ANANDRATHI

India I Equities

Technology

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

28 October 2021

Persistent Systems

Growth outperforms while margin gap to industry reduces further; Buy

Rating: Buy
Target Price: Rs.4,650
Share Price: Rs.4,007

Persistent had another strong quarter with 9.3% q/q growth, 34% y/y. IT Services reached 88% of revenue; hence, we are not segregating the IP division performance. Recent acquisitions will add steam in Q3. TCV peaked in Q3 FY21 and has since been steady (Q3 is seasonally strong; hence, a clearer picture will emerge). The EBITDA margin was down 40bps q/q due to wage hikes, expected to be 16-17%. We raise our estimates 0-6%, and our target to Rs4650, 45x FY23, in line with peers. EBITDA/PAT growth is likely to continue outperforming the industry as the margin gap narrows further. We maintain a Buy.

Everything firing up together. Persistent is capitalising on its positioning in the three growth verticals (no exposure to laggard verticals). The SW/Hi-tech vertical is growing 32% (42% excl. the top client), Healthcare 47% and BFSI 29%. The top client has started growing in the last two quarters. TCV was up 15% q/q and is now just 6% off the peak in Q3 (which is seasonally strong). ACV trends suggest 1.5 years as tenure of deals, which lends visibility to FY23.

Margin gap with industry narrowing. PSYS has narrowed its margin gap to the industry from 4-5% in FY21 to ~2% now. It expects ~100-150bp margin expansion in the next six quarters as it catches up with peers. This is likely to be driven by slightly better revenue productivity (utilisation or resource re-allocation from IP to Services) and by leveraging fixed costs, given high growth rates. This would result in higher EBITDA/PAT growth as has been the case LTM-basis. Headcount is up 47% y/y and the company is looking to build a global delivery model through near-shore locations. It expects to build a bigger presence in Europe (now subscale and unable to fully capture demand).

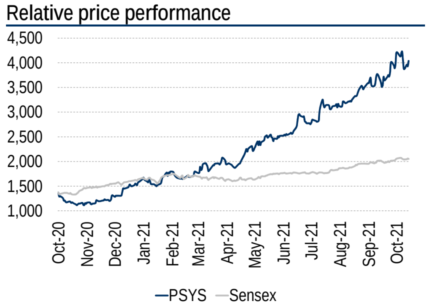
Estimates raised; target higher. After the strong Q1, we raise our estimates further, building in 33% growth in FY22 and 22% in FY23. EBITDA margins are likely to be steady with FY23 margins on par with FY21, absorbing the acquisition impact and re-opening costs. This will translate to a 28% EBITDA CAGR over FY21-23. We value the company at 45x FY23. **Risk:** Supply-side challenges.

Key data	PSYS IN / PERS.BO
52-week high / low	Rs4390 / 1075
Sensex / Nifty	61143 / 18211
3-m average volume	$15.4m
Market cap	Rs309bn / $4113.3m
Shares outstanding	76m

Shareholding pattern (%)	Sep'21	Jun'21	Mar'21
Promoters	31.3	31.3	31.3
- *of which, Pledged*	-	-	-
Free float	68.7	68.7	68.7
- Foreign institutions	19.3	19.4	19.3
- Domestic institutions	27.9	29.2	29.6
- Public	21.6	20.1	19.9

Estimates revision (%)	FY22e	FY23e
Sales ($)	2.0	3.8
EBITDA	0.4	4.6
PAT	0.1	6.4

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Sales (Rs m)	33,659	35,658	41,879	55,893	68,364
Net profit (Rs m)	3,517	3,403	4,507	6,911	7,895
EPS (Rs)	44.1	44.5	59.0	90.4	103.3
P/E (x)	87.7	90.7	68.5	44.6	39.1
EV / EBITDA (x)	49.7	58.6	42.3	30.8	25.9
P/BV (x)	13.2	12.9	11.0	9.4	8.1
RoE (%)	15.7	14.4	17.4	22.7	22.2
RoCE (%)	16.0	11.6	15.9	22.0	23.1
Dividend yield (%)	1.0	1.0	0.3	0.6	0.9
Net debt / equity (x)	-0.4	-0.4	-0.6	-0.4	-0.5

Source: Company, Anand Rathi Research

Mohit Jain
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Revenues (US$m)	481.0	501.6	566.1	755.0	922.4
Growth (%)	2.2	4.3	12.9	33.4	22.2
Net revenues (Rs m)	33,659	35,658	41,879	55,893	68,364
Employee & Direct Costs	19,874	21,934	26,468	36,158	44,861
Gross Profit	13,785	13,724	15,411	19,735	23,504
Gross Margin %	40.96	38.49	36.80	35.31	34.38
SG&A	7,980	8,795	8,581	10,350	12,348
EBITDA	5,805	4,930	6,830	9,386	11,156
EBITDA margins (%)	17.2	13.8	16.3	16.8	16.3
- Depreciation	1,573	1,660	1,756	1,513	1,809
Other income	631	1,254	1,020	1,449	1,300
Interest Exp					
PBT	4,863	4,523	6,094	9,322	10,647
Effective tax rate (%)	28	25	26	26	26
+ Associates/(Minorities)					
Net Income	3,517	3,403	4,507	6,911	7,895
WANS	80	76	76	76	76
FDEPS (Rs/share)	44.1	44.5	59.0	90.4	103.3

