

HOLD

TP: Rs 5,330 | ▲ 12%

PERSISTENT SYSTEMS

Technology & Internet

24 July 2023

Resilient quarter but growth guided to soften near term

- Top BFS client the driving force behind Q1 growth, but management expects weakness in the vertical for the next few quarters
- Bagged marquee hyperscaler and healthcare deals, though spillover of some contracts to Q2 led to softer sequential TCV
- Management remains confident of above-industry growth in FY24; we retain HOLD and a TP of Rs 5,330

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Resilient Q1: PSYS delivered a topline of US\$ 283mn, up 2.9% QoQ and 16.9% YoY in Q1FY24, led by the top client (T1) which increased 13% QoQ (10.2% of total revenue). Non-top clients and smaller accounts contributed modest gains, with revenue from the top 50 bracket up 5.7% QoQ, backed by IP (+8%) and services (+2.7%) business. Recent macro challenges have led to execution delays, particularly in BFS, and hence management expects this vertical to soften over the near term. The hi-tech vertical was flat and life sciences/healthcare dipped 5% QoQ due to a material drag from the scientific instrument and medical device segment.

Poor deal TCV and softer growth outlook: Total deal TCV declined 11% sequentially to US\$ 380mn off a high base and due to the spillover of some signings into Q2. Despite marquee deal wins in the hyperscaler, healthcare and offshore development centre domains for software and hi-tech clients, average contract value declined materially by 14% QoQ with the book-to-bill ratio falling below 1x in Q1 (1.1x in Q4FY23). Management moderated its quarterly revenue growth guidance for FY24 to 2-4% from 3-5%.

EBIT margin dips QoQ: EBIT margin at 14.9% contracted 44bps QoQ as topline growth was offset by higher visa cost (-40bps impact), amortisation and doubtful debt. Higher G&A expense due to new office space (+20bps) along with debt provisions (-10bps) had a further negative impact. Though wage hikes will affect Q2, management expects to leverage fresher billing and utilisation for the next few quarters. Days sales outstanding have declined which we believe will aid OCF in Q2-Q3. Headcount was at 23,130, up by 241, and attrition moderated materially to 15.5% in Q1 from 19.8% in Q4FY23. Management has guided for the FY24 margin to hold at FY23 levels of ~15%.

Upside limited; maintain HOLD: PSYS aspires to achieve above-industry growth of 7-10% for FY24 and now guides for quarterly growth of 2-4%. The stock is currently trading at 26.7x FY25E EPS, having rallied 7% over the past one quarter, which leaves limited upside. We maintain our HOLD rating and TP of Rs 5,330, based on 30x FY25E EPS (vs. the stock's historical average of 34.4x over FY20-FY23).

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	PSYS IN/Rs 4,750
Market cap	US\$ 4.6bn
Free float	70%
3M ADV	US\$ 21.5mn
52wk high/low	Rs 5,279/Rs 3,092
Promoter/FPI/DII	30%/26%/44%

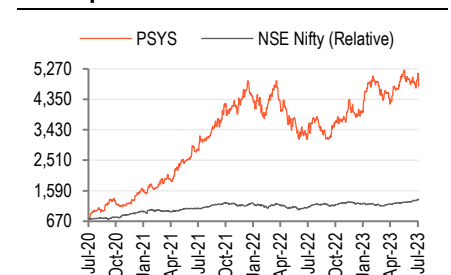
Source: NSE | Price as of 21 Jul 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	83,506	96,822	1,11,253
EBITDA (Rs mn)	15,191	18,155	21,063
Adj. net profit (Rs mn)	9,507	11,422	13,574
Adj. EPS (Rs)	124.4	149.4	177.6
Consensus EPS (Rs)	124.4	146.7	174.8
Adj. ROAE (%)	27.4	30.8	33.7
Adj. P/E (x)	38.2	31.8	26.7
EV/EBITDA (x)	24.9	21.1	18.1
Adj. EPS growth (%)	43.7	20.1	18.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

