

ANNEXURE - GRADING RATIONALE FOR IPO GRADING

Persistent Systems Limited (Persistent Systems)

CRISIL IPO Grade 4/5 (Above average)

February 26, 2010

IPO Grade

CRISIL IPO Grade '4/5': The grade indicates that the fundamentals of the issue are above average relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals.

Issue Details

Equity Shares of Rs. 10 each ("Equity Shares") offered to public	5,419,706 Equity Shares. This includes a fresh issue of 4,139,000 Equity Shares and an offer for sale of 1,280,706 Equity Shares.
As a percent of post issue equity	13.55%
Object of the Issue	Establish development facilities at Pune (Hinjewadi) and Nagpur, capitalize subsidiaries for establishing development facilities, procure hardware and general corporate purposes and to achieve the benefits of listing on the Stock Exchanges.
Amount proposed to be raised	Approximately Rs 1,900-2,000 million (including Equity Shares, which are on offer for sale)
Price Band	Not available at the time of grading
Lead managers	Enam Securities Private Limited, J.P.Morgan India Private Limited

Company Background

Persistent Systems Limited ("Persistent Systems" or the "Company"), promoted by first generation entrepreneurs - Dr. Anand Deshpande and Mr. S. P. Deshpande (father of Dr. Anand Deshpande), was incorporated in 1990. The Company provides outsourced software product development services to its customers, majority of who are independent software vendors (ISVs). It provides services across the value chain of product development - product conceptualisation, design, development, testing and support. As of March 31, 2009, the Company has 297 customers, of which the top 10 customers account for around 37 per cent of its revenues. As of November 30, 2009, Persistent Systems employed around 4,400 employees (including those under contractual employment with the Company and its subsidiaries as well as trainees).

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Grading Highlights

Business Prospects

- Outsourced software product development (OPD) market is expected to be driven by increased outsourcing among ISVs and enterprises and maturing global offshore delivery model.
- Persistent Systems commands a strong position in the OPD space by virtue of its ability to offer solutions across each stage of product development.
- The Company has significant domain expertise in telecommunications, life sciences and healthcare and in infrastructure and systems.
- Apart from catering to leading ISV's, Persistent Systems offers end-to-end solutions to smaller software product companies. This has led to a well-diversified customer base
- The Company is focusing on augmenting its business through emerging technologies/new initiatives such as cloud computing/SaaS, analytics, enterprise mobility and enterprise collaboration services
- Persistent Systems R&D efforts have enabled it to further domain capabilities thereby facilitating the company to move up the value chain
- However, Persistent Systems is dependent on outsourced projects largely from the US market and is also vulnerable to currency fluctuation and wage inflation

Financial Performance

- Persistent Systems has clocked a healthy growth rate of 40 per cent CAGR during the period 2007-09 largely driven by an increasing trend of offshoring among ISV's. However, in the first 6 months of the calendar year 2009, the Company faced pressure on revenues due to delay in product release / upgrade by few large ISV's and closure of some small ISV's.
- Rising wage inflation has been an area of concern for the Company in line with the industry trend. In 2008-09, Persistent Systems reported operating margins of 30 per cent.
- The Company has a comfortable cash position of Rs. 1,036 million as of March 2009 and has sustained net cash accruals of Rs 800-1000 million in each of the past 3 years due to its sustained topline growth, debt free position and low effective tax rates.
- Persistent Systems has a policy of hedging substantial proportion of its export revenues. However, given the volatility in currency in 2008-09, Persistent Systems incurred forex losses to the tune of Rs. 874 million.
- The Company currently enjoys tax concession under the STPI scheme, which is slated to be withdrawn by the government post March 31, 2011. If the scheme is not extended, it could have an adverse impact on post tax net margins.

Management Capabilities

- Promoters of the Company have sound technical background along with relevant experience in the field.
- Persistent Systems has a well structured and strong second line of management
- During 2008-09, the Company has made some key appointments at the senior level in the sales team in order to actively tap the Europe and Asia markets, focus on building partnerships (channel sales) as well as strengthen its US sales

Corporate Governance

- Strong corporate governance architecture with two of the independent directors on board since 2001
- Independent directors bring to the table a good blend of strategy, technological and financial expertise
- The independent directors have shown the ability and willingness to exercise management oversight
- Persistent Systems follows stringent and transparent accounting standards, as reflected from the ICAI award it received in 2008-09 for Excellence in Financial Reporting in the IT, Communications and Media & Entertainment category

Detailed Grading Rationale

Overall Grading Summary (CRISIL IPO Grade 4/5)

To arrive at the overall grade, CRISIL has considered the following parameters:

- **Business prospects and financial performance**
- **Management capability**
- **Corporate governance**

CRISIL has assigned a CRISIL IPO Grade '4/5' (pronounced 'four on five') to the proposed Initial Public Offering of Persistent Systems. The grade indicates that the fundamentals of the issue are above average relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The offer price for the issue may be higher or lower than the level justified by its fundamentals. The grade is not a recommendation to buy / sell or hold the graded instrument, the graded instrument's future market price or its suitability for a particular investor.

