

## Persistent Systems reported an exceptional Q2FY22 performance with the best-ever sequential growth (on the back of an already strong Q1 performance) and coupled with steady margins despite wage hike during the quarter

- \$ revenue: \$182.32 Mn, +9.3% qoq / +34% yoy and 1.5% above our estimates
- INR revenue: INR 13,512 Mn, +9.9% qoq / +34.1% yoy and 1.6% above our estimates
- EBITDA: INR 2,243 Mn, +11.4% qoq / +34.8% yoy and +2.1% vs our estimates
- EBITDA margins: 16.6%, vs 16.4% / 16.5% in Q1FY22 / Q2FY21 respectively and 10 bps above our estimates. 10 The company reported steady and in fact positive EBITDA margins despite a 230 bps impact of wage hike during the quarter
- EBIT: INR 1,873 Mn, +12.5% qoq / +53% yoy
- EBIT margins: 13.9%, vs 13.5% / 12.1% in Q1FY22 / Q2FY21 respectively
- PAT: INR 1,617.5 Mn, +6.9% qoq / +58.6% yoy and 6.8% above our estimates
- EPS at INR 21.2 in Q2FY22 vs 19.8 / 13 in Q1FY22 / Q2FY21 respectively and versus our estimate of INR 19.8
- Deal wins were also healthy at \$149.3 Mn vs \$147.7 Mn / \$137.7 Mn in Q1FY22 / Q2FY21 respectively

### Result Highlights

- **Services (87.5% of revenue)** grew by 10.1% qoq /39.9% yoy. **IP-led business (12.5% of revenue)** de-grew by 4.3% qoq / 3.4% yoy
- **TCV for Q2FY22 stood at \$149.3 Mn** (versus \$147.7 Mn / 137.7 Mn in Q1FY22 / Q2FY21)
- **>\$5 Mn bucket** increased from 21 to 22 qoq and **>\$3 Mn bucket** increased from 76 to 84
- **Top Client (16.9% of revenue)** grew by 8.6% qoq whereas **Top 2 - 5 clients (18.9% of revenue)** grew by 5.9% qoq and **Top 5 - 10 (9.6% of revenue)** grew by 2.9% qoq
- **BFSI (30.7% of revenue)** grew by 8.9% qoq / 28.9% yoy. **Healthcare & Lifesciences (21% of revenue)** grew by 13% qoq / 47.2% yoy. **Technology Companies (48.1% of revenue)** grew 7.9% qoq / 32% yoy

### Financial Summary

Y/E Mar (Rs mn)	FY 19	FY 20	FY21E	FY22E	FY23E
Net sales	33,659	35,658	41,879	55,986	66,639
EBITDA	5,506	4,923	6,830	9,381	11,408
Adjusted net profit	3,517	3,403	4,507	6,779	7,949
Free cash flow	7,821	(240)	6,329	5,898	8,563
EPS (Rs)	44.0	44.5	59.0	88.7	104.0
growth (%)	9%	1%	32%	50%	17%
P/E (x)	91.8	90.7	68.5	45.5	38.8
P/B (x)	91.8	90.7	68.5	45.5	38.8
EV/EBITDA (x)	56.8	61.8	43.8	31.5	25.4
ROCE (%)	12.5	10.2	14.1	18.4	19.1
RoE (%)	15.7	14.4	17.4	22.4	22.6
Dividend yield (%)	0.3	0.3	0.3	0.5	0.6

Source: Company

Please refer to our disclaimer given at the last page.

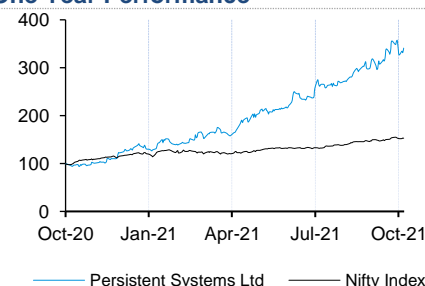
Rating	TP (Rs)	Up/Dn (%)
<b>BUY</b>	<b>5,200</b>	<b>29</b>

### Market data

Current price	Rs	4,038
Market Cap (Rs.Bn)	(Rs Bn)	309
Market Cap (US\$ Mn)	(US\$ Mn)	4,117
Face Value	Rs	10
52 Weeks High/Low	Rs	4390 / 1075
Average Daily Volume	('000)	382
BSE Code		533179
Bloomberg		PSYS.IN

