

HOLD

TP: Rs 3,651 | ▲ 8%

PERSISTENT SYSTEMS

Technology & Internet

07 May 2024

A discretionary push to drive the growth trajectory

- **Cost take-out projects and vendor consolidation to be the prime growth driver for PSYS in FY25**
- **Flattish Q4, PSYS retains medium-term margin outlook due to large deal wins**
- **We trim our earnings for FY25E/FY26E by ~7% each and maintain our HOLD rating with a new TP to Rs 3,651, valued at 35x FY26E EPS**

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Healthy growth, strong product expertise: PSYS reported healthy QoQ revenue growth of 3.3% both in US dollar and in constant currency (CC) terms to US\$ 311mn, driven by material engagement in healthcare & BFSI verticals. BFSI revenue continued to surprise its peers with growth of 1.8% QoQ, whereas hi-tech declined (0.75%). Geographically, North America/India grew 4% QoQ each and Europe de-grew by 9.4%. Despite weak macros, PSYS delivered a healthy topline on the back of improved sales, strong product development, vendor consolidation, cost take-out projects, rebadging, higher annuity business and a well-balanced portfolio mix

Building senior management team with strong pedigree: The inclusion of Tier-I DNAs will strengthen the senior management squad and the most recent hire was the Head of BFSI & Europe (formerly at Wipro). We believe this will improve PSYS's business scalability and mine large accounts better. A recent large deal win from a European energy conglomerate includes setting up an offshore development centre.

Transformational deal wins yet to improve: The company has had several US\$ 50mn deals with a high component of managed services/vendor consolidation, which will impact margin negatively due to higher onsite mix, higher subcon cost and lower utilisation. Due to weak discretionary spends and elongated decision-making cycle, the number of transformational deal wins is likely to stay modest in the near term which will impact the company at the operating level, in our view.

Flattish Q4 margin: The company has prioritised growth over margin improvement. Most of its investments are directed at SG&A expenses to improve the win run-rate and the remainder on upfront costs related to large deal wins including improving capabilities such as Gen AI.

Valuation outlook: PSYS trades at 39.1/32.5x FY25E/FY26E EPS Modest deal wins/ stable broad-based growth indicates at modest growth acceleration in FY25. We trim our FY25/FY26E EPS earnings by 7%/7.3% and maintain our HOLD rating with a new TP of Rs3,651 (previously Rs 3,938), based on 35x on FY26E EPS.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	PSYS IN/Rs 3,396
Market cap	US\$ 3.1bn
Free float	70%
3M ADV	US\$ 20.5mn
52wk high/low	Rs 4,450/Rs 2,309
Promoter/FPI/DII	30%/26%/44%

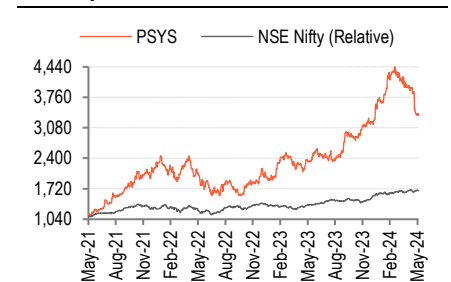
Source: NSE | Price as of 6 May 2024

Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	98,216	1,07,359	1,20,696
EBITDA (Rs mn)	17,243	20,184	23,415
Adj. net profit (Rs mn)	11,421	13,204	15,783
Adj. EPS (Rs)	73.4	86.8	104.3
Consensus EPS (Rs)	73.4	87.4	107.9
Adj. ROAE (%)	25.6	24.7	25.7
Adj. P/E (x)	46.3	39.1	32.5
EV/EBITDA (x)	15.1	12.7	10.8
Adj. EPS growth (%)	15.4	18.3	20.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

