

REDUCE

TP: Rs 530 | ▲ 5%

PERSISTENT SYSTEMS

| IT Services

| 06 May 2020

IP business spoils the show yet again

Persistent Systems (PSYS) reported a weak Q4FY20 as revenue declined 1.8% QoQ to US\$ 127mn due to a 24% drop in IP revenue. This was the weakest IP revenue show in 35 quarters on an already soft Q3FY20 base. The services (non-IP) business held strong with 4.2% QoQ dollar revenue growth. We cut FY21/FY22 EPS by 29%/16% to bake in pandemic-led challenges and revise our Mar'21 TP to Rs 530 (vs. Rs 650). Retain **REDUCE** as we remain wary of IP business volatility and subpar expertise in the enterprise business.

Ruchi Burde | Seema Nayak

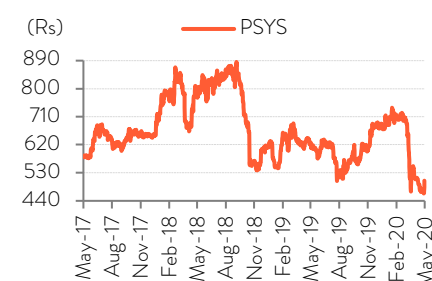
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Continued weak performance in IP segment: PSYS saw the highest QoQ decline in IP revenues in the last 35 quarters, partly due to seasonality. IBM royalty revenues dropped despite PSYS securing gold partner status. The reseller business is also facing challenges due to structural and leadership changes. Despite induction of an ex-IBM CEO, IP revenues have failed to ramp up over the last year. The Alliance business with IBM needs to be revived by cross-selling, in our view.

Ticker/Price	PSYS IN/Rs 505
Market cap	US\$ 531.7mn
Shares o/s	80mn
3M ADV	US\$ 0.8mn
52wk high/low	Rs 740/Rs 420
Promoter/FPI/DII	30%/26%/44%

Source: NSE

Margins resilient in Q4 but slump in FY20: Despite a slowdown in the lucrative IP business, Q4 EBITDA margins improved 40bps QoQ to 13.8%, aided by 30bps of currency-led tailwinds. But FY20 margins at 13.8% contracted 340bps due to higher sales, marketing and employee costs. Management is hopeful of recovery supported by the absence of some one-time costs and rebranding expenses (US\$ 1.5mn). We see downside risk to FY21 margin recovery targets given a weak demand outlook and increasing requests for concessions from clients struggling with Covid-19 challenges.

STOCK PERFORMANCE

Source: NSE

Retain REDUCE: We trim FY21/FY22 earnings estimates by 29%/16%, pare our target FY22E P/E multiple to 11.3x (vs. 12.5x earlier) baking in Covid-led uncertainty, and revise our TP to Rs 530.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	30,337	33,659	35,658	37,181	41,749
EBITDA (Rs mn)	4,687	5,805	4,930	5,537	6,635
Adj. net profit (Rs mn)	3,231	3,516	3,403	2,972	3,766
Adj. EPS (Rs)	40.4	43.9	42.7	37.3	47.2
Adj. EPS growth (%)	7.1	8.8	(2.9)	(12.7)	26.7
Adj. ROAE (%)	16.0	15.7	14.1	11.5	13.5
Adj. P/E (x)	12.5	11.5	11.8	13.5	10.7
EV/EBITDA (x)	8.3	6.6	7.8	7.0	5.7