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19e	FY20e	FY21	FY22e	FY23e
Share capital	791	764	764	764	764
Net worth	23,447	23,858	27,957	32,881	38,112
Total debt (including Pref)	12	46	44	44	-
Minority interest					
DTL/(Asset)	-405	-960	-1,038	-1,038	-1,038
Capital employed	23,054	22,944	26,963	31,888	37,075
Net tangible assets	2,331	2,791	3,254	3,925	3,770
Net Intangible assets	1,595	1,435	1,230	4,555	4,912
Goodwill	81	89	86	86	86
CWIP (tangible and intangible)	316	303	122	122	122
Investments (Strategic)	4,346	4,621	3,621	3,621	3,621
Investments (Financial)	3,296	5,165	6,375	8,287	10,774
Current Assets (ex Cash) Incl L	9,462	10,985	11,121	14,552	17,334
Cash	6,724	4,572	9,809	5,926	6,758
Current Liabilities (ex ST Loan/	5,098	7,018	8,654	9,188	10,301
Working capital	4,365	3,967	2,467	5,365	7,032
Capital deployed	23,054	22,944	26,963	31,888	37,075
Contingent Liabilities	299	247	506	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY19e	FY20e	FY21	FY22e	FY23e
PBT	4,863	4,523	6,094	9,322	10,647
+ Non-cash items	1,155	1,402	1,269	204	669
Operating profit before WC cha	6,018	5,925	7,363	9,526	11,316
- Incr./(decr.) in WC	290	1,369	-1,578	2,898	1,668
Others incuding taxes	-1,405	-1,328	-1,582	-2,411	-2,752
Operating cash-flow	4,323	3,228	7,359	4,216	6,896
- Capex (tangible + Intangible)	374	746	1,251	2,562	1,281
Free cash-flow	3,949	2,482	6,108	1,654	5,615
Acquisitions	148	435	448	2,948	729
- Dividend (including buyback &	1,588	2,978	1,070	1,986	2,664
+ Equity raised	-	-	-	-	-
+ Debt raised	-5	38	4	-	-44
- Fin Investments	2,245	-515	4,084	1,912	2,486
- Misc. Items (CFI + CFF)	-4,050	1,774	-4,726	-1,309	-1,140
Net cash-flow	4,310	-2,151	5,236	-3,883	832

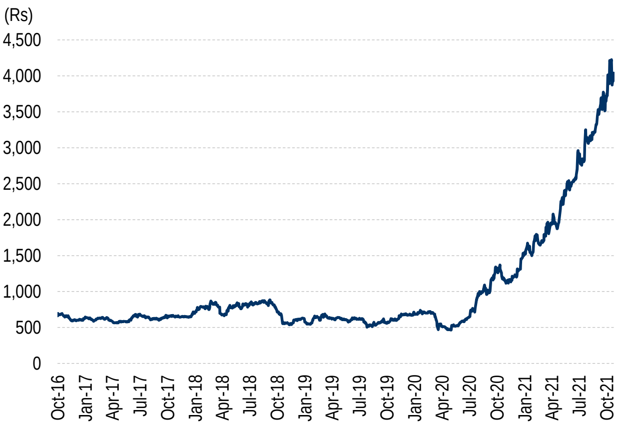
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY19	FY20	FY21	FY22e	FY23e
P/E (x)	87.7	90.7	68.5	44.6	39.1
EV/EBITDA (x)	49.7	58.6	42.3	30.8	25.9
EV/sales (x)	8.87	8.38	6.98	5.27	4.26
P/B (x)	13.2	12.9	11.0	9.4	8.1
RoE (%)	15.7	14.4	17.4	22.7	22.2
RoCE (%) - After tax	16.0	11.6	15.9	22.0	23.1
RoIC (%) - After tax	30.8	25.3	39.0	46.3	40.8
DPS (Rs per share)	41.4	39.0	14.0	26.0	34.8
Dividend yield (%)	1.0	1.0	0.3	0.6	0.9
Dividend payout (%) - Inc. DDT	93.9	87.5	23.7	28.7	33.7
Net debt/equity (x)	-0.4	-0.4	-0.6	-0.4	-0.5
Receivables (days)	73	82	69	72	72
Inventory (days)					
Payables (days)	20	27	28	27	26
CFO:PAT%	122.9	94.9	163.3	61.0	87.3
FCF:PAT% - includ M&A payou	116.5	85.7	145.5	66.6	80.4

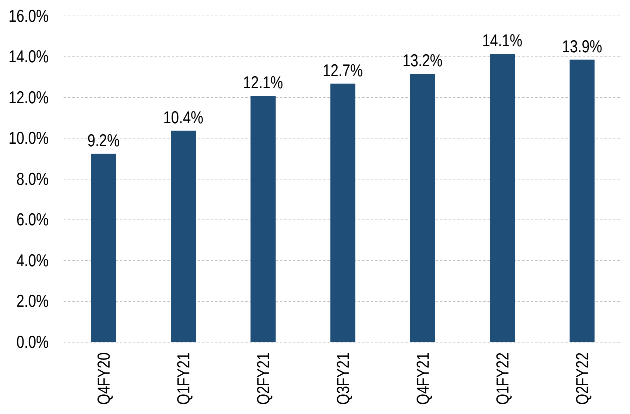
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBIT margins



