

Strong revenue growth; adjusted margin disappoints

Information Technology ▶ Result Update ▶ July 20, 2024

TARGET PRICE (Rs): 4,150

Persistent posted yet another quarter of impressive revenue growth at 5.6% QoQ, above our est. of 5% QoQ. Growth was largely led by Healthcare followed by BFSI, while growth in Software, Hi-Tech, and Emerging Industries was again muted. Reported EBITM of 14% was a tad better than our expectations. But adjusted EBITM of 9.5% missed our estimate. Despite the weakness in adjusted EBITM in Q1, the mgmt. is confident of achieving flattish EBITM YoY in FY25, and has reiterated its medium-term target of a 200-300bps expansion in coming couple of years. The mgmt. is positive about sustaining revenue growth momentum backed by broad-based strong deal intake and deal pipeline. Growth is likely to be led by HLS, followed by BFSI and Hi-Tech. We tweak FY25-27E EPS by 0.2% to 2.2%, building in the Q1 performance. We hike target multiple to 36x (from 34x) to capture the strong revenue momentum and healthy deal intake. We retain REDUCE on the stock with TP of Rs4,150/sh at 36x Jun-26E EPS, as valuations remain rich even after a ~7% correction on 19-Jul-24.

Persistent Systems: Financial Snapshot (Consolidated)					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Revenue	83,506	98,216	116,360	136,815	160,621
EBITDA	15,191	16,757	19,721	24,416	29,275
Adj. PAT	9,211	10,935	13,266	16,748	20,625
Adj. EPS (Rs)	60.3	71.0	86.1	108.7	133.9
EBITDA margin (%)	18.2	17.1	16.9	17.8	18.2
EBITDA growth (%)	56.1	10.3	17.7	23.8	19.9
Adj. EPS growth (%)	33.4	17.8	21.3	26.2	23.1
RoE (%)	25.9	24.5	24.7	26.5	27.5
RoIC (%)	39.8	34.9	37.1	42.2	48.0
P/E (x)	76.1	64.6	53.2	42.2	34.2
EV/EBITDA (x)	45.4	41.2	34.8	27.8	22.8
P/B (x)	17.7	14.2	12.2	10.3	8.6
FCFF yield (%)	1.5	1.4	1.2	1.8	2.4

Source: Company, Emkay Research

Results Summary

Revenue grew 5.6% QoQ (similar in CC terms) to US\$328.2mn, above our estimates. Reported EBITM declined by 40bps QoQ to 14.0%, but adjusted for one-offs, EBITM stood at 9.5%, lower than our estimate of 13.7%. Margin was impacted by visa costs (-60bps), higher subcontracting costs related to ramp-up of recently won deals (-210bps), and higher SG&A costs (-70bps) and partially offset by higher utilization (90bps), operating efficiencies (90bps), incremental benefits from reversal of earn out credit related to prior acquisitions (60bps), change in useful life estimates of computer and networking assets (40bps), and net employee benefit rationalization (10bps). Revenue growth was led by HLS (16.5% QoQ; ~70% of incremental revenue) and BFSI (5.9%), while Software, Hi-Tech, and Emerging Industries saw a decline of 0.5% QoQ in revenue. Among geographies, North America (6.4% QoQ), Europe (5.6%), and India (2.4%) reported growth, while revenue for RoW (-10.3%) declined. **What we liked:** Strong revenue growth, healthy deal intake. **What we did not like:** Adjusted margin miss, weak cash conversion (OCF/EBITDA: 33.2%).

