

Industry
Bloomberg
BSE CODE

TECHNOLOGY
PSYS IN
533179

Largest client drags the margin in 3Q

RATING	NEUTRAL
CMP	690
Price Target	627
Potential Upside	-9%

Rating Change	↔
Estimate Change	↓
Target Change	↔

STOCK INFO	
52wk Range H/L	472/740
Mkt Capital (Rs Cr)	5275
Free float (%)	69%
Avg. Vol 1M (,000)	6
No. of Shares (Crs)	8
Promoters Pledged %	0

Fig in Rs Cr

FINANCIAL	FY19	FY20E	FY21E
Net Sales	3,366	3,587	4,004
EBITDA	556	519	606
EBIT	399	353	431
PAT	352	357	402
EPS (Rs)	44	46	52
EPS growth (%)	9%	5%	13%
ROE (%)	16%	15%	16%
ROCE (%)	18%	15%	17%
BV	295	311	349
P/B (X)	2	2	2
P/E (x)	14	15	13

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3QFY20 Result Update

- Persistent reported mixed set of numbers in its 3QFY20 result. Revenue grew 3.1%QoQ to USD129.4 million which is in line while margin remained way below our estimates.
- EBIT during the quarter stood at Rs 81 crore, a growth of 2%QoQ. Margin came at 8.8% for the quarter mainly impact by drop in largest client revenue. Drop in IP led revenue was partially absorbed by lower SG&A during the quarter thus resulting in overall 10 bps decline in Ebit margin.
- Gross margin for the quarter dropped 140bps to 33.3% vs. 34.7% last quarter
- PAT for the quarter stood at Rs 88 crore, a growth of 2.3%QoQ, primarily led to higher other income.
- The Company provided Rs 5 crore towards ILFS exposure and cumulative provision now stands at 38.2crore against total exposure of Rs 43 crore.

Lower than expected royalty impacted IP led revenue

Persistent revenue grew 3.1% showing strong growth in services business while IP led revenue remained soft. Service business grew 4.9%QoQ While IP-led business (21.2% of revenue), after a strong quarter declined 2.8%QoQ majorly attributable to lower than expected royalty revenue. Segment wise, Technology service unit led the growth by growing 6.4%QoQ owing to growth across BFSI, Healthcare & Life Sciences and ISVs. Alliance and Accelerite segment reported a soft growth of 2%/13.7%QoQ impacted by weakness in largest client.

Margin continue to remain weak

Persistent margins have been deteriorating for last 5 quarters and 3Q was no different. Margin has almost contracted 400bps in 9MFY20 mainly owing to lower volume and continued weakness in IP led revenue. In 3QFY20 Ebit Margin further declined 10bps to 8.8% mainly owing to weakness in largest client revenue dragging the overall margin. Going forward management expects margin to improve gradually and get back to its historical 15% level as the growth picks up.

View and valuation

Persistent reported a moderate growth in 3QFY20. Revenue posted a healthy growth driving mostly from service business (grew 4.9%) while dip in IP led revenue due to weakness in largest client offset some growth. Margin continued to remain flat. Digital business which has been responsible for revenues drag in the last few quarter, showed a 6.1% QoQ growth, still much lower than peers. Going forward we expect recent leadership changes and large deal win (long tenured deal wins in BFSI) will improve growth in coming quarters. However despite having large opportunities in alliance, we expect there will be laggard growth in this business as largest account continues to remain volatile.

Margins have bottomed out and thus we expect margins to improve as stability in Alliance and SG&A efficiencies will play out.

Post result, we have reduced our margin estimates by 72/70bps for FY20/FY21E seeing the miss in margins. Thus we maintain our neutral stance on the stock with target price of Rs 627.

Key Risks to our rating and target

- Delay in project execution.
- Slow momentum in Digital segment.

