

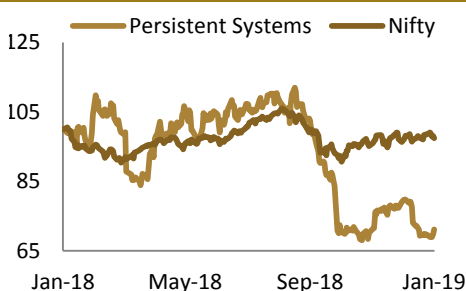
Market statistics

| | |
|-------------------------|---------|
| Current stock price (₹) | 565 |
| Shares O/S (cr.) | 8.0 |
| Mcap (₹ cr) | 4,518 |
| 52W H/L (₹) | 915/533 |
| 6m avg. volume | 257,765 |
| Bloomberg | PSYS IN |

Shareholding pattern

| | |
|-----------------------------|-------|
| Promoters | 30.47 |
| Domestic Institution | 19.55 |
| Foreign Institution | 23.52 |
| Non-institution | 26.45 |
| of which more than 1% | |
| Shridhar Bhalchandra Shukla | 1.53 |
| Ashutosh Vinayak Joshi | 1.40 |

Persistent Systems vs Nifty



Capital efficiency & valuations

| Particulars | FY19E | FY20E | FY21E |
|-------------------|-------|-------|-------|
| RoE (%) | 16.0 | 15.8 | 15.8 |
| EPS (₹) | 45.6 | 51.0 | 57.2 |
| CEPS (₹) | 65.6 | 72.6 | 80.5 |
| P/E (x) | 12.4 | 11.1 | 9.9 |
| P/BV (x) | 1.8 | 1.7 | 1.5 |
| EV/EBITDA (x) | 6.2 | 5.4 | 4.7 |
| Income growth (%) | 11.7 | 7.9 | 6.7 |
| EBITDA growth (%) | 33.0 | 8.9 | 9.2 |
| PAT growth (%) | 13.0 | 11.8 | 12.0 |

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Persistent Systems reported an increase of 2.2% QoQ in revenue in US\$ terms, while margins increased 252bps QoQ. The increase in revenue was on account of 2.2% QoQ increase in the Services volume QoQ and the North America business (up 4.4% QoQ), while the IP business was down 0.3%, which PSYS management says is difficult to forecast. 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. However, there are multiple headwinds to the revenue and margins which play spoilsport. Hence, we maintain our Hold rating on the stock and await better entry points.

Revenue increase of 2.2% QoQ in US\$ terms: PSYS reported lower-than-expected revenue growth in Q3FY19, Low growth was attributed to the deferment of expected IP sales in Q3FY19. However, no strict assurance related to future recovery of these revenues was provided. Digital growth and related commentary saw a recovery as it indicated a continuation of strong growth momentum in this segment (Digital grew 6.4% qoq in USD terms in Q3FY19). EBITDA margin, surprised positively. Margin expansion was aided by INR depreciation, increase in employee utilization, and improvement in its delivery mix. While management indicated the sustainability of these margin levels (19.7% now vs. 17.2% in Q2FY19), we believe that increased investments in sales and talent amid increasing attrition can dampen these expectations to an extent.

IL&FS Exposure: Persistent has corporate FDs worth Rs430mn with IL&FS. Persistent expressed hopes of recovery with government intervention and transparent sale of select assets under the leadership of newly appointed IL&FS board. Persistent indicated that it has not taken any haircut on its investments as of now and would be deciding the extent of impairment in due course.

Share Buyback: Persistent's board has approved a share buyback of up to Rs2.25bn through the open market route and at a maximum price of Rs750/share. Persistent has also declared an interim dividend of Rs8/share in Q3FY19.

