

Persistent Systems

BUY

INDUSTRY	IT
CMP (As on 16 Dec 2016)	Rs 614
Target Price	Rs 770
Nifty	8,139
Sensex	26,490
KEY STOCK DATA	
Bloomberg	PSYS IN
No. of Shares (mn)	80
MCap (Rs bn) / (\$ mn)	49/725
6m avg traded value (Rs mn)	68
STOCK PERFORMANCE (%)	
52 Week high / low	Rs 798/501
	3M 6M 12M
Absolute (%)	0.3 (12.8) (6.8)
Relative (%)	7.7 (12.7) (10.7)
SHAREHOLDING PATTERN (%)	
Promoters	37.86
FIs & Local MFs	12.30
FIIIs	22.24
Public & Others	27.60
Source : BSE	

Apurva Prasad
apurva.prasad@hdfcsec.com
+91-22-6171-7327

Amit Chandra
amit.chandra@hdfcsec.com
+91-22-6171-7345

En route transformation

We attended Persistent's (PSYS) Investor meet which showcased the company's digital capabilities ranging from live hackathons to demos of multiple use-cases in blockchain technology (financial services, supply chain industries) and IoT.

For us, PSYS' (1) Platform-centric strategy (non-linearity promise), (2) API capabilities backed by tech alliances (Salesforce, Appian), (3) Robust demand environment (4.5x addressable opportunity), (4) Competitive strength and positioning, and (5) IBM alliance (30% of revs) augur well in challenging (and evolutionary) times for Indian IT mid-caps.

Enterprise (28% of revenues, 7.1% CQGR over 8 qtrs) and IP (28% of revenues, 8.8% CQGR) should continue to fire growth even as ISV (44% of revenues, 0.6% CQGR) remains soft. We expect 15.5% CAGR in earnings over FY16-19E. Maintain BUY with TP of Rs 770, 15x Sep-18 EPS. Our assigned multiple is at 10% premium to 5-year average multiple for PSYS, and at <1 PEG (in-line with 5-year average) given the higher visibility and confidence on growth.

Key Highlights

- Services business (46.6% of revenue) margins are not expected to deteriorate over medium-to-long term. 47% of US onsite workforce are locals (vs ~35% for sector), which limits H1B clampdown risks.

- Persistent plans to increase its share of revenue (currently at 10%) from new-age tech which offer much stronger growth opportunities (ER&D growth of consumer software/ecommerce at 28% vs 5% for overall). PSYS growth strategy includes 'fly-wheel approach' by securing US\$150-250k projects and converting the opportunities into larger US\$3-5mn scope.
- The IoT market is expected to grow from US\$ 130bn in CY15 to US\$ 883bn in CY22E at 32% CAGR. Focus verticals within Persistent's IoT strategy include healthcare, industrials and smart cities supported by Persistent's Accelerite Concert platform, which is a cloud/vertical neutral platform.
- Near-term outlook:** PSYS' 3Q is expected to rebound supported by higher IP revenue, aided by the IBM alliance as well as some digital projects moving from 2Q to 3Q. The recent stock correction (post sale of shares by promoter entities) offers a low risk entry point (19% below peak, -8% over the trailing year).

Financial Summary

YE (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	18,913	23,123	28,866	32,425	36,891
EBITDA	3,906	4,171	4,596	5,596	6,893
APAT	2,906	2,974	3,046	3,640	4,596
Diluted EPS (Rs)	36.3	37.2	38.1	45.5	57.4
P/E (x)	16.9	16.5	16.1	13.5	10.7
EV / EBITDA (x)	12.2	11.4	10.3	8.4	6.6
RoE (%)	22.1	19.5	17.2	17.7	19.0

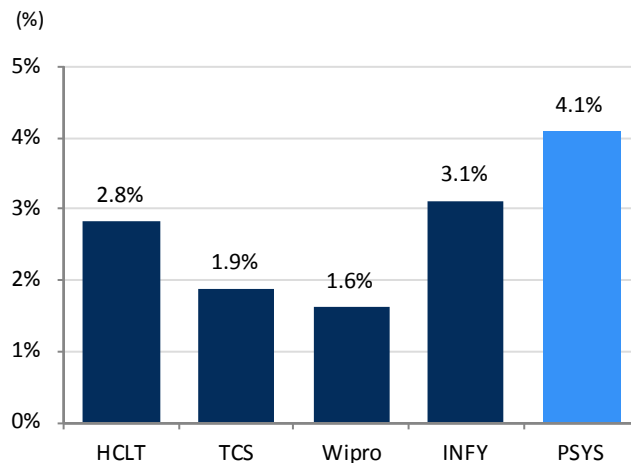
Source: Company, HDFC sec Inst Research

Persistent's growth has outpaced larger peers' engineering services revenue growth

