

19 November 2020

Persistent Systems – BUY

CMP : Rs.1,138.0
Target Price : Rs.1,365.0
Upside : 20%+
Stop Loss : Rs.995.0 (Closing basis)

Investment Thesis

Recently, the stock price of Persistent Systems Ltd. (Persistent Systems) corrected by ~18.0% from 52-week high of Rs.1,390.60 despite the company had minimal impact due to Covid-19 and reported better-than-expect numbers in the recent quarters.

Persistent System has better vertical mix as compare to other Indian peers and had minimal impact on IT business due to Covid-19 outbreak. Its customers are spread across geographies including the US, Europe and India, which diversified business structure and minimizes impact due to Covid-19. Although there are near term challenges to growth owing to Covid-19, we believe in its strategy of delivering profitable growth in tough environment. We believe Persistent Systems is well placed to bounce back post Covid-19 pandemic led by better vertical mix thereby faster recovery in terms of IT spending as well as significant growth opportunities in Technology Services and Allied Services. We believe, ramp up in new deal wins and strong client addition will help Persistent Systems to attain long term sustainable growth going ahead.

Persistent Systems has unique business model divided mainly into two business segments. Technology services segment includes services like IP led revenues, product Engineering services, Platform based solutions and other specialized services. Its Services vertical includes ADM, Cloud transformations, Business Analytics, IoT and other digital business transformations services. Its technology services segment (77.1% of revenue) has been consistently growing despite a tough environment led by large accounts mining and sales re-organisation. Persistent Systems continue to focus on the BFSI, healthcare and life-science verticals and expects growth momentum in these verticals to continue in the medium term due to strong deal wins, new logo and a healthy deal pipeline.

Financials

- During the past 5 years, revenue of Persistent Systems grew at a CAGR of 13.5% while PAT grew at a CAGR of 3.2% in the same period.

| Consol. (Rs.Mn.) | FY18 | FY19 | FY20 | FY21E | FY22E |
|------------------|--------|--------|--------|--------|--------|
| Revenue | 30,337 | 33,659 | 35,658 | 41,007 | 47,158 |
| EBITDA | 4,517 | 5,489 | 4,923 | 5,661 | 6,510 |
| % growth | -2.9 | 21.5 | -10.3 | 15.0 | 15.0 |
| PAT | 3,231 | 3,517 | 3,403 | 3,712 | 4,265 |
| EPS (INR) | 40.4 | 44.4 | 44.5 | 48.6 | 55.8 |
| P/E (x) | 28.2 | 25.6 | 25.6 | 23.5 | 20.4 |
| RoE (%) | 15.3% | 15.0% | 14.4% | 14.4% | 15.0% |

- Persistent Systems has reported 1.7% QoQ growth in revenue in rupee term to Rs.10,077mn in Q2FY21 led by 5.3% QoQ increase in services revenues partially offset by 3.0% QoQ decline in IP led revenues.

Stock Data

| | |
|-----------------------|------------------|
| Market Cap (Rs. Mn) | 86,972 |
| Market Cap (\$ Mn) | 1,165.4 |
| Shares O/S (in Mn) | 76.4 |
| Avg. Volume (3 month) | 2,26,000 |
| 52-Week Range (Rs.) | 1,390.60/ 420.05 |

Shareholding Pattern

| | |
|-------------------------------|--------|
| Promoters | 31.29% |
| FIIIs | 18.74% |
| Institutions | 28.87% |
| Others (incl. body corporate) | 21.10% |

| Performance (%) | 1M | 6M | 1Yr |
|-----------------|--------|--------|-------|
| Absolute | -11.2% | 121.7% | 87.6% |
| BSE IT | -3.4% | 56.2% | 42.6% |

Key Ratios

| | |
|---------------|--------|
| Div Yield | 1.1% |
| TTM PE | 23.9x |
| ROE | 14.3% |
| TTM EPS (Rs.) | 47.6/- |

- Persistent Systems' greater than US\$5 million clients has increased by five over the past two quarters led by its focus on mining existing clients and winning multi-year large deals.
- In terms of verticals, Persistent Systems' growth was led by technology & emerging vertical (up 4.5% QoQ) and financial services (up 4.2% QoQ).

Key Business Highlights

- Persistent Systems offers specialized services in cloud computing, digitisations, business analytics and other related services. With an experienced management team, it continues to focus on increasing wallet share from existing clients.
- Persistent Systems helps enterprises to transform their business to software-driven business in North America, Europe and Asia. It has moved away from effort-based business (low growth prospects) to value-based business (high growth prospects and better margins).
- Persistent Systems focus is supported by its strategy of aggressively emphasis on digital business, increasing its efforts on IP and non-linear revenue through the IBM partnership along with allied deal wins and reducing its focus on linear revenue.