Source: Company, Anand Rathi Research

Result Highlights

Q2 FY22 Results at a Glance

Fig 7 – Segment-wise results

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q/Q	Y/Y
Revenue ($ m)	136	146	153	167	182	9.3%	34.0%
Growth Y/Y %	8.4%	12.2%	18.7%	27.3%	34.0%		
Industry Y/Y % (est.)	2%	3%	6%	20%	21%		
Revenue (Rs m)	10,077	10,754	11,134	12,299	13,512	9.9%	34.1%
Effec. exchange rate	74.1	73.6	72.9	73.7	74.1	0.5%	0.1%
TCV($ m)	225.0	302.0	246.5	244.8	282.5	15.4%	25.6%
TCV(LTM)		827.0	961.0	1,018.3	1,075.8	5.6%	NA
Y/Y %			119%	31%	26%		
TCV:Rev.	1.7	2.1	1.6	1.5	1.5		
Employees (EoP)	10,820	12,438	13,680	14,904	15,879	6.5%	46.8%
Rev. prod. ($ '000/employee)	12.6	12.6	11.7	11.7	11.8	1.5%	-5.8%
Utilisation % (IT Services)	81.2%	81.0%	79.1%	80.1%	82.8%	270 bps	160 bps
Attrition %	10.6%	10.3%	11.7%	16.6%	23.6%	700 bps	1300 bps
CoR (excl. D&A)	(6,577)	(7,064)	(7,363)	(8,173)	(8,982)	9.9%	36.6%
As % of revenue	-65%	-66%	-66%	-66%	-66%	-2 bps	-121 bps
SG&A	(1,843)	(1,865)	(1,887)	(2,037)	(2,287)	12.2%	24.1%
As % of revenue.	-18%	-17%	-17%	-17%	-17%	-36 bps	137 bps
EBITDA	1,658	1,825	1,883	2,089	2,244	7.4%	35.4%
EBITDA margins %	16.4%	17.0%	16.9%	17.0%	16.6%	-38 bps	16 bps
EBIT	1,218	1,364	1,464	1,739	1,873	7.7%	53.8%
EBIT margins %	12.1%	12.7%	13.2%	14.1%	13.9%	-27 bps	178 bps
Industry margins % (est.)	16.2%	17.8%	17.6%	16.8%	16.2%	-62 bps	-1 bps
Other income (excl. forex)	208	288	211	183	293	60.1%	41.0%
Non-recurring / Forex	(51)	(2)	174	109	10	-90.5%	NM
Interest expenses							
PBT	1,375	1,650	1,849	2,031	2,176	7.2%	58%
PBT margins %	13.6%	15.3%	16.6%	16.5%	16.1%	-40 bps	246 bps
Taxes	(355)	(441)	(471)	(518)	(559)	7.9%	57%
ETR %	-26%	-27%	-25%	-26%	-26%	-16 bps	16 bps
Associates / Minority							
Net income	1,020	1,209	1,378	1,512	1,618	6.9%	59%
Net margins %	10.1%	11.2%	12.4%	12.3%	12.0%	-33 bps	185 bps
Industry net margins %	12.5%	13.4%	12.6%	13.8%	13.5%	-36 bps	95 bps
EPS (Rs)	13.3	15.8	18.0	19.8	21.2		

Source: Company, Anand Rathi Research

Fig 8 – Quarterly result

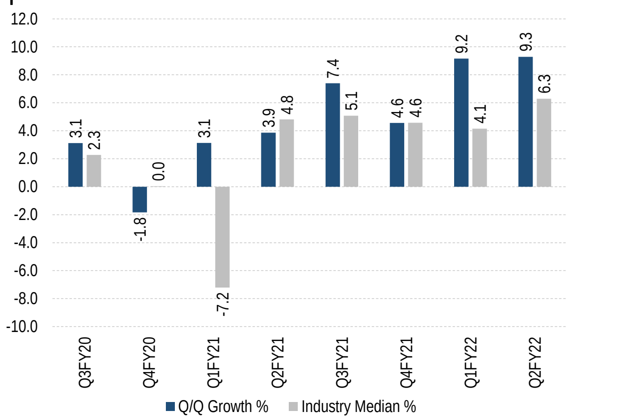
Year-end: Mar (Rs m)	Q2FY22	% chg. Q/Q	% chg. Y/Y	H1 as a % of FY22	FY21	FY21 % chg. Y/Y	FY22e % chg. Y/Y
Sales ($ m)	182	9.3	34.0	46%	566	12.9	33.4
Sales	13,512	9.9	34.1	46%	41,879	17.4	33.5
EBITDA	2,244	7.4	35.4	46%	6,830	38.6	37.4
EBITDA margin (%)	17	-38bps	16bps	-	16	248bps	48bps
EBIT	1,873	7.7	53.8	46%	5,075	55.2	55.1
EBIT margin (%)	14	-27bps	178bps	-	12	295bps	197bps
PBT	2,176	7.2	58.3	45%	6,094	34.7	53.0
Tax	(559)	7.9	57.3	45%	(1,588)	41.7	51.9
Tax rate (%)	(26)	-16bps	16bps	-	(26)	-128bps	18bps
Net income	1,618	6.9	58.6	45%	4,507	32.4	53.3

Source: Company, Anand Rathi Research

PSYS growing fast, beats estimates

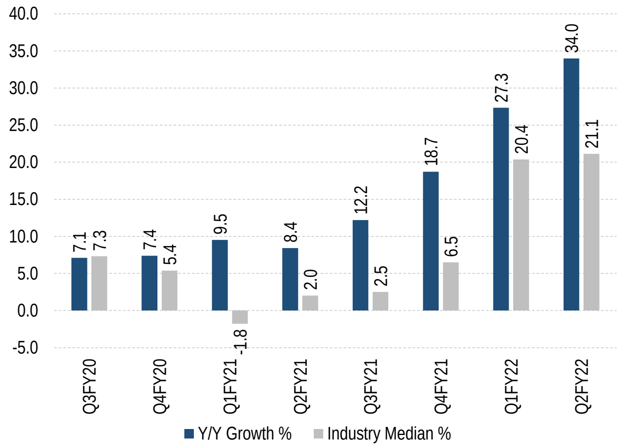
Persistent grew fast in Q2 as well, beating estimates and industry growth rates by a margin. In Q2 FY22, it grew 9% sequentially and has been at par or above the industry median growth for the previous four quarters after Q2 FY21. From a y/y perspective, it delivered 34% revenue growth, matching Mindtree's growth in midcap IT space. However, Mindtree had the benefit of lower base of FY21 (Rev growth was -1%) while Persistent is delivering it on a solid base of FY21 (Rev growth was +13%), making FY22 growth more significant. The y/y growth has been accelerating for the past 4 quarters and the company has been ahead of industry growth for last 7 quarters, thereby suggesting a healthy mix of deals and ramp ups – something also visible in the client buckets.

