

# Stock Update

Margins surprised positively, upgrade to Buy

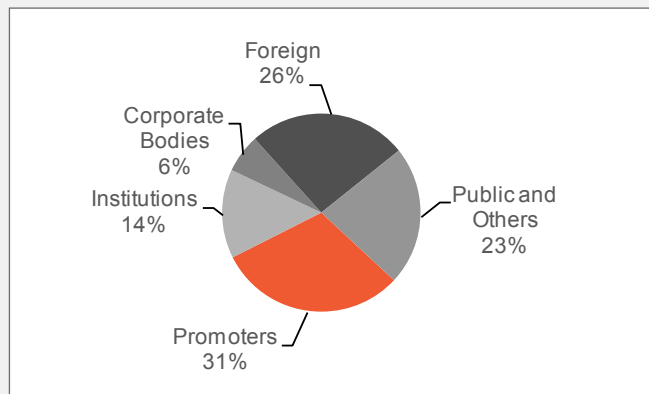
## Persistent Systems

Reco: Buy | CMP: Rs792

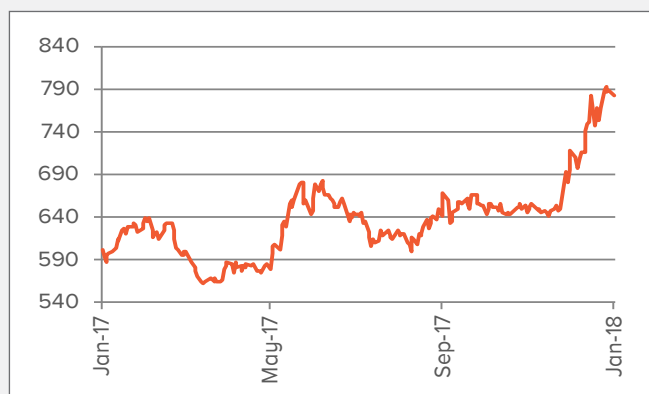
### Company details

Price target:	Rs900
Market cap:	Rs6,340 cr
52-week high/low:	Rs820/558
NSE volume: (No of shares)	1.1 lakh
BSE code:	533179
NSE code:	PERSISTENT
Sharekhan code:	PERSISTENT
Free float: (No of shares)	5.6 cr

### Shareholding pattern



### Price chart



### Price performance

(%)	1m	3m	6m	12m
Absolute	21.7	20.4	22.7	30.2
Relative to Sensex	14.5	10.2	9.3	-1.2

### Key points

- In-line revenue, margins beat estimates:** During Q3FY2018, Persistent Systems Limited (PSL) reported in-line revenue performance, reporting 3.8% q-o-q revenue growth to \$122.5 million, led by 12.5% q-o-q growth in IBM Alliance business. Revenue of digital services increased by 9.2% q-o-q, led by inorganic revenue from PARX acquisition (3.2% q-o-q in organic terms). IT services revenue increased by 2.7% q-o-q despite furloughs and higher number of holidays, driven by 2.7% q-o-q growth in realisation. EBITDA margin improved by ~220 BPS q-o-q to 17.4%, ahead of our expectation. Margin improvement was driven by higher revenue from IP-led and operational efficiencies, partially offset by wage hikes (85 BPS). Improved operational performance along with lower tax provisions (down 10.4% q-o-q, reversal of tax liability and tax benefit due to R&D activities) led to 10.9% q-o-q growth in net profit to Rs. 91.7 crore in Q3FY2018.
- Digital remains solid, margin trajectory shaping up well:** Management is hopeful the co-creation business model in digital services (especially in the healthcare and financial services verticals) will drive its revenue growth in FY2019. Further, traction in European region for its digital business, reseller agreement with IBM, strong deal pipeline and additional revenue from DACH region (Q4FY2018 onwards owing to PARX acquisition) will aid growth in FY2019. Management also stated that the legacy business has bottomed out and good signs of deals have started flowing into its ISV segment (though muted growth in Q3FY2018). Revenue from Accelerite declined during the quarter due to ramp down of an account. However, management expects steady growth in this business in the coming quarters, as it sees traction among customers for ShareInsights 2.0 (launched in Q3FY2018) and Sentient. In IBM IOT partnership, management expects 5-7% revenue growth (5% y-o-y growth in CY2018, below street's expectation) to continue in FY2019 and profitability to be better compared to FY2018. Overall, major focus of the company would remain on areas including (a) expansion outside North America, (b) increasing revenue in IP business and (c) building capabilities in emerging technologies (such as Blockchain and machine learning) to drive revenue performance

in the coming years. On the margins front, the company expects to improve profitability in FY2019 through better operational efficiencies, higher IP revenue and improving profitability in CE/CLM and Accelerite business, though investments in enterprise digital transformation will continue.

