INSTITUTIONAL EQUITY RESEARCH

IT Services

One + One = Eleven *(Part 2)*

12 December 2019

INDIA | IT SERVICES | Sector Update

We predicted it five years ago: Five years ago, we had published a report *(read here)* where we had highlighted that most midcap IT companies will find it difficult to withstand competition in the rapidly evolving technology landscape – and hence, their promoters (also driven by lack of succession planning), might look to sell themselves out. We had further hypothesized that IF one or more of these midcap IT companies could be brought together to merge with another (perhaps facilitated by large PE investors), they could lead to the formation of a formidable IT company, which could perform much better than the individual components, and would also command valuation premium.

Perhaps the report was a little ahead of its time! While this did not materialize immediately, we are seeing transactions of this exact nature happening NOW – FIVE years later. Over the last few quarters, promoters of multiple midcap companies (Mindtree, NIIT Tech, KPIT) have exited their businesses. The acquisition of Mindtree by L&T group and NIIT Tech by Barings PE group are definite precursors to these acquired entities eventually merging with group IT companies. We pat ourselves on having predicted this highly imaginative (five years ago) hypothesis well ahead, accurately. We expect the trend to continue, and more consolidation to take place in the IT midcap space over the next few years.

Spate of M&A activity in last five years: Over the last five years, we have witnessed (1) acquisition of the promoter stake in Hexaware and NIIT Tech by Barings PE, (2) acquisition of the promoter stake in Mphasis by Blackstone, (3) demerger of KPIT Tech and merger of its IT business with Birlasoft, (4) acquisition of Mindtree by the L&T group, paving the way for a future merger with LTI, and (5) acquisition of Polaris by Virtusa. The list is a perfect nod to our 2014 report – four out of the five likely 'targets', highlighted in our report, have gone through a change in ownership and merger-demerger activity.

Growth challenges and lack of succession planning to drive M&A: We believe that promoters of midcap companies exiting their businesses (some due to lack of succession planning, some due to hostile takeovers) signal that the businesses and their valuations have peaked out. Over the last two years, we have seen the IT midcap companies outperforming their largecap counterpart significantly – registering double-digit growth, as compared to mid-single-digit growth by large-caps. But with the 'digital' technology cycle now entering its 'early majority' phase and deal sizes gradually increasing, midcaps will find it extremely difficult to grab deals (and marketshare) from largecaps.

Expect M&A activity to continue in the IT mid-cap space: Accordingly, we expect M&A activity to continue over the next few years, and the 'remaining' IT midcaps to be targets for larger peers and also for PE firms. Companies like Cyient and Persistent have been struggling to grow their businesses, and have been constantly losing market share. Cyient could be a perfect target for companies like LTTS or HCL Tech (also for any foreign ERD company) due to its strength in the ERD space. But Persistent might find it difficult to fit into most other business models, given its unique offerings. Also, we believe small-cap companies like Sonata Software and Zensar – with unique value propositions in niche domains – could also be potential M&A targets.

IT mid-cap attractive post time correction, event-based opportunities offer option value: Over the last one year, most midcaps (excl NITEC) have undergone significant time/price/both correction, and no longer appear as expensive as they did, year ago. While the growth too has tapered down over this period, we believe select midcap stocks currently offer a favourable risk-reward profile, along with event-based opportunities, offered by potential M&A activity in these stocks.

We upgrade LTTS, Mindtree and Cyient to BUY, based on potential turnaround opportunity and attractive valuations. We continue to find valuations expensive for LTI and NITEC.

Companies

L&T Infotech	**Neutral**
CMP	1650
TP	1750
L&T Technology Services	**Buy**
CMP	1475
TP	1760
MindTree	**Buy**
CMP	740
TP	910
Cyient	**Buy**
CMP	391
TP	490
NIIT Technologies	**Neutral**
CMP	1455
TP	1550

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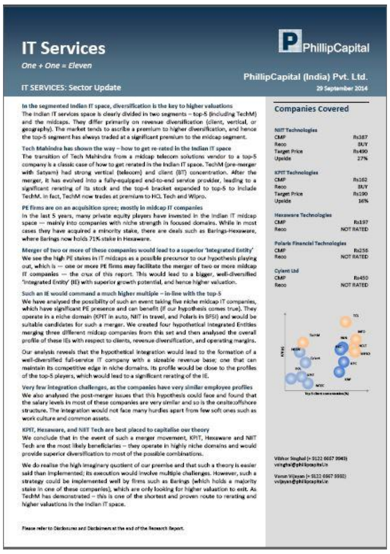
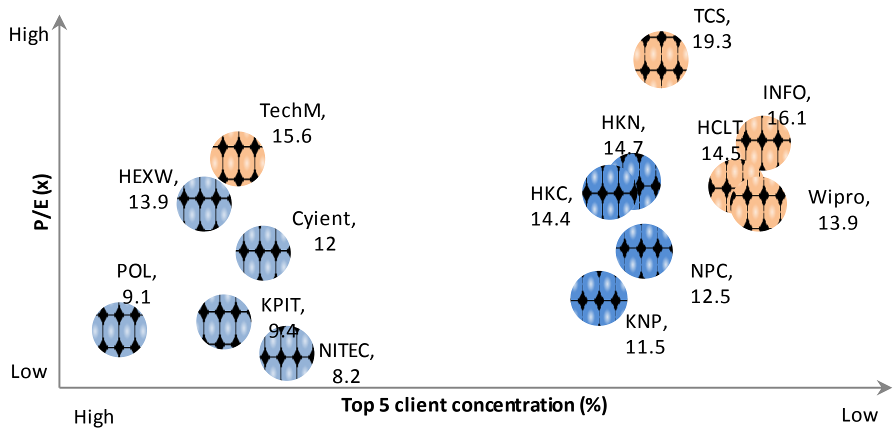
We predicted it FIVE years ago!



Five years ago, we had published a report (read here) where we had highlighted that most midcap IT companies will find it difficult to withstand competition, in the rapidly evolving technology landscape – and hence, might look to sell themselves out, over the next few years. We had also hypothesized that IF one or more of these midcap IT companies could be merged (perhaps facilitated by PE owners), this could lead to the formation of a formidable IT company that could perform much better than its individual components, and would also command a valuation premium.

We had analysed this by taking five niche midcap IT companies with significant PE presence. We then created four hypothetical Integrated Entities (IEs) merging three different midcap companies from this set and then analysed the overall profile of these IEs with respect to clients, revenue diversification, and operating margins. Our analysis had revealed that the hypothetical integration would have led to formation of well-diversified full-service IT companies with a sizeable revenue base; ones which could maintain their competitive edge in niche domains. Their profile would have been very similar to the profiles of the top-5 players, which would have led to them being significantly rerated.

We predicted in 2014, that the IEs will trade at higher valuations than constituent companies – leading to significant value creation



Source: PhillipCapital India Research

Perhaps our report was a little ahead of its time! While what we postulated did not materialise immediately, we are seeing transactions of this exact nature happening NOW – FIVE years later. Over the last few quarters, promoters of multiple midcap companies (Mindtree, NIIT Tech, KPIT) have exited their businesses. Mindtree's acquisition by L&T group and NIIT Tech's by Barings Group are definite precursors to these acquired entities eventually merging with other IT companies owned by the acquiring groups.

In fact, over the last four years, multiple midcap IT companies have either merged with another larger IT companies (iGate, Geometric, Polaris, KPIT, Syntel) or have sold significant promoter stake to PE investors (Hexaware, Mphasis, Zensar).

We give ourselves a little pat for having predicted this highly hypothetical scenario five years ago (well ahead) accurately. We further expect this trend to continue and more consolidation happening in the IT midcap space over the next few years. Select midcaps will be its beneficiaries, and owning them could possibly lead to significant wealth creation for minority investors.

IT Midcap space – Consolidating!

In Aug 2013, Barings Private Equity acquired the Hexaware promoter's stake for US$ 465mn (total acquisition price for 73% stake). Hexaware was a midcap IT company then, with a revenue of US$ 364mn and strong presence in the BFSI space. This, in many ways, marked the beginning of a series of promoter exits from various midcap IT companies. Over the next four years, multiple transactions took place in the IT midcap space in which promoters offloaded their entire stake, or a large part of their stake, to strategic or financial investors.

Spate of M&A activity in Indian IT midcap space, over last five years

Target Co	Acquirer	Date	Acquisition Value (US$ mn)	Sales (US$ mn)	EV/Sales
NIIT Tech	Baring PE	Apr '19	709	528	2.0
Mindtree	L&T Group	Mar '19	1,533	1,001	1.7
Geometric Ltd	HCL Tech	Apr '16	192	135	1.4
Mphasis	Blackstone	Apr '16	1,390	932	1.5
Polaris	Virtusa	Nov '15	348	310	1.1
Zensar	Apax Partners	Oct '15	57	45	1.3
iGate	CapGemini	Apr '15	4,040	1,270	3.2

Source:PhillipCapital India Research

We see four primary reasons for this series of promoter exits from midcap IT companies:

1) Lack of succession planning.
2) Scale becoming critical for future growth.
3) High pace of technology evolution.
4) Expensive valuations.

1. Lack of succession planning

Most of the current lot of midcap IT companies were started by first-generation entrepreneurs in the 1990s or early 2000s. Following the footsteps of Infosys, which became a global IT services player within few years of its inception, these midcap promoters chose a niche – a specific domain – to build their expertise in, and thereafter diversify into other segments or service lines. They were highly successful in this strategy, as they continued to win tier-2 and tier-3 clients, and smaller contracts. This is because large companies such as Accenture, CapGemini, TCS, and Infosys focussed only on tier-1 clients and large contracts.

However, even after operating for many decades, most of these companies are still largely promoter-driven, with very little say granted to the professional management. These companies *have* hired leading executives from their larger peers, which have meaningfully impacted their growth trajectory and overall professionalism. However, the 'final call' still rests with the promoters in most cases. Because of this culture – typical to most Indian family-run enterprises – the control baton has to be necessarily passed on to a member of the promoter's family.

Most midcpas currently have low promoter holding

Company	Promoters	Promoter Stake (%)	Major PE	PE stake (%)
NIIT Tech*	Rajendra Pawar, Vijay Thadani	30.5%	Baring Asia PE	70.7%
Mindtree*	KK, Subroto Bagchi, Rostow Ravanan and Parthsarthy NS	13.3%	L&T Group^	60.2%
Zensar	RPG Group	48.9%	Apax Partners	22.9%
Persistent	Anand Deshpande	31.7%	NA	NA
Hexaware*	Atul Nishar	27.7%	Baring Asia PE	62.5%
Cyient	BVR Mohan Reddy	22.7%	NA	NA
KPIT	Kishor Patil	41.6%	NA	NA

Source: PhillipCapital India Research *(*Pre acquisition, ^Conglomerate)*

This is where the problems begin. Most of the promoters of these companies started them in the early 1990s, when they were about 20-30 years old. Most are now close to retirement age. However, hardly any of them have a proper succession plan in place. Their 'heirs' tend to have other business interests and many do not want to work in the IT services business.

Under the circumstances, the only solution left for these promoters is to sell their stake to a strategic or financial investor, and exit the company that they have founded. New investors would run the company in a much more professional way – either as a part of a larger professional IT company (if acquired by a strategic investor) or as part of a portfolio of professionally run companies (if acquired by a financial investor). Either way, the company would have a better future and this scenario would present better stake-monetization opportunities for promoters.

2. Scale to become critical for future growth

Over the last two years, midcap IT companies have outperformed their largecap peers, in terms of growth. Even in FY20, most midcap companies will report 10-15% yoy USD growth while largecaps will barely touch double digits. However, much of this growth over the last two years has been driven by an abundance of smaller contracts in the new-age digital domain. The domain being new, is being approached by clients in a cautious manner – by awarding smaller shorter-duration contracts to multiple niche developers; this way, they can test domain expertise and delivery capability. Over the last few years, with the advent of new technology (digital), clients preferred to diversify their vendor base by awarding smaller multiple contracts to several vendors.

However, over the last year, the trend appears to have reversed, with many Indian IT companies reporting multi-year multi-billion-dollar deals. As we have seen with tech disruptions before – as the digital domain will mature, the deal sizes will increase. At that stage, large-caps will give stiff competition to these midcaps, making it difficult for them to survive and grow.

Large deal announcements in last few months

	Time	Geo	Client	USD mn	Years	Details of the deal
TCS	Jan '18	EU	M&G Prudential	690	10	To support 4mn policies of Prudential; 1100 incumbent supplier's employees to move to TCS, with further 700 new roles in India
	Sep '19	US	General Motors	NA	5	TCS will acquire certain assets of GM – India (along with 1,300 employees) and support GM's global vehicle programs with engineering design services
	Jan '18	US	Transamerica	2500	10	TCS will simplify the service of more than 10mn policies into a single integrated modern platform, and drive greater sustainable growth opportunities through superior customer experiences; 2200 Transamerica employees will join TCS
	Dec '17	US	Nielsen Holdings	2250	10	ADM, BPO, KPO and Analytics. Assured of $320mn of business every year from 2017-2020, $186mn every year from 2021-2024 and $139.5mn in 2025. The deal will incrementally add $70-80mn annually
	Jan '18	UK	Marks & Spencer	NA	5	Digital Transformation; 250 employees to be transferred to TCS
HCLT	Jan '18	UK	Cadent	NA	5	Integrated public cloud hosting and SAP and Application Maintenance Services, including the migration of a significant applications portfolio to AWS public cloud
	Nov '17	UK	Jardine Lloyd Thompson	NA	5	Implement a fully orchestrated and automated cloud management platform with advanced automation capabilities, supported through DRYiCE
Wipro	Dec '17	NA	Fortune 500Medical devices	NA	MYMM	Global front-office transformation project
	Sep '19	India	ICICI Bank	300	7	To provide a comprehensive suite of services through HOLMES platform. Wipro will absorb 3,800 employees of Vara Infotech, who is the current service provider to ICICI Bank
	Dec '17	NA	Global BFSI service provider	NA	MYMM	Upgrade its use experience and simplify their sales and service process
	Nov '17	US	Luxury departmental store	NA	MYMM	Reimagine its employee experience and modernize their HR processes.
	Dec '17	NA	International payment provider	NA	MYMM	Leverage Designit's expertise in technology, product and service design.

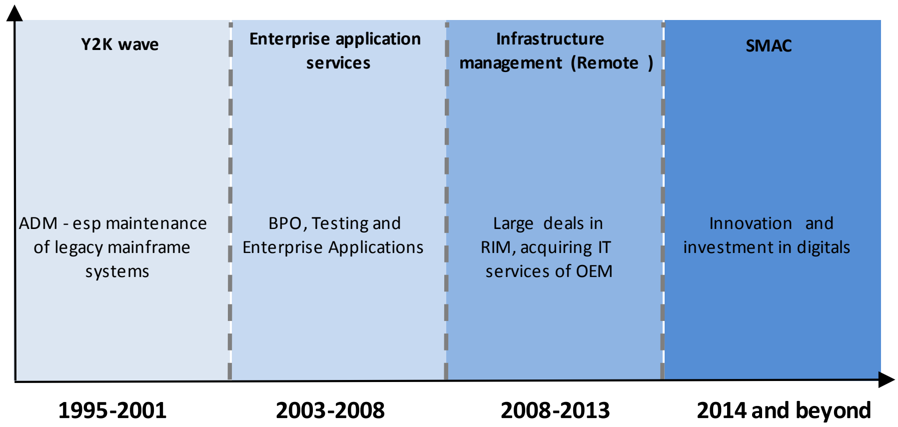
Source: Companies, PhillipCapital India Research *(*MYMM – Multi Year Multi Million)*

The average revenue size of the midcap IT companies today is US$ 500-1500mn. At that size, these companies are in an in-between stage – neither are they big enough (like the largecaps) to be invited in large tenders, nor are they small enough to be able to survive and grow by focussing only on small deals. They need to be a part of a larger group where they are invited due to their size and are then able to clinch the contract based on their domain expertise. Integration with another player offers them just that.

3. High pace of technology evolution

One of the biggest troubles that IT companies face is change of pace in the technology evolution. From Enterprise Applications in early 2000s to IMS in early 2010s, followed by Digital in 2014, the IT industry has witnessed new technologies evolve, which then challenge existing business models. We note that, a significant part of the evolution is due to the fact that Indian IT companies have moved in the value chain to 'solution-centric' models from 'cost-arbitrage' models.