Fig 9 – Grew faster than industry for fourth consecutive quarter



Source: Company, Anand Rathi Research

Fig 10 – Consistently growing faster than industry

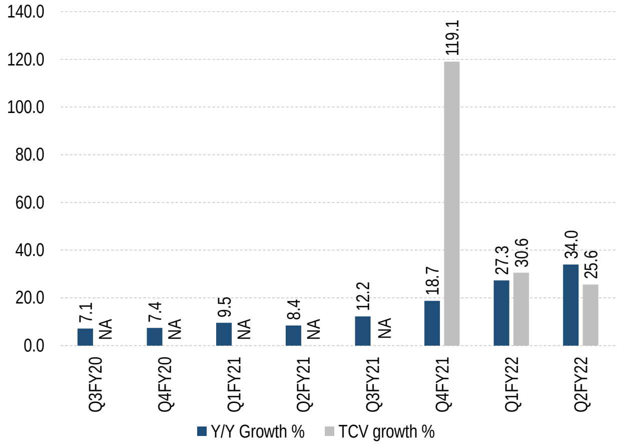


Source: Company, Anand Rathi Research Note:

On the TCV front, it had a good quarter q/q with Q2 at $282.5m (y/y comparison not available), compared to $244.8m in Q1. The company closed on a large deal of $50m in BFSI vertical in Q2. It is also seeing a good mix of short-medium and longer-tenure deals. Over the last 4 quarters, its average tenure has moved up from 1.2 years to 1.4 years, which lends visibility for growth in FY23 as well.

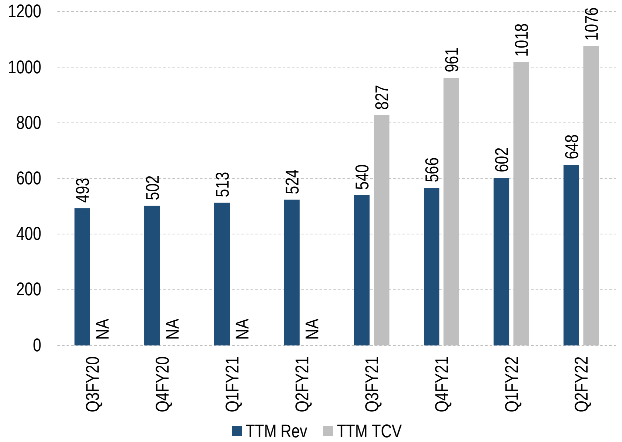
Unlike some of the peers who have stated that TCV may not represent the growth ahead as deals are tilting towards shorter ones, PSYS believes that it has not observed such a trend in its deal pipeline (ACV flattish for last three quarters) yet and hence, total TCV is a good representation of revenues and growth ahead. PSYS started disclosing deal data from 3QFY21, prior periods data used below are extrapolated from rev trends and commentary.

Fig 11 – TCV y/y and revenue y/y growth



Source: Company, Anand Rathi Research Note:

Fig 12 – TCV growing faster than revenue



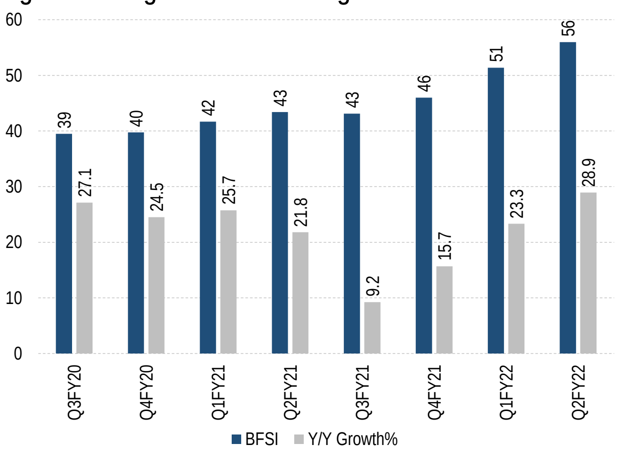
Source: Company, Anand Rathi Research Note:

Strong play on growth sectors - Hi-tech, BFSI and Healthcare accelerate on growth

Persistent, from a vertical exposure perspective, operates in three verticals: Hi-tech (48% of revenue), BFSI (31%) and Healthcare (21%). Interestingly, BFSI is the largest vertical for Indian IT where PSYS is trying to establish itself as a strong challenger (~$200m p.a. rev, growing at 30%). It has few large US banks as its clients and is also expanding base in India in this vertical. In Q2 BFSI continue to accelerate on growth, the company won a large deal of $50m+ spread over 5 years

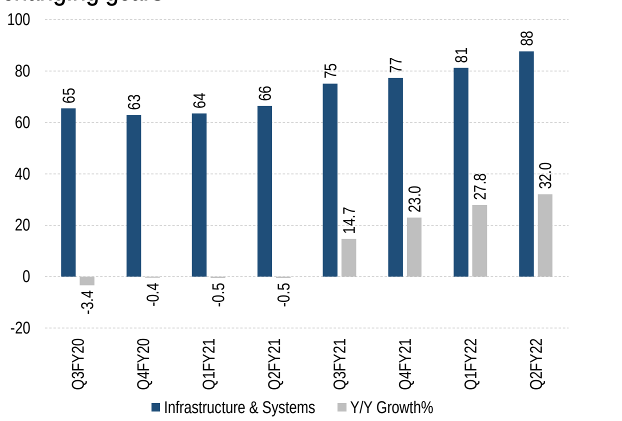
The other two are high growth verticals for Indian IT. PSYS's Hi-Tech vertical recorded growth of 30%+ in 2Q and the outlook remains strong with more ISVs looking for partners in their quest to time-efficient and cost-efficient development cycles. PSYS has also seen growth in its top client (which used to be a drag till Q2FY21) accelerating in the last few quarters with Q2 growth at 9% q/q and 17%y/y. In FY22, it is likely to reach previous highs of FY17/18 in terms of absolute revenues. Excluding top client, Hi-Tech has grown at 42% y/y. PSYS won 3 deals in this vertical in Q2.

