

**SELL**

TP: Rs 1,340 | ▼ 34%

**PERSISTENT SYSTEMS**

| IT Services

| 30 April 2021

## Good execution despite IP seasonality

**Persistent Systems (PSYS) reported in-line Q4FY21 numbers, with dollar revenue growth at 4.6% QoQ. Though IP business faltered, the services division grew sequentially. Operating margin at 13.2% expanded 47bps QoQ. As the alliance business is expected to recover in FY22, we raise FY22/ FY23 EPS by 10%/2%. Rolling valuations over, we have a revised Mar'22 TP of Rs 1,340 (from Rs 1,260), based on an unchanged P/E of 19x. Given IP revenue volatility and heady valuations at 38x FY23 EPS, we reiterate SELL.**

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**Deft execution:** PSYS reported 4.6% QoQ dollar revenue growth in Q4, in line with our estimate. IP dollar revenue declined 14% QoQ due to seasonality and a higher base in Q3. The services business led the quarter with ~9% QoQ growth. Revenue from the Capiot acquisition also came through in Q4. Europe business was strong with 19% QoQ growth. Among verticals, healthcare/BFSI led the way, growing 5.7%/6.7% QoQ. Top client concentration decreased to 17.9% from 18.5% in Q3. Despite salary hikes, EBIT margin was up 47bps QoQ to 13.2% (11% est.) due to increased offshoring, reduced SG&A and lower depreciation cost.

Ticker/Price	PSYS IN/Rs 2,038
Market cap	US\$ 2.2bn
Shares o/s	80mn
3M ADV	US\$ 4.3mn
52wk high/low	Rs 2,185/Rs 460
Promoter/FPI/DII	30%/26%/44%

Source: NSE

**TCV slows down:** PSYS reported TCV of US\$ 246.5mn (-18% QoQ). New business formed 56% of total TCV (-200bps QoQ). Annual contract value was at US\$ 201mn, down 22%. Key deal wins came from the hi-tech, BFSI and healthcare-life sciences verticals.

## STOCK PERFORMANCE



Source: NSE

**Maintain SELL:** Following the induction of new management in FY21, PSYS has posted a strong operational performance. However, given its delayed pivot to enterprise business, the project-based nature of revenues, IP revenue volatility, alliance business weakness (-7.3% QoQ), inferior EBIT margin vs. peers and rich valuations (trading at 38x FY23E EPS), we maintain SELL.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	33,659	35,658	41,879	52,211	58,596
EBITDA (Rs mn)	5,805	4,930	6,830	8,066	9,124
Adj. net profit (Rs mn)	3,516	3,403	4,507	5,023	5,552
Adj. EPS (Rs)	43.9	42.7	56.5	63.0	69.6
Adj. EPS growth (%)	8.8	(2.9)	32.4	11.5	10.5
Adj. ROAE (%)	15.7	14.1	17.1	17.1	16.9
Adj. P/E (x)	46.4	47.8	36.1	32.4	29.3
EV/EBITDA (x)	27.8	32.7	23.6	20.0	17.6

Source: Company, BOBCAPS Research | P – Provisional

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## Other highlights

- The board has announced dividend of Rs 6/sh in Q4FY21.
- DSOs declined to 55 days, down by 2 days QoQ.
- Attrition has picked up from 10.3% in Q3FY21 to 11.7% in Q4FY21.
- PSYS hired 1,242 freshers in Q4FY21, causing the utilisation rate to decline ~200bps QoQ to 79%.

### FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
<b>Revenue (US\$ mn)</b>	<b>152.8</b>	<b>127.1</b>	<b>20.3</b>	<b>146.2</b>	<b>4.6</b>	<b>566</b>	<b>502</b>	<b>12.9</b>
<b>Revenue Rs mn</b>	<b>11,134</b>	<b>9,264</b>	<b>20.2</b>	<b>10,754</b>	<b>3.5</b>	<b>41,879</b>	<b>35,658</b>	<b>17.4</b>
Operating Expenditure	9,250	7,987	15.8	8,929	3.6	35,049	30,729	14.1
Cost of revenues	7,363	6,130	20.1	7,064	4.2	27,650	23,494	17.7
as % of sales	66.1	66.2	-	65.7	-	66.0	65.9	-
SG&A expenses	1,887	1,857	1.6	1,865	1.2	7,398	7,234	2.3
as % of sales	17.0	20.0	-	17.3	-	17.7	20.3	-
<b>EBITDA</b>	<b>1,883</b>	<b>1,277</b>	<b>47.5</b>	<b>1,825</b>	<b>3.2</b>	<b>6,830</b>	<b>4,930</b>	<b>38.6</b>
Depreciation	419	420	(0.3)	461	(9.1)	1,756	1,660	5.8
<b>EBIT</b>	<b>1,464</b>	<b>857</b>	<b>70.9</b>	<b>1,364</b>	<b>7.4</b>	<b>5,075</b>	<b>3,270</b>	<b>55.2</b>
Other Income	385	274	-	286	-	1,020	1,254	-
PBT	1,849	1,130	63.5	1,650	12.0	6,094	4,523	34.7
Total Tax	471	292	61.2	441	6.9	1,588	1,121	41.7
<b>Adjusted PAT</b>	<b>1,378</b>	<b>838</b>	<b>64.3</b>	<b>1,209</b>	<b>13.9</b>	<b>4,507</b>	<b>3,403</b>	<b>32.4</b>
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	0	0	-
APAT after MI	1,378	838	64.3	1,209	13.9	4,507	3,403	32.4
Extra ordinary items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>1,378</b>	<b>838</b>	<b>64.3</b>	<b>1,209</b>	<b>13.9</b>	<b>4,507</b>	<b>3,403</b>	<b>32.4</b>
Reported EPS	17.2	10.5	64.3	15.1	13.9	56.3	43	32.4
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			
EBIDTA	16.9	13.8	313	17.0	(5)	16.3	13.8	248
EBIT	13.2	9.2	390	12.7	47	12.1	9.2	295
EBT	16.6	12.2	440	15.3	126	14.6	12.7	187
PAT	12.4	9.0	332	11.2	113	10.8	9.5	122
Effective Tax rate	25.5	25.9	(36)	26.7	(123)	26.1	24.8	128

Source: BOBCAPS Research, Company

**FIG 2 – OPERATING METRICS**

(in US\$ terms)	Q4FY21 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Geography</b>			
North America	79.2	2.1	18.8
Europe	10.0	18.8	36.7
India, APAC	10.1	4.6	10.4
<b>Client Concentration</b>			
Top Client	17.9	1.2	(6.8)
Top 5 Clients	36.4	0.7	(12.3)
Top 10 Clients	46.3	3.0	(7.2)
Non-Top 10 Clients	53.7	5.9	7.2
<b>Revenue by Vertical</b>			
BFSI	30.1	6.7	15.7
Healthcare and Lifesciences	19.3	5.7	20.9
Tech. Cos. & Emerging Verticals	50.6	2.9	23.0
	<b>Q4FY21</b>	<b>Q3FY21</b>	<b>Q4FY20</b>
<b>Onsite- Offshore mix (%)</b>			
Onsite	30.4	30.5	33
Offshore	54.7	51.4	50.7
IP-led	14.9	18.1	16.3
Utilisation	79.1	81.0	78.7
Headcount	13,680	12,438	10,632

Source: BOBCAPS Research, Company

## Valuation methodology

Management has guided for recovery in the alliance segment (21% of Q4FY21 revenues) based on a couple of deals bagged in Q3 and Q4. We raise our FY22/FY23 EPS estimates by 10%/2% based on the robust Q4FY21 operating performance and guided uptick in the alliance business. Rolling valuations forward, we have a revised Mar'22 target price of Rs 1,340 (Rs 1,260 earlier), set at an unchanged one-year forward P/E of 19.2x. Our multiple is based on the five-year average plus 1SD.

We remain wary of (1) volatility in the IP segment, (2) the project-based nature of revenues coupled with 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 38x FY23E EPS which looks rich in our view. Reiterate SELL.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	654.2	669.4	2.3	721.2	748.8	3.8
YoY growth (%)	15.5	18.2	-	10.2	11.9	-
Revenues	51,027	52,211	2.3	56,251	58,596	4.2
EBITDA	7,894	8,066	2.2	9,189	9,124	(0.7)
EBITDA margin (%)	15.5	15.4	-	16.3	15.6	-
Net profits	4,550	5,023	10.4	5,438	5,552	2.1
EPS (Rs)	57.0	63.0	10.4	68.2	69.6	2.1