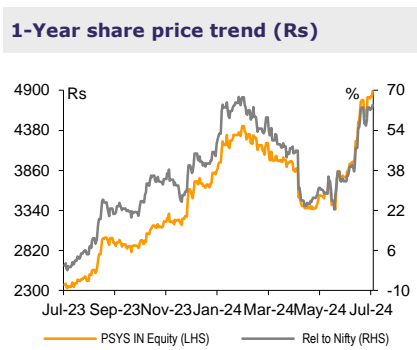
Earnings Call KTAs

i) The company announced wage hike wef Jul-24, with the gross impact expected at ~150-200bps, which will be partly negated by utilization, offshoring, and optimization of SG&A spends. ii) Europe revenue fell 7% YoY, partly due to decline in salesforce-related revenue and tail account rationalization linked with salesforce work. iii) The company's play in the AI domain has two broad vectors: AI for technology (transforming the way software is developed) and AI for business (transforming enterprises, from business model transformation, operational transformation and data, to insights and action, customer experience, and leveraging GenAI). iv) As Persistent embarks on a US\$2bn journey, it has spawned two company-wide initiatives – revenue enhancement (focus on enhancing service offerings and approach in mining strategic accounts), and cost optimization (benchmarking policies wrt the industry's best-in-class). Though some policies will provide one-time benefit, most are aimed at structurally balancing the cost base while enabling the right investment to fuel the company's growth aspirations. v) Growth in Healthcare was backed by a large deal but was more broad-based. New leaders and continued investment in the sector grant confidence to the management about its growth journey in Healthcare. vi) One-off benefits (earn out credit reversal; reversal of long service accrual award; change in depreciation policy) of 450bps in Q1 EBITM.

Target Price – 12M	Jun-25
Change in TP (%)	6.4
Current Reco.	REDUCE
Previous Reco.	REDUCE
Upside/(Downside) (%)	(9.5)
CMP (19-Jul-24) (Rs)	4,583.5

Stock Data	Ticker
52-week High (Rs)	4,929
52-week Low (Rs)	2,317
Shares outstanding (mn)	154.1
Market-cap (Rs bn)	706
Market-cap (US\$ mn)	8,440
Net-debt, FY25E (Rs mn)	-20,732
ADTV-3M (mn shares)	1
ADTV-3M (Rs mn)	2,709.9
ADTV-3M (US\$ mn)	32.4
Free float (%)	66.0
Nifty-50	24,531
INR/US\$	83.7
Shareholding, Jun-24	
Promoters (%)	31.0
FPIs/MFs (%)	22.6/28.2

Price Performance			
(%)	1M	3M	12M
Absolute	19.3	18.0	78.4
Rel. to Nifty	14.3	6.5	44.2



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Exhibit 1: Quarterly snapshot

(Rs mn)	Q1FY25	Q4FY24	QoQ (%)	Q1FY24	YoY (%)
Net sales (US\$ mn)	328.2	310.9	5.6	282.9	16.0
Net sales	27,372	25,905	5.7	23,212	17.9
Operating expenses	22,820	21,362	6.8	19,468	
EBITDA	4,552	4,544	0.2	3,743	21.6
Margins (%)	16.6	17.5	-90	16.1	50
Depreciation	712	799		763	
EBIT	3,840	3,744	2.6	2,980	28.9
Margins (%)	14.0	14.5	-40	12.8	120
Other income	165	210		91	
Pre-tax profit	4,005	3,955	1.3	3,070	30.4
Tax provided	941	802		783	
Profit after tax	3,064	3,153	-2.8	2,288	
Emkay Net profit	3,064	3,153	-2.8	2,288	33.9
EPS (Rs)	19.9	20.5	-2.8	14.9	33.8

Source: Company, Emkay Research

Exhibit 2: Actuals vs estimates

(Rs mn)	Actual	Estimates		Variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenues (US\$ mn)	328.2	326.4	325.2	0.5%	0.9%	Revenue came slightly above our expectations
Sales	27,372	27,225	27,120	0.5%	0.9%	
EBIT	3,840	3,739	3,775	2.7%	1.7%	
EBIT margin	14.0%	13.7%	13.9%	30 bps	10 bps	Reported EBITM was ahead of our expectations, while adjusted EBITM missed estimates.
PAT	3,064	2,958	3,016	3.6%	1.6%	Profit was better than expectations due to a beat on EBIT and lower ETR.

