

## Patience holds the key

CMP: Rs 363  
Target Price (TP): Rs 460  
52wk H/L: Rs 503/ Rs 305

Persistent Systems' (PSYS) Q1FY12 numbers were a tad short of expectations. However, growth momentum is intact.

### Steady quarter

PSYS reported results in line with our estimates (however, marginally below street expectations), delivering sequential revenue growth of 6.3% to USD50mn (5.2%QoQ to Rs2.24bn). EBITDA margin remained flat at 17.9%. The PAT of Rs276mn (-16.8%QoQ) and came in marginally lower than street estimates, impacted by significant jump in tax rates from 5% to 31%. However PBT grew 15%QoQ to Rs4bn.

### Partnerships/acquisitions to bolster organic opportunities

Client addition continues to remain healthy with 31 new clients added in Q1 (22 in Q3). Demand side is buoyant as the company continues to invest in IP initiatives. The company is making further strides to strengthen its portfolio in emerging growth areas, viz. acquisition of Agilent's software marketing and development business and the LTC deal to tap into the arena of personal medicine to bolster the life sciences practice, the partnership with Realcom in Japan, to expand the collaboration initiative.

### Margin pressure in FY12 to ease off in FY13

PSYS' EBITDA margin will be under pressure due to impending wage increases next quarter. We expect a bounce back in margins from Q3FY12, but expect a 100bps overall decline in FY12 to 19.3%. The four new technology areas analytics, mobility, cloud and collaboration are gaining traction, while contribution of IP-led revenue is expected to rise from 8.8% (FY11) to over 10.5% in FY13, providing cushion to margins. Apart from these, other margin levers available are fresher hiring, utilization (room to inch up from current 72.7%) and the 'Sell-with' initiative to up-sell products. We believe FY13 EBITDA margin will expand 50bps.

### Valuation and Recommendation

We expect PBT to grow 27% in FY12. Although we expect FY12 EPS to be lower than in FY11, we expect healthy EPS growth of 21% in FY13 to Rs40. The stock trades at 11x FY12 and 9.1x FY13 earnings. We value the stock at 11.5x FY13, which yields TP of Rs460. With demand expected to be robust and margin levers in place, we remain bullish, although the climb upwards would be gradual due to imminent headwinds in FY12. We recommend **BUY**.

#### Stock data

Market Cap (Rs bn)	15.7
Market Cap (USD mn)	353.3
Shares Outstanding (mn)	40.0
Free Float (%)	61.1
3M avg. daily vol.(mn)	0.07
Bloomberg Code	PSYS IN
Reuters Code	PERS.BO

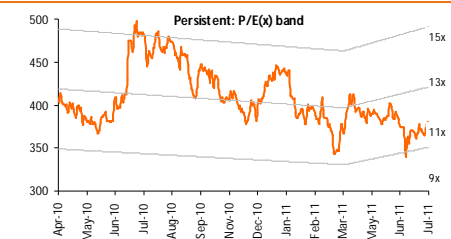
#### Shareholding Pattern (%)

Promoter	38.9
Institutions	31.1
Public & Others	30.0

#### Stock Performance

Return (%)	1m	3m	6m	12m
Absolute	13.1	(9.2)	(6.7)	(1.9)
Relative	6.3	(9.2)	(1.4)	(10.4)