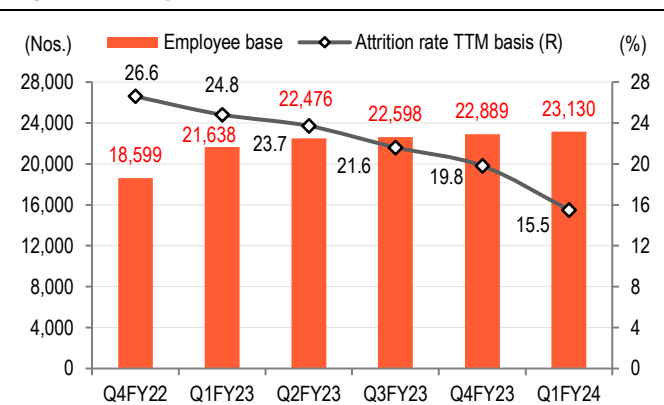


Fig 1 – Quarterly performance

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue	283	275	242	2.9	16.9	284	(0.4)
INR Revenue	23,212	22,545	18,781	3.0	23.6	23,345	(0.6)
EBIT	3,466	3,466	2,688	0.0	28.9	3,576	(3.1)
PAT	2,288	2,515	2,116	(9.0)	8.1	2,802	(18.4)
EBIT Margin (%)	14.9	15.4	14.3	(44bps)	62bps	15.3	(39bps)
PAT Margin (%)	9.9	11.2	11.3	(130bps)	(141bps)	12.0	(215bps)

