THE NAME SAYS IT ALL

Having just celebrated its 25th anniversary, Pune-based Persistent Systems isn't just another IT outsourcer, but a high-technology IT products company. Having got into technologies like cloud computing and big data analytics before they were even heard of in India, the company has been growing at an astounding rate and is now, all set to make the next 25 years its own

Since its IPO in FY2010, Persistent Systems' revenue has grown at a CAGR of 25.8%, which is the same as that for market leader TCS

BY SHAKTI SHANKAR PATRA

The Indian IT sector is a crowded place. Even if you ignore the Big Four – TCS, Infosys, Wipro and HCL Tech – there are several other listed players, with over $1 billion in market capitalisation. The trouble is that there is hardly anything to differentiate them, other than their sizes. Not only do most of them provide similar kind of services, but also provide them to similar kind of clients, most of them in the US. And this is where Persistent Systems stands out. For, not only is it a IT product company, instead of being a run-of-the-mill IT services company that most Indian IT outsourcers have become, but it also was one of the first ones to get into stuff like cloud computing and big data analytics. Validating this, retail brokerage, ICICIdirect, in a research report earlier this year, wrote, "Persistent Systems had a first mover advantage in newer technologies as it defined cloud, analytics, collaboration and mobility as a category, much ahead of Gartner, who later defined it as Social, Mobility, Analytics and Cloud (SMAC) in 2010." What makes Persistent Systems even more unique is that it has continuously invested in high technology startups and in fact, a couple of months back, setup a $10 million venture capital fund solely for this purpose.

CONSISTENT SYSTEMS

If one takes a look at Persistent Systems' revenue growth over the last five years, one would recommend its board to change its name to Consistent Systems.

THE COMPANY HAS MIGRATED FROM TECHNOLOGY TO BUSINESS ORIENTED SALES TEAM HIRING

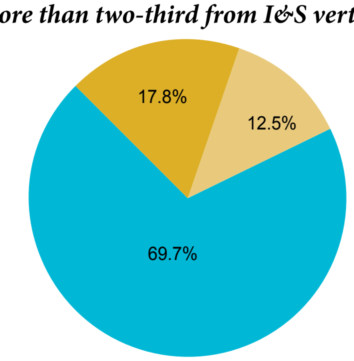
For, in four out of the last five years, Persistent Systems' topline has grown at an incredibly consistent rate of 29% (+/- 50 bps) y-o-y. That during this period, the Indian rupee has moved all over the place, and the US – its main market – hasn't really been an example of consistent growth, only makes this even more remarkable.

The only year this consistent run has faltered – FY2015 – the company has more than made up by reporting its highest profit margin since the tax holiday for IT companies came to an end in FY2011. This, despite a 460 bps y-o-y jump in employee benefits expense. So, how did an IT company manage a jump in the profit margin, despite a surge in employee benefits expense, which is its single biggest expense? Simple. It ensured its tax rate was at its lowest since FY2011 and also ensured a close to 3x jump in its other income.

Another great example of Persistent Systems' consistency is its EBITDA margin, which has stayed in a band of just 220 bps, between 24.8% and 27%, for a decade, except for the GFC year of FY2009. This, despite its employee benefits expense moving all over the place

Persistent Systems' revenue mix (segment wise)

More than two-third from I&S vertical

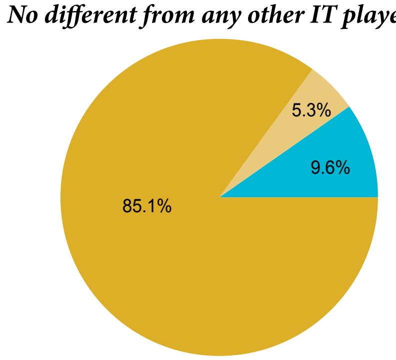


Telecom and Wireless · Life Sciences and Healthcare · Infrastructure and Systems

Source: Company Annual Report; breakup for FY2014 (Consolidated)

Persistent Systems' revenue mix (geography wise)

No different from any other IT player



North America · Europe · Asia Pacific

Source: Company Annual Report; breakup for FY2014 (Consolidated)

– from a high of 66% of revenue to a low of 53.5% – during the period. At the same time, it's worth noting that despite such high volatility in employee benefits expense, the company has managed to consistently bring down its attrition rate (which, at 21.2% in FY2008, had forced the management to cite it as a risk in the red herring prospectus during the IPO) to just 13.4% in FY2014.

