Morning Insight

OCTOBER 23, 2018

	22-Oct	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Indian Indices				
SENSEX Index	34,134	(0.5)	(7.3)	(6.5)
NIFTY Index	10,245	(0.6)	(8.1)	(6.9)
NSEBANK Index	25,079	(0.0)	(2.0)	(6.7)
NIFTY 500 Index	8,577	(0.7)	(9.0)	(7.6)
CNXMcap Index	16,308	(1.3)	(11.1)	(9.7)
BSESMCAP Index	13,805	(2.0)	(12.4)	(12.2)
World Indices				
Dow Jones	25,317	(0.5)	(5.3)	1.1
Nasdaq	7,469	0.3	(6.5)	(4.8)
FTSE	7,043	(0.1)	(6.0)	(8.0)
NIKKEI	22,615	0.4	(7.3)	(1.2)
Hangseng	22,615	0.4	(7.3)	(1.2)
Shanghai	26,153	2.3	(7.8)	(8.8)

Value traded (Rs cr)	22-Oct	% Chg Day
Cash BSE	2,483	(18.6)
Cash NSE	30,815	(17.3)
Derivatives	871,268	6.6

Net inflows (Rs cr)	19-Oct	MTD	YTD
FII	(661)	(18,773)	(33,835)
Mutual Fund	556	12,429	100,684

Nifty Gainers & Losers 22-Oct	Price (Rs)	Chg (%)	Vol (mn)
Gainers			
Indiabulls Housing	713	9.1	27.7
Eicher Motor	22,425	3.7	0.1
ICICI Bank	327	3.7	33.6
Losers			
Indusind Bank	1,449	(8.1)	6.5
BPCL	271	(4.4)	4.8
Ultratech Cement	3,463	(4.1)	0.7

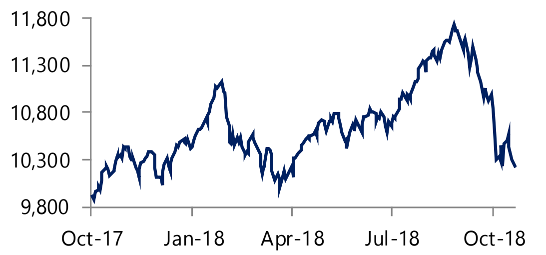
Advances / Declines (BSE)

22-Oct	A	B	T	Total	% total
Advances	107	262	34	403	100
Declines	323	776	67	1,166	289
Unchanged	1	14	15	30	7

Commodity	22-Oct	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Crude (US$/BBL)	79.6	(0.3)	1.0	8.9
Gold (US$/OZ)	1,222.0	(0.4)	2.1	(0.1)
Silver (US$/OZ)	14.6	(0.1)	1.8	(5.4)

Debt / forex market	22-Oct	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.9	7.9	8.1	7.8
Re/US$	73.6	73.3	72.6	68.9

Nifty



Source: Bloomberg

News Highlights

- The crude oil import bill for India is expected to increase by $37 bn to $125 bn during FY19, 42 per cent spike over the 2017-18 bill of $88 bn. The latest estimates were released by the Petroleum Planning and Analysis Cell (PPAC). The previous estimate for the year was $105 bn. Rising crude oil prices and a weak rupee are the main reasons for this rise. (BS)
- In a move that might add to the unease of the central bank, the finance ministry will likely make a case for relaxing the so-called prompt corrective action (PCA) framework of the Reserve Bank of India (RBI), when the regulator's board meets in Mumbai. The board will also discuss steps to ease credit flow to non-banking finance companies (NBFCs) in the wake of the crisis at Infrastructure Leasing and Financial Services (IL&FS). While the ministry's likely move follows demand of several stressed public-sector banks (PSBs), for its part the central bank has been reluctant to ease the "stringent" PCA norms. (FE)
- **Lakshmi Machine Works** approved the buyback of 2,66,666 equity shares at a price not exceeding Rs 6,000 per share. (MC)
- **ITD Cementation India** said it has won orders valued over Rs 10.7 bn from Airports Authority of India, Vizhinjam Port, Visakhapatnam Port, Mumbai Metro and Rail Vikas Nigam. (BS)
- **Tata Steel Ltd** objected to lenders of debt-laden Bhushan Power and Steel Ltd (BPSL) finalizing a bid of its rival **JSW Steel Ltd.** The lenders allowed JSW Steel to change the basic parameters of its bid after having previously declared Tata Steel as the highest bidder, according to a plea filed by Tata Steel at the National Company Law Appellate Tribunal (NCLAT). (ET)
- **Bharat Heavy Electricals Ltd** informed bourses that its board will consider the proposal for buyback of shares on Thursday. (ET)
- **Himachal Futuristic Communications** Bags Advance Purchase Order For Rs.3.7 bn approx From Bharat Sanchar Nigam Limited (BSNL) For Providing Broadband Connectivity In The State Of Assam Under Bharatnet Phase-II Network Of Government Of India. (BL)
- **Orient Press Ltd** informed that it has received a letter from Maharashtra Pollution Control Board (MPCB), Thane for violation of certain conditions/provisions of Water (Preventions & Control of Pollution) Act, 1974 and the Air (Prevention & Control of Pollution) Act, 1981 by a plant of the Company located at Plot No. G-73, M.I.D.C., Tarapur Industrial Area, Boisar-401506, Dist. Palghar manufacturing flexible packaging and consequently directing the Company to close the manufacturing activities of the said plant within 72 hours. The Company has suitably replied the said letter and taking all necessary steps to prevent Closure of the plant. (BL)
- S K Birla Group-owned **Digjam Ltd.** announced the temporary closure of its Jamnagar mill due to cash crunch. Digjam is one of the biggest exporters of woollen and worsted fabrics in India. (BT)