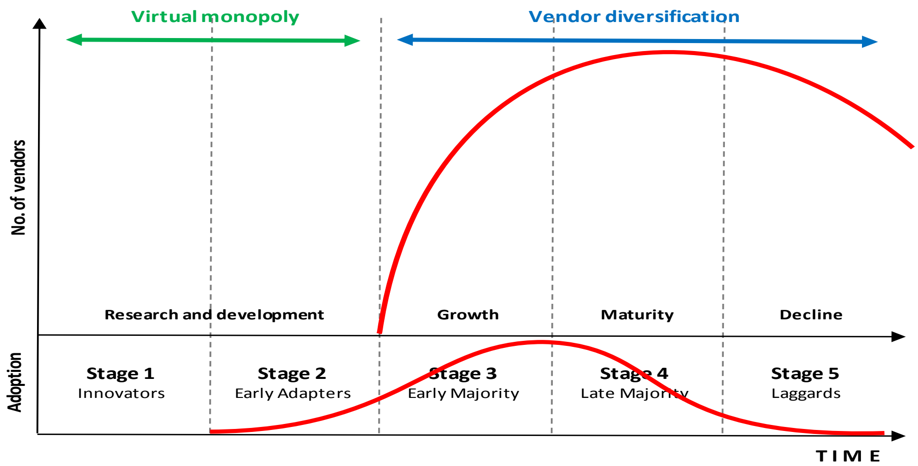
The various waves of the global IT industry



Source: PhillipCapital India Research

Historically, NO technology disruption has lasted more than 3-4 years; after this period, usually multiple players thrive in the market. The digital technology (SMAC) is already into its fourth year, and the 'Innovator' and 'Early Adaptor' phases appear to be reaching an end – leading to the advent of the 'Early Majority' phase. Theoretically, the number of players in the market expands in this phase, fizzling-out once the technology matures.

No of vendors increases in the growth phase, but reduces in the maturity phase



Source: PhillipCapital India Research

As technology matures, the number of players in the market starts declining – with the clients putting more faith in vendors that have scale and experience across technology platforms. This translates into bad news for mid-cap companies, as they have to compete with large players for deals that are also increasing in size.

More importantly, constantly evolving technology means that companies have to keep investing resources in upgrading its workforce with the latest technology development. This means a continuous drain on resources – something that large companies can bear much more easily than smaller ones. This, we believe, will lead to even more promoters looking to sell out, as the current tech cycle matures.

4. Expensive valuations

As is typical in the early years of any new technology cycle, over the last few years, we saw clients diversifying their vendor base, awarding smaller multiple contracts to several vendors. This led to an overall reduction in deal size and tenure – enhancing the competiveness of Indian IT midcap companies. Due to this phenomenon, midcaps were able to compete with the large IT behemoths, offering specialist capabilities in niche domains, and as a result, they reported much stronger deal flow and revenue/earnings growth, over the last few years – which the market also acknowledged, by attributing them higher valuations.

By FY19 end, most midcap companies were trading at 18-20x one year forward PEs – a sharp premium to the 15-17x PEs that largecaps were getting. The premium was reflective of the much superior growth the midcaps had reported in FY18/19, and their guidance/expectations; largecaps reported muted growth in FY18 and posted grim outlooks. These midcap valuations were also the peak valuations that most of them had ever received in their trading history.

Current valuations of IT Midcaps are expensive – in absolute and historical terms

Company	Mar-18 PE*	FY19 rev growth	Mar-19 PE*	FY20E rev growth	CMP PE*	FY21E rev growth	Avg	Peak
TCS	17.0	9.6%	22.0	7.2%	21.5	8.8%	17.8	25.1
Infosys	16.0	7.9%	19.0	9.5%	15.6	9.1%	16.0	24.7
Wipro	14.1	2.9%	15.1	2.4%	13.3	7.5%	11.7	19.1
HCL Tech	13.0	10.1%	15.3	15.4%	13.1	11.5%	13.0	26.1
Tech Mahindra	12.9	4.2%	17.2	4.8%	15.1	6.1%	12.3	30.0
LTI	15.4	19.1%	20.3	10.1%	17.2	12.0%	14.4	22.3
LTTS	16.8	24.6%	19.5	10.0%	17.1	12.0%	17.4	23.9
MindTree	16.8	18.3%	26.2	9.4%	15.9	11.0%	14.5	31.3
Cyient	15.6	8.7%	16.3	0.0%	9.1	8.0%	12.0	20.2
NIIT Tech	12.9	13.9%	17.9	12.9%	16.4	12.0%	9.5	23.0
Average largecap	**14.6**		**17.7**		**15.7**			
Average midcap	**15.5**		**20.1**		**15.1**			

Source: PhillipCapital India Research *(* All PEs on one year fwd earnings)*

We believe that peak valuation was also one of the reasons that prompted promoters of a company like NIIT Tech to exit – apart from lack of succession planning. A promoter knows best when the business or valuations have reached a peak, and a smart promoter knows when to cash out. Having said that, there are ways that a professional owner such as a PE company, has improved operational efficiencies in a business and can lead to superior growth/valuations after the promoter's exit – Hexaware being a glaring testimony of the same.

Even at current prices, most midcaps (excluding Cyient and PSYS, due to their operational issues) are trading at a premium to most large-caps (excluding TCS). We believe these could be really attractive valuations for promoters to exit their businesses – IF they are looking to exit at some point. Over the next few years, we expect valuations to also be a key driver for higher M&A activity in the sector.

PE firms on an acquisitions spree in mid-cap space

In the last five years, private equity players have invested heavily in the Indian IT midcap space. Companies with niche strength in focused domains – either horizontals or verticals – are attracting stronger attention from PE investors whose primary target is to improve overall portfolio value by turning around the operational performance of the company. They target companies that have differentiated domain expertise and capabilities, but are performing below-par, primarily due to size issues or lack of professionalism in approach.

High competitive pressure has led to many midcap companies 'cashing-out'

Target Co	Acquirer	Date	Acquisition Value (US$ mn)	Sales (US$ mn)	EV/Sales
NIIT Tech	Baring PE	Apr-19	709	528	2.0
Mindtree	L&T Group	Mar-19	1,533	1,001	1.7
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Zensar	Apax Partners	Oct-15	57	45	1.3
Serco	Blackstone	Sep-15	383	480	0.8
Infogain	Chryscap	Aug-15	63	NA	NA
iGate	CapGemini	Apr-15	4,040	1,270	3.2

Source:PhillipCapital India Research

With PE firms acquiring minority or majority stakes in companies intending to turnaround operations and exiting at a later date at higher valuations, we see an interesting and exciting theme playing out in these PE-held midcap IT companies.

Midcaps are facing the brunt of competition and global uncertainty

Recent transactions of Mindtree and NIIT Tech are a clear evidence of high level of competition that most midcap IT services companies are facing presently. Despite strong financial performances over the last few quarters, concerns about the sustainability of this performance have begun to loom large.

Most IT companies reported moderate numbers for Q4FY19, which slipped further in 1HFY20 due to macro uncertainties (TCS, Wipro, LTTS) and/or client specific issues (LTI, Cyient). Also, recent deal data by ISG and 2QFY20 commentary by all companies reflects more headwinds, at least for FY20.

Most midcaps are reeling under competitive pressure over last few quarters

Last 6 quarters	Mindtree	L&T Info	L&T Tech	Cyient	NITEC
US$ revenues CQGR	2.33%	2.61%	3.23%	0.42%	3.65%
Change in EBIT Margins (bps, yoy)	(381)	(344)	108	(169)	(52)

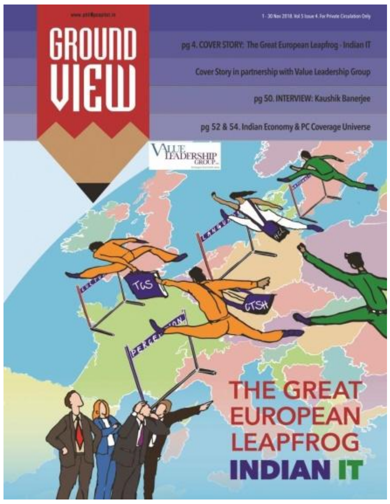
ACV data by ISG

		3Q19 ACV ($ bn)	3Q YoY Change %	2Q19 ACV ($ bn)	2Q YoY Change %
Global Combined Market ACV		**13.8**	**11.3**	**13.5**	**13.7**
By Type	Outsourcing	6.7	4.7	7.0	-3.0
	As-a-Service	7.1	18.3	6.7	14.0
By Region	Americas	7.7	24.2	6.5	6.0
	EMEA	4.1	-8.9	5.0	3.0
	Asia Pacific	2.0	19.3	2.2	6.0

Source: ISG, PhillipCapital India Research

In these turbulent times, we expect most midcap IT companies' promoter to seek a timely exit. We expect few of these companies to either merge together to form a formidable force, or some of the large IT services companies acquiring one of them. We have already seen many similar acquisitions in the last six months, and expect many more over the next few quarters.

Consolidation in the European IT space: Our thesis is playing out to perfection



In June 2019, Capgemini announced that it has entered into exclusive negotiations to acquire Altran, the world's largest ER&D company, for a cash consideration of €3.6bn (EV of €5bn) (read here).

- This announcement came on the heels of similar transactions earlier – when the Finnish IT Services firm Tieto acquired the Norwegian IT Services firm EVRY, for US$ 1.5bn (read here).
- That acquisition was preceded by another transaction in January 2019, when the US-based IT services firm DXC Technologies, acquired the Swiss-based Luxoft, for US$ 2bn (read here).

This spate of M&A activity in the European IT space is BANG in line with the hypothesis that we laid out in our Ground View report – The Great European Leapfrog by Indian IT (read **here**). In this report, we had depicted how Indian IT companies had significantly outperformed and snatched market share from the local European vendors. We had predicted that this would continue, due to the superior delivery capabilities and the significantly better 'value for money' experience offered by Indian IT companies – which would lead to consolidation among European vendors. Three transactions within a space of six months are enough proof of the pudding!

Recent M&A transactions in Europe

	Capgemini – Altran	**Tieto - EVRY**	**DXC - Luxoft**
Date of Announcement	June 24, 2019	June 18, 2019	January 7, 2019
Expected completion	December 2019	December 2019	June 2019
Acquirer	**Capgemini**	**Tieto Corp**	**DXC Technology**
Sales	€ 13.2bn	€ 1.6bn	$ 20.7bn
EBIT Margins	12.1%	9.7%	8.3%
Employees	211,000	15,000	130,000
HQ	France	Finland	US
Target	**Altran Technologies**	**EVRY**	**Luxoft Holding**
Sales	€ 2.9bn	€ 1.3bn	$ 907mn
EBIT Margins	12.1%	7.9%	6.6%
Employees	47,000	8,800	13,000
HQ	France	Norway	Switzerland
Consideration	€ 14 per Altran share	0.12 shares in Tieto and NOK 5.28 in cash	$59 per Luxoft share
EV	**€ 5.0bn (incl Debt of € 1.4bn)**	**€ 1.38bn (incl cash consideration of € 0.2bn)**	**$2bn**
EV/Sales	***1.7x***	***1.1x***	***2.2x***

Source: Companies, PhillipCapital India Research

One + One = Eleven

Four of the five companies that we had highlighted in our 2014 report, have gone through change in ownership – validating one part of the hypothesis of our report. However, only one company, KPIT, has so far undergone a merger activity, to validate the "1 + 1 = 11" hypothesis. We acknowledge that merging two companies is much easier written in a report, than actually done. Notwithstanding, the KPIT + Birlasoft merger has definitely created a superior entity, than the two struggling entities pre-merger – setting a precedent for more transactions in future.

Birlasoft = Birlasoft + KPIT (IT Services)

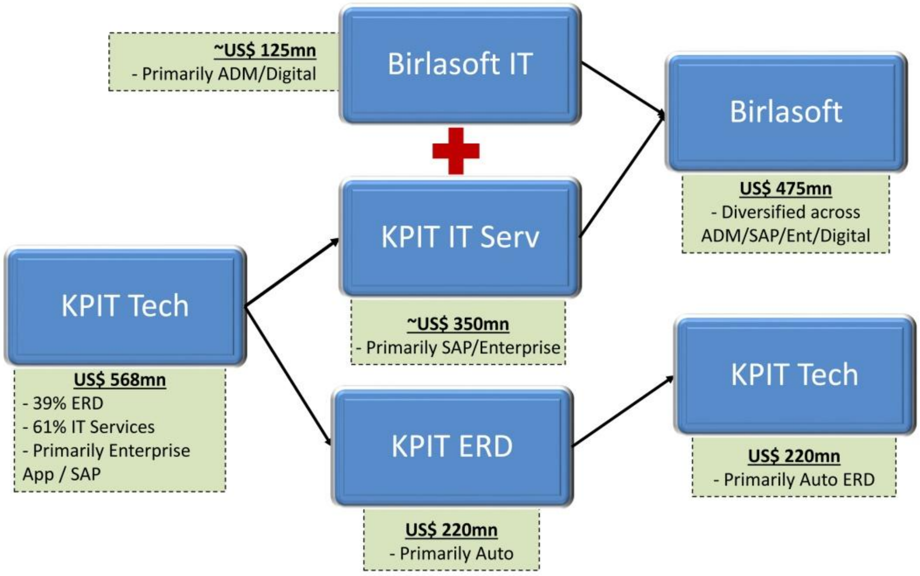
In Jan-2018, KPIT Technologies and Birlasoft announced their plans to merge their IT Services businesses, to create two separately listed entities:

- KPIT's Engineering business ($220mn)
- Merged entity comprising of KPIT's IT Services ($350mn) and Birlasoft ($125mn)

The rationale for the merger-demeger was precisely what our hypothesis has been. KPIT's IT Services business (mainly comprising of SAP/Oracle implementation) and Birlasoft's IT business (primarily BFSI and healthcare) were struggling independently. While KPIT's engineering business continued to prosper, its SAP/Enterprise business was continuously dragging the overall growth. At the same time, Birlasoft, due to its small size, was not able to capitalize on large deals and customers.

A demerger of engineering business form KPIT meant that the management could focus on the engineering business. At the same time, merger of Birlasoft with KPIT's IT Services business, provided Birlasoft the scale (combined entity revenue of $500mn vs. earlier Birlasoft revenue of $125mn) it needed to grow in that domain.

The merger-demerger process of KPIT Tech and Birlasoft *(FY18 numbers)*



Source: Companies, PhillipCapital India Research

We expect the current trend of M&A activity in the IT midcap space to continue over the next few years. We believe we will finally see, in the next few years, mergers among these midcap companies playing out – leading to formation of Integrated Entities (IEs) that would have much superior (strong growth and higher RoEs) and diversified (across verticals, geographies, and service lines) business profiles. A look at some of the IEs we expect to be formed:

IE-1 = L&T Infotech + Mindtree *(Most likely)*

In March 2019, L&T group – in a surprising but not entirely unexpected move, entered into a share-purchase agreement with V.G. Siddhartha and the Coffee Day Group to acquire their 20.15% stake held by them in Mindtree. It raised its stake further through open-market purchases and an open offer, taking its stake to 60.55% of Mindtree's total equity.

An integrated entity (say IE-1), formed by merger of these two companies (without taking merger synergies into account), will have a revenue base of US$ 2.4bn and EBIT margins of 16%. BFSI will constitute 35% of its revenues, followed by Telecom (24%) and Manufacturing (10%). The firm will also have 17% of its revenues coming from Europe – reducing its dependence on the US to 70%.

IE-1 = L&T Infotech + Mindtree *(FY19 numbers)*

	MTCL	LTI	LTI + MTCL	Rev share
Top line (USD mn)	**1,001**	**1,349**	**2,351**	
EBIT margin (%)	**13%**	**18%**	**16%**	
Key verticals				
BFSI	218	614	832	35%
Auto, Manf	-	224	224	10%
E&U	-	148	148	6%
Travel, Transport	164	-	164	7%
Telecom	397	167	564	24%
Others	222	196	418	18%
Geographies				
US	738	896	1,634	70%
EU	185	221	407	17%
ROW	79	233	313	13%
Horizontals				
ADM	553	511	1,064	45%
IMS	233	148	382	16%
EAS	81	394	475	20%
BI & Analytics	-	252	252	11%
IP + Products	11	43	54	2%
Others	123	-	123	5%

Why we believe a merger is imminent, despite managements' denial?

L&T's management (as well as LTI and MTCL's managements) has indicated that MTCL would remain an independent listed entity and has ruled out any merger between the two in the near future. However, we still believe a merger is imminent (maybe in 2-3 years) for the following reasons:

- **Scale benefits:** The primary reason for L&T group's hostile takeover of MTCL was to provide size to their IT business. The merged entity, at almost US$ 2.5bn in revenues, will be the seventh-largest Indian IT company, and will open up multiple doors to new deals and clients for the group.
- **Complimentary profile:** While LTI is strong in BFSI (47% of revenue), MTCL has a strong presence in Hi-tech and Media (39% of revenue). Similarly, LTI does not have any presence in E&U (16% of MTCL's revenue). Also, due to their unique offerings, there is very minimal overlap among large clients between the two.
- **Conflict of interest:** Even with minimal overlap in LTI and MTCL clients and businesses, both businesses, led by aggressive managements, would end up chasing the same deals eventually.

IE-1: SWOT analysis

Strength	Weakness	Opportunity	Threat
Strong presence in BFSI, and telecom	Near-absence of IP-led business	Larger revenue base would open doors of large clients and deals	Increasing proportion of insourcing in BFSI
Diversified geographic mix	Weak presence in Manufacturing and E&U		Revenue diversification might lead to loss of focus in key verticals

Source: PhillipCapital India Research

IE-2 = NIIT Tech + Hexaware *(Most likely)*

In April 2019, Baring Private Equity Asia (BPEA) entered into an agreement with NIIT Ltd and other promoters to acquire their 30.2% stake in NIIT Tech at Rs 1,394 per share (for Rs 26.3bn). It raised its stake through open-market purchases and open offer taking the stake to 70.7% of the total equity in NIIT Tech. BPEA is also the promoter of Hexaware (it holds 62.6% stake).

