

Stock Update

Soft quarter

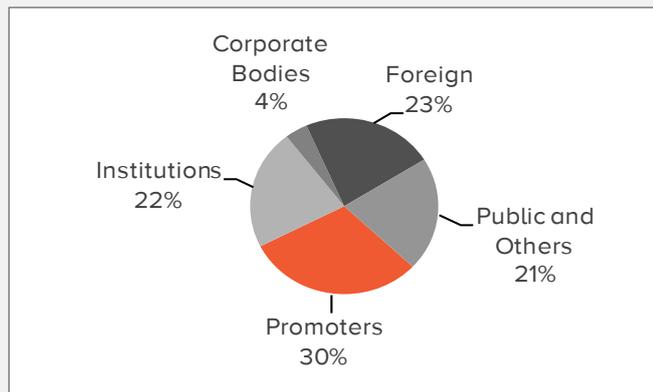
Persistent Systems

Reco: Hold | CMP: Rs635

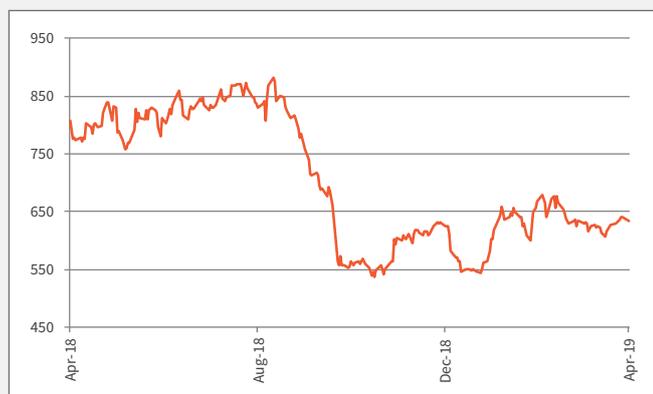
Company details

Price target:	Rs720
Market cap:	Rs5,083 cr
52-week high/low:	Rs915 / 533
NSE volume: (No of shares)	2.2 lakh
BSE code:	533179
NSE code:	PERSISTENT
Sharekhan code:	PERSISTENT
Free float: (No of shares)	5.5 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.6	15.3	16.4	-16.1
Relative to Sensex	-1.6	6.1	-1.0	-26.4

Key points

- Soft quarter:** Persistent Systems Limited (PSL) reported slightly ahead of our muted USD revenue estimates in Q4FY2019, registering a decline of 2.1% q-o-q at \$118.3 million (versus our estimate of \$116 million). Revenue decline during the quarter was due to 15.4% q-o-q fall in IP-led revenue, as Q4 is a seasonally soft quarter for IP-led revenue (because budgets are usually getting allocated in the U.S.), whereas IT services revenue grew by 2.3% q-o-q. Growth in IT services revenue was driven by 1.7% q-o-q growth in volume and 0.6% q-o-q growth in realisation. Digital revenue continued its growth momentum for the second consecutive quarter at 4.3% q-o-q. EBITDA margin contracted by 450 BPS q-o-q to 15.2% in Q4FY2019, below our expectations, owing to lower IP revenue, higher SG&A expenses (includes Rs. 18.25 crore for probable impairment of deposits owing to liquidity crisis in a NBFC) and rupee headwind, which was partially offset by cost optimisation and reversal in variable pay for sales on missing targets (\$1.2 million) for the year. Excluding the provision for impairment of deposits, adjusted EBITDA margin during the quarter stood at 17.4%, above our estimates. Lower profitability was offset by higher-than-expected other income (up 23.4% q-o-q led by higher interest income) and lower-than-expected tax rate (24.1% vs. 29.2% in Q3FY2019 on account of R&D tax credit), resulting in beat to our net profit estimates. Net profit during the quarter declined by 7.9% q-o-q to Rs. 84.5 crore.

- Digital and Accelerite continued to grow, while IP revenue remained soft:** Digital revenue continued its growth momentum for the second consecutive quarter at 4.3% q-o-q in Q4FY2019, while services revenue bounced back to growth at 4.2% q-o-q (vs. a decline of 0.4% q-o-q in Q3FY2019). Alliance revenue declined by \$6.2 million/17.4% q-o-q owing to weak seasonality for IP-led revenue, which is lower than the top client's (IBM) revenue drop of \$7.9 million/24.8% during the quarter. This was because of stable performance of other IPs during the quarter. Regionally, North America's revenue was down by 5.4% q-o-q, while Europe's revenue increased by 1.8% q-o-q during Q4FY2019. India and RoW business growth turned positive to 10.9%/80.3% on a sequential basis.