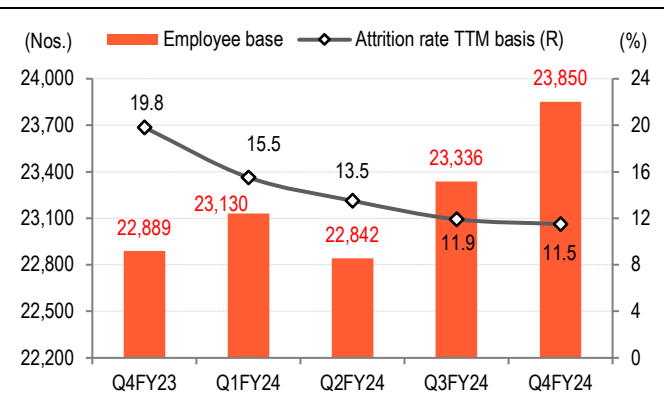


Fig 1 – Quarterly Performance

(Rs mn)	Q4FY24	Q3FY24	Q4FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue	311	301	275	3.3	13.1	311	0.0
INR Revenue	25,905	24,982	22,545	3.7	14.9	25,813	0.4
EBIT	3,744	3,631	3,466	3.1	8.0	3,820	(2.0)
PAT	3,153	2,861	2,515	10.2	25.4	2,994	5.3
EBIT Margin (%)	14.5	14.5	15.4	(8bps)	(92bps)	14.8	(34bps)
PAT Margin (%)	12.2	11.5	11.2	72bps	102bps	11.6	57bps

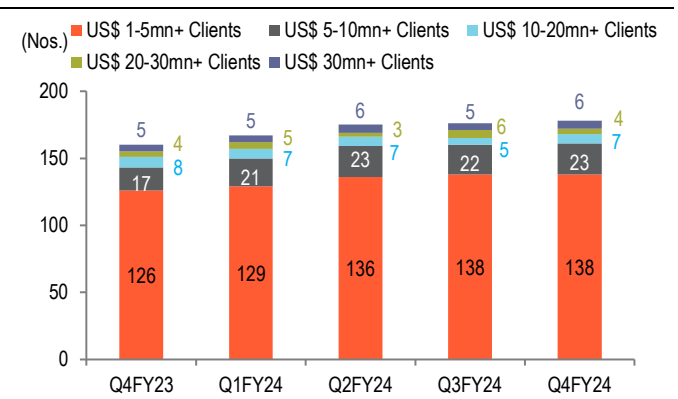
Source: Company, BOBCAPS Research

Fig 2 – Employee metrics



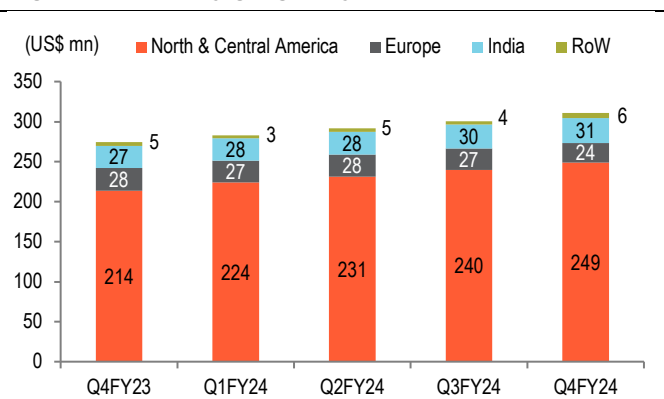
Source: Company, BOBCAPS Research | TTM: Trailing Twelve Month

