

SELL

TP: Rs 1,260 | ▼ 17%

PERSISTENT SYSTEMS

IT Services

29 January 2021

IP business seasonality bolsters growth

Persistent Systems (PSYS) reported a surprisingly strong set of numbers in Q3FY21, with dollar revenue growth at 7.4% QoQ. Both the IP-led and services businesses grew sequentially. Operating margin at 12.7% was up 60bps QoQ. We increase FY21/FY22/FY23 EPS by 6%/2%/4% and raise our target P/E to 19x (from 13.5x) to bake in a better revenue and margin outlook. Rolling valuations over, we have a revised Dec'21 TP of Rs 1,260 (from Rs 840). Given IP revenue volatility and heady valuations, we reiterate SELL.

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Strong traction in IP business: PSYS reported 7.4% QoQ dollar revenue growth in Q3, ahead of our optimistic estimate of 5%. IP revenue grew strongly by 20.7% while services grew 5%. IP revenue was strong due to seasonality. Revenue from capiot acquisition also came through in Q3. Europe business bounced back with 24% sequential growth. The healthcare/tech-emerging verticals grew 6%/13% QoQ while BFSI remained flat. Top client concentration decreased to 18.5% from 19.4% in Q2FY21. Despite salary hikes, EBIT margin was up 60bps QoQ to 12.7% (12% est.) due to increased offshoring and reduced SG&A costs.

Healthy deal wins: The deal pipeline looks healthy going into Q4FY21 with several multimillion-dollar engagements across the BFSI, healthcare, hi-tech and industrial verticals. TCV at US\$ 302mn was disclosed for the first time.

Upbeat management outlook: Management stated that digital projects continued their momentum in Q3. The Alliance segment pipeline has increased owing to the expanded relationship with IBM. Hi-tech is expected to remain the strongest growth vertical going forward. BFSI has slowed QoQ but management expects a recovery as a large multiyear deal has already been signed in the vertical. This apart, interim dividend of Rs 14/sh was announced in Q3.

Ticker/Price	PSYS IN/Rs 1,524
Market cap	US\$ 1.7bn
Shares o/s	80mn
3M ADV	US\$ 3.1mn
52wk high/low	Rs 1,700/Rs 420
Promoter/FPI/DII	30%/26%/44%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	33,659	35,658	42,454	51,027	56,251
EBITDA (Rs mn)	5,805	4,930	6,828	7,894	9,189
Adj. net profit (Rs mn)	3,516	3,403	4,206	4,550	5,438
Adj. EPS (Rs)	43.9	42.7	52.7	57.0	68.2
Adj. EPS growth (%)	8.8	(2.9)	23.6	8.2	19.5
Adj. ROAE (%)	15.7	14.1	16.1	15.7	16.9
Adj. P/E (x)	34.7	35.7	28.9	26.7	22.4
EV/EBITDA (x)	20.7	24.3	17.6	15.1	12.8

