

HOLD

TP: Rs 4,170 | ▲ 3%

PERSISTENT SYSTEMS

Technology & Internet

27 October 2021

Growth outperformance continues

- Stellar Q2 print with revenue growth of 9.3% QoQ USD (incl. Capiot) driven by BFSI and healthcare
- EBIT margin at 13.9% beat our/consensus estimates. TCV at a robust US\$ 282.5mn (+15% QoQ)
- We raise FY22/FY23 EPS and hike our target P/E to 40x. Revise TP to Rs 4,170 (vs. Rs 3,560) but retain HOLD as upsides look capped

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Revenue well ahead of estimates: PSYS reported revenue growth of 9.3% QoQ USD in Q2FY22 vs. our optimistic estimate of 7.4%. IP revenue grew 4.3% QoQ USD despite seasonality and services grew 10.1% QoQ. Growth was spread across three verticals, led by healthcare (+13% QoQ USD).

Robust margin: EBIT margin stood at 13.9% (+30bps QoQ) vs. 13.1% estimated. Offshoring continued to improve with 57.1% revenue share (+160bps QoQ). While offshore billing rates were up 0.5% QoQ, PSYS was able to reduce onsite billing by 2.7% due to lower cost in Mexico, aiding margins. Blended utilisation at 82.8% improved 270bps QoQ backed by talent deployment over the last couple of quarters.

Attrition accelerates: As the industry continues to reel under a talent crunch, PSYS reported its highest-ever attrition rate of 23.6% (+7ppt QoQ). To backfill this, PSYS inducted 975 employees QoQ. Management expects supply pressure to persist for the next few quarters. To contain attrition, PSYS has launched an ESOPs programme covering 80% of employees. Supply-side costs are expected to impact margins and hence PSYS is in talks with clients for better billing rates.

Strong deal wins: The pipeline is strong with TCV at US\$ 282.5mn in Q2, up 15% QoQ. ACV at US\$ 201.1mn was up 7% QoQ. The quarter saw key wins in the software, hi-tech, BFSI and healthcare verticals. The largest BFSI deal win was worth >US\$ 50mn in TCV, spread over a period of five years. PSYS added eight new clients in the US\$ 1mn-5mn revenue bucket and one in the >US\$ 5mn bucket.

Maintain HOLD: In line with sector-wide commentary, management is confident of demand growth for the next 2-3 years and indicated that its steady TCV win rate is directly proportional to revenue growth. Based on the buoyant outlook and contribution from acquired entities (SCI and Shree Partners), we raise FY22/FY23/FY24 revenue estimates by 4%/6%/5%. EPS rises only 6%/1%/1% due to lower USDINR estimates and a conservative margin outlook. We also upgrade our target P/E to 40x (vs. 35x) on steady deal wins and upbeat growth, yielding a new Sep'22 TP of Rs 4,170 – retain HOLD as current valuations of 39.7x FY23E price in the strong outlook.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	PSYS IN/Rs 4,038
Market cap	US\$ 4.3bn
Free float	70%
3M ADV	US\$ 14.3mn
52wk high/low	Rs 4,390/Rs 1,103
Promoter/FPI/DII	30%/26%/44%

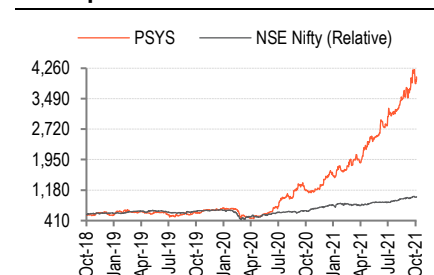
Source: NSE | Price as of 27 Oct 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	41,879	56,441	68,837
EBITDA (Rs mn)	6,830	9,034	11,193
Adj. net profit (Rs mn)	4,507	6,260	7,374
Adj. EPS (Rs)	56.5	78.5	92.4
Consensus EPS (Rs)	56.5	83.7	101.7
Adj. ROAE (%)	17.1	21.0	21.5
Adj. P/E (x)	71.5	51.5	43.7
EV/EBITDA (x)	47.1	35.5	28.6
Adj. EPS growth (%)	32.4	38.9	17.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Other highlights

