

Persistent Systems Limited

SELL

Rich Valuations; Margins to remain stable

Choice

July 20, 2024

Persistent Systems delivered healthy Q1FY25 revenues at \$328.2mn, up 5.6% sequentially and 16.0% YoY in USD terms led by robust growth in Healthcare and Lifesciences vertical. In INR terms, revenue came at INR27.4bn, up 5.7% sequentially and 17.9% YoY. PAT for the quarter stood at INR3,064mn (+33.9% YoY). The order booking for the quarter was at \$462.8mn in TCV and at \$337.3mn in ACV terms.

- **Outlook for FY25E:** The management expects to maintain healthy growth around similar levels as FY24 amidst the challenging micro environment. Growth to be driven by Healthcare and Life Sciences sector followed by BFSI sector and lastly Hi-tech sector. Company has been scouting for a suitable M&A target in contact center space as it continues to build internal capabilities. It is embarked on a journey to USD2bn. It has spawned off two company-wide initiatives, one focused on enhancing its service offerings and approach in mining its strategic accounts, and the other one on cost optimization. On the cost optimization and operational efficiency side, it has been benchmarking its policies with respect to industry best-in-class, enabling the right investments to fuel its growth aspirations.
- **Secular adoption of GenAI:** Strategic investment in AI has two broad vectors, AI for technology and AI for business. The AI for technology vector is all about transforming the way software gets developed. AI for business vector is about transforming enterprises right from business model transformation, operational transformation, data to insights and action, customer experience, and leveraging generative AI. This approach is centered around three foundational pillars spanning across a shift to platform-based services from a human based services approach, making strategic inorganic bets to complement the internal investments and bringing the best of partner ecosystem to its clients leverage. Company has developed a set of IPs and accelerators such as iAURA and GenAI Hub, which enable enterprises to speed up the adoption of GenAI use cases that are enterprise-grade, enterprise safe and enterprise scale. The goal in longer term is to drive increased revenue and profit per employee through the AI adoption journey in the years to come.
- **Margins to remain at similar levels:** Operating Margins for the year came at 14.0% (+119bps YoY). Margins are aspired to be in the same range as FY24. It shall work towards improving utilization, on-site/offshore mix, and other operational efficiencies to keep moving towards their medium-term target of improving margins by 200-300bps over the next three years.

Valuation: Persistent is committed to proactively staying closer to their clients and aiding them in prioritizing their technology spend towards cost optimization and transformation. They have pivoted to an AI-led, platform-driven services approach, deepening hyperscalers partnerships and developing a suite of innovative solutions. The stock has rallied significantly during the last month and a similar margin level helps us downgrade our rating to **SELL** to arrive at a revised target price of INR4,560 implying a PE of 41x on FY26E EPS of INR111.

Financial Snapshot

Year end: March	FY22	FY23	FY24	FY25E	FY26E
Revenue (USD Mn.)	766	1,036	1,186	1,388	1,659
Revenue (INR Mn.)	57,107	83,506	98,216	1,15,859	1,38,795
Gross Profit (INR Mn.)	14,540	23,384	27,113	31,320	38,918
EBIT (INR Mn.)	7,922	12,472	13,663	16,502	21,291
EBIT Margin (%)	13.9	14.9	13.9	14.2	15.3
EPS (INR)	46.4	61.9	72.4	86.3	111.3

Source: Company, CEBPL

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CMP (Rs.)	4,581
Target Price (Rs.)	4,560
Potential Downside (%)	-0.4

Company Info

BB Code	PSYS IN EQUITY
ISIN	INE262H01021
Face Value (Rs.)	5.0
52 Week High (Rs.)	4,925
52 Week Low (Rs.)	2,318.8
Mkt Cap (Rs bn.)	705.6
Mkt Cap (\$ bn.)	8.4
Shares o/s (Mn.)/Float(%)	154.0/69
FY24 EPS (Rs.)	72.4
FY26E EPS (Rs.)	111.3