What's Inside

- **Result Update:** Persistent Systems Ltd

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

PERSISTENT SYSTEMS LTD

Result Update

Stock Details

Market cap (Rs mn)	:	45196
52-wk Hi/Lo (Rs)	:	915 / 536
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	221,945
Shares o/s (mn)	:	80

Source:Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	30,337	35,272	40,002
Growth (%)	5.4	16.3	13.4
EBITDA	4,687	6,025	7,233
EBITDA margin (%)	15.5	17.1	18.1
PAT	3,230	3,814	4,905
EPS	40.4	47.7	61.3
EPS Growth (%)	7.2	18.1	28.6
BV (Rs/share)	266	300	343
Dividend/share (Rs)	10.0	11.1	15.0
ROE (%)	16.0	16.8	19.1
ROCE (%)	18.4	22.3	24.4
P/E (x)	13.9	11.7	9.1
EV/EBITDA (x)	9.0	7.0	5.7
P/BV (x)	2.1	1.9	1.6

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Sep-18	Jun-18	Mar-18
Promoters	30.4	30.5	30.6
FII	26.5	26.5	24.0
DII	17.2	14.1	14.5
Others	22.6	28.9	30.9

Source: Company

Price Performance (%)

(%)	1M	3M	6M
Persistent Systems	(30.4)	(31.4)	(23.0)
Nifty	(8.1)	(6.9)	(3.0)

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

Sumit Pokharna
sumit.pokharna@kotak.com
+91 22 6218 6438

PRICE RS.560 TARGET RS.870 BUY

IP revenue volatility continues: Persistent Systems indicated better revenue growth and margin improvement in H2FY19 which will partly mitigate the impact of one-offs in Q2FY19. Revenue growth will be supported by good deal wins, project starts in Q2FY19, higher contribution from healthcare business (strong demand on the digital side and higher deal sizes), meaningful jump in IP business and the reseller segment due to seasonally strong Q3FY19. In Q2FY19, it has added net 400 people reflecting strong project pipeline. Margin improvement will be supported by better sales mix (higher offshore mix), better utilization, and efficiency improvement. With strong balance sheet, it is looking for acquisitions of smaller businesses in healthcare, data and machine learning, which can support in geographical expansion.

Key Highlights

- In Q2FY19, the biggest disappointment is the poor growth in Digital segment.
- Persistent's Q2FY19 consolidated revenue decreased by 4.3% qoq in US$ terms to US$ 118 mn led by 10% qoq decline in IP revenue (US$ 30mn).
- Consolidated revenues increased merely by 0.2% qoq to Rs.8.36 bn (+9.8% yoy) supported by 3.7% qoq increase in technology services revenue but revenue from Alliance-IBM declined by 8.3% qoq.
- Operating profit increased to Rs.1.44 bn (3% qoq and 24% yoy) due to rupee depreciation, lower sales and marketing expenses/ project related travel expenses and lower purchase/royalty expenses. EBITDA margin rose by 40 bps qoq, with rupee depreciation (110 bps benefit) and higher utilization offsetting the wage hike impact.
- In Aug'18, the company has completed acquisition of Herald Health. It's a Boston based start-up that transforms healthcare data overload into clear and actionable insights for care providers and patients.
- Persistent had deposits of Rs.430 mn with Infrastructure Leasing & Financial Services Ltd. (IL&FS) and IL&FS Financial Services Ltd. and the same are due for maturity from Jan'19 to Jun'19. As of Sept'18 end, there have been no defaults in payment of interest. Accordingly, the management believes that there is no immediate need to recognize any impairment.

Valuation & outlook

We have lowered our EPS estimates to reflect H1FY19 performance, higher tax rate guided by company and minor other changes. Accordingly, we now expect Persistent to report an EPS of Rs.47.7/share (earlier Rs.52.2) in FY19E and an EPS of Rs. 61.3/share (earlier Rs.65.1) in FY20E. Margin improvement and decent revenue visibility makes us positive on its growth prospects. We maintain BUY rating on Persistent and a multiple based price target of Rs.870/share (earlier Rs.1025/share). We have valued the stock at 14x PE multiple at a 30% discount to its peers. Additionally, attractive valuations, cash rich balance sheet, strong free cash flow and healthy return ratios (ROE 16+% and ROCE 18+%) also provide high comfort. At CMP, the stock is valued at 5.7x EV/EBITDA and 9.1x P/E on FY20 basis.

