

JUNE 18, 2019

	17-Jun	% Chg		
		1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	38,961	(1.2)	2.7	2.5
NIFTY Index	11,672	(1.3)	2.3	2.1
NSEBANK Index	30,273	(1.1)	2.8	3.0
NIFTY 500 Index	9,544	(1.3)	2.3	0.5
CNXMcap Index	17,359	(1.2)	2.9	(2.8)
BSESMCAP Index	14,173	(1.3)	2.1	(4.5)
World Indices				
Dow Jones	26,113	0.1	1.4	0.8
Nasdaq	7,845	0.6	0.4	1.7
FTSE	7,357	0.2	0.1	0.8
NIKKEI	21,124	0.0	(0.9)	(2.4)
Hangseng	27,227	0.4	(1.9)	(6.8)
Shanghai	2,888	0.2	0.3	(6.6)

	17-Jun	% Chg Day	
Value traded (Rs cr)			
Cash BSE	1,939		(14.2)
Cash NSE	28,492		(0.9)
Derivatives	802,265		5.1

	14-Jun	MTD		YTD
Net inflows (Rs cr)				
FII	(184)	340	78,387	
Mutual Fund	88	(362)	2,140	

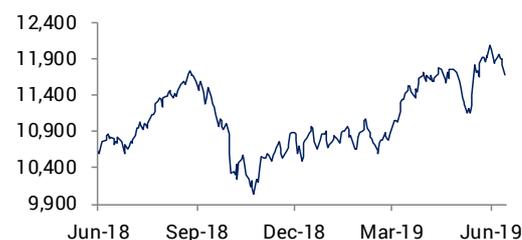
	17-Jun	Price (Rs)	Chg (%)	Vol (mn)
Gainers				
Yes Bank Ltd		116	1.0	84.4
Zee Entertainment		338	0.5	5.1
Wipro		299	0.1	6.2
Losers				
Tata Steel		473	(5.7)	11.9
JSW Steel		260	(4.1)	8.5
Tata Motors		159	(3.3)	14.4

	17-Jun	Advances / Declines (BSE)				% total
		A	B	T	Total	
Advances	70	228	40	338	100	
Declines	389	737	78	1,204	356	
Unchanged	2	25	5	32	9	

	17-Jun	% Chg		
		1 Day	1 Mth	3 Mths
Commodity				
Crude (US\$/BBL)	60.8	(0.2)	(15.8)	(9.9)
Gold (US\$/OZ)	1,339.6	(0.2)	5.0	2.9
Silver (US\$/OZ)	14.8	(0.1)	3.0	(3.3)

	17-Jun	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	6.9	6.9	7.4	7.3
Re/US\$	69.9	69.8	70.2	68.5

Nifty



Source: Bloomberg

News Highlights

- ▶ Government is considering selling controlling stakes in some of the smaller state-run banks in a bid to raise funds to boost spending on programs for the poor. (BS)
- ▶ Fitch Ratings Inc. lowered India's growth forecast to 6.6 percent for the current fiscal from 6.8 percent projected earlier, as manufacturing and agriculture sectors showed signs of slowing down over the past year. (Mint)
- ▶ The Securities and Exchange Board of India (Sebi) is likely to lay down a slew of measures to improve transparency and risk-management practices for the mutual fund (MF) industry's loan-against-shares (LAS) exposure. (BS)
- ▶ **HDFC Asset Management Company (AMC)** has offered exits to investors of some fixed-maturity plans (FMPs) by transferring Rs 5 bn worth of their exposures to Essel group firms on to its own books. (BL)
- ▶ Lenders to **Jet Airways (India) Ltd.** have decided to approach the National Company Law Tribunal to initiate insolvency proceedings against the airline. (BS)
- ▶ **Airtel** will sell shares of its Africa unit in the planned initial public offering in London at a discount to its previous fundraising. Airtel Africa IPO price at 80-100 pence per share. It plans to raise close to \$750 million. (ET)
- ▶ **Indigo** would be ordering jet engines worth \$20 billion from CFM International, a joint venture of General Electric Co. and France's Safran SA, to power 280 Airbus A320neo and A321neo aircraft operated by it. (Mint)
- ▶ **YES Bank** plans to raise \$1.2 billion over 18 months to bolster its capital buffer through a mix of public and private share sale. (BS)
- ▶ **UCO Bank** has declared Yashovardhan Birla as wilful defaulter for non-payment of Rs 675 mn given to Birla Surya Ltd. (BL)
- ▶ **Piramal Enterprises Ltd (PEL)** has sold its entire direct investment of 9.96 per cent in the fully paid-up share capital of Shriram Transport Finance Company Ltd (STFC) to third party investors on the floor of the stock exchange. PEL had acquired this stake in 2013. (BL)
- ▶ **Bandhan Bank** has reduced interest rate on microloans by 70 basis points to 17.95 per cent from 18.65 per cent at present. The new rate of interest would be applicable to new disbursements from June 18, 2019. (BL)

