Persistent Systems (PERSYS)

ICICI direct Research

CMP: ₹ 5,600 | Target: ₹ 6,500 (16%) | Target Period: 12 months | **BUY**

October 24, 2024

Strong execution!

About the stock: Persistent Systems (Persistent) offers cloud, data, product & design led services to BFSI, healthcare & hi-tech verticals.

- Persistent had a strong year (FY24) with revenue growth of 14.5% in dollar terms & rupee revenue growth of 17.6%
- Healthy double digit return ratio (with RoCE of 28.8%)

Q2FY25 Performance: Persistent reported revenues at US$345.5 mn, up 5.3% QoQ/18.4% YoY. In CC terms, revenue was up 5.1% sequentially. In absolute terms it reported EBIT of ₹406.2 crore, up 5.8% QoQ/ 28.8% YoY while EBIT margins remained stable at 14%, flat QoQ/up 30 bps YoY. The PAT stood at ₹325 crore, up 6.1% QoQ/23.4% YoY realising into margins of 11.2%, flat QoQ/ up 30 bps YoY.

Investment Rationale

- **Sustainable revenue and margin growth momentum:** Persistent has maintained its target to achieve revenue of US$2 bn by FY27 (implying a CAGR of 19%). On the margins front, the company remains confident of improving margins by 200-300 bps over 2-3 years on the back of various margin levers such as slower pace of sales and marketing investments, pricing, right shoring and higher proportion of platform-based services which have higher profitability than normal deals. **We believe the company's dollar revenue will grow at CAGR of ~19% between FY24-27E, compared to CAGR of 19.8% between FY19-24. We also bake in steady margins expansion and expect EBIT margins of 14.5%/15.6%/16.6% in FY25E/26E/27E.**
- **Strong deal pipeline, order book and T-100 program to boost growth in H2:** The TCV came at record high of US$529 mn (up 14% QoQ/10% YoY) with new bookings contributing US$390 mn and management expects this number to go even higher in Q3 due to higher renewals. ACV stood at $348 mn, of which $219 mn came from new bookings. The company expects to maintain healthy QoQ growth despite seasonality and furloughs in its BFSI and Hi-tech verticals in Q3 on the back of this strong and broad-based order book and pipeline. It also launched the T100 program (initiative focussed on scaling Top 100 accounts) which is centered on four key pillars – Talent Amplification, Value Maximization, AI-driven Innovation and Ecosystem Leadership.
- **Increased focus on GenAI:** On the AI front, it has developed a robust strategy focused on two key areas: **AI for technology and AI for business and plans to integrate AI across all verticals. It has launched platforms like SASVA and iAura and sees rapid adoption for its GenAI Hub across industries**.

Rating and Target Price

- We **expect earnings growth of ~25.8% over FY24-27E with diversified** portfolio and increased traction for its GenAI platforms to be a key catalyst of its long-term growth.
- We assign **BUY** rating on the stock, valuing it at **target price of ₹ 6,500; at 46x P/E on FY27E EPS.**

PERSISTENT

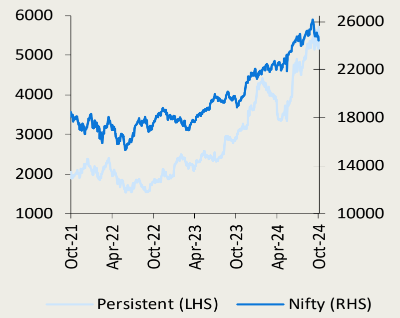
Particulars

Particular	Amount
Market Cap (₹ Crore)	86,222
Total Debt (₹ Crore)	171
Cash & Invests (₹ Crore)	1,296
EV (₹ Crore)	85,097
52 week H/L	5798/ 1420
Equity capital	77.0
Face value	5.0

Shareholding pattern

	Dec-23	Mar-24	Jun-24	Sep-24
Promoter	31	31	31.0	31
FII	25	25	22.6	23
DII	26	26	28.2	27
Public	18	18	18.2	19

Price Chart



Key risks

- Continued weakness in Hi-Tech vertical;
- Better than expected revenue growth owing to T-100 program