The grading reflects the Company's presence across the value chain of product development – product conceptualization, design, development, testing and support – diversified client base, growing cash accruals coupled with management's proven execution capabilities. Apart from catering to leading ISV's, Persistent Systems offers end-to-end solutions to smaller software product companies. The Company is focusing on augmenting its business through emerging technologies/new initiatives such as Cloud Computing/SaaS, Analytics, Enterprise Mobility and Enterprise Collaboration Services. Moreover, its R&D efforts have enabled Persistent Systems to further strengthen its domain capabilities, thereby executing projects across all stages of product development. The Company also has a strong financial position given its unleveraged position and generation of robust cash.

The grading also factors in sound technical background of promoters and experienced second line of management. Also, the corporate governance architecture in the Company is strong given the presence of eminent independent directors on its board for the past few years coupled with adoption of high disclosure standards. However, the grading is tempered due to its dependence on outsourced projects from developed markets, vulnerability to currency fluctuations and wage inflation. The possible withdrawal of tax concessions post March 31, 2011 could adversely impact post tax profitability.

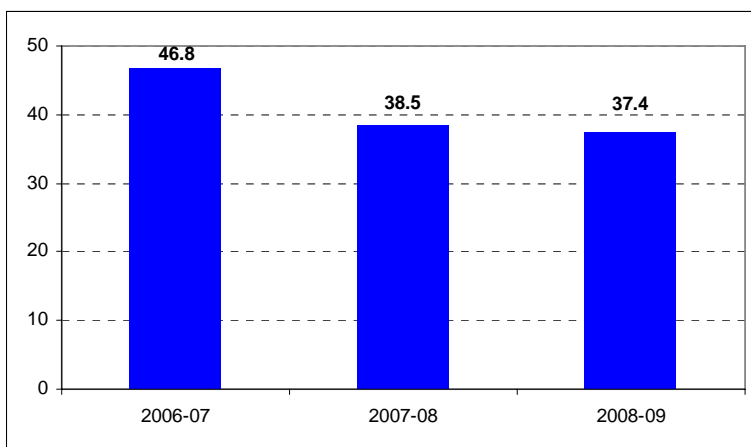
➤ **Offshoring, a win-win situation for global vendors and OPD players**

Persistent Systems primarily provides outsourced software product development to large global software product companies. The Company's services help its customers not only reduce overall costs but also reduce time to market and release management bandwidth to address core areas. Another value proposition to global software vendors is the mitigation of failure risk during the development process, given the technical/domain expertise available in India. Moreover, offshoring enables global software vendors and enterprises to focus their efforts on core business activities. A confluence of the above mentioned factors has led to an increasing trend of outsourcing among ISVs, thereby benefiting OPD players.

➤ **End-to-end solutions coupled with diversified client base has led to an established position**

Persistent Systems has a presence across the value chain of product development - product conceptualization, design, development, testing and support – and over all stages of the product life cycle. The Company not only caters to large ISV's but also services small early stage software companies. Working with mid-size and smaller software companies provides the Company an opportunity to explore new areas and build skills in new domains. Also, given the nature of services offered by Persistent Systems and the upfront investments made by clients, stickiness of customers is relatively higher as compared to IT services. In 2008-09, the Company's top-10 customers contributed around 37 per cent to revenues, although this client concentration has been coming down over the past 2 years.

Percentage contribution from top 10 clients



Source: DRHP

➤ **New business initiatives to capitalise on evolving technologies**

Keeping in sync with emerging technology trends in the industry, in addition to focus on growth of IP driven business, the Company has taken focused initiatives in cloud Computing/SaaS (Software as a service), Analytics, Enterprise Mobility and Enterprise Collaboration. These new models of products, services and storage delivery will meet enterprises' requirements as they are constantly on the lookout for solutions to increase capacity or add-on capabilities with limited investment. Consequently, product companies will have to spend to upgrade their systems to match new business models, enable inter compatibility and rake in cost efficiencies, thereby having a positive impact on OPD players. Moreover, Persistent Systems is proactively channeling efforts towards R&D to identify new trends in order to offer value proposition to its clients.