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Revenue (US\$ mn)	146.2	129.4	12.9	136.1	7.4	413.3	374.6	10.3
Revenue (Rs mn)	10,754	9,227	16.5	10,077	6.7	30,745.3	26,394.4	16.5
Operating Expenditure	8,929	7,993	11.7	8,420	6.1	25,798.4	22,741.7	13.4
Cost of revenues	7,064	6,157	14.7	6,577	7.4	20,287.2	17,364.7	16.8
as % of sales	65.7	66.7	-	65.3	-	66.0	65.8	-
SG&A expenses	1,865	1,836	1.6	1,843	1.2	5,511.2	5,377.0	2.5
as % of sales	17.3	19.9	-	18.3	-	17.9	20.4	-
EBITDA	1,825	1,234	47.8	1,658	10.1	4,946.9	3,652.7	35.4
Depreciation	461	428	7.6	440	4.8	1,336.5	1,239.4	7.8
EBIT	1,364	806	69.2	1,218	12.0	3,610.4	2,413.3	49.6
Other Income	286	334	-	157	-	635.2	979.7	-
PBT	1,650	1,140	44.8	1,375	20.0	4,245.7	3,393.0	25.1
Total Tax	441	260	69.2	355	24.1	1,116.5	828.3	34.8
Adjusted PAT	1,209	879	37.5	1,020	18.6	3,129.2	2,564.7	22.0
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	0.0	0.0	-
APAT after MI	1,209	879	37.5	1,020	18.6	3,129.2	2,564.7	22.0
Extra ordinary items	0	0	-	0	-	0.0	0.0	-
Reported PAT	1,209	879	37.5	1,020	18.6	3,129.2	2,564.7	22.0
Reported EPS	15.1	11.0	37.5	12.7	18.6	39.1	32.1	22.0
Margins (%)			(bps)		(bps)			
EBITDA	17.0	13.4	359	16.4	52	16.1	13.8	225
EBIT	12.7	8.7	395	12.1	60	11.7	9.1	260
EBT	15.3	12.4	299	13.6	170	13.8	12.9	95
PAT	11.2	9.5	172	10.1	112	10.2	9.7	46
Effective Tax rate	26.7	22.9	386	25.8	88	26.3	24.4	188

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

(in US\$ terms)	Q3FY21 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Revenue by Geography			
North America	81.1	5.1	14.3
Europe	8.8	24.3	(6.3)
India, APAC	9.3	7.4	12.9
Client Concentration			
Top Client	18.5	2.4	(14.0)
Top 5 Clients	37.8	(2.4)	(10.6)
Top 10 Clients	47.0	(0.1)	(8.0)
Non-Top 10 Clients	53.0	15.0	8.4
Revenue by Vertical			
BFSI	29.5	(0.7)	9.2
Healthcare and Lifesciences	19.1	6.3	14.1
Tech. Cos. & Emerging Verticals	51.4	13.1	14.7
	Q3FY21	Q2FY21	Q3FY20
Onsite- Offshore mix (%)			
Onsite	30.5	33.1	31.5
Offshore	51.4	50.7	47.3
IP-led	18.1	16.2	21.2
Utilisation (%)	81.0	81.2	79.8
Headcount	12,438	10,820	10,532

Source: BOBCAPS Research

Valuation methodology

We raise our FY21/FY22/FY23 EPS estimates by 6%/2%/4% based on the robust operating performance in Q3FY21. Rolling valuations forward, we have an updated Dec'21 target price of Rs 1,260 (Rs 840 earlier), set at a higher one-year forward P/E of 19x (vs. 13.5x) – our multiple is based on the five-year average + 1SD as we factor in the more consistent performance of the new management team vis-à-vis that in FY20 as well as sectoral tailwinds.

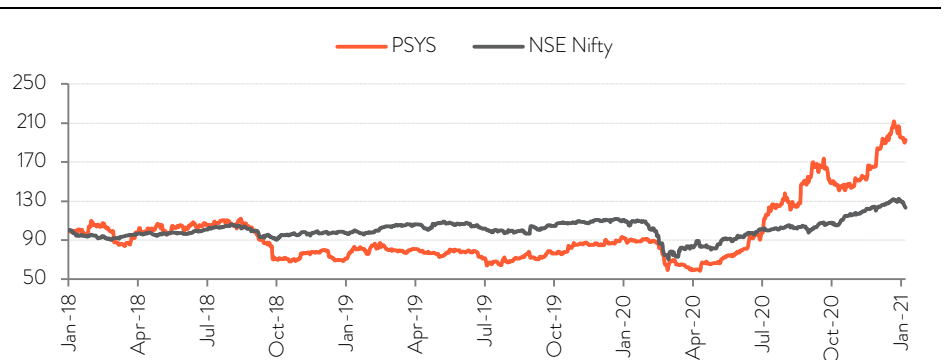
Nevertheless, we remain wary of (1) volatility in the IP segment, (2) the project-based nature of revenues and lack of annuity, (3) below-industry-average margins and (4) a delayed pivot to 'enterprise', leading to weak domain expertise compared to other mid-tier peers. The stock is trading at 32x/28x FY21E/FY22E EPS which looks rich in our view. Reiterate SELL.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	545.8	566.3	3.8	594.4	654.2	10.1	659.3	721.2	9.4
YoY growth (%)	8.8	12.9	-	8.9	15.5	-	10.9	10.2	-
Revenues	41,106	42,454	3.3	46,303	51,027	10.2	51,422	56,251	9.4
EBITDA	6,722	6,828	1.6	7,794	7,894	1.3	8,880	9,189	3.5
EBITDA margins (%)	16.4	16.1	-	16.8	15.5	-	17.3	16.3	-
Net profits	3,991	4,206	5.4	4,479	4,550	1.6	5,227	5,438	4.0
EPS (Rs)	50.0	52.7	5.5	56.2	57.0	1.5	65.5	68.2	4.1