#### P/E(x) band



Source: Bloomberg, Almondz Research

#### Exhibit 1: Quarterly Results

In Rs mn	FY11				FY12E				1QFY12 QoQ	FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			
Revenue	1,811	1,870	1,949	2,128	2,238	2,456	2,664	2,842	5.2%	7,758	10,199
Total Expenses	1,467	1,440	1,522	1,747	1,837	2,067	2,110	2,218	5.1%	6,175	8,233
EBITDA	344	430	428	381	401	389	553	623	5.3%	1,583	1,966
EBITDA margin (%)	19.0%	23.0%	21.9%	17.9%	17.9%	15.8%	20.8%	21.9%	0bps	20.4%	19.3%
Less: Depreciation	98	101	106	119	126	131	130	131	6.0%	424	518
Less: Interest	0	0	0	0	0	0	0	0		0	0
PBT (operating)	247	330	321	262	275	258	423	492	5.0%	1,159	1,448
Other income	125	59	73	87	126	115	111	111	44.6%	344	463
PBT	371	389	395	348	400	373	534	603	14.9%	1,504	1,911
Less: Tax	26	31	32	17	125	114	163	184	628%	106	586
Eff. tax rate (%)	7.0%	7.9%	8.2%	4.9%	31.1%	30.5%	30.5%	30.5%		7.1%	30.6%
PAT	345	358	362	331	276	259	371	419	-16.8%	1,397	1,326
Prior period items	0	0	0	0	0	0	0	0		0	0
Ex income/(loss)	0	0	0	0	0	0	0	0		0	0
PAT (after EO)	345	358	362	331	276	259	371	419	-16.8%	1,397	1,326
Basic EPS (Rs)	9.21	9.51	9.59	8.74	7.23	6.80	9.74	10.93	-17.3%	37.04	34.72
Dil. EPS (Rs)	8.63	8.96	9.06	8.27	6.89	6.48	9.26	10.42	-16.7%	34.92	33.06
Dil. shares (mn)	40.0	40.0	40.0	40.1	40.0	40.0	40.1	40.3		40.0	40.1

Source: Company, Almondz Research

**Exhibit 2: Common-size P&L key ratios**

P&L cost item % of sales	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	3Q FY11	4Q FY11	1Q FY12
Direct Costs	51.2%	60.0%	58.4%	62.0%	57.8%	60.9%	67.8%	62.7%
S&M expenses	8.7%	6.0%	7.6%	7.9%	9.1%	7.2%	7.7%	7.9%
G&A expenses	12.3%	10.6%	11.7%	11.1%	10.1%	10.0%	6.5%	11.4%

Source: Company, Almondz Research

**Robust pipeline to drive growth**

The product pipeline in North America is strong and growth in Europe has accelerated. Management continues to exude confidence in the pipeline ahead. PSYS' is focused on four growth areas, Mobility, Cloud computing, Analytics and Collaboration that continue to exhibit traction. Contribution of these new initiatives is currently ~40% of revenue. It is expected to increase to 43-45% next fiscal. This implies strong growth from these new efforts. Management plans to continue investing in IP, which would lead to contribution of IP-based revenue expanding to more than 10% in FY12 compared with 8.8% in FY11.

Overall, the growth engines – IP and the four growth areas continue to do well and are expected to accelerate in FY12.

**Exhibit 3: Vertical performance**

Telecom leads from the front →

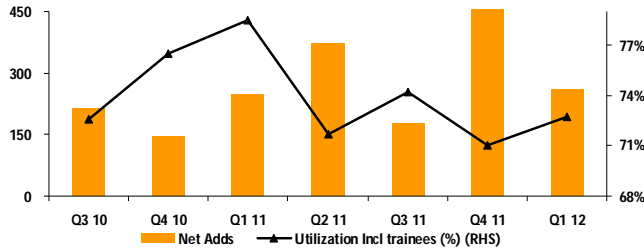
QoQ USD Growth	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Telecom & wireless	9.2%	-3.0%	-3.5%	10.8%	22.7%	-3.0%	15.2%
Infrastructure & systems	23.0%	15.2%	8.8%	-0.7%	0.5%	13.6%	5.7%
Life sciences & healthcare	10.8%	4.7%	2.8%	11.9%	16.7%	5.1%	-6.0%
<b>Total</b>	<b>18.2%</b>	<b>9.9%</b>	<b>5.7%</b>	<b>2.6%</b>	<b>6.7%</b>	<b>8.8%</b>	<b>6.3%</b>
Revenue Breakup							
Telecom & wireless	23.0%	20.3%	18.5%	20.0%	23.0%	20.5%	22.2%
Infrastructure & systems	66.5%	69.7%	71.7%	69.4%	65.4%	68.3%	67.9%
Life sciences & healthcare	10.5%	10.0%	9.7%	10.6%	11.6%	11.2%	9.9%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Company, Almondz Research