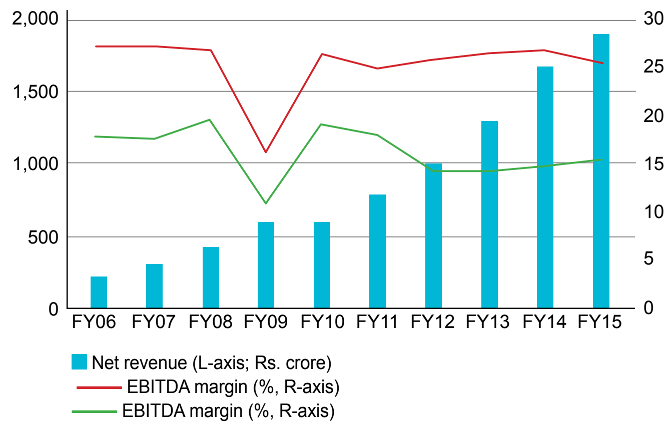
MISSED CALL

Persistent Systems, essentially, works under three segments – Telecom and Wireless; Life Sciences and Healthcare; and Infrastructure and Systems. And within these three segments, not only is Infrastructure and Systems' contribution to overall revenue the highest, at 69.7% in FY2014, but also it's growing at an unbelievable rate – 41.8% in FY2014. On the other hand, the problem area for the company is the Telecom & Wireless vertical, which saw a drop of 12.2% in FY2014, and negated some of the fabulous growth shown by the Infrastructure and Systems vertical. And Dr. Anand Deshpande, Founder, Chairman and Managing Director, Persistent Systems, blames this poor performance by the Telecom and Wireless vertical on market conditions. "The market situation is such that we cannot expect a larger development or a surge in them," he tells *The Dollar Business*.

At times, Persistent Systems' shares trade at higher price-earnings multiple than that of even Infosys, Wipro and HCL Tech!

Persistent Systems' revenue and margins

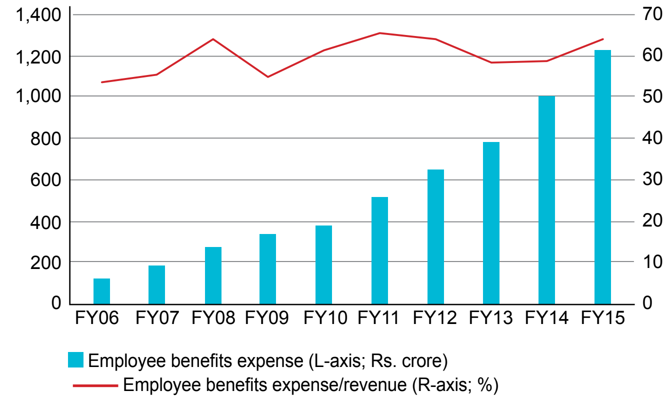
The company's margins are as stable as it can get



Source: Company Annual Report, TDB Intelligence Unit

Persistent Systems' employee benefits expense

It has never exceeded 65% of revenue in the last decade



Source: Company Annual Report

GLASS HALF EMPTY

A major issue with Persistent Systems is its overdependence on a few clients. For, even while citing risks in its red herring prospectus before its IPO, the company had mentioned that its top client accounted for 8.25% of its revenue in FY2008. Since then, this dependence has only increased, with it earning 21.2% of its revenue from its top client in FY2014. Similarly, while its top ten clients had accounted for 38.47% of its revenue in FY2008, in FY2014 the revenue from the same had jumped to 47%.

Although some would cite this as a positive, since it means it's getting repeat orders from the same clients, it also means it's struggling to diversify its client base. So, just a couple of major clients moving away from it would mean nothing short of a disaster.

To counter this problem of overdependence on just a few clients, one of the biggest focus areas for Persistent Systems, today, is sales and marketing. Hence, in FY2014, not only did the company rejig its marketing team and get a new Head of Sales – Ranga Puranik – for itself, but also changed its sales strategy. Explaining this in a research report a couple of months back, brokerage house Prabhudas Lilladhar, which has a 'Buy' rating on the Persistent Systems stock, wrote, "Persistent Systems has migrated from technology to business oriented sales team hiring. Moreover, marketing exercise for the success of Enterprise Digital Transformation (EDT) is likely to continue."

Speaking about some of the challenges that the company has faced in recent years, Deshpande says, "The challenges that we have been facing can be categorised into to two types. One is that we started working with partners and small number of customers, were we would go with the partners and sell our products to the customers. This did not work out the way we wanted as there were various issues, including the leaving of customers as they decided they wanted change. The second is that the deployment of the technologies were not up to the levels expected."

VALUED IN SILVER

Persistent Systems just celebrated its 25th anniversary. In these 25 years, it has been a pioneer in many new technologies and has always been ahead of the curve. It spoke about cloud computing, when most in India hadn't even heard about it. Just in the last two years, it has acquired many small but high technology oriented companies and products like Hoopz, HPCA, NQ, TNPM, rCloud and LBS.

Speaking about these acquisitions, Deshpande says, "We have been building some interesting IT portfolios, with good components, which would help us stand out in the IT space today." Because of such ahead of times thinking, even Dalal Street rates Persistent Systems very highly and gives it higher multiples than most of its peers. In fact, at times, Persistent Systems' shares trade at higher price-earnings multiple than that of even Infosys, Wipro and HCL Tech!

On its part, the company hasn't disappointed either. Since listing in FY2010, its topline has grown at a CAGR of 25.8% – the same as market leader TCS.

While many would say a company, with a lower base, should have grown at a faster rate, an inherent characteristic of the IT sector is that because it is people-oriented and has nothing to do with capacity, in it, the big keep getting bigger, and the small, only smaller. Hence, any small company, which manages to keep pace with the market leader, deserves more than a bit of applaud.