PSYS has outpaced its midcap IT peers on revenue growth (supported by acquisitions of IP)

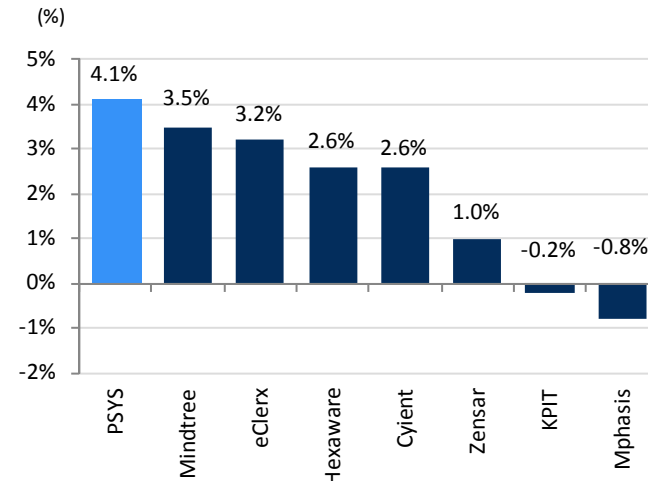
Margin impact of IBM integration in FY17E, earnings expected to accelerate ahead; FY16-19E EPS growth estimated at 15.6% CAGR supported by EBITDA% of 18/15.9/17.3/18.7% for FY16/17/18/19E

ER&D services growth 8-qtr CQGR %



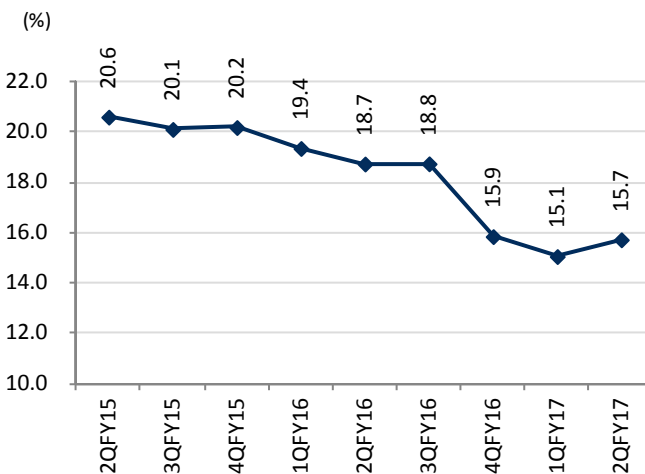
Source: Company, HDFC sec Inst Research

Revenue trend vs midcap IT peers (8-qtr CQGR)