- PSYS's biggest IP account (IBM) will be transitioned from reseller business-based reporting to a TTM-based model. This will lead to reduced reported IP revenue and growth in IT services, driving a slight uptick in margin from Q3FY22.
- The company has launched an ESOP plan for ~80% of its employees. Management believes the estimated 70-80bps impact of ESOP expense on margins would be offset by increased employee participation, leading to a sense of ownership.
- The company aims to hire 2,500-3,000 freshers in the next one year.
- PSYS announced the acquisition of SCI, its affiliate Fusion 360, and Shree Partners in Sep'21. No revenue was registered in Q2FY22.
- Management plans to also expand its footprint in Canada and Mexico.
- DSO increased by 1 day QoQ to 55 days in Q2.

Details of acquired entities

- **Software Corporation International (SCI):** SCI has 30+ years of payments industry experience and brings deep domain consulting capabilities, specialising in payment solutions, integration, and support services for an impressive portfolio of leading US banks. Fusion360 provides application development, maintenance, and support for leading payment platforms including IBM's Financial Transaction Manager (FTM).

The total purchase consideration was US\$ 53mn, comprising US\$ 34mn upfront and the balance in earnouts (over two years) or retention (over three years). SCI has annual revenue of US\$ 17.1mn; the purchase consideration thus implies an EV/revenue multiple of 3.1x.

- **Shree Partners:** Established in 2005, Shree Partners is a digital transformation and technology solutions company. It helps clients in BFSI and other industries increase profitability by implementing and maintaining innovative cloud, infrastructure, data, and AI/ML solutions that reduce costs and drive revenue.

The total purchase consideration was US\$ 6.9mn, comprising US\$ 3.4mn upfront and the balance in earnouts (over two years) or retention (over three years). Based on annual revenue of US\$ 7.6mn, the purchase consideration implies an EV/revenue multiple of 0.9x.

Fig 1 – Quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenue (US\$ mn)	182.3	136.1	34.0	166.8	9.3	349	267	30.7
Revenue	13,512	10,077	34.1	12,299	9.9	25,812	19,991	29.1
Operating Expenditure	11,268	8,420	33.8	10,284	9.6	21,552	16,869	27.8
Cost of revenues	8,982	6,577	36.6	8,173	9.9	17,155	13,223	29.7
as % of sales	66.5	65.3	-	66.5	-	66.5	66.1	-
SG&A expenses	2,286	1,843	24.1	2,111	8.3	4,397	3,646	20.6
as % of sales	16.9	18.3	-	17.2	-	17.0	18.2	-
EBITDA	2,244	1,658	35.4	2,015	11.4	4,259	3,122	36.4
Depreciation	371	440	(15.7)	350	5.9	721	875	(17.6)
EBIT	1,873	1,218	53.8	1,665	12.5	3,538	2,247	57.5
Other Income	303	157	-	366	-	669	349	-
PBT	2,176	1,375	58.3	2,031	7.2	4,207	2,596	62.1
Total Tax	559	355	57.3	518	7.9	1,077	676	59.4
Adjusted PAT	1,618	1,020	58.6	1,513	6.9	3,131	1,920	63.1
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	0	0	-
APAT after MI	1,618	1,020	58.6	1,513	6.9	3,131	1,920	63.1
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	1,618	1,020	58.6	1,513	6.9	3,131	1,920	63.1
Reported EPS	20.2	12.7	58.6	18.9	6.9	39	24	63.1
Margins (%)			(bps)		(bps)			
EBITDA	16.6	16.4	16	16.4	22	16.5	15.6	88
EBIT	13.9	12.1	178	13.5	32	13.7	11.2	247
EBT	16.1	13.6	246	16.5	(40)	16.3	13.0	332
PAT	12.0	10.1	185	12.3	(33)	12.1	9.6	252
Effective Tax rate	25.7	25.8	(16)	25.5	17	25.6	26.0	(44)