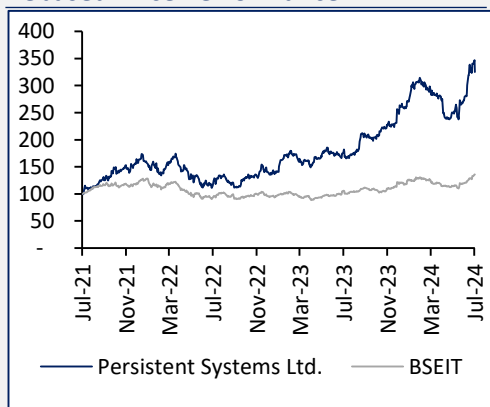
Shareholding Pattern (%)

	Jun-24	Mar-24	Dec-23
Promoters	31.02	31.02	31.06
FII's	22.55	24.96	24.55
DII's	28.23	25.88	26.13
Public	18.20	18.14	18.24

Relative Performance (%)

YTD	3Y	2Y	1Y
BSE IT	35.7	45.1	28.0
PSYS	224.9	175.4	78.4

Rebased Price Performance



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Sequential Operating Performance

	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25
Income Statement						
Revenues (USD Mn.)	275	283	292	301	311	328
Revenues (INR Mn.)	22,545	23,212	24,117	24,982	25,905	27,372
Gross Profit (INR mn.)	6,758	6,900	6,358	6,887	6,970	7,420
<i>Gross Margin (%)</i>	30.0	29.7	26.4	27.6	26.9	27.1
EBIT (INR mn.)	3,466	2,980	3,308	3,631	3,744	3,840
<i>EBIT Margin (%)</i>	15.4	12.8	13.7	14.5	14.5	14.0
PAT (INR mn.)	2,515	2,288	2,633	2,861	3,153	3,064
Basic EPS (INR)	16.8	15.1	17.4	18.9	20.7	20.1
Operating Metrics						
Revenue - Geography (%)						
North America	77.9	79.2	79.2	79.7	80.1	80.7
Europe	10.3	9.7	9.5	8.9	7.8	7.8
India	10.0	9.9	9.7	10.0	10.1	9.8
Rest of the world	1.8	1.2	1.6	1.4	2.0	1.7
Total	100.0	100.0	100.0	100.0	100.0	100.0
Revenue - Industry (%)						
BFSI	32.3	33.3	32.3	31.2	30.7	30.8
Healthcare & Life Sciences	19.7	18.6	19.3	21.8	24.2	26.7
Software, Hi-Tech & Emerging	48.0	48.1	48.4	47.0	45.1	42.5
Total	100.0	100.0	100.0	100.0	100.0	100.0
Employee Metrics						
Technical	21,295	21,511	21,263	21,738	22,224	21,866
Sales & Business Development	414	428	443	465	484	510
Others	1,180	1,191	1,136	1,133	1,142	1,143
Total Headcount	22,889	23,130	22,842	23,336	23,850	23,519
Blended Utilization (%)	77.3	-	-	-	-	-
India Utilization (%)	75.9	-	-	-	-	-
Attrition Rate LTM (%)	19.8	15.5	13.5	11.9	11.5	11.9