Source: Bloomberg

### One Year Performance



Source: Bloomberg

% Shareholding	Sep-21	Jun-21
Promoters	31.26	31.26
Public	65.69	66.34
Others	3.05	2.40
<b>Total</b>	<b>100</b>	<b>100</b>

Source: BSE

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## Conference Call Key Takeaways

- **Offshore linear revenues** grew by 12.4% qoq, Volume grew 11.8% qoq and Billing Rate: 0.5% qoq
- **Onsite Linear Revenues** grew 6% qoq, Volume grew 8.9% qoq and Billing Rate: -2.7% qoq. Billing rate came down due to lower revenue from Europe (due to vacation period and lost billing days) and increase in billing from Mexico which has lower billing rate. Trajectory: looking at near-shore delivery over the last 3-4 quarters from countries such as Mexico and Canada. Although this quarter the onsite billing rate was down qoq but not to read too much into it, don't see much volatility.
- **Attrition measures:** developing own talent through lateral and freshers, upskilling, enhancing employee engagement, etc.
- **New initiative: ESOP** for 80% of the employee base and this will have **70-80 bps impact** but benefits from this initiative would offset the cost in the long term. This will be over and above the core compensation.
- **Changes in IP segment:** working on improving margins and revamped one major client contract to T&M which should aid margins going ahead. Going ahead: stable to slight growth in the medium term and decline in the longer run. This will have marginal revenue impact but will be margin accretive at the consolidated level. Seasonality should come down from Q4FY22 onwards.
- 230 bps impact of wage hike offset by increase in revenue and utilization
- SG&A is higher due to higher recruitment cost. Growth in revenue allowed to absorb higher cost
- **Margin improvement initiatives:** utilisation improvement, pyramid improvement, increasing billing rates as customers have been amenable and receptive to discussion and hiring freshers. Aspire to improve margins the tune of 100-150 bps over the next 2-3 years.
- Cash and Bank of INR 18,704 Mn. Gave loan of INR 188 Mn to ESOP trust to purchase shares from the secondary market
- Presence in product development industry as against ADAM and IMS ensures that deal wins are long term and steady in nature and therefore a good indication of revenue performance going ahead. Presence in software engineering, verticals and industries which are different from other domestic IT services companies, see strong demand for the next 2-3 years
- **Retention Cost impact:** See 1 or 2 quarters of pressure on margins due to supply crunch but tailwinds from fresher employee substitution should play after 2-3 quarters as they are deployed Retention costs may impact 30-40 bps on margins over the next 2 quarters

- No further impairments expected
- Target to hire 2500-3000 freshers over the next 1 year
- Travel should come back to 2/3<sup>rd</sup> of where it used to be so can increase by 15-20 bps qoq for the next 2-3 quarters

## Quarterly Performance Analysis

### Exhibit 1

YE March (Rs. Mn)	Q2 FY22	Q1 FY22	Q-o-Q change %	Q2 FY21	Y-o-Y change %	Q2 FY22 estimates	Deviation %
Net Sales (US\$ Mn)	182.3	166.8	9.3%	136	34.0%	179.6	1.5%
Net Sales (INR Mn)	13,512	12,299	9.9%	10,077	34.1%	13,303	1.6%
Less:							
Employees Remuneration & Benefits	10,092	9,128	10.6%	7,448	35.5%	9,815	2.8%
SG&A Expenses	1,177	1,156	1.8%	965	21.9%	1,290	(8.8%)
Total Operating Expenditure	11,269	10,284	9.6%	8,413	33.9%	11,105	1.5%
EBITDA	2,244	2,015	11.4%	1,664	34.8%	2,198	2.1%
EBIT	1,873	1,665	12.5%	1,224	53.0%	1,650	13.5%
Less: Depreciation	371	350	5.9%	440	(15.7%)	547	(32.3%)
Less: Interest	21	23	(7.4%)	14	47.5%	15	
Add: Other income	324	388	(16.5%)	165	96.5%	399	(18.8%)
Profit Before Tax	2,176	2,031	7.2%	1,375	58.3%	2,034	7.0%
Adjusted Profits	2,176	2,031	7.2%	1,375	58.3%	2,034	
Less: Total Tax	559	518	7.9%	355	57.3%	519	
PAT	1,618	1,512	6.9%	1,020	58.6%	1,515	6.8%
Adjusted PAT	1,618	1,512	6.9%	1,020	58.6%	1,515	6.8%
Reported Diluted EPS (Rs.)	21.2	19.8	6.9%	13.3	58.6%	19.8	
Adjusted Diluted EPS (Rs.)	21.2	19.8	6.9%	13	58.6%	19.8	6.8%
No of Shared Diluted (mn)	76	76		76		76	
<b>Margin Analysis %</b>			<b>Change in bps</b>		<b>Change in bps</b>		<b>Deviation in bps</b>
EBIT margin	13.9%	13.5%	32	12.1%	171	12.4%	146
EBIDTA Margin	16.6%	16.4%	22	16.5%	9	16.5%	9
NPM	12.0%	12.3%	(33)	10.1%	185	11.4%	58
Adjusted NPM	12.0%	12.3%	(33)	10.1%	185	11.4%	58
Effective Tax Rate %	25.7%	25.5%	16	25.8%	(16)	25.5%	16
<b>Cost Analysis %</b>			<b>Change in bps</b>		<b>Change in bps</b>		<b>Deviation in bps</b>
Employee Cost/Net Sales	74.7%	74.2%	47	73.9%	78	73.8%	91
SG&A/Net sales	8.7%	9.4%	(69)	9.6%	(87)	9.7%	(99)