➤ **Persistent Systems has adopted a small scale acquisition strategy**

After the acquisition of ControlNet (India) Private Limited in 2005-06 and IP Assets from Metrikus India Private Limited in 2007-08, Persistent Systems acquired PaxPro Business Solutions from Paxonix, Inc. as subsidiary of MeadWestvaco Corporation in October 2009. PaxPro is a branding and packaging solutions and largely caters to the lifestyle and food and beverages enterprises. According to Persistent Systems, the inorganic strategy would facilitate it to build service capabilities and expand its product portfolio.

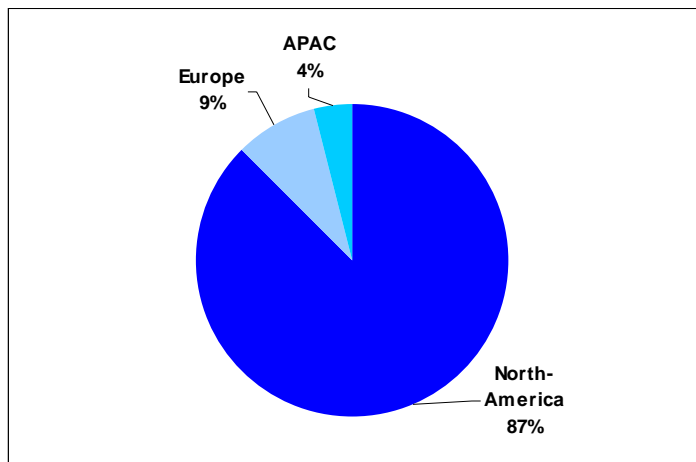
➤ **Operating margins stood at 30 per cent in 2008-09**

Given the slowdown in global economies, there was downward pressure on billing rates along with slack in projects being outsourced, especially from the US market. Persistent Systems' operating margins stood at 30 per cent in 2008-09 with revenue expansion on the back of farming existing clients and adding new clients coupled with control of personnel cost. With the downturn continuing during the first six months of the calendar year 2009, operating margin was around 26 per cent as of September 2009.

➤ **Dynamic global economic factors to continue to play out on Persistent Systems**

Although Persistent Systems does not have a direct linkage to the end-user community, the Company remains exposed to global uncertainties since it relies on different geographies for offshored projects. Thus any cutback in IT budgets by its clients would have a cascading effect on revenue growth. Moreover, since the Company is highly dependent on the US market, it is vulnerable to movement in the foreign currency. Persistent Systems hedges a substantial proportion of its export revenues; although an unfavourable movement in currency would have an adverse impact on topline. For instance, in 2008-09, the Company incurred a forex loss of Rs 874 million.

Geographical revenue split (2008-09)

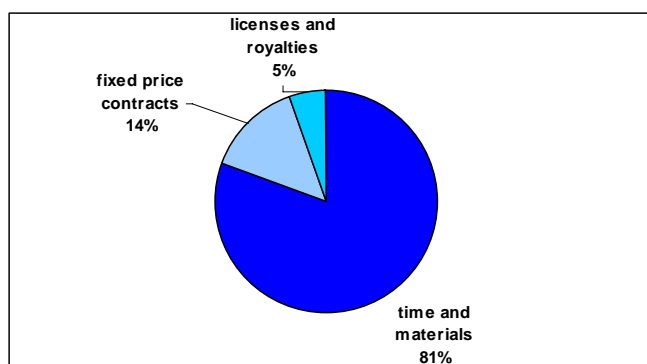


Source: DRHP

Financial Profile

- For the year ended March 2009, Persistent Systems posted total income of Rs. 5,946 million as compared to Rs 4,475 million in 2007-08, a growth of 33 per cent. Increased offshoring of product development by ISV's on the back of apparent value proposition offered by Indian IT players has been driving the OPD market. Moreover, Persistent Systems domain capabilities, especially in the field of telecom (contributes 21 per cent to total revenues), healthcare (contributes 14 per cent to total revenues) during the financial year ending March 31, 2009 and infrastructure and systems have enabled the Company to maintain and expand its client portfolio.
- While Persistent Systems offers services both on time and material basis and fixed price basis, revenues from time and material contracts dominated the revenue share with an 80 per cent contribution for the financial year ending March 31, 2009.