Digital commentary improves, but far from exciting: While Persistent expects a continuation of growth momentum in Digital (~23% of sales) with two new additions to its top-client bucket (>USD3mn), it still expects 25-30% YoY growth in this segment, which we believe is low when larger peers are growing at a much faster rate in this segment (TCS to post ~50% YoY growth on a base of ~US\$4bn in FY19E). In addition, the continuous disappointment in its IP sales negates some of the improved outlook on the digital side. However, EBITDA margins at 19.7% saw a 252bps recovery QoQ on the back of INR depreciation (50bps), a 20bps increase in employee utilization, and an improvement in its delivery mix (high-margin offshore revenues contributed ~63% of incremental sales). While persistent expects to retain these benefits in the coming quarters, we believe that increasing investments in sales, new talent addition, and employee retention in a constrained market should offset a part of these benefits.

Outlook & Valuation: While client addition in the Top bucket has been decent in FY19, it has not yet translated into growth for Persistent. Further, the normalization of Persistent's expectations from the alliance portfolio does not excite us on the revenue growth front. There are multiple headwinds to the margins which plays spoilsport. Hence, we maintain our Hold rating on the stock and await better entry points, even though PSYS is trading at cheap valuations.



Exhibit 1: Quarterly details

| ` mn | 3QFY18 | 2QFY19 | 3QFY19 | QoQ (%) | YoY (%) | Comments |
|----------------------------------|--------------|--------------|--------------|---------------|----------------|--|
| Revenues (in US\$ mn) | 122.5 | 118.2 | 120.8 | 2.2 | (1.4) | Volume up 2.2% QoQ in Services (onsite: 0.5% QoQ and offshore: +2.5%). IP-led solutions was down 0.3% |
| Revenues | 7,919 | 8,356 | 8,642 | 3.4 | 9.1 | |
| - Operating costs | 6,544 | 6,919 | 6,939 | 0.3 | 6.0 | |
| EBITDA | 1,375 | 1,436 | 1,703 | 18.6 | 23.9 | |
| EBITDA margin (%) | 17.4 | 17.2 | 19.7 | 252bps | 234bps | EBITDA margin improved by despite lower IP revenue, led by operational efficiencies, change in onshore mix and rupee tailwinds (5bps). |
| - Interest expense | 0 | 1 | 1 | (37.4) | 378.6 | |
| - Depreciation | 393 | 399 | 396 | (0.6) | 0.9 | |
| + Other income, net (incl forex) | 193 | 232 | (11) | (104.7) | (105.7) | |
| PBT | 1,175 | 1,269 | 1,295 | 2.1 | 10.2 | |
| - Taxes | 258 | 387 | 378 | (2.4) | 46.3 | |
| Effective tax rate (%) | 22.0 | 30.5 | 29.2 | (134)bps | 719bps | Effective tax rate for FY19 to be between ~27-28% |
| PAT | 917 | 881 | 917 | 4.1 | 0.1 | |
| Net Margin | 11.6 | 10.5 | 10.6 | 6bps | (96)bps | |

Source: Company

Exhibit 2: Change in estimates

| ` mn | FY19E | | | FY20E | | |
|-------------------|--------|--------|--------|--------|--------|--------|
| | Old | New | %Chg | Old | New | %Chg |
| Revenue (US\$ mn) | 490 | 485 | (1.0) | 537 | 522 | (2.8) |
| Revenue | 34,092 | 33,875 | (0.6) | 37,613 | 36,537 | (2.9) |
| EBITDA margin (%) | 17.1 | 18.3 | 115bps | 17.2 | 18.5 | 125bps |
| EPS (`) | 46.5 | 45.6 | (1.9) | 54.3 | 51.0 | (6.1) |