- ◆ **Earnings momentum to accelerate, upgrade to Buy:** We have marginally revised upward our earnings estimates for FY2018/FY2019E on account of higher-than-expected operating performance and introduced FY2020 numbers

in this note. We continue to see PSL as a good investment bet among mid-cap IT companies, as the company has been continuously focusing on strengthening its digital capabilities to remain relevant to clients in the ongoing IT industry transition. At the CMP, the stock is trading at 16.8x/14.5x its FY2019E/FY2020E EPS. Given its strong focus on digital services (up 10.4% CQGR in the past seven quarters) coupled with improved profitability to drive 12.4% earnings CAGR (FY2018-FY2020E), we have upgraded our rating on the stock to Buy from Hold earlier with a revised price target (PT) of Rs. 900.

#### Valuations

Particulars	FY2017	FY2018E	FY2019E	FY2020E	Rs cr
Net sales	2,878.4	3,084.4	3,450.9	3,899.1	
EBITDA margin (%)	16.2	16.2	16.6	17.0	
Net profit	312.9	341.3	373.0	432.0	
EPS (Rs)	39.1	42.7	46.6	54.0	
P/E	20.0	18.3	16.8	14.5	
EV/EBITDA (x)	12.2	10.7	8.9	7.2	
Price/BV (x)	3.3	2.9	2.6	2.3	
RoCE (%)	22.9	22.1	21.6	22.3	
RoE (%)	17.6	16.9	16.4	16.9	

Source: Company data, Sharekhan estimates

#### Results

Particulars	Q3FY18	Q3FY17	Q2FY18	YoY (%)	QoQ (%)	Rs cr
<b>Revenue (\$ mn)</b>	<b>122.5</b>	<b>110.0</b>	<b>118.1</b>	<b>11.4</b>	<b>3.8</b>	
Net sales	791.9	745.5	761.3	6.2	4.0	
Direct costs	500.9	475.1	499.4	5.4	0.3	
SG&A	153.5	151.8	146.1	1.1	5.1	
<b>EBITDA</b>	<b>137.5</b>	<b>118.7</b>	<b>115.8</b>	<b>15.9</b>	<b>18.8</b>	
Depreciation & amortisation	39.3	38.7	37.9	1.6	3.5	
EBIT	98.3	80.0	77.8	22.8	26.2	
Forex gain/(loss)	5.0	17.4	20.3	-71.5	-75.5	
Other income	14.3	14.3	13.3	-0.2	7.1	
PBT	117.5	111.8	111.5	5.1	5.4	
Tax provision	25.8	29.9	28.8	-13.5	-10.4	
<b>Net profit</b>	<b>91.7</b>	<b>81.9</b>	<b>82.6</b>	<b>11.9</b>	<b>10.9</b>	
EPS (Rs)	11.5	10.2	10.3	11.9	10.9	
<b>Margin (%)</b>				<b>BPS</b>	<b>BPS</b>	
EBITDA	17.4	15.9	15.2	145	216	
EBIT	12.4	10.7	10.2	168	218	
NPM	11.6	11.0	10.9	59	72	

Source: Company data

#### Other result highlights:

- ◆ Cash and cash equivalents stood at Rs. 1,117 crore in Q3FY2018 as against Rs. 999.2 crore reported in Q2FY2018.
- ◆ The company had hedges worth \$85 million at the rate of Rs. 67.1 compared to \$100 million at the rate of Rs. 67.99 in Q2FY2018.
- ◆ Days sales outstanding (DSO) remained flat q-o-q at 66 days.
- ◆ The company reduced its headcount by 137 q-o-q on net basis during the quarter, taking the total headcount to 9,109 employees. The company's technical workforce declined by 139 people to 8,460 employees. Sales and business development employees also declined by 2 people to 206 employees.

