

October 18, 2012

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Rating	<b>BUY</b>
Price	Rs428
Target Price	Rs540
Implied Upside	26.2%
Sensex	18,792
Nifty	5,719

(Prices as on October 18, 2012)

#### Trading data

Market Cap. (Rs bn)	17.1
Shares o/s (m)	40.0
3M Avg. Daily value (Rs m)	11.1

#### Major shareholders

Promoters	38.95%
Foreign	2.60%
Domestic Inst.	32.07%
Public & Other	26.37%

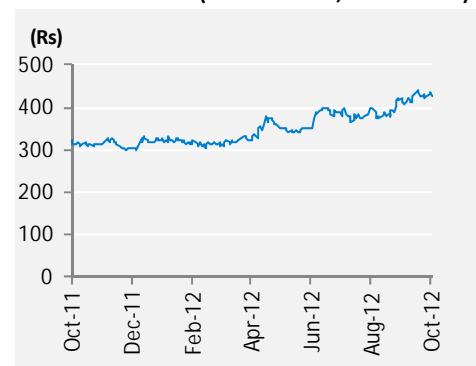
#### Stock Performance

(%)	1M	6M	12M
Absolute	3.6	28.4	35.9
Relative	2.0	20.3	23.7

#### How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	48.0	44.5	7.9
2014	55.4	49.3	12.5

#### Price Performance (RIC: PERS.BO, BB: PSYS IN)



Source: Bloomberg

Persistent Systems' (Persistent's) Q2FY13 results gave strong beat to consensus/PL estimates. We were ~3%/10% higher than consensus for revenue/PAT growth. IP-led revenue growth has given cushion to margin headwinds from wage hike. The management commentary was upbeat for the demand environment and deal pipeline. The success of differentiated S&M approach, partnership model, IP-investments and capitalizing on inorganic opportunity has pushed the performance envelope. We retain "BUY" rating. We revise our target price to **Rs 540 (Old Rs480)**.

- Revenue in line, margin softer:** Persistent's Q2FY13 results have exceeded PL/Consensus expectation on all counts. Revenue grew 8.7% QoQ to Rs3,269m (PL: Rs3,159m Cons: Rs3,091m) and 9.4% QoQ in USD terms to \$60m (PL: US\$57.4m). EBITDA margins expanded by 41bps to 27.2% (PL: 25.8%, Cons: 24.6%) despite a salary hike (~360bps) & currency impact (~60bps) countervailed by IP-revenue, higher utilization and realization. EPS grew by 7.4% QoQ to Rs11.58 (PL: Rs11.46, Cons: Rs10.15).
- Four strategic pillars to hold up growth:** The strategic initiatives by the company have started yielding results. Key initiatives in recent time are **1)** equipping S&M team with understanding of technology **2)** Organic & inorganic route for IP accumulations (rCloud, location-based software) **3)** Acquiring "End of Lifecycle" products (IBM-TNMP) and **4)** Sell with Partners (IBM, Salesforce, Oracle, Cisco). We expect initiatives around IP to boost margin higher-than-peer.
- rCloud acquisition:** The company acquired rCloud platform from Doyenz that has revenue of US\$4m/year. Persistent has rebadged 17 employees and got 3,500 clients. The payback period for the acquisition is expected to be ~1.5 yrs.
- Valuation & Recommendation:** The company's performance got boosted by IP-revenue. The management expects growth in H2FY13 to get better. We expect consensus to upgrade their revenue/margin estimates by ~4%/~10% in line with our expectation. We reiterate 'BUY' rating, with TP to **Rs540**, 10x FY13e earnings estimates (**roll our model forward for FY14**).