Quarterly result update

Persistent has provided for around 8% hike (average) in off-shore employees, and ~3% hike for non-India employees (average).

Forex gains of Rs.36 mn in Q2FY19 vs Rs.21 mn in Q1FY19.

P&L A/C (Rs. Mn)	Sep-18	Sep-17	YoY (%)	QoQ (%)
Services/Linear revenue (US$ Mn)	88	87	0.7	(2.0)
IP Led includes IBM Alliance (US$ Mn)	30	31	(1.6)	(10.4)
Cons. Revenue (US$ Mn)	118	118	0.1	(4.3)
Avg. Exchange Rate Rs./US$	71	64	9.6	4.7
Cons. Revenues (INR mn)	8,356	7,613	9.8	0.2
Cost of revenues	5,410	4,994	8.3	0.7
Cost of revenues to sales (%)	64.74	65.60	(0.9)	0.3
Gross profit	**2,946**	**2,618**	**12.5**	**(0.8)**
Gross margin (%)	35.3	34.4	0.86	(0.3)
SG&A expenses	1,510	1,461	3.4	(3.8)
SG&A expenses to sales (%)	18.1	19.2	(1.1)	(0.7)
EBITDA	**1,436**	**1,158**	**24.0**	**2.6**
Operating margin (%)	17.2	15.2	1.98	0.4
Depreciation	399	379	5.0	(0.6)
EBIT	**1,038**	**778**	**33.3**	**3.8**
Depreciation to Sales (%)	4.8	5.0	(0.2)	(0.0)
Other income + Forex gain	231	336	(31)	24
PBT	**1,269**	**1,115**	**13.8**	**7.0**
Tax	387	288	34.4	23.9
Effective tax rate (%)	30.53	25.87	4.66	4.2
PAT	**881**	**826**	**6.7**	**0.9**
PAT margin (%)	10.5	10.9	(0.3)	0.1
Equity Capital	800	800	-	0.0
EPS (Rs)	**11.0**	**10.3**	**6.7**	**0.9**

Source: Company; Note: Services revenue is linear revenue.

Segmental details

	Sep-18	Sep-17	YoY (%)	QoQ (%)
Segment Revenue				
Technology Services	5,437	4,916	10.6	3.7
Alliance-IBM (Re-seller business)	2,467	2,082	18.5	(8.3)
Accelerite	452	615	(26.5)	10.5
Total	8,356	7,613	9.8	0.2
Segment EBIT (Adj for exceptional)				
Technology Services	2,035	1,823	11.6	1.8
Alliance-IBM (Re-seller business)	827	657	25.8	(3.9)
Accelerite	242	283	(14.6)	48.6
Total	3,103	2,763	12.3	2.7
Capital Employed (Rs. Mn)	**Sep-18**	**Sep-17**	**YoY (%)**	
Technology Services	3,427	3,641	(5.9)	
Alliance-IBM (Re-seller business)	1,100	668	64.7	
Accelerite	251	529	(52.5)	
Total	4,778	4,838	(1.2)	
EBIT Margin %	**Sep-18**	**Sep-17**	**YoY (ppts)**	**QoQ (ppts)**
Technology Services	37	37	0.34	(1)
Alliance-IBM (Re-seller business)	34	32	1.94	2
Accelerite	53	46	7.46	14

EBIT/CE (%)	Sep-18	Sep-17	YoY (%)
Technology Services	238	200	37
Alliance-IBM (Re-seller business)	301	394	(93)
Accelerite	385	214	171
Total	260	228	31

Segment Revenue Contribution (%)	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
Technology Services	65	65	0	2
Alliance-IBM (Re-seller business)	30	27	2	(3)
Accelerite	5	8	(3)	1
				-

Segment EBIT Contribution (%)	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
Technology Services	65.6	66.0	(0)	(1)
Alliance-IBM (Re-seller business)	26.6	23.8	3	(2)
Accelerite	7.8	10.2	(2)	2

Business Offerings: Revenue Mix (in $)	Sep-18	Sep-17	YoY (%)	QoQ (ppt)
Services (%)	74.4	74.0	0.4	1.7
IP Led (%)	25.6	26.0	(0.4)	(1.7)
Total	100.0	100.0		

Segments: Revenue Mix	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
Services	43.0%	43.7%	(0.7)	1.5
Digital	22.0%	20.9%	1.1	0.6
Alliance	29.5%	27.3%	2.2	(2.6)
Accelerite	5.5%	8.1%	(2.6)	0.5

Geography: Revenue Mix	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
North America	82.6%	83.4%	(0.8)	2.9%
Europe	7.50%	8.50%	(1.0)	-4.5%
India	7.3%	5.6%	1.7	1.2%
ROW	2.60%	2.50%	0.1	0.4%

