8 | |
| Diluted EPS Growth | 32.5% | 53.2% | 28.0% | 25.8% | 15.3% | |
| Total Dividend + Tax | 1,529 | 2,369 | 3,536 | 4,449 | 5,129 | |
| Dividend Per Share (INR) | 20.0 | 31.0 | 46.3 | 58.2 | 67.1 | |

Source: Company, JM Financial

| Cash Flow Statement | | (INR mn) | | | | |
|------------------------------|---------------|----------------|---------------|---------------|---------------|--|
| Y/E March | FY21A | FY22A | FY23E | FY24E | FY25E | |
| Profit before Tax | 6,094 | 9,243 | 11,784 | 14,830 | 17,097 | |
| Depn. & Amort. | 1,756 | 1,660 | 2,716 | 2,867 | 3,104 | |
| Net Interest Exp. / Inc. (-) | -986 | -1,052 | -727 | -825 | -825 | |
| Inc (-) / Dec in WCap. | 1,500 | 883 | -2,633 | -1,798 | -2,555 | |
| Others | 0 | 0 | 0 | 0 | 0 | |
| Taxes Paid | -1,665 | -2,424 | -3,045 | -3,708 | -4,274 | |
| Operating Cash Flow | 6,699 | 8,310 | 8,096 | 11,367 | 12,547 | |
| Capex | -1,828 | -13,376 | -6,320 | -1,300 | -1,300 | |
| Free Cash Flow | 4,871 | -5,066 | 1,776 | 10,067 | 11,247 | |
| Inc (-) / Dec in Investments | -210 | 1,772 | 2,035 | 0 | 0 | |
| Others | 986 | 1,052 | 727 | 825 | 825 | |
| Investing Cash Flow | -1,053 | -10,552 | -3,559 | -475 | -475 | |
| Inc / Dec (-) in Capital | 0 | 0 | 0 | 0 | 0 | |
| Dividend + Tax thereon | -568 | -1,991 | -3,536 | -4,449 | -5,129 | |
| Inc / Dec (-) in Loans | -2 | 2,757 | 781 | 0 | 0 | |
| Others | 160 | 813 | 0 | 0 | 0 | |
| Financing Cash Flow | -410 | 1,578 | -2,755 | -4,449 | -5,129 | |
| Inc / Dec (-) in Cash | 5,237 | -664 | 1,782 | 6,443 | 6,943 | |
| Opening Cash Balance | 4,572 | 9,809 | 9,145 | 10,927 | 17,233 | |
| Closing Cash Balance | 9,809 | 9,145 | 10,927 | 17,369 | 24,176 | |

Source: Company, JM Financial

| Balance Sheet | | (INR mn) | | | | |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|--|
| Y/E March | FY21A | FY22A | FY23E | FY24E | FY25E | |
| Shareholders' Fund | 27,957 | 33,682 | 38,986 | 45,660 | 53,353 | |
| Share Capital | 764 | 764 | 764 | 764 | 764 | |
| Reserves & Surplus | 27,192 | 32,918 | 38,222 | 44,896 | 52,589 | |
| Preference Share Capital | 0 | 0 | 0 | 0 | 0 | |
| Minority Interest | 0 | 0 | 0 | 0 | 0 | |
| Total Loans | 44 | 2,801 | 3,582 | 3,582 | 3,582 | |
| Def. Tax Liab. / Assets (-) | -1,038 | -1,123 | -1,223 | -1,223 | -1,223 | |
| Total - Equity & Liab. | 26,963 | 35,360 | 41,344 | 48,018 | 55,712 | |
| Net Fixed Assets | 4,691 | 16,407 | 20,011 | 18,444 | 16,640 | |
| Gross Fixed Assets | 17,788 | 27,391 | 33,483 | 34,783 | 36,083 | |
| Intangible Assets | 86 | 2,790 | 2,880 | 2,880 | 2,880 | |
| Less: Depn. & Amort. | 13,305 | 14,845 | 17,562 | 20,428 | 23,533 | |
| Capital WIP | 122 | 1,071 | 1,209 | 1,209 | 1,209 | |
| Investments | 9,996 | 8,225 | 6,190 | 6,190 | 6,190 | |
| Current Assets | 20,930 | 28,387 | 37,118 | 47,831 | 59,876 | |
| Inventories | 0 | 0 | 0 | 0 | 0 | |
| Sundry Debtors | 5,709 | 9,484 | 13,318 | 15,691 | 18,363 | |
| Cash & Bank Balances | 9,809 | 9,145 | 10,927 | 17,233 | 24,067 | |
| Loans & Advances | 206 | 4,394 | 4,661 | 5,492 | 6,427 | |
| Other Current Assets | 5,206 | 5,363 | 8,212 | 9,415 | 11,018 | |
| Current Liab. & Prov. | 8,654 | 17,658 | 21,974 | 24,583 | 27,239 | |
| Current Liabilities | 0 | 0 | 0 | 0 | 0 | |
| Provisions & Others | 8,654 | 17,658 | 21,974 | 24,583 | 27,239 | |
| Net Current Assets | 12,276 | 10,729 | 15,144 | 23,248 | 32,637 | |
| Total - Assets | 26,963 | 35,360 | 41,344 | 47,882 | 55,466 | |

