IDEA2WIN – Persistent System

CMP: ₹ 4,320-4400; 1-Year Target: ₹ 5,058

Sector	IT
Recommendation	BUY
Upside	16%

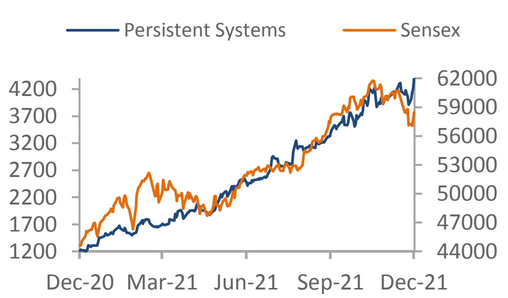
Stock Data	
Sensex	58,150
52 Week h/l (₹)	4,442/1,185
Market cap (` Cr)	32,073
BSE code	533179
NSE code	Persistent
FV (₹)	10
Div. yield (%)	0.48%

Shareholding Pattern

	Mar-21	Jun-21	Sep-21
Promoter	31.29	31.26	31.26
FII+DII	48.85	48.61	47.18
Others	19.86	20.14	21.56

Source: www.bseindia.com

Share Price Trend



Analyst - Jayesh Bhanushali
Jaynit Vora
research@iifl.com

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Profile

Persistent Systems (PSYS) is a technology services company which was incorporated in May 1990. The company's focus is on helping clients build and manage software driven businesses. Its business strategy is aligned around four key areas – (a) Digital: Bringing together their technology partner ecosystem, solutions and a unique architecture to enable enterprises with digital transformation, (b) Alliance: Focus on long-standing and multi-dimensional relationship between PSYS and IBM, (c) Services: Focus on services for software and product development including agile and experience design, (d) Accelerite: Focus on products that include business-critical infrastructure software for enterprises, telecom operators and public sector.

Investment Rationale

Another stellar quarter for Services; IP rebounds: Overall revenues were aided by continued strength in the Services segment (+10.1% QoQ), while the IP-led revenues rebounded (+4.2% QoQ). Among verticals, BFSI (+8.9%) and Healthcare (+13%) showed strong growth, helped by deal ramp ups. Within geographies, Europe was soft due to the holiday season. We now forecast PSYS to deliver 29% Cagr in FY21-23ii (industry-leading), on strong deal ramp ups.

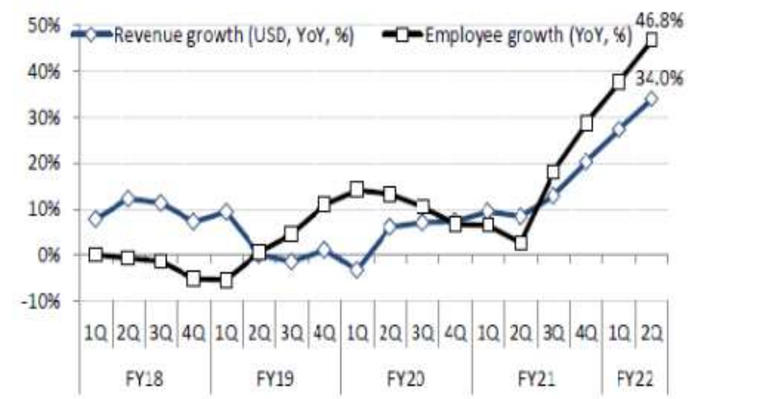
Stable margins despite wage hikes: 2Q margins at 13.9% (-20bps QoQ) were above IIFL estimates (13.4%) despite full impact of wage hikes (~230bps) during the quarter. We forecast EBIT margins to expand by 290bps over FY21-24ii, driven by levers like pyramid rationalisation, lower sub-con costs and optimising IP margins.

Broad-based growth drives the revenue beat: PSYS' 2QFY22 revenue of USD182m grew a robust 9.3% QoQ (+34% YoY), above IIFL expectations of 8.2% QoQ growth. The Services unit delivered strong sequential growth of 10.1% QoQ (+40% YoY). Growth was likely aided by ramp up of deals won earlier. The IP-led unit rebounded, to grow at 4.2% QoQ and 3.2% YoY, after two quarters of decline. Among verticals, BFSI saw robust sequential growth of 8.9% QoQ (+28.9% YoY) on the back of 11.7% QoQ growth in 1Q; Healthcare too saw growth, of a staggering 13% QoQ (+47.1% YoY), on the back of 15.9% QoQ growth in 1Q. Tech & Emerging vertical grew 7.9% QoQ (+32% YoY).