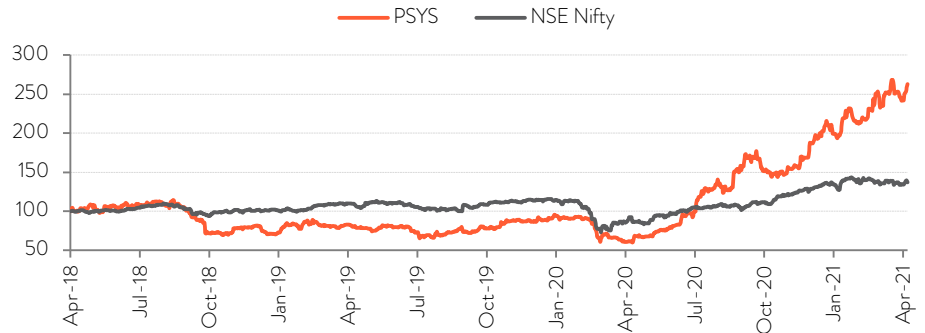
Source: BOBCAPS Research

**FIG 4 – PEER COMPARISON**

Company	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target PE (x)
				FY22E	FY23E	FY22E	FY23E	
TCS	BUY	3,780	17.2	118	135	44	41	28.0
INFO	ADD	1,540	13.1	56	59	30	30	26.0
HCLT	BUY	1,190	11.9	55	63	23	23	18.8
TECHM	BUY	1,190	15.0	64	76	21	22	15.7
LTI	BUY	4,740	20.1	136	161	33	33	30.4
MPHL	REDUCE	1,550	14.4	81	96	22	24	16.9
MTCL	ADD	2,180	14.4	89	93	31	28	23.4
PSYS	SELL	1,340	15.0	63	70	17	17	19.2
COFORGE	BUY	3,350	24.2	121	154	24	25	22.0

Source: BOBCAPS Research

**FIG 5 – 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	FY21P	FY22E	FY23E
<b>Total revenue</b>	<b>33,659</b>	<b>35,658</b>	<b>41,879</b>	<b>52,211</b>	<b>58,596</b>
EBITDA	5,805	4,930	6,830	8,066	9,124
Depreciation	1,573	1,660	1,756	1,757	2,058
EBIT	4,232	3,270	5,075	6,309	7,066
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	631	1,254	1,020	525	622
Exceptional items	0	0	0	0	0
EBT	4,863	4,523	6,094	6,834	7,688
Income taxes	1,347	1,121	1,588	1,811	2,135
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>3,516</b>	<b>3,403</b>	<b>4,507</b>	<b>5,023</b>	<b>5,552</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>3,516</b>	<b>3,403</b>	<b>4,507</b>	<b>5,023</b>	<b>5,552</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	3,158	3,810	4,607	5,579	6,261
Provisions	1,939	1,954	2,719	2,861	3,211
Debt funds	12	12	44	44	44
Other liabilities	0	0	0	0	0
Equity capital	791	791	764	764	764
Reserves & surplus	22,656	24,002	27,192	30,091	33,973
Shareholders' fund	23,447	24,793	27,957	30,855	34,737
<b>Total liabilities and equities</b>	<b>28,556</b>	<b>30,569</b>	<b>35,327</b>	<b>39,339</b>	<b>44,253</b>
Cash and cash eq.	1,739	1,461	2,419	2,913	3,648
Accounts receivables	4,923	5,862	5,709	8,583	9,632
Inventories	0	0	0	0	0
Other current assets	3,861	5,373	4,945	6,008	7,545
Investments	13,304	13,304	17,853	17,853	19,853
Net fixed assets	4,242	4,083	3,277	3,170	2,762
CWIP	316	316	122	122	122
Intangible assets	81	81	86	86	86
Deferred tax assets, net	405	405	1,038	727	727
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>28,556</b>	<b>30,569</b>	<b>35,327</b>	<b>39,339</b>	<b>44,253</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	5,031	5,063	6,262	6,780	7,611
Interest expenses	(285)	(1,254)	(1,020)	(525)	(622)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(290)	(1,784)	2,143	(2,823)	(1,555)
Other operating cash flows	(135)	0	(1,706)	0	0
<b>Cash flow from operations</b>	<b>4,321</b>	<b>2,025</b>	<b>5,679</b>	<b>3,432</b>	<b>5,434</b>
Capital expenditures	(374)	(1,500)	(392)	(1,650)	(1,650)
Change in investments	1,472	0	(3,722)	0	(2,000)
Other investing cash flows	(3,428)	1,254	1,020	525	622
<b>Cash flow from investing</b>	<b>(2,330)</b>	<b>(247)</b>	<b>(3,094)</b>	<b>(1,125)</b>	<b>(3,028)</b>
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)	(1,627)	(1,814)	(1,671)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(1,596)</b>	<b>(2,057)</b>	<b>(1,627)</b>	<b>(1,814)</b>	<b>(1,671)</b>
<b>Changes in cash and cash eq.</b>	<b>394</b>	<b>(278)</b>	<b>958</b>	<b>493</b>	<b>735</b>
<b>Closing cash and cash eq.</b>	<b>1,740</b>	<b>1,461</b>	<b>2,419</b>	<b>2,913</b>	<b>3,648</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	43.9	42.7	56.5	63.0	69.6
Adjusted EPS	43.9	42.7	56.5	63.0	69.6
Dividend per share	13.2	12.8	16.9	18.9	17.4
Book value per share	293.0	310.8	350.5	386.8	435.5