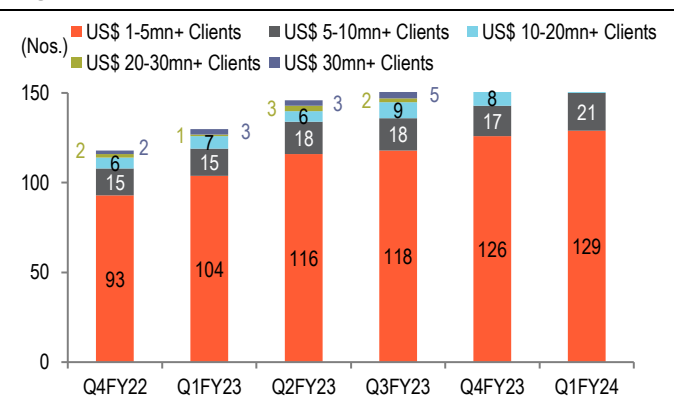
Source: Company, BOBCAPS Research

Fig 2 – Employee matrix



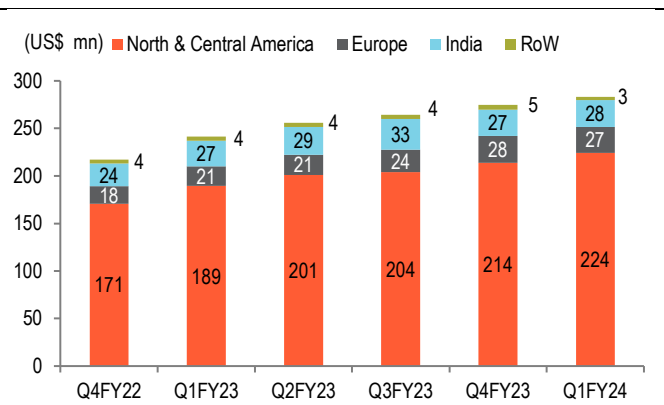
Source: Company, BOBCAPS Research

Fig 3 – Client breakup



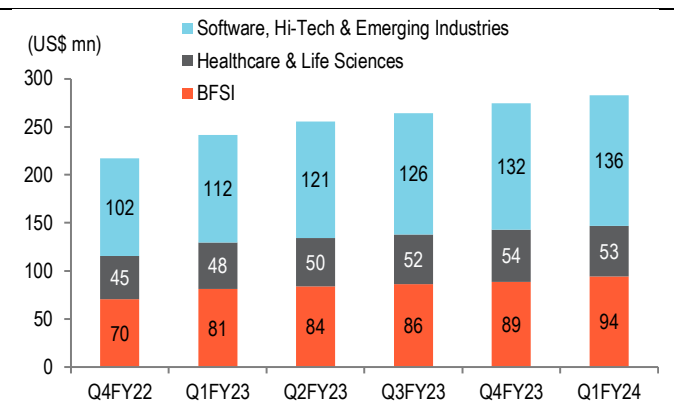
Source: Company, BOBCAPS Research

Fig 4 – Revenue by geography



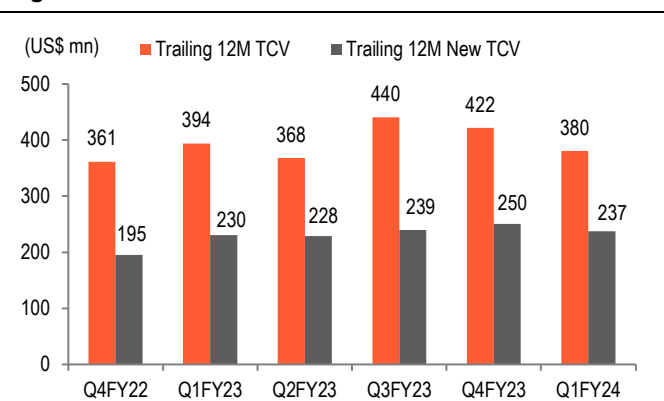
Source: Company, BOBCAPS Research

Fig 5 – Revenue by vertical



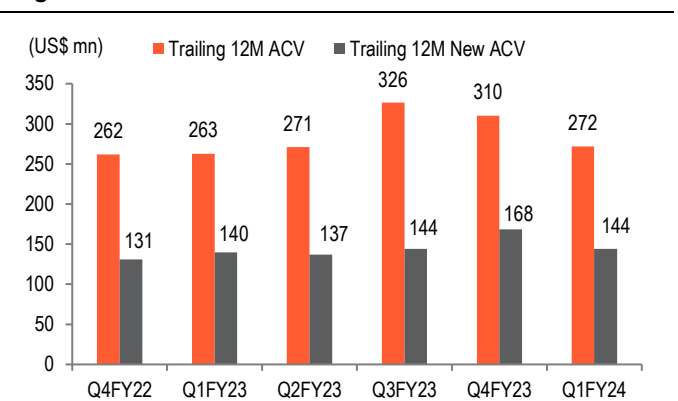
Source: Company, BOBCAPS Research

Fig 6 – Deal TCV



Source: Company, BOBCAPS Research

Fig 7 – Deal ACV



Source: Company, BOBCAPS Research

Earnings call highlights

- PSYS's T1 account grew by 13% QoQ in dollar terms and T50 accounts grew ~5.7% QoQ in Q1FY24.
- Due to macro headwinds, management indicated that enterprises are maintaining a cautious approach in the near term, leading to deal pushouts/deferrals. Thus, while BFS witnessed strong growth in Q1, PSYS believes business may turn softer in coming quarters.
- PSYS has bagged five large healthcare deals in Q1, and expects the healthcare and hi-tech verticals to perform well going ahead.
- Management anticipates a slowdown in deal signings for 2-3 quarters before they revert to the historical quarterly average TCV of ~US\$ 400mn.
- PSYS has added four new +US\$ 5mn clients in Q1 for a total of 38 in this category.
- Revenue from North America grew 4.9% QoQ, whereas Europe declined 2.8% in Q1.
- The company has prioritised its focus on generative AI and has collaborated with AWS, Microsoft and Google on various platform-based offerings.
- A total of 241 new employees were added in Q1 and 800 freshers are likely to come on board between August and December. During the quarter, utilisation improved to 78.3% (from 77.3% in Q4FY23).
- Wage hikes continue to be implemented in July with increments of 7.5% effected within India and 3.5-4% outside India.
- PSYS recently opened offices in Indore, Jaipur, Hyderabad and Kolkata and plans to expand further in tier-2/3 cities which will help lower talent cost and attrition.