What's Inside

- ▶ **Company Update:** Persistent Systems Ltd

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, BQ = BloombergQuint, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

Analyst Meet Update

PERSISTENT SYSTEMS LTD (PERSISTENT)

Stock Details

Market cap (Rs mn)	:	48888
52-wk Hi/Lo (Rs)	:	915 / 532
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	154,366
Shares o/s (mn)	:	79

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Revenue	33,659	36,431	39,296
Growth (%)	11.0	8.2	7.9
EBITDA	5,805	6,289	6,784
EBITDA margin (%)	17.2	17.3	17.3
PAT	3,517	3,835	4,058
EPS	45.5	49.6	52.5
EPS Growth (%)	8.8	9.1	5.8
BV (Rs/share)	296	338	375
Dividend/share (Rs)	11.0	12.0	13.0
ROE (%)	15.7	15.5	14.7
ROCE (%)	22.8	21.5	20.8
P/E (x)	13.6	12.5	11.8
EV/EBITDA (x)	7.1	6.3	5.4
P/BV (x)	2.1	1.8	1.7

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	30.5	30.5	30.4
FII	23.5	23.5	26.5
DII	19.6	19.6	17.2
Others	23.6	23.6	22.6

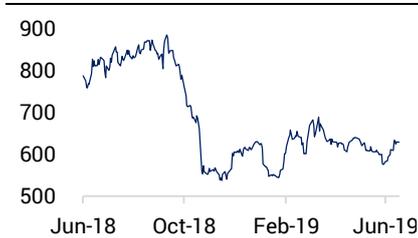
Source: Bloomberg

Price Performance (%)

(%)	1M	3M	6M
Persistent Systems	2.0	(7.5)	1.5
Nifty	2.3	2.1	7.2

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

PRICE RS.619

TARGET RS.735

BUY

Recently, we attended Persistent Systems analyst meet conducted in Mumbai, organized to share future roadmap, post the appointment of the new CEO Mr. Christopher (Chris) O'Connor. Mr. Chris has more than three decades of experience in the IT sector and is associated with Persistent as a customer for nearly 10 years.

During the first 100 days, the new CEO met with more than 50 clients in various geographies and has shared his observations and areas where he will focus to boost growth. The management has outlined its plans for digital, cloud, platform and ISV segments. Internally, the company is focusing on understating the people, business learning and refining its structure.

The new CEO's focus is on sales and marketing. The management emphasized that it needs to aggressively market its multiple capabilities for better client mining. The company also highlighted retaining people as one of the key focus areas to maintain continuity in execution and growth going forward.

The management believes simplified structure (like marketing team consolidation) and assigning people what they can do the best (10k+ people should be expert in their field) will help in improving productivity and client mining. He defined it as "one leader, one role".

Key focus areas 1). BFSI, 2). Healthcare & Life sciences and 3). Industrial verticals. Persistent is providing offerings that clients' needs and on strategic long term account planning.

In cloud, the management believes the journey has just began. Currently, only 5-10% of the organization are on cloud – there is a long way to go. Around 85% of the clients are waiting to be on digital. Finally, Persistent has the ability to go-to-the-market for cloud.

Persistent thrust is on continuous growth in logos, balancing and growing its largest client with industrial sector focus, and revenue predictability. Earlier, the company was working on new customers acquisition's but was lacking in providing all the services to its clients.

Valuation & outlook:

We expect Persistent to report an EPS of Rs.49.6/share in FY20E and an EPS of Rs. 52.5/share in FY21E. With the change in the management, we expect better execution, lower attrition, and improvement in revenue growth in the medium to long term and resolution of past challenges. The management has refrained from giving any growth guidance for FY20 as of now, we will wait for a few more quarters to see the pace of execution.