3QFY20 Results

Mixed performance

Fig in Rs Cr

FINANCIALS	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales	864	832	832	885	923	6.8%	4.3%	3033.7	3365.9	11.0%
Other Income	(1)	28	30	38	35	-3261.4%	-9.1%	119	88	-26.4%
Employee Exp	491	486	492	537	559	14.0%	4.2%	1,832	1,925	5.1%
Other Expenses	203	225	220	226	240	18.1%	6.1%	733	885	20.6%
EBITDA	170	121	120	122	124	-27.5%	1.6%	469	556	18.7%
Depreciation	40	38	39	42	43	8.1%	0.7%	158	157	-0.8%
EBIT	131	83	82	79	81	-38.2%	2.0%	310	399	28.6%
Interest	0	0	2	2	1	2103.0%	-19.6%	0	0	286.1%
PBT	130	111	110	116	114	-12.0%	-1.3%	429	486	13.3%
Tax	38	27	27	29	26	-31.1%	-11.7%	106	135	26.9%
PAT	92	84	82	86	88	-4.1%	2.3%	323	352	8.9%

Concall Highlights

- **Dip in IP led revenue:** The Company reported 3%QoQ dip in the IP led revenue. The decline is majorly attributable to lower than expected royalty revenue. The company sees growth and have healthy pipeline with the largest client. The company is working on strategy of balanced growth across all areas of software business, large Alliance business and from own organic activities which will require few more quarters.
- **Margin performance:** The drop in largest client revenue impacted the EBITDA margin (13.4% vs. 13.8% last quarter). Gross margin dropped 140bps to 33.3% vs. 34.7% last quarter .Drop in IP led revenue was partially absorbed by lower SG&A during the quarter. The company investment in event and conference for future opportunities resulted in higher other income.
- **ILFS exposure:** The Company provided Rs5 crore towards ILFS exposure and cumulative provision now stands at 38.2crore against Total exposure of Rs 43 crore.
- **Change in tax rate:** The effective tax rate for the quarter was 22.9% vs. 25.5% last quarter. The ETR was lower on account of R&D tax credits in some locations. The ETR on annual basis is expected to be in the range of 24% to 25%.Also the company has decided to opt for the new corporate tax regime which will allow the company to get the benefit of deduction in corporate tax.
- **Jump in DSO:** The company DSO days for the quarter increased from 64 to 68 days, partly the reason is due to furloughs and also as couple of customers has increased the payment from 60 days to 90days impacting DSO by 3 days.
- **Resignation:** The Company saw illusive change in the business with separation with Mr Mark (President of alliance).Mark separated due to difference in opinion.
- **Alliance business:** The revenue from largest client surprised the company. The company reported a 2% dip in revenue however continued to see growth in industrial sector (significant part of overall alliance unit which grew 19%QoQ).Going forward ,The company continues to see deal flow in industrial sector . Also it will expands in other larger client .The company remain bullish on growth from IBM and is positive on the potential opportunity from IBM's Red Hat acquisition.
- **Technology services business:** The Company saw strong 3Q in this segment with 6.4%QoQ growth on back of 3.5% growth in 2Q.The company saw strong growth across all verticals .BFSI services grew 6.7%QoQ, ISV emerging vertical grew 6.4% and healthcare grew 5.9%QoQ. The company won several deal wins in most of the verticals and thus sees healthy pipeline going ahead.
- **BFSI pipeline:** The company's BFSI pipeline remains healthy cross both existing customer as well as new customers .The company is able to sell more service lines , grow wallet share from customer .Also addition to that , the company also have offering in digital banking , AI &ML platform development which is seeing new area of customer pipeline .
- **Healthcare vertical:** This vertical for the company is basically split in three categories, Pharma side, Payer and provider side.In the Pharma side , the company continue to be strong player with large companies as client .The company continue to add logos here. Also on ISV &emerging vertical the company seeing ES playing out well and the company will continues to see growth in this segment .
- **Outlook on margins:** The Company expects to bring back the EBITDA margin to 15% level going ahead. G&M is expected to rebound to 35% plus (1% to 1.5% improvement).For SG&A side, optimization of 1% to 1.5% is target for the company. The company is aspiring to grow at 3% to 3.5% run rate on sustained basis.