Valuation methodology

PSYS aspires to achieve above-industry growth of 7-10% for FY24 and now guides for quarterly growth of 2-4%. The stock is currently trading at 26.7x FY25E EPS, having rallied 7% over the past one quarter, which leaves limited upside. We maintain our HOLD rating and TP of Rs 5,330, based on 30x FY25E EPS (vs. the stock's historical average of 34.4x over FY20-23)

Key risks

- Better-than-expected improvement in the BFSI, retail and hi-tech verticals in developed economies represents an upside risk to our estimates.
- Further reduction in IT-related spends by target clients would be a key downside risk.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.3	1,047	1,110	HOLD
Coforge	COFORGE IN	3.5	4,640	4,830	HOLD
HCL Technologies	HCLT IN	36.8	1,115	1,240	HOLD
Infosys	INFO IN	68.1	1,332	1,760	BUY
Mphasis	MPHL IN	5.3	2,331	2,541	HOLD
Persistent Systems	PSYS IN	4.6	4,750	5,330	HOLD
Tata Consultancy Services	TCS IN	150.0	3,368	3,580	HOLD
Tech Mahindra	TECHM IN	12.7	1,195	1,130	HOLD
Wipro	WPRO IN	27.0	405	420	HOLD

Source: BOBCAPS Research, NSE | Price as of 21 Jul 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Total revenue	41,879	57,108	83,506	96,822	1,11,253
EBITDA	6,830	9,582	15,191	18,155	21,063
Depreciation	1,756	1,660	2,719	3,052	3,169
EBIT	5,075	7,922	12,472	15,103	17,894
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	1,020	1,322	233	228	204
Exceptional items	0	0	0	0	0
EBT	6,094	9,243	12,705	15,331	18,098
Income taxes	1,588	2,339	3,198	3,909	4,525
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	4,507	6,904	9,507	11,422	13,574
Adjustments	0	0	0	0	0
Adjusted net profit	4,507	6,904	9,507	11,422	13,574

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	0	0	0	0	0
Other current liabilities	4,607	9,911	9,151	9,284	10,668
Provisions	2,719	4,195	4,118	4,775	5,486
Debt funds	44	6,004	6,004	6,004	6,004
Other liabilities	0	0	0	0	0
Equity capital	764	764	764	764	764
Reserves & surplus	27,192	32,918	35,065	37,550	41,540
Shareholders' fund	27,957	33,682	35,830	38,315	42,304
Total liab. and equities	35,327	53,792	55,103	58,378	64,463
Cash and cash eq.	2,419	2,978	3,405	5,934	10,716
Accounts receivables	5,709	9,484	10,295	11,937	13,716
Inventories	0	0	0	0	0
Other current assets	4,945	5,355	6,497	7,003	8,046
Investments	17,853	18,445	18,445	18,445	18,445
Net fixed assets	3,277	13,617	12,548	11,146	9,627
CWIP	122	1,071	1,071	1,071	1,071
Intangible assets	86	2,790	2,790	2,790	2,790
Deferred tax assets, net	1,038	1,123	1,123	1,123	1,123
Other assets	0	0	0	0	1
Total assets	35,327	53,792	55,103	58,378	64,463

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash flow from operations	5,679	8,448	9,204	12,888	15,812
Capital expenditures	(392)	(3,808)	(1,650)	(1,650)	(1,650)
Change in investments	(362)	(212)	0	0	0
Other investing cash flows	1,020	(5,754)	(4,267)	(5,272)	(5,296)
Cash flow from investing	266	(9,773)	(5,917)	(6,922)	(6,946)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(324)	3,928	0	0	0
Interest expenses	0	(118)	0	0	0
Dividends paid	(1,627)	(1,987)	(2,861)	(3,436)	(4,084)
Other financing cash flows	0	0	0	0	1
Cash flow from financing	(1,951)	1,823	(2,861)	(3,436)	(4,083)
Chg in cash & cash eq.	3,995	497	426	2,529	4,783
Closing cash & cash eq.	5,456	2,979	3,405	5,934	10,716