Fig 3 – Client contributions



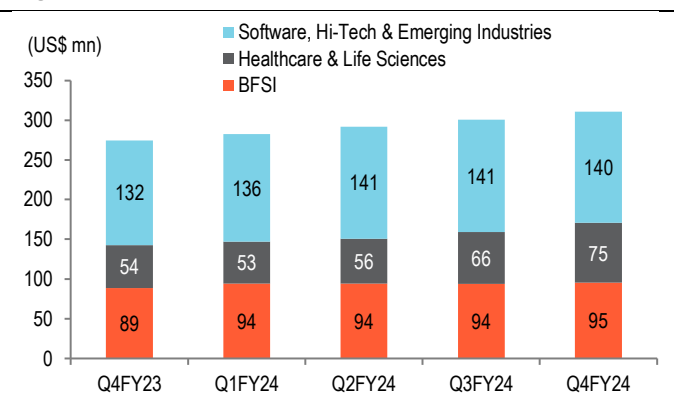
Source: Company, BOBCAPS Research

Fig 4 – Revenue by geography



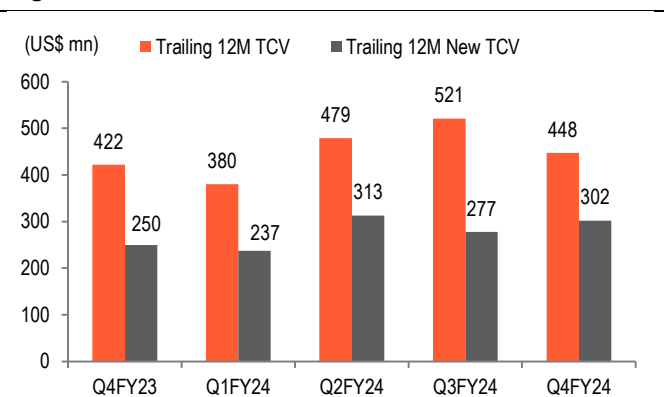
Source: Company, BOBCAPS Research

Fig 5 – Vertical-wise revenue



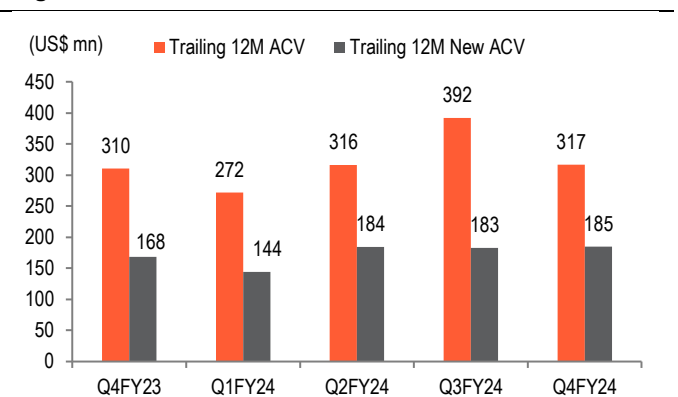
Source: Company, BOBCAPS Research

Fig 6 – Deal TCV



Source: Company, BOBCAPS Research | TCV: Total Contract Value

Fig 7 – Deal ACV



Source: Company, BOBCAPS Research | ACV: Average Contract Value

Earnings call highlights

- Persistent is gaining BFSI market share from its larger competitors. The FY25 growth story will be driven by Healthcare, BFSI and Hi-tech.
- During the last quarter, the company materially progressed with several proof of concepts turning into production programmes. PSYS is leveraging its AI platform SASVA for opportunities in AI for product engineering.
- Investments in Gen AI and customer experience centers are already at peak. PSYS has targeted margin expansion of 200-300bps over the next three years.
- The company is focusing on M&A strategy for market penetration in Western Europe and for delivery penetration in Eastern Europe.
- The top five to ten, and top 10-20 accounts barely grew/declined on a QoQ basis, indicating weak growth in larger accounts.
- Technical headcount increased 2.2% QoQ and 4.4% YoY to 22,224. Attrition declined by 40bps to 11.5%, whereas sales and development headcount increased by 19 to 484 which indicates the company's aggressive efforts to win new deals.

Valuation methodology

On a long-term perspective, PSYS is well placed within the midcap peers, given its multiple large deal wins which leads to improved revenue visibility and its front-ended business trajectory. PSYS trades at 39.1/32.5x FY25E/FY26E EPS. Modest deal wins/stable broad-based growth indicates at modest growth acceleration in FY25. We trim our earnings for FY25E/FY26E by 7%/& 7.3% and maintain our HOLD rating with a new TP of Rs3,651 (previously Rs 3,938), based on 35x on FY26E EPS.