Fig 13 – BFSI growth accelerating



Source: Company, Anand Rathi Research

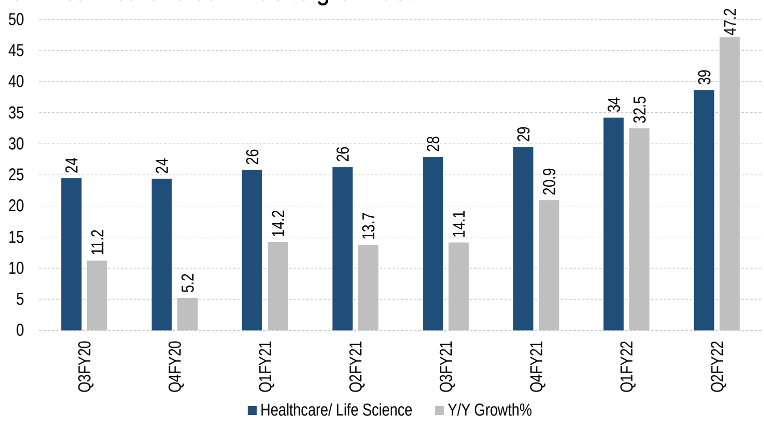
Fig 14 – Software, Hi-tech & Emerging Industries vertical changing gears



Source: Company, Anand Rathi Research Note:

On the Healthcare & Life Sciences vertical, Persistent has been delivering good growth and is expected to continue to grow faster than the company. During Q2 the company closed three deals in this vertical.

Fig 15 – Healthcare to continue to grow fast



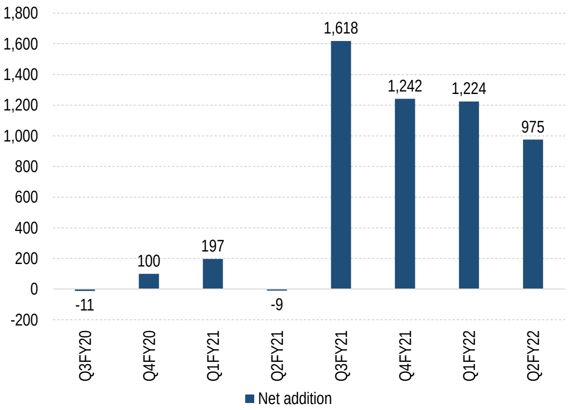
Source: Company, Anand Rathi Research Note:

Supply side challenges impacted margins in 2Q; productivity improves

Persistent added 2,199 employees in the last six months, despite which it achieved higher utilization of 82.8% in Q2 FY22 from 79.1% in Q4 FY21. Hiring was a little lower in this quarter sequentially (as has been the case with many companies in the sector) despite accelerating revenue growth y/y and steady growth q/q. As of Q2, it has increased its technical headcount by 47%, forcing the company to buy another facility in Pune in Q2. The company shared that is targeting to hire 2,500-3,000 freshers over the next one year. On the margin side, it was able to improve margins by 16bps y/y (decline of 38bps q/q) in Q2, absorbing the cost escalations by way of strong growth, higher offshore and higher utilization.

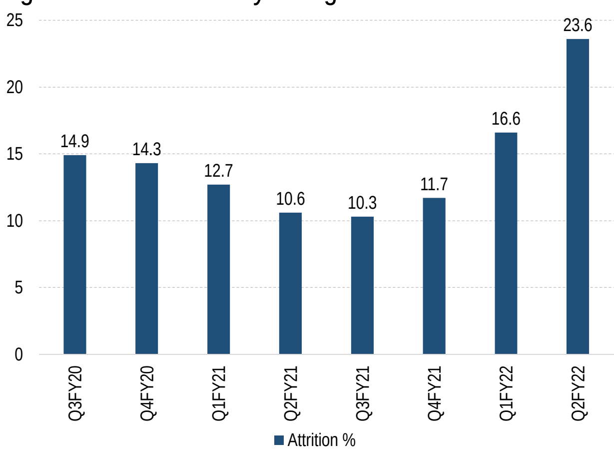
Attrition, on the other hand, has reached 23.6% (a four-year high). To retain the employee base, the company has approved an ESOP plan which covers ~80% of the employee base. This should impact margins by 70-80bps but the company is confident it will offset the impact over time.

Fig 16 – Net additions slows, turning towards adding freshers



Source: Company, Anand Rathi Research

Fig 17 – Attrition at four year high

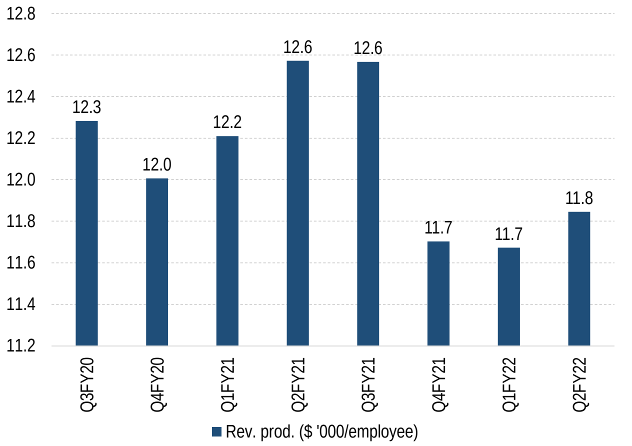


Source: Company, Anand Rathi Research Note:

From an employee productivity perspective, PSYS is approximately 6% lower than in the recent past but has started improving from last quarter.

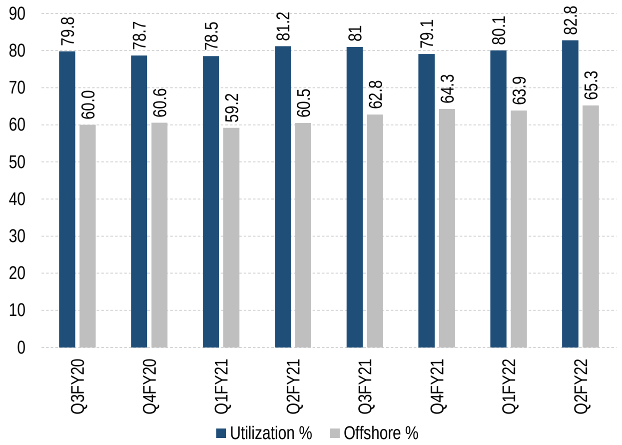
The company had to offer some discounts (onsite billing rates moved lower around 4QFY21), had near-shore delivery coming into picture which typically has lower rates, and also moved to lower utilization in 4Q on account of capacity build up.

