

# Persistent

Rating: ◀▶

Target price: ▼

EPS: ▼

CMP

Rs. 409

Absolute

BUY

Target

Rs. 500

Relative

Outperform

## Weighed down by wage pressures

### An unexpected round of wage hikes ahead

Persistent posted solid revenue growth of 6.7% qoq and 27% yoy in US\$ terms, but faced a 110bps sequential EBITDA margin decline due to onsite shift and higher SG&A expenses than expected. Further, an unexpected 2<sup>nd</sup> round of wage hikes (~10% increase in wages) is on the cards for FY11, with effect from 1 Jan 2011. Midcap IT names have seen intense pressure on the wage front in 3Q, and Persistent is no exception. On the positive side, revenue momentum seems strong and management commentary on the tech spend environment is positive. Cloud and mobility in particular were flagged as areas seeing solid momentum. We agree that wage hike pressures will make for a muted near-term, but remain convinced on the medium-term growth potential for Persistent hinged on the structurally growing OPD market. Reiterate BUY with a Rs 520 target price.

### Highlights of the quarter's performance

- **Wage hike pressures ahead:** To mitigate high attrition levels, management has instituted a ~10% wage hike with effect from 1 Jan 2011. While this is expected to have a near term impact to the extent of 2.5ppts on Persistent's margins, this will get mitigated over time as the benefits of fresher hiring (~900 adds planned from the FY11 batch) and operational efficiencies begin to flow through. In balance the wage hikes should help stem attrition in the near term which should reduce the need for lateral hiring. Overall, we expect EBITDA margins to increase 90bps yoy in FY12E.
- **Key metrics:** The % of fixed price projects in the revenue mix increased to 13.9% in 3Q vs 10.7% in 2Q. DSOs increased to 67 days vs just 60 days in 3Q, reflecting the difficulty in garnering collections during the holiday season in the Western markets. There was a sharp increase in number of \$1-3mn clients to 29 vs 21 in 2Q which suggests improved traction in account mining efforts. Finally, sales efforts are on track with an addition of 7 salespeople in the quarter – sales headcount stands at 94 now vs. 71 at end of 4QFY10. This suggests a strong demand environment ahead as Persistent ramps up efforts to capture growth in a relatively benign environment.
- **Reiterate positive stance:** We agree that the stock faces a relatively muted near-term hinged on wage hike concerns and the flat earnings trajectory for FY12E. However, we still like Persistent in view of the structural growth prospects for OPD and Persistent's leading position within this space: as the market begins to look past the flat FY12E earnings, we believe Persistent will be viewed in better light. We reiterate our BUY/OPF on the stock with a Rs 500 target price.

### Financial summary

Year	Revenues (Rs. bn)	EBITDA (Rs. bn)	PAT (Rs. bn)	EPS (Rs.)	P/E(x)	EV/EBITDA(x)
FY10	6,012	1,464	1,150	32.1	14.2	8.9
FY11E	7,646	1,611	1,430	35.8	11.5	8.1
FY12E	9,607	2,113	1,462	36.6	11.2	6.2

### 3QFY11 Update

Date: Jan 27, 2010

#### Market Data

SENSEX	18684
Nifty	5604
Bloomberg	PSYS IN
Shares o/s	40mn
Market Cap	Rs 16.4bn
52-wk High-Low	Rs 507-365
3m Avg. Daily Vol	Rs 33mn
Index member	BSE Midcap

#### Latest shareholding (%)

Promoters	39
Institutions	31
Public	30

#### Stock performance (%)

	1m	3m	12m
Persistent	-3	-1	nm
CNXIT	-1	8	24
Nifty	-4	-5	14

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# Persistent

## Quarterly Financial Results

<b>CMP</b>	Rs. 409	<b>Absolute</b>	BUY
<b>Target</b>	Rs. 500	<b>Relative</b>	Outperform

Quarterly financial results								
Rs. mn\Period	31-Dec-10	31-Dec-09	yoy Growth	30-Sep-10	qoq Growth	FY11E	FY12E	yoy Growth
Revenue	1,949	1,584	23.1%	1,870	4.2%	7,646	9,607	25.6%
Software development expenses	1,270	967	31.3%	1,191	6.6%	5,021	6,254	24.6%
Operating and other expenses	252	227	10.6%	249	1.1%	1,015	1,240	22.2%
EBITDA	428	389	9.9%	430	-0.6%	1,611	2,113	31.2%
Depreciation and amortisation	106	90	17.6%	101	5.6%	405	426	5.2%
EBIT	321	299	7.6%	330	-2.5%	1,206	1,688	39.9%
Interest Income	38	37	nm	41	-7.0%	164	225	37.4%
Forex gain / loss	35	17	nm	18	92.9%	190	90	-52.5%
Interest Expense	0	0	nm	0		0	0	
PBT	395	353	12.0%	389	1.5%	1,560	2,003	28.4%
Tax	32	27	19.6%	31	5.7%	130	541	317.5%
PAT	362	325	11.4%	358	1.1%	1,430	1,462	2.2%
Extra Ordinary expense	0	0	nm	0		0	0	
PAT after extraordinary	362	325	11.4%	358	1.1%	1,430	1,462	2.2%
Basic EPS	9.6			9.5	0.8%	35.8	36.6	2.2%
<b>Diluted EPS</b>	<b>9.1</b>	<b>8.1</b>	<b>11.4%</b>	<b>9.0</b>		<b>35.8</b>	<b>36.6</b>	
Gross margin	35%	39%		36%		34%	35%	
EBITDA margin	22%	25%		23%		21%	22%	
EBIT margin	16.5%	18.9%		17.6%		15.8%	17.6%	
PAT margin	18.6%	20.6%		19.2%		18.7%	15.2%	