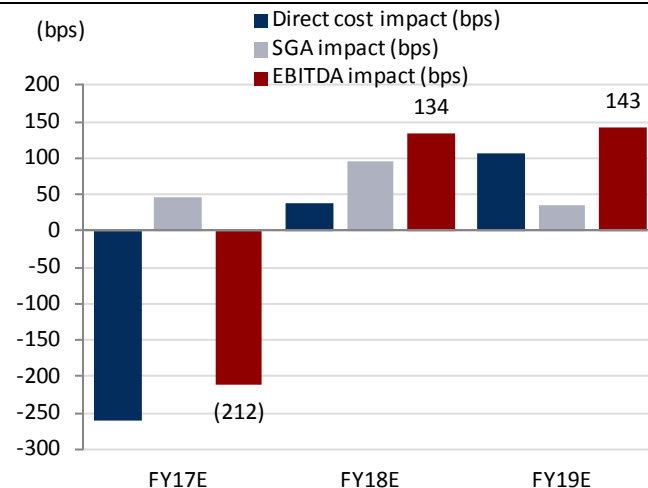
Source: Company, HDFC sec Inst Research

EBITDA Margin; IBM alliance impact from 4QFY16



Source: Company, HDFC sec Inst Research

EBITDA% impact; to improve on efficiencies



Source: Company, HDFC sec Inst Research

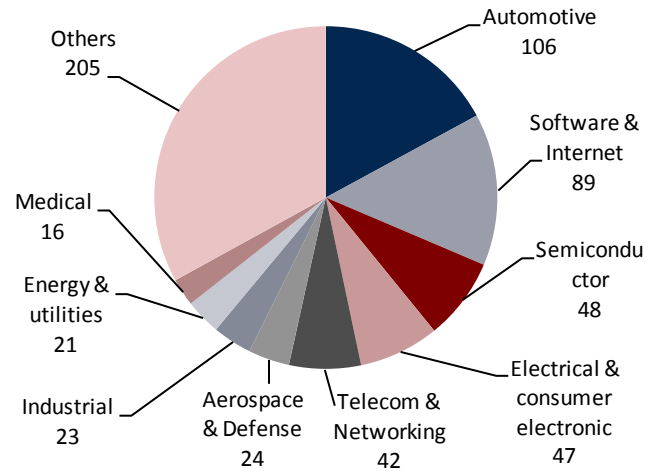
Global R&D spend by G500 companies at US\$ 621bn, US\$ 232bn is the services spend opportunity as compared to current outsourced ER&D at US\$ 51bn

Persistent's technology competency recognized within IoT technology, enterprise and consumer software (Zinnov ratings)

From earlier horizontal focus of Persistent's IoT strategy, it's now moving to vertical-led approach; this resonates with Epam Systems' (PSYS' competitor) strategy

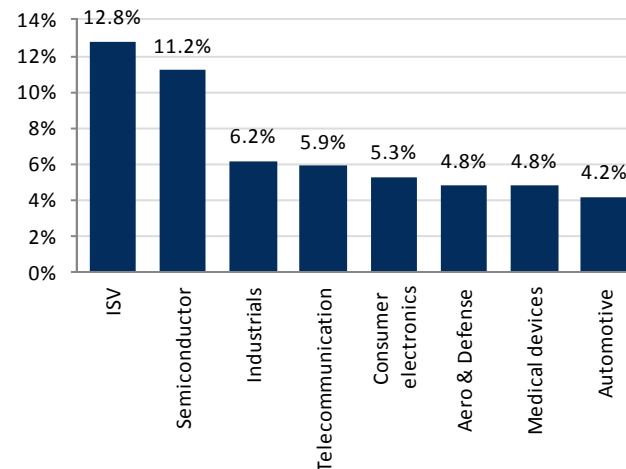
Persistent's 'Concert' platform partners with IBM Watson to leverage data modelling

R&D spend by Global500 (US\$621bn)



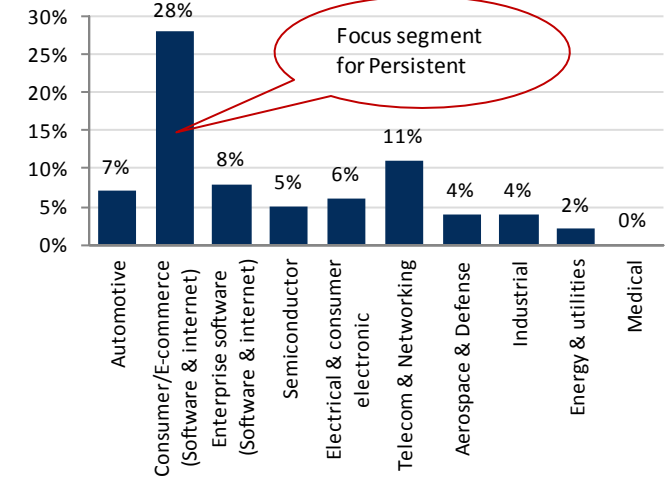
Source: Zinnov, HDFC sec Inst Research

R&D Spend % of Revenue



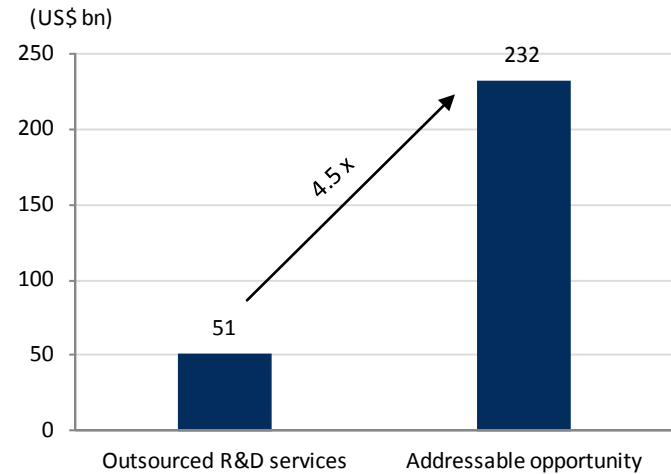
Source: Zinnov, HDFC sec Inst Research

Growth in Global500 R&D spend in CY16 (yoy % cc)