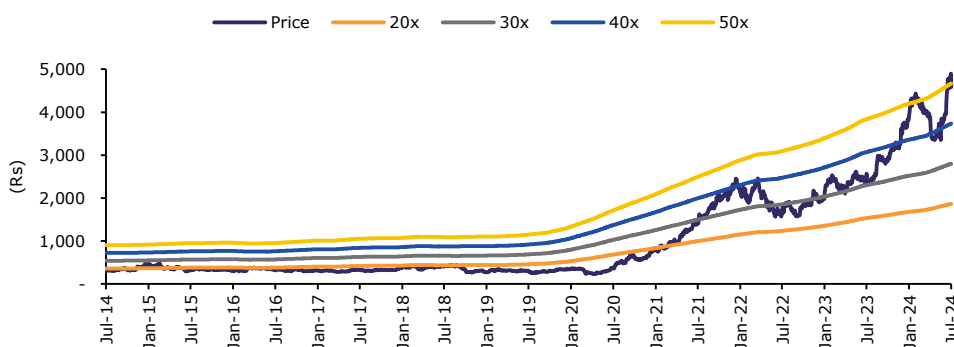
Source: Company, Bloomberg, Emkay Research

Exhibit 3: Changes in estimates

(Rs mn)	FY25E			FY26E			FY27E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenues (US\$ mn)	1,364.3	1387.6	1.7%	1,582.5	1609.6	1.7%	1,836.2	1867.7	1.7%
YoY growth	15.0%	17.0%		16.0%	16.0%		16.0%	16.0%	
Revenue	114,407	116,360	1.7%	134,509	136,815	1.7%	157,914	160,621	1.7%
EBIT	16,695	16,758	0.4%	21,241	21,178	-0.3%	25,425	25,835	1.6%
EBIT margins (%)	14.6	14.4		15.8	15.5		16.1	16.1	
Net profit	13,138	13,266	1.0%	16,723	16,748	0.2%	20,180	20,625	2.2%
EPS (Rs)	85.3	86.1	1.0%	108.6	108.7	0.2%	131.0	133.9	2.2%

Source: Company, Emkay Research

Exhibit 4: PSYS – One-year forward PER



Source: Company, Emkay Research

Persistent Systems: Consolidated Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Revenue	83,506	98,216	116,360	136,815	160,621
Revenue growth (%)	46.2	17.6	18.5	17.6	17.4
EBITDA	15,191	16,757	19,721	24,416	29,275
EBITDA growth (%)	56.1	10.3	17.7	23.8	19.9
Depreciation & Amortization	2,719	3,094	2,963	3,238	3,440
EBIT	12,472	13,663	16,758	21,178	25,835
EBIT growth (%)	54.6	9.5	22.7	26.4	22.0
Other operating income	0	0	0	0	0
Other income	706	1,280	1,439	1,725	2,269
Financial expense	473	467	497	422	419
PBT	12,705	14,476	17,700	22,481	27,685
Extraordinary items	(297)	0	0	0	0
Taxes	3,198	3,541	4,433	5,733	7,060
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	9,211	10,935	13,266	16,748	20,625
PAT growth (%)	33.4	18.7	21.3	26.2	23.1
Adjusted PAT	9,211	10,935	13,266	16,748	20,625
Diluted EPS (Rs)	60.3	71.0	86.1	108.7	133.9
Diluted EPS growth (%)	33.4	17.8	21.3	26.2	23.1
DPS (Rs)	25.0	26.0	31.5	40.0	49.0
Dividend payout (%)	41.5	36.6	36.6	36.8	36.6
EBITDA margin (%)	18.2	17.1	16.9	17.8	18.2
EBIT margin (%)	14.9	13.9	14.4	15.5	16.1
Effective tax rate (%)	25.2	24.5	25.0	25.5	25.5
NOPLAT (pre-IndAS)	9,333	10,321	12,561	15,778	19,247
Shares outstanding (mn)	76.4	154.1	154.1	154.1	154.1

