



Persistent Systems

1QFY20 Result Update

Another weak quarter

Sector: Technology

CMP: ` 565

Recommendation: Hold

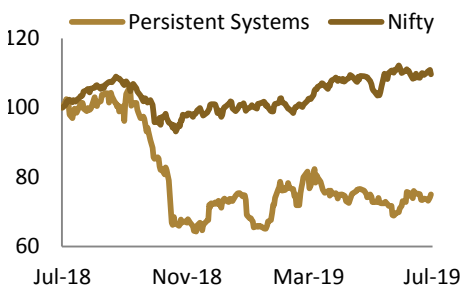
Market statistics

Current stock price (`)	565
Shares O/S (cr.)	7.7
Mcap (` cr)	4,318
52W H/L (`)	915/533
6m avg. volume	202,559
Bloomberg	PSYS IN

Shareholding pattern

Promoters	31.67
Domestic Institution	21.83
Foreign Institution	20.00
Non-institution	26.50
of which more than 1%	

Persistent Systems vs Nifty



Capital efficiency & valuations

Particulars	FY19	FY20E	FY21E
RoE (%)	16.5	15.7	16.2
EPS (`)	46.5	48.6	53.9
CEPS (`)	66.2	69.4	76.5
P/E (x)	13.7	11.6	10.5
P/BV (x)	2.2	1.8	1.6
EV/EBITDA (x)	7.5	6.1	5.2
Income growth (%)	11.0	2.1	8.5
EBITDA growth (%)	28.5	(6.4)	10.6
PAT growth (%)	14.5	1.2	10.9

Persistent Systems reported an increase of 1.1% QoQ in revenue in US\$ terms, while margins decreased 176bps QoQ. The increase in revenue was on account of 1.8% QoQ increase in the Services volume QoQ and the North America business (up 3.2% QoQ), while the IP business was up 0.8%, 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 1.1% QoQ in US\$ terms: PSYS reported lower-than-expected revenue growth in Q1FY20. Revenue growth was primarily driven by strong growth in IBM Alliance (up 13.3% QoQ), which was partially offset by a 5.9% QoQ decline in the digital business. Lower-than-expected revenue growth can also be attributed to muted growth in IP-led revenue (up 0.8% QoQ). IT services revenue grew by 1.2%, led by 3% growth in the enterprise business, while ISV revenue growth was down 0.4% QoQ. EBITDA margin contracted by 176bps QoQ to 15.6% in Q1FY20, below our estimates, owing to lower utilization (-50bps), visa expenses (-70bps), rupee appreciation (-30bps) and lower IP revenue.

Digital and Accelerite declined; Strong net hiring: Digital business (22.7% of total revenue) declined by 5.9% QoQ in Q1FY20 after last two consecutive quarters of growth. Accelerite business dropped by 39.7% QoQ, though it only accounted for 3.7% of total revenue. Services business continued its growth momentum of 3.8% QoQ, while Alliance business bounced back to growth at 13.3% QoQ. Top client's revenue grew by 18.1% QoQ in Q1FY20 against 24.8% drop in Q4FY19 and top 2-5 clients' revenue increased by 7.2%. Regionally, Europe delivered strong revenue growth of 8.8% QoQ in Q1FY19 and North America's revenue grew by 3.1% QoQ. Within industry verticals, BFSI and technology verticals grew by 3.7% and 1.1% on a QoQ basis, respectively, during the quarter, while the healthcare vertical declined by 2.5% QoQ.

Focus on large deal wins, margins could remain under pressure in Q2: Management highlighted that the company sharply focuses on new large deals (particularly annuity deals), new logos and conversion of deal pipeline to accelerate its growth trajectory. The company has won multimillion deals in each vertical such as BFSI, healthcare and technology during the quarter. Further, IBM has recently completed the Red Hat acquisition, which would create significant opportunity for PSL. We believe recent structural changes in the management team and alignment of sales team will take some time to execute its strategy. The company would continue to invest in product development as well as platform development, which would create a huge addressable market for the company. Management indicated that the decline in Accelerite business has bottomed out and expects recovery in revenue in the coming quarter. Margin is expected to be impacted by 250-270bps in Q2FY20 owing to wage revision, some of which would be recouped with improvement in utilisation, recovery in IP revenue and benefits from hedges. Management also believes ongoing investments in deepening the client relationships would play out well and help in improving the margin trajectory.

Outlook & Valuation: While client addition in the Top bucket has been decent, 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.