Source: Zinnov, HDFC sec Inst Research

Opportunity for ER&D services outsourcing

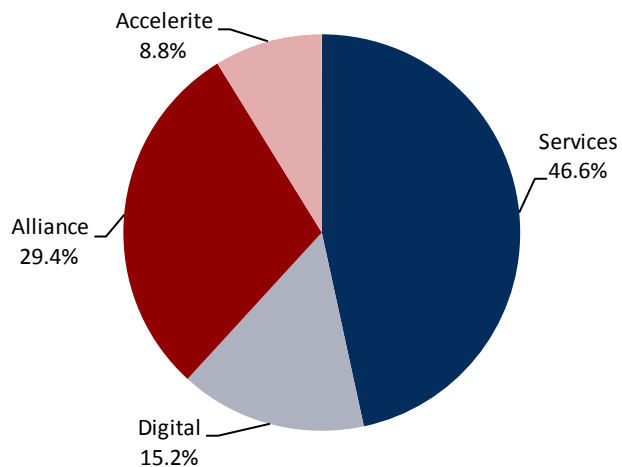


Source: Zinnov, HDFC sec Inst Research

PSYS' has increased its investments in Aepona, which is platform-agnostic and expects Radia to post steady growth

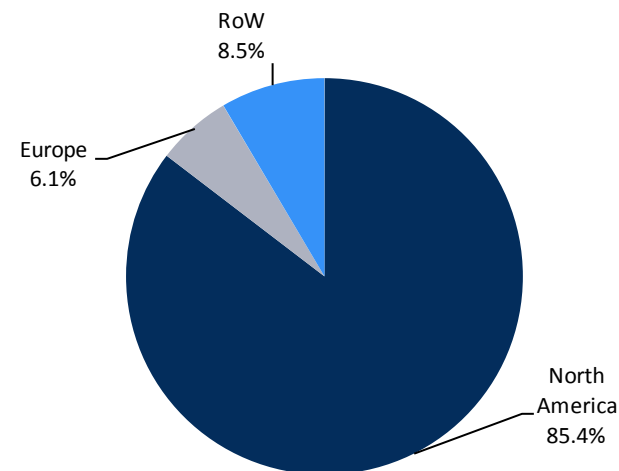
Limited cross currency impact as Europe exposure limited to 6.1% of revenue, which is lowest within midcap IT peers