Contract-wise revenue split (2008-09)



Source: DRHP

- In the first six months of the calendar year 2009, the global downturn lead to cutback in IT budgets of major software vendors and enterprises, which had a cascading effect on topline growth of Persistent Systems. As of December 2009, the Company's operating margins stood around the 25 per cent mark.
- Persistent Systems continues to have a stable financial profile, which is marked by its unleveraged position and strong liquidity. The Company has a comfortable cash position of Rs. 1,036 million as of March 31, 2009 and has sustained net cash accruals of Rs 800-1000 million in each of the past 3 years.
- Return on Capital Employed (RoCE) and Return on Equity (RoE) were 42.8 per cent and 18.5 per cent, respectively, in 2008-09.
- Going forward, we believe that rising wage inflation, volatility in currency and withdrawal of tax concession currently enjoyed by the Company are some of the key monitorables.

Financial performance snapshot

Particulars	Unit	2006-07	2007-08	2008-09
Operating income	Rs million	3,157	4,254	5,946
Operating margins	Per cent	26.8	21.6	30.2
Net profits	Rs million	544	825	661
Net margins	Per cent	17.2	19.4	11.1
Return on capital employed	Per cent	25.5	30.5	42.8
Return on equity	Per cent	25	29.4	18.5
No. of equity shares	Million	8.15	35.86	35.86
Net worth	Rs million	2,496	3,292	3,937
Basic earnings per share	Rs	66.8	23	18.4
Diluted earnings per share	Rs	13.7	23	18.4
Book value	Rs per share	295.4	89.4	109.8
Gearing	Times	0	0	0

Note: Numbers have been reclassified as per CRISIL Research's standards.

Source: CRISIL Research and DRHP

Business Profile

Brief description of the Company's activities

Persistent Systems, promoted by first generation entrepreneurs - Dr. Anand Deshpande and Mr. S. P. Deshpande (father of Dr. Anand Deshpande), was incorporated in 1990. The Company provides outsourced software product development services to its customers, majority of who are ISVs. It provides services across the value chain of product development - product conceptualisation, design, development, testing and support. The Company has around 220 customers, of which the top 10 customers account for around 37 per cent of its revenues. As of November 30, 2009, Persistent Systems employed around 4,400 employees (including those under contractual employment with the Company and its subsidiaries as well as trainees).

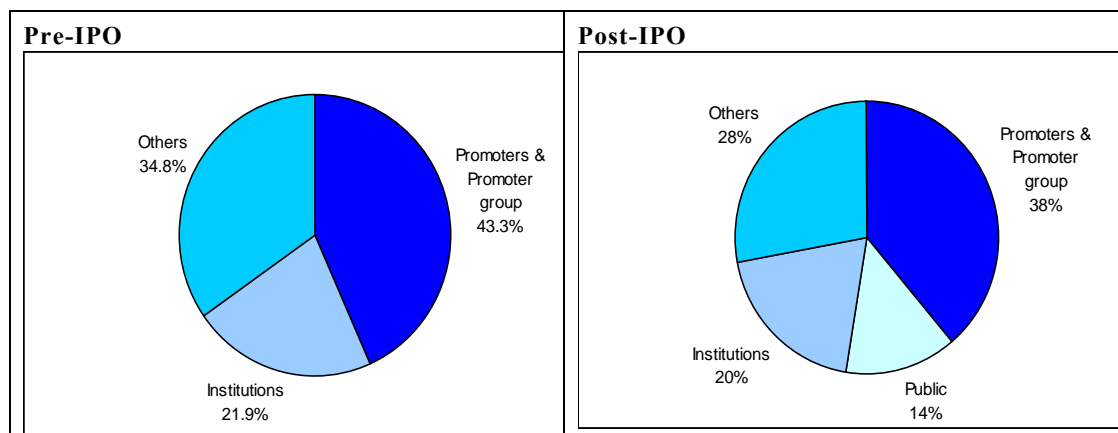
Persistent Systems offshore development centres are located in Pune, Nagpur, Goa and Hyderabad. The Company owns most of its development centres. The recently commissioned facility at Hyderabad, which is on a long-term lease, would enable the Company to take advantage of the tax benefits available under the SEZ scheme. Persistent Systems plans to use its IPO proceeds to construct two new development centres – one in Pune and the other in Nagpur, with a capacity to seat 3,000 and 1,200 employees, respectively, capitalize subsidiaries for establishing development facilities, procure hardware and general corporate purposes and to achieve the benefits of listing on the Stock Exchanges.