# Persistent Business Overview

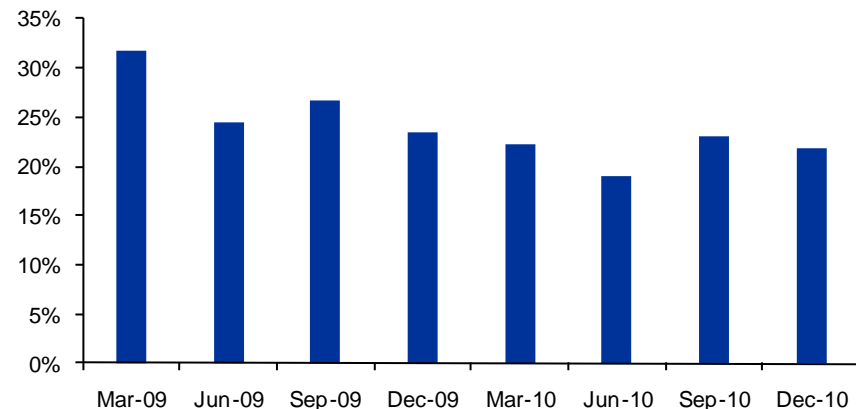
<b>CMP</b>	Rs. 409	<b>Absolute</b>	<b>BUY</b>
<b>Target</b>	Rs. 500	<b>Relative</b>	<b>Outperform</b>

## Key estimate revision

	FY11E			FY12E		
	Old	New	Change	Old	New	Change
US\$ Revenue	165	<b>168</b>	2.0%	204	<b>213</b>	4.7%
Revenue	7,486	<b>7,646</b>	2.1%	9,173	<b>9,607</b>	4.7%
USD/INR rate	45.5	<b>45.5</b>	0.1%	45.0	<b>45.0</b>	0.0%
EBITDA	1,653	<b>1,611</b>	-2.5%	2,191	<b>2,113</b>	-3.6%
Margin %	22.1%	<b>21.1%</b>		23.9%	<b>22.0%</b>	
EPS	37.2	<b>35.8</b>	-3.8%	38.1	<b>36.6</b>	-3.9%

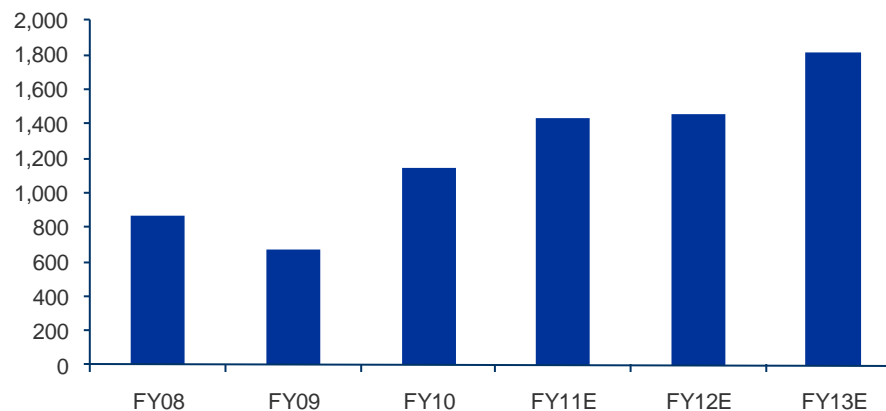
All figures in Rs. mn, except EPS, which is in Rs.