An integrated entity (say IE-2), formed by merger of these two companies (without taking merger synergies into account), will have a revenue base of US$ 1.2bn, and EBIT margins of 14%. BFSI will constitute 43% of its revenues, followed by Manufacturing (29%) and TTL (17%). The firm will have 22% of its revenues coming from Europe and 65% from US.

IE-2 = NIIT Tech + Hexaware *(FY19 numbers)*

	NITEC	HEXW	NITEC + HEXW	Rev share
Topline ($mn)	**528**	**678**	**1,206**	
EBIT margin (%)	**14%**	**14%**	**14%**	
Key verticals				
BFSI	232	285	518	43%
Auto, Manf	153	197	350	29%
E&U	-	-	-	0%
Travel, Transport	143	67	210	17%
Healthcare	-	129	129	11%
Geographies				
US	259	521	780	65%
EU	174	88	262	22%
ROW	95	68	163	14%
Horizontals				
ADM	370	238	608	50%
IMS	90	119	208	17%
EAS	21	64	86	7%
BI & Analytics	-	89	89	7%
BPO	21	49	71	6%
IP + Products	26	-	26	2%
Others	-	119	119	10%

Source: PhillipCapital India Research

Why we believe a merger is imminent, despite the managements' denials?

As part of the NITEC deal, BPEA will not merge the two companies (NITEC and Hexaware), at least for the next two years. This has been echoed by both managements. However, we still believe a merger is likely maybe 2-3 years down the line because of what we call **Baring's Hexaware Dilemma**:

- BPEA invested in Hexaware in Aug-13, which makes it a six-year-old investment. As part of its Fund-I, the PE needs to exit the investment, but has been unable to (it sold 8.4% stake in Aug-18). We find it highly unlikely that it will be able to find an investor (financial/strategic) to acquire 50% stake in HEXW at current valuations and in the current macro-environment.
- We believe the acquisition of NITEC by BPEA was done to facilitate HEXW's exit. Integrated together, IE-2 would be a +US$ 1bn company, with a presence across ALL key verticals and geographies – much more 'saleable' entity than HEXW.
- We note that other than a strategic investor buying HEXW/NITEC/IE-2, BPEA does not have too many options to monetize its investment. Cross-selling holdings from one fund to another, is virtually impossible because of different charters for different funds.

IE-2: SWOT analysis

Strength	Weakness	Opportunity	Threat
Strong presence in BFSI and Travel/Transport	Near absence of Telecom and E&U	Larger revenue base would open doors of large clients and deals	High level of competition in BFSI services
Diversified geographic mix	Higher share of ADM; zero presence in ERD		Revenue diversification might lead to loss of focus in key verticals

Source: PhillipCapital India Research

IE-3.1 = L&T Tech + Cyient *(Hypothetical)*

L&T Technology Services

CYIENT

LTTS and Cyient are among the few players in the listed Indian IT space that have a strong presence in the ER&D space. This segment has emerged as the next-gen domain for Indian IT, with Indian IT companies witnessing robust growth over the last five years (15% CAGR). More importantly, the quality of work being outsourced to India has evolved significantly – to innovation and development-driven high-end projects from cost-arbitrage driven low-end tasks. Both companies have niche capabilities in their selected verticals, with LTTS strong in Transportation and Industrials, while Cyient has a strong presence in Aerospace and Railways.

Both of these companies have reported double-digit USD revenue CAGR over FY16-18. However, in FY19, while LTTS continued its strong performance with 24.6% revenue growth (on the back of strong deal-flow and recovery in the Process Design segment), Cyient reported muted growth of 6.4% (impacted by client-specific issues and delay in spending in its key verticals).

Also, UTC – Cyient's largest customer (contributes 20% to its revenue as per our estimates), faces issues due to concerns about NEO engines – resulting in UTC lowering its IT spend on other areas in which Cyient operates. Based on this, along with issues with other clients in the communications segment and disappointing performance in Q1/Q2, Cyient can, at best, report ZERO revenue growth for FY20. With low promoter shareholding in Cyient (promoter stake at 22.74%), and cheaper valuations (largely due to the below-par financial performance in recent times), it could be a good acquisition target for a company like LTTS.

IE-3 = L&T Tech + Cyient *(FY19 numbers)*

	LTTS	CYL	LTTS + CYL	Rev share
Topline ($mn)	**724**	**660**	**1,384**	
EBIT margin (%)	**16%**	**12%**	**14%**	
Key verticals				
Aerospace	-	224	224	16%
Transportation	238	81	319	23%
E&U	-	86	86	6%
Manufacturing	140	-	140	10%
Medical Devices	51	13	64	5%
Telecom	189	147	337	24%
Others	106	108	215	16%
Geographies				
US	426	376	802	58%
EU	216	174	390	28%
ROW	81	110	191	14%

Source: PhillipCapital India Research

An integrated entity (say IE-3.1), formed by merger of these two companies (without taking merger synergies into account), will have a revenue base of US$ 1.4bn, and EBIT margins of 14%. Transport (incl Aero) will constitute 39% of its revenues, followed by Telecom (24%) and Others (16%). The firm will have 28% of its revenues coming from Europe and 58% from the US.

IE-3: SWOT analysis

Strength	Weakness	Opportunity	Threat
Strong presence in Aerospace and Transport	Cyient business currently suffering from client specific issues, which could take some time to recover	Strong presence in Plant Engineering	Volatility in revenues due to nature of domain
Diversified revenue profile across verticals		Larger revenue base would open the doors of large clients and deals	Dependence on capex cycle of the industry

Source: PhillipCapital India Research

IE-3.2 = HCl Tech + Cyient *(Hypothetical)*

Similar to LTTS, Cyient can potentially be a good acquisition target for HCL Tech as well – which has strong presence in the ER&D domain. HCL Tech, over the last three years, has acquired 24 companies (including 9 IP partnerships and IBM products buy-out), including multiple acquisitions in the ER&D space.

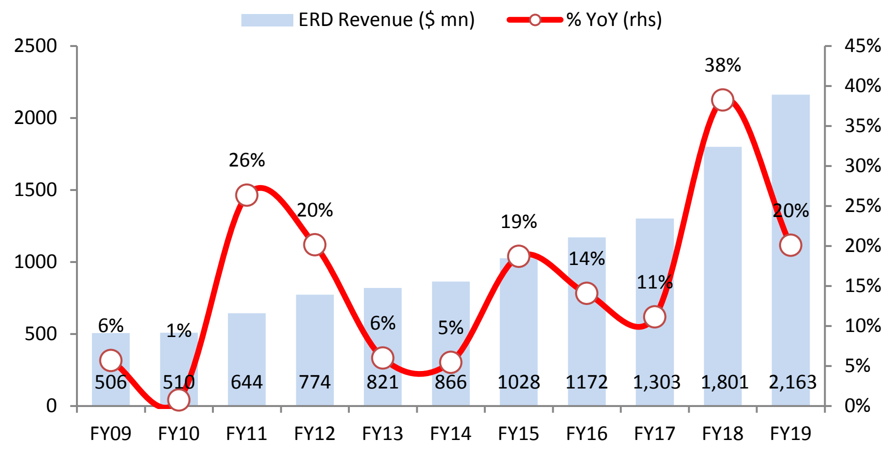
In April 2016, HCLT acquired Geometric Ltd. The acquisition gave it access to Geometric's 60 clients (ABB, Boston Gear, Daimler Chrysler, Honda R&D, Siemens etc.) and a highly trained workforce of 4,800 employees. Similarly, in October 2016, HCLT acquired Butler America Aerospace, which provides engineering (mechanical and structural design, electrical and tool design and aftermarket engineering services) and design services to US aerospace and defence customers. Through this acquisition, HCLT added 900 highly skilled engineers to its force. A company like Cyient would fit perfectly into HCL's ERD business, though with aviation being the strong domain for both companies, there could be some overlap in terms of clients.

HCLT has made multiple acquisitions to grow its ERD business

Date	Target	Country	Business Description	Consideration ($ mn)	Revenue ($ mn)
Dec-16	Butler America Aerospace	US	Engineering & Design services to Aerospace and Defense customers	85	85
Apr-16	Geometric	India	PLM and engineering services	195	135
Oct-15	C2SiS	India	Engineering services firm	2	NA

Source: Company, PhillipCapital India Research

HCL Tech has grown its ERD business, organically as well as inorganically



Source: Company, PhillipCapital India Research

IE-3.2 = Cyient acquired by HCL Tech *(FY19 numbers)*

	Cyient	HCL ERD	LTTS + HCL ERD
Topline (US$ mn)	**660**	**2,163**	**2,823**

Source: PhillipCapital India Research

IE-4 = Mphasis + Zensar *(Hypothetical)*

Both Mphasis and Zensar have a significant PE shareholding. While Mphasis is backed by Blackstone (purchased 84% stake in Apr-2016), Zensar has Apax Partners as one of the largest shareholder (purchased 23.2% stake from Electra Partners in October 2015). The IE formed will benefit from Mphasis' strong presence in BFSI and Zensar's presence in manufacturing/retail.

An integrated entity (say IE-4), formed by merger of these two companies (without taking merger synergies into account), will have a revenue base of US$ 1.7bn, and EBIT margins of 14%. BFSI will constitute 45% of its revenues, followed by Manufacturing (17%). The firm will have 13% of its revenues coming from Europe and 78% from US.

IE-4 = Mphasis + Zensar *(FY19 numbers)*

	Mphasis	Zensar	MPHL + Zensar	Rev share
Topline ($mn)	**1,119**	**557**	**1,676**	
EBIT margin (%)	**16%**	**11%**	**14%**	
Key verticals				
BFSI	630	128	758	45%
Auto, Manf	-	284	284	17%
Telecom	193	-	193	12%
Others	489	145	633	38%
Geographies				
US	868	428	1,296	77%
EU	128	84	212	13%
ROW	123	45	168	10%
Horizontals				
ADM	726	473	1,199	72%
IMS	142	84	226	14%
BPO	70	-	70	4%
Others	180	-	180	11%

Source: PhillipCapital India Research

Why we believe this seemingly 'far-fetched' merger is likely?

We believe a merger between Mphasis and Zensar is possible (even likely) for the following reasons:

- **Blackstone is in the same boat (almost) as Baring's**: Blackstone, with 52% stake in Mphasis, is almost in the same boat as BPEA, which owns 50% stake in HEXW. We believe both PEs will find it extremely difficult to get an investor (financial/strategic) to acquire such a high stake at current valuations in the current macro-environment. The solution could be to sell the older and larger investment 'internally', and create a much better 'saleable' entity to sell in a more conducive environment later.
- **High PE (and low promoter) stake in Zensar:** Apart from Mphasis being 'owned' by a PE firm (Blackstone), Apax Partners owns 23% stake in Zensar (acquired in 2015). It will also not find it easy to divest such a large stake, at current valuations and in the current macro-environment. A merger could be a possible solution to create a more 'saleable' entity.
- **Scale benefits:** The merged IE-4 will be just short of US$ 2bn in revenues – a sizeable entity in the Indian IT space. The size can open up multiple doors to new large deals and clients for the entity, thus enhancing its profile and saleability.

IE-4: SWOT analysis

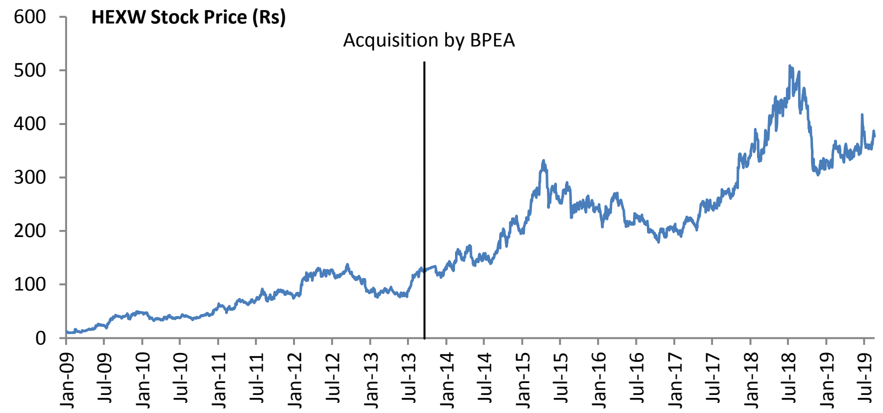
Strength	Weakness	Opportunity	Threat
Strong presence in BFSI	Absence of ER&D and Enterprise as a service line	Larger revenue base would open the doors of large clients and deals	High level of competition in BFSI services
Diversified geographic mix	No presence in Healthcare and TTL		Revenue diversification might lead to loss of focus in key verticals

Source: PhillipCapital India Research

M&A activity can lead to significant wealth creation

The acquisitions, if done at cheaper valuations or with niche capabilities, will create significant wealth over the period of time. The best example of this is the acquisition of Hexaware by Baring PE Asia. Baring acquired Hexaware in August 2013 at Rs 135 per share, for a valuation of 10x CY13 earnings. Over the next few years, with the new management and change in strategy, Hexaware became a leading mid-cap IT company, resulting in significant appreciation in the stock price (2.8x) since the acquisition.

HEXW stock has delivered 180% returns since BPEA acquired promoter stake



Source: Bloomberg, PhillipCapital India Research

BPEA acquisition boosted the dividend payout for HEXW

	CY12	CY13	CY14	CY15	CY16	CY17	CY18
Dividend per Share (Rs)	5.4	11.1	9.4	8.6	5.5	4.0	8.5
Dividend payout (%)	47.2%	81.0%	79.5%	66.4%	39.7%	23.8%	43.3%
Total Dividend (incl DDT) (Rs mn)	1,924	4,002	3,419	3,138	1,998	1,428	3,038
Buyback (Rs mn)	-	-	-	-	-	1,367	-
Total return to shareholders (Rs mn)	**1,924**	**4,002**	**3,419**	**3,138**	**1,998**	**2,795**	**3,038**

Source: Company, PhillipCapital India Research

At the same time, PE firms are also known to significantly enhance the dividend payout profile of their portfolio companies (as is evident in the case of HEXW above) – which also enhances shareholders' returns.

In our September 2014 note, we had highlighted growing competition and rerating potential leading to heightened M&A activity in the sector. We had also forecasted the most likely candidates for acquisitions – four of them (Polaris, NIIT Tech, Hexaware and KPIT) have already been acquired.

Going forward, we continue to believe that investing in select companies that are likely to see change of ownership, which will lead to improvement in business operations – can lead to significant wealth creation in the sector over the next 3-4 years. We see many companies (like L&T Infotech, Mindtree, Hexaware, NIIT Tech, L&T Technology, Cyient, Zensar, and Mphasis) as the next potential candidates for merger/acquisition.