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	56.5	86.6	124.4	149.4	177.6
Adjusted EPS	56.5	86.6	124.4	149.4	177.6
Dividend per share	16.9	26.0	31.1	37.4	44.4
Book value per share	350.5	422.3	468.8	501.3	553.5

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	9.0	6.6	4.5	4.0	3.4
EV/EBITDA	55.4	39.3	24.9	21.1	18.1
Adjusted P/E	84.1	54.9	38.2	31.8	26.7
P/BV	13.6	11.2	10.1	9.5	8.6

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	73.9	74.7	74.8	74.5	75.0
Interest burden (PBT/EBIT)	120.1	116.7	101.9	101.5	101.1
EBIT margin (EBIT/Revenue)	12.1	13.9	14.9	15.6	16.1
Asset turnover (Rev./Avg TA)	127.1	128.2	153.4	170.6	181.1
Leverage (Avg TA/Avg Equity)	1.2	1.4	1.6	1.5	1.5
Adjusted ROAE	17.1	22.4	27.4	30.8	33.7

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Revenue	17.4	36.4	46.2	15.9	14.9
EBITDA	38.6	40.3	58.5	19.5	16.0
Adjusted EPS	32.4	53.2	43.7	20.1	18.8
Profitability & Return ratios (%)					
EBITDA margin	16.3	16.8	18.2	18.8	18.9
EBIT margin	12.1	13.9	14.9	15.6	16.1
Adjusted profit margin	10.8	12.1	11.4	11.8	12.2
Adjusted ROAE	17.1	22.4	27.4	30.8	33.7
ROCE	15.3	19.0	24.8	29.3	35.3
Working capital days (days)					
Receivables	50	49	43	42	42
Inventory	0	0	0	0	0
Payables	44	56	51	43	40
Ratios (x)					
Gross asset turnover	11.4	6.8	6.4	8.2	10.7
Current ratio	1.8	1.3	1.5	1.8	2.0
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	0.1	0.1	0.0	(0.1)

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

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BUY – Expected return >+15%

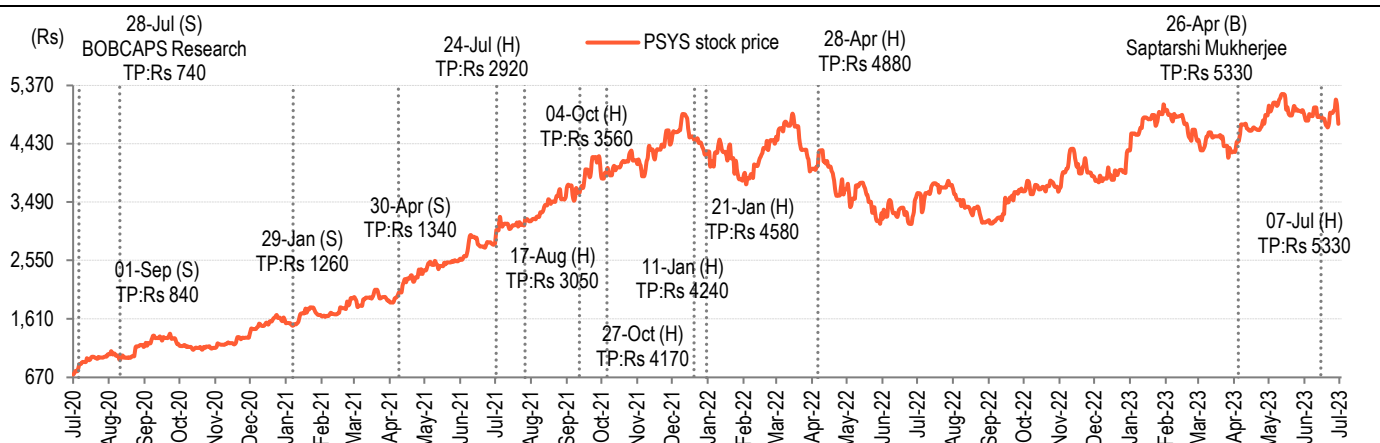
HOLD – Expected return from -6% to +15%

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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