

Persistent Systems

Bloomberg: PSYS IN EQUITY

Reuters: PERS.BO

Recommendation: HOLD

Downgrade from Buy



RESULT UPDATE

It's a marathon, not a sprint

Persistent's stock performance has been nothing short of a dream run at 26% since our recent initiation report (refer 'Leading Persistently', dated 14 June 2010). While 1Q FY11 results have been better-than-expected and our confidence on the fundamentals of the business model continues, valuations at 13.3x FY11E and 11.9x FY12E EPS appear fair. We are revising our Mar-11 target price upwards to Rs525 (13x FY12E EPS) which presents a 9% upside. We are changing the recommendation from BUY to HOLD as we believe that most of the triggers required for re-rating have played out and the stock movement could be sedate from hereon.

- Strong topline growth, IP led revenues grow well:** Revenues at US\$39.5 mn grew by 5.8% QoQ (v/s estimate of 3.7% QoQ) led by volume growth of 3% QoQ, IP led revenue contribution increase of 1.1% QoQ and rest from improvement in pricing realization. IP led revenues grew strongly by 20.2% QoQ to 8.9% of revenues. Rupee revenue at Rs1.81 bn grew 5.4% QoQ (v/s est. of 3.0% QoQ). PAT at Rs345 mn declined by 13.0% QoQ better than est. at -18.4% QoQ.
- EBITDA margin decline of 330 bps, average wage hikes/promotions of 12.5%:** EBITDA margin at 19.0% declined by 330bps (v/s est. -110bps). Margins were impacted primarily due to wage hikes & promotions (12.5% average) and strong onsite movement (+1.1% QoQ).
- Demand environment looks sanguine; traction in ISVs remains strong:** Management mentioned that the demand environment looks sanguine and they see a robust pipeline ahead. Infrastructure and systems (71.1% of revenue) grew strongly at 9.0% QoQ. Management noted that large product companies are looking at feature upgrades and new products and are increasingly looking at redesigning the products to host it on the cloud platform. Further, the enterprise opportunity looks promising (where there is a possibility to garner higher margins). We believe that Persistent's in-depth technical expertise and service offerings in the emerging technologies (cloud computing, enterprise collaboration, mobility and analytics) lends it a real competitive edge and would keep it ahead of the growth curve in the Outsourced Product Development space.
- Guidance maintained, but outperformance looks very obvious:** Management has chosen to maintain its US\$ revenue guidance and PAT (Rs terms) for FY11E at 21.7% YoY. We believe that this displays management's over-conservativeness as the required CQGR for achieving the guidance is only at -1% on revenues and +1% on PAT, which looks visibly low. We remain confident of our +30% US\$ revenue growth est. in FY11/FY12E.

We are increasing our EPS estimates to Rs36.3 (+3.0%) for FY11E and Rs40.3 (+6.6%) for FY12E given the better-than-expected topline and PAT performance. Consequently, we are revising our target price upwards to Rs 525 (13x FY12E EPS) which implies an upside potential of 9% from the current price.

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Recommendation

CMP:	Rs481
Target Price (Mar-11):	Rs525
Previous TP:	Rs455
Upside/Downside (%)	9.0
EPS (FY11E):	Rs36.3
Change from previous (%)	3.0

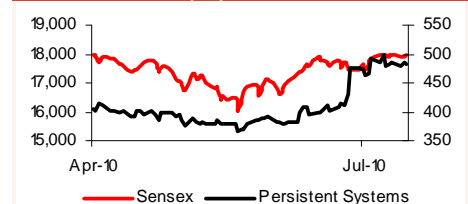
Stock Information

Mkt cap (mn):	Rs19,290/US\$407
52-wk H/L:	508/310
3M Avg. daily vol. (mn):	1
Beta (x):	0.0
BSE Sensex:	17,977
Nifty:	5,399

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	21.2	19.8	0.0	0.0
Rel. to Sensex	20.5	16.4	0.0	0.0

Performance (%)



Source: Bloomberg, Ambit Capital research

Exhibit 1: Change in assumptions

Change in assumptions	New estimates		Old estimates	
	FY11E	FY12E	FY11E	FY12E
Revenue (US\$ mn)	171	224	164	207
Revenue growth (US\$,%)	34.2	31.2	28.8	26.5
Avg US\$/INR (appreciation)/depreciation (%)	(4.6)	(2.0)	(6.0)	(2.1)
Revenue (Rs mn)	7,717	9,926	7,294	9,038
Revenue growth (Rs,%)	28.4	28.6	21.3	23.9
EBITDA margin (%)	20.9	22.9	22.1	22.3
Effective tax rate (%)	8.9	23.0	9.5	23.0
EPS (Rs)	36.3	40.3	35.2	37.8
EPS growth (%)	25.8	11.2	22.2	7.4
Target price (Rs)		524		455

