

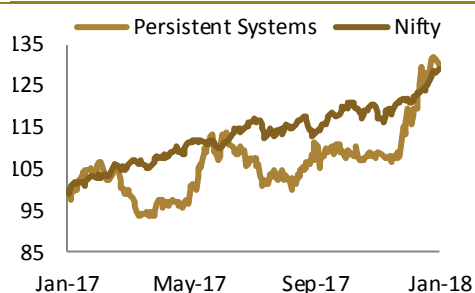
Market statistics

| | |
|-------------------------|---------|
| Current stock price (`) | 782 |
| Shares O/S (cr.) | 8.0 |
| Mcap (` cr) | 6,258 |
| 52W H/L (`) | 819/558 |
| 6m avg. volume | 131,810 |
| Bloomberg | PSYS IN |

Shareholding pattern

| | |
|------------------------------------|-------|
| Promoters | 30.62 |
| Domestic Institution | 14.49 |
| Foreign Institution | 23.99 |
| Non-institution | 30.90 |
| of which more than 1% | |
| Saif India Iv Fii Holdings Limited | 5.33 |
| HDFC Trustee Company | 2.97 |

Persistent Systems vs Nifty



Capital efficiency & valuations

| Particulars | FY18E | FY19E | FY20E |
|-------------------|-------|-------|-------|
| RoE (%) | 16.6 | 17.0 | 17.2 |
| EPS (`) | 42.3 | 49.4 | 56.5 |
| CEPS (`) | 61.8 | 70.6 | 79.7 |
| P/E (x) | 18.5 | 15.8 | 13.8 |
| P/BV (x) | 2.9 | 2.5 | 2.2 |
| EV/EBITDA (x) | 11.5 | 9.0 | 7.7 |
| Income growth (%) | 7.7 | 14.2 | 11.7 |
| EBITDA growth (%) | 6.8 | 23.3 | 12.6 |
| PAT growth (%) | 8.2 | 16.7 | 14.4 |

Persistent Systems reported 3.8% QoQ revenue increase in US\$ terms, while margins increased 216bps QoQ suggests that PSYS managed this quarter well by keeping costs under control. 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 revenue, margins and rich valuations play spoilsport. Hence, we maintain our Hold rating on the stock and await better entry points.

Revenue increase of 3.8% QoQ in US\$ terms: The company reported US\$ revenue increase of 3.8% QoQ driven by an increase of 2.7% QoQ from Services (73.2% revenue share) and a 6.8% QoQ revenue from IP-Led Solutions. PSYS has changed its strategy to leave non-strategic clients from the 2Q. Volume was flat QoQ in the Services (onsite +2.9% QoQ and offshore -0.6%).

EBITDA Margin increased by 216bps QoQ: Margins were up on account of better operational efficiencies (higher utilization) and higher proportion of non-linear revenue mix this quarter. Utilisation improved 130bps QoQ to 79.9%. Profits at Rs917mn (up 11% QoQ) was higher than our estimates due to higher margin, helped by lower tax expense. We believe offshore-mix, and SG&A efficiency to drive tailwind for operating margin are limited from FY19.

Structural weakness - Persistent's 3QFY18 performance continued to confirm structural weakness in ISV business (increased by just 0.1% QoQ) after a series of QoQ declines, reflect our concerns on medium term challenges. Revenue from the Top client (IBM) was up 11% QoQ. Clients billed in both the segments, Services and IP-led business were up 12 and down 9 QoQ respectively to 431 and 268 respectively.

PARX acquisition - Persistent had announced the acquisition of PARX Werk AG (PARX), a Salesforce platinum partner in the DACH region with 70+ employees and revenues of ~CHF8mn in CY16 (~28% CAGR over 2 years). The EV payable is ~CHF8.5mn, with additional CHF7.5mn payable over 3 years contingent on performance/retention of management employees. 2Q revenue had US\$1.9mn of contribution from PARX.