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

(in USD terms)	Q2FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Geography			
North America	78.7	9.0	27.2
Europe	8.8	1.2	55.1
India, APAC	12.5	17.8	76.3
Client Concentration			
Top Client	16.9	8.6	(12.9)
Top 5 Clients	35.8	7.2	(13.9)
Top 10 Clients	45.4	6.3	(10.1)
Non Top 10 Clients	54.6	12.0	10.3
Revenue by Vertical			
BFSI	30.7	8.9	28.9
Healthcare and Lifesciences	21.2	13.0	47.1
Tech. Cos. & Emerging Verticals	48.1	7.9	32.0

	Q2FY22	Q1FY22	Q2FY21
Onsite-Offshore mix			
Onsite	30.4	31.4	33.1
Offshore	57.1	55.5	50.7
IP-led	12.5	13.1	16.2
Utilisation (%)	82.8	80.1	81.2
Headcount	15,879	14,904	10,820

Source: Company, BOBCAPS Research

Valuation methodology

Incorporating the stellar Q2FY22 print, we raise FY22/FY23/FY24 EPS estimates by 6%/1%/1%, baking in higher revenue growth assumptions and contribution from acquired entities. The increase in EPS estimates is relatively muted given reduced USDINR assumptions and management's conservative margin outlook. PSYS's sustained growth momentum coupled with stable margins and regular TCv gives us confidence on earnings.

We increase our target one-year forward P/E from 35x to 40x, which is in line with our target multiple for L&T Infotech (LTI) – this yields a new Sep'22 TP of Rs 4,170 (vs. Rs 3,560 earlier). While we expect PSYS to maintain its strong growth momentum, we see limited upside at current valuations of 39.7x FY23E EPS and hence retain HOLD.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	746.9	879.6	992.1	719.2	829.4	941.2	3.8	6.1	5.4
YoY growth (%)	31.9	17.8	12.8	27.0	15.3	13.5	-	-	-
Revenues	56,441	68,837	77,878	54,654	64,905	73,882	3.3	6.1	5.4
EBITDA	9,034	11,193	12,657	8,765	11,084	12,519	3.1	1.0	1.1
EBITDA margin (%)	16.0	16.3	16.3	16.0	17.1	16.9	-	-	-
Net profits	6,260	7,374	8,404	5,899	7,294	8,308	6.1	1.1	1.1
EPS (Rs)	78.5	92.4	105.4	74.0	91.4	104.2	6.1	1.1	1.1

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	566	747	880	992
Revenues growth YoY (%)	12.9	31.9	17.8	12.8
EBITDA margin (%)	16.3	16.0	16.3	16.3

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		RoE (%)		P/E (x)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	BUY	4,630	13.8	103.4	119.7	39.4	37.4	33.7	29.1
INFO IN	BUY	2,000	14.4	53.9	59.5	29.6	30.7	32.1	29.1
WPRO IN	BUY	840	18.4	23.4	26.9	21.2	21.6	28.6	24.9
HCLT IN	BUY	1,440	10.7	49.1	55.2	20.3	20.5	24.0	21.3
TECHM IN	BUY	1,890	15.3	65.2	80.0	21.4	23.3	24.1	19.6
LTI IN	BUY	7,980	21.1	134.5	161.8	29.5	29.9	34.9	29.0
MPLH IN	HOLD	3,510	16.1	76.5	92.6	21.0	23.6	43.8	36.2
MTCL IN	SELL	3,390	21.0	94.1	100.2	33.0	29.8	48.7	45.7
PSYS IN	HOLD	4,170	24.7	78.5	92.4	21.0	21.5	51.7	43.9
COFORGE IN	BUY	6,680	27.1	125.6	172.0	28.4	32.8	40.1	29.3
ECLX IN	BUY	2,880	20.4	122.7	143.6	25.3	26.7	18.1	15.5

