



Persistent Systems

Sector: Technology

1QFY17 Result Update

CMP: ₹ 665

Organic revenue flat, Maintain Hold on SMAC story

Recommendation: Hold

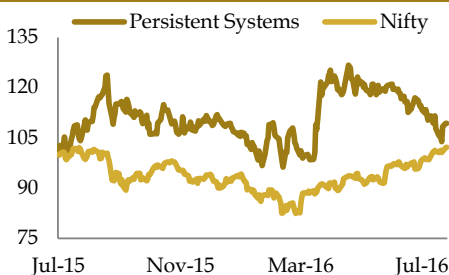
Market statistics

Current stock price (₹)	665
Shares O/S (cr.)	8.0
Mcap (₹ cr)	5,324
52W H/L (₹)	798/563
6m avg. volume	125,689
Bloomberg	PSYS.IN

Shareholding pattern

Promoters	38.20
Domestic Institution	12.14
Foreign Institution	22.56
Non-institution	27.10
of which more than 1%	
Fidelity Management And Research Company A/c Fidelity Advisor Series 1	5.33
Fidelity Advisor Small Cap Fund	
Edgbaston Asian Equity Trust	2.89

Persistent Systems vs Nifty



Capital efficiency & valuations

Particulars	FY16	FY17E	FY18E
RoE (%)	19.5	17.3	18.7
EPS (₹)	37.2	38.2	47.3
CEPS (₹)	49.2	55.9	65.9
P/E (x)	20.5	17.4	14.1
P/BV (x)	3.7	2.8	2.5
EV/EBITDA (x)	12.6	11.0	8.4
Income growth (%)	22.3	23.2	14.2
EBITDA growth (%)	6.9	12.2	21.8
PAT growth (%)	2.3	10.2	23.9

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Persistent Systems reported 4.3% QoQ revenue increase in US\$ terms, while margins dipped 68bps QoQ. Persistent has been able to create a differentiated model through its early investment in digital technologies, and select acquisition of IP from its existing customers. Going forward, we expect Persistent Systems to maintain healthy revenue growth trajectory. There are multiple headwinds to the margins and rich valuations play spoilsport. Hence, we maintain our Hold rating on the stock and await better entry points.

Revenue increase of 4.3% QoQ in US\$ terms: The company reported US\$ revenue increase of 4.3% QoQ (IBM-Watson IoT deal had revenue of US\$11.5m and Citrix reported US\$2m. Excluding the incremental addition from these two, revenue was flat during the quarter), driven by an increase of 4.4% QoQ from Services (71.8% revenue share) and a 4.1% increase from IP-led solutions. There was a volume increase of 2.5% QoQ in the Services (onsite decline of 1.4% QoQ and offshore increase of 3.2%), while onsite pricing was up 5.9% QoQ and offshore pricing up 1.2%. EBITDA margins decreased 68bps QoQ to 15.1%. Net profit at ₹733mn decreased 9.3% QoQ and up 30.5% YoY, dented by a higher tax expense of 24.3% of PBT (vs 21.4% in Q4FY16).

EBITDA Margin dips 68bps QoQ: Margins were dented on account of investments made into the Watson IoT platform. However, the margin decline was lower-than-estimated. We see margin pressure to sustain in Q2FY17 on account of full integration of IBM business, bonus payout, and business investments. Moreover, Q2FY17 would witness pressure due to wage hike. We see utilization, offshore-mix, and SG&A efficiency to drive tailwind for operating margin from Q2FY17.

Segment-wise performance - ISVs and Enterprise drive growth - Revenue growth in ISVs was 3.4% QoQ, driven by additional revenue from top client. Revenue from this segment had been under pressure till 4QFY16, as it clocked a four-quarter CQGR of -0.1%, despite addition to revenue growth by the acquisition of RGEN in 2Q. Enterprise grew by 5.9% QoQ compared to 4QFY16 growth of 1.8%. Traction in this segment has relatively weakened over the last two quarters. IP revenues grew by 4.3% QoQ. In 1Q, excluding the incremental revenue from the IBM-Watson IoT deal and the full integration of Citrix, IP revenue declined by ~13% QoQ.