Source: Trust Research

Exhibit 3: Geographical wise Performance

| Geographical mix | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 |
|------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| US | 86.6 | 86.5 | 85.5 | 83.4 | 84.4 | 80.9 | 79.7 | 82.6 | 83.7 |
| Europe | 5.3 | 5.3 | 5.9 | 8.5 | 7.3 | 8.2 | 12.0 | 7.5 | 7.6 |
| APAC | 8.1 | 8.2 | 8.6 | 8.1 | 8.3 | 10.9 | 8.3 | 9.9 | 8.7 |
| 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 | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Top client (%) | 29.5 | 26.5 | 27.9 | 25.9 | 28.0 | 21.7 | 23.8 | 25.7 | 26.3 |
| Top 5 clients (%) | 46.0 | 43.3 | 45.7 | 43.8 | 46.3 | 40.9 | 43.8 | 43.3 | 45.0 |
| Top 10 clients (%) | 54.6 | 52.4 | 55.2 | 53.5 | 55.3 | 49.9 | 53.7 | 52.4 | 54.6 |
| Large >US\$3mn | 15 | 15 | 18 | 19 | 19 | 18 | 18 | 18 | 20 |
| Medium > US\$1m <US\$3m | 50 | 55 | 52 | 49 | 51 | 53 | 58 | 56 | 56 |
| Clients billed (Services) | 315 | 313 | 303 | 419 | 431 | 426 | 438 | 433 | 437 |
| Clients billed (IP Led) | 338 | 308 | 306 | 277 | 268 | 177 | 181 | 178 | 192 |

Source: Company



Human Resources: 228 employees on a net basis joined PSYS QoQ taking total head-count to 9,530. Attrition was up 100bps QoQ at 16.4%.

Exhibit 5: Employee strength at PSYS

| (Nos) | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Billable Personnel – onsite | 2,109 | 2,236 | 2,431 | 2,689 | 2,777 | 2,713 | 2,757 | 2,656 | 2,659 |
| Billable Personnel - offshore | 14,968 | 14,942 | 15,205 | 15,556 | 15,166 | 14,669 | 14,836 | 14,827 | 15,163 |
| Total billable employees | 17,077 | 17,178 | 17,636 | 18,245 | 17,943 | 17,382 | 17,593 | 17,483 | 17,822 |
| Billed Personnel - onsite | 1,867 | 1,907 | 2,104 | 2,346 | 2,413 | 2,391 | 2,348 | 2,221 | 2,232 |
| Billed Personnel - offshore | 11,610 | 11,459 | 11,507 | 11,994 | 11,922 | 11,728 | 11,857 | 12,097 | 12,402 |
| Total billed employees | 13,477 | 13,366 | 13,611 | 14,340 | 14,335 | 14,119 | 14,205 | 14,318 | 14,634 |
| Utilisation details | | | | | | | | | |
| Utilisation (blended, %) | 78.9 | 77.8 | 77.2 | 78.6 | 79.9 | 81.2 | 80.7 | 81.9 | 82.1 |
| Utilisation (onsite, %) | 88.5 | 85.3 | 86.5 | 87.2 | 87.2 | 88.1 | 85.2 | 83.6 | 83.9 |
| Utilisation (offshore, %) | 77.6 | 76.6 | 75.7 | 77.1 | 77.1 | 80.0 | 79.9 | 81.6 | 81.8 |
| Employees | | | | | | | | | |
| Technical | 8,562 | 8,808 | 8,744 | 8,599 | 8,460 | 8,329 | 8,196 | 8,566 | 8,761 |
| Sales & Business Development | 200 | 193 | 210 | 208 | 206 | 211 | 237 | 247 | 266 |
| Others | 467 | 459 | 447 | 439 | 443 | 436 | 469 | 489 | 503 |
| Total | 9,229 | 9,460 | 9,401 | 9,246 | 9,109 | 8,976 | 8,902 | 9,302 | 9,530 |

Source: Company

Exhibit 6: Billing rates

| US\$/ppm | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 |
|----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Onsite | 15,704 | 15,914 | 16,307 | 16,023 | 16,314 | 16,662 | 16,360 | 15,787 | 16,204 |
| Offshore | 4,257 | 4,244 | 4,212 | 4,148 | 4,220 | 4,349 | 4,333 | 4,372 | 4,392 |

Source: Company

Exhibit 7: Other details

| Revenue mix | Q3FY17 | Q4FY17 | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 |
|---------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Onsite | 26.7 | 27.8 | 29.9 | 31.9 | 32.1 | 34.1 | 31.1 | 29.7 | 29.9 |
| Offshore | 44.9 | 44.6 | 42.9 | 42.1 | 41.1 | 43.6 | 41.5 | 44.7 | 45.1 |
| IP Led | 28.4 | 27.6 | 27.2 | 26.0 | 26.8 | 22.3 | 27.4 | 25.6 | 25.0 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DSO | 70 | 65 | 64 | 66 | 66 | 66 | 68 | 63 | 61 |
| Attrition (%) | 15.8 | 15.7 | 15.5 | 15.5 | 14.7 | 14.7 | 14.8 | 15.4 | 16.4 |