Operating metrics							
Particulars	Q3FY18	Q3FY17	Q2FY18	y-o-y (%)	q-o-q (%)	Comments	
<b>Geographic mix (%)</b>							
North America	84.4	86.6	83.4	8.5	5.0	U.S. business grew by 5.0% q-o-q (vs. 2.0% q-o-q growth in Q2FY2018)	
\$ mn	103.4	95.3	98.5				
Europe	7.3	5.3	8.5	53.4	-10.9		
\$ mn	8.9	5.8	10.0				
India	5.8	5.5	5.6	17.4	7.5		
\$ mn	7.1	6.1	6.6				
ROW	2.5	2.6	2.5	7.1	3.8		
\$ mn	3.1	2.9	3.0				
<b>Industry verticals</b>							
ISV	38.5	42.5	39.9	0.9	0.1	ISV revenue contribution to total revenue continued to decline. Expect to report steady growth in the coming quarters.	
\$ mn	47.2	46.8	47.1				
Enterprise	34.7	29.1	34.1	32.8	5.6		
\$ mn	42.5	32.0	40.3				
IP Led	26.8	28.4	26.0	5.1	6.9		
\$ mn	32.8	31.2	30.7				
<b>Service delivery</b>							
Onsite	32.1	26.7	31.9	33.9	4.4	Onsite revenue increased by 4.4% q-o-q (vs. 11.5% q-o-q growth in Q2FY2018).	
\$ mn	39.3	29.4	37.7				
Offshore	41.1	44.9	42.1	1.9	1.3		
\$ mn	50.4	49.4	49.7				
IP led revenue mix	26.8	28.4	26.0	5.1	6.9		
\$ mn	32.8	31.2	30.7				
<b>Segment mix</b>							
Services	41.9	43.9	43.7	6.3	-0.5	Alliance revenue increased by 12.5% q-o-q, led by strong seasonality. Accelerite revenue declined due to ramp-down of an account.	
\$ mn	51.3	48.3	51.6				
Digital	22.0	16.9	20.9	45.0	9.2		
\$ mn	27.0	18.6	24.7				
Alliance	29.6	30.6	27.3	7.7	12.5		
\$ mn	36.3	33.7	32.2				
Accelerite	6.5	8.6	8.1	-15.8	-16.7		
\$ mn	8.0	9.5	9.6				
<b>Clients billed</b>							
Clients billed in services	431	315	419	36.8	2.9		Clients billed in the services business grew by 2.9% q-o-q.
Clients billed in IP-led	268	339	277	-20.9	-3.2		
<b>Clients contribution</b>							
Top Client's	28.0	29.5	25.9	5.7	12.2	Revenue from the top client grew by 12.2% q-o-q, against the decline of 3.0% q-o-q in Q2FY2018.	
\$ mn	34.3	32.5	30.6				
Top 5 clients	46.3	46.0	43.8	12.1	9.7		
\$ mn	56.7	50.6	51.7				
Top 10 clients	55.3	54.6	53.5	12.8	7.2		
\$ mn	67.8	60.1	63.2				
Other than Top 10 Clients	44.7	45.4	46.5	9.6	-0.3		
\$ mn	54.8	50.0	54.9				
<b>Revenue (USD/PPM)</b>							
Onsite (USD / PPM)	16,314	15,704	16,023	3.9	1.8	Yield grew by 5.1% q-o-q.	
Offshore (USD / PPM)	4,220	4,257	4,148	-0.9	1.7		
Yield (USD / PPM)**	5,355	5,020	5,096	6.7	5.1		
<b>Efforts Mix</b>							
Billable person months - Onsite	2,777	2,109	2,689	31.7	3.3	Total billed person months growth remained flat on a sequential basis during the quarter.	
Billable person months - Offshore	15,166	14,968	15,556	1.3	-2.5		
Total billable person months	17,943	17,077	18,245	5.1	-1.7		
Billed person months - Onsite	2,413	1,867	2,346	29.2	2.9		
Billed person months - Offshore	11,922	11,610	11,994	2.7	-0.6		
Total billed person months	14,335	13,478	14,340	6.4	0.0		

## Operating metrics

Particulars	Q3FY18	Q3FY17	Q2FY18	y-o-y (%)	q-o-q (%)	Comments
<b>Number of clients</b>				<b>Change in clients y-o-y</b>	<b>Change in clients q-o-q</b>	
3 million dollar +	19	15	19	4	-	Addition of two clients (>\$1 million) during the quarter.
1 million dollar +	51	50	49	1	2	
<b>Employee metrics</b>				<b>Change in No (s)/BPS y-o-y</b>	<b>Change in No (s)/BPS in q-o-q</b>	
Technical	8,460	8,562	8,599	-102	-139	Headcount continued to decline – net reduction remained at 350 employees in 9MFY2018.
Sales & marketing	206	200	208	6	-2	
Rest	443	467	439	-24	4	
Headcount	9,109	9,229	9,246	-120	-137	
Attrition (%)	14.7	15.8	15.5	-110BPS	-80BPS	
<b>Utilisation rate</b>				<b>Change in BPS y-o-y</b>	<b>Change in BPS q-o-q</b>	
Utilisation (%)	79.9	78.9	78.6	100BPS	130BPS	Blended utilisation improved by ~130 BPS q-o-q.
Onsite utilisation (%)	86.9	88.5	87.2	-160BPS	-30BPS	
Offshore utilisation (%)	78.6	77.6	77.1	100BPS	150BPS	
<b>DSO</b>				<b>Change in days y-o-y</b>	<b>Change in days q-o-q</b>	
DSO	66	70	66	-4	-	DSO remained flat q-o-q.

\*\* Yield is computed as a ratio of revenue to billable person months (excluding employees under training).

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