ANALYST

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Exhibit 1: Quarterly details

` mn	1QFY19	4QFY19	1QFY20	QoQ (%)	YoY (%)	Comments
Revenues (in US\$ mn)	123.6	118.3	119.6	1.1	(3.2)	Volume up 1.8% QoQ in Services (onsite: -1.2% QoQ and offshore: +2.3%). IP-led solutions was up 0.8%
Revenues	8,343	8,319	8,321	0.0	(0.3)	
- Operating costs	6,942	6,871	7,019	2.2	1.1	
EBITDA	1,401	1,448	1,302	(10.1)	(7.0)	
EBITDA margin (%)	16.8	17.4	15.6	(176)bps	(114)bps	EBITDA margin declined due to lower utilization (-50bps), visa expenses (-70bps), rupee appreciation (-30bps) and lower IP revenue).
- Interest expense	0	1	19	NA	NA	
- Depreciation	401	377	386	2.5	(3.7)	
+ Other income, net (incl forex)	187	225	300	33.2	60.8	
PBT	1,186	1,296	1,198	(7.6)	1.0	
- Taxes	313	268	273	1.7	(12.7)	
Effective tax rate (%)	26.4	20.7	22.8	207bps	(358)bps	Effective tax rate for FY20 to be between ~27-28%
PAT	873	1,027	925	(10.0)	5.9	
Net Margin	10.5	12.3	11.1	(124)bps	64bps	

Source: Company

Exhibit 2: Change in estimates

` mn	FY20E			FY21E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	506	494	(2.4)	539	536	(0.6)
Revenue	35,414	34,350	(3.0)	37,699	37,272	(1.1)
EBITDA margin (%)	18.1	16.3	(175)bps	18.4	16.6	(175)bps
EPS (`)	50.8	48.6	(4.3)	56.2	53.9	(4.1)

Source: Trust Research

Exhibit 3: Geographical wise Performance

Geographical mix	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
US	85.5	83.4	84.4	80.9	79.7	82.6	83.7	80.9	82.5
Europe	5.9	8.5	7.3	8.2	12.0	7.5	7.6	7.9	8.5
APAC	8.6	8.1	8.3	10.9	8.3	9.9	8.7	11.2	9.0
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	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Top client (%)	27.9	25.9	28.0	21.7	23.8	25.7	26.3	20.2	23.6
Top 5 clients (%)	45.7	43.8	46.3	40.9	43.8	43.3	45.0	40.0	44.6
Top 10 clients (%)	55.2	53.5	55.3	49.9	53.7	52.4	54.6	50.2	52.6
Large >US\$3mn	18	19	19	18	18	18	20	20	22
Medium > US\$1m <US\$3m	52	49	51	53	58	56	56	57	56
Clients billed (Services)	303	419	431	426	438	433	437	420	429
Clients billed (IP Led)	306	277	268	177	181	178	192	185	167

Source: Company



Human Resources: 205 employees on a net basis joined PSYS QoQ taking total head-count to 10,167. Attrition was up 40bps QoQ at 17.1%.

Exhibit 5: Employee strength at PSYS

(Nos)	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Billable Personnel – onsite	2,431	2,689	2,777	2,713	2,757	2,656	2,659	2,630	2,658
Billable Personnel - offshore	15,205	15,556	15,166	14,669	14,836	14,827	15,163	16,034	16,783
Total billable employees	17,636	18,245	17,943	17,382	17,593	17,483	17,822	18,664	19,441
Billed Personnel - onsite	2,104	2,346	2,413	2,391	2,348	2,221	2,232	2,206	2,179
Billed Personnel - offshore	11,507	11,994	11,922	11,728	11,857	12,097	12,402	12,674	12,962
Total billed employees	13,611	14,340	14,335	14,119	14,205	14,318	14,634	14,880	15,141
Utilisation details									
Utilisation (blended, %)	77.2	78.6	79.9	81.2	80.7	81.9	82.1	79.7	77.9
Utilisation (onsite, %)	86.5	87.2	87.2	88.1	85.2	83.6	83.9	83.9	82.0
Utilisation (offshore, %)	75.7	77.1	77.1	80.0	79.9	81.6	81.8	79.0	77.2
Employees									
Technical	8,744	8,599	8,460	8,329	8,196	8,566	8,761	9,185	9,363
Sales & Business Development	210	208	206	211	237	247	266	273	272
Others	447	439	443	436	469	489	503	504	532
Total	9,401	9,246	9,109	8,976	8,902	9,302	9,530	9,962	10,167

Source: Company

Exhibit 6: Billing rates

US\$/ppm	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Onsite	16,307	16,023	16,314	16,662	16,360	15,787	16,204	16,846	16,742
Offshore	4,212	4,148	4,220	4,349	4,333	4,372	4,392	4,385	4,427

Source: Company

Exhibit 7: Other details

Revenue mix	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Onsite	29.9	31.9	32.1	34.1	31.1	29.7	29.9	31.4	30.5
Offshore	42.9	42.1	41.1	43.6	41.5	44.7	45.1	47.0	48.0
IP Led	27.2	26.0	26.8	22.3	27.4	25.6	25.0	21.6	21.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
DSO	64	66	66	66	68	63	61	63	65
Attrition (%)	15.5	15.5	14.7	14.7	14.8	15.4	16.4	16.7	17.1

Source: Company



Financials

Income Statement (` mn)

