

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.

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.

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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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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

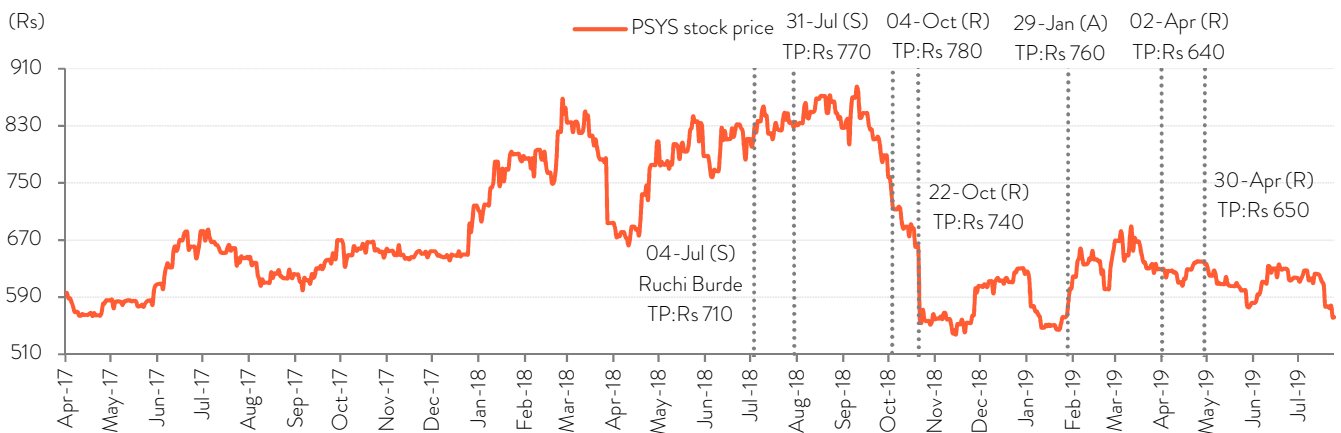
ADD – Expected return from >+5% to +15%

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)



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

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