

PERSISTENT SYSTEMS

SUBSCRIBE

PRICE BAND: Rs 290-310

Issue Details

Issue size to public (Rs.)	157-168 Cr
Face value (Rs.)	10
Bid opens	17-Mar, 2010
Bid closes	19-Mar, 2010
Issue band (Rs.)	290-310
Issue type	100% BB
CRISIL rating	4/5

Lead Managers

Enam Securities Private Limited
 J. P. Morgan India Private Limited

Registrar

Link Intime India Private Limited

Issue structure

Issue structure	Equity shares
Total shares	5,419,706
QIB portion	2,926,638
MF portion	146,332
Balance for all QIBs	2,780,306
Non-institutional portion	487,773
Retail portion	1,463,319

Equity shares outstanding before the issue	35,861,000
Equity shares outstanding after the issue	40,000,000

Promotor and Promotor Group holding – Pre Issue	43.3%
Promotor and Promotor Group holding – Post Issue	38.9%

COMPANY DESCRIPTION

Persistent Systems is a pure play Outsourced software Product Development (OPD) services company. The company is different from other IT companies as it caters to Independent Software Vendors (ISV) as well as smaller product development companies. Persistent Systems offers its customers OPD services that help them reduce time-to-market, better the quality of their products, improve predictability and reliability of the engineering process and helping them lower their over-all product engineering costs. As a result, client stickiness is higher than other IT companies. It has a total of nine development centers development centers in Europe, America and Asia and has employee strength of around 4400. During the last five years, Persistent Systems has released over 2000 software products. It has a well-diversified client base of over 200 active clients. The company derives most of its business from ISVs (47%), telecom (24%) and life sciences and healthcare (15%). It is also investing in new technologies such as cloud computing, enterprise mobility and analytics, which are bound to draw more offshore revenues.

OBJECTIVES OF THE ISSUE

The objectives of the issue are to:

- Establish development facilities
- Capitalize subsidiaries for establishing development facilities and meet fit outs and interior design costs
- Procure hardware
- Fund expenditure for general corporate purposes

(all figures in Rs. Crore)

Project	Total fund req. till Nov 09	Funds deployed	Funds to be utilized from the proceeds*
Establishment of development facilities	174.90	97.10	77.79
Capitalizing subsidiaries for establishing development facilities	2.96	-	2.96
Procuring hardware	20.45	-	20.45
TOTAL			101.2

* estimated figures

Sector: Information Technology

Analyst: Kushal Patel

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INVESTMENT RATIONALE

Healthy balance sheet

Persistent Systems has a strong balance sheet with cash and investments Rs. 150 Cr and net worth of Rs. 485.18 Cr as on 31th December 2009. It has been a zero debt company since the last four years. The debtor days were in the range of 60-65 over the last three fiscal years; which is lower than most tier II IT firms.

Aggressive expansion plans

The investment in 2 new development facilities is set to increase the employee strength to almost double the current strength by the end of the next fiscal year. Clearly, there will a major thrust on the top-line and bottom-line figures once these centres are operational.

Continued interest from VC firms

VC firms Norwest Venture Partners, Gabriel Venture Partners, Intel Capital and Hewlett Packard Company collectively hold 25% of equity. None of the investors are eyeing exit in this IPO.

Dedicated client base

The company has an active client base of around 237 clients. Out of these, there are 37 clients with revenues over \$1 billion. The value addition provided by the company has resulted in long standing relationships with the clients. The company also offers a product partnership model to its client under which they can share the profit or loss with the clients and build crucial ties with the clients.

FINANCIALS

Persistent Systems has exhibited a consistent growth in software sales during the last decade. Barring the previous fiscal year, the net profit has also seen regular growth. The cash-flow from operations has also been robust and the growth has mainly been organically through accruals.

The company has reported strong margins historically with operating margin over 20% and net profit margin over 17%. Due to heavy foreign exchange losses the margins were under pressure in the previous financial year. However, the company delivered healthy margins during the last nine months. Persistent Systems derives around 77% of its revenues from Time & Material projects. A shift towards more Fixed Price projects can further improve the margins.

(in Rs. Crore)	Full Year FY2006-07	Full Year FY2007-08	Full Year FY2008-09	4-year CAGR	9 Months FY2009-10
Net Sales	312.32	424.85	593.83	41.8%	429.41
Expenditure	231.78	338.54	504.32		328.69
EBITDA	80.54	86.31	89.51		100.72
Depreciation	28.94	28.00	29.68		24.74
Interest	0.11	0.00	0.00		0.00
Other Income	5.85	27.30	7.90		6.40
PBT	57.34	85.61	67.73		82.38
Tax	1.82	2.23	0.96		7.04
Net Profit	55.52	83.38	66.77	18.4%	75.34
Operating Profit Margin (%)	25.78	20.32	15.07		23.45
Net Profit Margin (%)	17.77	19.63	11.23		17.54
Diluted EPS (Rs.)	15.67	24.23	19.03		21.04

RISKS AND CONCERNS

Dependence on US market

The company derives a majority share of its revenue from the US market. In percentage terms, this is over 80% compared to the industry average of around 60%. This also results in heavy dependence on the US-INR exchange rate and any further depreciation of the US dollar can impact the reported numbers.

Expiry of tax holidays

Persistent Systems enjoys tax exemption under the STPI scheme. As a result, the effective tax rate has been in the range of 1.9-7.5% over the last four years. After this scheme expires on 31st March 2010, the company will come under the umbrella of full tax paying companies. The company's investment in a SEZ unit in Hyderabad might provide tax relief but going forward the tax rate can be in the range of 20-25% percent.

VALUATION AND FUTURE OUTLOOK

From our discussion with management, it is clear that the company has the management expertise and the necessary cash to pave the path for aggressive growth in the years to come. Persistent Systems continuously spends in R&D to better its technical skill sets. It has dedicated 5% of its total technical workforce to investing in new technologies.

At the upper price band, the issue is priced at a P/E of 12x its annualised earnings for the 9 months ended December 2009. It is attractively priced considering the potential upside due to capacity addition and earnings in the long term. Even from a long-term perspective, the company can provide significant returns. We recommend investors to SUBSCRIBE to the issue if they wish to get an exposure to the mid-cap IT sector.

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RATING INTERPRETATION

BUY	Expected to appreciate more than 20% over a 12m period
ACCUMULATE	Expected to appreciate up to 20% over a 12m period
OUTPERFORMER	Expected to outperform Sensex/Sector by 5 to 15%
UNDERPERFORMER	Expected to underperform Sensex/Sector by 5 to 15%
SELL	Expected to depreciate more than 20% over a 12m period
NOT RATED	No specific call on the stock

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