Other details: #2-4 and #6-10 clients grew 5% and declined 4.7% QoQ. 137 employees on a net basis left PSYS QoQ taking total head-count to 9,109. Attrition was down 80bps QoQ at 14.7%. Utilization (blended) increased to 79.9% (Q2FY18: 78.6%). DSO days were flat QoQ in 3QFY18. Industry classification wise, ISV was up 0.1% QoQ while Enterprise was up 5.6%. Geographically, North America was up 3.9%, APAC was up 5.2%, while Europe decreased 11.8%. The company added 2 clients QoQ in the US\$1mn-US\$3mn bracket QoQ to take the list to 51. Accelerite was down 16.7% QoQ, while Alliance was up 12.5% QoQ. Digital was up 9.2% QoQ, while Services declined 0.5%. Management continued to indicate revenue growth in low teens and better margins YoY at constant currency in FY19. Challenges remain in the traditional business of effort-based billing as effort required for same work is going down. Wage hikes will put pressure in 4QFY18.

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.

ANALYST

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Exhibit 1: Quarterly details

| ` mn | 3QFY17 | 2QFY18 | 3QFY18 | QoQ (%) | YoY (%) | Comments |
|----------------------------------|--------------|--------------|--------------|---------------|---------------|--|
| Revenues (in US\$ mn) | 110.0 | 118.1 | 122.5 | 3.8 | 11.4 | Volume was flat QoQ in the Services (onsite +2.9% QoQ and offshore -0.6%). IP-led solutions was up 6.8% |
| Revenues | 7,455 | 7,613 | 7,919 | 4.0 | 6.2 | |
| - Operating costs | 6,269 | 6,455 | 6,544 | 1.4 | 4.4 | |
| EBITDA | 1,187 | 1,158 | 1,375 | 18.8 | 15.9 | |
| EBITDA margin (%) | 15.9 | 15.2 | 17.4 | 216bps | 145bps | Margins were up on account of better operational efficiencies and IP –related business mix this quarter. Utilisation improved 130bps QoQ to 79.9%. |
| - Interest expense | 0 | 0 | 0 | (12.5) | (22.2) | |
| - Depreciation | 387 | 379 | 393 | 3.5 | 1.6 | |
| + Other income, net (incl forex) | 318 | 336 | 193 | (42.6) | (39.4) | |
| PBT | 1,118 | 1,114 | 1,175 | 5.5 | 5.1 | |
| - Taxes | 299 | 288 | 258 | (10.4) | (13.5) | |
| Effective tax rate (%) | 26.7 | 25.9 | 22.0 | (389)bps | (474)bps | Effective tax rate for FY19 to be between ~25-27% |
| PAT | 819 | 826 | 917 | 11.0 | 11.9 | |
| Net Margin | 11.0 | 10.8 | 11.6 | 73bps | 59bps | |

Source: Company

Exhibit 2: Change in estimates

| ` mn | FY18E | | | FY19E | | |
|-------------------|--------|--------|-------|--------|--------|--------|
| | Old | New | %Chg | Old | New | %Chg |
| Revenue (US\$ mn) | 476 | 480 | 0.8 | 537 | 545 | 1.5 |
| Revenue | 30,798 | 30,996 | 0.6 | 34,889 | 35,396 | 1.5 |
| EBITDA margin (%) | 15.0 | 16.0 | 95bps | 15.5 | 17.3 | 180bps |
| EPS (`) | 41.3 | 42.3 | 2.4 | 48.2 | 49.4 | 2.5 |

Source: Trust Research

Exhibit 3: Geographical wise Performance

| Geographical mix | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 |
|------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| US | 85.3 | 86.1 | 87.0 | 85.4 | 86.6 | 86.5 | 85.5 | 83.4 | 84.4 |
| Europe | 6.3 | 6.7 | 5.2 | 6.1 | 5.3 | 5.3 | 5.9 | 8.5 | 7.3 |
| APAC | 8.4 | 7.2 | 7.8 | 8.5 | 8.1 | 8.2 | 8.6 | 8.1 | 8.3 |
| 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 | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Top client (%) | 17.4 | 25.4 | 29.0 | 28.4 | 29.5 | 26.5 | 27.9 | 25.9 | 28.0 |
| Top 5 clients (%) | 34.3 | 40.8 | 44.7 | 44.3 | 46.0 | 43.3 | 45.7 | 43.8 | 46.3 |
| Top 10 clients (%) | 44.1 | 49.6 | 52.7 | 52.8 | 54.6 | 52.4 | 55.2 | 53.5 | 55.3 |
| Large >US\$3mn | 19 | 18 | 15 | 15 | 15 | 15 | 18 | 19 | 19 |
| Medium > US\$1m <US\$3m | 44 | 42 | 50 | 51 | 50 | 55 | 52 | 49 | 51 |
| Clients billed (Services) | 337 | 319 | 340 | 314 | 315 | 313 | 303 | 419 | 431 |
| Clients billed (IP Led) | 291 | 353 | 338 | 335 | 338 | 308 | 306 | 277 | 268 |