Source: Company, CEBPL

CEBPL Estimates vs Actual for Q1FY25

Persistent (INR Mn.)	Q1FY25	Q1FY24	YoY(%)	Q4FY24	QoQ (%)	CEBPL Est.	Dev. (%)
Revenue USD	328	283	16.0	311	5.6	321	2.2
Revenues (INR mn.)	27,372	23,212	17.9	25,905	5.7	26,764	2.3
Employee Cost	19,952	16,312	22.3	18,936	5.4		
Gross Profit (INR mn.)	7,420	6,900	7.5	6,970	6.5	7,333	1.2
Gross Margin (%)	27.1	29.7	(262) bps	26.9	20 bps	27.4	(29) bps
Other costs	2,868	3,156	(9.1)	2,426	18.2		
Depreciation	712	763	(6.7)	799	(10.9)		
EBIT (INR mn.)	3,840	2,980	28.9	3,744	2.6	3,800	1.0
EBIT Margin (%)	14.0	12.8	119 bps	14.5	(42.5) bps	14.2	(17) bps
Other Income	306	216	41.5	308	(0.5)		
Interest	141	126	12.0	97	45.0		
PBT (INR mn.)	4,005	3,070	30.4	3,955	1.3		
Tax	941	783	20.2	802	17.4		
Adj. PAT (INR mn.)	3,064	2,288	33.9	3,153	(2.8)	3,011	1.8
Basic EPS (INR)	20.1	15.1	32.8	20.7	(3.1)	19.8	1.5

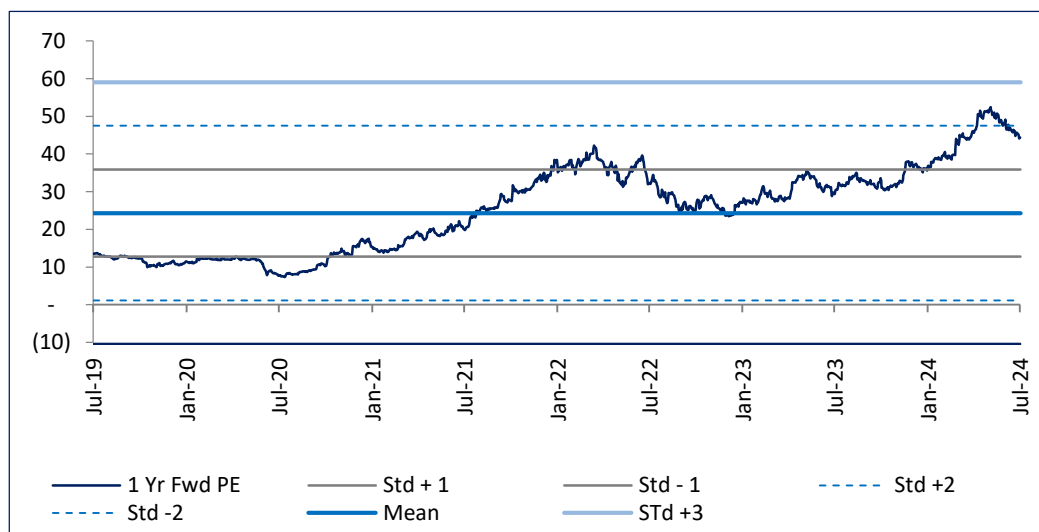
Source: Company, CEBPL

Changes in Estimates

Income Statement (INR Mn.)	FY25E			FY26E		
	Old	New	Dev. (%)	Old	New	Dev. (%)
Revenues (USD Mn.)	1,371	1,388	1.2	1,633	1,659	1.6
Revenues	1,14,278	1,15,859	1.4	1,36,085	1,38,795	2.0
Gross Profit Margin (%)	27.6	27.0	(53.6) bps	28.4	28.0	(33.5) bps
EBIT	16,420	16,502	0.5	20,722	21,291	2.7
EBIT Margin (%)	14.4	14.2	(12.6) bps	15.2	15.3	11 bps
EPS	85.5	86.3	1.0	108.6	111.3	2.4