Key financials (Y/e March)	2011	2012	2013E	2014E
Revenues (Rs m)	7,758	10,003	12,752	14,145
Growth (%)	29.1	28.9	27.5	10.9
EBITDA (Rs m)	1,583	2,324	3,362	3,584
PAT (Rs m)	1,396	1,418	1,921	2,217
EPS (Rs)	34.9	35.4	48.0	55.4
Growth (%)	21.3	1.6	35.5	15.4
Net DPS (Rs)	7.0	5.8	7.5	9.0

Profitability & Valuation	2011	2012	2013E	2014E
EBITDA margin (%)	20.4	23.2	26.4	25.3
RoE (%)	20.0	17.8	20.9	20.2
RoCE (%)	20.0	17.7	20.7	20.1
EV / sales (x)	2.1	1.6	1.1	0.9
EV / EBITDA (x)	10.2	6.8	4.4	3.6
PE (x)	12.3	12.1	8.9	7.7
P / BV (x)	2.3	2.0	1.7	1.4
Net dividend yield (%)	1.6	1.4	1.8	2.1

Source: Company Data; PL Research

**Exhibit 1: Strong performance – Strong beat to consensus expectation on all counts (Rs m)**

Y/e March	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY	Cons	PLe	Var (Act. Vs Est.)
Sales (\$ m)	60.1	54.9	9.4%	51.5	16.5%		57.4	4.6%
Period Average Rate	54.27	54.76	-0.9%	46.22	17.4%		55.0	
Sales	3,258.6	3,007	8.4%	2,382	36.8%	3,091.0	3,159.0	3.2%
EBITDA	890.2	806.7	10.3%	453.5	96.3%	759.8	815.0	9.2%
<i>EBITDA Margin</i>	<i>27.3%</i>	<i>26.8%</i>	<i>49 bps</i>	<i>19.0%</i>	<i>828 bps</i>	<i>24.6%</i>	<i>25.8%</i>	<i>152 bps</i>
PBT	622.8	575.5	8.2%	451.2	38.0%	622.6	600.0	3.8%
Tax	176.3	159.7	10.4%	127.1	38.8%	210.7	168.0	4.9%
<i>Tax Rate</i>	<i>28.3%</i>	<i>27.7%</i>	<i>56 bps</i>	<i>28.2%</i>	<i>15 bps</i>	<i>33.8%</i>	<i>28.0%</i>	<i>31 bps</i>
PAT	446	416	7.4%	324	37.8%	411.9	432.0	3.3%
EPS (Rs)	11.84	11.03	7.4%	8.60	37.8%	10.2	11.5	3.3%

Source: Company Data, Bloomberg, PL Research

- Conference call Highlights:**
  - Revenue growth of 9.4% QoQ (IP-Driven: 6.4%, PES: 3%)
  - Offshore: 4% (Volume 1.8%, Pricing: 2.1%); Onsite: -0.4% (Volume: -1%, Pricing: 0.6%)
  - Cash & Cash Equivalents Rs3.87bn
  - Added 48 new clients (6 multi-billion dollar enterprise)
  - Margin headwinds (salary hike ~360bps, currency ~60 bps)
  - Capex H2FY13 ~Rs600-700m (H1FY13: Rs249m)
  - Tax rate for FY13 ~27-28%
  - Attrition: 16.8%
  - Hedge: US\$91m @Rs54.79
  - To hire ~600 people in H2FY13.

**Exhibit 2: America: Consistent performance; Europe: A positive surprise**

By Geography (\$m)	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY
America	50.8	46.3	9.6%	42.3	20.2%
Europe	4.4	3.8	17.3%	4.0	10.3%
APAC	4.8	4.8	0.6%	5.2	-8.2%
<b>% of Total</b>					
America	84.6%	84.4%	20 bps	82.0%	258 bps
Europe	7.4%	6.9%	50 bps	7.8%	-42 bps
APAC	8.0%	8.7%	-70 bps	10.2%	-216 bps

