

PERSISTENT SYSTEMS

IT - SERVICES

HOLD

Target Price: Rs 700

IBM deal: Key milestone in next gen

Persistent hosted an investor call to sharedetails on its collaboration with IBM which focusses on Internet of Things (IoT) and next gen software driven products/ services. The company has aligned its business under Digital, IBM Alliance, Agile Services and Accelerite.

IBM deal, key milestone in IoT/ next gen offerings: focusses on (1) investments in IBM platforms, and (2) preferred alliance with IBM in offering software-driven solutions. Deal has potential to drive incremental revenue of 15-20% at ~USD 50-70 mn (over FY16 revenue) in first year of this deal (thus taking IBM to being a USD 100 mn+ client). Deal would involve investments and impact margin by ~200-250 bps pa in the first two years. We believe these investments will be remunerative in long term and scale its EDT[^]/ IoT offerings. Also, Persistent has multiple levers which will support margin.

CMP : Rs 740
Potential Upside : -5%

MARKET DATA

No. of Shares : 80mn
Free Float : 61%
Market Cap : Rs59bn
52-week High / Low : Rs817 / Rs563
Avg. Daily vol. (6mth) : 93,241 shares
Bloomberg Code : PSYS IB Equity
Promoters Holding : 39%
FII / DII : 17% / 11%

IBM deal highlights:

- ◆ Market opportunity remains high with McKinsey IoT insights highlighting that IoT can yield ~USD 4 trn to USD 11 trn economic value add by 2025 (<http://www.mckinsey.com/mgi>)
- ◆ IBM deal would facilitate Persistent's end-to-end solution offerings in digital transformation/ IoT, enable joint go-to-marketing to Enterprise clients in addition to continuously developing engineering platforms
- ◆ The deal would involve deployment of additional 500 employees (currently 1,000 people are deployed on IBM) across key geographies of US, UK, India and some in Mexico/ Israel
- ◆ The deal also strengthens its 15+ year relationship with IBM
- ◆ EPS Sensitivity on IBM deal on page 2

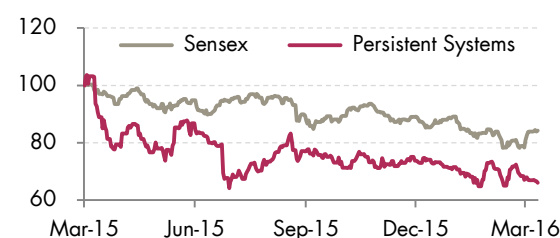
Financial summary before new IBM deal

Y/E March	FY15	FY16E	FY17E	FY18E
Sales (Rs mn)	18,913	22,376	26,596	30,253
Adj PAT (Rs mn)	2,906	2,946	3,734	4,190
Con. EPS* (Rs.)	-	37	44	51
EPS (Rs.)	36	37	47	52
Change YOY (%)	17	1	27	12
P/E (x)	20.4	20.1	15.9	14.1
RoE (%)	22	20	22	22
RoCE (%)	29	26	29	29
EV/EBITDA (x)	14.8	13.3	10.1	8.6
DPS	10	12	15	17

Key drivers: Persistent before new IBM deal

(USD mn)	FY16E	FY17E	FY18E
Revenue	344	395	450
% change YoY	12%	15%	14%

Price performance



Source: *Consensus broker estimates, Company, Axis Capital

[^] EDT: Enterprise Digital Transformation

Estimates and valuation: Incorporating new IBM deal for FY17, we now expect USD revenue of USD 464mn, EBITDA margin of 17.5% (FY16: 19%) and EPS of ~Rs 44 (earlier: Rs 47). While it is margin dilutive in FY17E, Persistent has multiple margin levers like improvement in Aepona profitability (~3% annualized revenue share), better utilization and scale from IP/ EDT revenue. We raise our target PE multiple to 16x FY17E (15x earlier) with TP of Rs 700 to factor in huge potential from this deal and improving services/products portfolio. We rate Persistent as a HOLD given the recent stock price appreciation (5% downside).

Exhibit 1: Persistent's FY17 estimates with low-end revenue growth of 15% from new IBM deal

(Rsmn)	Existing FY16	Low-end of deal			% change YoY
		Existing FY17	New IBM FY17	Consolidated Existing+ IBM	
Revenue (USD mn)	344	395	52	447	30
Growth in IBM deal (%)					
Revenue	22,376	26,596	3,475	30,071	34
EBITDA	4,260	5,477	(278)	5,199	22
PAT	2,946	3,734	(452)	3,282	11
No: of shares	80	80	80	80	
EPS	36.8	46.7	(5.6)	41.0	
Margins					
OPM	19.0%	20.6%	-8.0%	17.3%	(1.75)
NPM	13.2%	14.0%	-13.0%	10.9%	(2.25)

Source: Company, Axis Capital

Exhibit 2: Persistent's FY17 estimates with high-end revenue growth of 20% from new IBM deal