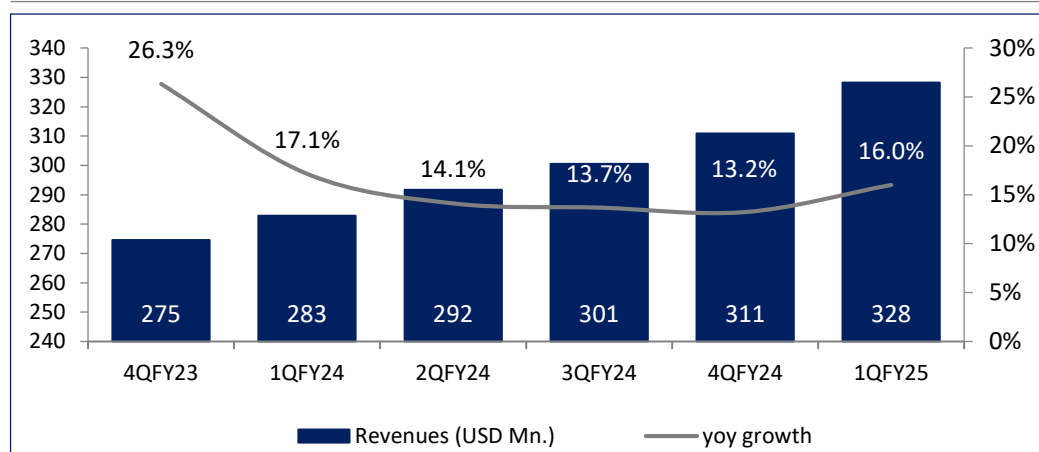
Source: Company, CEBPL

Historical 1 Yr Fwd PE Band



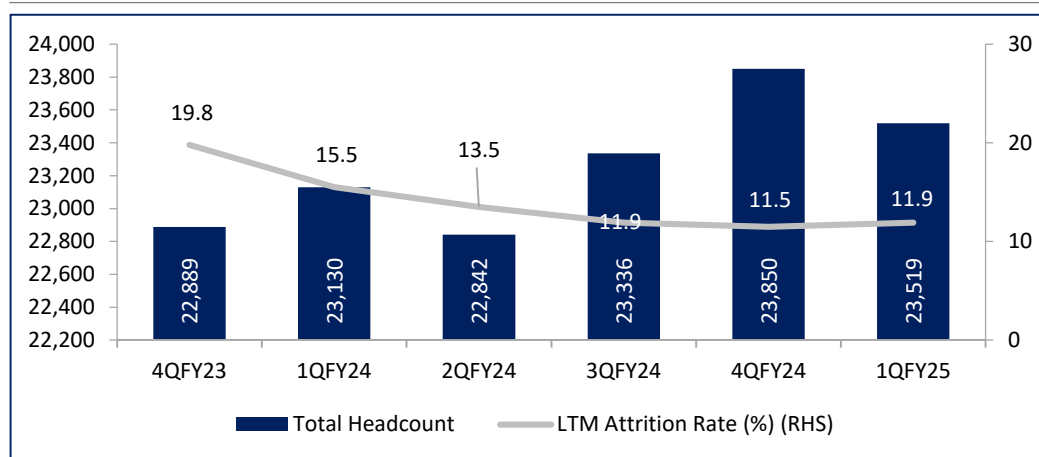
Source: Company, CEBPL

Quarterly Revenues on upward trend



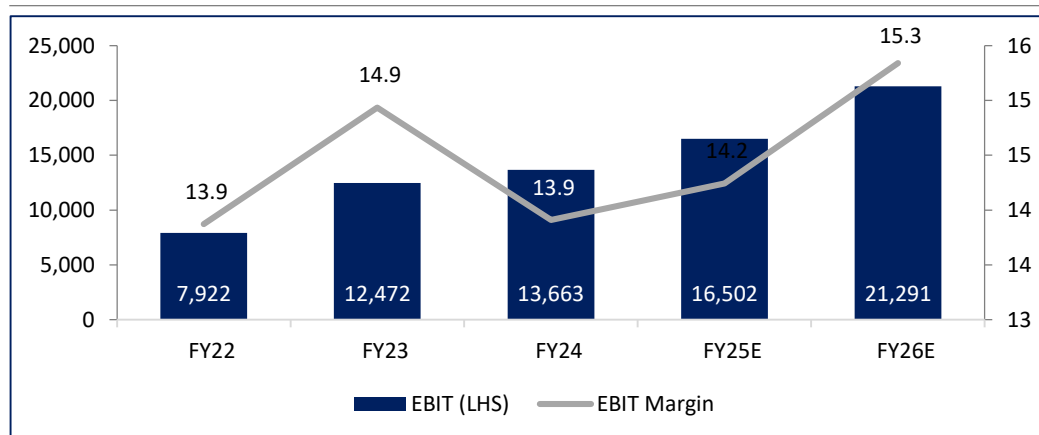
Source: Company, CEBPL

Slight decrease in headcount; Attrition marginally increased



Source: Company, CEBPL

EBIT Margins expected to improve marginally



Source: Company, CEBPL

Management Concall Highlights

- North America demonstrated robust growth with revenues increasing by a healthy 18.2% YoY in USD terms. Meanwhile, India showed a commendable growth of 15.7%. In contrast, European revenue declined by 7.1% YoY, primarily impacted by reduced Salesforce-related business and the rationalization of underperforming customers in that segment. The rest of the world revenue surged by 65.6% YoY, albeit from a lower base.
- The Healthcare Life Sciences and BFSI segments drove this quarter's growth, expanding by 66.8% and 7.3% respectively YoY. Software, high-tech, and emerging verticals grew modestly by 2.4% YoY. Notably, the BFSI segment achieved a milestone, surpassing \$100mn in revenue for the first time in the Company's history.
- The company has intensified its focus on AI initiatives through strategic partnerships with Google and acquisitions like Starfish Associates.