IT Midcaps – Recommendations summary

	CMP	Mkt Cap	Target	PT	Upside	Rating	USD Rev Growth (%)		EBIT Margins (%)		EPS (Rs)	
	Rs	Rs bn	Multiple	Rs	%		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
LTI	1,650	287	16	1,750	6%	NEU	10.1	12.0	16.1	16.6	85	96
LTTS	1,475	153	18	1,760	19%	**BUY**	10.0	12.0	16.7	16.5	78	86
MindTree	740	121	16	910	23%	**BUY**	9.4	11.0	9.6	11.5	35	47
Cyient	391	43	10	490	25%	**BUY**	-0.0	8.0	10.1	10.8	40	43
NIIT Tech	1,455	89	15	1,550	7%	NEU	12.9	12.0	13.7	14.8	75	89

Source: Companies, Bloomberg, PhillipCapital India Research

IT Midcaps – Financials and valuation snapshot

	USD Revenues ($mn)			INR Revenues (Rs mn)			EBIT (Rs mn)			PAT (Rs mn)		
Companies	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
LTI	1,485	1,663	1,853	1,04,849	1,18,101	1,33,387	16,882	19,647	22,280	14,813	16,736	19,059
LTTS	795	890	1,006	56,122	63,203	72,433	9,362	10,419	12,049	8,143	8,954	10,183
MindTree	1,096	1,216	1,350	77,268	86,315	97,189	7,417	9,916	11,993	5,736	7,647	9,283
Cyient	660	713	765	46,561	50,616	55,064	4,688	5,450	6,206	4,380	4,708	5,441
NIIT Tech	596	668	748	41,954	47,399	53,822	5,759	7,031	8,137	4,592	5,437	6,314

	$ Revenue Growth (%)			EBIT Margins (%)			EPS (Rs)			EPS Growth (%)		
Companies	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
LTI	10.1	12.0	11.4	16.1	16.6	16.7	85	96	110	-2.3	13.0	13.9
LTTS	10.0	12.0	13.0	16.7	16.5	16.6	78	86	98	6.0	10.0	13.7
MindTree	9.4	11.0	11.0	9.6	11.5	12.3	35	47	57	-23.9	33.3	21.4
Cyient	-0.0	8.0	7.3	10.1	10.8	11.3	40	43	49	-10.0	7.5	15.6
NIIT Tech	12.9	12.0	12.0	13.7	14.8	15.1	75	89	103	12.3	18.4	16.1

	ROE (%)			PE (x)			PB (x)			Div Yield (%)		
Companies	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
LTI	26.6	25.4	24.3	19.4	17.2	15.1	5.2	4.4	3.7	1.7%	1.9%	1.9%
LTTS	28.5	25.9	24.0	18.8	17.1	15.1	5.4	4.4	3.6	1.5%	1.7%	1.2%
MindTree	18.0	20.7	21.2	21.1	15.9	13.1	3.8	3.3	2.8	1.6%	1.8%	1.8%
Cyient	15.9	15.4	15.7	9.8	9.1	7.9	1.6	1.4	1.2	3.1%	3.1%	3.1%
NIIT Tech	18.7	18.8	18.5	19.4	16.4	14.1	3.6	3.1	2.6	1.0%	1.0%	1.0%

Source: Companies, PhillipCapital India Research

IT Midcaps – Our estimates versus consensus

Company	Consensus EPS estimates			Our EPS estimates			% Difference		
	FY20	FY21	FY22	FY20	FY21	FY22	FY20	FY21	FY22
L&T Infotech	86.5	100.0	112.0	85.1	96.2	109.5	-2%	-4%	-2%
L&T Tech	77.0	86.0	95.0	78.3	86.1	97.9	2%	0%	3%
MindTree	36.0	47.0	54.8	35.0	46.7	56.6	-3%	-1%	3%
Cyient	40.0	46.0	50.0	39.8	42.8	49.5	0%	-7%	-1%
NIIT Tech	74.0	88.5	101.0	75.0	88.8	103.2	1%	0%	2%

Source: Bloomberg, PhillipCapital India Research

PhillipCapital

L&T Infotech (LTI IN)

Revenue concentration remains a key risk

INDIA | IT SERVICES | Company Update

12 December 2019

LTI's performance (both business and stock) has been remarkable over the last two years. The company, considered by many to be 'just another regular IT Services company', has won large deals, commendable certifications, and delivered industry-leading growth. We have always had a cautious stance on the company, concerned about its revenue concentration from BFSI at 46% and almost a third of that (not disclosed any longer) coming from one client. These concerns have played out over the last few quarters, with the top client decelerating and few other BFSI clients showing weakness – leading to significant overall deceleration. While the business now appears to be on a recovery path, we believe a repeat of the bad times is quite possible, given LTI's revenue concentration and headwinds in the BFSI space. The stock appears fully valued, trading at 17x FY21PE.

Concentrated business profile – once a booster, now a drag

LTI has one of the strongest solutions portfolios in the BFSI segment, which is quite unique in nature. This segment constitutes 46% of its revenues, deriving revenue from four stable streams – Property & Casualty insurance (P&C, ~20%), Citibank (~14%), Platforms (~4%) business and Global Risk & Compliance & Others (GRC, ~8%). We have viewed and highlighted this as a potential risk to the sustainability of LTI's industry-leading growth in FY18-19; our fears panned out over the last two quarters.

While LTI's revenues from Citibank reported a CQGR of 3.3% over Q1FY16-Q4FY17 (due to increase in its wallet share), over the last two quarters, these have significantly decelerated. Issues with its Africa and Nordic BFSI clients have added to the gloom, and now it does not seem likely that LTI will be able to report double-digit revenue growth in FY20 – significantly underperforming its peers. We continue to see this high revenue concentration as a risk to LTI's growth profile.

Digital business gaining traction; SAP certification is a testimony of its growing capabilities

LTI derives 40% of its revenues from Digital, which has seen 6.2% CQGR over the last six quarters. It has a dedicated team of digital managers and has started a new initiative ADEA (Analytics and Digital in Every Account) aimed at increasing the presence of newer-age technologies in every account. This is evident in digital penetration in 37 of its top-50 clients. The company has also been developing capabilities in multiple domains. It is one of the top-16 SAP certified vendors – a significant achievement for a company of its size.

Stable management team; lateral hires enhance growth prospects

After the appointment of Mr Sanjay Jalona as MD & CEO in Aug-15, LTI has significantly strengthened its management team through a series of recruitments at the sales and delivery levels. Post hiring Mr Sudhir Chaturvedi (ex-Infosys, ex-NIIT), the company hired Mr Nachiket Deshpande (ex-Cognizant) as COO. Other lateral recruits, with proven track records, have significantly enhanced LTI's profile and growth prospects.

Merger with Mindtree is a matter of time; will add significant value

Despite management's claims and denials, we believe the LTI-Mindtree merger is inevitable. As discussed in the sector part, the two companies have a complimentary profile, with very little client overlap. A merger between the two would thus benefit LTI immensely (and Mindtree too) – though we expect it to play out in the long term (two years hence).

Outlook and valuations

We expect LTI to report a 10% USD revenue growth in FY20, in line with midcap peers. It is currently trading at 17x FY21 P/E – at a slight premium to most mid-cap companies, despite a slightly risky business profile. We find current valuations too expensive and see limited upside potential in the near-to-medium term. We introduce FY22 estimates and roll forward our valuation to FY22. We value LTI at 16x FY22 PE. Maintain NEUTRAL with price target of Rs 1,750 (Rs 1,510 earlier).

NEUTRAL (Maintain)

CMP RS 1650

TARGET RS 1750 (+6%)

SEBI CATEGORY: LARGE CAP

COMPANY DATA

O/S SHARES (MN) :	174
MARKET CAP (RSBN) :	284
MARKET CAP (USDBN) :	4.0
52 - WK HI/LO (RS) :	1897 / 1437
LIQUIDITY 3M (USDMN) :	3.5
PAR VALUE (RS) :	1

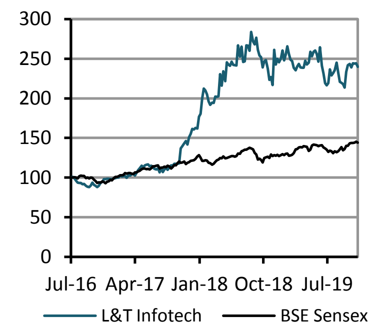
SHARE HOLDING PATTERN, %

	Sep 19	Jun 19	Mar 19
PROMOTERS :	74.6	74.8	74.8
FII / NRI :	8.1	8.3	7.9
FI / MF :	7.8	6.6	6.9
NON PRO :	3.4	3.4	3.3
PUBLIC & OTHERS :	6.1	6.9	7.1

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	0.3	-0.4	7.2
REL TO BSE	0.1	-8.8	-7.7

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	1,04,849	1,18,101	1,33,387
EBIT	16,882	19,647	22,280
Net Profit	14,813	16,736	19,059
EPS, Rs	85.1	96.2	109.5
PER, x	19.2	17.0	14.9
EV/EBIT, x	16.5	14.0	12.1
P/BV, x	5.1	4.3	3.6
ROE, %	26.6	25.4	24.3

Source: PhillipCapital India Research Est.

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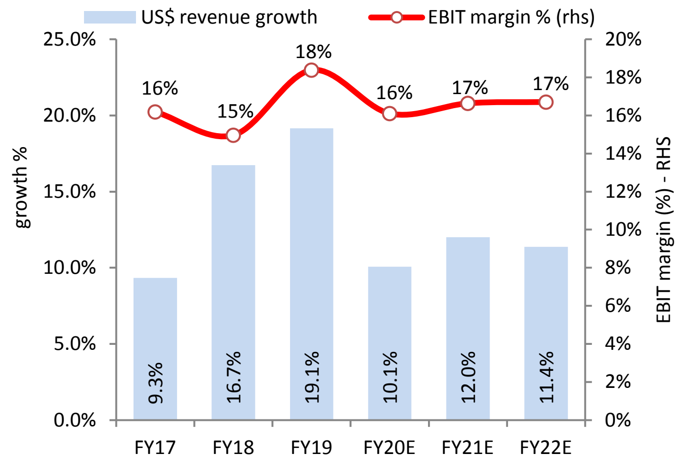
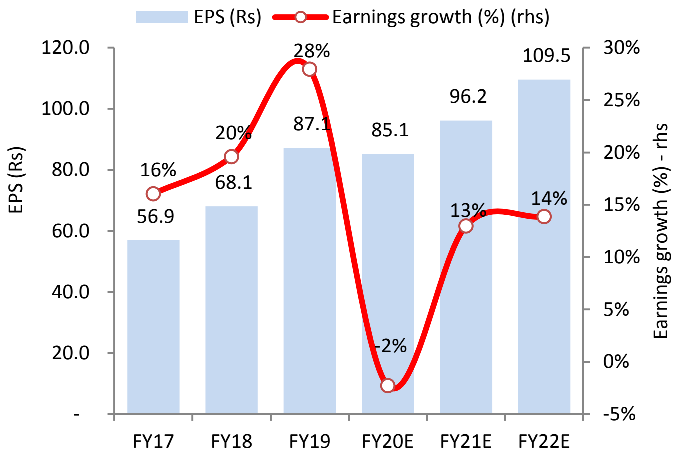
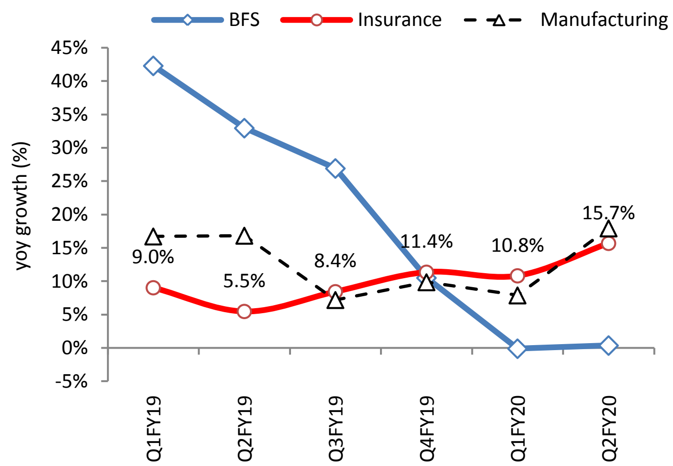
Revenue growth and Margins profile



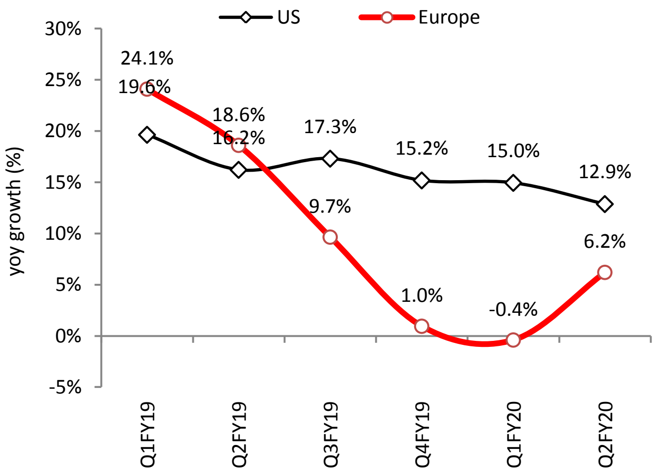
Earnings growth profile



Vertical growth rate (yoy) over last few quarters



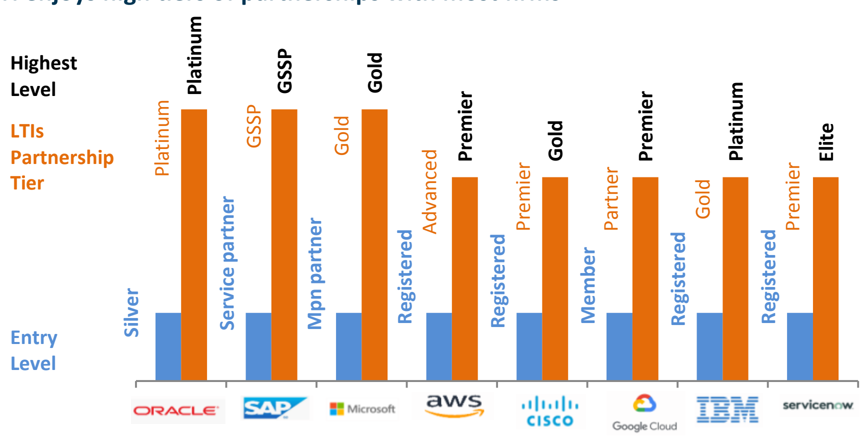
Geographical growth rate (yoy) over last few quarters



Focussed acquisitions continue to be the growth driver for LTI

Time	Acquired entity	Country	Description	Consideration ($mn)
Dec 2006	GDA Technologies	US	Electronic Design Services and Silicon Intellectual Provider	NA
Jan 2011	Citigroup Fund Services	Canada	Captive centre of Citigroup Canada	47
Oct 2014	ISRC	US	IT unit of Otis Elevator	13
Oct 2016	Augment IQ	India	Big Data Platform	NA
Nov 2017	Syncordis	Europe	To enhance core banking implementation capabilities	23
Jan 2019	Ruletronics	US	Pega-systems Implementation partner	8
Feb 2019	NIELSEN + PARTNER	Germany	Temenos WealthSuite Specialist	32
Jul 2019	Lymbyc Solutions	India	AI, Machine Learning and Advanced Analytics company with proprietary product “Leni”	5.4

LTI enjoys high tiers of partnerships with most firms



Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	**94,458**	**1,04,849**	**1,18,101**	**1,33,387**
Growth, %	29	11	13	13
Total income	94,458	1,04,849	1,18,101	1,33,387
Employee expenses	-61,643	-70,858	-80,360	-90,936
Other Operating expenses	-13,980	-14,499	-15,353	-17,340
EBITDA (Core)	**18,835**	**19,492**	**22,387**	**25,111**
Growth, %	50.8	3.5	14.9	12.2
Margin, %	19.9	18.6	19.0	18.8
Depreciation	-1,471	-2,611	-2,740	-2,831
EBIT	**17,364**	**16,882**	**19,647**	**22,280**
Growth, %	58.8	(2.8)	16.4	13.4
Margin, %	18.4	16.1	16.6	16.7
Interest paid	-106	-785	-784	-784
Other Income	3,021	3,691	3,601	4,087
Pre-tax profit	**20,279**	**19,788**	**22,464**	**25,583**
Tax provided	-5,122	-4,975	-5,728	-6,524
Profit after tax	**15,157**	**14,813**	**16,736**	**19,059**
Others (Minorities, Associates)	0	0	0	0
Net Profit	**15,157**	**14,813**	**16,736**	**19,059**
Growth, %	30.5	(2.3)	13.0	13.9
Net Profit (adjusted)	**15,157**	**14,813**	**16,736**	**19,059**
Wtd avg shares (m)	174	174	174	174

	FY19	FY20E	FY21E	FY22E
US$ Revenue ($ mn)	**1,349**	**1,485**	**1,663**	**1,853**
Growth, %	19.1	10.1	12.0	11.4
Re / US$ (rate)	70.0	70.6	71.0	72.0

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	4,150	6,341	9,767	15,402
Debtors	23,845	25,652	28,738	32,149
Loans & advances	3,854	3,151	3,569	4,009
Other current assets	0	0	0	0
Total current assets	31,849	35,144	42,073	51,560
Investments	17,402	20,320	24,320	28,320
Net fixed assets	9,414	17,726	18,326	18,926
Non-current assets	5,641	6,639	7,438	8,321
Total assets	**66,692**	**82,485**	**94,813**	**1,09,783**
Current liabilities	13,981	14,425	16,105	18,038
Provisions	3,335	12,032	12,460	12,951
Total current liabilities	17,316	26,458	28,565	30,989
Non-current liabilities	430	379	379	379
Total liabilities	17,746	26,837	28,944	31,368
Paid-up capital	174	174	174	174
Reserves & surplus	48,772	55,475	65,696	78,240
Shareholders' equity	48,946	55,649	65,870	78,414
Total equity & liabilities	**66,692**	**82,485**	**94,813**	**1,09,783**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	20,279	19,788	22,464	25,583
Depreciation	1,471	2,611	2,740	2,831
Chg in working capital	-2,870	7,039	-2,195	-2,309
Total tax paid	-4,771	-5,296	-5,728	-6,524
Cash flow from operating activities	**14,109**	**24,142**	**17,281**	**19,581**
Capital expenditure	-4,011	-10,923	-3,340	-3,431
Chg in investments	-4,759	-2,918	-4,000	-4,000
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	**-8,770**	**-13,841**	**-7,340**	**-7,431**
Free cash flow	5,339	10,301	9,941	12,150
Equity raised/(repaid)	2	0	0	0
Debt raised/(repaid)	0	0	0	0
Dividend (incl. tax)	-5,686	-5,802	-6,515	-6,515
Other financing activities	862	-2,308	0	0
Cash flow from financing activities	**-4,822**	**-8,110**	**-6,515**	**-6,515**
Net chg in cash	517	2,191	3,426	5,635

Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	87.1	85.1	96.2	109.5
Growth, %	28.0	(2.3)	13.0	13.9
Book NAV/share (INR)	281.3	319.8	378.6	450.7
CEPS (INR)	95.6	100.1	111.9	125.8
CFPS (INR)	93.9	136.9	93.6	104.5
DPS (INR)	27.9	28.5	32.0	32.0
Return ratios				
Return on assets (%)	25.3	20.5	19.4	19.1
Return on equity (%)	31.0	26.6	25.4	24.3
Return on capital employed (%)	32.1	25.3	23.4	22.9
Turnover ratios				
Asset turnover (x)	4.3	3.8	3.5	3.7
Sales/Total assets (x)	1.6	1.4	1.3	1.3
Sales/Net FA (x)	11.6	7.7	6.6	7.2
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	92.1	89.3	88.8	88.0
Payable days	22.5	50.2	50.0	49.5
Working capital days	53.0	50.1	50.1	49.6
Liquidity ratios				
Current ratio (x)	2.3	2.4	2.6	2.9
Quick ratio (x)	2.3	2.4	2.6	2.9
Interest cover (x)	163.8	21.5	25.1	28.4
Dividend cover (x)	3.1	3.0	3.0	3.4
Total debt/Equity (%)	-	-	-	-
Net debt/Equity (%)	(8.5)	(11.4)	(14.8)	(19.6)
Valuation				
PER (x)	18.8	19.2	17.0	14.9
PEG (x) - y-o-y growth	0.7	(8.5)	1.3	1.1
Price/Book (x)	5.8	5.1	4.3	3.6
Yield (%)	1.7	1.7	2.0	2.0
EV/Net sales (x)	3.0	2.7	2.3	2.0
EV/EBITDA (x)	14.9	14.3	12.3	10.7
EV/EBIT (x)	16.1	16.5	14.0	12.1

PhillipCapital

MindTree (MTCL IN)

Potential turnaround story, under the new management

INDIA | IT Services | Company Update

12 December 2019

Until not so long ago, MTCL was a poster boy for mid-cap companies. Born digital, it had a superior digital portfolio (42% of its revenues) and marquee clients (Microsoft, Unilever, etc.). For three consecutive years through FY14-16, it reported the highest growth in the sector and its valuation multiple remained the highest in the mid-cap space. However, with a change in management, coupled with global uncertainties (Brexit), its fortunes started to dwindle. It lost key personnel to competition, its acquisitions didn't play out as expected, and its margins nosedived as growth receded to single digits. Things seemed to getting better again in FY19, with the company registering strong USD revenue growth of 18.3% (though largely driven by the top-client), – when L&T group made an unexpected 'hostile takeover'; possibly the first hostile takeover in the Indian IT space.