We maintain **BUY** rating on Persistent and a multiple based unchanged price target of Rs.735/share. Additionally, attractive valuations, cash rich balance sheet, strong free cash flow and healthy return ratios (ROE ~15% and ROCE 20+%) also provide high comfort. At CMP, the stock is valued at 5.4x EV/EBITDA and 11.8x P/E on FY21E basis. We have valued the stock at 14x PE multiple, discount to its peer.

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Key highlights from the analyst meet

- The new CEO Mr. Christopher (Chris) O'Connor highlighted that Persistent's highly skilled and motivated team distinguishes itself by delivering business-critical software solutions to global customers across the industry. With all the foundational elements in place, the company is well poised for growth.
- During first 100 days, the new CEO met with more than 50 clients in various geographies and has shared his observations and areas where he will focus to boost growth. Internally, the management is focusing on understanding the people, business learning and refining its structure.
- Persistent highlighted that it will focus on sales and marketing, without any major investment in S&M.
- The new CEO believes simplified structure (like marketing team consolidation) and assigning people what they can do the best (10k+ people should be expert in their field) will help in improving productivity and client mining. He defined it as "one leader, one role".
- Persistent has also hired people for IOT (ex-IBM). He believes "local market - local leaders" goes well as it creates trust and bonding.
- Key focus areas 1). BFSI, 2). Healthcare & Life sciences and 3). Industrial verticals. In BFSI, Persistent is doing more than 100 projects. Persistent has rich penetration in life sciences and working with partner's healthcare. In the industrial vertical, the company believes there is ample scope for growth. It is providing offerings that clients' need and on strategic long term account planning.
- In cloud, the CEO believes the journey has just began. Currently, only 5-10% of the organization are on cloud - there is long way to go. Around 85% of the clients waiting to be on digital. Finally, Persistent has the ability to go-to-the-market for cloud.
- Persistent's immediate horizon is 1) Continuous growth in Logos (have internal machines for adding logos), 2). Continue to balance largest clients with industrial sector focus, 3). Revenue predictability - a). Rigorous account management, b). Aligned sales team and compensation (this is almost done), c). Marketing, offering and business model programmatic.
- Capital allocation policy: The Company is contemplating to increase the cap on dividend payout ratio to 40% from 30%, currently. The company has declared a final dividend of Rs.3 per share along with Rs.8 per share interim dividend declared earlier. The ex-date for the same is 11th July'19.
- The company highlighted that strong balance sheet will support M&A in near to medium term.
- Persistent thrust is on continuous growth in logos, balancing and growing its largest client with industrial sector focus, and revenue predictability. Earlier, the company was working on new customers acquisition's and was lacking in providing all the services to all its clients.
- Persistent expects re-seller business to do better in FY20E.
- ETR is expected to be in a range of 27-28% in FY20E due to various tax benefits.

Brief background about Mr. Christopher (Chris) O'Connor:

Earlier, Mr. Christopher (Chris) O'Connor was heading the Internet of Things business unit at IBM including roles as its General Manager, Head of Sales and Head of all software R&D. He has been the founding strategist, leader and industry wide innovator of IBM IoT. His prior roles in IBM have centered around building new businesses for IBM such as Systems Management, IBM Commerce and Financial Software, and founding the IBM Smart Cities software and services business. He also has led network hardware R&D in the startup community both exiting and returning to IBM in that tenure.

Educational background

An alumnus of the Rutgers University, Mr. Christopher (Chris) O'Connor holds a dual Bachelor of Science degree in Electrical Engineering and Computer Science. He has remained academically active, achieving a management certificate from the University of North Carolina and advanced management training from Harvard University. He is a regular guest lecturer at Duke University, Harvard University and a member of the board of Computer Information Technology at Appalachian State University.

Maintain BUY

We expect Persistent to report an EPS of Rs.49.6/share in FY20E and an EPS of Rs. 52.5/share in FY21E. With the change in the management, we expect better execution, lower attrition, and improvement in revenue growth in the medium to long term and resolution of past challenges. The management has refrained from giving any growth guidance for FY20 as of now, we will wait for a few more quarters to see the pace of execution.

We maintain BUY rating on Persistent and a multiple based unchanged price target of Rs.735/share. Additionally, attractive valuations, cash rich balance sheet, strong free cash flow and healthy return ratios (ROE ~15% and ROCE 20+%) also provide high comfort. At CMP, the stock is valued at 5.4x EV/EBITDA and 11.8x P/E on FY21E basis. We have valued the stock at 14x PE multiple, discount to its peer.