Valuation

- Digital is an important part of Persistent Systems future growth journey with revenue from digital business is growing ~24% CAGR over FY18-21. Persistent Systems is witnessing strong traction in digital transformation demand where clients are looking at custom built development on newer technology. The company is targeting overall double-digit revenue growth for FY22E on account of healthy traction in Digital business, especially in Healthcare and BFSI. The company's strategy is to focus on IP-led offerings, digital transformation, software-based services and large enterprise accounts for its future growth. The management has articulated that data, digital and IoT are the key elements for building digital solutions for its customers in the Healthcare, Financial, Industrial and Manufacturing verticals.
- Persistent Systems provides services to three main verticals viz BFSI, Healthcare and Life Science and Technology and Technologies & Emerging verticals. BFSI Verticals is having maximum contribution to the revenue (32% to the top line). Healthcare is the second largest vertical (contributes 20% to the top line). The remaining revenues are distributed among Technologies & other emerging verticals. Persistent Systems has better vertical mix as compare to other Indian peers. BFSI is one of the fastest growing vertical and seen robust demand for digital transformation and cloud. Healthcare vertical also seen the robust demand after the global pandemic. We believe better vertical mix will help Persistent Systems to generate long term sustainable growth.
- With minimal impact on IT business due to Covid-19 outbreak, unique business model and better product mix, focus on Digital is an important part of future growth journey and BFSI is one of the fastest growing vertical & seen robust demand for digital transformation, we value Persistent Systems at 24.5x FY22E EPS of Rs.55.80 to arrive at target price of Rs.1,365.00, an upside of ~20%.

Risk & Concern

- Any fluctuations in the currencies will impact the revenue of Persistent Systems as majority of the revenue comes from offshore business.
- Increase in Visa fees will increase the cost. Any rise in the visa fees will lead to rise in the operating cost of Persistent Systems.
- Any change in the economic climate / legislation against Indian offshore development in the countries where Persistent Systems provides its services.

Graphs & Charts

Figure 1: Net Sales Trend

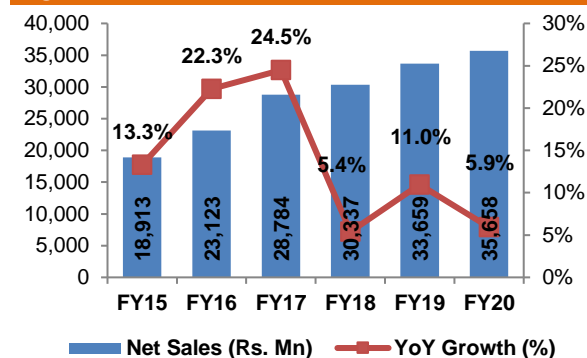


Figure 2: EBITDA & EBITDA Margin Trend

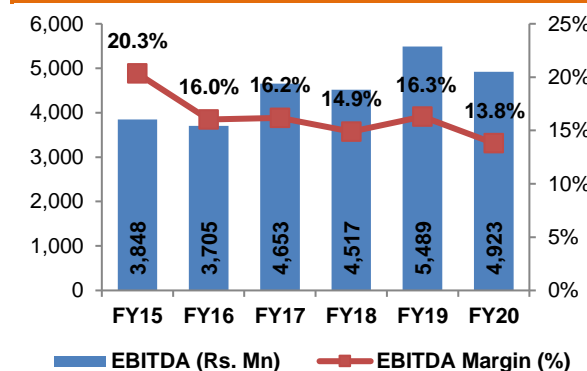


Figure 3: PAT Trend

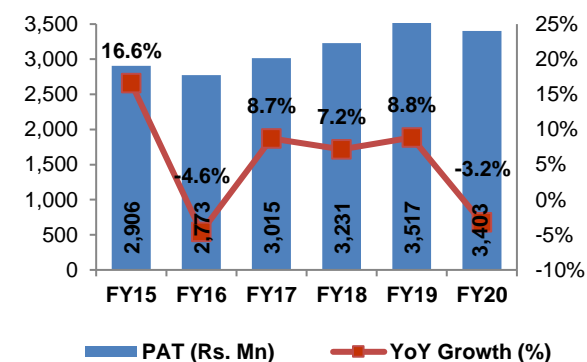
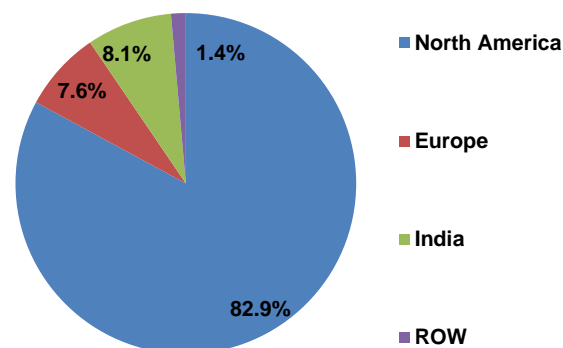


Figure 4: Geography-wise Revenue (Q2FY21)



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Disclosure:

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