Revenue Segments by re-organized Services segment



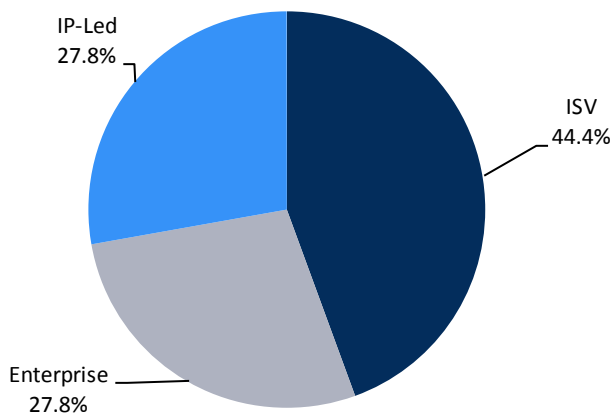
Source: Company, HDFC sec Inst Research

Revenue Segments by Geography



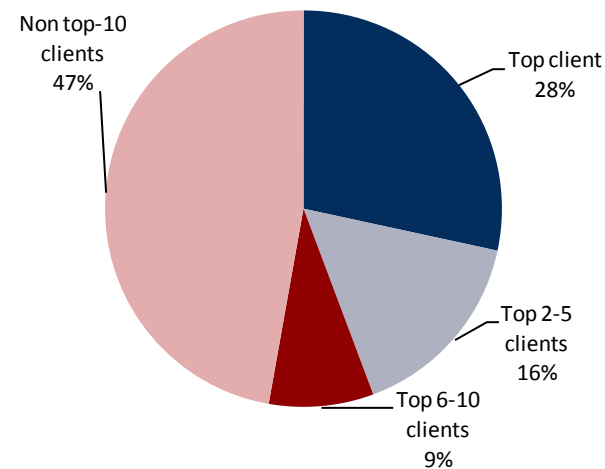
Source: Company, HDFC sec Inst Research

Revenue segments by Service Line



Source: Company, HDFC sec Inst Research

Revenue Segments by Client



Source: Company, HDFC sec Inst Research

ISV growth is expected to be soft largely on cost pressures faced by clients

IP division is expected to post strong growth in 3Q supported by IBM

Service Line Revenue Growth

(QoQ, %)	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
ISV	0.5	(3.1)	5.9	(3.1)	0.0	3.4	(1.8)
Enterprise	5.0	0.3	14.1	16.2	1.8	5.9	5.7
IP-driven	(4.0)	(0.1)	(7.2)	34.2	57.1	4.1	(0.8)
Total	0.7	(1.8)	5.5	8.1	12.0	4.3	0.4

Source: Company, HDFC Sec Inst Research

Revenue Growth by re-organized services

(QoQ, %)	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
Services	NA	NA	NA	NA	NA	NA	(1.7)
Digital	NA	NA	NA	NA	NA	NA	7.5
Alliance	NA	NA	NA	NA	NA	NA	(1.6)
Accelerite	NA	NA	NA	NA	NA	NA	7.7
Total	NA	NA	NA	NA	NA	NA	0.4

Source: Company, HDFC Sec Inst Research

Geographical Revenue Growth

(QoQ, %)	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
North Americas	1.5	(2.9)	7.8	6.9	13.1	5.4	(1.4)
Europe	(3.6)	(9.0)	13.9	0.1	19.1	(19.0)	17.8
RoW	(4.3)	17.1	(20.6)	29.7	(4.0)	13.0	9.4
Total	0.6	(1.8)	5.5	8.1	12.0	4.3	0.4

Source: Company, HDFC Sec Inst Research

Peer Valuation

Company	Mcap (Rs bn)	CMP (Rs)	Reco.	TP (Rs)	EPS (Rs)			P/E (x)			RoE (%)		
					FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
Mindtree	83	501	SELL	400	32.9	25.5	32.0	15.2	19.7	15.7	25.0	17.3	19.6
eClerx	58	1,400	NEU	1,400	88.7	95.0	100.1	15.8	14.7	14.0	40.3	31.0	27.9
Hexaware *	62	206	NEU	215	13.0	12.7	14.8	15.8	16.2	13.9	28.9	24.4	24.4
Cyient	58	512	NEU	554	29.0	33.3	39.5	17.6	15.4	13.0	17.0	18.5	19.7
Persistent	49	614	BUY	770	37.2	38.1	45.5	16.5	16.1	13.5	19.5	17.2	17.7
Zensar	46	1,016	BUY	1,195	69.3	70.0	85.9	14.7	14.5	11.8	23.4	19.8	20.6
KPIT Tech	27	137	SELL	125	14.2	12.3	14.1	9.6	11.4	10.5	21.0	16.1	15.6

Source: HDFC sec Inst Research, * Dec Y/E

Income Statement – Consolidated

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net Revenues (US\$ mn)	309	352	431	484	551
Growth (%)	12.6%	14.0%	22.6%	12.3%	13.8%
Net Revenues	18,913	23,123	28,866	32,425	36,891
Growth (%)	13.3%	22.3%	24.8%	12.3%	13.8%
Personal Expenses	11,317	14,305	18,606	20,778	23,247
SG&A Expenses	3,690	4,647	5,664	6,052	6,751
EBITDA	3,906	4,171	4,596	5,596	6,893
EBITDA Margin (%)	20.7%	18.0%	15.9%	17.3%	18.7%
EBITDA Growth (%)	-9.2%	6.8%	10.2%	21.8%	23.2%
Depreciation	939	965	1,450	1,520	1,670
EBIT	2,967	3,206	3,146	4,075	5,223
Other Income (Including EO Items)	936	751	911	778	905
Interest	3	1	0	0	0
PBT	3,900	3,956	4,057	4,853	6,128
Tax (Incl Deferred)	993	983	1,011	1,213	1,532
RPAT	2,906	2,974	3,046	3,640	4,596
APAT	2,906	2,974	3,046	3,640	4,596
APAT Growth (%)	16.6%	2.3%	2.4%	19.5%	26.3%
Adjusted EPS (Rs)	36.3	37.2	38.1	45.5	57.4
EPS Growth (%)	16.6%	2.3%	2.4%	19.5%	26.3%