New CEO to provide stability and new parent, business efficiency

Following the acquisition by the L&T group and the exit of promoters from its Board, Debashis Chatterjee was appointed as the CEO & MD. Mr Chatterjee has previously worked with Cognizant for 22 years across various leadership roles (BFSI, managing delivery operations, Next-gen technologies). With the new leadership team and the new parent (L&T group) at its helm, we expect MTCL to become more aggressive in chasing large deals, maintaining greater focus on enhancing business efficiencies, and improving operating margins – leading to a lucrative potential turnaround story. Recent top-management exits have also stemmed, and the company plans to fill up vacated posts through lateral hiring and internal promotions.

Margin recovery is the key to a rerating

MTCL's EBIT margins have fallen sharply from 13-14% in FY18/19to 9.3% in 2QFY20. Even ignoring the 6.4% EBIT margins in 1QFY20 *(dampened by the one-time bonus to employees)*, its gross margins have slipped by almost 250bps yoy (from 36.4% in 2QFY19 to 33.9% in 2QFY20). Key to margin recovery lies in the company being able to recover this drop in gross margins while keeping attrition levels in check. We believe operational efficiencies and regulation of investment programs can yield enough levers for the company to be able to recuperate margins to FY19 levels, latest by Q4FY21.

Top client driving growth

Top clients contributed 20% of revenue from Mindtree in FY19, growing by 42% yoy (38% of incremental revenues). While the revenue contribution and client concentration might be a concern, we note that strong growth for top clients was driven by diversification into different services lines and relevant presence in growth areas of the client. Though the growth rate for the top client may decelerate going ahead, the management is confident of strong growth, given it is still not in the top-three vendors for the client. Also, non top-10 clients have grown strongly over the past six quarters, thus diversifying its growth base.

Strong orderbook provides visibility for growth

Over the last 12 months, MTCL has won deals worth US$ 1.1bn – a book-to-bill of 1.1x. Of this, US$ 561mn (42%) is in digital. While Q1FY20 TCV might appear moderate at +6% yoy, we note that it was despite the uncertainties over the hostile takeover – Q2FY20 dealflow improved to +13% yoy. The management remains confident of the deal pipeline in its focused verticals of Technology & Media and Travel & Hospitality; BFSI and Retail, dented by structural challenges, are seeing moderate demand.

Outlook and valuations – good franchise, but management transition a short-term hiccup

While the company may face a few headwinds for growth over the next 2-3 quarters because of the transition process, we believe the medium to long term outlook remains bright, given the credentials of the new CEO and the L&T parentage. We introduce FY22 estimates and roll forward our valuation to FY22. We value MTCL at 16x FY22 PE. Upgrade to BUY with a target of Rs 910 (Rs 700 earlier).

BUY (Upgrade)

CMP RS 740

TARGET RS 910 (+23%)

SEBI CATEGORY: MIDCAP

COMPANY DATA

O/S SHARES (MN) :	165
MARKET CAP (RSBN) :	124
MARKET CAP (USDBN) :	1.8
52 - WK HI/LO (RS) :	974 / 653
LIQUIDITY 3M (USDMN) :	6.4
PAR VALUE (RS) :	10

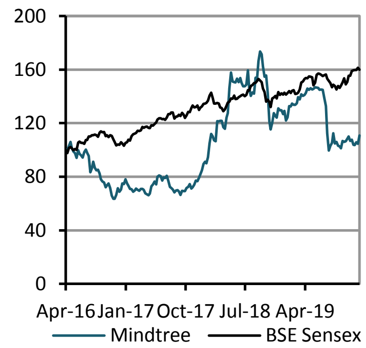
SHARE HOLDING PATTERN, %

	Sep 19	Jun 19	Mar 19
PROMOTERS :	73.8	13.3	13.3
FII / NRI :	11.0	37.2	41.1
FI / MF :	5.2	7.7	9.7
NON PRO :	4.0	5.4	6.9
PUBLIC & OTHERS :	6.1	36.5	29.1

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	9.5	11.2	-10.3
REL TO BSE	9.3	2.8	-25.2

PRICE VS. SENSEX



KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	77,268	86,315	97,189
EBIT	7,417	9,916	11,993
Net Profit	5,736	7,647	9,283
EPS, Rs	35.0	46.7	56.6
PER, x	21.6	16.2	13.3
EV/EBIT, x	16.3	12.1	9.7
P/BV, x	3.9	3.3	2.8
ROE, %	18.0	20.7	21.2

Source: PhillipCapital India Research Est.

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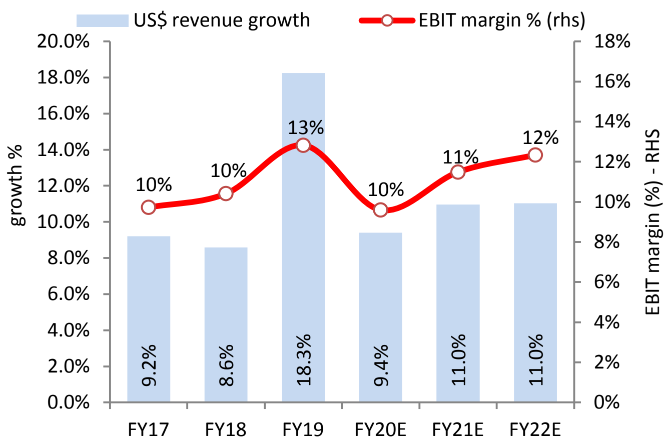
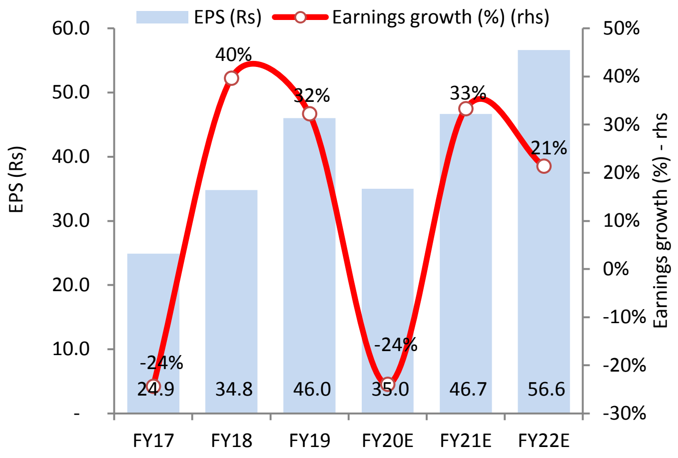
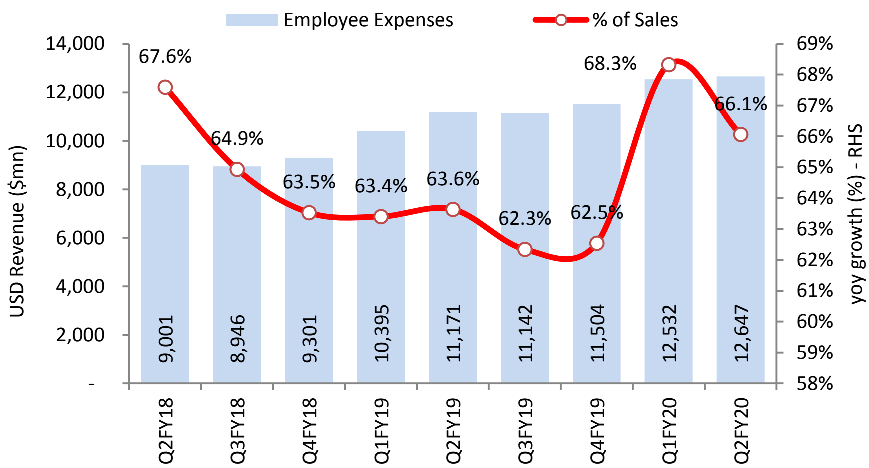
Revenue growth and margins profile



Earnings growth profile

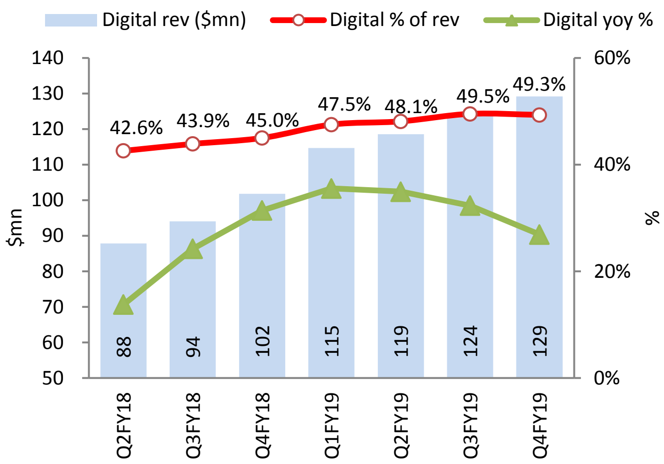


Gross margins have fallen in last two quarters, due to high employee expense

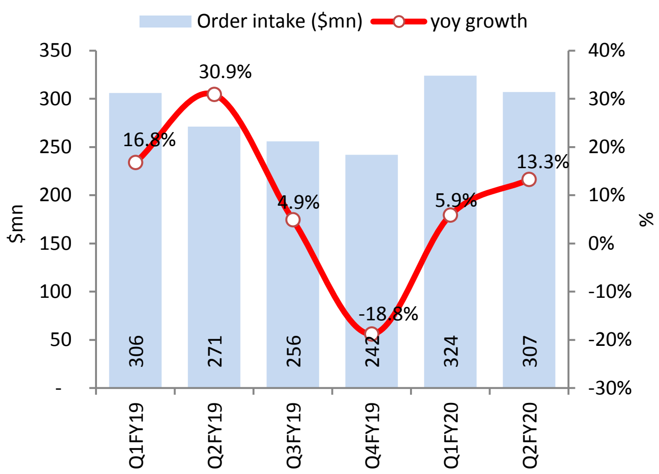


1QFY20 margins were impacted 220bps due to one-time special reward to employees

Digital revenues picking up momentum



Order intake has remained in upward trajectory



MindTree acquired four cutting edge technology firms in 2015-16

Date	Target	Country	Business Description	Consideration ($ mn)	Revenue ($ mn)
Jan '16	Magnet 360	US	Salesforce platform	50	25
Jul '15	Relational Solutions Inc	US	IT solutions - CPG	10	3
Jul '15	Bluefin Solutions	UK	IT solutions, SAP HANA solutions	63.5	48
Jan '15	Discoverture Solutions	US	P&C Insurance	15	14

Source: Company, Phillip Capital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	**70,215**	**77,268**	**86,315**	**97,189**
Growth, %	28.5	10.0	11.7	12.6
Total income	70,215	77,268	86,315	97,189
Employee expenses	-44,212	-50,765	-56,182	-62,467
SG&A	-15,358	-16,297	-17,263	-19,438
EBITDA (Core)	**10,645**	**10,206**	**12,870**	**15,284**
Growth, %	43.8	(4.1)	26.1	18.8
Margin, %	15.2	13.2	14.9	15.7
Depreciation	-1,641	-2,788	-2,954	-3,291
EBIT	**9,004**	**7,417**	**9,916**	**11,993**
Growth, %	58.2	(17.6)	33.7	21.0
Margin, %	12.8	9.6	11.5	12.3
Other Operating expenses	893	797	833	936
Pre-tax profit	**9,868**	**7,670**	**10,196**	**12,377**
Tax provided	-2,327	-1,934	-2,549	-3,094
Profit after tax	**7,541**	**5,736**	**7,647**	**9,283**
Net Profit	**7,541**	**5,736**	**7,647**	**9,283**
Growth, %	32.3	(23.9)	33.3	21.4
Net Profit (adjusted)	**7,541**	**5,736**	**7,647**	**9,283**
Wtd avg shares (m)	164	164	164	164

US$ Revenues

	FY19	FY20E	FY21E	FY22E
US$ Revenue ($ mn)	**1,001**	**1,096**	**1,216**	**1,350**
Growth, %	18.3	9.4	11.0	11.0
Re / US$ (rate)	70.1	70.5	71.0	72.0

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	2,562	2,589	3,518	7,585
Debtors	13,356	14,456	15,973	18,005
Loans & advances	3,326	3,348	3,698	4,167
Other current assets	2,267	2,002	2,212	2,493
Total current assets	21,511	22,395	25,400	32,250
Investments	8,036	6,011	8,011	8,011
Gross fixed assets	9,669	16,177	16,977	17,777
Add: Capital WIP	297	41	41	41
Net fixed assets	9,966	16,218	17,018	17,818
Non-current assets	1,889	1,779	1,966	2,216
Total assets	**41,790**	**46,935**	**52,927**	**60,827**
Current liabilities	7,151	8,167	8,837	9,725
Provisions	1,399	1,697	1,864	2,086
Total current liabilities	8,550	9,864	10,702	11,812
Non-current liabilities	179	5,237	5,237	5,237
Total liabilities	8,729	15,101	15,939	17,049
Paid-up capital	1,642	1,646	1,646	1,646
Reserves & surplus	31,419	30,188	35,342	42,132
Shareholders' equity	33,061	31,834	36,988	43,778
Total equity & liabilities	**41,790**	**46,935**	**52,927**	**60,827**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	9,868	7,670	10,196	12,377
Depreciation	1,641	2,788	2,954	3,291
Chg in working capital	-5,403	5,332	-1,593	-2,145
Total tax paid	-2,216	-1,781	-2,382	-2,872
Cash flow from operating activities	**3,890**	**14,010**	**9,176**	**10,651**
Capital expenditure	-1,947	-9,040	-3,754	-4,091
Chg in investments	-772	2,025	-2,000	0
Cash flow from investing activities	**-2,719**	**-7,015**	**-5,754**	**-4,091**
Free cash flow	1,171	6,994	3,422	6,560
Equity raised/(repaid)	3	4	0	0
Debt raised/(repaid)	-4	-5	0	0
Dividend (incl. tax)	-6,328	-2,301	-2,493	-2,493
Other financing activities	4,431	-4,666	0	0
Cash flow from financing activities	**-1,898**	**-6,968**	**-2,493**	**-2,493**
Net chg in cash	-727	27	929	4,067

Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	46.0	35.0	46.7	56.6
Growth, %	32.3	(23.9)	33.3	21.4
Book NAV/share (INR)	201.7	194.2	225.7	267.1
FDEPS (INR)	46.0	35.0	46.7	56.6
CEPS (INR)	56.0	52.0	64.7	76.7
CFPS (INR)	38.7	79.9	52.0	60.8
DPS (INR)	33.0	12.0	13.0	13.0
Return ratios				
Return on assets (%)	19.1	13.7	16.0	16.9
Return on equity (%)	22.8	18.0	20.7	21.2
Return on capital employed (%)	24.9	17.2	20.1	21.0
Turnover ratios				
Asset turnover (x)	3.4	3.5	3.6	3.7
Sales/Total assets (x)	1.8	1.7	1.7	1.7
Sales/Net FA (x)	7.2	5.9	5.2	5.6
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	69.4	68.3	67.5	67.6
Payable days	13.1	13.3	13.4	13.4
Working capital days	54.1	47.0	47.3	48.3
Liquidity ratios				
Current ratio (x)	2.5	2.3	2.4	2.7
Quick ratio (x)	2.5	2.3	2.4	2.7
Dividend cover (x)	1.4	2.9	3.6	4.4
Total debt/Equity (%)	0.0	-	-	-
Net debt/Equity (%)	(7.7)	(8.1)	(9.5)	(17.3)
Valuation				
PER (x)	16.4	21.6	16.2	13.3
PEG (x) - y-o-y growth	0.5	(0.9)	0.5	0.6
Price/Book (x)	3.7	3.9	3.3	2.8
Yield (%)	4.4	1.6	1.7	1.7
EV/Net sales (x)	1.7	1.6	1.4	1.2
EV/EBITDA (x)	11.4	11.9	9.3	7.6
EV/EBIT (x)	13.5	16.3	12.1	9.7

L&T Technology Services (LTTS IN)

Engineering in the DNA; Valuations getting attractive

INDIA | IT SERVICES | Company Update

12 December 2019

LTTS has reported strong performance in FY18/19, – outperforming peers with 20%/25% yoy growth in US revenues. While it started FY20 with a guidance of 14-16% USD growth (and has reported 13% yoy growth in 1HFY20), persistent weakness in telecom/hi-tech (due to global trade concerns) has led to the management cutting its guidance twice – to the current 10-12% growth. All along, the dealflow and performance in other segments remains strong. We do not see any cascading effect of the expected weak performance of 2HFY20 and expect the company to revert to its strong growth path in FY21. The growth will be driven by strong deal-flow and continued strength in Transport & Plant design. With time correction (-2% returns in the last 12 months), the stock is no longer expensive, and presents an attractive risk-reward profile. We upgrade to BUY.