Research Analyst

Bhupendra Tiwary, CFA
bhupendra.tiwary@icicisecurities.com

CA Anjini Sharma
anjini.sharma@icicisecurities.com

Deep Thosani
deep.thosani@icicisecurities.com

Result Update

ICICI Securities – Retail Equity Research

Key Financial Summary

(₹ Crore)	FY22	FY23	FY24	5 Year CAGR (FY19-24)	FY25E	FY26E	FY27E	3 Year CAGR (FY24-27E)
Net Sales	5,711	8,351	9,822	23.9%	11,859	14,167	16,873	19.8%
EBITDA	958	1,519	1,724	6.0%	2,038	2,593	3,257	23.6%
EBITDA Margins (%)	16.8	18.2	17.6		17.2	18.3	19.3	
Net Profit	690	921	1,093	47.4%	1,355	1,717	2,177	25.8%
EPS (₹)	44.8	59.8	71.0		87.9	111.5	141.3	
P/E (x)	124.9	90.7	75.5		63.7	50.2	39.6	
RoCE (%)	23.1	27.3	28.8		29.6	31.2	32.3	
RoE (%)	20.5	23.2	22.1		23.3	24.2	25.0	

Source: Company, ICICI Direct Research

Performance highlights and Outlook

- **Revenue Performance:** The company reported revenues at US$345.5 mn, up 5.3% QoQ/18.4% YoY, marking its 18th consecutive quarter of growth. In CC terms, revenue was up 5.1% sequentially while in rupee terms it stood at ₹2,897 crore, up 5.8% QoQ/20.1% YoY.
- **Other Income:** The company has had a **onetime gain ₹80 mn on account of pre-closure of some lease premises in Pune and Indore, which were underutilized**. Additionally, it invested in newer facilities in Chennai and Hyderabad
- **Margin Performance:** In absolute terms it reported EBIT of ₹406.2 crore, up 5.8% QoQ/ 28.8% YoY while **EBIT margins remained stable at 14%, flat QoQ/up 30 bps YoY aided by tailwinds of 120 bps from improved utilization rates, 70 bps from reduced subcon costs, 50 bps from lower resale business, 30 bps from forex gains, 60 bps due to absence of visa cost and balance 130 bps benefit from a combination of pricing and right shoring which were mitigated by headwinds of 210 bps from wage hikes, 130 bps from absence of benefits from policy rationalisation initiatives, 60 bps incremental impact of ESOP's issuance and 60 bps from lower earnout credit**. The PAT stood at ₹325 crore, up 6.1% QoQ/23.4% YoY realising into margins of 11.2%, flat QoQ/ up 30 bps YoY.
- **Geography performance:** Geography wise **North America (81.3% of the mix) and Europe (7.9% of the mix) reported a sequential growth of 6.1% and 6.6** while India (9.2% of the mix) and ROW (1.6% of the mix) declined 1.2% and 0.9% QoQ
- **Segment Performance:** Segment wise Healthcare (27.8% of the mix), BFSI (31.5% of the mix) and TMT (40.7% of the mix) grew sequentially by 9.6%, 7.7% & 0.8% respectively.
  - **Hi-Tech and BFSI Segment: Hi-Tech segment saw a continued muted performance for the 4th consecutive quarter**. While, BFSI reported a strong sequential growth. **Management stated that Hi-Tech and BFSI will see some furloughs in Q3. However, the Hi-Tech segment is expected to be bottoming out and will see a revival in the coming quarters**. It further mentioned that the recent rate cuts are expected to improve the discretionary spends which will further bolster the BFSI and the Hi-Tech segments.

- **Deal Wins:** TCV for the quarter came at US$529 mn, with **new bookings contributing US$390 mn (highest ever quarterly bookings). The company has also launched T100 program, an initiative focused on top 100 clients**. The program is designed to drive better customer value and deepen relationships. The management indicated that increased new deal wins have been driven by platform led engagements. Further it mentioned that many deal wins involve setting up large teams, new outsourced work and transitioning works from incumbents.