(Rsmn)	Existing FY16	High-end of deal			% change YoY
		Existing FY17	New IBM FY17	Consolidated Existing+ IBM	
Revenue (USD mn)	344	395	69	464	35
Growth in IBM deal (%)					
Revenue	22,376	26,596	4,634	31,229	40
EBITDA	4,260	5,477	-	5,477	29
PAT	2,946	3,734	(232)	3,502	19
No: of shares	80	80	80	80	
EPS	36.8	46.7	(2.9)	43.8	
Margins					
OPM	19.0%	20.6%	0.0%	17.5%	-1.50
NPM	13.2%	14.0%	-5.0%	11.2%	-1.95

Source: Company, Axis Capital

Financial summary (before new IBM deal)

Profit & loss (Rsmn)

Y/E March	FY15	FY16E	FY17E	FY18E
Net sales	18,913	22,376	26,596	30,253
Other operating income	-	-	-	-
Total operating income	18,913	22,376	26,596	30,253
Cost of goods sold	(11,317)	(13,619)	(15,831)	(18,021)
Gross profit	7,596	8,757	10,765	12,232
Gross margin (%)	40	39	40	40
Total operating expenses	(3,690)	(4,497)	(5,288)	(6,031)
EBITDA	3,906	4,260	5,477	6,201
EBITDA margin (%)	21	19	21	20
Depreciation	(939)	(962)	(1,117)	(1,301)
EBIT	2,967	3,298	4,360	4,900
Other income	932	671	686	762
Profit before tax	3,900	3,969	5,046	5,662
Total taxation	(993)	(1,023)	(1,312)	(1,472)
Tax rate (%)	25	26	26	26
Profit after tax	2,906	2,946	3,734	4,190
Adjusted net profit	2,906	2,946	3,734	4,190
Adj. PAT margin (%)	15	13	14	14
Net non-recurring items	-	-	-	-
Reported net profit	2,906	2,946	3,734	4,190

Balance sheet (Rsmn)

Y/E March	FY15	FY16E	FY17E	FY18E
Paid-up capital	856	856	856	856
Reserves & surplus	13,200	14,979	17,235	19,765
Net worth	14,055	15,835	18,090	20,621
Borrowing	3	-	-	-
Total liabilities	17,749	20,456	23,605	26,850
Gross fixed assets	9,408	10,481	11,953	13,962
Less: Depreciation	(5,331)	(6,293)	(7,410)	(8,711)
Net fixed assets	4,076	4,188	4,542	5,251
Add: Capital WIP	40	400	450	450
Total fixed assets	4,116	4,588	4,992	5,701
Total Investment	6,735	6,735	6,735	6,735
Debtors	3,586	4,177	4,964	5,645
Cash & bank	1,416	2,539	4,147	5,692
Loans & advances	417	460	528	586
Current liabilities	3,549	4,429	5,273	5,937
Net current assets	2,906	4,261	6,162	8,034
Other non-current assets	443	443	443	443
Total assets	17,749	20,456	23,605	26,850

Source: Company, Axis Capital

Cash flow (Rsmn)

Y/E March	FY15	FY16E	FY17E	FY18E
Profit before tax	3,900	3,969	5,046	5,662
Depreciation & Amortisation	(939)	(962)	(1,117)	(1,301)
Chg in working capital	67	(233)	(293)	(327)
Cash flow from operations	3,856	3,675	4,558	5,163
Capital expenditure	(595)	(1,433)	(1,522)	(2,010)
Cash flow from investing	(7,143)	(1,383)	(1,472)	(1,960)
Equity raised/ (repaid)	-	-	-	-
Debt raised/ (repaid)	3	(3)	-	-
Dividend paid	(961)	(1,167)	(1,479)	(1,659)
Cash flow from financing	(959)	(1,169)	(1,479)	(1,659)
Net chg in cash	(4,246)	1,123	1,608	1,545

Key ratios

Y/E March	FY15	FY16E	FY17E	FY18E
OPERATIONAL				
FDEPS (Rs)	36	37	47	52
CEPS (Rs)	48	49	61	69
DPS (Rs)	10	12	15	17
Dividend payout ratio (%)	28	33	33	33
GROWTH				
Net sales (%)	13	18	19	14
EBITDA (%)	(9)	9	29	13
Adj net profit (%)	17	1	27	12
FDEPS (%)	17	1	27	12
PERFORMANCE				
RoE (%)	22	20	22	22
RoCE (%)	29	26	29	29
EFFICIENCY				
Asset turnover (x)	2.0	1.7	2.0	2.1
Sales/ total assets (x)	1.1	1.2	1.2	1.2
Receivable days	69	68	68	68
Payable days	13	13	13	13
FINANCIAL STABILITY				
Current ratio (x)	1.8	2.0	2.2	2.4
VALUATION				
PE (x)	20.4	20.1	15.9	14.1
EV/ EBITDA (x)	14.8	13.3	10.1	8.6
EV/ Net sales (x)	3.1	2.5	2.1	1.8
PB (x)	4.2	3.7	3.3	2.9
Dividend yield (%)	1.4	1.6	2.1	2.3

Source: Company, Axis Capital

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