Telecom & Hi-tech have remained volatile; Transport remains strong

Telecom & Hi-tech (20% of revenue) has remained volatile for LTTS due to macro (highly competitive domain, global uncertainties) and micro (ramp-down by key clients) reasons. While in FY18, the segment saw a strong recovery (+66% yoy), driven by large deal wins and acquisition of Esencia, the segment has declined by -12% yoy in 1HFY20. The managements continues to expect a weak 2HFY20 for the segment. We expect 3QFY20 to the bottom for the segment, with pick-up in deal activity and low-base driving growth in FY21.

On the other hand, LTTS continues to see strong traction in Transport (35% of revenue), CQGR of 6% over last eight quarters. The management remains highly optimistic about the domain, though near term bumps might be seen amidst global trade war and dwindling auto sales across the globe.

Plant Engineering recovered in FY19

Plant Engineering is a segment that involves part/complete design of plants for various chemicals, FMCG, and petroleum companies. LTTS has a competitive advantage in this domain and has been able to make inroads into many clients (Shell, Unilever, P&G) because of its parent company L&T. The segment had remained muted over FY17-18, due to lower incremental capex by clients in E&U and retail segments. With crude prices now inching up, and retail companies looking to expand capacity, the segment is already witnessing a revival (FY19/1HFY20 growth of 38%/29% yoy).

IP monetization to aide margin

LTTS is betting big on monetization of its IPs. It is looking to develop plug-and-play solutions for various industries, and monetize them to implement the 'develop once deploy multiple' strategy. It has developed various IP platforms like UBIQWeise, WAGES, and I-BEMS. In fact, one of its Israel-based clients recently launched the "Smartest Office in the World" project – which is being run on LTTS' smart campus platform i-BEMS. The company intends to increase the higher-margin IP revenue. Any traction in IP business can lead to significant margin expansion (US$ 1mn of incremental IP revenue results in 80bps margin expansion).

Potential candidate for M&A activity

We see LTTS as a potential M&A candidate, though more as an acquirer. We believe if LTTS continues to do well, and Cyient continues to struggle, LTTS' management wouldn't be shy of exploring M&A opportunities with Cyient – given Cyient's strong clientele (especially in aerospace) and L&S management track record (recent Mindtree acquisition).

Outlook and valuations

We expect revenue CAGR of 12% over FY19-22 — one of the highest in our coverage universe. We continue to like companies in the ERD space, – especially LTTS, with its diversified profile and strong credentials. With time correction, the valuations that once appeared expensive are now getting into the attractive range. We introduce FY22 estimates and roll forward our valuation to FY22. We value LTTS at 18x FY22 PE. Upgrade to BUY with target of Rs 1,760 (Rs 1,530 earlier).

BUY (Upgrade)
CMP RS 1475
TARGET RS 1760 (+19%)

SEBI CATEGORY: MIDCAP

COMPANY DATA

O/S SHARES (MN) :	104
MARKET CAP (RSBN) :	156
MARKET CAP (USDBN) :	2.2
52 - WK HI/LO (RS) :	1818 / 1396
LIQUIDITY 3M (USDMN) :	2.7
PAR VALUE (RS) :	10

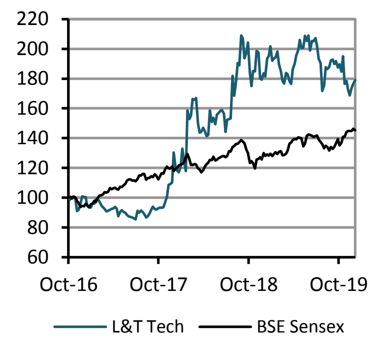
SHARE HOLDING PATTERN, %

	Sep 19	Jun 19	Mar 19
PROMOTERS :	75.0	75.0	78.9
FII / NRI :	9.8	9.4	5.1
FI / MF :	3.9	3.9	4.4
NON PRO :	3.6	2.4	3.2
PUBLIC & OTHERS :	7.7	9.4	8.4

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	3.4	-7.6	-3.6
REL TO BSE	3.3	-16.0	-18.5

PRICE VS. SENSEX



KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	56,122	63,203	72,433
EBIT	9,362	10,419	12,049
Net Profit	8,143	8,954	10,183
EPS, Rs	78.3	86.1	97.9
PER, x	19.1	17.4	15.3
EV/EBIT, x	16.6	14.8	12.5
P/BV, x	5.4	4.5	3.7
ROE, %	28.5	25.9	24.0

Source: PhillipCapital India Research Est.

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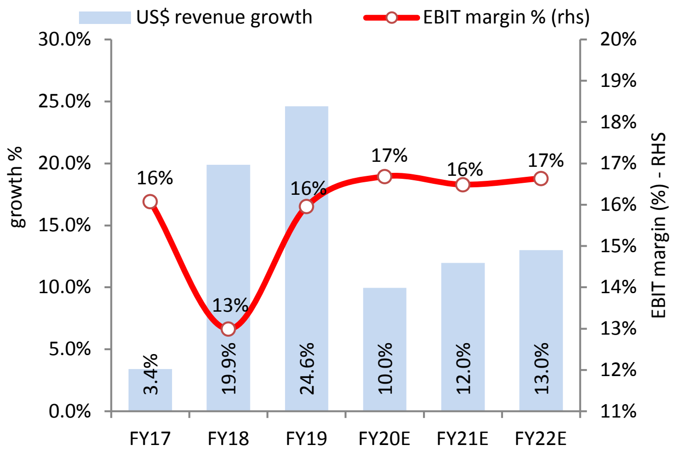
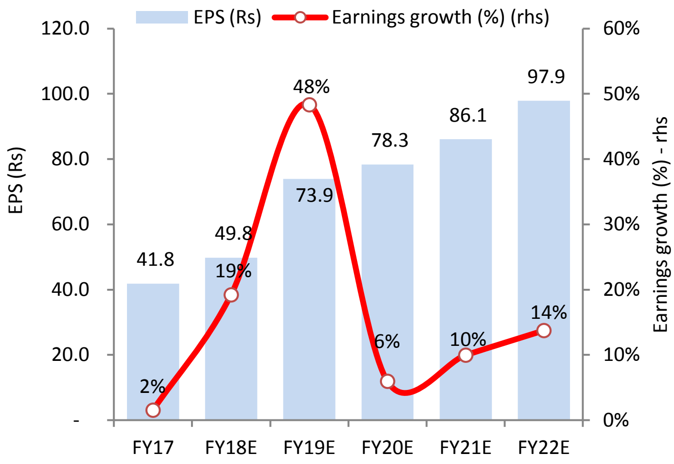
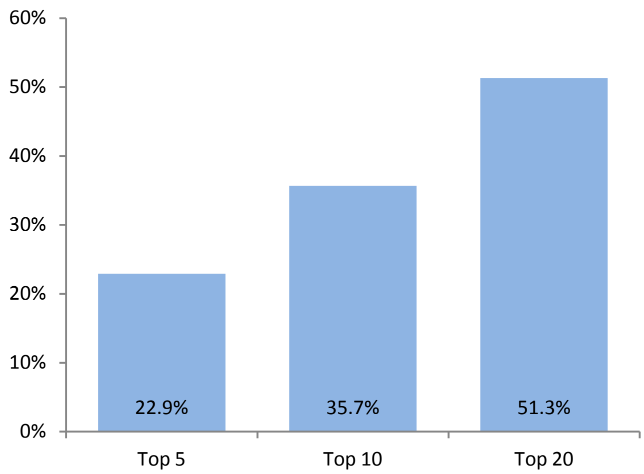
Revenue growth and Margins profile



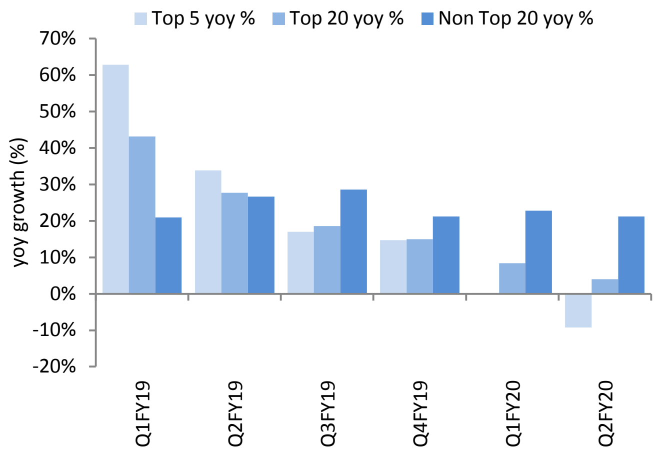
Earnings growth profile



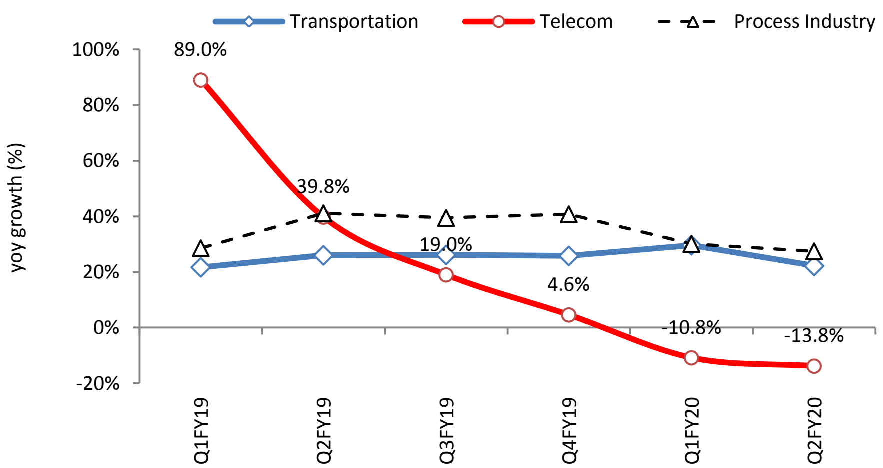
Client concentration remains high for LTTS....



..... But Non-Top 20 clients have also been growing



Vertical growth rate (yoy) over last few quarters



LTTS has deployed a focussed acquisition strategy

Time	Company	Remarks	Consideration
Sep '18	Graphene Semi-conductor	ASIC/VSIC and Embedded software segment	$14 mn
May '17	Esencia Technologies (US)	Embedded Systems and Perceptual Computing	$27 mn
Nov '14	Dell USA	Engineering Services Division	$12.2mn
July '14	Dell India	Engineering Services Division	Rs 13.6mn
Jun '14	Thales Software India Pvt Ltd	74% of stake	Rs 60.4mn

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	**50,783**	**56,122**	**63,203**	**72,433**
Growth, %	36	11	13	15
Total income	50,783	56,122	63,203	72,433
Employee expenses	-35,165	-37,875	-42,804	-48,718
Other Operating expenses	-6,472	-7,121	-8,153	-9,778
EBITDA (Core)	**9,146**	**11,125**	**12,246**	**13,937**
Growth, %	58.9	21.6	10.1	13.8
Margin, %	18.0	19.8	19.4	19.2
Depreciation	-1,042	-1,763	-1,827	-1,888
EBIT	**8,104**	**9,362**	**10,419**	**12,049**
Growth, %	66.5	15.5	11.3	15.6
Margin, %	16.0	16.7	16.5	16.6
Interest paid	0	0	0	0
Other Income	1,277	1,044	1,121	1,352
Pre-tax profit	**10,315**	**10,999**	**12,100**	**13,761**
Tax provided	-2,630	-2,857	-3,146	-3,578
Profit after tax	**7,685**	**8,143**	**8,954**	**10,183**
Others (Minorities, Associates)	0	0	0	0
Net Profit	**7,685**	**8,143**	**8,954**	**10,183**
Growth, %	51.7	6.0	10.0	13.7
Net Profit (adjusted)	**7,685**	**8,143**	**8,954**	**10,183**
Wtd avg shares (m)	104	104	104	104

	FY19	FY20E	FY21E	FY22E
US$ Revenue ($ mn)	**723**	**795**	**890**	**1,006**
Growth, %	24.6	10.0	12.0	13.0
Re / US$ (rate)	70.2	70.6	71.0	72.0

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	2,051	3,164	4,589	8,680
Debtors	10,643	11,944	12,659	14,519
Loans & advances	3,783	4,452	5,202	5,318
Other current assets	0	0	0	0
Total current assets	16,477	19,559	22,450	28,517
Investments	5,749	6,471	8,471	10,071
Net fixed assets	7,800	11,819	12,219	12,619
Non-current assets	3,486	3,185	3,978	4,148
Total assets	**33,638**	**41,034**	**47,118**	**55,355**
Current liabilities	7,285	10,982	11,288	11,527
Provisions	1,341	1,453	1,320	1,325
Total current liabilities	8,626	12,436	12,608	12,852
Non-current liabilities	190	0	0	0
Total liabilities	8,816	12,436	12,608	12,852
Paid-up capital	208	208	208	208
Reserves & surplus	24,614	28,390	34,302	42,295
Shareholders' equity	24,822	28,598	34,510	42,503
Total equity & liabilities	**33,638**	**41,034**	**47,118**	**55,355**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	10,315	10,999	12,100	13,761
Depreciation	1,042	1,763	1,827	1,888
Chg in working capital	-833	2,141	-2,087	-1,902
Total tax paid	-2,496	-2,921	-3,146	-3,578
Cash flow from operating activities	**8,028**	**11,983**	**8,694**	**10,169**
Capital expenditure	-1,747	-5,782	-2,227	-2,288
Chg in investments	-3,542	-722	-2,000	-1,600
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	**-5,289**	**-6,504**	**-4,227**	**-3,888**
Free cash flow	2,739	5,479	4,467	6,281
Equity raised/(repaid)	3	0	0	0
Debt raised/(repaid)	0	0	0	0
Dividend (incl. tax)	-2,248	-2,738	-3,042	-2,190
Other financing activities	15	-1,628	0	0
Cash flow from financing activities	**-2,230**	**-4,366**	**-3,042**	**-2,190**
Net chg in cash	509	1,113	1,425	4,091

Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	73.9	78.3	86.1	97.9
Growth, %	48.3	6.0	10.0	13.7
Book NAV/share (INR)	238.7	275.0	331.8	408.7
CEPS (INR)	83.9	95.2	103.7	116.1
CFPS (INR)	50.0	104.8	79.8	85.8
DPS (INR)	18.5	22.5	25.0	18.0
Return ratios				
Return on assets (%)	25.3	21.8	20.3	19.9
Return on equity (%)	31.0	28.5	25.9	24.0
Return on capital employed (%)	32.6	28.9	27.2	25.6
Turnover ratios				
Asset turnover (x)	3.0	2.9	3.0	3.1
Sales/Total assets (x)	1.7	1.5	1.4	1.4
Sales/Net FA (x)	6.8	5.7	5.3	5.8
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	76.5	77.7	73.1	73.2
Payable days	16.5	17.7	17.7	18.9
Working capital days	51.3	35.2	38.0	41.9
Liquidity ratios				
Current ratio (x)	2.3	1.8	2.0	2.5
Quick ratio (x)	2.3	1.8	2.0	2.5
Interest cover (x)				
Dividend cover (x)	4.0	3.5	3.4	5.4
Total debt/Equity (%)	13.9	11.2	9.4	7.8
Net debt/Equity (%)	5.6	0.1	(3.9)	(12.6)
Valuation				
PER (x)	20.2	19.1	17.4	15.3
PEG (x) - y-o-y growth	0.4	3.2	1.7	1.1
Price/Book (x)	6.3	5.4	4.5	3.7
Yield (%)	1.2	1.5	1.7	1.2
EV/Net sales (x)	3.1	2.8	2.4	2.1
EV/EBITDA (x)	17.2	14.0	12.6	10.8
EV/EBIT (x)	19.4	16.6	14.8	12.5

INSTITUTIONAL EQUITY RESEARCH

Cyient Limited (CYL IN)

THE most lucrative acquisition target ...