Fig 18 – Productivity improves after stagnating for 2 quarters



Source: Company, Anand Rathi Research Note:

Fig 19 – Utilization and Offshore (at highs



Source: Company, Anand Rathi Research Note:

This in addition to offshore shift resulted into lower productivity from Q4FY21. PSYS also has historically enjoyed better billing rates but gets diluted in productivity due to 3% (by effort) extra offshore that the company has compared to peers. Company expects utilization to be in the range of 83-84% and we don't see much scope of increase in offshore delivery. Persistent, therefore, will mostly rely on SG&A leverage to cover up on the margin gap with peers. LTI and MTCL both operate ~20% EBITDA margins versus PSYS at 16-17%. Company has guided for 100bps better margins ahead. Also, it highlighted that IP-led revenues are operating at lower-than company average margins and could partially bridge the gap between PSYS and peers. To this effect, PSYS will convert one large IP-led contract into a T&M contract from 4QFY22.

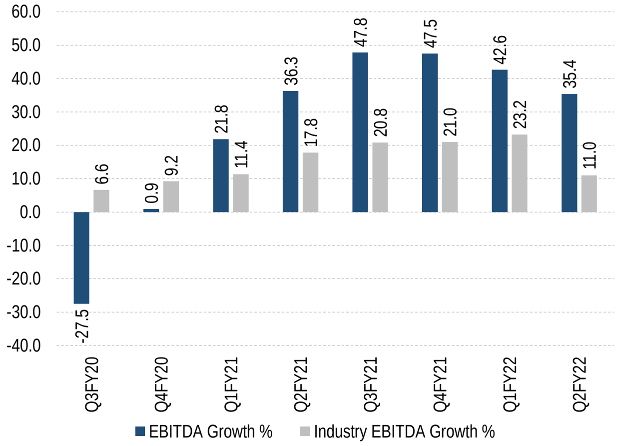
Healthy EBIDTA/NI growth

PSYS delivered 35% y/y EBITDA growth in Q2 FY22 and 39% in H1 FY22, way ahead of the industry. Y/Y basis, it has expanded margins 16bps to 16.6% in Q2 FY22 and intends to improve margins by 100-150bps over the next 8-10 quarters. The acquired entities will be integrated from 3Q and are margin accretive at the gross level. Travel costs had an impact of 15bps in Q2 and could add 15bps each quarter if travel continues to open up.

PSYS is also looking at ESOP cost impact of 70-80bps in margins but still expects its margins to hold up at current levels. The company is also in negotiation with some clients for better billing rates which would be another and strongest lever for margin expansion ahead. Despite all the challenges, the company has done well in terms of margins over the last year and its EBITDA growth is still way above industry average and marginally below that of Mindtree (+40% y/y).

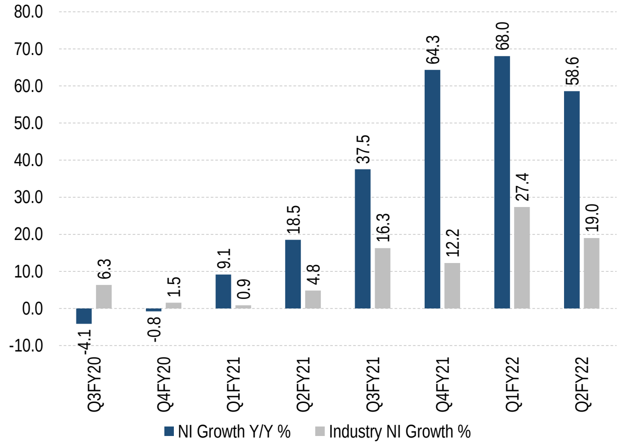
NI grew 59% in Q2 while NI margins expanded 185bps y/y.

Fig 20 – EBITDA growth continue to be higher than industry



Source: Company, Anand Rathi Research

Fig 21 – NI growth continue to be higher than industry



Source: Company, Anand Rathi Research Note:

In terms of client metrics, Persistent has scaled up well to $5m+ clients with LTM addition of 6 clients (on a base of 16 to reach 22 by Q2FY22), up from 5 added in the previous period (LTM till Q2FY21). In addition, maximum success came in mid-sized client ($1m+) base which increased by 21 to reach 84 by 4Q. In comparison, smaller clients have not grown with the same momentum. Thereby, company also saw increase in average tenure of deals signed.

Conference Call Highlights

Q2 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth after a long time.
- Growth in Q2 was led by Healthcare and Life sciences, followed by BFSI and Hi-tech.
- Returned to normal wage hike (Jul) and Q2 saw the full impact (230bps gross), cushioned by growth and utilisation.
- ESOP plan introduced, which covers 80% of employees, in addition to their packages. ESOP scheme to have an impact of 70-80bps on margins; over time this should be offset.
- Acquisition of SCI and Shree Partners in September; no cost or revenue from these two in Q2. The company is evaluating more tuck-in M&As.
- On the IP business, it is working on optimizing margins and has converted a long-standing contract to a T&M one, which should boost margins and not have any seasonality. This will see some additional resources being released and re-deployed to Services or having more billability. In both the scenarios, margins should improve.
- The drop in the billing rate onsite was due to lower revenue from Europe (essentially due to seasonality) and an increase in revenue from Mexico which typically comes at a lower rate than the US.
- SG&A was higher due to more recruitment expenses although revenue growth aided in covering this. We expect operating leverage ahead.
- Supply-side challenges and attrition would pressure margins but the company expects to navigate these challenges.
- DSO was 55 days compared to 54 in Q1.
- It won a deal with a third-party insurance administrator (an existing customer). The TCV exceeds $50m over five years.
- In Healthcare, it won two deals with a contract-research organization and a leading US healthcare provider among other deals
- In Hi-tech the company was chosen by an employee engagement solutions organization and leading tax preparation and financial technology provider amongst other deals
- Management has plans to go bigger in the US, Canada and Mexico for near-shore delivery. This will help it build a more global delivery model.
- Management is seeing a healthy demand environment. TCV is a good representation of revenue ahead.
- Deals are a good mix of short-medium term and medium term.
- Expect 83-84% utilization.
- No further impact from impairments.
- IP business to be stable for some time and decline over a long tail, steep declines behind the company now.
- Acquisitions to have an impact of 30-40bps over two quarters on EBIT but should be manageable. At the gross margin level, acquisitions are accretive.