- ◆ **Leadership changes, expect stable margin in FY2020E:** PSL has appointed former IBM executive Mr. Christopher (Chris) O'Connor and Sandeep Kalra as its CEO and President – Technology Services. Dr. Anand Deshpande will continue as the Executive Chairman of the company and focus on strategy and opportunities in the market. The new leadership team will focus on sales resources, business and new areas in the digital space to drive growth in FY2020E. However, the success is yet to reflect in numbers. Moreover, attrition rate has been inching up for the past four quarters owing to change in sales model at the starting of FY2019. We believe the attrition rate would remain elevated on account of appointment of the new leadership team, possibilities of change in sales policy, transition in its business model (towards IP and digital business) and improvement of overall hiring environment. Management expects margin to remain stable in FY2020E on account of improvement of offshore mix, increased pricing in onsite locations owing to constraint in talent supply and anticipated higher revenue from digital/IP business. In addition, PSL's management highlighted that it would use cash reserves (Rs. 1,498 crore) for acquisitions, which would fill the technology/domain-related gaps and diversification in the European market.
- ◆ **Modest earnings trajectory, maintain Hold:** We have fine tuned our earnings estimates for FY2020E/FY2021E, factoring in better-than-expected adjusted operating profitability along with continued soft performance in IP revenue for the last couple of quarters. Though revenue growth rate was uninspiring for FY2019 owing to internal challenges, we expect the growth trajectory in FY2020E to be better than FY2019 on account of good partnership framework, strong capabilities in product development and robust hiring in the past three quarters. However, overall revenue growth in FY2020E could lag the average growth rate of its mid-tier peers owing to possibilities of further change in sales structure under the new CEO and constraint in talent supply in key markets. The ongoing buyback programme (63% completed) along with 29% of market cap in cash and cash equivalents would lend support to the downside protection of the stock price. Given lack of growth triggers in the medium term, we maintain our Hold rating on the stock with a price target (PT) of Rs. 720.

Valuations

Particulars	Rs cr				
	FY18	FY19	FY20E	FY21E	
Net sales	3,033.7	3,365.9	3,624.8	3,974.7	
EBITDA margin (%)	15.5	17.2	17.2	17.3	
Net profit	323.1	351.7	386.2	420.2	
EPS (Rs.)	40.4	44.4	48.8	53.1	
P/E	15.7	14.3	13.0	12.0	
EV/EBITDA (x)	9.3	7.9	6.6	5.6	
Price/BV (x)	2.4	2.1	2.0	1.8	
RoCE (%)	20.9	21.4	21.7	21.7	
RoE (%)	16.0	15.7	15.8	15.8	

Results					Rs cr	
Particulars	Q4FY19	Q4FY18	Q3FY19	Y-o-Y (%)	Q-o-Q (%)	
Revenue (\$ mn)	118.3	117.0	120.8	1.2	-2.1	
Net sales	831.9	752.5	864.2	10.5	-3.7	
Direct costs	525.5	491.8	534.1	6.8	-1.6	
SG&A	179.8	149.7	159.8	20.2	12.5	
EBITDA	126.6	111.1	170.3	13.9	-25.7	
Depreciation & amortisation	37.7	42.1	39.6	-10.5	-4.9	
EBIT	88.9	69.0	130.7	28.8	-32.0	
Forex gain/(loss)	-5.9	15.0	-24.1	-139.1	-75.7	
Other income	28.3	14.4	22.9	96.2	23.4	
PBT	111.3	98.3	129.5	13.2	-14.1	
Tax provision	26.8	24.6	37.8	8.9	-29.0	
Net profit	84.5	73.7	91.7	14.6	-7.9	
EPS (Rs)	10.6	9.2	11.5	14.9	-7.6	
Margin (%)				BPS	BPS	
EBITDA	15.2	14.8	19.7	45	-449	
EBIT	10.7	9.2	15.1	152	-444	
NPM	10.2	9.8	10.6	36	-46	

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