INDIA | IT SERVICES | Company Update

12 December 2019

Cyient's stock price has corrected ~35% over the last one year on its below-par performance in four of the last six quarters. All operating parameters – revenue, margins, profitability, geographies, verticals and top 5/10 clients have deteriorated over the last few quarters because of client/company-specific issues. The stock now trades at 10x FY21 EPS, a significant discount to all its peers and also at its lowest multiple since the 2008 financial crisis. While we had downgraded the stock following dismal performance in Q1, the sharp correction after Q2 results and our thesis of Cyient being a good acquisition target makes us turn positive again. We upgrade it to BUY.

Domain expertise in aerospace, but struggling off late

Cyient generates 35% of its revenues from aerospace, with clients like P&W, Boeing, Airbus, and Bombardier. While its long-standing relationships and niche capabilities in Aerospace helped it to report double-digit revenue growth until FY17, it could not sustain this afterwards due to restructuring at a top client, client-specific issues with other top clients, and macro uncertainties. We expect the slowdown in its top client to continue in the short term, before any meaningful recovery takes place.

Muted order intake indicates a subdued FY20

In the last few quarters, order intake has remained muted because of reduced spending by a large client and offshore shift by few of other clients. Order intake for Q2FY20 was US$ 165mn (+7% qoq, -16% yoy) – the second lowest in the last eight quarters (Q1 was the lowest). With below-par performance and muted order intake, the management refrained from giving any revenue guidance for FY20 *('high-single digit' growth in services earlier)*.

Margins to recover to FY18/19 levels by FY22

Cyient's EBIT margin fell to 10.5%-11.5% over FY16-19 (from an average 14% over FY21-15), largely due to client-specific issues and lower margin in DLM. In 1HFY20, the 'cost optimization' exercise and decline in IT services business led to margins dropping further to 9.4%. The exercise will continue through FY20, and yield 'net positive' results only by Q1FY21. Even disregarding any significant benefits from the exercise (highly unlikely), margins should expand by 80-100bps yoy in FY21. We expect +70bps/+50bps margin expansion in FY21/22 – taking FY22 EBIT margins back to FY18/19 levels of 11.3%.

Perfect candidate for acquisition; we expect this outcome soon

Strong client relationships, struggling business, low promoter stake and inexpensive valuations – make for THE PERFECT combination of an acquisition target. Cyient has strong relationships (esp. in Aerospace/Transport segment) and could really benefit companies like LTTS or HCL Tech. Low promoter holding (22%) and inexpensive valuations (10x FY21 PE) make it a highly attractive acquisition target. We believe we could see Cyient being acquired as early as next 12 months by a leading ERD player or a PE player – making it an attractive bet to play the 'event'.

Outlook and valuations

After a disappointing performance in 1HFY20, the company is highly likely to report USD revenue decline in services; growth in DLM might keep the consolidated revenue flat yoy. We expect revenue/earnings CAGR of 5%/4% over FY19-22 – hardly impressive. However, at 9x FY21 PE, all negatives appear to be priced in.

Organically, Cyient continues to face challenges, and would keep underperforming its peers in the near to medium term. However, the possibility of it being acquired opens up an 'event-based' opportunity, which could lead to decent value creation. We upgrade to BUY, ONLY on this event-based opportunity.

We introduce FY22 estimates and roll forward our valuation to FY22. We value Cyient at 10x FY22 PE. Price target of Rs 490 (Rs 420 earlier). Upgrade to BUY.

BUY (Upgrade)

CMP RS 391

TARGET RS 490 (+25%)

SEBI CATEGORY: SMALL CAP

COMPANY DATA

O/S SHARES (MN) :	110
MARKET CAP (RSBN) :	43
MARKET CAP (USDBN) :	0.6
52 - WK HI/LO (RS) :	692 / 380
LIQUIDITY 3M (USDMN) :	0.9
PAR VALUE (RS) :	5

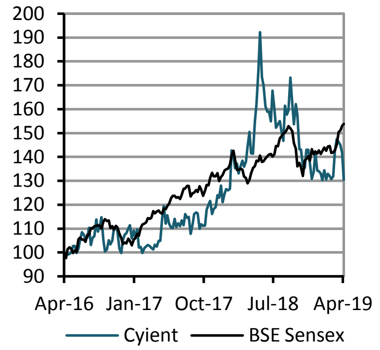
SHARE HOLDING PATTERN, %

	Sep 19	Jun 19	Mar 19
PROMOTERS :	22.8	22.7	22.5
FII / NRI :	46.8	48.3	45.9
FI / MF :	19.0	18.8	20.5
NON PRO :	4.4	4.4	4.5
PUBLIC & OTHERS :	7.1	7.2	6.7

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-2.2	-13.5	-36.9
REL TO BSE	-2.4	-21.9	-51.9

PRICE VS. SENSEX



KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	46,561	50,616	55,064
EBIT	4,688	5,450	6,206
Net Profit	4,380	4,708	5,441
EPS, Rs	39.8	42.8	49.5
PER, x	9.7	9.0	7.8
EV/EBIT, x	8.4	7.0	5.8
P/BV, x	1.5	1.4	1.2
ROE, %	15.9	15.4	15.7

Source: PhillipCapital India Research Est.

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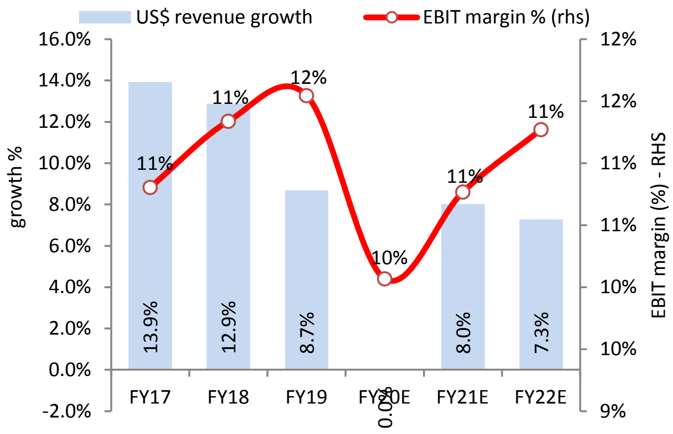
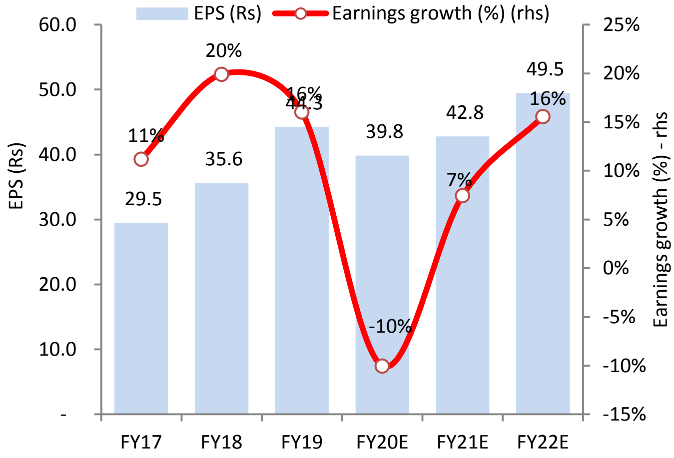
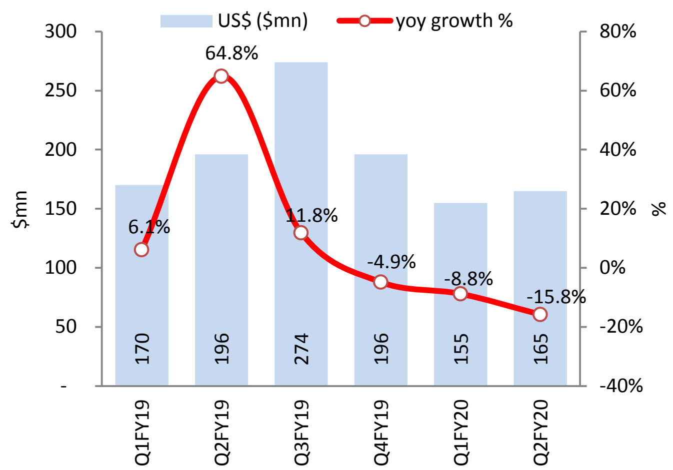
Revenue growth and margins profile



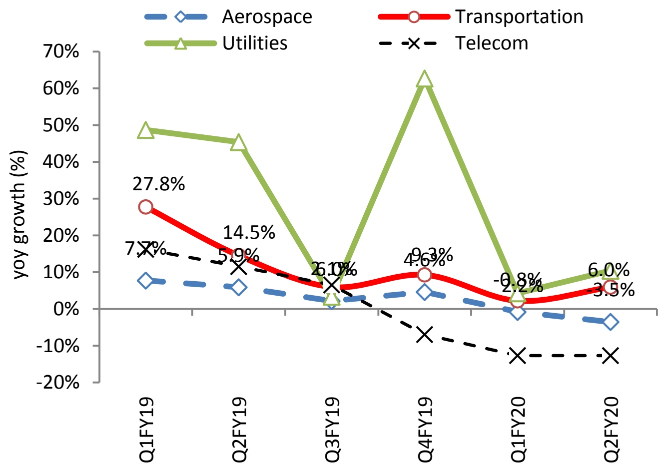
Earnings growth profile



Order intake has remained volatile in the recent times



Verticals performance over last few quarters



Source: Company, PhillipCapital India Research Estimates

DLM's financial performance has revived, esp on the margins front

DLM	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	FY18	FY19
Revenue ($mn)	**11.8**	**15.8**	**12.1**	**22.0**	**18.0**	**22.9**	**20.6**	**18.2**	**18.7**	**61.8**	**79.7**
% Growth qoq	-26.2%	33.7%	-23.3%	81.2%	-17.9%	27.0%	-10.2%	-11.4%	2.4%	13.5%	29.1%
Revenue	763	1,017	785	1,418	1,212	1,610	1,479	1,282	1,297	3,983	5,583
Gross Profit	42	97	95	188	150	180	180	146	108	422	656
Gross Profit Margin (%)	5.5%	9.5%	12.1%	13.3%	12.4%	11.2%	12.2%	11.4%	8.3%	10.6%	11.7%
EBITDA	-53	8	9	98	55	59	58	52	25	62	224
EBITDA Margin (%)	-6.9%	0.8%	1.1%	6.9%	4.5%	3.7%	3.9%	4.1%	1.9%	1.6%	4.0%
PBT	-92	(37)	(23)	48	14	14	9	(6)	(22)	(104)	31
PBT Margin (%)	-12.1%	-3.6%	-2.9%	3.4%	1.2%	0.9%	0.6%	-0.5%	-1.7%	-2.6%	0.6%

Source: Company, PhillipCapital India Research

Acquisition has remained the growth driver for Cyient

Year	Acquired company	Country	Acquisition Price	Revenue	Valuation (x)	Margin
2015	Invati Insights.	India (Hyderabad)	NA	$1mn	NA	NA
2015	Softential	USA	$19mn	$ 17 mn	0.9	25-30%
2015	Rangsons Electronics	India (Mysore)	$50mn	$66mn	0.8	2-4%
2016	Global Services Engineering Asia	Singapore	$6mn	$12mn	0.5	12-14%
2016	Blom Aerofilms	UK	NA	$10mn	NA	10%
2017	Certon Software	US	$8mn	$7mn	1.1	Low double digit
2017	B&F Design	US	NA	$8-9mn	NA	NA
2018	AnSem N.V.	Europe	$17mn	$10mn	1.7	20%+

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	**46,175**	**46,561**	**50,616**	**55,064**
Growth, %	18	1	9	9
Employee expenses	-24,052	-24,129	-25,533	-27,720
Other Operating expenses	-15,679	-15,884	-17,603	-18,978
EBITDA (Core)	**6,444**	**6,548**	**7,480**	**8,365**
Growth, %	17.3	1.6	14.2	11.8
Margin, %	14.0	14.1	14.8	15.2
Depreciation	-1,113	-1,860	-2,029	-2,159
EBIT	**5,331**	**4,688**	**5,450**	**6,206**
Growth, %	20.0	(12.1)	16.3	13.9
Margin, %	11.5	10.1	10.8	11.3
Interest paid	-362	-585	-628	-583
Other Income	1,340	1,581	1,331	1,489
Pre-tax profit	**6,309**	**5,684**	**6,154**	**7,113**
Tax provided	-1,427	-1,305	-1,446	-1,671
Exceptional item	0	0	0	0
Profit after tax	**4,882**	**4,378**	**4,708**	**5,441**
Others (Minorities, Associates)	4	2	0	0
Net Profit	**4,886**	**4,380**	**4,708**	**5,441**
Growth, %	13.9	(10.4)	7.5	15.6
Net Profit (adjusted)	**4,886**	**4,380**	**4,708**	**5,441**
Wtd avg shares (m)	110	110	110	110

	FY19	FY20E	FY21E	FY22E
US$ Revenue ($ mn)	**660**	**660**	**713**	**765**
Growth, %	8.7	0.0	8.0	7.3
Re / US$ (rate)	70.0	70.5	71.0	72.0

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	9,705	8,718	9,562	11,613
Debtors	8,137	9,397	9,946	10,839
Inventory	1,833	2,014	2,131	2,323
Other current assets	5,900	5,369	5,683	6,193
Total current assets	25,575	25,497	27,323	30,967
Investments	545	1,360	2,160	2,160
Net fixed assets	10,820	14,284	14,884	15,484
Non-current assets	1,658	2,014	2,131	2,323
Total assets	**38,892**	**43,581**	**46,924**	**51,360**
Current liabilities	9,182	10,235	10,701	11,457
Provisions	1,870	1,998	2,112	2,295
Total current liabilities	11,052	12,233	12,813	13,752
Non-current liabilities	2,218	3,857	3,457	3,057
Total liabilities	13,270	16,090	16,270	16,809
Paid-up capital	552	550	550	550
Reserves & surplus	25,070	26,941	30,104	34,001
Shareholders' equity	25,622	27,491	30,654	34,551
Total equity & liabilities	**38,892**	**43,581**	**46,924**	**51,360**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	6,309	5,684	6,154	7,113
Depreciation	1,113	1,860	2,029	2,159
Chg in working capital	-1,715	-85	-519	-846
Total tax paid	-1,351	-1,515	-1,446	-1,671
Cash flow from operating activities	**4,356**	**5,944**	**6,218**	**6,754**
Capital expenditure	-3,443	-5,324	-2,629	-2,759
Chg in investments	883	-815	-800	0
Cash flow from investing activities	**-2,560**	**-6,139**	**-3,429**	**-2,759**
Free cash flow	1,796	-195	2,789	3,995
Equity raised/(repaid)	-11	-2	0	0
Debt raised/(repaid)	804	1,717	-400	-400
Dividend (incl. tax)	-1,952	-1,544	-1,544	-1,544
Other financing activities	-743	-965	0	0
Cash flow from financing activities	**-1,898**	**-792**	**-1,944**	**-1,944**
Net chg in cash	-102	-987	844	2,051

Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	44.3	39.8	42.8	49.5
Growth, %	16.0	(10.0)	7.5	15.6
Book NAV/share (INR)	232.1	249.9	278.7	314.1
CFPS (INR)	23.2	41.7	45.5	49.6
DPS (INR)	15.1	12.0	12.0	12.0
Return ratios				
Return on assets (%)	13.9	11.5	11.2	11.8
Return on equity (%)	19.1	15.9	15.4	15.7
Return on capital employed (%)	18.2	15.0	14.6	15.2
Turnover ratios				
Asset turnover (x)	2.7	2.2	2.1	2.2
Sales/Total assets (x)	1.3	1.1	1.1	1.1
Sales/Net FA (x)	4.8	3.7	3.5	3.6
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	64.3	73.7	71.7	71.8
Inventory days	14.5	15.8	15.4	15.4
Payable days	34.1	39.1	38.4	38.7
Working capital days	52.9	51.3	50.9	52.4
Liquidity ratios				
Current ratio (x)	2.8	2.5	2.6	2.7
Quick ratio (x)	2.6	2.3	2.4	2.5
Interest cover (x)	14.7	8.0	8.7	10.7
Dividend cover (x)	2.9	3.3	3.6	4.1
Total debt/Equity (%)	15.4	21.1	17.6	14.5
Net debt/Equity (%)	(24.6)	(15.5)	(20.6)	(25.4)
Valuation				
PER (x)	8.7	9.7	9.0	7.8
PEG (x) - y-o-y growth	0.5	(1.0)	1.2	0.5
Price/Book (x)	1.7	1.5	1.4	1.2
Yield (%)	3.9	3.1	3.1	3.1
EV/Net sales (x)	0.8	0.8	0.8	0.7
EV/EBITDA (x)	5.7	6.0	5.1	4.3
EV/EBIT (x)	6.9	8.4	7.0	5.8

PhillipCapital

NIIT Technologies (NITEC IN)

Business doing well; valuations expensive

INDIA | IT SERVICES | Company Update

12 December 2019

Promoters exit; management denies any merger with Hexaware, at least for two years

Just like Mindtree, NIIT Tech also witnessed its promoters exiting the business recently – though in a much less dramatic way. In April 2019, Baring Private Equity Asia (BPEA) announced the acquisition of promoters' stake (30.2% stake) in NIIT Tech at a price of Rs 1,394/share. Thereafter, it increased its stake to 70.7% following the mandatory open offer and share purchase from the secondary market.