Year End-March	FY17	FY18	FY19	FY20E	FY21E
Revenues	28,784	30,337	33,659	34,350	37,272
Op. Expenses	24,131	25,677	27,671	28,742	31,070
EBITDA	4,654	4,660	5,988	5,608	6,202
Other Income	958	1,217	633	1,125	1,325
Depreciation	1,490	1,585	1,573	1,599	1,739
EBIT	4,122	4,293	5,049	5,134	5,788
Interest	1	1	3	22	22
PBT	4,121	4,292	5,046	5,112	5,767
Tax	992	1,062	1,347	1,369	1,615
PAT	3,129	3,230	3,699	3,743	4,152
Minority	-	-	(183)	-	-
Adj Pat	3,129	3,230	3,517	3,743	4,152

Key Parameters

Year End-March	FY17	FY18	FY19	FY20E	FY21E
Per share (`)					
EPS	39.1	40.4	46.2	48.6	53.9
CEPS	57.7	60.2	65.9	69.4	76.5
BVPS	237.4	265.9	293.1	313.6	350.5
DPS	9.0	10.0	11.0	13.0	14.0
Payout (%)	26.9	29.0	27.8	31.3	31.6
Valuation (x)					
P/E	15.3	17.1	13.7	11.6	10.5
P/BV	2.5	2.6	2.2	1.8	1.6
EV/EBITDA	9.4	10.8	7.5	6.1	5.2
Dividend Yield (%)	1.5	1.4	1.7	2.3	2.5
Return ratio (%)					
EBITDA Margin	16.2	15.4	17.8	16.3	16.6
PAT Margin	11.3	10.6	10.4	10.9	11.1
ROAE	17.7	16.0	16.5	15.7	16.2
ROACE	23.3	21.3	22.6	21.6	22.6
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.3)	(0.3)	(0.2)	(0.3)	(0.3)
Debt/EBITDA	0.0	0.0	0.0	0.0	0.0
Interest Coverage	-	-	-	-	-
Current ratio	3.8	3.9	4.3	4.6	4.8
Growth Ratios (%)					
Income growth	24.5	5.4	11.0	2.1	8.5
EBITDA growth	18.9	0.1	28.5	(6.4)	10.6
PAT growth	12.8	3.2	14.5	1.2	10.9
Turnover Ratios					
F.A Turnover x	10.2	11.7	14.4	13.4	13.2
Debtors Days	67	60	59	58	56
Payable days	20	23	22	21	21

Balance Sheet (` mn)

Year End-March	FY17	FY18	FY19	FY20E	FY21E
Sources of Funds					
Equity Share Capital	800	800	791	791	791
Reserves & Surplus	18,193	20,472	22,656	25,228	28,070
Total Shareholders Fund	18,993	21,272	23,447	26,019	28,861
Non-current liabilities	445	201	302	314	324
Long term Borrowings	22	17	12	12	12
Deferred tax liabilities	277	25	37	37	37
Other LT liabilities & prov	146	160	253	265	276
Current Liabilities	3,720	4,474	4,402	4,646	5,022
Trade payables	1,210	1,673	1,517	1,575	1,702
Other cur liabilities & Prov	2,510	2,801	2,885	3,071	3,320
Total Liabilities	23,157	25,947	28,151	30,980	34,208
Assets					
Non-current Assets					
Fixed assets	2,817	2,589	2,343	2,563	2,824
Non-current investments	5,172	5,466	6,326	6,326	6,326
Long-term loans & adv	131	143	164	188	204
Other non-current assets	994	129	418	471	510.57
Current assets	14,043	17,620	18,900	21,432	24,343
Current investments	4,500	5,916	3,296	3,296	3,296
Trade receivables	4,754	4,847	4,923	5,082	5,514
Cash & bank balances	1,461	1,344	1,739	4,011	5,721
Short-term loans & adv	14	7	8	9	10
Other current assets	3,314	5,506	8,934	9,035	9,803
Total Assets	23,157	25,947	28,151	30,980	34,208

Cash flow Statement

Year End-March	FY17	FY18	FY19	FY20E	FY21E
PBT	4,121	4,292	5,046	5,112	5,767
Depreciation	1,995	1,333	1,585	1,599	1,739
Interest expense	1	1	3	22	22
CF before W.cap	6,117	5,626	6,451	6,733	7,527
Inc/dec in W.cap	1,387	657	3,793	82	871
Op CF after W.cap	4,730	4,969	2,658	6,651	6,656
Less Taxes	992	1,062	1,347	1,369	1,615
Net CF From Operations	3,738	3,907	1,311	5,282	5,042
Inc/(dec) in F.A + CWIP	1,034	1,357	1,327	1,819	2,000
(Pur)/sale of investments	2,141	1,711	(1,761)	-	-
Others	(1)	(1)	(3)	(22)	(22)
CF from Invst Activities	(3,176)	(3,069)	431	(1,840)	(2,022)
Loan raised	(4)	(5)	(5)	-	-
Equity Raised	313	(15)	(314)	(0)	0
Dividend	842	936	1,028	1,171	1,310
CF from Fin Activities	(533)	(956)	(1,347)	(1,171)	(1,310)
Net inc /(dec) in cash	29	(118)	396	2,271	1,710
Op. bal of cash	1,432	1,461	1,344	1,739	4,011
Cl. balance of cash	1,461	1,344	1,739	4,011	5,721



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