

Mgmt meeting allays fears of margin underperformance

Buy for ~40% upside

Post our recent co. meeting, Retain PSYS as preferred mid-cap IT pick (along with Hexaware) with PO of Rs550 at 13x FY13P/E, 5-10% premium to mid-cap peers. We were encouraged by (1) a strategic deal win reflecting continuing momentum in IP-based revenues that should aid operating margin performance, (2) a declining trend in attrition rates that should abate FY12 wage hike pressures and (3) the recent acquisition of Infospectrum, which improves the company's presence in the European market.

Momentum in IP-based revs & other margin levers intact

The company recently closed a strategic deal win in the life-sciences space and has another two in the pipeline. We have estimated IP-led revs to increase to ~12% in FY13 (vs. 8% in FY11) and is a key lever for the company to offset impact of wage hikes. Widening of employee pyramid (925 campus hires for FY12 vs. 400 last year) & improved utilization rates are the other margin levers.

Slowing attrition to moderate FY12 wage hike pressures

Company had declared an interim wage hike of 10% in Q3 to safeguard from any potential impact to delivery (from high attrition) as it remains in a high growth environment. Attrition rates are now showing a declining trend on a month-on-month basis vs Q3 (22% LTM). We believe that as attrition concerns abate further, FY12 wage hikes at Persistent are likely to be lower than industry and possibly staggered over the year.

Infospectrum acquisition to improve European presence

Recent acquisition of Infospectrum, another Offshore Product Development player with focus on cloud computing, enterprise mobility improves presence in the European market (currently just 5% of revs). Client overlap is minimal with potential cost synergies to be realized in Persistent's Nagpur facility.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	661	1,150	1,347	1,351	1,767
EPS	18.43	32.05	33.67	33.77	44.18
EPS Change (YoY)	NA	73.9%	5.0%	0.3%	30.8%
Dividend / Share	1.00	2.20	4.00	0	0
Free Cash Flow / Share	6.52	35.24	7.88	10.55	16.10

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	20.88x	12.01x	11.43x	11.40x	8.71x
Dividend Yield	0.260%	0.572%	1.04%	0%	0%
EV / EBITDA*	6.21x	7.58x	7.01x	5.19x	3.93x
Free Cash Flow Yield*	1.43%	7.79%	2.05%	2.78%	4.27%

* For full definitions of *iQmethod*SM measures, see page 4.



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Stock Data

Price	Rs384.90
Price Objective	Rs550.00
Date Established	9-Jan-2011
Investment Opinion	C-1-8
Volatility Risk	HIGH
52-Week Range	Rs308.41-Rs504.89
Mrkt Val / Shares Out (mn)	US\$323 / 37.8
Average Daily Volume	48,284
BofAML Ticker / Exchange	XPSYF / NSI
Bloomberg / Reuters	PSYS IN / PERS.BO
ROE (2011E)	19.3%
Net Dbt to Eqty (Mar-2010A)	-54.5%
Est. 5-Yr EPS / DPS Growth	20.0% / NA
Free Float	43.0%

Key Changes

(Rs)	Previous	Current
2011E EPS	33.81	33.67
2012E EPS	33.81	33.77
2013E EPS	44.22	44.18
2011E EBITDA (m)	1,582.8	1,583.8
2012E EBITDA (m)	2,128.8	2,139.4
2013E EBITDA (m)	2,813.2	2,825.0

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Refer to important disclosures on page 5 to 7. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11028162

10 March 2011

iQprofileSM Persistent Systems

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	5,938	6,012	7,700	10,002	12,418
Gross Profit	2,902	2,639	3,005	3,920	5,023
Sell General & Admin Expense	(1,115)	(1,176)	(1,422)	(1,780)	(2,198)
Operating Profit	1,491	1,128	1,171	1,680	2,256
Net Interest & Other Income	(805)	112	296	249	164
Associates	NA	NA	NA	NA	NA
Pretax Income	685	1,241	1,467	1,929	2,421
Tax (expense) / Benefit	(9)	(91)	(120)	(579)	(654)
Net Income (Adjusted)	661	1,150	1,347	1,351	1,767
Average Fully Diluted Shares Outstanding	36	36	40	40	40

Key Cash Flow Statement Data

Net Income	676	1,150	1,347	1,351	1,767
Depreciation & Amortization	297	335	412	459	569
Change in Working Capital	(401)	498	(614)	(321)	(425)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	127	(373)	(139)	(149)	(164)
Cash Flow from Operations	698	1,611	1,007	1,340	1,747
Capital Expenditure	(490)	(476)	(709)	(934)	(1,125)
(Acquisition) / Disposal of Investments	(164)	(710)	(1,168)	0	0
Other Cash Inflow / (Outflow)	60	45	(134)	149	164
Cash Flow from Investing	(594)	(1,142)	(2,011)	(785)	(960)
Shares Issue / (Repurchase)	(15)	4	0	0	0
Cost of Dividends Paid	(36)	(27)	(142)	0	0
Cash Flow from Financing	(51)	1,264	(142)	0	0
Free Cash Flow	208	1,134	298	405	622
Net Debt	(1,046)	(3,479)	(3,501)	(4,055)	(4,841)
Change in Net Debt	NA	NA	NA	NA	NA