Source: Company, Emkay Research

Cash flows					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
PBT	12,705	14,476	17,700	22,481	27,685
Others (non-cash items)	4,635	3,202	1,918	1,720	1,395
Taxes paid	(3,405)	(3,414)	(4,433)	(5,733)	(7,060)
Change in NWC	(4,377)	(2,052)	(2,557)	(2,831)	(3,295)
Operating cash flow	9,558	12,213	12,627	15,637	18,725
Capital expenditure	(4,321)	(2,791)	(4,509)	(3,280)	(2,680)
Acquisition of business	(4,311)	(2,074)	0	0	0
Interest & dividend income	539	597	1,046	1,519	2,045
Investing cash flow	(4,213)	(4,695)	(13,136)	4,239	(635)
Equity raised/(repaid)	0	1,608	0	0	0
Debt raised/(repaid)	(514)	(2,414)	(1,000)	(700)	0
Payment of lease liabilities	(545)	(760)	0	0	0
Interest paid	0	0	0	0	0
Dividend paid (incl tax)	(2,981)	(4,084)	(4,853)	(6,162)	(7,548)
Others	(545)	(1,047)	0	0	0
Financing cash flow	(4,039)	(5,937)	(5,853)	(6,862)	(7,548)
Net chg in Cash	1,305	1,581	(6,362)	13,013	10,542
OCF	9,558	12,213	12,627	15,637	18,725
Adj. OCF (w/o NWC chg.)	13,935	14,265	15,184	18,468	22,020
FCFF	5,237	9,423	8,118	12,357	16,045
FCFE	5,302	9,553	8,666	13,453	17,671
OCF/EBITDA (%)	62.9	72.9	64.0	64.0	64.0
FCFE/PAT (%)	57.6	87.4	65.3	80.3	85.7
FCFF/NOPLAT (%)	56.1	91.3	64.6	78.3	83.4

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Share capital	764	770	770	770	770
Reserves & Surplus	38,887	48,807	57,221	67,807	80,884
Net worth	39,651	49,577	57,991	68,577	81,654
Minority interests	0	0	0	0	0
Deferred tax liability (net)	(1,129)	(1,341)	(1,341)	(1,341)	(1,341)
Total debt	4,285	2,073	1,073	373	373
Total liabilities & equity	42,807	50,309	57,723	67,610	80,687
Net tangible fixed assets	4,860	4,420	4,224	4,140	4,240
Net intangible assets	9,171	4,575	3,945	2,890	1,940
Net ROU assets	2,198	2,307	2,449	2,630	2,720
Capital WIP	0	0	0	0	0
Goodwill	7,184	10,913	11,713	11,713	11,713
Investments [JV/Associates]	0	0	0	0	0
Cash & equivalents	15,428	18,495	21,806	28,819	39,360
Current assets (ex-cash)	26,059	31,332	35,143	41,140	48,118
Current Liab. & Prov.	22,256	22,067	21,857	24,022	27,706
NWC (ex-cash)	3,803	9,265	13,286	17,118	20,413
Total assets	42,807	50,309	57,723	67,610	80,687
Net debt	(11,143)	(16,421)	(20,732)	(28,446)	(38,987)
Capital employed	42,807	50,309	57,723	67,610	80,687
Invested capital	27,378	31,815	35,918	38,791	41,326
BVPS (Rs)	259.4	321.8	376.4	445.2	530.1
Net Debt/Equity (x)	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)
Net Debt/EBITDA (x)	(0.7)	(1.0)	(1.1)	(1.2)	(1.3)
Interest coverage (x)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	33.1	32.1	33.7	36.5	37.9

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
P/E (x)	76.1	64.6	53.2	42.2	34.2
P/CE(x)	57.3	50.3	43.5	35.3	29.3
P/B (x)	17.7	14.2	12.2	10.3	8.6
EV/Sales (x)	8.3	7.0	5.9	5.0	4.2
EV/EBITDA (x)	45.4	41.2	34.8	27.8	22.8
EV/EBIT(x)	27.2	25.5	40.9	32.0	25.8
EV/IC (x)	12.4	21.7	19.1	17.5	16.1
FCFF yield (%)	1.5	1.4	1.2	1.8	2.4
FCFE yield (%)	1.5	1.4	1.2	1.9	2.5
Dividend yield (%)	0.5	0.6	0.7	0.9	1.1
DuPont-RoE split					
Net profit margin (%)	11.4	11.1	11.4	12.2	12.8
Total asset turnover (x)	2.1	2.1	2.2	2.2	2.2
Assets/Equity (x)	1.1	1.0	1.0	1.0	1.0
RoE (%)	25.9	24.5	24.7	26.5	27.5
DuPont-RoIC					
NOPLAT margin (%)	11.2	10.5	10.8	11.5	12.0
IC turnover (x)	4.3	3.6	3.3	3.4	3.7
RoIC (%)	39.8	34.9	37.1	42.2	48.0
Operating metrics					
Core NWC days	16.6	34.4	41.7	45.7	46.4
Total NWC days	16.6	34.4	41.7	45.7	46.4
Fixed asset turnover	2.7	3.0	3.5	3.9	4.3
Opex-to-revenue (%)	81.8	82.9	83.1	82.2	81.8