EBIT margins above expectations: EBIT margins stood at 13.9% (-20bps QoQ), above IIFL expectations of 13.4%, despite the full impact of wage hikes during the quarter (~230bps). The impact of wage hikes was offset by operating leverage from higher growth and increase in utilisation. Utilisation picked up by 270bps QoQ to 82.8%. Management sees limited room for further improvement in utilisation, but expects EBITDA margins to remain steady in the 16- 17% range over the near term, with a focus on growth. Travel costs have started to rear their head again and management expects a 15-20bps impact every quarter from the rising travel costs.

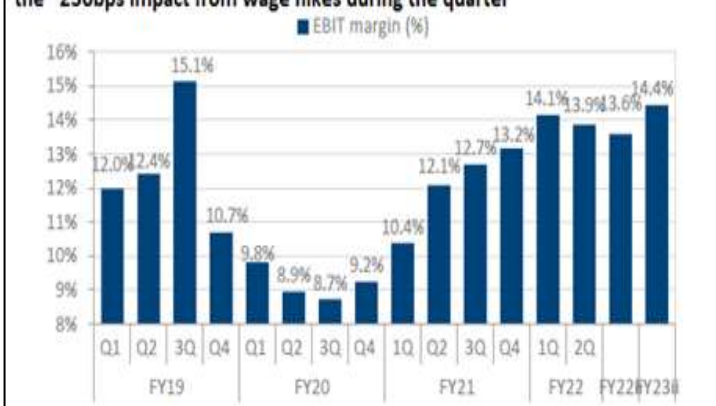
Hiring to pick up pace: North America saw a robust 9% growth QoQ. RoW (21.4% QoQ) and India (17.1% QoQ) were also strong. Europe was soft, growing only 1.2% QoQ due to the holiday season. Hiring was strong for a fourth straight quarter, with net headcount growing 7% QoQ (+1k) given a good mix of laterals and freshers, while attrition saw a 700bps QoQ uptick to 23.6%. Management expects attrition to remain elevated in the near term and to ease once fresh hires by the industry become billable. Company targets hiring 2,500-3,000 freshers over the next year.

Headcount suggests that PSYS is well placed to deliver sector-leading growth in FY22ii



Source: Company, IIFL Research

Adjusted margins at 13.9% (-20bps QoQ) were better than expectations, despite the ~250bps impact from wage hikes during the quarter



Source: Company, IIFL Research

Risks

Employee growth: Taking in more employees than what is required for can have an impact on the margin in future.

Outlook & Valuation:

In the past 4 quarters, PSYS has won deals worth 150% of FY21 revenues, executable in the next 12 months. Its headcount also grew, by 47% YoY in 2Q, and is a key leading indicator of growth for coming 12 months. A combination of improved revenue visibility (29% Cagr in FY21-23ii) and steady margin improvement over the next two years will drive 39% EPS Cagr over FY21-23ii. Our EPS for FY23ii-24ii rises by up to 7%, on higher revenues, while getting cut by 4% for FY22ii, to incorporate the recently-announced acquisitions and ESOP plan. Hence, our 12-mth TP rises to Rs5,058 based on 35x 2YF P/E (unchanged). We continue to believe that PSYS has the highest potential for earnings upgrades, even though we are 5-13% above Bloomberg consensus EPS for FY22ii-24ii. PSYS remains our top pick in the mid-cap space, with further scope for rerating.

Financial Summary

Consolidated (INR in mn)	FY20	FY21	FY22ii	FY23ii	FY24ii
Total Income	35,658	41,879	55,885	69,706	82,853
YoY growth (%)	5.9	17.4	33.4	24.7	18.9
EBITDA margin (%)	13.8	16.3	16.6	17.2	17.5
PAT	3,403	4,507	6,741	8,765	10,782
ROE (%)	14.4	17.4	22.6	26.0	28.1
P/B (x)	13.0	11.0	9.8	8.6	7.6
EV/EBITDA (x)	59.8	42.3	31.5	23.9	19.6
Net Debt/Equity (x)	(0.6)	(0.7)	(0.5)	(0.6)	(0.6)

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Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%
Accumulate – Absolute return between 0% to +10%
Reduce – Absolute return between 0% to -10%
Sell – Absolute return below -10%

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