Revenue Mix

STRONG GROWTH IN SERVICE WHILE ACCELERITE CONTINUED TO DRAG

SERVICE(USD Mn)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	YoY%
Services	51	51	51	53	55	57	60	6.1%	18.8%
Digital	27	26	28	29	27	28	30	6.8%	8.4%
Alliance	40	35	36	29	33	35	35	-2.0%	-2.8%
Accelerite	6	6	7	7	4	5	5	-13.7%	-33.6%

Revenue by Industry

SOFTNESS IN IP LED REVENUE

INDUSTRY WISE (USD MN)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	YoY%
ISV	48	47	48	49	49	48	50	4.2%	4.89%
Enterprise	42	41	43	44	45	49	52	5.5%	21.03%
IP Led	34	30	30	26	26	28	27	-2.8%	-9.23%

Revenue by Verticals

SOLID GROWTH IN BFS WHILE TECHNOLFY VERTICAL DECLINED

VERTICAL (USD MN)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	YoY%
BFS	29	29	31	32	33	36	39	10.8%	27.03%
Healthcare & Life Science	22	21	22	23	23	23	24	6%	11.16%
Technology Cos. &	73	67	68	63	64	67	65	-2%	-3.45%

Exhibit: Revenue trend

Revival in service revenue led to solid growth in 3QFY20.

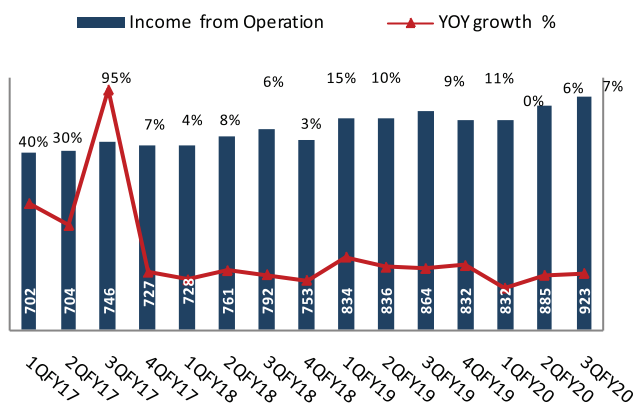


Exhibit: Digital revenue

Recovery seen in digital revenue but still below peers.

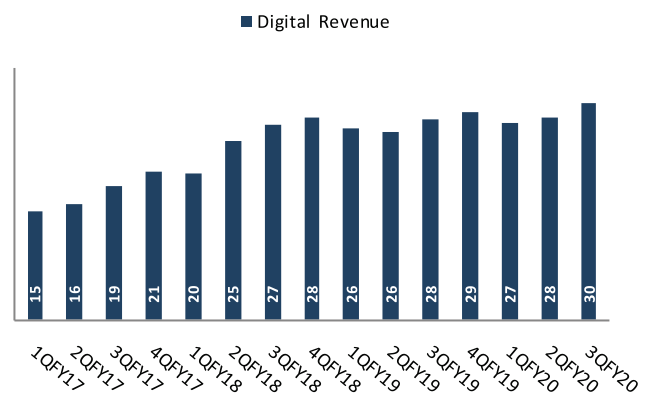


Exhibit: Ipled revenue

IP revenue has been volatile, remained weak in 3Q.

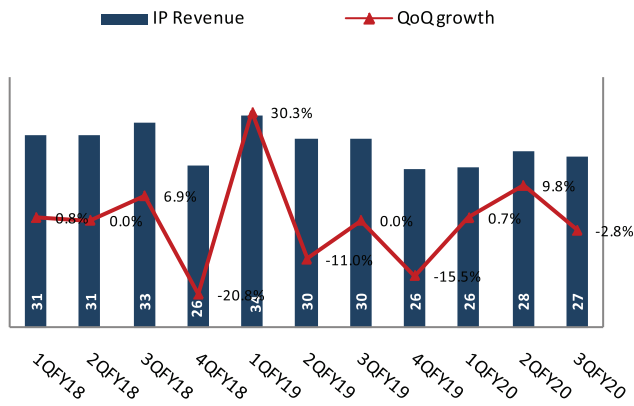


Exhibit: Margin Trend

T1 account decline impacted the margins .