- **AI/GenAI:** On the AI front, the company has developed a robust strategy focused on two key areas: AI for technology and AI for business and **plans to integrate AI across all verticals.**
  - **AI for technology:** The company has launched **SASVA 2.0** – AI-driven platform designed to enhance software engineering services across the product development lifecycle.
  - **AI for business:** The company is seeing rapid adoption of the **GenAI Hub and its iAURA platform. It has expanded its GenAI Hub library of pre-built AI models and use cases by over 50% since Q1FY25.** The company's iAura platform is a suite of data tools for AI and machine learning implementations. **Persistent has also partnered with key ecosystem players such as Google Cloud to create generative AI offerings.** Further, the management didn't disclose the

revenue generated from the AI business, but stated that they're trying to infuse AI into everything they do.

- **Update on acquisitions:** Following to their Q1 announcement, the company **has fully integrated its Starfish acquisition**. They're enhancing their contact centre portfolio with AI-enabled administration and workflow assistance, and expect some early deal wins from this portfolio to reported from the end of the next quarter.

- **Revenue and Margin Guidance/Aspiration: The management stated that it expects the margins to expand by 200-300 bps over the span of next 2-3 years on the back of its cost optimization program and operational efficiencies** such as right shoring, slower pace of sales and marketing investments and pricing. **It further maintained its aspirations to achieve the US$ 2 bn revenue mark, implying a CAGR of 19% over FY24-27.**

- **Attrition & Employee addition:** The total employees for the quarter stood at 23,337, after a net reduction of 282 employees, given the company's focus on improving its utilisation. Its attrition for the quarter remained was up 10 bps QoQ at 12%.

Exhibit 1: Quarter Performance

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
Revenue (USD mn)	345.5	291.7	18.4	328.2	5.3	Revenue grew by 5.1% QoQ in CC terms
Revenue	2,897.2	2,411.7	20.1	2,737.2	5.8	
Employee expenses	1,929.4	1,612.7	19.6	1,832.9	5.3	
Gross Margin	967.8	799.0	21.1	904.3	7.0	
Gross margin (%)	33.4	33.1	28 bps	33.0	37 bps	
Other expenses	487.0	393.8	23.7	449.1	8.4	
EBITDA	480.7	405.2	18.6	455.2	5.6	
EBITDA Margin (%)	16.6	16.8	-21 bps	16.6	-4 bps	
Depreciation & amortisation	74.5	74.4	0.1	71.2	4.6	
EBIT	406.2	330.8	22.8	384.0	5.8	
EBIT Margin (%)	14.0	13.7	31 bps	14.0	-1 bps	EBIT margins remained stable at 14%, flat QoQ/up 30 bps YoY aided by tailwinds of 120 bps from improved utilization rates, 70 bps from reduced subcon costs, 50 bps from lower resale business, 30 bps from forex gains, 60 bps due to absence of visa cost & balance 130 bps benefit from a combination of pricing & right shoring which were mitigated by headwinds of 210 bps from wage hikes, 130 bps from absence of benefits from policy rationalisation initiatives, 60 bps incremental impact of ESOP's issuance and 60 bps from lower earnout credit.
Other income	28.3	25.0	13.2	16.5	71.2	
PBT	434.5	355.8	22.1	400.5	8.5	
Tax paid	109.5	92.5	18.4	94.1	16.3	
PAT	325.0	263.3	23.4	306.4	6.1	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY24	FY25E	FY26E	FY27E
Total Revenues	**9,822**	**11,859**	**14,167**	**16,873**
Growth (%)	17.6	20.7	19.5	19.1
Employee & Subcon costs	6,523	7,839	9,279	10,968
Total Operating Expenditure	8,097	9,821	11,574	13,617
EBITDA	**1,724**	**2,038**	**2,593**	**3,257**
Growth (%)	13.5	18.2	27.2	25.6
Depreciation & Amortization	309	320	383	456
Other Income	81	82	80	101
Interest	-	-	-	-
PBT before Excp Items	1,496	1,799	2,290	2,902
Growth (%)	17.8	20.3	27.3	26.7
Tax	354	445	572	726
PAT before Excp Items	1,142	1,355	1,717	2,177
Exceptional items	49	-	-	-
PAT before MI	1,093	1,355	1,717	2,177
Minority Int & Pft. frm asso	-	-	-	-
PAT	**1,093**	**1,355**	**1,717**	**2,177**
Growth (%)	18.7	23.9	26.8	26.7
Diluted EPS	71	88	111	141
EPS (Growth %)	18.7	23.8	26.8	26.7