Source: Company Data, PL Research

**Exhibit 3: Telecom performance got inorganic boost by IBM-TNMP, Openwave-Location**

By Vertical Offering (\$ m)	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY
Telecom	16.8	13.3	26.5%	11.3	48.3%
Infrastructure and Systems	37.5	35.3	6.1%	34.7	7.9%
Life Sciences & Healthcare	5.8	6.3	-8.7%	5.5	5.5%
<b>% of Total</b>					
Telecom	28.0%	24.2%	380 bps	22.0%	600 bps
Infrastructure and Systems	62.4%	64.3%	-190 bps	67.4%	-500 bps
Life Sciences & Healthcare	9.6%	11.5%	-190 bps	10.6%	-100 bps

Source: Company Data, PL Research

**Exhibit 4: IP-led revenue driving growth**

By Project Type (\$ m)	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY
T&E	44.0	43.2	1.8%	41.4	6.1%
FPP	4.7	4.1	15.2%	6.2	-23.3%
IP Driven	11.3	7.6	48.7%	3.9	189.8%
<b>% of Total</b>					
T&E	73.2%	78.6%	-540 bps	80.4%	-720 bps
FPP	7.9%	7.5%	40 bps	12.0%	-410 bps
IP Driven	18.9%	13.9%	500 bps	7.6%	1130 bps

Source: Company Data, PL Research

**Exhibit 5: Pricing improved third quarter in succession – No pressure on pricing**

Delivery Split	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY
Onsite	10.6	10.6	-0.3%	10.7	-0.9%
Offshore	38.1	36.6	4.1%	36.9	3.2%
IP Driven	11.3	7.6	48.7%	3.9	189.8%
<b>Fee Revenue</b>					
Onsite	17.6%	19.3%	-170 bps	20.7%	-310 bps
Offshore	63.5%	66.7%	-320 bps	71.7%	-820 bps
IP Driven	18.9%	13.9%	500 bps	7.6%	1130 bps
<b>Pricing (USD/ person month)</b>					
Onsite	12,863	12,789	0.6%	12,665	1.6%
Offshore	3,978	3,898	2.1%	3,771	5.5%
Yield	3746.0	3345.0	12.0%	3208.0	16.8%

Source: Company Data, PL Research

**Exhibit 6: Attrition down, Utilization to push for 600 hires in H2FY13**

Manpower details	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY
Billed Person Months	11,783	11,422	3.2%	11,097	6.2%
<i>Utilization</i>	<i>77.7%</i>	<i>71.7%</i>	<i>600 bps</i>	<i>73.8%</i>	<i>389 bps</i>
Sales & Business Development	99	94	5.3%	113	-12.4%
Support	315	310	1.6%	318	-0.9%
Technical	5,956	6,132	-2.9%	6,469	-7.9%
Total	6,370	6,536	-2.5%	6,900	-7.7%
DSO	64.0%	68	-99.1%	66	-99.0%
<i>Attrition (LTM)</i>	<i>16.9%</i>	<i>18.9%</i>	<i>-200 bps</i>	<i>17.7%</i>	<i>-80 bps</i>

Source: Company Data, PL Research

**Exhibit 7: Top 6-10 clients' bucket weak, strong performance on all other counts**

Client Details	Q2FY13	Q1FY13	QoQ	Q2FY12	YoY
Large > \$ 3m	15	13	15.4%	10	50.0%
Medium > \$ 1m, < \$ 3m	32	35	-8.6%	32	0.0%
Small up to \$ 1m	246	243	1.2%	211	16.6%
<b>Total</b>	<b>293</b>	<b>291</b>	<b>0.7%</b>	<b>253</b>	<b>15.8%</b>
Top Client	12.4	9.8	27.2%	8.2	50.8%
Top 2-5 Clients	9.4	8.6	8.7%	11.6	-19.6%
Top 5 Clients	21.8	18.4	18.5%	19.9	9.6%
Top 6-10 Clients	6.4	6.5	-0.8%	5.6	15.5%
Top 10 Clients	28.2	24.9	13.5%	25.5	10.9%
Non Top 10 Clients	31.8	30.0	6.0%	26.1	22.1%
<b>% of Total</b>					
Top Client	20.7%	17.8%	290 bps	16.0%	470 bps
Top 5 Clients	36.3%	33.5%	280 bps	38.6%	-230 bps
Top 10 Clients	47.0%	45.3%	170 bps	49.4%	-240 bps
Non Top 10 Clients	53.0%	54.7%	-170 bps	50.6%	240 bps
Revenue from repeat business	11.0	5.3	106.3%	3.7	196.2%
Non-repeat business	49.1	49.6	-1.1%	47.8	2.6%
<b>% of Total</b>					
New Business	18.3%	9.7%	860 bps	7.2%	1110 bps
Repeat Business	81.7%	90.3%	-860 bps	92.8%	-1110 bps