**Persistent's Q1FY12 Takeaways**

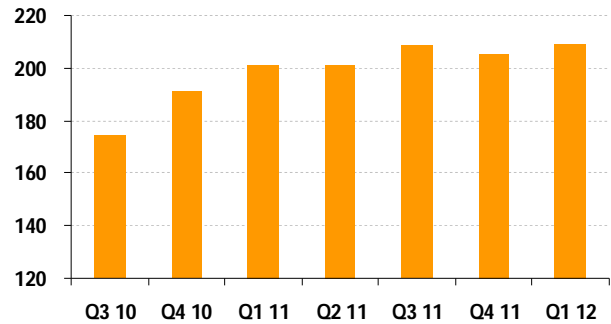
Positives	Negatives
<ul style="list-style-type: none"> <li>* Strong demand in OPD, atleast 6%QoQ to sustain FY12 remainder</li> <li>* Telecom growth robust at 15%QoQ</li> <li>* Growth in EBITDA/employee by 3%QoQ vs. 7% (INFY), -2%(TCS)</li> <li>* Maximum attrition decline by 1.2%</li> <li>* Highest growth in Europe - 36%QoQ</li> </ul>	<ul style="list-style-type: none"> <li>EBITDA margin pressure with 2nd round of wage hikes next quarter</li> <li>Highest tax rate for FY12 at 31%</li> <li>Lumpiness in IP-led revenues where cash strapped due to continued investments</li> </ul>

Exhibit 4: Hiring vs. Utilization



Source: Company, Almondz Research

Exhibit 5: Revenue/client (\$ '000s) – Expanding account sizes



Source: Company, Almondz Research

Europe market driving into fast lane

Exhibit 6: Geographic mix

QoQ USD Revenue growth	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
North America	14%	17%	3%	3%	7%	10%	2%
Europe	13%	-14%	7%	-5%	-6%	19%	36%
APAC	83%	-26%	35%	4%	17%	-8%	32%
<b>Total</b>	<b>18.2%</b>	<b>9.9%</b>	<b>5.8%</b>	<b>2.6%</b>	<b>6.7%</b>	<b>8.8%</b>	<b>6.3%</b>
% of revenue							
North America	82.0%	87.0%	85.1%	85.5%	85.4%	86.3%	82.8%
Europe	8.2%	6.4%	6.5%	6.0%	5.3%	5.8%	7.4%
APAC	9.8%	6.6%	8.4%	8.5%	9.3%	7.9%	9.8%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Company, Almondz Research

Exhibit 7: Other operating metrics

Operating Metrics	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
<b>Onsite-Offshore (Revenue) Mix</b>							
Onsite	11.6%	18.2%	19.3%	20.2%	22.2%	22.3%	22.6%
Offshore revenue	88.4%	81.8%	80.7%	79.8%	77.8%	77.7%	77.4%
<b>Revenue Mix</b>							
Fixed-price	16.9%	11.7%	9.8%	10.7%	13.9%	15.5%	14.1%
IP-driven	8.9%	7.8%	8.9%	8.1%	7.5%	10.3%	6.1%
T&M	74.2%	80.5%	81.3%	81.1%	78.6%	74.2%	79.8%
<b>Utilization</b>	<b>72.6%</b>	<b>76.5%</b>	<b>78.5%</b>	<b>71.7%</b>	<b>74.2%</b>	<b>71.0%</b>	<b>72.7%</b>
<b>Net Additions</b>	<b>213</b>	<b>144</b>	<b>249</b>	<b>370</b>	<b>179</b>	<b>900</b>	<b>260</b>
<b>Revenue/employee (\$)</b>	<b>8,105</b>	<b>8,639</b>	<b>8,671</b>	<b>8,256</b>	<b>8,523</b>	<b>7,903</b>	<b>8,093</b>
<b>EBITDA/employee (\$)</b>	<b>1,894</b>	<b>1,927</b>	<b>1,648</b>	<b>1,900</b>	<b>1,870</b>	<b>1,414</b>	<b>1,450</b>
<b>Client Concentration</b>							
Top 1	10.1%	14.7%	13.6%	16.3%	14.4%	19.4%	15.1%
Top 5	33.7%	41.5%	38.2%	37.9%	36.8%	41.5%	39.0%
Top 10	46.0%	51.7%	49.2%	49.5%	48.0%	52.8%	51.2%
<b>Clients billed</b>	<b>195</b>	<b>195</b>	<b>196</b>	<b>201</b>	<b>207</b>	<b>229</b>	<b>239</b>
<b>Repeat Business</b>	<b>87.8%</b>	<b>88.6%</b>	<b>98.8%</b>	<b>94.6%</b>	<b>92.7%</b>	<b>89.4%</b>	<b>97.0%</b>
<b>Attrition TTM</b>	<b>10.8%</b>	<b>13.7%</b>	<b>16.3%</b>	<b>18.6%</b>	<b>21.9%</b>	<b>19.6%</b>	<b>18.4%</b>

Utilization on an uptrend

Per employee (unit) metric improves

Client acquisitions take off with initiatives 'Sell-with'

Source: Company, Almondz Research

**Our estimates**

We expect PSYS to record 34.5% revenue growth in USD terms to USD229mn, ahead of the company's guidance of USD220mn. Although we estimate EPS to de-grow 5% in FY12 to Rs33.06 (due to significant increase in tax rates), growth at the PBT level is expected to be robust at 27%. We expect PS of Rs40 in FY13, a 21% growth.