Source: Company



Human Resources: 137 employees on a net basis left PSYS QoQ taking total head-count to 9,109. Attrition was down 80bps QoQ at 14.7%. Utilization (blended) increased to 79.9% (Q2FY18: 78.6%).

Exhibit 5: Employee strength at PSYS

| (Nos) | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Billable Personnel – onsite | 2,097 | 2,108 | 2,121 | 2,048 | 2,109 | 2,236 | 2,431 | 2,689 | 2,777 |
| Billable Personnel - offshore | 14,621 | 14,523 | 14,909 | 15,426 | 14,968 | 14,942 | 15,205 | 15,556 | 15,166 |
| Total billable employees | 16,718 | 16,631 | 17,030 | 17,474 | 17,077 | 17,178 | 17,636 | 18,245 | 17,943 |
| Billed Personnel - onsite | 1,817 | 1,811 | 1,786 | 1,720 | 1,867 | 1,907 | 2,104 | 2,346 | 2,413 |
| Billed Personnel - offshore | 10,640 | 10,693 | 11,030 | 11,246 | 11,610 | 11,459 | 11,507 | 11,994 | 11,922 |
| Total billed employees | 12,457 | 12,504 | 12,816 | 12,966 | 13,477 | 13,366 | 13,611 | 14,340 | 14,335 |
| Utilisation details | | | | | | | | | |
| Utilisation (blended, %) | 74.5 | 75.2 | 75.3 | 74.2 | 78.9 | 77.8 | 77.2 | 78.6 | 79.9 |
| Utilisation (onsite, %) | 86.6 | 85.9 | 84.2 | 84.0 | 88.5 | 85.3 | 86.5 | 87.2 | 87.2 |
| Utilisation (offshore, %) | 72.8 | 73.6 | 74.0 | 72.9 | 77.6 | 76.6 | 75.7 | 77.1 | 77.1 |
| Employees | | | | | | | | | |
| Technical | 8,334 | 8,618 | 8,698 | 8,612 | 8,562 | 8,808 | 8,744 | 8,599 | 8,460 |
| Sales & Business Development | 203 | 201 | 204 | 207 | 200 | 193 | 210 | 208 | 206 |
| Others | 429 | 445 | 487 | 486 | 467 | 459 | 447 | 439 | 443 |
| Total | 8,966 | 9,264 | 9,389 | 9,305 | 9,229 | 9,460 | 9,401 | 9,246 | 9,109 |

Source: Company

Exhibit 6: Billing rates

| US\$/ppm | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 |
|----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Onsite | 14,717 | 14,574 | 15,437 | 16,101 | 15,704 | 15,914 | 16,307 | 16,023 | 16,314 |
| Offshore | 4,217 | 4,275 | 4,325 | 4,288 | 4,257 | 4,244 | 4,212 | 4,148 | 4,220 |

Source: Company

Exhibit 7: Other details

| Revenue mix | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 |
|---------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Onsite | 29.8 | 26.3 | 26.3 | 26.3 | 26.7 | 27.8 | 29.9 | 31.9 | 32.1 |
| Offshore | 50.1 | 45.5 | 45.5 | 45.9 | 44.9 | 44.6 | 42.9 | 42.1 | 41.1 |
| IP Led | 20.1 | 28.2 | 28.2 | 27.8 | 28.4 | 27.6 | 27.2 | 26.0 | 26.8 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DSO | 69 | 62 | 63 | 66 | 70 | 65 | 64 | 66 | 66 |
| Attrition (%) | 17.1 | 16.4 | 16.7 | 15.9 | 15.8 | 15.7 | 15.5 | 15.5 | 14.7 |