Valuation

Particulars	Unit	FY20E
EPS (FY20E)	Rs./share	52.5
Target – P/E	x	14.0
Target price (Rs/share)	Rs. Mn	735
CMP	Rs. Mn	619
Potential upside/(downside)	%	19

Source: Kotak Securities - Private Client Research

Key Risk and Concerns:

- Wide currency fluctuation and INR appreciation will impact earnings. 80%-90% of Persistent's foreign currency exposure is in USD.
- High client concentration - Top 1 client contributes 24% of the revenue.
- Continuous declining margins.
- Event-specific risks could impact IT budgets, cut discretionary spend and delay new deals.
- Higher investment in new products will put pressure on margins.
- Volatility in revenues sourced through the partners.

Company Background

Incorporated in 1990, Persistent is founded by Mr. Anand Deshpande. In 2000, it became one of the first companies in Asia to receive an investment from Intel 64 LLC. The Company provides product engineering services, platform based solutions and IP-based software products to its global customers. It designs, develops and maintains software systems and solutions, creates new applications and enhances the functionality of the customer’s existing software products.

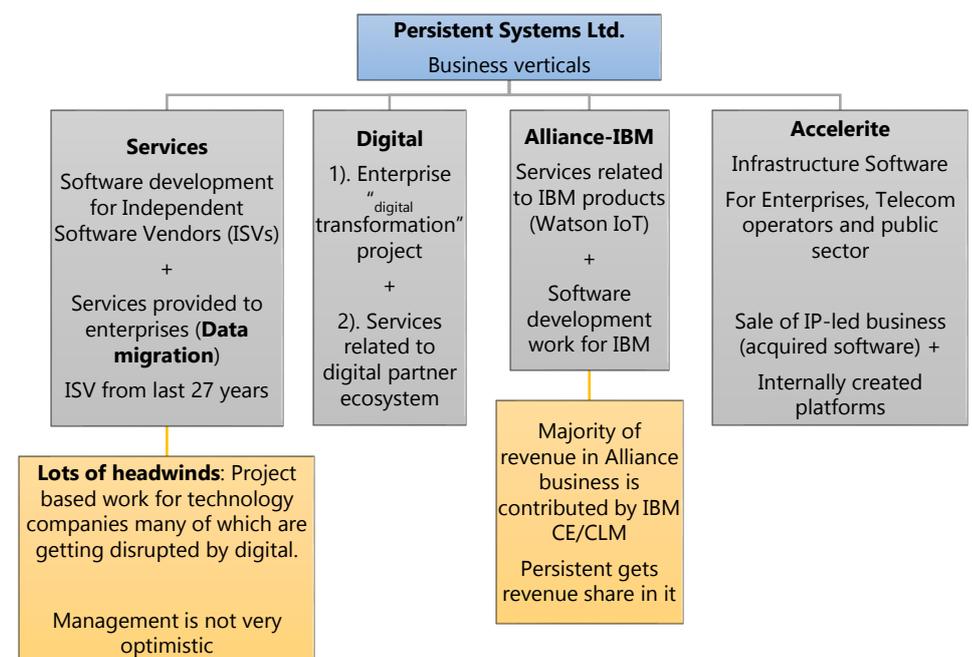
Note: Product engineering service can be defined as an engineering consulting activity, which uses various hardware, embedded, software and IT services solution for the designing and development of products.

It delivers services across all stages of the product life–cycle, which enables it to work with a wide–range of customers and allows it to develop, enhance and deploy its customers’ software products. It has been recognized as one of the leading technology companies in the Deloitte Touche Tohmatsu Technology Fast 500 Asia Pacific 2009.

Persistent specializes in software product and technology services and has delivery centers in North America, Europe, and Asia. It has over 9,000 team members worldwide. The company is helping enterprises to transform their business to software-driven business. It has moved from effort-based company (limitations) to value-based company. Further, it has strong foot hold in building software products which offers a distinct advantage and a broader market for growth. It develops best-in-class solutions in key next-generation technology areas including Analytics, Big Data, Cloud Computing, Mobility and Social, for the healthcare and banking & financial services verticals.

Persistent has reorganized its business to four key growth areas which clearly highlights its focus areas. The company has transformed its business from outsourced product development to helping its customers to become software-driven business.