Source: Company, BOBCAPS Research

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FIG 1 – MAR'20 QUARTER PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Revenue (US\$ mn)	127.1	118.3	7.4	129.4	(1.8)	501.6	481.0	4.3
Revenue (Rs mn)	9,264	8,319	11.4	9,227.3	0.4	35,658.1	33,658.8	5.9
Operating Expenditure	7,987	7,053	13.2	7,993.0	(0.1)	30,728.5	27,854.1	10.3
Cost of revenues	6,130	5,255	16.7	6,157.4	(0.5)	23,494.3	21,378.2	9.9
as % of sales	66.2	63.2	-	66.7	-	65.9	63.5	-
SG&A expenses	1,857	1,798	3.3	1,835.6	1.2	7,234	6,475.9	11.7
as % of sales	20.0	21.6	-	19.9	-	20.3	19.2	-
EBITDA	1,277	1,266	0.9	1,234.3	3.4	4,930	5,804.8	(15.1)
Depreciation	420	377	11.5	428.3	(1.9)	1,660	1,572.5	5.5
EBIT	857	889	(3.6)	806.0	6.3	3,270	4,232.3	(22.7)
Other Income	274	224	-	333.7	-	1,254	630.5	-
PBT	1,130	1,113	1.6	1,139.8	(0.8)	4,523	4,862.8	(7.0)
Total Tax	292	268	8.9	260.5	12.2	1,121	1,346.6	(16.8)
Adjusted PAT	838	845	(0.8)	879.3	(4.7)	3,403	3,516.2	(3.2)
(Profit)/loss from JV's/Ass/MI	-	-	-	0.0	-	-	-	-
APAT after MI	838	845	(0.8)	879.3	(4.7)	3,403	3,516.2	(3.2)
Extra ordinary items	0	0	-	0.0	-	-	-	-
Reported PAT	838	845	(0.8)	879.3	(4.7)	3,403	3,516.2	(3.2)
Reported EPS	10.5	10.6	(1.1)	11.0	(4.7)	43	44.0	(3.3)
Margins (%)			(bps)		(bps)			
EBITDA	13.8	15.2	(143)	13.4	41	13.8	17.2	(342)
EBIT	9.2	10.7	(144)	8.7	51	9.2	12.6	(340)
EBT	12.2	13.4	(118)	12.4	(15)	12.7	14.4	(176)
PAT	9.0	10.2	(111)	9.5	(48)	9.5	10.4	(90)
Effective Tax rate	25.9	24.1	174	22.9	300	24.8	27.7	(292)

Source: Company, BOBCAPS Research

FIG 2 – MAR'20 QUARTER OPERATING METRICS

(In US\$ terms)	Q4FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Revenue breakup by Geography			
North America	80.2	(1.7)	6.5
Europe	8.8	(18.5)	19.6
India, APAC	9.3	(1.8)	(10.8)
Revenue breakup by Industry			
ISV	41.7	5.0	8.7
Enterprise	42.0	3.6	21.3
IP Led	16.3	(24.5)	(19.0)
Client Concentration			
Top Client	19.2	(12.3)	(5.0)
Top 5 Clients	41.5	(3.7)	3.8
Top 10 Clients	49.9	(4.1)	(0.6)
Non-Top 10 Clients	50.1	0.6	0.6
Revenue Mix			
Services	48.4	2.2	16.5

(In US\$ terms)	Q4FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Digital	25.3	7.0	11.4
Alliance	22.2	(18.4)	(3.9)
Accelerite	4.1	11.8	(29.0)

	Q4FY20	Q3FY20	Q4FY19
Onsite- Offshore mix (%)			
Onsite	33.0	31.5	31.4
Offshore	50.7	47.3	47
IP led	16.3	21.2	21.6
Headcount	10,632	10,532	9,962