Source: Company



Financials

Income Statement (` mn)

| Year End-March | FY16 | FY17 | FY18E | FY19E | FY20E |
|-----------------|---------------|---------------|---------------|---------------|---------------|
| Revenues | 23,123 | 28,784 | 30,996 | 35,396 | 39,549 |
| Op. Expenses | 18,985 | 24,131 | 26,026 | 29,270 | 32,652 |
| EBITDA | 4,138 | 4,654 | 4,970 | 6,126 | 6,897 |
| Other Income | 784 | 958 | 1,104 | 981 | 1,150 |
| Depreciation | 965 | 1,490 | 1,558 | 1,695 | 1,855 |
| EBIT | 3,957 | 4,122 | 4,516 | 5,412 | 6,192 |
| Interest | 1 | 1 | 1 | 1 | 1 |
| PBT | 3,956 | 4,121 | 4,515 | 5,412 | 6,191 |
| Tax | 983 | 992 | 1,129 | 1,461 | 1,672 |
| PAT | 2,974 | 3,129 | 3,386 | 3,950 | 4,520 |
| Minority | - | - | - | - | - |
| Adj Pat | 2,974 | 3,129 | 3,386 | 3,950 | 4,520 |

Key Parameters

| Year End-March | FY16 | FY17 | FY18E | FY19E | FY20E |
|----------------------------|-------|-------|-------|-------|-------|
| Per share (`) | | | | | |
| EPS | 37.2 | 39.1 | 42.3 | 49.4 | 56.5 |
| CEPS | 49.2 | 57.7 | 61.8 | 70.6 | 79.7 |
| BVPS | 204.9 | 237.4 | 271.5 | 308.1 | 348.8 |
| DPS | 8.0 | 9.0 | 10.0 | 11.0 | 13.5 |
| Payout (%) | 25.2 | 26.9 | 27.6 | 26.1 | 28.0 |
| Valuation (x) | | | | | |
| P/E | 20.5 | 15.3 | 18.5 | 15.8 | 13.8 |
| P/BV | 3.7 | 2.5 | 2.9 | 2.5 | 2.2 |
| EV/EBITDA | 12.6 | 9.4 | 11.5 | 9.0 | 7.7 |
| Dividend Yield (%) | 1.0 | 1.5 | 1.3 | 1.4 | 1.7 |
| Return ratio (%) | | | | | |
| EBITDA Margin | 17.9 | 16.2 | 16.0 | 17.3 | 17.4 |
| PAT Margin | 12.9 | 11.3 | 10.9 | 11.2 | 11.4 |
| ROAE | 19.5 | 17.7 | 16.6 | 17.0 | 17.2 |
| ROACE | 25.9 | 23.3 | 22.2 | 23.3 | 23.6 |
| Leverage Ratios (x) | | | | | |
| Long Term D/E | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Debt/Equity | (0.4) | (0.3) | (0.4) | (0.4) | (0.4) |
| Debt/EBITDA | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest Coverage | - | - | - | - | - |
| Current ratio | 2.9 | 3.8 | 4.2 | 4.4 | 4.6 |
| Growth Ratios (%) | | | | | |
| Income growth | 22.3 | 24.5 | 7.7 | 14.2 | 11.7 |
| EBITDA growth | 6.9 | 18.9 | 6.8 | 23.3 | 12.6 |
| PAT growth | 2.3 | 12.8 | 8.2 | 16.7 | 14.4 |
| Turnover Ratios | | | | | |
| F.A Turnover x | 7.1 | 10.2 | 11.4 | 11.6 | 12.4 |
| Debtors Days | 74 | 67 | 66 | 65 | 64 |
| Payable days | 35 | 20 | 19 | 19 | 19 |