- Travel expense had a 10-15bp impact in Q2; if travel continues to open up, it expects this to increase 15bps each quarter.
- Its Europe business was hit by attrition in Q2, or it would have seen growth otherwise. In the medium term, this should move to 10-15% of revenue.
- The IP business has healthy margins; higher than the company average

Business Outlook

- Goal of a $1bn run rate to be achieved in 6-8 quarters. This will mostly be through organic growth but some inorganic growth like that in Q2 could be added. Looking for capability acquisitions in cloud, data, security or salesforce.
- Q2 margins sustainable; expect margins of 16-17%.
- Margins to improve 100-150bps over the next 8-10 quarters

Q1 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth in the history of the company. Growth was broad based in Q1. Sureline Systems was integrated during the quarter but was small.
- Attrition is an area of focus and measures are in place to bring it down. These measures are better employee engagement, flexible work hours, intake of fresh graduates and upskilling of employees. FY22 returned to a normal wage-hike cycle; hence, wage hikes were given in July.
- Integration of Capiotis is progressing well. IP and business assets of Sureline acquired in Q1. These acquisitions will enhance Persistent's abilities in cloud migration. The company is evaluating M&A targets.
- H1 B visas had an impact of 50bps on margins in Q1 FY22. Gross margin down due to seasonality. Reported G&A for the quarter includes impairment in one of the start-up investments, resulting in a ~60bp impact.
- D&A down as one product completed amortization in Q4.
- Capiot contributed a further $0.5m q/q
- Travel expenses to return gradually; expect 30-40bps increase in travel expenses in the next few quarters. For the quarter, visa expenses are included.
- Wage hike to impact margins by 250-275bps at the gross level; expect levers to absorb most of it; the net impact should not be more than 75-100bps (net impact) in Q2.
- Sub-contracting costs to go down as travel opens up.
- As soon as Covid-19 restrictions are lifted, expect near shore centers and more presence onsite. It is a lever ahead.
- Pricing power with a few customers, most clients are under competitive pricing, limiting scope for increases.
- Added 400 freshers in Q1; for the year looking at adding 2,000. Overall headcount to continue to increase.
- Billing rate moved up in Q1

- Europe growth will not see volatility as it moved to net accounting on the reseller-revenues part of the business.
- Evaluating 3-4 tuck-in acquisitions; hope to announce something in Q2.

Q4 FY21 concall takeaways

- Overcame seasonality in Q4 for the first time in the last 5 years. The company had a q/q growth as Services generated strong growth.
- Order booking TCV was $246.5m ($302m in Q3), ACV was $200.7m.
- Full effect of pay hike seen in Q4, wagesto be hiked in July.
- Continue to scout for acquisitions in focus areas, expect an update in Q1FY22
- BFSI – chosen by a large insurance company
- Healthcare – chosen by a leading health system and a global leading CRO
- Software, Hitech and emerging industries –chosen by a leading technology company (a five-year multi-million dollar deal) and a low code provider. Also, won a deal from a top-25 ISV.
- S&M investments to be in line with current percentage of sales
- Deals to be of TCV $10m-15m(larger ones), deal termsof 1-5 years, bigger deals in the range of 3-5 years
- Next quarter expects a benefit of 50bps from amortization and D&A to then stabilise.
- Expect TCV of $200m - $215meach quarter on average
- Client mining now in focus, expect figures to reflect this in the next 2-3 quarters
- Freshers hiring to be little higher than usual (800-1000 annually).
- Overall Services business to grow 3.5-4% q/q.
- Alliance business to get back to growth trajectory in FY22.
- EBITDA margin ahead to be close to 16-17%.

Factsheet

Fig 22 – Revenue split

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Effort-Led	83.8	81.9	85.1	86.9	87.5
IP-Led	16.2	18.1	14.9	13.1	12.5

Source: Company, Anand Rathi Research

Fig 23 – Revenue-split, by region

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
North America	82.9	81.1	79.2	78.9	78.7
Europe	7.6	8.8	10.0	9.5	8.8
Asia-Pacific	9.5	10.1	10.8	11.6	12.5

Source: Company, Anand Rathi Research

Fig 24 – Revenue-split, by industry

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
BFSI	32	30	30	31	31
Healthcare	19	19	19	21	21
Infrastructure & Systems	49	51	51	49	48

Source: Company, Anand Rathi Research

Fig 25 – Client profiles (LTM)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Client profiling					
Top 1	19.4	18.5	17.9	17.0	16.9
Top 5	41.6	37.8	36.4	36.5	35.8
Top 10	50.5	47.0	46.3	46.7	45.4
$1m+	63	65	66	76	84
$5m+	16	17	17	21	22
Active Clients (effort based)	487	530	558	568	596

Source: Company, Anand Rathi Research

Fig 26 – Workforce

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Employee Movement					
Technical(EOP)	10,001	11,533	12,706	13,833	14,657
Net Adds (Qtr)	-26	1,532	1,173	1,127	824
Net Adds (LTM)	275	1,804	2,871	3,806	4,656
Utilization %	81.2	81.0	79.1	80.1	82.8
Attrition %	10.6	10.3	11.7	16.6	23.6
Sales(EOP)	268	277	273	308	296
Net Adds (Qtr)	(6)	9	(4)	35	(12)
Net Adds (LTM)	(17)	11	10	34	28

Source: Company, Anand Rathi Research

Fig 27 – Revenue-split, by segment ($ m)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Technology Services	105.2	111.5	120.7	NA	NA
Alliance	30.9	34.6	32.1	NA	NA

Source: Company, Anand Rathi Research

Fig 28 – Revenue-split, by delivery type and billing rates

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Delivery Type(%)					
On-site	39.5	37.2	35.7	36.1	34.7
Offshore	60.5	62.8	64.3	63.9	65.3
Reported Billing Rates ($ /hr)					
On-site	90.9	89.8	88.8	90.9	88.5
Offshore	23.0	22.5	22.5	22.9	23.0