## Financial summary

	(Rs mn)				
Income Statement	FY09	FY10	FY11	FY12E	FY13E
<b>Net sales</b>	<b>5938</b>	<b>6012</b>	<b>7758</b>	<b>10199</b>	<b>12749</b>
Other operating income	0	0	0	0	0
Total operating income	<b>5938</b>	<b>6012</b>	<b>7758</b>	<b>10199</b>	<b>12749</b>
Less: Total operating	<b>5025</b>	<b>4548</b>	<b>6175</b>	<b>8233</b>	<b>10229</b>
Raw materials					
Employee cost	3324	3687	4833	6574	8366
Power & Fuel					
SG&A	1701	860	1342	1659	1863
Others					
EBITDA	<b>914</b>	<b>1464</b>	<b>1583</b>	<b>1966</b>	<b>2520</b>
<b>EBITDA margin (%)</b>	<b>15.4%</b>	<b>24.3%</b>	<b>20.4%</b>	<b>19.3%</b>	<b>19.8%</b>
Less: Depreciation	297	335	424	518	576
Less: Interest	0	0	0	0	0
PBT (operating)	<b>617</b>	<b>1128</b>	<b>1159</b>	<b>1448</b>	<b>1944</b>
Add: Other income	69	112	344	463	309
PBT	<b>685</b>	<b>1241</b>	<b>1504</b>	<b>1911</b>	<b>2254</b>
Less: Tax	10	91	106	586	637
Effective tax rate (%)	1.4%	7.3%	7.1%	30.6%	28.3%
<b>PAT</b>	<b>676</b>	<b>1150</b>	<b>1397</b>	<b>1326</b>	<b>1617</b>
Add: Share of earnings of	(15)	0	0	0	0
Less: Minority interest	0	0	0	0	0
<b>Net income (before E.O.)</b>	<b>661</b>	<b>1150</b>	<b>1397</b>	<b>1326</b>	<b>1617</b>
Prior period items	0	0	0	0	0
Extraordinary income/(loss)	0	0	0	0	0
<b>Net income (after E.O.)</b>	<b>661</b>	<b>1150</b>	<b>1397</b>	<b>1326</b>	<b>1617</b>

	(Rs mn)				
Balance Sheet	FY09	FY10	FY11	FY12E	FY13E
Equity capital	359	400	400	405	405
Preference capital	0	0	0	0	0
Reserves and surplus	3589	5990	7071	8176	9568
Net worth	<b>3948</b>	<b>6390</b>	<b>7471</b>	<b>8581</b>	<b>9973</b>
Minority interest	0	0	0	0	0
Total debt	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Deferred tax liability	(20)	38	(30)	122	122
<b>Total liabilities</b>	<b>3927</b>	<b>6428</b>	<b>7441</b>	<b>8703</b>	<b>10095</b>
Gross block	3372	3715	4543	5983	7033
Less: Acc. depreciation	1573	1881	2281	2800	3375
Net block	<b>1800</b>	<b>1834</b>	<b>2261</b>	<b>3183</b>	<b>3658</b>
CWIP	377	485	605	683	683
Goodwill	0	0	0	0	0
Investments	880	1562	2500	2172	2172
Current assets	<b>1784</b>	<b>4258</b>	<b>3677</b>	<b>4669</b>	<b>6085</b>
Inventories	0	0	0	0	0
Debtors	1034	1363	1582	1970	2445
Cash	165	1918	1000	1236	1651
Loans and advances	454	638	869	1158	1504
Other Current assets	130	340	226	306	484
Current liabilities	<b>914</b>	<b>1710</b>	<b>1602</b>	<b>2004</b>	<b>2503</b>
Creditors	744	1394	1206	1591	1986
Provisions	170	317	396	414	516
Net working capital	<b>870</b>	<b>2548</b>	<b>2075</b>	<b>2665</b>	<b>3583</b>
<b>Total assets</b>	<b>3927</b>	<b>6428</b>	<b>7441</b>	<b>8703</b>	<b>10095</b>