Balance Sheet (` mn)

| Year End-March | FY16 | FY17 | FY18E | FY19E | FY20E |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|
| Sources of Funds | | | | | |
| Equity Share Capital | 800 | 800 | 800 | 800 | 800 |
| Reserves & Surplus | 15,593 | 18,193 | 20,643 | 23,564 | 26,820 |
| Total Shareholders Fund | 16,393 | 18,993 | 21,443 | 24,364 | 27,620 |
| Non-current liabilities | (77) | 445 | 464 | 477 | 499 |
| Long term Borrowings | 26 | 22 | 22 | 22 | 22 |
| Deferred tax liabilities | (228) | 277 | 277 | 277 | 277 |
| Other LT liabilities & prov | 126 | 146 | 165 | 178 | 200 |
| Current Liabilities | 4,517 | 3,720 | 3,993 | 4,491 | 5,010 |
| Trade payables | 1,651 | 1,210 | 1,283 | 1,443 | 1,610 |
| Other cur liabilities & Prov | 2,866 | 2,510 | 2,710 | 3,047 | 3,399 |
| Total Liabilities | 20,833 | 23,157 | 25,900 | 29,331 | 33,128 |
| Assets | | | | | |
| Non-current Assets | 7,697 | 9,114 | 9,168 | 9,668 | 9,984 |
| Fixed assets | 3,273 | 2,817 | 2,722 | 3,042 | 3,187 |
| Non-current investments | 2,703 | 5,172 | 5,172 | 5,172 | 5,172 |
| Long-term loans & adv | 851 | 131 | 170 | 194 | 217 |
| Other non-current assets | 870 | 994 | 1,104 | 1,261 | 1,409 |
| Current assets | 13,136 | 14,043 | 16,732 | 19,663 | 23,144 |
| Current investments | 4,828 | 4,500 | 4,500 | 4,500 | 4,500 |
| Trade receivables | 4,275 | 4,754 | 5,095 | 5,819 | 6,501 |
| Cash & bank balances | 1,432 | 1,461 | 3,486 | 5,175 | 7,485 |
| Short-term loans & adv | 812 | 14 | 85 | 97 | 108 |
| Other current assets | 1,788 | 3,314 | 3,567 | 4,073 | 4,551 |
| Total Assets | 20,833 | 23,157 | 25,900 | 29,331 | 33,128 |

Cash flow Statement

| Year End-March | FY16 | FY17 | FY18E | FY19E | FY20E |
|---------------------------------|--------------|----------------|----------------|----------------|----------------|
| PBT | 3,956 | 4,121 | 4,515 | 5,412 | 6,191 |
| Depreciation | 1,050 | 1,995 | 1,558 | 1,695 | 1,855 |
| Interest expense | 1 | 1 | 1 | 1 | 1 |
| CF before W.cap | 5,007 | 6,117 | 6,074 | 7,107 | 8,047 |
| Inc/dec in W.cap | 2,455 | 1,387 | 521 | 912 | 801 |
| Op CF after W.cap | 2,552 | 4,730 | 5,553 | 6,195 | 7,245 |
| Less Taxes | 983 | 992 | 1,129 | 1,461 | 1,672 |
| Net CF From Operations | 1,569 | 3,738 | 4,424 | 4,734 | 5,574 |
| Inc/(dec) in F.A + CWIP | 1,141 | 1,034 | 1,463 | 2,015 | 2,000 |
| (Pur)/sale of investments | (224) | 2,141 | - | - | - |
| Others | (1) | (1) | (1) | (1) | (1) |
| CF from Invst Activities | (918) | (3,176) | (1,464) | (2,016) | (2,001) |
| Loan raised | 1 | (4) | - | - | - |
| Equity Raised | 113 | 313 | 0 | 0 | (0) |
| Dividend | 749 | 842 | 936 | 1,030 | 1,264 |
| CF from Fin Activities | (635) | (533) | (936) | (1,030) | (1,264) |
| Net inc /(dec) in cash | 16 | 29 | 2,024 | 1,689 | 2,310 |
| Op. bal of cash | 1,416 | 1,432 | 1,461 | 3,486 | 5,175 |
| Cl. balance of cash | 1,432 | 1,461 | 3,486 | 5,175 | 7,485 |

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|----------------|--|
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| Hold | 15% to -15% |
| Sell | Less than -15% |

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