Industry Classification	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
ISV-Service business	39.5%	39.9%	(0.4)	0.7
Enterprise	34.9%	34.1%	0.8	1.1
IP Led (Product business)	25.60%	26.00%	(0.4)	(1.8)
Total	100%	100%		

Revenue by delivery Centers	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
Global Development Centers	29.7%	31.9%	(2.2)	(1.4)
India	44.7%	42.1%	2.6	3.2
IP Led	25.6%	26.0%	(0.4)	(1.8)

	Sep-18	Sep-17	YoY (%)	QoQ (%)
Clients billed	611	696	(12)	(1)
Services	433	419	3	(1)
IP Led	178	277	(36)	(2)

Revenue Concentration	Sep-18	Sep-17	YoY (ppt)	QoQ (ppt)
Top 1	25.7%	25.9%	(0.2)	1.9
Top 5	43.3%	43.8%	(0.5)	(0.5)
Top 10	52.4%	53.5%	(1.1)	(1.3)

Client Engagement Size	Sep-18	Sep-17	YoY (%)	QoQ (%)
Large > $ 3M	18	19	(5)	0
Medium > $ 1M, < $ 3M	56	49	14	(3)
DSO	**Sep-18**	**Sep-17**	**YoY (%)**	**QoQ (%)**
Days nos	63	66	(5)	(7)
Yield (USD / PPM)	5,329	5,096	5	(3)
Linear Revenue Per Billed Person Month	**Sep-18**	**Sep-17**	**YoY (%)**	**QoQ (%)**
Global Delivery centers – Linear	15,787	16,023	(1)	(4)
India - Linear	4,372	4,148	5	1
Attrition Rate (TTM basis) %	15.40%	15.50%	(0.1)	0.6
Net hiring	**Sep-18**	**Sep-17**	**YoY (%)**	**QoQ (%)**
People Numbers	9,302	9,246	1	4
Technical	8,566	8,599	(0)	5
Sales & Business Development	247	208	19	4
Others	489	439	11	4
Efforts and Utilization Mix - Linear	**Sep-18**	**Sep-17**	**YoY (%)**	**QoQ (%)**
Billable Person Months	17,483	18,245	(4)	(1)
a). Global Delivery Centers	2,656	2,689	(1)	(4)
b). India	14,827	15,556	(5)	(0)
Billed Person Months	14,318	14,340	(0)	1
a). Global Delivery Centers	2,221	2,346	(5)	(5)
b). India	12,097	11,994	1	2
Utilization	**Sep-18**	**Sep-17**	**YoY (ppt)**	**QoQ (ppt)**
a).Linear (Blended)	81.90%	78.60%	3.3	1.2
b). Global Delivery Centers	83.60%	87.20%	(3.6)	(1.6)
c).India	81.60%	77.10%	4.5	1.7

Source: Company

Quarterly result analysis

Dismal performance in Q2FY19

- **Revenue in US dollar terms:** Persistent's Q2FY19 consolidated revenue decreased by 4.3% qoq in US$ terms to US$ 118 mn (flat on yoy) led by 10% qoq decline in high-margin IP revenue (US$ 30mn) and 2% qoq decline in services revenue. Services revenue decline due to earlier than expected project completed (US$ 0.8 mn negative impact).
- In the digital segment, it has again disappointed as revenue dipped for the second successive quarter.
- **Revenue (Rupee terms):** Consolidated revenues increased merely by 0.2% qoq to Rs.8.36 bn (+9.8% yoy) supported by 3.7% qoq increase in technology services revenue but revenue from Alliance-IBM declined by 8.3% qoq.
- The company has highlighted three reasons for sequential decline in revenue 1). Seasonality with one partner in the re-seller business, 2). In digital business, one project got closed unexpectedly in Sep'18 (second half) due to change in product requirement, and 3). Part of the business has moved from US on-site to offshore business which negatively impact revenue growth but improves margin and profitability (better management control, better operating cost, etc.).

- **Staff Cost:** Employee cost increased by 6% qoq/yoy to Rs.5.04 bn in Q2FY19 due to wage hike undertaken. Staff cost to revenue (percent) increased 326 bps qoq to 60.3% (-226 bps yoy). Persistent has provided for around 8% hike (average) to off-shore employees, and ~3% hike to non-Indian employees (average).
- **Project related Travel Expenses**: Travel expenses as a percent of revenue went down by 60 bps qoq to 1.83%. In absolute terms, travel expenses have decreased by 23% qoq to Rs. 153 mn (30% yoy).
- **Gross Profit:** In Q2FY19, gross profit decline marginally by 0.8% qoq to Rs.2.95 bn (12.5% yoy) supported by higher revenues and lower cost of revenue.
- **SG&A expenses:** The Company's SG&A expenses decreased 4% qoq to Rs.1.51 bn (+3.4% yoy). In Q2FY19, SG&A expenses as a percent of revenues decreased by 70 bps qoq to 18.1%.