Source: Company, Anand Rathi Research

Fig 29 – Key areas and horizontals growth (%)

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Key Area-wise Growth (Y/Y)					
North America	10.4	14.3	18.8	24.9	27.2
Europe	(16.8)	(6.3)	36.7	18.6	55.1
Asia-Pacific	18.4	22.6	18.1	57.1	76.3
Segment Growth (Y/Y)					
Effort-Led	17.2	16.4	20.4	33.9	39.9
IP-Led	(21.8)	(3.4)	10.1	(3.9)	3.2
Growth, by vertical (Y/Y)					
BFSI	21.8	9.2	15.7	23.3	28.9
Healthcare	13.7	14.1	20.9	32.5	47.2
Infrastructure & Systems	(0.5)	14.7	23.0	27.8	32.0
Horizontals Growth (Q/Q)					
Technology Services	4.1	6.0	8.3	NA	NA
Alliance	3.0	12.1	(7.3)	NA	NA

Source: Company, Anand Rathi Research

Fig 30 – TCV Data

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Net New TCV $ m	150	176	138	148	149
Total TCV	225	302	247	245	283

Source: Company, Anand Rathi Research

Valuations

At the ruling price, the stock trades at a P/E of 39x FY23e and EV/ EBITDA of 26x FY23e. FY21 grew 13%, with practically no impact from the pandemic. Revenues are likely to touch $755m by FY22, and $922m by FY23 incl. the two acquisitions. The EBIT margin is expected to expand from 12.1% in FY21 to 13.7% in FY23.

IP sales were down 8% in FY21 and we expect them to be soft as the management focus has shifted to building the Services business. The company's reliance on its top client has come down to 18.4% in FY21 (16.9% in Q2 FY22) from 22% in FY20. The RedHat/Persistent partnership is boosting Services revenue from the top client. This will help Persistent reduce the drag from the top client. In the last two quarters, the top client has started contributing to the growth of the company and is no longer a drag. Management is expecting the Alliance business to return to a growth trajectory in FY22.

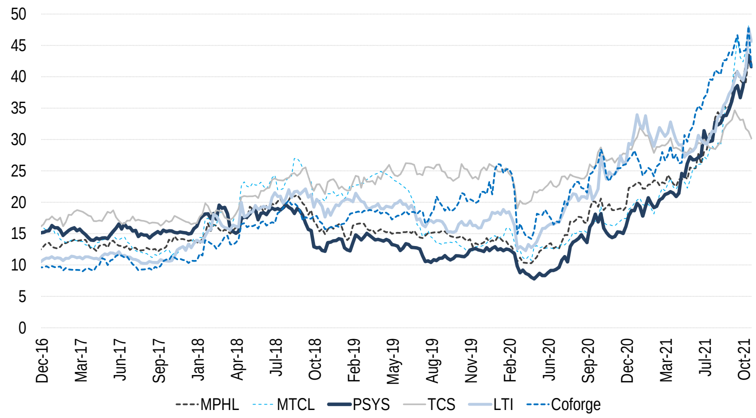
We value the stock based on a target PE of 45x FY23e EPS, previously 44x FY23e, in line with Mphasis on the very strong growth execution. This reflects Persistent's focus on building the BFSI business faster, bulking up from inorganic initiatives as well. The target multiple reflects the reducing exposure to its top client (thereby, reducing volatility) and its improving execution and track record in growth. The constraints related to Persistent's evolving client metrics will further ease as the company scales up many client relationships to large deals (beyond the $5m-band now). Reflecting these, we are valuing it at a similar multiple as Mphasis.

Fig 31 – Change in estimates

(Rs m)	FY22			FY23		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	755	740	2.0	922	889	3.8
Revenues	55,893	54,733	2.1	68,364	65,825	3.9
EBITDA	9,386	9,346	0.4	11,156	10,664	4.6
EBITDA margins %	16.8%	17.1%	-31 bps	16.3%	16.2%	12 bps
EBIT	7,873	7,706	2.2	9,347	8,727	7.1
EBIT margins %	14.1%	14.1%	-1 bps	13.7%	13.3%	37 bps
PBT	9,322	9,317	0.1	10,647	10,017	6.3
Net profit	6,911	6,902	0.1	7,895	7,421	6.4

Source: Anand Rathi Research

Fig 32 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Supply-side challenges.

Appendix

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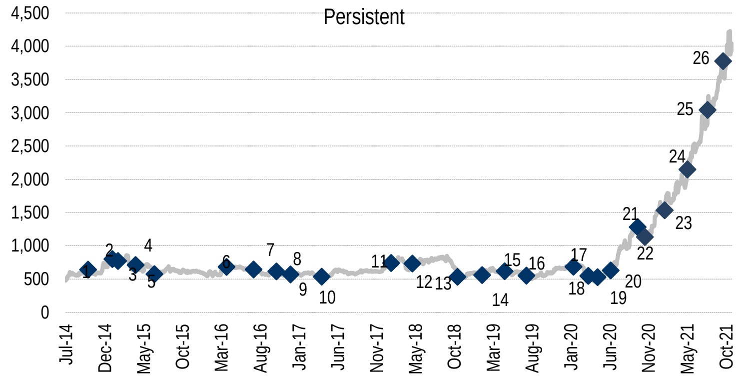

	Date	Rating	TP (Rs)	Share Price (Rs)
13	23-Oct-18	Buy	820	560
14	29-Jan-19	Buy	760	565
15	30-Apr-19	Hold	700	565
16	26-Jul-19	Hold	630	552
17	31-Jan-20	Sell	690	704
18	31-Mar-20	Buy	670	704
19	07-May-20	Buy	630	503
20	29-Jun-20	Hold	680	627
21	15-Oct-20	Sell	940	1,369
22	27-Oct-20	Sell	960	1,187
23	01-Feb-21	Sell	1,270	1,526
24	02-May-21	Hold	2,050	2,038
25	26-Jul-21	Hold	3,290	3,040
26	01-Oct-21	Buy	4,275	3,716

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