FY17 margins to remain under pressure: The costs associated with the IBM deal are upfront and are expected to weigh heavy upon margins to the tune of ~200bps in FY17. Margins would face the headwinds in 2Q; although a lot of it can be offset by margin levers. The recovery to margins would only begin once revenue from the IBM deal reached a point where it exceeds the cost associated with it, which is likely to be back-ended. We believe that would be seen in FY18.

Other details: Top client revenue was up 19.2% QoQ at US\$21.8mn. 125 employees on a net basis joined PSYS QoQ taking total head-count to 9,389. Attrition was up 30bps QoQ at 16.7%. Utilization (blended) increased to 75.3% (Q4FY16: 75.2%). DSO days were up by 1 to 63 QoQ in 1QFY17. Industry classification wise, ISV was up 3.4% QoQ while Enterprise was up 5.9%. Geographically, North America was up 5.5% QoQ, APAC was up 13.1%, while Europe decreased 19%. PSYS billed 21 clients more (net) QoQ in the Services division to take the total to 340, while it billed 15 clients lower QoQ in the IP-Led business to take the total to 338. The company lost 3 and added 8 clients QoQ in the US\$3mn+ and US\$1mn+ bracket QoQ to take the list to 15 and 50.

Outlook & Valuation: Going forward, we expect Persistent Systems to maintain healthy revenue growth trajectory. There are multiple headwinds to the margins and rich valuations play spoilsport. Hence, we maintain our Hold rating on the stock and await better entry points.



Exhibit 1: Quarterly details

₹ mn	1QFY16	4QFY16	1QFY17	QoQ (%)	YoY (%)	Comments
Revenues (in US\$ mn)	78.6	100.4	104.8	4.3	33.3	Volume increase of 2.5% QoQ in the Services (onsite decline of 1.4% and offshore increase of 3.2%). IP-led solutions increased 4.1%.
Revenues	5,004	6,771	7,018	3.6	40.2	
- Operating costs	4,142	5,704	5,960	4.5	43.9	
EBITDA	862	1,067	1,058	(0.9)	22.6	
EBITDA margin (%)	17.2	15.8	15.1	(68)bps	(217)bps	Margins were dented on account of investments made into the Watson IoT platform.
- Interest expense	0	0	0	(5.0)	(26.9)	
- Depreciation	227	256	343	34.0	51.3	
+ Other income, net (incl forex)	160	217	253	16.6	58.0	
PBT	796	1,028	968	(5.8)	21.6	
- Taxes	234	220	235	7.0	0.3	
Effective tax rate (%)	29.5	21.4	24.3	291bps	(517)bps	Effective tax rate for FY17 to be between 24-25%
PAT	561	808	733	(9.3)	30.5	
Net Margin	11.2	11.9	10.4	(149)bps	(78)bps	

Source: Company

Exhibit 2: Change in estimates

₹ mn	FY17E			FY18E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	432	435	0.7	497	500	0.6
Revenue	28,090	28,480	1.4	32,301	32,523	0.7
EBITDA margin (%)	16.0	15.4	(55)bps	17.0	16.5	(45)bps
EPS (₹)	39.7	38.2	(3.8)	49.0	47.3	(3.5)

Source: Trust Research

Exhibit 3: Geographical wise Performance

Geographical mix	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
US	85.9	86.1	84.7	85.4	84.4	86.2	85.3	86.1	87.0
Europe	6.5	6.3	7.1	6.8	6.3	6.8	6.3	6.7	5.2
APAC	7.6	7.6	8.2	7.8	9.3	7.0	8.4	7.2	7.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company

Exhibit 4: Client details

Client concentration	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Top client (%)	20.8	19.0	17.5	16.5	18.1	17.6	17.4	25.4	29.0
Top 5 clients (%)	38.7	36.1	35.0	34.1	36.0	35.4	34.3	40.8	44.7
Top 10 clients (%)	49.0	45.0	44.2	43.2	45.6	44.7	44.1	49.6	52.7
Large >US\$3mn	14	14	14	14	15	17	19	18	15
Medium > US\$1m <US\$3m	38	41	41	48	52	46	44	42	50
Clients billed (Services)	260	281	273	268	277	311	337	319	340
Clients billed (IP Led)	347	376	349	326	310	299	291	353	338

Source: Company



Human Resources: 125 employees on a net basis joined PSYS QoQ taking total head-count to 9,389. Attrition was up 30bps QoQ at 16.7%. Utilization (blended) increased to 75.3% (Q4FY16: 75.2%).