Expenses (Rs. mn)

	Sep-18	Sep-17	YoY (%)	QoQ (%)
Staff costs	5,040	4,764	5.8	5.9
Purchase / Royalty	216	112	92.1	(48)
Project related Travel	153	118	30.2	(23)
Sales & Marketing	741	714	3.8	(4)
Admin. & Other	743	723	2.8	0
Doubtful Debt Provision	7	6	7.3	(82)
CSR Activities	19	17	8.9	4
Total	6,919	6,455	7.2	(0)

Source: Company

Expenses Ratio (%)

	Sep-18	Sep-17	YoY (ppts)	QoQ (ppts)
Staff to Revenue	60.32	62.58	(2.3)	3.3
Purchase / Royalty to IP Revenue only	10.1	5.7	4.4	(8.0)
Project related Travel Expenses to Revenue	1.83	1.55	0.3	(0.6)
Sales & Marketing Exps to Revenue	8.87	9.38	(0.5)	(0.4)
Admin. & Other Exps to Revenue	8.90	9.50	(0.6)	0.0
Doubtful Debt Provision to Revenue	0.08	0.08	(0.0)	(0.4)
CSR Activities to Revenue	0.22	0.23	(0.0)	0.0
Total expenses to Revenue	82.81	84.79	(2.0)	(0.4)

Source: Company

- **Operating profit (Rs. Mn):** The management attributed increase in operating profit to rupee depreciation, lower sales and marketing expenses/ Project related travel expenses and lower purchase/royalty expenses. The management indicated that in H2FY19 sales and marketing expenses will increase. Persistent reported meaningful increase in EBIDTA to Rs.1.44 bn in Q2FY19 (3% qoq and 24% yoy).
- **Operating margin (%):** EBITDA margin increased to 17.2% (+40 bps qoq and +200 bps yoy), due to rupee depreciation and lower operating cost.

Margin Ratio (%)

	Sep-18	Sep-17	YoY (ppts)	QoQ (ppts)
EBITDA Margin	17.2	15.21	2.0	0.4
EBIT Margin	12.4	10	2.2	0.4
Adj PAT Margin	11	11	(0.3)	0.1
Other Income/PBT	18	30	(12)	2.5
Tax/PBT	31	26	4.7	4.2

Source: Company

- **Depreciation charge:** Depreciation has decreased 1% qoq. Depreciation as a percentage of revenue stands at 4.8% in Q2FY19 v/s 5.0% in Q2FY18.
- **Other income:** In Q2FY19, other income increased 24% (partly base effect) to Rs.231 mn (-31% yoy). Other income consists of interest, forex gain and dividend income.
- **Profit before tax (PBT):** Persistent's PBT increased 7% qoq to Rs.1.27 bn in Q2FY19 (+14% yoy), supported by higher operating income, lower depreciation charge, and higher sequential other income.
- **PAT:** Persistent's PAT has increased 1% qoq to Rs.881 mn (7% yoy) due to higher PBT. We would like to highlight that quarterly fluctuations are inherent in an IP-based business.

Key margin drivers

	Sep-18	Sep-17	YoY (%)	QoQ (%)
Exchange rate (Rs./USD)	70.7	64.5	9.6	4.7
Consolidated revenues (Rs. mn)	8,356	7,613	9.8	0.2
A. EXECUTION METRICS				
Utilization (Blended)	81.9%	78.6%	3%	1.2
Average realization (USD/p-m) - Blended				
Onsite	15,787	16,023	(1.5)	(3.5)
Offshore	4,372	4,148	5.4	0.9
Billed effort – Services (p-m) - Total				
Onsite	2,221	2,346	(5.3)	(5.4)
Offshore	12,097	11,994	0.9	2.0
B. COST DRIVERS				
Wage costs (INR mn)	5,040	4,764	5.8	5.9
Employee to Revenue (%)	60.3	62.6	(2.26)	3.3
SG&A (INR mn)	1,510	1,461	3.4	(3.8)
SG&A to revenues (%)	18.1	19.2	(1.12)	(0.7)
EBITDA (INR mn)	1,436	1,158	24.0	2.6
EBITDA margin	17	15	1.98	0.4

Source: company

Key manpower and execution metrics

	Sep-18	Sep-17	YoY (%)	QoQ (%)
Total headcount	9,302	9,246	1	4
Cons. Revenues (INR mn)	118	118	0	(4)
Technical (no. of employees)	8,566	8,599	(0)	5
Revenue Productivity ($/employee)	13,802	13,734	0	(8)
Sales & Business Development	247	208	19	4
Support	489	439	11	4

Source: Company

Enterprise and product (IP) business are the key growth areas

Industry classification

	Sep-18	Sep-17	YoY (bps)	QoQ (bps)
Distribution				
ISVs (part of Service)	39.5%	39.9%	(0.4)	0.7
Enterprise	34.9%	34.1%	0.8	1.1
IP Led (Product business)	25.6%	26.0%	(0.4)	(1.8)
Revenue (USD mn and growth)				
ISVs	46.7	47.1	(0.9)	(2.6)
Enterprise				
IP Led	41.3	40.3	2.5	(1.2)

Source: Company. Note: ISVs includes product development work for product companies. ISV is not classified as digital and non-digital segment.