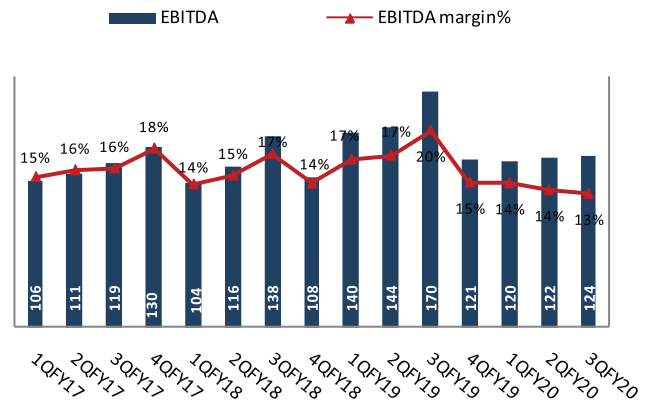


Exhibit: Utilization trend

Uptick in Utilization after declining in 2QFY20 .

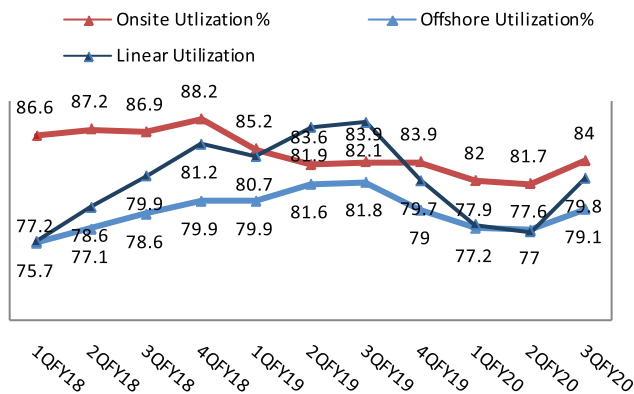


Exhibit: Attrition trend

Attrition moderated after getting into peak .

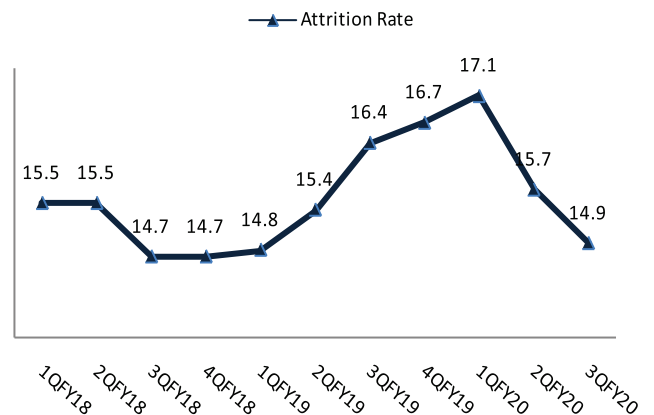
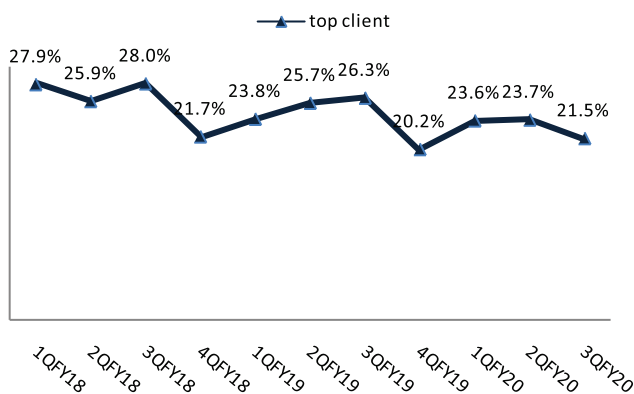


Exhibit: Top Client contribution

Weakness seen in 3Q.