Source: Ambit Capital research

Exhibit 2: Quarterly performance

Rs mn	1Q 10	4Q 10	1Q 11	1Q 11E	QoQ %	YoY%
Revenue	1,320	1,717	1,811	1,769	5.4	37.1
Software development expenses	691	1,002	1,123	1,040	12.1	62.6
Gross profit	629	715	687	729	-3.9	9.2
Selling and marketing expenses	133	131	143	143	9.2	7.6
General and administration expenses	174	201	200	210	-0.3	14.8
EBITDA	322	383	344	375	-10.2	6.8
EBITDA margin (%)	24.4	22.3	19.0	21.2	-331bps	-539bps
Depreciation	76	88	98	90	11.0	27.9
Other income	18	15	33	35	120.8	88.4
Foreign exchange gain/(loss)	-77	107	91	37	-14.4	-218.4
PBT	186	417	371	358	-11.0	99.0
Tax	11	20	26	34	28.6	131.2
PAT	175	397	345	324	-13.0	96.9

Source: Company, Ambit Capital research

Financials

Exhibit 3: Profit and loss statement

Y/E March (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
Net sales	4,249	5,938	6,012	7,717	9,926
Growth (%)	34.6	39.8	1.2	28.4	28.6
EBITDA	913	1,788	1,464	1,610	2,272
EBITDA (%)	21.5	30.1	24.3	20.9	22.9
Growth (%)	13.4	95.8	-18.1	10.0	41.1
Other non-operational income	256	-805	112	378	314
Depreciation & amortisation	280	297	335	399	496
EBIT	889	685	1,241	1,589	2,090
Taxes	22	10	91	142	481
Extraordinary (income)/expense (net)	35	15	0	0	0
Restatements	3	7	0	0	0
Adjusted net profit	835	668	1,150	1,447	1,609
Margin (%)	19.6	11.2	19.1	18.8	16.2
Diluted Share capital (mn)	40	40	40	40	40
EPS (Rs)	20.9	16.7	28.8	36.3	40.3
Growth (%)	45.8	-20.0	73.3	25.8	11.2

Source: Company, Ambit Capital research

Exhibit 4: Cash flow statement

Y/E March (Rsmn)	FY08	FY09	FY10	FY11E	FY12E
Net Profit Before Tax & Exceptional Items	892	685	1,241	1,589	2,090
Depreciation/amortisation	280	297	335	399	496
(Inc)/dec in working capital	-45	-401	498	-486	208
Others	-103	118	-464	-517	-795
Net cash from operations (a)	1,024	699	1,611	985	1,999
(Inc)/dec in investments (net)	-451	-164	-710	-1,284	0
Capex	-510	-490	-476	-1,250	-800
Others	29	60	45	378	314
Cash flow from inv. (b)	-932	-594	-1,142	-2,156	-486
Inc/(dec) in capital	0	0	41	0	0
Dividends paid + dividend tax	-50	-36	-27	-105	-172
Inc/dec in loans	0	0	0	0	0
Others	142	87	-1,278	209	344
Financial cash flow (c)	-92	-51	1,264	-105	-172
Net inc/dec in cash (a+b+c)	0	55	1,733	-1,276	1,342
Opening cash balance	109	109	163	1,918	641
Exchange difference on translation of foreign currency	0	0	0	0	0
Closing cash balance	109	164	1,896	641	1,983

Source: Company, Ambit Capital research

Exhibit 5: Balance sheet

Y/E March (Rsmn)	FY08	FY09	FY10	FY11 E	FY12E
Share capital	359	359	400	400	400
Stock options outstanding	6	21	32	32	32
Reserves & surplus	2,915	3,569	5,958	7,236	8,657
Networth	3,280	3,948	6,390	7,668	9,089
Deferred tax liability	3	0	45	45	45
Sources of funds	3,282	3,948	6,435	7,713	9,134
Fixed assets	2,928	3,372	3,715	4,865	5,565
Less: Depreciation/amortisation	1,286	1,573	1,881	2,280	2,776
Net block	1,643	1,800	1,834	2,585	2,789
CWIP	331	377	485	585	685
Deferred tax assets	0	20	7	7	7
Current assets	2,038	2,664	5,820	6,321	7,871
Sundry debtors	745	1,034	1,363	1,311	1,632
Cash & bank balance	113	165	1,918	640	1,981
Other current assets	781	1,010	1,901	3,002	3,046
Loans & advances	399	454	638	1,369	1,212
Current liabilities & provisions	745	914	1,710	1,784	2,217
Net current assets	1,293	1,750	4,110	4,537	5,654
Application of funds	3,267	3,948	6,435	7,713	9,134

Source: Company, Ambit Capital research

Exhibit 6: Key ratios

Y/E March (Rsmn)	FY08	FY09	FY10	FY11 E	FY12E
ROCE (%)	21.7	41.2	21.7	17.1	21.1
ROE (%)	29.8	18.9	22.3	20.6	19.2
Valuation ratios (x)					
PER	18.4	23.1	16.7	13.3	11.9
PBV	4.7	3.9	3.0	2.5	2.1
EV/EBITDA	17.9	9.0	9.3	8.5	5.4
EV/Sales	3.8	2.7	2.3	1.8	1.2
Turnover ratios (no.)					
Debtor days	55	55	73	63	54

Source: Company, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	< 5%

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