Maintain BUY

We have lowered our EPS estimates to reflect H1FY19 performance, higher tax rate guided by company and minor other changes. Accordingly, we now expect Persistent to report an EPS of Rs.47.7/share (earlier Rs.52.2) in FY19E and an EPS of Rs. 61.3/share (earlier Rs.65.1) in FY20E. Margin improvement and decent revenue visibility makes us positive on its growth prospects. We maintain BUY rating on Persistent and a multiple based price target of Rs.870/share (earlier Rs.1025/share). We have valued the stock at 14x PE multiple at a 30% discount to its peers. Additionally, attractive valuations, cash rich balance sheet, strong free cash flow and healthy return ratios (ROE 16+% and ROCE 18+%) also provide high comfort. At CMP, the stock is valued at 5.7x EV/EBITDA and 9.1x P/E on FY20 basis.

Valuation

Particulars Unit FY20E	Unit	
EPS (FY20E)	Rs./share	61
Target – P/E	x	14
Target price (Rs/share)	Rs. Mn	870
CMP	Rs. Mn	560
Potential upside/(downside)	%	55

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 >25% 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.

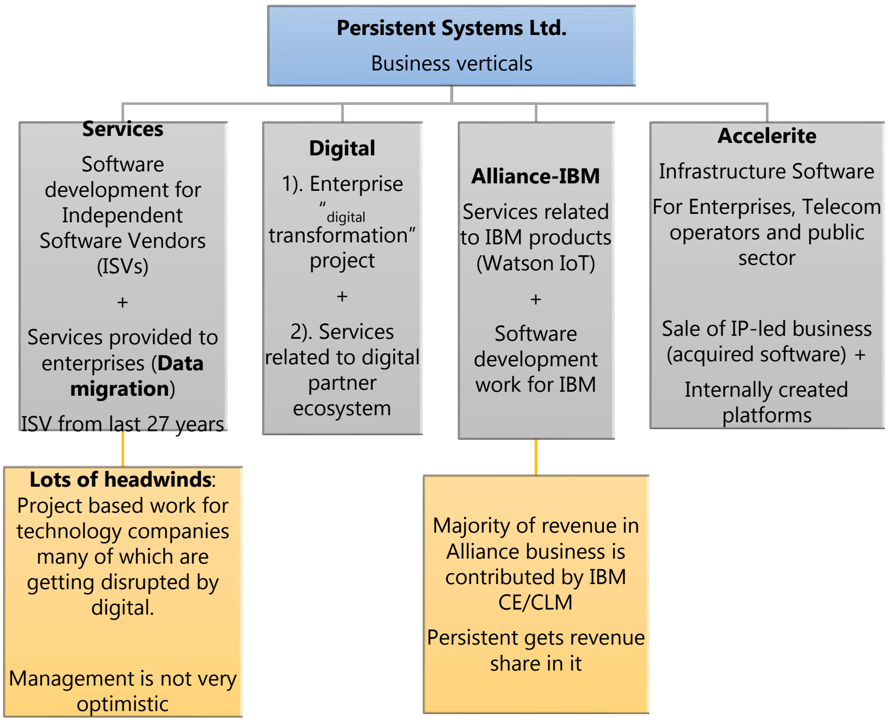
Note: Product engineering service can be defined as an engineering consulting activity, which uses various hardware, embedded, software and IT services solution for the designing and development of products.

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)	FY17	FY18	FY19E	FY20E
Revenues	**28,784**	**30,337**	**35,272**	**40,002**
% change YoY	24.5	5.4	16.3	13.4
EBITDA	**4,653**	**4,687**	**6,025**	**7,233**
% change YoY	11.6	0.7	28.5	20.1
Other Income	843	1,190	915	1,326
Depreciation	1,490	1,585	1,677	1,793
EBIT	**4,007**	**4,293**	**5,263**	**6,766**
% change YoY	1.3	7.1	22.6	28.6
Net interest	1	1	1	1
Profit before tax	**4,006**	**4,292**	**5,262**	**6,765**
% change YoY	1.3	7.1	22.6	28.6
Tax	992	1,062	1,448	1,860
as % of PBT	24.8	24.7	27.5	27.5
Profit after tax	**3,014**	**3,230**	**3,814**	**4,905**
Minority interest	0	0	0	0
Share of profit of associates	0	0	0	0
Net income	3,014	3,230	3,814	4,905
% change YoY	1.4	7.2	18.1	28.6
Shares outstanding (m)	80	80	80	80
EPS (reported) (Rs)	**37.7**	**40.4**	**47.7**	**61.3**
CEPS (Rs)	54.4	52.9	66.1	77.7
DPS (Rs)	9.0	10.0	11.1	15.0