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	4.8	4.5	3.9	3.1	2.7
EV/EBITDA	27.8	32.7	23.6	20.0	17.6
Adjusted P/E	46.4	47.8	36.1	32.4	29.3
P/BV	7.0	6.6	5.8	5.3	4.7

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	72.3	75.2	73.9	73.5	72.2
Interest burden (PBT/EBIT)	114.9	138.3	120.1	108.3	108.8
EBIT margin (EBIT/Revenue)	12.6	9.2	12.1	12.1	12.1
Asset turnover (Revenue/Avg TA)	122.1	120.6	127.1	139.9	140.2
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.3	1.3
Adjusted ROAE	15.7	14.1	17.1	17.1	16.9

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	10.9	5.9	17.4	24.7	12.2
EBITDA	23.8	(15.1)	38.6	18.1	13.1
Adjusted EPS	8.8	(2.9)	32.4	11.5	10.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	17.2	13.8	16.3	15.4	15.6
EBIT margin	12.6	9.2	12.1	12.1	12.1
Adjusted profit margin	10.4	9.5	10.8	9.6	9.5
Adjusted ROAE	15.7	14.1	17.1	17.1	16.9
ROCE	15.0	10.9	15.3	17.3	17.3
<b>Working capital days (days)</b>					
Receivables	53	55	50	50	57
Inventory	0	0	0	0	0
Payables	42	41	44	42	44
<b>Ratios (x)</b>					
Gross asset turnover	7.2	8.6	11.4	16.2	19.8
Current ratio	2.1	2.2	1.8	2.1	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research



## Disclaimer

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

**BUY** – Expected return >+15%

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

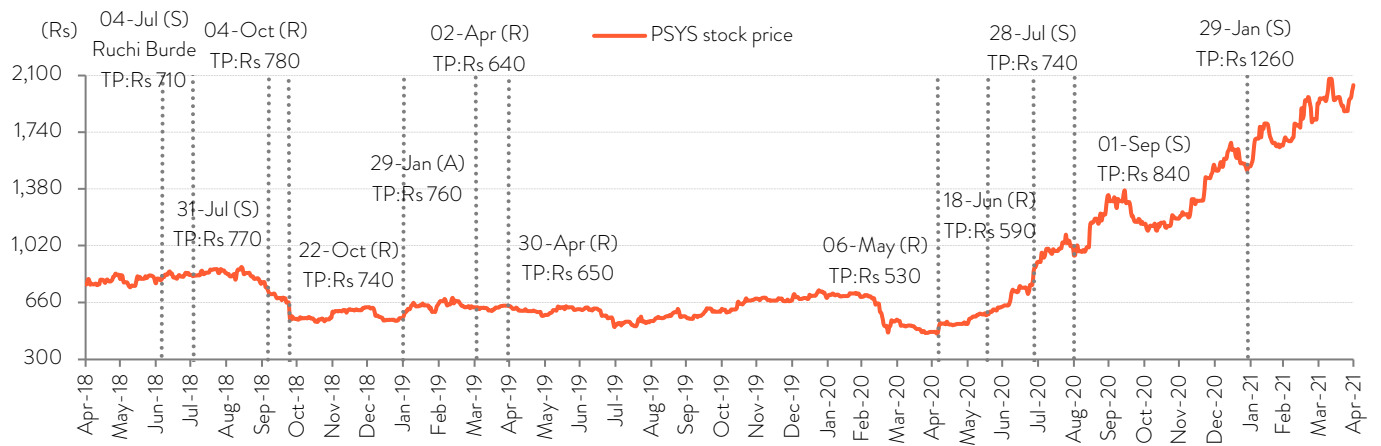
**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

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

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, A – Add, R – Reduce, S – Sell

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