Operational Details

INDUSTRY REVENUE MIX	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
BFSI	23.7%	24.7%	25.7%	27.0%	27.7%	28.4%	30.5%
Healthcare & Life Science	17.6%	18.2%	18.2%	19.6%	18.9%	18.4%	18.9%
Technology Cos. & Emerging Verticals	58.7%	57.1%	56.1%	53.4%	53.4%	53.2%	50.6%

GEOGRAPHY	4QFY19	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
North America	80.9%	79.7%	82.6%	83.7%	80.9%	82.5%	81.4%	80.1%
Europe	8.2%	12.0%	7.5%	7.6%	7.9%	8.5%	9.9%	10.6%
India	7.9%	6.1%	7.3%	6.8%	7.7%	6.7%	6.7%	7.4%
ROW	3.0%	2.2%	2.6%	1.9%	3.5%	2.3%	2.0%	1.9%

INDUSTRY WISE(%)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
ISV	40.6%	38.8%	39.5%	39.8%	41.2%	40.6%	38.6%	39.0%
Enterprise	37.1%	33.8%	34.9%	35.2%	37.2%	37.9%	38.9%	39.8%
IP Led	22.3%	27.4%	25.6%	25.0%	21.6%	21.5%	22.5%	21.2%

CLIENT	4QFY19	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Top 1	21.7%	23.8%	25.7%	26.3%	20.2%	23.6%	23.7%	21.5%
Top 5	40.9%	43.8%	43.3%	45.0%	40.0%	44.6%	44.3%	42.3%
Top 10	49.9%	53.7%	52.4%	54.6%	50.2%	52.6%	53.4%	51.1%
Large > \$ 3Mn	18	18	18	20	20	22	20	22
Medium > \$1Mn, < \$ 3Mn	53	58	56	56	57	56	56	53

DELIVERY CENTERS	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Onsite	34	31	30	30	31	31	31	31.5
Offshore	44	42	45	45	47	48	47	47.3
IP Led	22	27	26	25	22	22	23	21.2

YIELD	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
yield	5225	5497	5329	5386	5082	4953	5134	5231

PEOPLE NUMBERS	4QFY19	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Technical	8329	8196	8566	8761	9185	9363	9726	9729
Sales & Business Development	211	237	247	266	273	272	285	266
Rest	436	469	489	503	504	532	532	537
Grand Total	8976	8902	9302	9530	9962	10167	10543	10532

Operational Details

ATTRITION RATE	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Attrition Rate	14.7	14.8	15.4	16.4	16.7	17.1	15.7	14.9

UTILIZATION	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
LINEAR Utilization	81.2	80.7	81.9	82.1	79.7	77.9	77.6	79.8
Onsite Utilization %	88.2	85.2	83.6	83.9	83.9	82.0	81.7	84.0
Offshore Utilization%	79.9	79.9	81.6	81.8	79.0	77.2	77.0	79.1

SEGMENTS	4QFY19	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Services	45.5%	41.5%	43.0%	41.9%	44.6%	45.8%	45.2%	46.5%
Digital	24.0%	21.4%	22.0%	22.9%	24.4%	22.7%	22.4%	23.2%
Alliance	24.3%	32.1%	29.5%	29.4%	24.8%	27.8%	28.1%	26.7%
Accelerite	6.2%	5.0%	5.5%	5.8%	6.2%	3.7%	4.3%	3.6%

Financial Details

Balance Sheet

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	40	80	80	80	80	80	77	77
Reserves	1,182	1,326	1,559	1,819	2,047	2,266	2,317	2,608
Networth	1,222	1,406	1,639	1,899	2,127	2,345	2,394	2,685
Debt	3	2	3	2	2	1	1	1
Other Non Current Liab	39	12	13	28	43	25	25	25
Total Capital Employed	1,226	1,408	1,642	1,901	2,129	2,346	2,395	2,686
Net Fixed Assets (incl CWIP)	436	409	445	557	509	424	331	264
Non Current Investments	82	212	135	234	288	435	435	435
Other Non Cur Asst	46	1	87	7	9	7	7	7
Non Current Assets	478	456	571	701	599	524	431	364
Debtors	303	359	428	475	485	492	525	586
Cash & Bank	96	142	143	151	242	672	644	789
Other Curr Assets	90	104	179	86	156	139	148	165
Current investments	407	462	483	450	592	330	488	676
current tax asset	-	-	-	9	11	19	19	19
Short-term loans and advances	41	41	81	1	1	1	1	1
Current Assets	937	1,106	1,314	1,404	1,763	1,890	2,061	2,473
Creditors	43	53	165	121	167	152	162	180
Provisions	121	176	122	139	160	169	180	201
Other Curr Liab	114	127	164	111	120	112	120	134
Other financial liability	-	-	-	45	40	44	44	44
Curr Liabilities	278	355	452	417	487	484	513	567
Net Curr Assets	658	751	861	987	1,276	1,406	1,548	1,906
Total Assets	1,543	1,775	2,107	2,346	2,659	2,856	2,933	3,278