Source: Company, Kotak Securities – Private Client Research

Balancesheet (Rsmn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	1,510	2,414	2,459	3,785
Accounts receivable	4,754	4,847	5,412	6,137
Inventories	0	0	0	0
Loans and Adv & Others	4,406	4,714	5,707	6,707
Current assets	10,669	11,975	13,577	16,629
Misc exp.	0	0	0	0
LT investments	6,839	8,797	10,843	11,843
Net fixed assets	5,649	5,174	4,920	4,622
Total assets	**23,157**	**25,947**	**29,340**	**33,094**
Payables	1,209	1,673	1,836	1,863
Others	1,428	1,344	1,563	1,677
Current liabilities	2,637	3,018	3,399	3,540
Provisions	1,701	2,011	2,297	2,452
LT debt	22	17	0	0
Min. int and Others	-196	-372	-372	-372
Equity	800	800	800	800
Reserves	18,194	20,473	23,216	26,674
Total liabilities	**23,157**	**25,947**	**29,340**	**33,094**
BVPS (Rs)	237	266	300	343

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBIT	4,007	4,293	5,263	6,766
Depreciation	1,490	1,585	1,677	1,793
Change in working capital	(865)	113	(889)	(1,430)
Chgs in other net current assets	-	-	-	-
Operating cash flow	4,632	5,990	6,051	7,129
Interest	(1)	(1)	(1)	(1)
Tax	(992)	(1,062)	(1,448)	(1,860)
Cash flow from operations	**3,639**	**4,928**	**4,602**	**5,268**
Capex	(2,503)	(1,110)	(1,423)	(1,495)
(Inc)/dec in investments	(455)	(1,958)	(2,046)	(1,000)
Cash flow from investments	**(2,958)**	**(3,068)**	**(3,469)**	**(2,495)**
Others	268	12	-	(0)
Increase/(decrease) in debt	(11)	(5)	(17)	-
Proceeds from share premium	-	-	-	-
Dividends	(867)	(963)	(1,071)	(1,447)
Cash flow from financing	**(610)**	**(956)**	**(1,088)**	**(1,447)**
Opening cash	1,439	1,510	2,414	2,459
Closing cash	**1,510**	**2,414**	**2,459**	**3,785**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	16.2	15.5	17.1	18.1
EBIT margin (%)	13.9	14.1	14.9	16.9
Net profit margin (%)	10.5	10.6	10.8	12.3
Receivables (days)	60.3	58.3	56.0	56.0
Inventory (days)	-	-	-	-
Sales/gross assets(x)	1.6	1.5	1.5	1.5
Interest coverage (x)	-	-	-	-
Debt/equity ratio(x)	0.0	0.0	-	-
ROE (%)	16.9	16.0	16.8	19.1
ROCE (%)	21.6	18.4	22.3	24.4
EV/ Sales	1.5	1.4	1.2	1.0
EV/EBITDA	9.3	9.0	7.0	5.7
Price to earnings (P/E)	14.9	13.9	11.7	9.1
Price to book value (P/B)	2.4	2.1	1.9	1.6

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY – We expect the stock to deliver more than 12% returns over the next 12 months

ACCUMULATE – We expect the stock to deliver 5% - 12% returns over the next 12 months

REDUCE – We expect the stock to deliver 0% - 5% returns over the next 12 months

SELL – We expect the stock to deliver negative 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.

SUBSCRIBE - We advise investor to subscribe to the IPO.

RS – **Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.

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.

FUNDAMENTAL RESEARCH TEAM

Rusmik Oza
Head of Research
rusmik.oza@kotak.com
+91 22 6218 6441

Arun Agarwal
Auto & Auto Ancillary
arun.agarwal@kotak.com
+91 22 6218 6443

Amit Agarwal
Transportation, Paints, FMCG
agarwal.amit@kotak.com
+91 22 6218 6439

Nipun Gupta
Information Tech, Midcap
nipun.gupta@kotak.com
+91 22 6218 6433

Deval Shah
Research Associate
deval.shah@kotak.com
+91 22 6218 6423

Sanjeev Zarbade
Cap. Goods & Cons. Durables
sanjeev.zarbade@kotak.com
+91 22 6218 6424

Ruchir Khare
Cap. Goods & Cons. Durables
ruchir.khare@kotak.com
+91 22 6218 6431

Jatin Damania
Metals & Mining, Midcap
jatin.damania@kotak.com
+91 22 6218 6440

Cyndrella Carvalho
Pharmaceuticals
cyndrella.carvalho@kotak.com
+91 22 6218 6426

Ledo Padinjarathala
Research Associate
ledo.padinjarathala@kotak.com
+91 22 6218 7021

Teena Virmani
Construction, Cement, Buildg Mat
teena.virmani@kotak.com
+91 22 6218 6432

Sumit Pokharna
Oil and Gas, Information Tech
sumit.pokharna@kotak.com
+91 22 6218 6438