Source: Company, HDFC sec Inst Research

Balance Sheet – Consolidated

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	800	800	800	800	800
Reserves	13,255	15,593	18,214	21,382	25,411
Total Shareholders' Funds	14,055	16,393	19,014	22,182	26,211
Total Debt	25	26	38	44	52
Net Deferred Taxes	(313)	(233)	(233)	(233)	(233)
Long-term Provisions & Others	117	126	144	162	184
TOTAL SOURCES OF FUNDS	13,885	16,312	18,964	22,156	26,216
APPLICATION OF FUNDS					
Net Block	3,057	3,007	3,559	3,808	3,947
CWIP	40	24	340	377	422
Goodwill & intangibles	1,019	1,597	1,373	1,583	2,034
Investments	2,116	1,348	1,588	1,946	2,213
LT Loans & Advances	127	1,721	1,529	1,678	1,868
Total Non-current Assets	6,359	7,697	8,389	9,392	10,484
Debtors	3,586	4,275	5,299	5,952	6,772
Other Current Assets	1,452	2,600	3,233	3,632	4,132
Cash & Equivalents	6,036	6,260	7,773	9,617	12,150
Total Current Assets	11,074	13,136	16,305	19,200	23,054
Creditors	529	1,651	1,977	2,221	2,527
Other Current Liabilities & Prov.	3,020	2,870	3,753	4,215	4,796
Total Current Liabilities	3,549	4,521	5,730	6,436	7,323
Net Current Assets	7,525	8,614	10,575	12,764	15,731
TOTAL APPLICATION OF FUNDS	13,885	16,312	18,964	22,156	26,216

Source: Company, HDFC Sec Inst Research

Cash Flow Statement – Consolidated

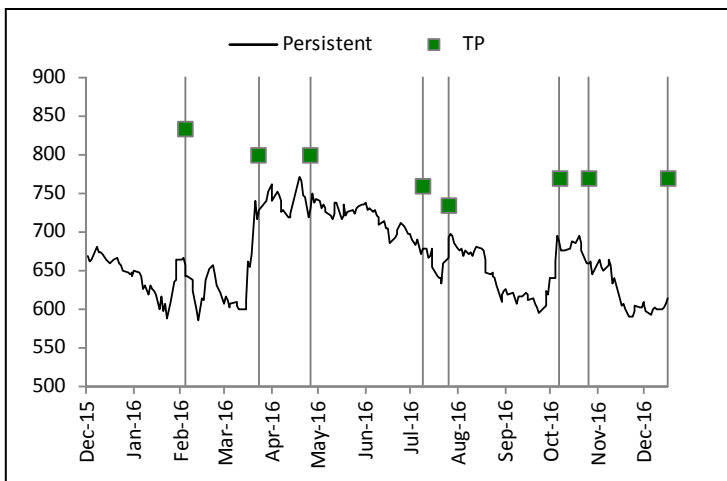
Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Reported PBT	3,900	3,956	4,057	4,853	6,128
Non-operating & EO items	683	(2,033)	715	82	100
Interest expenses	3	1	0	0	0
Depreciation	939	965	1,450	1,520	1,670
Working Capital Change	(276)	(838)	(951)	(559)	(701)
Tax Paid	(993)	(983)	(1,011)	(1,213)	(1,532)
OPERATING CASH FLOW (a)	4,255	1,069	4,259	4,684	5,664
Capex	(957)	(1,659)	(1,876)	(2,108)	(2,398)
Free cash flow (FCF)	3,298	(590)	2,383	2,576	3,266
Investments	(1,359)	498	(242)	(175)	464
Non-operating Income	0	0	0	0	0
INVESTING CASH FLOW (b)	(2,315)	(1,162)	(2,118)	(2,282)	(1,934)
Debt Issuance/(Repaid)	(7)	1	12	6	8
Interest Expenses	(3)	(1)	0	0	0
FCFE	3,287	(590)	2,395	2,583	3,274
Share Capital Issuance	0	0	0	0	0
Dividend	(472)	(378)	(425)	(472)	(566)
FINANCING CASH FLOW (c)	(483)	(378)	(412)	(466)	(558)
NET CASH FLOW (a+b+c)	1,457	(470)	1,729	1,936	3,172
Closing Cash & Equivalents	6,036	6,260	7,773	9,617	12,150