	(Rs mn)				
Cash Flow Statement	FY09	FY10	FY11	FY12E	FY13E
Net profit	<b>661</b>	<b>1150</b>	<b>1397</b>	<b>1326</b>	<b>1617</b>
Depreciation	297	335	424	518	576
Working capital changes	(1221)	(1335)	(1706)	(2504)	(3360)
Others	962	1460	1460	2736	665
<b>Cash from Operations</b>	<b>698</b>	<b>1611</b>	<b>1575</b>	<b>2075</b>	<b>(502)</b>
Capital expenditure	(397)	(235)	(708)	(1362)	(1050)
Increase/Decrease in	188	682	939	(328)	0
Others	(221)	(878)	(2759)	250	1050
<b>Cash from investing</b>	<b>(430)</b>	<b>(431)</b>	<b>(2529)</b>	<b>(1440)</b>	<b>0</b>
Increase/Decrease in Equity	0	41	0	5	0
Change in borrowings	0	0	0	0	0
Dividends paid (incl. tax)	4	(22)	(240)	(191)	(194)
Others	(221)	553	275	(213)	1111
<b>Cash from financing</b>	<b>(217)</b>	<b>573</b>	<b>36</b>	<b>(399)</b>	<b>918</b>
<b>Net change in cash</b>	<b>52</b>	<b>1752</b>	<b>(918)</b>	<b>236</b>	<b>415</b>
Opening cash balance	<b>113</b>	<b>165</b>	<b>1918</b>	<b>1000</b>	<b>1236</b>
<b>Closing cash balance</b>	<b>165</b>	<b>1918</b>	<b>1000</b>	<b>1236</b>	<b>1651</b>

Ratio Analysis	FY09	FY10	FY11	FY12E	FY13E
EPS (Rs.)	18.43	32.06	34.92	33.06	40.03
EPS growth (%)	-20.5%	74.0%	8.9%	-5.3%	21.1%
Cash EPS (Rs.)	27	41	46	46	54
BV (Rs.)	124	199	198	225	257
DPS (Rs.)	0	2.5	5.5	5.0	5.0
Payout (%)		8%	16%	15%	12%

Valuation (x)	FY09	FY10	FY11	FY12E	FY13E
P/E (on adjusted FD EPS)		11.7	10.7	11.0	9.1
P/CEPS		9.0	8.2	8.1	6.9
P/BV		1.9	1.9	1.7	1.5
EV/EBITDA		5.8	6.7	5.5	4.2
EV/Sales		1.4	1.4	1.1	0.8
Dividend yield (%)		0.7%	1.5%	1.3%	1.3%

Profitability ratios (%)	FY09	FY10	FY11	FY12E	FY13E
RoE	18.3%	22.3%	20.2%	16.5%	17.4%
RoCE	18.7%	22.2%	20.2%	16.4%	17.2%

Turnover ratios	FY09	FY10	FY11	FY12E	FY13E
Debtors (days)	64	83	74	71	70
Inventory (days)					
Creditor (days)	15	39	35	35	33
Net Working capital (days)	48	43	39	35	37
Asset turnover (x)	1.5	0.9	1.0	1.2	1.3

Solvency ratio (x)	FY09	FY10	FY11	FY12E	FY13E
Gross debt / equity					
Net debt / equity	(0.3)	(0.5)	(0.5)	(0.4)	0.0
Net debt/ EBITDA	(1.1)	(2.4)	(2.2)	(1.7)	(1.5)
Interest Coverage (EBIT /					

Growth ratios (%)	FY09	FY10	FY11	FY12E	FY13E
Net sales	40%	1%	29%	31%	25%
EBITDA	2%	60%	8%	24%	28%
PAT (before E.O.)	-21%	74%	21%	-5%	22%
EPS	-21%	74%	9%	-5%	21%

Operating ratios (%)	FY09	FY10	FY11	FY12E	FY13E
EBITDA margin	15%	24%	20%	19%	20%
EBIT margin	12%	21%	19%	19%	18%
PAT margin	11%	19%	18%	13%	13%
Other income/PBT	10%	9%	23%	24%	14%
Effective Tax rate	1%	7%	7%	31%	28%

## Team Coordinates

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