Revised estimates

(Rs mn)	New		Old		Change (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Revenue (US\$ mn)	1,291	1,451	1,285	1,395	0.5	4.0
Revenue	107,359	120,696	106,807	115,337	0.5	4.6
EBIT	16,748	19,694	18,849	23,128	(11.1)	(14.8)
EBIT margin (%)	15.6	16.3	17.6	20.1	(205bps)	(374bps)
EPS (Rs)	87.0	107.6	93.4	112.5	(7.0)	(7.3)

Source: BOBCAPS Research

Risks

Key upside/downside risks to our estimates are:

- Further decline in interest rates;
- elongated decision-making cycle, especially in BFSI/Healthcare/Hi-Tech.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24A	FY25E	FY26E
Total revenue	57,108	83,506	98,216	1,07,359	1,20,696
EBITDA	9,582	15,191	17,243	20,184	23,415
Depreciation	1,660	2,719	3,094	3,436	3,742
EBIT	7,922	12,472	14,149	16,748	19,674
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	1,322	233	813	799	1,093
Exceptional items	0	0	0	0	0
EBT	9,243	12,705	14,962	17,548	20,767
Income taxes	2,339	3,198	3,541	4,343	4,984
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	6,904	9,507	11,421	13,204	15,783
Adjustments	0	0	0	0	0
Adjusted net profit	6,904	9,507	11,421	13,204	15,783

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24A	FY25E	FY26E
Accounts payables	4,299	5,689	8,139	8,374	8,571
Other current liabilities	6,001	9,790	10,372	9,274	11,269
Provisions	4,195	5,022	3,878	3,824	3,968
Debt funds	6,014	6,578	1,770	1,770	1,770
Other liabilities	0	0	0	0	0
Equity capital	764	764	770	770	770
Reserves & surplus	32,918	38,887	48,807	56,730	64,621
Shareholders' fund	33,682	39,651	49,577	57,500	65,391
Total liab. and equities	49,893	61,042	65,598	72,368	82,399
Cash and cash eq.	2,978	4,670	6,625	7,222	7,843
Accounts receivables	9,484	15,963	17,491	19,119	21,494
Inventories	0	0	0	0	0
Other current assets	9,628	10,179	13,454	14,706	16,533
Investments	14,391	10,758	11,869	16,869	23,869
Net fixed assets	5,347	7,219	7,062	5,591	3,997
CWIP	1,071	161	335	335	335
Intangible assets	11,060	16,355	15,488	15,488	15,488
Deferred tax assets, net	1,302	1,586	1,747	1,747	1,747
Other assets	0	0	0	0	0
Total assets	54,191	66,731	73,736	80,742	90,970

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24A	FY25E	FY26E
Cash flow from operations	8,450	9,558	12,213	12,044	16,566
Capital expenditures	(3,808)	(4,321)	(2,791)	(1,964)	(2,147)
Change in investments	(212)	(206)	(1,994)	(5,000)	(7,000)
Other investing cash flows	(5,754)	314	89	0	0
Cash flow from investing	(9,773)	(4,213)	(4,695)	(6,964)	(9,147)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	3,928	(585)	(3,174)	0	0
Interest expenses	(118)	(473)	1,321	799	1,093
Dividends paid	(1,987)	(2,981)	(4,084)	(5,282)	(7,891)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	1,823	(4,039)	(5,937)	(4,482)	(6,798)
Chg in cash & cash eq.	499	1,305	1,581	597	621
Closing cash & cash eq.	2,978	4,670	6,625	7,222	7,843

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24A	FY25E	FY26E
Reported EPS	45.2	63.6	73.4	86.8	104.3
Adjusted EPS	45.2	63.6	73.4	86.8	104.3
Dividend per share	13.0	19.9	27.0	34.8	53.8
Book value per share	220.4	265.2	327.7	378.0	432.3