Source: Company, HDFC sec Inst Research

Key Ratios - Consolidated

	FY15	FY16	FY17E	FY18E	FY19E
PROFITABILITY (%)					
GPM	40.2	38.1	35.5	35.9	37.0
EBITDA Margin	20.7	18.0	15.9	17.3	18.7
APAT Margin	15.4	12.9	10.6	11.2	12.5
RoE	22.1	19.5	17.2	17.7	19.0
RoIC (or Core RoCE)	29.1	26.9	22.2	25.8	29.4
RoCE	22.1	19.7	17.3	17.7	19.0
EFFICIENCY					
Tax Rate (%)	25.5	24.8	24.9	25.0	25.0
Fixed Asset Turnover (x)	3.3	3.4	3.7	3.6	3.6
Debtors (days)	69	67	67	67	67
Payables (days)	10	26	25	25	25
Cash Conversion Cycle (days)	59	41	42	42	42
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
Net D/E (x)	(0.4)	(0.4)	(0.4)	(0.4)	(0.5)
Interest Coverage (x)	880	3,485	NA	NA	NA
PER SHARE DATA (Rs)					
EPS	36.3	37.2	38.1	45.5	57.4
CEPS	48	49	56	65	78
Dividend	10	8	9	10	12
Book Value	176	205	238	277	328
VALUATION					
P/E (x)	16.9	16.5	16.1	13.5	10.7
P/BV (x)	3.5	3.0	2.6	2.2	1.9
EV/EBITDA (x)	12.2	11.4	10.3	8.4	6.6
OCF/EV (%)	8.9	2.2	9.0	10.0	12.4
FCF/EV (%)	6.9	-1.2	5.0	5.5	7.2
FCFE/Mkt Cap (%)	6.7	-1.2	4.9	5.3	6.7
Dividend Yield (%)	1.6	1.3	1.5	1.6	2.0

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY


Date	CMP	Reco	Target
4-Feb-16	657	BUY	834
23-Mar-16	716	BUY	800
26-Apr-16	719	BUY	800
8-Jul-16	671	BUY	760
26-Jul-16	665	BUY	735
6-Oct-16	696	BUY	770
25-Oct-16	658	BUY	770
18-Dec-16	614	BUY	770

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

We, Apurva Prasad, MBA & Amit Chandra, MBA authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Research Analyst or his/her relative or HDFC Securities Ltd. does not have any financial interest in the subject company. Also Research Analyst or his relative or HDFC Securities Ltd. or its Associate may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Further Research Analyst or his relative or HDFC Securities Ltd. or its associate does not have any material conflict of interest.

Any holding in stock – No

Disclaimer:

This report has been prepared by HDFC Securities Ltd and is meant for sole use by the recipient and not for circulation. The information and opinions contained herein have been compiled or arrived at, based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This document is for information purposes only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments.

This report is not directed to, or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject HDFC Securities Ltd or its affiliates to any registration or licensing requirement within such jurisdiction.

If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purposes without prior written approval of HDFC Securities Ltd .

Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations, which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.

It should not be considered to be taken as an offer to sell or a solicitation to buy any security. HDFC Securities Ltd may from time to time solicit from, or perform broking, or other services for, any company mentioned in this mail and/or its attachments.

HDFC Securities and its affiliated company(ies), their directors and employees may; (a) from time to time, have a long or short position in, and buy or sell the securities of the 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 company(ies) discussed herein or act as an advisor or lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

HDFC Securities Ltd, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

HDFC Securities Ltd and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report, or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

HDFC Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

HDFC Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction in the normal course of business.

HDFC Securities or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither HDFC Securities nor Research Analysts have any material conflict of interest at the time of publication of this report. Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. HDFC Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. Research entity has not been engaged in market making activity for the subject company. Research analyst has not served as an officer, director or employee of the subject company. We have not received any compensation/benefits from the subject company or third party in connection with the Research Report. HDFC Securities Ltd. is a SEBI Registered Research Analyst having registration no. INH000002475

HDFC securities**Institutional Equities**

Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park, Senapati Bapat Marg, Lower Parel,

Mumbai - 400 013

Board : +91-22-6171 7330

www.hdfcsec.com