Source: Company



Financials

Income Statement (` mn)

| Year End-March | FY17 | FY18 | FY19E | FY20E | FY21E |
|-----------------|---------------|---------------|---------------|---------------|---------------|
| Revenues | 28,784 | 30,337 | 33,875 | 36,537 | 38,973 |
| Op. Expenses | 24,131 | 25,677 | 27,676 | 29,785 | 31,600 |
| EBITDA | 4,654 | 4,660 | 6,199 | 6,752 | 7,373 |
| Other Income | 958 | 1,217 | 508 | 650 | 850 |
| Depreciation | 1,490 | 1,585 | 1,596 | 1,729 | 1,869 |
| EBIT | 4,122 | 4,293 | 5,112 | 5,672 | 6,354 |
| Interest | 1 | 1 | 3 | 3 | 3 |
| PBT | 4,121 | 4,292 | 5,109 | 5,670 | 6,351 |
| Tax | 992 | 1,062 | 1,459 | 1,587 | 1,778 |
| PAT | 3,129 | 3,230 | 3,650 | 4,082 | 4,573 |
| Minority | - | - | - | - | - |
| Adj Pat | 3,129 | 3,230 | 3,650 | 4,082 | 4,573 |

Key Parameters

| Year End-March | FY17 | FY18 | FY19E | FY20E | FY21E |
|----------------------------|-------|-------|-------|-------|-------|
| Per share (`) | | | | | |
| EPS | 39.1 | 40.4 | 45.6 | 51.0 | 57.2 |
| CEPS | 57.7 | 60.2 | 65.6 | 72.6 | 80.5 |
| BVPS | 237.4 | 265.9 | 306.0 | 341.8 | 382.6 |
| DPS | 9.0 | 10.0 | 12.0 | 13.0 | 14.0 |
| Payout (%) | 26.9 | 29.0 | 30.8 | 29.8 | 28.7 |
| Valuation (x) | | | | | |
| P/E | 15.3 | 17.1 | 12.4 | 11.1 | 9.9 |
| P/BV | 2.5 | 2.6 | 1.8 | 1.7 | 1.5 |
| EV/EBITDA | 9.4 | 10.8 | 6.2 | 5.4 | 4.7 |
| Dividend Yield (%) | 1.5 | 1.4 | 2.1 | 2.3 | 2.5 |
| Return ratio (%) | | | | | |
| EBITDA Margin | 16.2 | 15.4 | 18.3 | 18.5 | 18.9 |
| PAT Margin | 11.3 | 10.6 | 10.8 | 11.2 | 11.7 |
| ROAE | 17.7 | 16.0 | 16.0 | 15.8 | 15.8 |
| ROACE | 23.3 | 21.3 | 22.3 | 21.9 | 21.9 |
| Leverage Ratios (x) | | | | | |
| Long Term D/E | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Debt/Equity | (0.3) | (0.3) | (0.4) | (0.4) | (0.5) |
| Debt/EBITDA | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest Coverage | - | - | - | - | - |
| Current ratio | 3.8 | 3.9 | 4.2 | 4.5 | 4.8 |
| Growth Ratios (%) | | | | | |
| Income growth | 24.5 | 5.4 | 11.7 | 7.9 | 6.7 |
| EBITDA growth | 18.9 | 0.1 | 33.0 | 8.9 | 9.2 |
| PAT growth | 12.8 | 3.2 | 13.0 | 11.8 | 12.0 |
| Turnover Ratios | | | | | |
| F.A Turnover x | 10.2 | 11.7 | 12.5 | 13.0 | 13.2 |
| Debtors Days | 67 | 60 | 61 | 61 | 61 |
| Payable days | 20 | 23 | 24 | 25 | 25 |

