BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIRST LIGHT

26 July 2019

RESEARCH

Persistent Systems | Target: Rs 650 | +16% | REDUCE

Results first cut: Lacklustre quarter

NCC | NOT RATED

Management call takeaways – A tough FY20; better times ahead

SUMMARY

Persistent Systems

Persistent Systems (PSYS) reported another quarter of subpar operating performance as both revenue and operating margins missed estimates in Q1FY20. Key highlights: (1) digital revenues contracted 5.9% QoQ in dollar terms, (2) topline growth was dismal at 1.1% QoQ, (3) adj. EBITDA margins at 15.6% came in below our estimate of 16.6%, (4) higher other income and lower tax rate restricted the decline in net profit to ~2.4% QoQ.

Click here **for the full report.**

NCC

We spoke with Y D Murthy, Executive Vice President – Finance, of NCC Ltd (NJCC) for an update on Andhra Pradesh work orders. Key takeaways: (1) New AP government cancels construction & engineering contracts issued prior to 1 Apr 2019 where work is yet to commence (estimated at ~Rs 400bn), (2) NJCC's ~40% AP exposure in jeopardy, (3) non-AP govt. works progressing well, and (4) management guides for FY20 revenue of Rs 125bn-130bn (incl. AP projects), EBITDA margins of 11.5% and order inflow of Rs 150bn-160bn.

Click here **for the full report.**

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	630
GAIL*	Buy	245
ONGC	Buy	230
TCS	Add	2,360
HPCL	Sell	210

*GAIL target price is adjusted for the 1:1 bonus issue

MID-CAP IDEAS

Company	Rating	Target
Balkrishna Ind	Buy	1,290
Future Supply	Buy	780
Greenply Industries	Buy	245
Laurus Labs	Buy	495
PNC Infratech	Buy	235

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	2.04	(4bps)	3bps	(93bps)
India 10Y yield (%)	6.44	(3bps)	(41bps)	(135bps)
USD/INR	68.98	(0.1)	0.5	(0.3)
Brent Crude (US$/bbl)	63.18	(1.0)	(2.6)	(14.5)
Dow	27,270	(0.3)	2.0	7.3
Shanghai	2,923	0.8	(2.8)	0.7
Sensex	37,848	(0.4)	(3.3)	2.7

India FII (US$ mn)	23 Jul	MTD	CYTD	FYTD
FII-D	9.1	1,130.7	2,559.0	2,014.4
FII-E	(398.0)	(1,873.1)	9,465.8	2,620.6

Source: Bank of Baroda Economics Research

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REDUCE
TP: Rs 650 | ▲ 16%

PERSISTENT SYSTEMS | IT Services | 26 July 2019

Results first cut: Lacklustre quarter

Persistent Systems (PSYS) reported another quarter of subpar operating performance as both revenue and operating margins missed estimates in Q1FY20.

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Digital revenues contract: Digital revenues for the June quarter declined 5.9% QoQ in dollar terms, a sharp contrast to the industrywide trend of strong digital growth. Moreover, revenue growth was limited to the top 5 clients, with the top 6 to 10 accounts declining 20.7% QoQ and non-top 10 client revenues down 3.8% QoQ (in dollar terms).

Dismal topline growth: Q1 revenue grew 1.1% QoQ (–3.2% YoY) to US$ 119.6mn, below our estimate of 2.8% QoQ growth. The services and alliance businesses grew 3.8% and 13.3% QoQ respectively, while digital and Accelrite revenues declined 5.9% and 39.7%. After three quarters of revenue contraction, IP revenues stabilised with 0.6% QoQ growth.

Miss on margins: Reported EBITDA margins at 14.4% declined 80bps sequentially as gross margins contracted 210bps QoQ and the company made a Rs 100mn provision toward an IL&FS deposit. Excluding this one-off provision, adj. EBITDA margins at 15.6% were still below our estimate of 16.6%. Reported EBITDA at Rs 1.2bn fell ~15% short of expectations.

PAT down 2.4%: Higher other income and lower tax rates restricted the decline in net profit to ~2.4% QoQ (Rs 825mn) despite an 8.2% QoQ drop in EBIT.

Maintain REDUCE: A subdued Q1FY20 adds to the already challenging FY20 recovery prospects for PSYS. Even modest high single-digit revenue growth in FY20 will be a tall task (5% YoY growth in FY20 requires a CQGR of 3.6% over the next three quarters vs. 0.3%/1.8% achieved in FY19/FY18). We maintain REDUCE as we remain wary of PSYS's high business volatility and relatively weaker competitive positioning in the non-ISV business.

Key monitorables: We await management commentary in the earnings call tomorrow regarding (1) health of the company's top clients, especially the top 6 to 10 accounts; (2) its margin defense strategy amid slower growth and rising attrition; and (3) the growth outlook for FY20.