Source: Company Data, PL Research

**Income Statement (Rs m)**

Y/e March	2011	2012	2013E	2014E
<b>Net Revenue</b>	<b>7,758</b>	<b>10,003</b>	<b>12,752</b>	<b>14,145</b>
Raw Material Expenses	—	—	—	—
Gross Profit	7,758	10,003	12,752	14,145
Employee Cost	5,327	7,285	8,801	9,971
Other Expenses	849	394	588	590
<b>EBITDA</b>	<b>1,583</b>	<b>2,324</b>	<b>3,362</b>	<b>3,584</b>
Depr. & Amortization	424	611	755	822
Net Interest	—	—	—	—
Other Income	344	256	80	276
<b>Profit before Tax</b>	<b>1,504</b>	<b>1,969</b>	<b>2,687</b>	<b>3,037</b>
Total Tax	108	551	766	820
<b>Profit after Tax</b>	<b>1,396</b>	<b>1,418</b>	<b>1,921</b>	<b>2,217</b>
Ex-Od items / Min. Int.	—	—	—	—
<b>Adj. PAT</b>	<b>1,396</b>	<b>1,418</b>	<b>1,921</b>	<b>2,217</b>
<b>Avg. Shares O/S (m)</b>	<b>40.0</b>	<b>40.0</b>	<b>40.0</b>	<b>40.0</b>
<b>EPS (Rs.)</b>	<b>34.9</b>	<b>35.4</b>	<b>48.0</b>	<b>55.4</b>

**Cash Flow Abstract (Rs m)**

Y/e March	2011	2012	2013E	2014E
C/F from Operations	1,575	1,436	2,248	2,984
C/F from Investing	(2,529)	(992)	(765)	(849)
C/F from Financing	57	(70)	(302)	(358)
Inc. / Dec. in Cash	(896)	375	1,182	1,777
Opening Cash	1,896	1,000	1,375	2,556
Closing Cash	1,000	1,375	2,556	4,333
FCFF	547	522	1,483	2,135
FCFE	547	599	1,483	2,135

**Key Financial Metrics**

Y/e March	2011	2012	2013E	2014E
<b>Growth</b>				
Revenue (%)	29.1	28.9	27.5	10.9
EBITDA (%)	8.2	46.8	44.7	6.6
PAT (%)	21.3	1.6	35.5	15.4
EPS (%)	21.3	1.6	35.5	15.4
<b>Profitability</b>				
EBITDA Margin (%)	20.4	23.2	26.4	25.3
PAT Margin (%)	18.0	14.2	15.1	15.7
RoCE (%)	20.0	17.7	20.7	20.1
RoE (%)	20.0	17.8	20.9	20.2
<b>Balance Sheet</b>				
Net Debt : Equity	(0.1)	(0.2)	(0.2)	(0.4)
Net Wrkng Cap. (days)	—	—	—	—
<b>Valuation</b>				
PER (x)	12.3	12.1	8.9	7.7
P / B (x)	2.3	2.0	1.7	1.4
EV / EBITDA (x)	10.2	6.8	4.4	3.6
EV / Sales (x)	2.1	1.6	1.1	0.9
<b>Earnings Quality</b>				
Eff. Tax Rate	7.2	28.0	28.5	27.0
Other Inc / PBT	22.9	13.0	3.0	9.1
Eff. Depr. Rate (%)	9.3	10.1	11.1	10.8
FCFE / PAT	39.2	42.3	77.2	96.3

Source: Company Data, PL Research.