Exhibit 5: Employee strength at PSYS

(Nos)	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Billable Personnel - onsite	1,283	1,403	1,518	1,551	1,623	1,854	2,097	2,108	2,121
Billable Personnel - offshore	14,856	14,612	14,513	14,512	14,515	14,212	14,621	14,523	14,909
Total billable employees	16,139	16,015	16,031	16,063	16,138	16,066	16,718	16,631	17,030
Billed Personnel - onsite	1,128	1,259	1,343	1,383	1,374	1,621	1,817	1,811	1,786
Billed Personnel - offshore	9,797	9,995	10,573	10,616	10,390	10,605	10,640	10,693	11,030
Total billed employees	10,925	11,254	11,916	11,999	11,764	12,226	12,457	12,504	12,816
Utilisation details									
Utilisation (blended, %)	67.7	70.3	74.3	74.7	72.9	76.1	74.5	75.2	75.3
Utilisation (onsite, %)	87.9	89.7	88.5	89.2	84.7	87.4	86.6	85.9	84.2
Utilisation (offshore, %)	65.9	68.4	72.9	73.2	71.6	74.6	72.8	73.6	74.0
Employees									
Technical	7,271	7,447	7,664	7,861	7,810	7,905	8,334	8,618	8,698
Sales & Business Development	202	212	208	224	216	208	203	201	204
Others	403	408	424	421	428	432	429	445	487
Total	7,876	8,067	8,296	8,506	8,454	8,545	8,966	9,264	9,389

Source: Company

Exhibit 6: Billing rates

US\$/ppm	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Onsite	14,905	14,864	14,862	15,159	15,321	15,075	14,717	14,574	15,437
Offshore	4,219	4,271	4,201	4,199	4,146	4,251	4,217	4,275	4,325

Source: Company

Exhibit 7: Other details

Revenue mix	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Onsite	23.1	24.5	25.1	26.2	26.8	29.5	29.8	26.3	26.3
Offshore	56.9	55.9	55.9	55.7	54.8	54.3	50.1	45.5	45.5
IP Led	20.0	19.6	19.0	18.1	18.4	16.2	20.1	28.2	28.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
DSO	69	65	65	64	67	68	69	62	63
Attrition (%)	14.0	14.1	14.7	15.5	16.4	17.1	17.1	16.4	16.7

Source: Company

Financials

Income Statement (₹ mn)

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Revenues	16,692	18,913	23,123	28,480	32,523
Op. Expenses	12,430	15,041	18,985	24,086	27,171
EBITDA	4,262	3,871	4,138	4,395	5,352
Other Income	191	970	784	1,059	1,184
Depreciation	1,026	939	965	1,417	1,487
EBIT	3,427	3,903	3,957	4,036	5,048
Interest	1	3	1	1	1
PBT	3,426	3,900	3,956	4,035	5,047
Tax	934	993	983	980	1,262
PAT	2,492	2,906	2,974	3,055	3,786
Minority	-	-	-	-	-
Adj Pat	2,492	2,906	2,974	3,055	3,786