Key Balance Sheet Data

Property, Plant & Equipment	1,800	1,834	1,999	2,290	2,653
Other Non-Current Assets	398	492	896	1,080	1,273
Trade Receivables	1,034	1,363	1,497	1,889	2,346
Cash & Equivalents	1,046	3,479	3,501	4,055	4,841
Other Current Assets	584	977	1,116	1,500	1,863
Total Assets	4,862	8,145	9,009	10,815	12,976
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	0	45	45	45	45
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	914	1,710	1,369	1,825	2,218
Total Liabilities	914	1,755	1,414	1,870	2,264
Total Equity	3,948	6,390	7,594	8,945	10,712
Total Equity & Liabilities	4,862	8,145	9,009	10,815	12,976

iQmethodSM - Bus Performance*

Return On Capital Employed	NA	20.3%	16.7%	15.4%	17.9%
Return On Equity	33.5%	22.3%	19.3%	16.3%	18.0%
Operating Margin	25.1%	18.8%	15.2%	16.8%	18.2%
EBITDA Margin	30.1%	24.3%	20.6%	21.4%	22.7%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.1x	1.4x	0.7x	1.0x	1.0x
Asset Replacement Ratio	1.7x	1.4x	1.7x	2.0x	2.0x
Tax Rate (Reported)	1.4%	7.3%	8.2%	30.0%	27.0%
Net Debt-to-Equity Ratio	-26.5%	-54.5%	-46.1%	-45.3%	-45.2%
Interest Cover	NA	NA	NA	NA	NA

Key Metrics

* For full definitions of iQmethodSM measures, see page 4.

Company Description

Persistent is a leading outsourced software product development company (in a fragmented industry) - with annualized revs of approx USD160m and over 5000 employees. The company has approx 300 clients (pre-dominantly software vendors) including large global technology players like IBM, Microsoft and many early stage companies.

Investment Thesis

We believe outsourced software product development industry is in a sweet spot as 1) Client R&D budgets are on the upswing and 2) offshore penetration levels are set to improve. Persistent should be a key beneficiary in this environment as its investments in cloud computing, mobility, enterprise collaboration and analytics begin pay-off.

Stock Data

Price to Book Value 1.9x

Price objective basis & risk

Persistent Systems (XPSYF)

Our PO of Rs550 is set at approx 13x FY13 P/E, a 5-10% premium vs. other mid-tier IT services vendors, justified in our view given highest EBITDA growth and ROCE vs. peers. Exceptional jump in tax rate from 9% (FY11) to 30% (FY12) impacts implied P/E for FY12 (16x).

Downside risks to our price objective are a slowdown in the US technology sector, sharp appreciation of the Rupee vs. the USD and higher-than-expected wage inflation in India.

Link to Definitions

Technology

Click [here](#) for definitions of commonly used terms.

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10 March 2011

India - Software & IT Services Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	D.B.Corp Ltd	XDDCF	DBCL IN	Pratish Krishnan
	Educomp Solu	EUSOF	EDSL IN	Pratish Krishnan
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	HCL	XHCLF	HCLT IN	Mitali Ghosh
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
	Jagran Prakashan Ltd	JGRPF	JAGP IN	Pratish Krishnan
	Persistent Systems	XPSYF	PSYS IN	Kunal Tayal
	Rolla India	RLTAF	RLTA IN	Pratish Krishnan
	Rolla India-GDR	XLROF	RTI LI	Pratish Krishnan
	Sun TV Network Ltd	SUTVF	SUNTV IN	Pratish Krishnan
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Zee Entertainment	XZETF	Z IN	Pratish Krishnan
NEUTRAL				
	ExlService Holdi	EXLS	EXLS US	Mitali Ghosh
	Infotech Enterprises Ltd	IFKFF	INFTC IN	Pratish Krishnan
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh
UNDERPERFORM				
	Genpact Ltd	G	G US	Mitali Ghosh
	Mastek	MSKDF	MAST IN	Pratish Krishnan
	Mphasis Ltd	MPSSF	MPLH IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations - Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations - Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

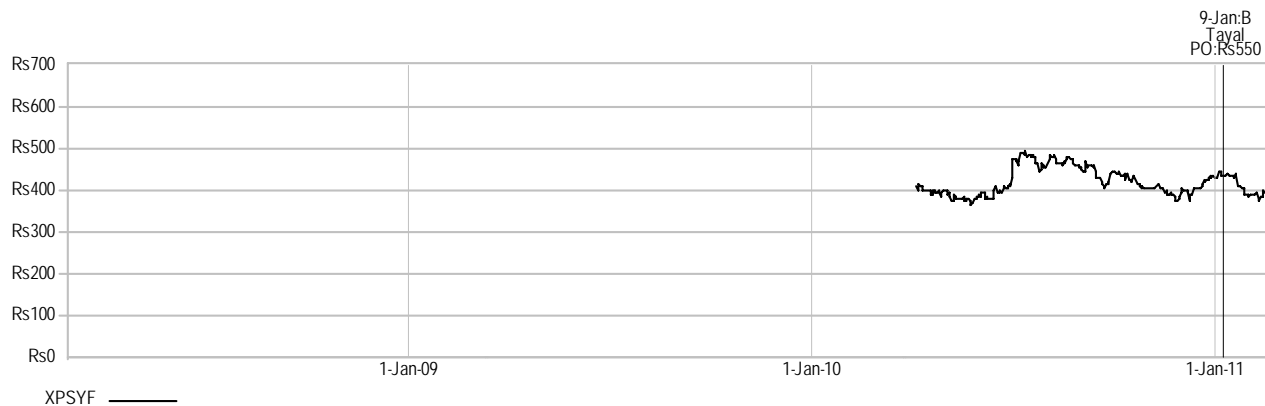
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XPSYF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2011 or such later date as indicated.

Investment Rating Distribution: Technology Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	128	54.01%	Buy	53	46.49%
Neutral	48	20.25%	Neutral	21	46.67%
Sell	61	25.74%	Sell	16	27.59%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
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Underperform	N/A	≥ 20%

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