Growth was broad-based across verticals and offerings.

EBITDA margin expanded 20 bps qoq despite a wage hike impact of 230 bps. Management has guided for a margin improvement of 100-150 bps over the next 2 years

Source: Dalal & Broacha Research, Company

## Valuation & Outlook

This is the 4<sup>th</sup> straight quarter of earnings surprise coupled with strong outlook and robust demand environment. Persistent is consistently signing strong deal wins which is not only evidence of the healthy pipeline but also a precursor to healthy performance going ahead.

While headwinds to margins such as higher retention costs and talent acquisition costs due to on-going supply crunch and from the ESOP initiative for 80% of the employees pressurize margins, management is confident of offsetting it through strong revenue growth, pyramid restructuring, renegotiating IP contracts and offshoring. On the contrary, management has guided for 100-150 bps margin expansion over the next 2-3 years.

We believe that Persistent will deliver industry-leading growth coupled with stable to positive margins over the next 2-3 years

Persistent is currently trading at 45.4x / 37.1x FY22e / FY23e EPS. Considering that midcap IT companies which are outperforming by delivering above industry average growth are trading in the 40-45x PE band, we believe that Persistent should command at least a 45x target multiple. Taking all the above factors into consideration, we recommend a BUY rating on the stock as we upgrade our EPS estimates from INR 80.9 / 90 to INR 88.7 / INR 104 and our applied multiple from 45x to 50x to arrive at target price of INR 5,200 (earlier TP INR 4,049).