Source: Company, Emkay Research

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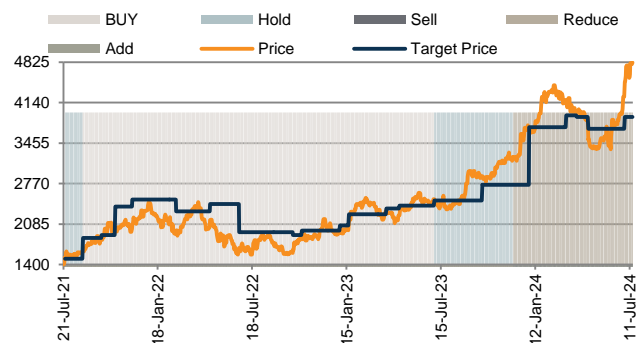
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RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
01-Jul-24	4,496	3,900	Reduce	Dipeshkumar Mehta
09-Jun-24	3,850	3,700	Reduce	Dipeshkumar Mehta
03-Jun-24	3,426	3,700	Reduce	Dipeshkumar Mehta
27-May-24	3,737	3,700	Reduce	Dipeshkumar Mehta
22-Apr-24	3,509	3,700	Reduce	Dipeshkumar Mehta
31-Mar-24	3,985	3,900	Reduce	Dipeshkumar Mehta
11-Mar-24	4,117	3,925	Reduce	Dipeshkumar Mehta
01-Mar-24	4,300	3,725	Reduce	Dipeshkumar Mehta
23-Jan-24	4,127	3,725	Reduce	Dipeshkumar Mehta
31-Dec-23	3,695	3,725	Reduce	Dipeshkumar Mehta
30-Nov-23	3,200	2,750	Reduce	Dipeshkumar Mehta
20-Oct-23	2,954	2,750	Hold	Dipeshkumar Mehta
02-Oct-23	2,898	2,750	Hold	Dipeshkumar Mehta
21-Jul-23	2,375	2,485	Hold	Dipeshkumar Mehta
02-Jul-23	2,506	2,485	Hold	Dipeshkumar Mehta
26-Apr-23	2,236	2,400	Buy	Dipeshkumar Mehta
01-Apr-23	2,305	2,350	Buy	Dipeshkumar Mehta
19-Jan-23	2,129	2,250	Buy	Dipeshkumar Mehta
02-Jan-23	2,014	2,063	Buy	Dipeshkumar Mehta
21-Oct-22	1,833	1,975	Buy	Dipeshkumar Mehta
04-Oct-22	1,649	1,900	Buy	Dipeshkumar Mehta
22-Jul-22	1,816	1,950	Buy	Dipeshkumar Mehta
23-Jun-22	1,684	1,950	Buy	Dipeshkumar Mehta
28-Apr-22	2,154	2,425	Buy	Dipeshkumar Mehta
01-Apr-22	2,361	2,300	Buy	Dipeshkumar Mehta
15-Mar-22	2,163	2,300	Buy	Dipeshkumar Mehta
22-Feb-22	1,964	2,300	Buy	Dipeshkumar Mehta
11-Feb-22	2,098	2,500	Buy	Dipeshkumar Mehta
22-Jan-22	2,151	2,500	Buy	Dipeshkumar Mehta
01-Jan-22	2,452	2,500	Buy	Dipeshkumar Mehta
30-Nov-21	2,069	2,500	Buy	Dipeshkumar Mehta
28-Oct-21	1,994	2,385	Buy	Dipeshkumar Mehta
02-Oct-21	1,822	1,900	Buy	Dipeshkumar Mehta
30-Sep-21	1,858	1,850	Buy	Dipeshkumar Mehta
13-Sep-21	1,794	1,850	Buy	Dipeshkumar Mehta
27-Aug-21	1,627	1,850	Buy	Dipeshkumar Mehta
24-Jul-21	1,520	1,500	Hold	Dipeshkumar Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Company, Bloomberg, Emkay Research

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ADD	5-15% upside
REDUCE	5% upside to 15% downside
SELL	<15% downside

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