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- increase in annuity business, and
- above-expected operating margin improvement.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,154	1,240	BUY
Coforge	COFORGE IN	4.2	5,043	6,680	BUY
eClerx Services	ECLX IN	1.1	2,213	2,880	BUY
HCL Technologies	HCLT IN	42.6	1,177	1,440	BUY
IndiaMart InterMesh	INMART IN	3.0	7,357	8,430	HOLD
Info Edge	INFOE IN	10.7	6,216	6,530	BUY
Infosys	INFO IN	98.1	1,729	2,000	BUY
Just Dial	JUST IN	0.7	821	1,190	BUY
L&T Infotech	LTI IN	15.6	6,659	7,980	BUY
Mindtree	MTCL IN	10.1	4,582	3,390	SELL
Mphasis	MPHL IN	8.3	3,352	3,510	HOLD
Persistent Systems	PSYS IN	4.3	4,038	4,170	HOLD
Tata Consultancy Services	TCS IN	174.5	3,490	4,630	BUY
Tech Mahindra	TECHM IN	18.2	1,568	1,890	BUY
Wipro	WPRO IN	49.4	671	840	BUY

Source: BOBCAPS Research, NSE | Price as of 27 Oct 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	35,658	41,879	56,441	68,837	77,878
EBITDA	4,930	6,830	9,034	11,193	12,657
Depreciation	1,660	1,756	1,599	1,854	1,938
EBIT	3,270	5,075	7,435	9,339	10,719
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	1,254	1,020	972	626	714
Exceptional items	0	0	0	0	0
EBT	4,523	6,094	8,408	9,965	11,433
Income taxes	1,121	1,588	2,148	2,591	3,030
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	3,403	4,507	6,260	7,374	8,404
Adjustments	0	0	0	0	0
Adjusted net profit	3,403	4,507	6,260	7,374	8,404

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	3,810	4,607	6,031	7,355	8,321
Provisions	1,954	2,719	3,093	3,772	4,267
Debt funds	12	44	44	44	44
Other liabilities	0	0	0	0	0
Equity capital	791	764	764	764	764
Reserves & surplus	24,002	27,192	30,881	36,036	41,912
Shareholders' fund	24,793	27,957	31,645	36,801	42,676
Total liab. and equities	30,569	35,327	40,813	47,972	55,309
Cash and cash eq.	1,461	2,419	3,047	4,003	8,978
Accounts receivables	5,862	5,709	9,278	11,316	12,802
Inventories	0	0	0	0	0
Other current assets	5,373	4,945	6,495	8,864	10,028
Investments	13,304	17,853	17,853	19,853	19,853
Net fixed assets	4,083	3,277	3,327	3,123	2,835
CWIP	316	122	122	122	122
Intangible assets	81	86	86	86	86
Deferred tax assets, net	405	1,038	727	727	727
Other assets	0	0	0	0	0
Total assets	30,569	35,327	40,813	47,972	55,308

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	2,025	5,679	3,565	6,199	8,439
Capital expenditures	(1,500)	(392)	(1,650)	(1,650)	(1,650)
Change in investments	0	(3,722)	0	(2,000)	0
Other investing cash flows	1,254	1,020	972	626	714
Cash flow from investing	(247)	(3,094)	(678)	(3,024)	(936)
Equities issued/Others	(828)	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(1,229)	(1,627)	(2,260)	(2,219)	(2,528)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,057)	(1,627)	(2,260)	(2,219)	(2,528)
Chg in cash & cash eq.	(278)	958	628	956	4,975
Closing cash & cash eq.	1,461	2,419	3,047	4,003	8,978

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	42.7	56.5	78.5	92.4	105.4
Adjusted EPS	42.7	56.5	78.5	92.4	105.4
Dividend per share	12.8	16.9	23.5	23.1	26.3
Book value per share	310.8	350.5	396.7	461.4	535.0