Source: Company, BOBCAPS Research

Valuation methodology

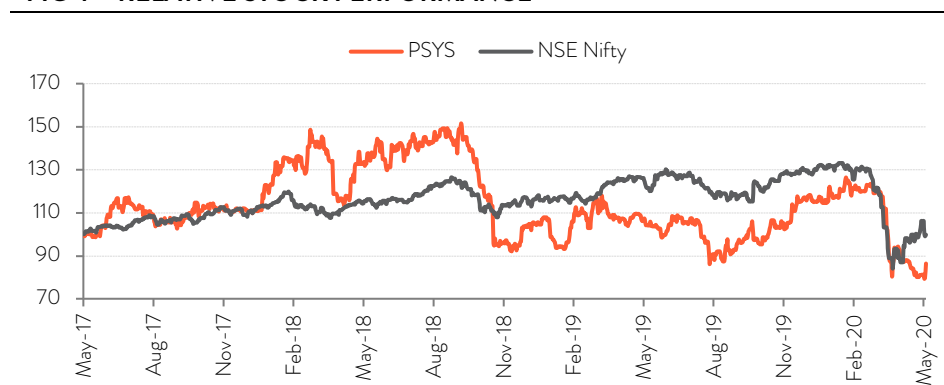
We cut FY21/FY22 EPS estimates by 29%/16%, pare our target FY22E P/E multiple to 11.3x to account for pandemic-led challenges (baking in a 10% discount to our earlier multiple of 12.5x), and revise our Mar'21 target price to Rs 530 (from Rs 650). We remain negative on PSYS due to: (1) continued poor performance in the IP segment, (2) project-based nature of revenues and lack of annuity, (3) dwindling margins, and (4) a delayed pivot to 'enterprise', leading to lower traction in the BFSI, healthcare and industrial verticals, plus relatively weak domain expertise compared to other mid-tier peers. Retain REDUCE.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	581.2	495.7	(14.7)	656.7	556.7	(15.2)
YoY growth (%)	12.8	(1.2)	-	13.0	12.3	-
Revenues	40,684	37,181	(8.6)	45,972	41,749	(9.2)
EBITDA	6,655	5,537	(16.8)	7,723	6,635	(14.1)
EBITDA margins (%)	16.4	14.9	-	16.8	15.9	-
Net Profits	4,007	2,972	(25.8)	4,482	3,766	(16.0)
EPS (Rs)	52.2	37.3	(28.6)	56.2	47.2	(16.0)

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates include:

- a sharp recovery in the ISV business, and
- above-expected operating margin improvement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	30,337	33,659	35,658	37,181	41,749
EBITDA	4,687	5,805	4,930	5,537	6,635
Depreciation	1,585	1,573	1,660	1,730	1,900
EBIT	3,102	4,232	3,270	3,807	4,734
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	1,191	631	1,254	321	496
Exceptional items	0	0	0	0	0
EBT	4,293	4,863	4,523	4,128	5,231
Income taxes	1,062	1,347	1,121	1,156	1,465
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	3,231	3,516	3,403	2,972	3,766
Adjustments	0	0	0	0	0
Adjusted net profit	3,231	3,516	3,403	2,972	3,766

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	3,270	3,158	3,810	3,973	4,461
Provisions	1,754	1,939	1,954	2,037	2,288
Debt funds	17	12	12	12	12
Other liabilities	270	0	0	0	0
Equity capital	800	791	791	791	791
Reserves & surplus	20,472	22,656	24,002	25,901	28,307
Shareholders' fund	21,272	23,447	24,793	26,692	29,099
Total liabilities and equities	26,583	28,556	30,569	32,714	35,859
Cash and cash eq.	2,413	1,739	1,461	3,257	5,212
Accounts receivables	4,847	4,923	5,862	6,112	6,863
Inventories	0	0	0	0	0
Other current assets	4,583	3,861	5,373	5,603	6,291
Investments	8,925	13,304	13,304	13,304	13,304
Net fixed assets	5,097	4,242	4,083	3,953	3,702
CWIP	52	316	316	316	316
Intangible assets	77	81	81	81	81
Deferred tax assets, net	642	405	405	405	405
Other assets	0	0	0	0	0
Total assets	26,583	28,556	30,569	32,714	35,859

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	4,664	5,031	5,063	4,702	5,667
Interest expenses	(161)	(285)	(1,254)	(321)	(496)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	56	(290)	(1,784)	(234)	(701)
Other operating cash flows	(349)	(135)	0	0	0
Cash flow from operations	4,210	4,321	2,025	4,147	4,469
Capital expenditures	3	(374)	(1,500)	(1,600)	(1,650)
Change in investments	(1,807)	1,472	0	0	0
Other investing cash flows	(1,569)	(3,428)	1,254	321	496
Cash flow from investing	(3,373)	(2,330)	(247)	(1,279)	(1,154)
Equities issued/Others	0	0	(828)	0	0
Debt raised/repaid	(5)	(5)	0	0	0
Interest expenses	(152)	(713)	0	0	0
Dividends paid	(800)	(879)	(1,229)	(1,073)	(1,360)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(956)	(1,596)	(2,057)	(1,073)	(1,360)
Changes in cash and cash eq.	(119)	394	(278)	1,795	1,956
Closing cash and cash eq.	2,413	1,740	1,461	3,257	5,212