Pankaj Kumar
Midcap
pankajr.kumar@kotak.com
+91 22 6218 6434

Jayesh Kumar
Economist
kumar.jayesh@kotak.com
+91 22 6218 5373

Krishna Nain
M&A, Corporate actions
krishna.nain@kotak.com
+91 22 6218 7907

K. Kathirvelu
Support Executive
k.kathirvelu@kotak.com
+91 22 6218 6427

TECHNICAL RESEARCH TEAM

Shrikant Chouhan
shrikant.chouhan@kotak.com
+91 22 6218 5408

Amol Athawale
amol.athawale@kotak.com
+91 20 6620 3350

DERIVATIVES RESEARCH TEAM

Sahaj Agrawal
sahaj.agrawal@kotak.com
+91 79 6607 2231

Malay Gandhi
malay.gandhi@kotak.com
+91 22 6218 6420

Prashanth Lalu
prashanth.lalu@kotak.com
+91 22 6218 5497

Prasenjit Biswas, CMT, CFTe
prasenjit.biswas@kotak.com
+91 33 6625 9810

Disclosure/Disclaimer

Kotak Securities Limited established in 1994, is a subsidiary of Kotak Mahindra Bank Limited. Kotak Securities is one of India's largest brokerage and distribution house.
Kotak Securities Limited is a corporate trading and clearing member of Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Limited (NSE), Metropolitan Stock Exchange of India Limited (MSE). Our businesses include stock broking, services rendered in connection with distribution of primary market issues and financial products like mutual funds and fixed deposits, depository services and Portfolio Management.
Kotak Securities Limited is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL). Kotak Securities Limited is also registered with Insurance Regulatory and Development Authority as Corporate Agent for Kotak Mahindra Old Mutual Life Insurance Limited and is also a Mutual Fund Advisor registered with Association of Mutual Funds in India (AMFI). We are registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014.
We hereby declare that our activities were neither suspended nor we have defaulted with any stock exchange authority with whom we are registered in last five years. However SEBI, Exchanges and Depositories have conducted the routine inspection and based on their observations have issued advise/warning/deficiency letters/ or levied minor penalty on KSL for certain operational deviations. We have not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has our certificate of registration been cancelled by SEBI at any point of time.
We offer our research services to clients as well as our prospects.
This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions.
This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Kotak Securities Ltd. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.
We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither Kotak Securities Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.
Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.
Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Equities Research Group of Kotak Securities Limited.
We and our affiliates/associates, officers, directors, and employees, Research Analyst(including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of Research Report or at the time of public appearance. Kotak Securities Limited (KSL) may have proprietary long/short position in the above mentioned scrip(s) and therefore may be considered as interested. The views provided herein are general in nature and does not consider risk appetite or investment objective of particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with KSL. Kotak Securities Limited is also a Portfolio Manager. Portfolio Management Team (PMS) takes its investment decisions independent of the PCG research and accordingly PMS may have positions contrary to the PCG research recommendation. Kotak Securities Limited does not provide any promise or assurance of favourable view for a particular industry or sector or business group in any manner. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and take professional advice before investing.
The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.
No part of this material may be duplicated in any form and/or redistributed without Kotak Securities' prior written consent.
Details of Associates are available on www.kotak.com
Research Analyst has served as an officer, director or employee of subject company(ies): No
We or our associates may have received compensation from the subject company(ies) in the past 12 months.
We or our associates have managed or co-managed public offering of securities for the subject company(ies) in the past 12 months: No
We or our associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received compensation or other benefits from the subject company(ies) or third party in connection with the research report. Our associates may have financial interest in the subject company(ies).
Research Analyst or his/her relative's financial interest in the subject company(ies): No
Kotak Securities Limited has financial interest in the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No.
Our associates may have actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report.
Research Analyst or his/her relatives has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No.
Kotak Securities Limited has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No
By referring to any particular sector, Kotak Securities Limited does not provide any promise or assurance of favourable view for a particular industry or sector or business group in any manner. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and take professional advice before investing. Such representations are not indicative of future results.
Subject company(ies) may have been client during twelve months preceding the date of distribution of the research report.
"A graph of daily closing prices of securities is available at https://www.nseindia.com/ChartApp/install/charts/mainpage.jsp and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" icon in the price chart)."
Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com/www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: INZ000200137 (Member of NSE, BSE, MSE, MCX & NCDEX), AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97. Our research should not be considered as an advertisement or advice, professional or otherwise. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and the like and take professional advice before investing. Investments in securities market are subject to market risks, read all the related documents carefully before investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Compliance Officer Details: Mr. Manoj Agarwal. Call: 022 - 4285 8484, or Email: ks.compliance@kotak.com.
In case you require any clarification or have any concern, kindly write to us at below email ids:

- **Level 1**: For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at ks.demat@kotak.com or call us on: Toll free numbers 18002099191 / 1860 266 9191
- **Level 2:** If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.
- **Level 3:** If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91- (022) 4285 8484.
- **Level 4:** If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91- (022) 4285 8301.