# Financial

Profit & Loss A/c						Balance Sheet (Consolidated)					
YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E	YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E
<b>Net Sales</b>	<b>33,659</b>	<b>35,658</b>	<b>41,879</b>	<b>55,986</b>	<b>66,639</b>	<b>Liabilities</b>					
<i>Growth %</i>	<i>11.0%</i>	<i>5.9%</i>	<i>17.4%</i>	<i>33.7%</i>	<i>19.0%</i>	Equity Capital	791	764	764	764	764
<b>Total Revenue</b>	<b>33,659</b>	<b>35,658</b>	<b>41,879</b>	<b>55,986</b>	<b>66,639</b>	Reserves & Surplus	22,656	23,093	27,192	31,789	37,178
Employee Cost & Related Expenses	22,740	25,475	30,722	40,261	44,806	<b>Equity</b>	<b>23,447</b>	<b>23,858</b>	<b>27,957</b>	<b>32,553</b>	<b>37,942</b>
Miscellaneous Expenses	5,413	5,260	4,327	6,344	10,425	<b>Net Worth</b>	<b>23,447</b>	<b>23,858</b>	<b>27,957</b>	<b>32,553</b>	<b>37,942</b>
<b>Total Operating Expenditure</b>	<b>28,153</b>	<b>30,735</b>	<b>35,049</b>	<b>46,605</b>	<b>55,231</b>	<b>Total Loans</b>	<b>12</b>	<b>407</b>	<b>760</b>	<b>760</b>	<b>760</b>
<b>EBIDTA</b>	<b>5,506</b>	<b>4,923</b>	<b>6,830</b>	<b>9,381</b>	<b>11,408</b>	<b>Capital Employed</b>	<b>23,712</b>	<b>24,448</b>	<b>28,958</b>	<b>33,668</b>	<b>39,126</b>
<i>Growth %</i>	<i>18.2%</i>	<i>-10.6%</i>	<i>38.8%</i>	<i>37.3%</i>	<i>21.6%</i>	<b>Assets</b>					
Less: Depreciation	1,573	1,660	1,756	1,626	1,999	Gross Block	7,390	7,370	7,885	8,885	9,885
<b>EBIT</b>	<b>3,934</b>	<b>3,263</b>	<b>5,075</b>	<b>7,754</b>	<b>9,409</b>	Less: Depreciation	5,059	5,145	5,483	7,109	9,109
<i>Growth %</i>	<i>27.9%</i>	<i>-17.1%</i>	<i>55.5%</i>	<i>52.8%</i>	<i>21.3%</i>	<b>Net Block</b>	<b>2,331</b>	<b>2,225</b>	<b>2,401</b>	<b>1,775</b>	<b>776</b>
Interest Paid	3	63	58	74	0	<b>Investments</b>	<b>4,763</b>	<b>5,311</b>	<b>4,089</b>	<b>4,346</b>	<b>4,565</b>
Non-operating Income	933	1,324	1,078	1,436	1,333	Intangible Assets	1,980	1,661	1,315	1,759	2,093
<b>Profit Before tax</b>	<b>4,864</b>	<b>4,523</b>	<b>6,094</b>	<b>9,116</b>	<b>10,742</b>	Right of Use Assets		567	853	630	0
Tax	1,347	1,121	1,588	2,337	2,793	<b>Current Assets</b>					
<b>Net Profit</b>	<b>3,517</b>	<b>3,403</b>	<b>4,507</b>	<b>6,779</b>	<b>7,949</b>	Sundry Debtors	4,923	5,922	5,709	7,669	9,129
<b>Adjusted Profit</b>	<b>3,517</b>	<b>3,403</b>	<b>4,507</b>	<b>6,779</b>	<b>7,949</b>	Current Investments	3,296	5,165	6,375	7,278	7,997
<b>Reported Diluted EPS Rs</b>	<b>44.0</b>	<b>44.5</b>	<b>59.0</b>	<b>88.7</b>	<b>104.0</b>	Cash and Bank Balance	6,724	4,572	9,809	13,369	19,127
<i>Growth %</i>	<i>8.9%</i>	<i>1.3%</i>	<i>32.4%</i>	<i>50.4%</i>	<i>17.3%</i>	<b>Total Current Assets</b>	<b>19,064</b>	<b>20,032</b>	<b>26,838</b>	<b>34,503</b>	<b>42,950</b>
<b>Adjusted Diluted EPS Rs</b>	<b>44.0</b>	<b>44.5</b>	<b>59.0</b>	<b>88.7</b>	<b>104.0</b>	<b>Less: Current Liabilities &amp; Provisions</b>					
<i>Growth %</i>	<i>8.9%</i>	<i>1.3%</i>	<i>32.4%</i>	<i>50.4%</i>	<i>17.3%</i>	Sundry Creditors	1,517	2,247	2,733	3,703	4,388
						<b>Total Current Liabilities &amp; Provision:</b>	<b>4,844</b>	<b>6,474</b>	<b>7,697</b>	<b>10,894</b>	<b>13,103</b>
						<b>Capital Applied</b>	<b>23,712</b>	<b>24,448</b>	<b>28,958</b>	<b>33,668</b>	<b>39,126</b>