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24A	FY25E	FY26E
EV/Sales	4.5	3.1	2.7	2.4	2.1
EV/EBITDA	26.8	17.0	15.1	12.7	10.8
Adjusted P/E	75.2	53.4	46.3	39.1	32.5
P/BV	15.4	12.8	10.4	9.0	7.9

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24A	FY25E	FY26E
Tax burden (Net profit/PBT)	74.7	74.8	76.3	75.3	76.0
Interest burden (PBT/EBIT)	116.7	101.9	105.7	104.8	105.6
EBIT margin (EBIT/Revenue)	13.9	14.9	14.4	15.6	16.3
Asset turnover (Rev./Avg TA)	127.6	138.1	139.8	139.0	140.6
Leverage (Avg TA/Avg Equity)	1.5	1.6	1.6	1.4	1.4
Adjusted ROAE	22.4	25.9	25.6	24.7	25.7

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24A	FY25E	FY26E
YoY growth (%)					
Revenue	36.4	46.2	17.6	9.3	12.4
EBITDA	40.3	58.5	13.5	17.1	16.0
Adjusted EPS	(20.1)	40.8	15.4	18.3	20.2
Profitability & Return ratios (%)					
EBITDA margin	16.8	18.2	17.6	18.8	19.4
EBIT margin	13.9	14.9	14.4	15.6	16.3
Adjusted profit margin	12.1	11.4	11.6	12.3	13.1
Adjusted ROAE	22.4	25.9	25.6	24.7	25.7
ROCE	19.0	23.8	25.0	26.0	26.9
Working capital days (days)					
Receivables	49	56	62	62	61
Inventory	0	0	0	0	0
Payables	41	42	45	41	39
Ratios (x)					
Gross asset turnover	13.2	13.3	13.8	17.0	25.2
Current ratio	1.5	1.5	1.7	1.9	1.9
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.1	0.0	(0.1)	(0.1)	(0.1)

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

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BUY – Expected return >+15%

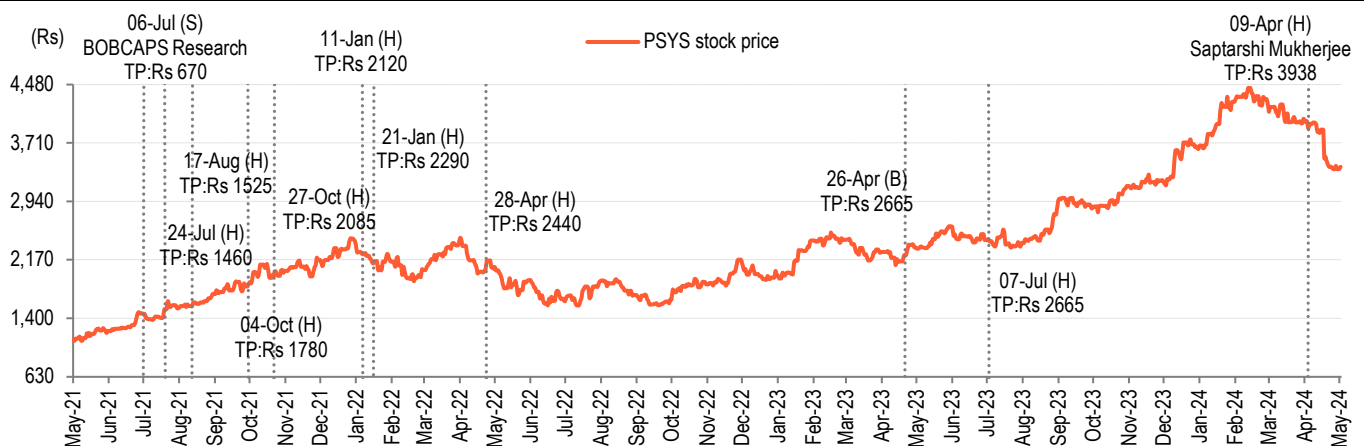
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SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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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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