Balance Sheet (` mn)

| Year End-March | FY17 | FY18 | FY19E | FY20E | FY21E |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|
| Sources of Funds | | | | | |
| Equity Share Capital | 800 | 800 | 800 | 800 | 800 |
| Reserves & Surplus | 18,193 | 20,472 | 22,999 | 25,864 | 29,127 |
| Total Shareholders Fund | 18,993 | 21,272 | 23,799 | 26,664 | 29,927 |
| Non- current liabilities | 445 | 201 | 217 | 231 | 245 |
| Long term Borrowings | 22 | 17 | 17 | 17 | 17 |
| Deferred tax liabilities | 277 | 25 | 25 | 25 | 25 |
| Other LT liabilities & prov | 146 | 160 | 176 | 190 | 204 |
| Current Liabilities | 3,720 | 4,474 | 4,853 | 5,223 | 5,541 |
| Trade payables | 1,210 | 1,673 | 1,820 | 1,958 | 2,078 |
| Other cur liabilities & Prov | 2,510 | 2,801 | 3,033 | 3,264 | 3,463 |
| Total Liabilities | 23,157 | 25,947 | 28,869 | 32,118 | 35,713 |
| Assets | | | | | |
| Non- current Assets | 9,114 | 8,327 | 8,334 | 8,683 | 8,841 |
| Fixed assets | 2,817 | 2,589 | 2,497 | 2,817 | 2,948 |
| Non-current investments | 5,172 | 5,466 | 5,466 | 5,466 | 5,466 |
| Long-term loans & adv | 131 | 143 | 186 | 200 | 214 |
| Other non-current assets | 994 | 129 | 186 | 200 | 214 |
| Current assets | 14,043 | 17,620 | 20,535 | 23,435 | 26,872 |
| Current investments | 4,500 | 5,916 | 5,916 | 5,916 | 5,916 |
| Trade receivables | 4,754 | 4,847 | 5,383 | 5,806 | 6,193 |
| Cash & bank balances | 1,461 | 1,344 | 3,101 | 5,096 | 7,705 |
| Short-term loans & adv | 14 | 7 | 9 | 10 | 11 |
| Other current assets | 3,314 | 5,506 | 6,125 | 6,607 | 7,047 |
| Total Assets | 23,157 | 25,947 | 28,869 | 32,118 | 35,713 |

Cash flow Statement

| Year End-March | FY17 | FY18 | FY19E | FY20E | FY20E |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|
| PBT | 4,121 | 4,292 | 5,109 | 5,670 | 6,351 |
| Depreciation | 1,995 | 1,333 | 1,596 | 1,729 | 1,869 |
| Interest expense | 1 | 1 | 3 | 3 | 3 |
| CF before W.cap | 6,117 | 5,626 | 6,707 | 7,402 | 8,223 |
| Inc/dec in W.cap | 1,387 | 657 | 862 | 551 | 522 |
| Op CF after W.cap | 4,730 | 4,969 | 5,845 | 6,851 | 7,701 |
| Less Taxes | 992 | 1,062 | 1,459 | 1,587 | 1,778 |
| Net CF From Operations | 3,738 | 3,907 | 4,387 | 5,264 | 5,923 |
| Inc/(dec) in F.A + CWIP | 1,034 | 1,357 | 1,503 | 2,049 | 2,000 |
| (Pur)/sale of investments | 2,141 | 1,711 | - | - | - |
| Others | (1) | (1) | (3) | (3) | (3) |
| CF from Invst Activities | (3,176) | (3,069) | (1,506) | (2,052) | (2,003) |
| Loan raised | (4) | (5) | - | - | - |
| Equity Raised | 313 | (15) | - | 0 | (0) |
| Dividend | 842 | 936 | 1,123 | 1,217 | 1,310 |
| CF from Fin Activities | (533) | (956) | (1,123) | (1,217) | (1,310) |
| Net inc /(dec) in cash | 29 | (118) | 1,757 | 1,995 | 2,610 |
| Op. bal of cash | 1,432 | 1,461 | 1,344 | 3,101 | 5,096 |
| Cl. balance of cash | 1,461 | 1,344 | 3,101 | 5,096 | 7,705 |



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|----------------|--|
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