Key Parameters

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Per share (₹)					
EPS	31.2	36.3	37.2	38.2	47.3
CEPS	44.0	48.1	49.2	55.9	65.9
BVPS	152.8	175.7	204.9	235.9	270.4
DPS	6.0	10.0	8.0	9.0	11.0
Payout (%)	22.5	32.2	25.2	27.6	27.2
Valuation (x)					
P/E	16.9	19.7	20.5	17.4	14.1
P/BV	3.4	4.1	3.7	2.8	2.5
EV/EBITDA	8.5	5.3	12.6	11.0	8.4
Dividend Yield (%)	1.1	1.4	1.0	1.4	1.7
Return ratio (%)					
EBIDTA Margin	25.5	20.5	17.9	15.4	16.5
PAT Margin	14.9	15.4	12.9	10.7	11.6
ROAE	22.2	22.1	19.5	17.3	18.7
ROACE	30.6	29.7	25.9	22.9	24.9
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.4)	(0.4)	(0.4)	(0.4)	(0.5)
Debt/EBITDA	0.0	0.0	0.0	0.0	0.0
Interest Coverage	-	-	-	-	-
Current ratio	3.4	3.1	2.9	2.9	3.1
Growth Ratios (%)					
Income growth	28.9	13.3	22.3	23.2	14.2
EBITDA growth	28.8	(9.2)	6.9	12.2	21.8
PAT growth	32.8	16.6	2.3	10.2	23.9
Turnover Ratios					
F.A Turnover x	5.4	6.1	7.1	9.0	10.5
Debtors Days	75	74	74	74	71
Payable days	14	14	35	33	32

Balance Sheet (₹ mn)

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Sources of Funds					
Equity Share Capital	400	800	800	800	800
Reserves & Surplus	11,823	13,255	15,593	17,805	20,561
Total Shareholders Fund	12,223	14,055	16,393	18,605	21,361
Non-current liabilities	166	(171)	(77)	(71)	(38)
Long term Borrowings	32	25	26	26	26
Deferred tax liabilities	(260)	(313)	(228)	(228)	(228)
Other LT liabilities & prov	394	117	126	132	165
Current Liabilities	2,785	3,549	4,517	5,609	6,327
Trade payables	434	529	1,651	1,980	2,233
Other cur liabilities & Prov	2,351	3,020	2,866	3,629	4,094
Total Liabilities	15,174	17,433	20,833	24,143	27,651
Assets					
Non-current Assets	5,805	6,369	7,697	7,913	8,114
Fixed assets	3,093	3,097	3,273	3,182	3,094
Non-current investments	2,115	3,135	2,703	2,703	2,703
Long-term loans & adv	138	123	851	1,014	1,158
Other non-current assets	459	13	870	1,014	1,158
Current assets	9,368	11,065	13,136	16,230	19,537
Current investments	4,071	4,620	4,828	4,828	4,828
Trade receivables	3,028	3,586	4,275	5,228	5,970
Cash & bank balances	957	1,416	1,432	3,053	5,175
Short-term loans & adv	410	407	812	936	1,069
Other current assets	902	1,035	1,788	2,185	2,495
Total Assets	15,174	17,433	20,833	24,143	27,651

Cash flow Statement

Year End-March	FY14	FY15	FY16	FY17E	FY18E
PBT	3,426	3,900	3,956	4,035	5,047
Depreciation	956	886	1,050	1,417	1,487
Interest expense	1	3	1	1	1
CF before W.cap	4,383	4,789	5,007	5,453	6,536
Inc/dec in W.cap	280	(260)	2,455	683	721
Op CF after W.cap	4,103	5,049	2,552	4,770	5,814
Less Taxes	934	993	983	980	1,262
Net CF From Operations	3,169	4,056	1,569	3,790	4,553
Inc/(dec) in F.A + CWIP	144	943	1,141	1,326	1,400
(Pur)/sale of investments	2,196	1,568	(224)	-	-
Others	(1)	(3)	(1)	(1)	(1)
CF from Invst Activities	(2,340)	(2,514)	(918)	(1,327)	(1,401)
Loan raised	18	(7)	1	-	-
Equity Raised	110	(138)	113	(0)	0
Dividend	562	936	749	842	1,030
CF from Fin Activities	(434)	(1,082)	(635)	(842)	(1,030)
Net inc/(dec) in cash	395	460	16	1,621	2,122
Op. bal of cash	561	957	1,416	1,432	3,053
Cl. balance of cash	957	1,416	1,432	3,053	5,175



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