Source: Company, JM Financial

| Dupont Analysis | | | | | | |
|---------------------|-------|-------|-------|-------|-------|--|
| Y/E March | FY21A | FY22A | FY23E | FY24E | FY25E | |
| Net Margin | 10.8% | 12.1% | 10.9% | 11.7% | 11.5% | |
| Asset Turnover (x) | 1.6 | 1.8 | 2.0 | 2.1 | 2.1 | |
| Leverage Factor (x) | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 | |
| RoE | 17.4% | 22.4% | 24.3% | 26.3% | 25.9% | |

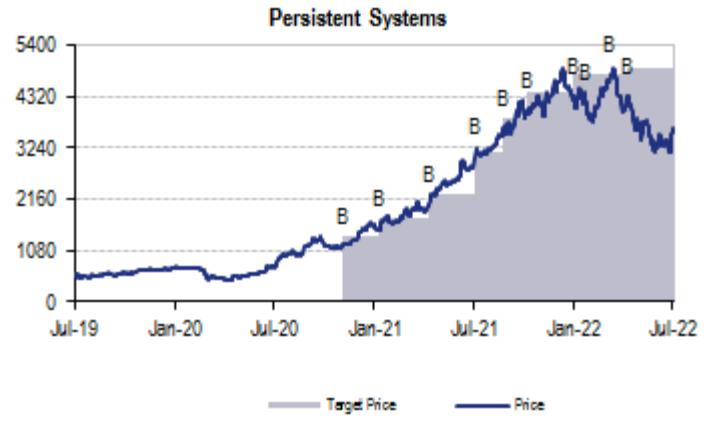
| Key Ratios | | | | | | |
|---------------------|-------|-------|-------|-------|-------|--|
| Y/E March | FY21A | FY22A | FY23E | FY24E | FY25E | |
| BV/Share (INR) | 365.8 | 440.7 | 510.1 | 597.4 | 698.1 | |
| ROIC | 42.3% | 43.3% | 37.1% | 40.9% | 46.7% | |
| ROE | 17.4% | 22.4% | 24.3% | 26.3% | 25.9% | |
| Net Debt/Equity (x) | -0.7 | -0.4 | -0.3 | -0.4 | -0.5 | |
| P/E (x) | 61.6 | 40.2 | 31.4 | 25.0 | 21.7 | |
| P/B (x) | 9.9 | 8.2 | 7.1 | 6.1 | 5.2 | |
| EV/EBITDA (x) | 37.5 | 27.3 | 19.1 | 15.2 | 12.8 | |
| EV/Sales (x) | 6.1 | 4.6 | 3.2 | 2.7 | 2.2 | |
| Debtor days | 50 | 61 | 60 | 60 | 60 | |
| Inventory days | 0 | 0 | 0 | 0 | 0 | |
| Creditor days | 0 | 0 | 0 | 0 | 0 | |

Source: Company, JM Financial

History of Recommendation and Target Price

| Date | Recommendation | Target Price | % Chg. |
|-----------|----------------|--------------|--------|
| 23-Nov-20 | Buy | 1,400 | |
| 30-Jan-21 | Buy | 1,770 | 26.4 |
| 30-Apr-21 | Buy | 2,250 | 27.1 |
| 23-Jul-21 | Buy | 3,160 | 40.4 |
| 15-Sep-21 | Buy | 3,850 | 21.8 |
| 27-Oct-21 | Buy | 4,400 | 14.3 |
| 21-Jan-22 | Buy | 4,800 | 9.1 |
| 11-Feb-22 | Buy | 4,800 | 0.0 |
| 29-Mar-22 | Buy | 4,800 | 0.0 |
| 28-Apr-22 | Buy | 4,900 | 2.1 |

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U67100MH2017PLC296081

Member of BSE Ltd., National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst – INH000000610

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| Definition of ratings | |
|-----------------------|---|
| Rating | Meaning |
| Buy | Total expected returns of more than 10% for large-cap stocks* and REITs and more than 15% for all other stocks, over the next twelve months. Total expected return includes dividend yields. |
| Hold | Price expected to move in the range of 10% downside to 10% upside from the current market price for large-cap* stocks and REITs and in the range of 10% downside to 15% upside from the current market price for all other stocks, over the next twelve months. |
| Sell | Price expected to move downwards by more than 10% from the current market price over the next twelve months. |

* Large-cap stocks refer to securities with market capitalisation in excess of INR200bn. REIT refers to Real Estate Investment Trusts.

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