**Balance Sheet Abstract (Rs m)**

Y/e March	2011	2012	2013E	2014E
Shareholder's Funds	7,501	8,405	10,025	11,884
Total Debt	—	77	77	77
Other Liabilities	—	—	—	—
<b>Total Liabilities</b>	<b>7,501</b>	<b>8,483</b>	<b>10,102</b>	<b>11,961</b>
Net Fixed Assets	2,866	3,725	3,735	3,761
Goodwill	—	149	149	149
Investments	2,500	2,038	2,038	2,038
Net Current Assets	2,075	2,464	4,074	5,906
<i>Cash &amp; Equivalents</i>	<i>1,000</i>	<i>1,375</i>	<i>2,556</i>	<i>4,333</i>
<i>Other Current Assets</i>	<i>2,677</i>	<i>2,750</i>	<i>3,435</i>	<i>3,868</i>
<i>Current Liabilities</i>	<i>1,602</i>	<i>1,660</i>	<i>1,918</i>	<i>2,295</i>
Other Assets	60	107	107	107
<b>Total Assets</b>	<b>7,501</b>	<b>8,483</b>	<b>10,102</b>	<b>11,961</b>

**Quarterly Financials (Rs m)**

Y/e March	Q3FY12	Q4FY12	Q1FY13	Q2FY13
<b>Net Revenue</b>	<b>2,677</b>	<b>2,706</b>	<b>3,007</b>	<b>3,269</b>
<b>EBITDA</b>	<b>696</b>	<b>773</b>	<b>807</b>	<b>890</b>
<i>% of revenue</i>	<i>26.0</i>	<i>28.6</i>	<i>26.8</i>	<i>27.2</i>
Depr. & Amortization	159	186	185	189
Net Interest	—	—	—	—
Other Income	28	(35)	(47)	(78)
<b>Profit before Tax</b>	<b>565</b>	<b>553</b>	<b>575</b>	<b>623</b>
Total Tax	159	140	160	176
<b>Profit after Tax</b>	<b>406</b>	<b>412</b>	<b>416</b>	<b>446</b>
<b>Adj. PAT</b>	<b>406</b>	<b>412</b>	<b>416</b>	<b>446</b>

**Key Operating Metrics**

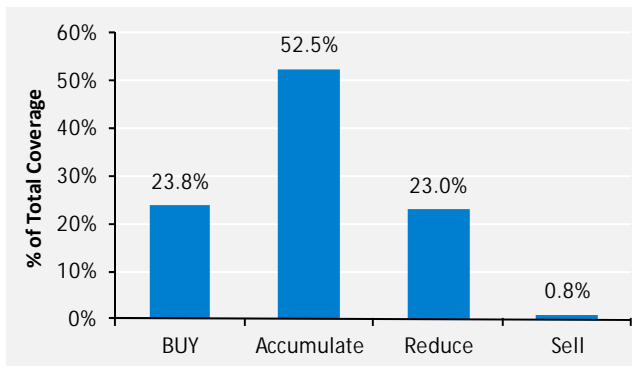
Y/e March	2011	2012	2013E	2014E
Volume (persons month)	37,014	44,037	51,083	58,745
Realization (US\$ / person month)	3,207	3,238	3,238	3,311
Currency (USDINR)	45.6	48.3	53.0	50.0
SW Devp. Cost (% of sales)	68.7	72.8	69.0	70.5
SG&A (% of sales)	10.9	3.9	4.6	4.2
Revenue (US\$ m)	170.2	207.4	240.6	282.9
EBITDA Margin Expansion/(Erosion) (bps)	(0.1)	20.8	0.5	(1.5)
Tax Rate (%)	7.2	28.0	28.5	27.0

Source: Company Data, PL Research.



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#### Rating Distribution of Research Coverage



#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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