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates include:

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

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	33,659	35,658	42,454	51,027	56,251
EBITDA	5,805	4,930	6,828	7,894	9,189
Depreciation	1,573	1,660	1,798	1,991	2,192
EBIT	4,232	3,270	5,030	5,903	6,997
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	631	1,254	711	416	556
Exceptional items	0	0	0	0	0
EBT	4,863	4,523	5,741	6,320	7,553
Income taxes	1,347	1,121	1,535	1,770	2,115
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	3,516	3,403	4,206	4,550	5,438
Adjustments	0	0	0	0	0
Adjusted net profit	3,516	3,403	4,206	4,550	5,438

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	3,158	3,810	4,536	5,452	6,010
Provisions	1,939	1,954	2,326	2,796	3,082
Debt funds	12	12	12	12	12
Other liabilities	0	0	0	0	0
Equity capital	791	791	791	791	791
Reserves & surplus	22,656	24,002	26,689	29,597	33,071
Shareholders' fund	23,447	24,793	27,480	30,388	33,862
Total liabilities and equities	28,556	30,569	34,355	38,648	42,967
Cash and cash eq.	1,739	1,461	3,304	5,237	8,452
Accounts receivables	4,923	5,862	6,979	8,388	9,247
Inventories	0	0	0	0	0
Other current assets	3,861	5,373	6,397	7,689	8,476
Investments	13,304	13,304	13,304	13,304	13,304
Net fixed assets	4,242	4,083	3,885	3,544	3,002
CWIP	316	316	316	316	316
Intangible assets	81	81	81	81	81
Deferred tax assets, net	405	405	405	405	405
Other assets	0	0	0	0	0
Total assets	28,556	30,569	34,355	38,648	42,967

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	5,031	5,063	6,004	6,541	7,630
Interest expenses	(285)	(1,254)	(711)	(416)	(556)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(290)	(1,784)	(1,043)	(1,315)	(801)
Other operating cash flows	(135)	0	0	0	0
Cash flow from operations	4,321	2,025	4,250	4,810	6,273
Capital expenditures	(374)	(1,500)	(1,600)	(1,650)	(1,650)
Change in investments	1,472	0	0	0	0
Other investing cash flows	(3,428)	1,254	711	416	556
Cash flow from investing	(2,330)	(247)	(889)	(1,234)	(1,094)
Equities issued/Others	0	(828)	0	0	0
Debt raised/repaid	(5)	0	0	0	0
Interest expenses	(713)	0	0	0	0
Dividends paid	(879)	(1,229)	(1,519)	(1,643)	(1,963)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(1,596)	(2,057)	(1,519)	(1,643)	(1,963)
Changes in cash and cash eq.	394	(278)	1,842	1,933	3,215
Closing cash and cash eq.	1,740	1,461	3,304	5,237	8,452