Ticker/Price	PSYS IN/Rs 562
Market cap	US$ 651.7mn
Shares o/s	80mn
3M ADV	US$ 0.9mn
52wk high/low	Rs 915/Rs 532
Promoter/FPI/DII	30%/26%/44%

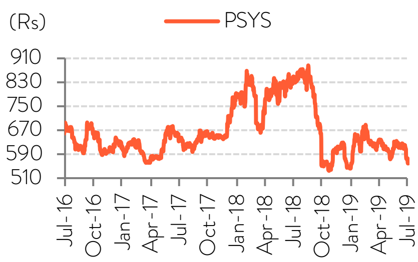
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20E	FY21E
Adj. net profit (Rs mn)	3,516	3,674	4,005
Adj. EPS (Rs)	43.9	47.9	52.2
Adj. EPS growth (%)	8.8	8.9	9.0
Adj. ROAE (%)	15.7	15.2	15.3
Adj. P/E (x)	12.8	11.7	10.8
EV/EBITDA (x)	7.3	6.5	5.8

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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NOT RATED

NCC | Construction | 25 July 2019

Management call takeaways – A tough FY20; better times ahead

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We spoke with Y D Murthy, Executive Vice President – Finance, of NCC Ltd (NJCC) for an update on Andhra work orders. Following are the key takeaways:

New AP govt. cancels work orders: On 29 May, the Andhra Pradesh (AP) chief secretary ordered all state departments to cancel construction & engineering contracts issued by the previous government prior to 1 Apr 2019 where work was yet to commence (estimated at ~Rs 400bn). Also, projects with <25% execution will be reviewed afresh and no payments made sans approval from relevant authorities (these may be allowed to continue or move into rebid-reverse bids).

NJCC's ~40% AP exposure in jeopardy: NJCC's Mar'19 standalone order backlog of Rs 392bn includes ~Rs 158bn from AP. Of this: (i) ~Rs 61bn are new orders likely to be cancelled as work has not begun (cancellation letter received for ~Rs 20bn worth of projects), (ii) ~Rs 10bn of orders are <25% complete and hence stalled pending review by the authorities, (iii) the balance projects are >25% complete but also stuck due to payment/other issues.

The stalled works are mainly affordable housing projects under PMAY (~Rs 50bn), Amaravati capital city projects (~Rs 47bn) and irrigation works. Outstanding receivables from AP stand at ~Rs 7bn (Rs 54bn for FY19). NJCC expects clarity from the government in 2-3 months and estimates that revenue share from AP could halve to Rs 15bn-20bn in FY20 from ~Rs 45bn in FY19.

Non-AP govt. works progressing well: Execution of the balance order backlog of Rs 234bn (non-AP projects) is going smoothly. Management expects revenue of ~Rs 110bn from these contracts in FY20 vs. ~Rs 76bn in FY19. Also, the pace of execution on Mumbai-Nagpur Expressway has picked up and management pegs revenue at ~Rs 10bn/~Rs 12bn in FY20/FY21. The project is scheduled for completion in FY22 and could earn an early completion bonus.

FY20 guidance: NJCC has guided for revenue of Rs 125bn-130bn (incl. AP projects), EBITDA margins of 11.5% and order inflow of Rs 150bn-160bn.

Our view: We believe the company's working capital levels will get stretched due to delays in receivables from AP state projects, in turn pushing up leverage. Execution is likely to remain muted in FY20 but should revive in FY21 as more clarity emerges from the AP government. The stock is trading at 7x/6.1x FY20E/FY21E standalone EPS (consensus). We do not have a rating on NJCC.

Ticker/Price	NJCC IN/Rs 75
Market cap	US$ 656.5mn
Shares o/s	601mn
3M ADV	US$ 17.7mn
52wk high/low	Rs 119/Rs 63
Promoter/FPI/DII	18%/21%/26%

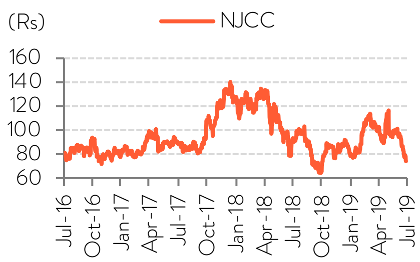
Source: NSE | Price as on 24 Jul 2019

KEY FINANCIALS (STANDALONE)

Y/E 31 Mar	FY17A	FY18A	FY19A
Adj. PAT (Rs mn)	2,525	3,971	6,228
Adj. EPS (Rs)	4.5	7.0	10.4
Adj. EPS growth (%)	(13.5)	54.1	48.1
ROE (%)	7.5	10.3	13.8
P/E (x)	16.5	10.7	7.2
Core EV/EBITDA (x)	6.7	5.5	3.7

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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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)

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