The bottom line: absolutely everything is in place for Persistent Systems. And the market and its clients are very aware of this. The new government focusing on Digital India also has the potential to open up new revenue streams for the company. "Persistent Systems has products that can be used by the government," an upbeat Deshpande tells *The Dollar Business*. All it needs to do now is milk the investments it has made over the years on high-end technology, and of course, get the sales team going. TDB

47% OF PERSISTENT SYSTEMS' REVENUE CAME FROM ITS TOP 10 CLIENTS IN FY2014

shakti@thedollarbusiness.com

"IT'S GOOD THAT GoI IS LARGELY TALKING ABOUT INVESTING IN TECHNOLOGY"

In the company's 25 years' journey, from a start-up to the publicly-traded global company of today (having a mcap of about $1 billion), he has been the man behind the wheel, all the time. In a free-wheeling interaction with *The Dollar Business*, Dr. Anand Deshpande, Founder, Chairman and MD, Persistent Systems, looks back at the last 25 years, and outlines his vision for the future

INTERVIEW BY AADHIRA ANANDH M.

TDB: Since listing in FY2010, Persistent Systems' revenue has grown at a CAGR of 25.8%, which has exactly been the growth rate for even industry leader Tata Consultancy Services (TCS). How content are you with this?
Anand Deshpande (AD): Markets, today, have become very dynamic and volatile. So, in order to adjust ourselves and be ahead of these changes, we have been moving from one drawing board to another. In other words, today, we face challenges of a different kind. Hence, we have to constantly be on our toes to ensure better results. This shift in approach is the reason for the higher growth rate achieved by us over the last few years.

TDB: Persistent Systems has always been known as an IT product company, which is not something many other Indian IT outsourcers can boast of. Tell us a bit more about how you stand out in the crowded Indian IT space?
AD: We largely focus on product development. The current scenario is such that we have newer technologies for everything. We see new upgradation in the market on a large scale. Our customers also know that they will be able to get access to new technologies periodically. So, we also make sure we provide them with the latest technologies at the time of them deciding to buy the product.

WE MAKE SURE WE PROVIDE OUR CUSTOMERS WITH THE LATEST TECHNOLOGIES

TDB: You were ahead of the curve investing in cloud computing, analytics etc. Are you satisfied with the results?
AD: We are very satisfied with the way our results have turned out and we have also continued to stay current in the market. We have been building some interesting IT portfolios, with good components, which help us stand out in the IT space today. The challenges that we have faced in the past can be categorised into two types. One is that we started operations with partnerships and a small number of customers, where we would go out with the partners to sell our products to the customers. This did not work out the way we wanted as there were several issues, including some customers, leaving just because they wanted change. The second challenge was that the deployment of technologies were not up to the levels expected.

TDB: Why Indian IT companies, including Persistent Systems, haven't been able to reduce their dependence on the US market? Tell us of your strategy, if any, to change this.
AD: Today, there is hardly any IT company that does not have an office or is based in the US. From bigshots like Google to us, all are based out of the US. We are also largely US centric because the use of technology there is on a much larger front. So, when we base our products there, its reach is also much larger.

TDB: While the infrastructure and systems segment continue to account for a lion's share of your revenue, what are your expectations from the telecom, wireless, life sciences and healthcare segments?
AD: The infrastructure and system segment has largely been our balancing area. When we take other areas, they are also at par with the infrastructure and system segment. However, the market situation is such that we cannot expect a larger development or a surge in them. They are quite balanced and our expectations from them are also the same. Above all, I will be happier if all the sectors did well.

TDB: There's a concern that there is, currently, a bubble in technology – be it social media stocks in the US, the entire NASDAQ, or e-commerce companies in India. What's your view on this?
AD: We cannot say there is a bubble in technology. It's largely subjective to companies. In the present scenario, technology is growing on a larger level. The markets and the products always work on a platform of upgrading to the latest version, with the view to present the best available version to the customer.

TDB: The Modi government is focusing a lot on Digital India and it is expected that government IT spend will be close to $7 billion this year. Are you positioned to benefit from this?
AD: It's a very good thing that our government has been talking largely on investing in technology, because if we compare with others the usage of technology in our country is very minimal. So, if the government can invest more and bring a change in the way technology can be accessed in our country, then it would be a big development. Persistent Systems has products that can be used by the government, but I am not very sure how we stand benefitting from the same.

TDB: You have always been interested in acquiring and investing in startups. You have also set up a $10 million VC fund to invest in 40 startups. Can you tell us why you are interested in startups rather than established companies?
AD: The venture capital fund we have set up for startups is not from a different fund. We have funds with in the firm, which we show in the company's financials as investment in startups. As we were largely interested in investing in startups, we thought of setting up a fund, whereby we could concentrate more on them. And as far the choice for startups is concerned, startups are almost always into innovation, and all of us know that anything new in technology always stands out. TDB

aadhira.anandh@thedollarbusiness.com

Dr. Anand Deshpande
Founder, Chairman & MD, Persistent Systems