Key Ratios						Cash Flows (Consolidated)					
YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E	YE March (Rs. Mn)	FY19	FY20	FY21	FY22E	FY23E
<b>EBIDTA (%)</b>	<b>16.4%</b>	<b>13.8%</b>	<b>16.3%</b>	<b>16.8%</b>	<b>17.1%</b>	<b>PAT</b>	<b>3,517</b>	<b>3,403</b>	<b>4,507</b>	<b>6,779</b>	<b>7,949</b>
<b>NPM (%)</b>	<b>10.4%</b>	<b>9.5%</b>	<b>10.8%</b>	<b>12.1%</b>	<b>11.9%</b>	Add: Depreciation	1,573	1,660	1,756	1,626	1,999
<b>RoE (%)</b>	<b>15.7%</b>	<b>14.4%</b>	<b>17.4%</b>	<b>22.4%</b>	<b>22.6%</b>	Add: Interest Paid	3	63	58	74	0
<b>RoCE (%)</b>	<b>12.5%</b>	<b>10.2%</b>	<b>14.1%</b>	<b>18.4%</b>	<b>19.1%</b>	<b>Operating Profit before WC Changes</b>	<b>4,160</b>	<b>3,802</b>	<b>5,242</b>	<b>7,043</b>	<b>8,615</b>
<b>Tax Rate %</b>	<b>27.7%</b>	<b>24.8%</b>	<b>26.1%</b>	<b>25.6%</b>	<b>26.0%</b>	(Inc)/Dec in Current Assets	3,128	(3,119)	(1,569)	(4,105)	(2,689)
<b>Book Value Per share (Rs.)</b>	<b>293.1</b>	<b>312.2</b>	<b>365.8</b>	<b>425.9</b>	<b>496.5</b>	Inc/(Dec) in Current Liabilities	(145)	1,629	1,223	3,197	2,208
						<b>Net Cash Generated From Operations</b>	<b>7,143</b>	<b>2,312</b>	<b>4,897</b>	<b>6,135</b>	<b>8,135</b>
Valuation Ratios						<b>Cash Flow from Investing Activities</b>					
<b>P/E (x)</b>	<b>91.8x</b>	<b>90.7x</b>	<b>68.5x</b>	<b>45.5x</b>	<b>38.8x</b>	(Inc)/Dec in Fixed Assets	(66)	20	(515)	(1,000)	(1,000)
<b>EV/EBITDA</b>	<b>56.8x</b>	<b>61.8x</b>	<b>43.8x</b>	<b>31.5x</b>	<b>25.4x</b>	Add: Non Operating Income	933	1,324	1,078	1,436	1,333
<b>P/BV (x)</b>	<b>13.8x</b>	<b>12.9x</b>	<b>11.0x</b>	<b>9.5x</b>	<b>8.1x</b>	<b>Cash Flow from Investing Activities</b>	<b>(49)</b>	<b>406</b>	<b>2,098</b>	<b>(655)</b>	<b>(516)</b>
<b>Market Cap. / Sales (x)</b>	<b>9.5x</b>	<b>8.7x</b>	<b>7.4x</b>	<b>5.5x</b>	<b>4.6x</b>	<b>Cash Flow from Financing Activities</b>					
						Dividend Paid	(869)	(917)	(1,577)	(1,898)	(2,226)
						<b>Net Cash Flow from Financing Activities:</b>	<b>(2,783)</b>	<b>(4,303)</b>	<b>(1,472)</b>	<b>(2,143)</b>	<b>(2,490)</b>
						<b>Net Inc/Dec in cash equivalents</b>	<b>4,310</b>	<b>(1,585)</b>	<b>5,523</b>	<b>3,337</b>	<b>5,129</b>
						<b>Opening Balance</b>	<b>2,414</b>	<b>6,724</b>	<b>4,572</b>	<b>9,809</b>	<b>13,369</b>
						<b>Closing Cash Balance</b>	<b>6,724</b>	<b>5,139</b>	<b>10,095</b>	<b>13,146</b>	<b>18,498</b>
Free Cash Flow Analysis											
	<b>FY19</b>	<b>FY20</b>	<b>FY21E</b>	<b>FY22E</b>	<b>FY23E</b>						
<b>EBITDA</b>	<b>5,506</b>	<b>4,923</b>	<b>6,830</b>	<b>9,381</b>	<b>11,408</b>						
<b>Add: Depreciation Tax Shield</b>	<b>435</b>	<b>411</b>	<b>457</b>	<b>417</b>	<b>520</b>						
<b>Working Capital Changes</b>	<b>3,292</b>	<b>-4,473</b>	<b>1,144</b>	<b>-562</b>	<b>428</b>						
<b>Less: Inc in FC Investment</b>	<b>66</b>	<b>-20</b>	<b>515</b>	<b>1,000</b>	<b>1,000</b>						
<b>Taxes Paid</b>	<b>1,347</b>	<b>1,121</b>	<b>1,588</b>	<b>2,337</b>	<b>2,793</b>						
<b>Total Free Cash Flows</b>	<b>7,821</b>	<b>-240</b>	<b>6,329</b>	<b>5,898</b>	<b>8,563</b>						

Source: Dalal & Broacha Research, Company

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