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	40.4	43.9	42.7	37.3	47.2
Adjusted EPS	40.4	43.9	42.7	37.3	47.2
Dividend per share	10.0	13.2	12.8	11.2	14.2
Book value per share	265.9	293.0	310.8	334.6	364.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	1.3	1.1	1.1	1.0	0.9
EV/EBITDA	8.3	6.6	7.8	7.0	5.7
Adjusted P/E	12.5	11.5	11.8	13.5	10.7
P/BV	1.9	1.7	1.6	1.5	1.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	75.3	72.3	75.2	72.0	72.0
Interest burden (PBT/EBIT)	138.4	114.9	138.3	108.4	110.5
EBIT margin (EBIT/Revenue)	10.2	12.6	9.2	10.2	11.3
Asset turnover (Revenue/Avg TA)	121.2	122.1	120.6	117.5	121.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	16.0	15.7	14.1	11.5	13.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	5.4	10.9	5.9	4.3	12.3
EBITDA	3.3	23.8	(15.1)	12.3	19.8
Adjusted EPS	7.1	8.8	(2.9)	(12.7)	26.7
Profitability & Return ratios (%)					
EBITDA margin	15.5	17.2	13.8	14.9	15.9
EBIT margin	10.2	12.6	9.2	10.2	11.3
Adjusted profit margin	10.7	10.4	9.5	8.0	9.0
Adjusted ROAE	16.0	15.7	14.1	11.5	13.5
ROCE	12.7	15.0	10.9	11.7	14.4
Working capital days (days)					
Receivables	58	53	55	59	57
Inventory	0	0	0	0	0
Payables	44	42	41	45	44
Ratios (x)					
Gross asset turnover	5.7	7.2	8.6	9.3	10.9
Current ratio	2.4	2.1	2.2	2.5	2.7
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

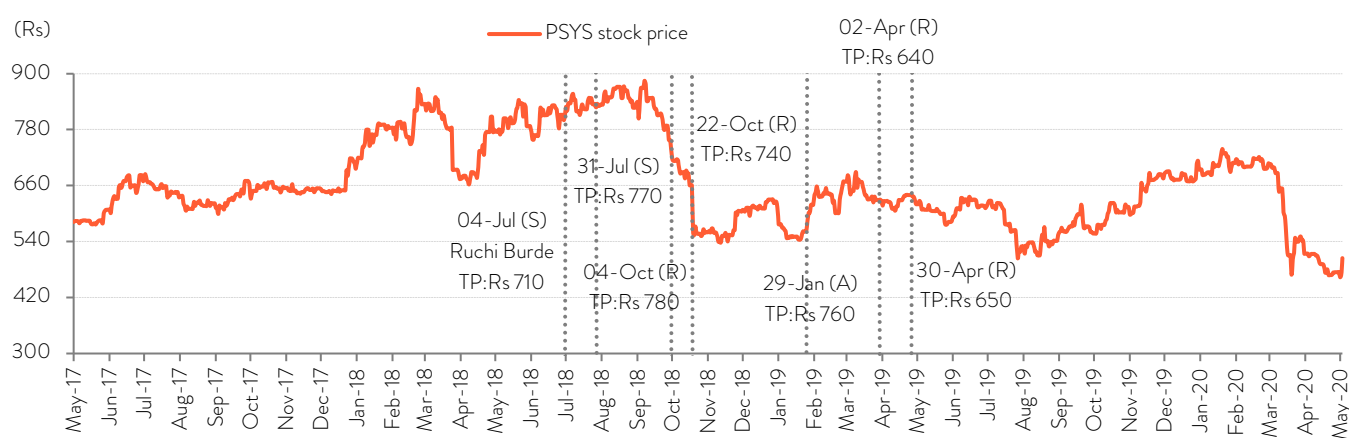
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: PERSISTENT SYSTEMS (PSYS IN)



B – Buy, A – Add, R – Reduce, S – Sell

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