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	43.9	42.7	52.7	57.0	68.2
Adjusted EPS	43.9	42.7	52.7	57.0	68.2
Dividend per share	13.2	12.8	15.8	17.1	20.5
Book value per share	293.0	310.8	344.5	381.0	424.5

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.6	3.4	2.8	2.3	2.1
EV/EBITDA	20.7	24.3	17.6	15.1	12.8
Adjusted P/E	34.7	35.7	28.9	26.7	22.4
P/BV	5.2	4.9	4.4	4.0	3.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	72.3	75.2	73.3	72.0	72.0
Interest burden (PBT/EBIT)	114.9	138.3	114.1	107.1	107.9
EBIT margin (EBIT/Revenue)	12.6	9.2	11.8	11.6	12.4
Asset turnover (Revenue/Avg TA)	122.1	120.6	130.8	139.8	137.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.3	1.3
Adjusted ROAE	15.7	14.1	16.1	15.7	16.9

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	10.9	5.9	19.1	20.2	10.2
EBITDA	23.8	(15.1)	38.5	15.6	16.4
Adjusted EPS	8.8	(2.9)	23.6	8.2	19.5
Profitability & Return ratios (%)					
EBITDA margin	17.2	13.8	16.1	15.5	16.3
EBIT margin	12.6	9.2	11.8	11.6	12.4
Adjusted profit margin	10.4	9.5	9.9	8.9	9.7
Adjusted ROAE	15.7	14.1	16.1	15.7	16.9
ROCE	15.0	10.9	15.5	17.2	19.9
Working capital days (days)					
Receivables	53	55	55	55	57
Inventory	0	0	0	0	0
Payables	42	41	43	42	44
Ratios (x)					
Gross asset turnover	7.2	8.6	10.7	13.7	17.2
Current ratio	2.1	2.2	2.4	2.6	2.9
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

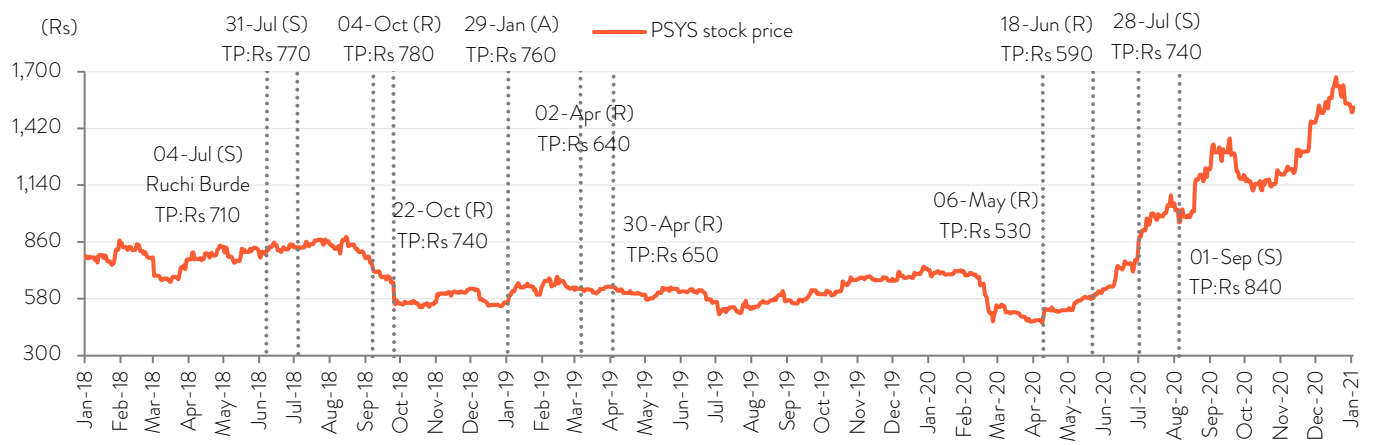
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): PERSISTENT SYSTEMS (PSYS IN)



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

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