## EBITDA margin progression



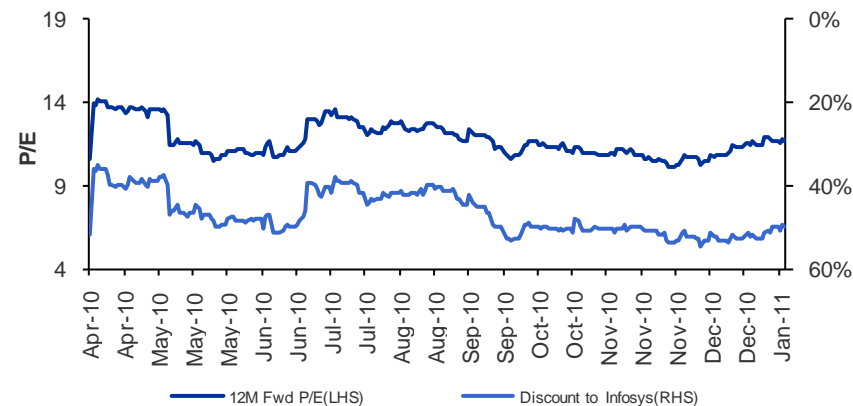
Source: Company data, Spark Capital

## Flattish PAT for FY12 – but this should improve in FY13



Source: Company data, Spark Capital

## Persistent 12-m forward P/E



Source: Bloomberg, Spark Capital

# Persistent Financial Summary

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Abridged Financial Statements				
Rs. mn	Mar-10	Mar-11	Mar-12	Mar-13
<b>Profit &amp; Loss</b>				
Revenues	6,012	7,646	9,607	11,554
Personnel expenses	3,687	5,021	6,254	7,470
Operating and other expenses	860	1,015	1,240	1,406
EBITDA	1,464	1,611	2,113	2,678
Depreciation and amortisation	335	405	426	519
EBIT	1,128	1,206	1,688	2,159
Interest Income	81	164	225	255
Forex gain / loss	32	190	90	0
PBT	1,241	1,560	2,003	2,414
Tax	91	130	541	604
PAT	1,150	1,430	1,462	1,811
Extra Ordinary expense	0	0	0	0
PAT after extraordinary	1,150	1,430	1,462	1,811
Diluted EPS	32	36	37	45
<b>Balance Sheet</b>				
Share capital	400	400	400	400
Shareholders Net worth	5,990	7,145	8,513	10,230
Deferred payment liabilities	45	36	36	36
<b>Liabilities</b>	<b>6,435</b>	<b>7,581</b>	<b>8,949</b>	<b>10,666</b>
<b>Gross Fixed Assets</b>	<b>3,715</b>	<b>4,353</b>	<b>5,053</b>	<b>5,853</b>
<b>Net fixed assets</b>	<b>1,834</b>	<b>2,086</b>	<b>2,361</b>	<b>2,642</b>
<b>CWIP</b>	<b>485</b>	<b>552</b>	<b>552</b>	<b>552</b>
Investments	1,562	2,513	2,513	2,513
Deferred tax assets	7	14	14	14
Current Assets	4,259	3,718	5,257	6,991
Current liabilities	1,711	1,302	1,747	2,045
<b>Total assets</b>	<b>6,435</b>	<b>7,581</b>	<b>8,949</b>	<b>10,666</b>

Key metrics				
Rs. mn	Mar-10	Mar-11	Mar-12	Mar-13
<b>Cash flows</b>				
Operations	1,611	1,183	1,258	1,775
Financials	-1,142	-2,289	-475	-545
Investing	1,264	-520	-39	-6
Closing Cash	1,896	269	1,013	2,238
<b>Key ratios (%)</b>				
Revenue grow th	1.2%	27.2%	25.6%	20.3%
EBITDA grow th	-18.1%	10.1%	31.2%	26.7%
PAT Grow th	74.0%	24.4%	2.2%	23.8%
EBITDA margin	24.3%	21.1%	22.0%	23.2%
EBIT Margin	18.8%	15.8%	17.6%	18.7%
PAT Margins	19.1%	18.7%	15.2%	15.7%
ROE	22.3%	20.5%	17.8%	18.5%
ROCE	22.3%	20.5%	17.8%	18.5%
<b>Valuation metrics</b>				
Shares o/s (mn)	32	40	40	40
Fully diluted shares (mn)	36	40	40	40
Market cap (Rs. mn)	16,380			
EV (Rs.mn)	13,027			
EV/Sales (x)	2.2x	1.7x	1.4x	1.1x
EV/EBITDA (x)	8.9x	8.1x	6.2x	4.9x
P/E (x)	14.2	11.5	11.2	9.0
EPS(E) / Current market price	7%	9%	9%	11%
<b>Per share data (Rs.)</b>				
Book value	178	189	223	266
Cash	96	70	88	119
Operating cash flow	45	30	31	44
Free cash flow	32	11	14	24

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## Absolute Rating Interpretation

<b>BUY</b>	Stock expected to provide positive returns of > 15% over a 1-year horizon
<b>ADD</b>	Stock expected to provide positive returns of <=15% over a 1-year horizon
<b>REDUCE</b>	Stock expected to fall <=15% over a 1-year horizon
<b>SELL</b>	Stock expected to fall >15% over a 1-year horizon

## Relative Rating Interpretation

<b>OUTPERFORM</b>	Stock expected to outperform sector index /sector peers in our coverage
<b>UNDERPERFORM</b>	Stock expected to underperform sector index/ sector peers in our coverage

## Recommendation History

Date	CMP	Target price	Absolute Rating	Relative Rating
10-Jan-11	438	520	BUY	OPF
14-Dec-10	401	520	BUY	OPF
22-Oct-10	421	520	BUY	OPF
11-Oct-10	433	520	BUY	OPF
30-Sep-10	438	520	BUY	OPF

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