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

(Year-end March)	FY24	FY25E	FY26E	FY27E
PBT	1,448	1,799	2,290	2,902
Depreciation & Amortization	309	320	383	456
WC changes	(205)	(61)	43	51
Other non cash adju.	11	(82)	(80)	(101)
CF from operations	**1,221**	**1,532**	**2,063**	**2,582**
Capital expenditure	(486)	(949)	(1,133)	(1,350)
Δ in investments	(43)	-	-	-
Other investing cash flow	60	82	80	101
CF from investing Activities	**(469)**	**(867)**	**(1,053)**	**(1,249)**
Issue of equity	161	-	-	-
Δ in debt funds	(223)	-	-	-
Dividends paid	(408)	(486)	(448)	(568)
Other financing cash flow	(123)	(30)	(30)	(30)
CF from Financial Activities	**(594)**	**(516)**	**(478)**	**(598)**
Δ in cash and cash bank bala	158	149	532	735
Effect of exchange rate chang	-	-	-	-
Opening cash	903	1,023	1,172	1,703
Cash c/f to balance sheet	**1,023**	**1,172**	**1,703**	**2,438**

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet ₹ crore

(Year-end March)	FY24	FY25E	FY26E	FY27E
Liabilities				
Equity	77	77	77	77
Reserves & Surplus	4,881	5,749	7,018	8,627
Networth	4,958	5,826	7,095	8,704
Minority Interest	-	-	-	-
Long term Liabilties & provisi	232	243	256	271
Source of funds	**5,189**	**6,069**	**7,351**	**8,975**
Assets				
Net fixed assets	706	1,057	1,470	1,955
Net intangible assets	457	765	1,134	1,572
Goodwill	1,091	1,091	1,091	1,091
Other non current assets	442	442	442	442
Investments	554	554	554	554
Debtors	1,676	1,787	2,135	2,543
Current Investments	273	273	273	273
Cash & Cash equivalents	1,023	1,172	1,703	2,438
Other current assets	1,152	1,152	1,152	1,152
Trade payables	814	709	847	1,009
Current liabilities	1,370	1,514	1,754	2,035
Application of funds	**5,189**	**6,069**	**7,351**	**8,975**

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

(Year-end March)	FY24	FY25E	FY26E	FY27E
Per share data (₹)				
Diluted EPS	71.0	87.9	111.5	141.3
Cash Per Share	66.4	76.1	110.6	158.3
BV	322.0	378.2	460.6	565.0
DPS	26.0	26.3	24.3	30.7
Operating Ratios (%)				
EBITDA Margin	17.6	17.2	18.3	19.3
PBT Margin	15.2	15.2	16.2	17.2
PAT Margin	11.1	11.4	12.1	12.9
Turnover Ratios				
Debtor days	62	55	55	55
Creditor days	30	22	22	22
Return Ratios (%)				
RoE	22.1	23.3	24.2	25.0
RoCE	28.8	29.6	31.2	32.3
RoIC	36.3	37.1	41.1	44.7
Valuation Ratios (x)				
P/E	75.5	63.7	50.2	39.6
EV / EBITDA	49.4	41.7	32.6	25.7
Market Cap / Sales	8.8	7.3	6.1	5.1
Solvency Ratios				
Current Ratio	1.3	1.3	1.3	1.2
Quick Ratio	1.3	1.3	1.3	1.2

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%

Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
Third Floor, Brillanto House,
Road No 13, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal

Contact number: 022-40701000 E-mail Address: complianceofficer@icicisecurities.com

For any queries or grievances: Mr. Bhavesh Soni Email address: headservicequality@icicidirect.com Contact Number: 18601231122

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