Four key business verticals



Source: Kotak Securities - Private Client Research. Note: CE: Continuous Engineering and CLM: Collaborative lifecycle management

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Revenues	30,337	33,659	36,431	39,296
% change YoY	5.4	11.0	8.2	7.9
EBITDA	4,687	5,805	6,289	6,784
% change YoY	0.7	23.9	8.3	7.9
Other Income	1,190	631	781	862
Depreciation	1,585	1,573	1,728	1,898
EBIT	4,293	4,863	5,342	5,747
% change YoY	7.1	13.3	9.8	7.6
Net interest	0	0	0	0
Profit before tax	4,293	4,863	5,342	5,747
% change YoY	7.1	13.3	9.8	7.6
Tax	1,062	1,347	1,506	1,690
as % of PBT	25	28	28	29
Profit after tax	3,231	3,517	3,835	4,058
Minority interest	0	0	0	0
Share of profit of associates	0	0	0	0
Net income	3,231	3,517	3,835	4,058
% change YoY	7.2	8.8	9.1	5.8
Shares outstanding (m)	80	79	77	77
EPS (reported) (Rs)	41.8	45.5	49.6	52.5
CEPS (Rs)	52.9	67.4	72.0	77.0
DPS (Rs)	10.0	11.0	12.0	13.0

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBIT	4,293	4,863	5,342	5,747
Depreciation	1,585	1,573	1,728	1,898
Change in working capital	113	135	(492)	8
Chgs in other net current assets	-	-	-	-
Operating cash flow	5,990	6,570	6,578	7,654
Interest	-	-	-	-
Tax	(1,062)	(1,347)	(1,506)	(1,690)
Cash flow from operations	4,929	5,224	5,071	5,964
Capex	(1,110)	(722)	(1,430)	(1,568)
(Inc)/dec in investments	(1,958)	1,156	(1,000)	-
Cash flow from investments	(3,068)	434	(2,430)	(1,568)
Others	11	(292)	(18)	-
Increase/(decrease) in debt	(5)	(5)	(12)	-
Proceeds from share premium	-	-	-	-
Dividends	(963)	(1,051)	(1,113)	(1,211)
Cash flow from financing	(956)	(1,348)	(1,143)	(1,211)
Opening cash	1,510	2,414	6,724	8,223
Closing cash	2,414	6,724	8,223	11,407

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Cash and cash equivalents	2,414	6,724	8,223	11,407
Accounts receivable	4,847	4,923	5,328	5,747
Inventories	0	0	0	0
Loans and Adv & Others	4,714	4,539	5,039	5,039
Current assets	11,975	16,186	18,590	22,194
Misc exp.	0	0	0	0
LT investments	8,797	7,641	8,641	8,641
Net fixed assets	5,174	4,323	4,025	3,695
Total assets	25,947	28,151	31,257	34,530
Payables	1,673	1,517	1,642	1,771
Others	1,344	1,566	1,695	1,828
Current liabilities	3,018	3,083	3,337	3,600
Provisions	2,011	2,014	2,174	2,339
LT debt	17	12	0	0
Min. int and Others	(372)	(405)	(405)	(405)
Equity	800	791	773	773
Reserves	20,473	22,656	25,378	28,224
Total liabilities	25,947	28,151	31,257	34,530
BVPS (Rs)	266	296	338	375

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBITDA margin (%)	15.5	17.2	17.3	17.3
EBIT margin (%)	14.1	14.4	14.7	14.6
Net profit margin (%)	10.6	10.4	10.5	10.3
Receivables (days)	58.3	53.4	53.4	53.4
Inventory (days)	-	-	-	-
Sales/gross assets(x)	1.5	1.5	1.4	1.4
Interest coverage (x)	-	-	-	-
Debt/equity ratio(x)	0.0	0.0	-	-
ROE (%)	16.0	15.7	15.5	14.7
ROCE (%)	18.4	22.8	21.5	20.8
EV/ Sales	1.5	1.2	1.1	0.9
EV/EBITDA	9.7	7.1	6.3	5.4
Price to earnings (P/E)	14.8	13.6	12.5	11.8
Price to book value (P/B)	2.3	2.1	1.8	1.7

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 15% returns over the next 12 months
ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
REDUCE	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
SELL	–	We expect the stock to deliver < -5% returns over the next 12 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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