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	9.0	7.7	5.7	4.7	4.1
EV/EBITDA	65.1	47.1	35.5	28.6	25.2
Adjusted P/E	94.7	71.5	51.5	43.7	38.3
P/BV	13.0	11.5	10.2	8.8	7.5

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	75.2	73.9	74.5	74.0	73.5
Interest burden (PBT/EBIT)	138.3	120.1	113.1	106.7	106.7
EBIT margin (EBIT/Revenue)	9.2	12.1	13.2	13.6	13.8
Asset turnover (Rev./Avg TA)	120.6	127.1	148.3	155.1	150.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.3	1.3	1.3
Adjusted ROAE	14.1	17.1	21.0	21.5	21.1

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	5.9	17.4	34.8	22.0	13.1
EBITDA	(15.1)	38.6	32.3	23.9	13.1
Adjusted EPS	(2.9)	32.4	38.9	17.8	14.0
Profitability & Return ratios (%)					
EBITDA margin	13.8	16.3	16.0	16.3	16.3
EBIT margin	9.2	12.1	13.2	13.6	13.8
Adjusted profit margin	9.5	10.8	11.1	10.7	10.8
Adjusted ROAE	14.1	17.1	21.0	21.5	21.1
ROCE	10.9	15.3	20.4	22.5	23.7
Working capital days (days)					
Receivables	55	50	48	55	57
Inventory	0	0	0	0	0
Payables	41	44	41	42	44
Ratios (x)					
Gross asset turnover	8.6	11.4	17.1	21.3	26.1
Current ratio	2.2	1.8	2.1	2.2	2.5
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

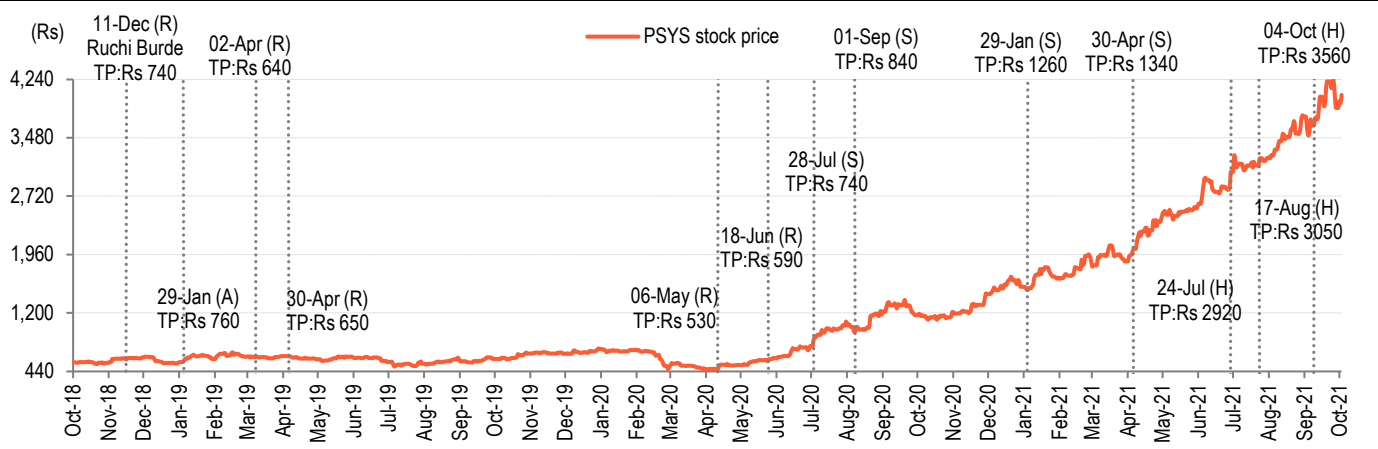
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): PERSISTENT SYSTEMS (PSYS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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