- Wage hikes, effective from July 2024, have been implemented in line with industry standards. However, the company's proactive cost optimization measures ensure that these adjustments do not adversely affect margins.
- As of the end of Q1, the total headcount reached 23,519, marking an increase of 389 YoY. Compared to the previous quarter, the headcount decreased by 331. The attrition rate for Q1FY25 stood at 11.9%, slightly up from 11.5% in the previous quarter.
- Due to internal business reorganization, invoicing was delayed in Q1 FY '25. Consequently, the billed Days Sales Outstanding (DSO) remained flat YoY, while unbilled DSO increased by 4 days to 25 days YoY. The company remains focused on improving invoicing timelines and enhancing collections efficiency over the coming quarters.

Financial Summary (Consolidated in INR Mn.)

Income Statement (INR Mn.)	FY22	FY23	FY24	FY25E	FY26E
Revenue (USD Mn.)	766	1,036	1,186	1,388	1,659
Revenue	57,107	83,506	98,216	115,859	138,795
Gross profit	14,540	23,384	27,113	31,320	38,918
EBITDA	9,582	15,191	16,757	19,603	25,039
Depreciation	1,660	2,719	3,094	3,101	3,747
EBIT	7,922	12,472	13,663	16,502	21,291
Other income	1,440	706	1,280	1,460	1,738
Interest expense	118	473	467	584	555
PAT	6,904	9,211	10,935	13,161	16,968
EPS (Rs)	46.4	61.9	72.4	86.3	111.3