The Company provides services both on time and material basis, where charges are based on the number of people dedicated and the effort invested in the project, and on a fixed price basis, where it provides services for a fixed price and agrees to complete the project in a fixed time. For 2008-09, its revenue on time and material basis dominated the revenue share with 80 per cent contribution, followed by fixed price contracts with 14 per cent, while the balance revenues came from licenses and royalty.

As on March 31, 2009, Persistent Systems sales, marketing and business development teams are divided into persons who engage in sales for generic products and those who engage in customer-focused sales efforts. It has offices in US (California; Washington; Massachusetts, Ohio, Texas, Indiana, Pennsylvania, Illinois, Connecticut, New York), Canada (Ottawa, Vancouver and Quebec), Europe (Scotland in the UK, Amsterdam in the Netherlands) and Asia (Singapore and Tokyo, Japan). The Company also works with external partners in The Netherlands, Germany and France. The sales and marketing efforts for India is undertaken from its headquarters in Pune.

Persistent Systems focuses exclusively on the OPD market. Apart from catering to large ISVs and enterprises, by providing services to mid-sized and small ISVs, the Company has been able to get access to the venture capital community. The Company continues to use the venture capital community to garner business within the small ISVs space.

Persistent Systems Ltd: Shareholding Pattern



Source: DRHP

Profile of Management and Board

The Company is headed by Dr. Anand Deshpande who is the Chairman and Managing Director. He has a sound technical background with expertise in database management. This coupled with his two decades of experience in the field of technology has established Persistent Systems position in the OPD space. All of the key management personnel are professionally qualified with the necessary skill sets. While Dr. Srikanth Sundararajan manages the overall operations of the six business units, Mr. Hari Haran is responsible for global sales and marketing along with client relationship management. Both have a strong educational background and have worked with leading IT companies.

The Board comprises six directors, three of whom are independent directors and two are non-executive directors. Each of the independent directors has fair experience in their respective fields and has shown the ability and willingness to exercise management oversight. The board also includes promoter directors viz. Dr. Anand Deshpande and S.P. Deshpande. S. P. Deshpande has retired from day to day operations of the Company and functions as a non-executive director.

Annexure: Profile of the directors

Name of Directors	Designation	Age	Qualification	Year of joining	Other Directorships
Dr. Anand Deshpande	Chairman and the Managing Director	47	B.Tech (Hons), IIT, Kharagpur Ph.D., Indiana University, USA	1990	Indian Companies 1. Persistent eBusiness Solutions Limited 2. Persistent Systems and Solutions Limited Foreign Companies 1. Persistent Systems, Inc. 2. Persistent Systems Pte. Ltd. Trusts 1. Persistent Foundation
S. P. Deshpande	Non-Executive Director	73	B.E. (Hons), Jabalpur Engineering College	1991	Indian Companies 1. Persistent eBusiness Solutions Limited 2. Persistent Systems and Solutions Limited Foreign Companies 1. Persistent Systems Pte. Ltd.
Ram Gupta	Independent Director	47	B.E., BITS, Pilani, India M.S., University of Massachusetts	2007	Indian Companies 1. Nil Foreign Companies 1. S1 Corporation 2. Yodlee, Inc 3. Cast Iron Systems, Inc. 4. Platform Computing, Inc.
Dr. Promod Haque	Non Executive Director	61	B.E., University of Delhi Ph.D., Northwestern University M.B.A., Northwestern's Kellogg Graduate School of Management	2005	Indian Companies 1. Sulekha.com New Media Private Limited 2. Adventity BPO India Private Limited 3. Adventity Financial Services Private Limited 4. Yatra Online Private Limited 5. Innovative Design Engineering Animation Private Limited 6. AppNomic Systems Private Limited Foreign Companies 1. AmberPoint, Inc. 2. Cast Iron Systems, Inc. 3. Open-Silicon, Inc. 4. Veraz Networks, Inc. 5. Sonoa Systems, Inc. 6. Veveo TV, Inc. 7. Virtela Communications, Inc. 8. Cyan Optics, Inc.
Prabhakar B. Kulkarni	Independent Non Executive Director	74	B.A., M.Com., Pune University C.A.I.I.B., Indian Institute of Bankers	2001	Indian Companies 1. Sicom Limited 2. GDA Trustee & Consultancy Limited Trusts 1. Supam Charitable Trust 2. Persistent Foundation
Prof. Krithivasan Ramamritham	Independent Non Executive Director	54	M.Tech., IIT, Madras Ph.D., University of Utah	2001	Trusts 1. Avishkar India Micro Ventures Capital Fund

Source: DRHP

Disclaimer

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