Income Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	1669	1891	2312	2878	3034	3366	3587	4004
Change (%)	29%	13%	22%	24%	5%	11%	7%	12%
EBITDA	414	390	414	465	469	556	519	606
Change (%)	32%	-6%	6%	12%	1%	19%	-7%	17%
Margin (%)	25%	21%	18%	16%	15%	17%	14%	15%
Depr & Amor.	103	94	97	149	158	157	166	175
EBIT	312	296	317	316	310	399	353	431
Int. & other fin. Cost	0	0	0	-	0	0	7	6
Other Income	31	94	78	96	119	88	127	111
EBT	343	390	396	412	429	486	473	536
Exp Item	-	-	-	11	-	-	-	-
Tax	93	99	98	99	106	135	116	134
Minority Int & P/L share of Ass.	-	-	-	-	-	-	-	-
Reported PAT	249	291	297	302	323	352	357	402
Adjusted PAT	249	291	297	302	323	352	357	402
Change (%)	33%	17%	2%	1%	7%	9%	1%	13%
Margin(%)	15%	15%	13%	10%	11%	10%	10%	10%

Financial Details

Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	22%	22%	20%	17%	16%	16%	15%	16%
ROCE	28%	23%	21%	18%	15%	18%	15%	17%
Asset Turnover	1	1	1	1	1	1	1	1
Current Ratio	3	3	2.9	3.4	3.6	3.9	4.0	4.4
Debtor Days	66	69	67	60	58	53	53	53
Book Value Per Share	9	10	26	15	20	16	16	16
Payable Days	306	171	207	237	266	295	311	349
Earnings Per Share	62	36	37	38	40	44	46	52
P/E	17	20	20	16	18	14	15	13
Price / Book Value	3	4	4	3	3	2	2	2
EV/EBITDA	10	14	14	10	12	9	10	8
EV/Sales	2	3	3	2	2	1	1	1

Cash Flow Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	343	390	396	401	429	486	473	536
(inc)/Dec in Working Capital	51	28	84	106	106	106	106	106
Non Cash Op Exp	87	49	43	97	108	115	167	175
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	98	100	101	105	121	141	116	134
others	0	0	0	0	0	0	0	0
CF from Op. Activities	281	312	254	286	421	432	511	553
(inc)/Dec in FA & CWIP	-58	-96	-166	-218	-65	-38	-73	-108
Free Cashflow	223	216	88	69	356	394	438	445
(Pur)/Sale of Inv	-1239	0	46	0	0	-14	-158	-188
others	1099	-126	44	-4	-278	168	0	0
CF from Inv. Activities	-196	-232	-116	-222	-347	-226	-231	-296
inc/(dec) in NW	0	0	0	0	0	0	-3	0
inc/(dec) in Debt	2	1	-1	0	0	0	0	0
Int. Paid	-44	0	0	0	0	0	0	0
Div Paid (inc tax)	-7	-67	-125	-58	-95	-102	-111	-111
others	0	0	0	0	0	0	0	0
CF from Fin. Activities	-50	-66	-127	-58	-96	-160	-308	-111
Inc(Dec) in Cash	35	14	11	6	-22	47	-29	146
Add: Opening Balance	48	84	129	140	156	127	174	145
Closing Balance	83	99	140	146	135	174	145	291

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