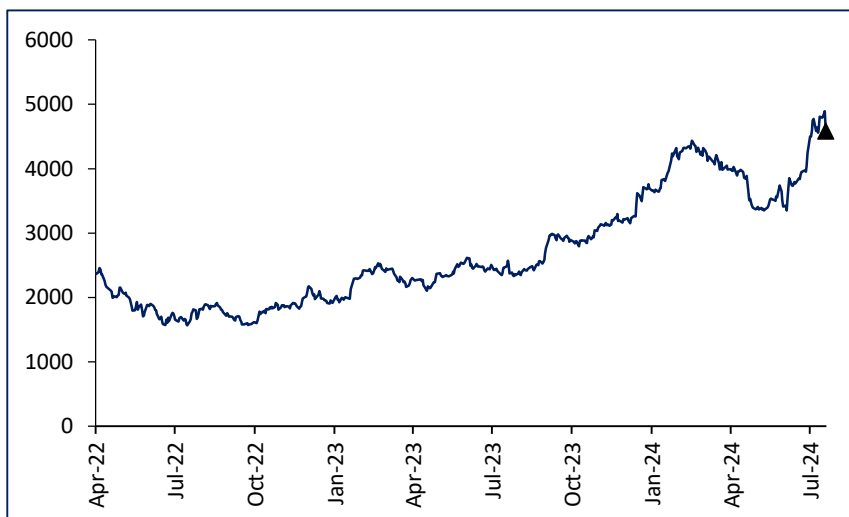
Balance Sheet (INR Mn.)	FY22	FY23	FY24	FY25E	FY26E
Tangible fixed assets	3,989	5,021	4,755	4,976	5,208
Goodwill & intangible assets	12,950	19,274	19,208	20,151	21,184
Investments	8,225	6,396	8,266	9,919	11,903
Cash & Cash equivalents	2,978	4,670	6,625	7,254	9,137
Other non-current assets	4,985	2,201	1,885	2,058	2,255
Other current assets	21,014	28,629	32,997	37,596	42,862
Total assets	54,141	66,191	73,736	81,954	92,549
Shareholder's funds	33,682	39,651	49,577	57,474	67,654
Minority interest	-	-	-	-	-
Borrowings	4,325	4,285	2,073	1,876	1,698
Lease liabilities	1,457	2,269	2,438	2,599	2,776
Other non-current liabilities	810	1,082	-1,364	-1,048	-729
Other current liabilities	13,867	18,905	21,012	21,054	21,150
Total equity & liabilities	54,141	66,191	73,736	81,954	92,549

Cash Flows (INR Mn.)	FY22	FY23	FY24	FY25E	FY26E
Cash flows from Operations	8,450	9,558	12,213	12,341	16,126
Cash flows from Investing	(9,773)	(4,213)	(4,695)	(1,862)	(2,241)
Cash flows from financing	1,823	(4,039)	(5,937)	(6,317)	(8,484)

Ratio Analysis	FY22	FY23	FY24	FY25E	FY26E
Growth Ratios (%)					
Revenues	36.4	46.2	17.6	18.0	19.8
Gross Profit	30.3	60.8	15.9	15.5	24.3
EBITDA	40.3	58.5	10.3	17.0	27.7
EBIT	56.1	57.4	9.5	20.8	29.0
Margin Ratios (%)					
Gross Profit Margin	25.5	28.0	27.6	27.0	28.0
EBITDA Margin	16.8	18.2	17.1	16.9	18.0
EBIT Margin	13.9	14.9	13.9	14.2	15.3
Profitability (%)					
Return on equity	22.4	25.1	24.5	24.6	27.1
Return on invested capital	22.6	32.2	30.3	31.1	34.4
Return on capital employed	30.1	38.7	35.7	36.7	40.7
Valuation					
OCF / Net profit (%)	122.4	103.8	111.7	93.8	95.0
EV / EBITDA (x)	15.4	22.6	19.0	18.0	18.0
Book Value per share (x)	226.2	266.3	328.4	376.8	443.6
Free Cash flow Yield	(0.6)	0.3	1.6	1.5	2.1

Source: Company, CEBPL

Historical recommendations and target price: Persistent Systems Ltd.



Persistent Systems Ltd.

1. 07-04-2022	Reduce,	Target Price 4,286
2. 29-04-2022	Neutral,	Target Price 4,440
3. 25-07-2022	Add,	Target Price 3,851
4. 27-10-2022	Add,	Target Price 4,146
5. 20-01-2023	Outperform,	Target Price 5,193
6. 26-04-2023	Add,	Target Price 5,109
7. 24-07-2023	Add,	Target Price 5,160
8. 25-09-2023	Neutral,	Target Price 5,735
9. 20-10-2023	Add,	Target Price 6,175
10. 23-01-2024	Add,	Target Price 8,610
11. 18-03-2024	Buy,	Target Price 8,610
12. 22-04-2024	Buy,	Target Price 3,970
13. 20-07-2024	Sell	Target Price 4,560

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