BPEA is also the promoter of Hexaware (63% stake) which operates in similar segments as NITEC. However, as part of the deal, BPEA will not merge the two companies (NITEC and Hexaware) at least for the next two years. Also, BPEA intends to continue with the same management team of NITEC.

Ownership by BPEA has the potential to enhance margins/cashflow/payout/ROE

Going by the precedent of Hexaware, NITEC might witness a focus on improving its operational margins, with a simultaneous bump in cashflow generation and distribution – leading to improvement in its ROE. BPEA is a PE company, and would focus on generating returns from the acquisition. However, these changes/benefits might only realize over the medium-long term – the short term story will continue to be driven by the core business.

Basic framework in place; efforts have started yielding results

NITEC has significantly rationalised its portfolio over the last three years, exiting the low-margin government business and focussing on the high-margin onsite business. It has executed its four-pronged strategy to perfection: cross-selling IMS, expanding the BFSI business in US, securing a leadership position in the transport vertical, and reducing the low-margin government business. Over FY14-19, IMS has grown by 63%, US' contribution has increased to 50% from 37%, and government business contribution reduced to 1% from 11%. Rationalisation is now complete and the current order book of US$ 395mn largely consists of high-margin business.

The orderbook has grown considerably in the last two years; Digital gaining traction

Over the last couple of years, the company has improved its sales effort considerably. It signed 14 large deals in FY19. Fresh order bookings in FY19 alone stood at US$ 646mn (US$ 507mn in FY18). The improved deal flow has resulted in a total orderbook (executable over the next twelve months) of US$ 4050mn – the highest in its history.

At the same time, NITEC's digital revenue is now 38% of its total (vs. 28% in FY19), registering a CQGR of 10% over the last six quarters. To report yoy growth of 50% yoy (1HFY20), on a relatively large base of digital revenues of US$ 70mn is commendable, and places NITEC in a strong position.

Subsidiaries' performance stabilizing

Over the last two years, NITEC's subsidiaries' revenue and margin performance has improved considerably. This has now stabilized in the last few quarters, largely due to the steps taken by the management in improving financial stability. Barring Morris (which was acquired by GateHouse Media in Oct 2017), all other subsidiaries have reported strong performance in FY19. The company has also divested its stake in its subsidiary ESRI India (GIS business) while it acquired a Digital Consulting firm Whishworks IT Consulting in April 2019.

Outlook and valuations – turnaround story playing out as expected

NIIT Tech's stock has risen almost 30% YTD, driven by a change in promoters and improved financial performance. Currently, the stock trades at 16.5x FY21 P/E – at a premium to the mid-cap average – expensive, in our opinion. We introduce FY22 estimates and roll forward our valuation to FY22. Maintain NEUTRAL – with the growth story intact, but valuations are capturing the same to a large extent. We value NITEC at 15x FY22 PE. Our price target is Rs 1,550 *(Rs 1,400 earlier).*

NEUTRAL (Maintain)

CMP RS 1455

TARGET RS 1550 (+7%)

SEBI CATEGORY: SMALL CAP

COMPANY DATA

O/S SHARES (MN) :	62
MARKET CAP (RSBN) :	93
MARKET CAP (USDBN) :	1.3
52 - WK HI/LO (RS) :	1596 / 1031
LIQUIDITY 3M (USDMN) :	11.2
PAR VALUE (RS) :	10

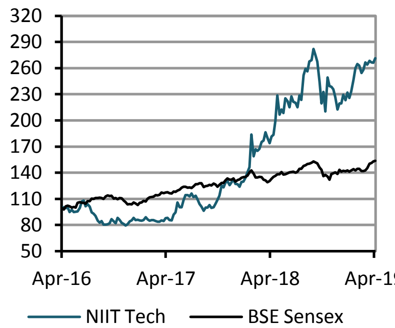
SHARE HOLDING PATTERN, %

	Sep 19	Jun 19	Mar 19
PROMOTERS :	70.0	33.9	30.5
FII / NRI :	15.2	37.1	41.7
FI / MF :	5.9	15.7	15.1
NON PRO :	4.1	7.3	6.8
PUBLIC & OTHERS :	4.7	6.0	5.9

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-5.5	4.7	34.2
REL TO BSE	-5.6	-3.7	19.2

PRICE VS. SENSEX



KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	41,954	47,399	53,822
EBIT	5,759	7,031	8,137
Net Profit	4,592	5,437	6,314
EPS, Rs	75.0	88.8	103.2
PER, x	19.8	16.7	14.4
EV/EBIT, x	14.0	10.8	8.5
P/BV, x	3.7	3.1	2.7
ROE, %	18.7	18.8	18.5

Source: PhillipCapital India Research Est.

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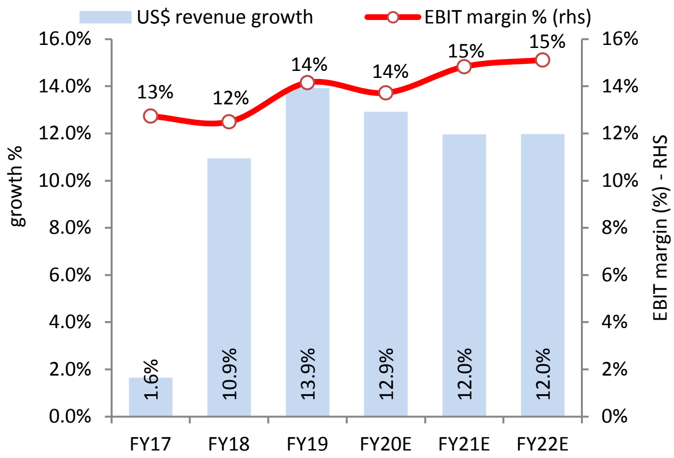
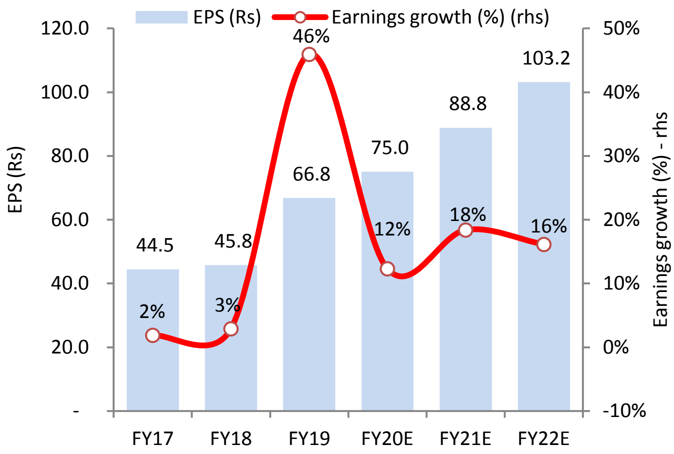
Revenue growth and margins profile

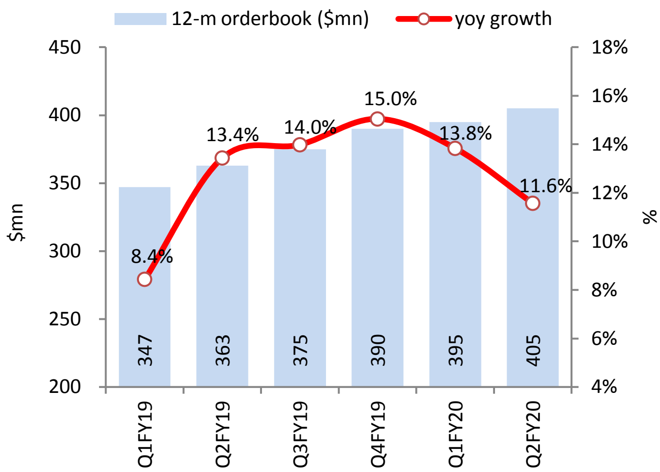


Earnings growth profile

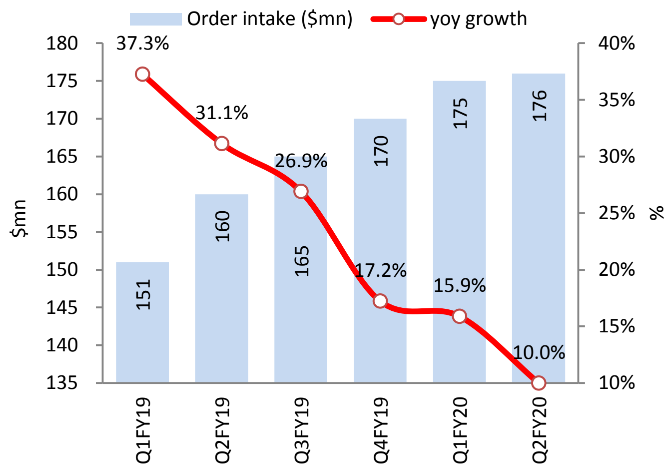


Source: Company, Phillip Capital India Research

Continuous growth in the 12-months orderbook ...

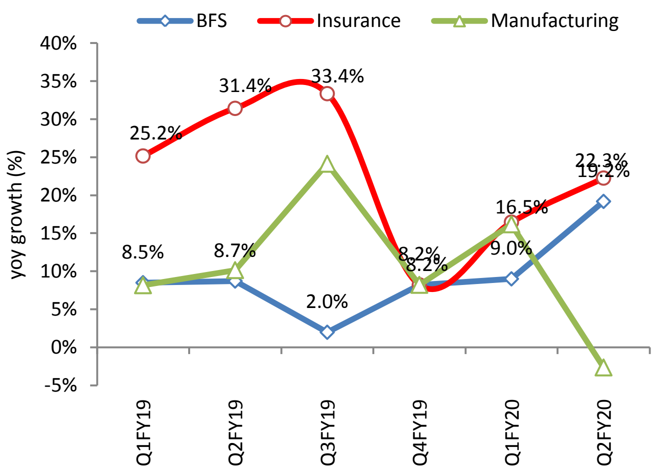


... with deceleration in order intake (base increasing)

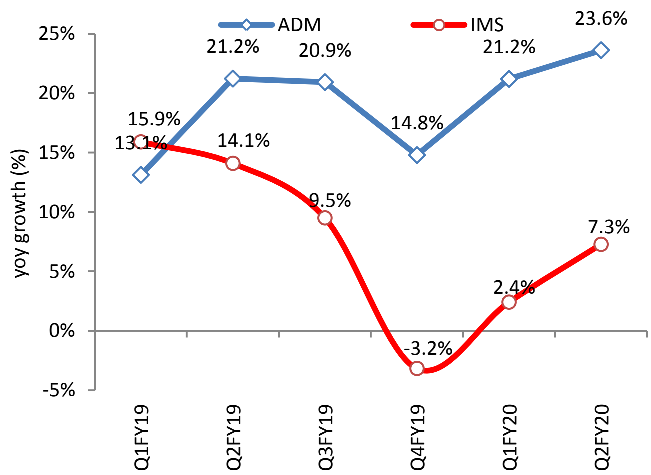


Source: Company, Phillip Capital India Research

Vertical growth rate (yoy) over last few quarters



Horizontal growth rate (yoy) over last few quarters



Source: Company, Phillip Capital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	**36,762**	**41,954**	**47,399**	**53,822**
Growth, %	22.9	14.1	13.0	13.6
Employee expenses	-23,907	-27,498	-31,055	-34,884
Other Operating expenses	-6,402	-7,045	-7,571	-9,035
EBITDA (Core)	**6,453**	**7,411**	**8,773**	**9,903**
Growth, %	28.8	14.9	18.4	12.9
Margin, %	17.6	17.7	18.5	18.4
Depreciation	-1,248	-1,653	-1,741	-1,766
EBIT	**5,205**	**5,759**	**7,031**	**8,137**
Growth, %	39.2	10.6	22.1	15.7
Margin, %	14.2	13.7	14.8	15.1
Interest paid	0	0	0	0
Other Non-Operating Income	476	486	468	572
Exceptional Item	-56	57	0	0
Pre-tax profit	**5,625**	**6,302**	**7,499**	**8,709**
Tax provided	-1,404	-1,448	-1,800	-2,090
Profit after tax	**4,221**	**4,854**	**5,699**	**6,619**
Others (Minorities, Associates)	-188	-204	-262	-304
Net Profit	**4,033**	**4,649**	**5,437**	**6,314**
Growth, %	45.9	12.3	18.4	16.1
Net Profit (adjusted)	**4,089**	**4,592**	**5,437**	**6,314**
Wtd avg shares (m)	61	61	61	61

US$ Revenues

	FY19	FY20E	FY21E	FY22E
US$ Revenue ($ mn)	**528**	**596**	**668**	**748**
Growth, %	13.9	12.9	12.0	12.0
Re / US$ (rate)	69.6	70.4	71.0	72.0

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	9,695	10,373	14,962	21,688
Marketable securities at cost	0	0	0	0
Debtors	6,189	7,471	8,441	9,585
Inventory	52	52	52	52
Other current assets	1,282	920	905	879
Total current assets	19,312	21,293	27,299	35,697
Investments	2,301	2,301	2,301	2,301
Net fixed assets	3,646	7,094	6,553	4,787
Non-current assets	0	0	0	0
Total assets	**26,385**	**31,853**	**37,317**	**43,949**
Total current liabilities	5,453	7,098	7,937	9,024
Non-current liabilities	134	99	99	99
Total liabilities	5,587	7,197	8,036	9,123
Paid-up capital	618	624	624	624
Reserves & surplus	20,105	23,907	28,271	33,511
Minorities	75	124	387	691
Shareholders' equity	20,798	24,656	29,281	34,826
Total equity & liabilities	**26,385**	**31,853**	**37,317**	**43,949**

Source: Company, PhillipCapital India Research Estimates

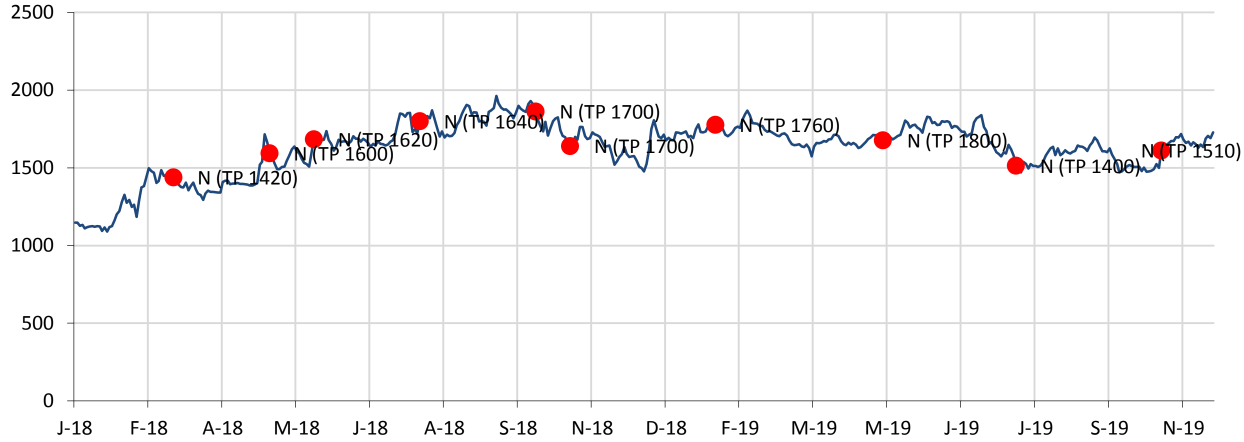
Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	5,625	6,302	7,499	8,709
Depreciation	1,248	1,653	1,741	1,766
Chg in working capital	-667	342	-578	-584
Total tax paid	-1,299	-1,487	-1,800	-2,090
Other operating activities	56	-57	0	0
Cash flow from operating activities	**4,963**	**6,753**	**6,863**	**7,800**
Capital expenditure	-681	-5,101	-1,200	0
Chg in investments	0	0	0	0
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	**-681**	**-5,101**	**-1,200**	**0**
Free cash flow	4,282	1,652	5,663	7,800
Equity raised/(repaid)	3	6	0	0
Debt raised/(repaid)	-90	-35	0	0
Dividend (incl. tax)	0	-1,074	-1,074	-1,074
Other financing activities	-1,110	284	0	0
Cash flow from financing activities	**-1,532**	**-974**	**-1,074**	**-1,074**
Net chg in cash	2,750	678	4,589	6,726

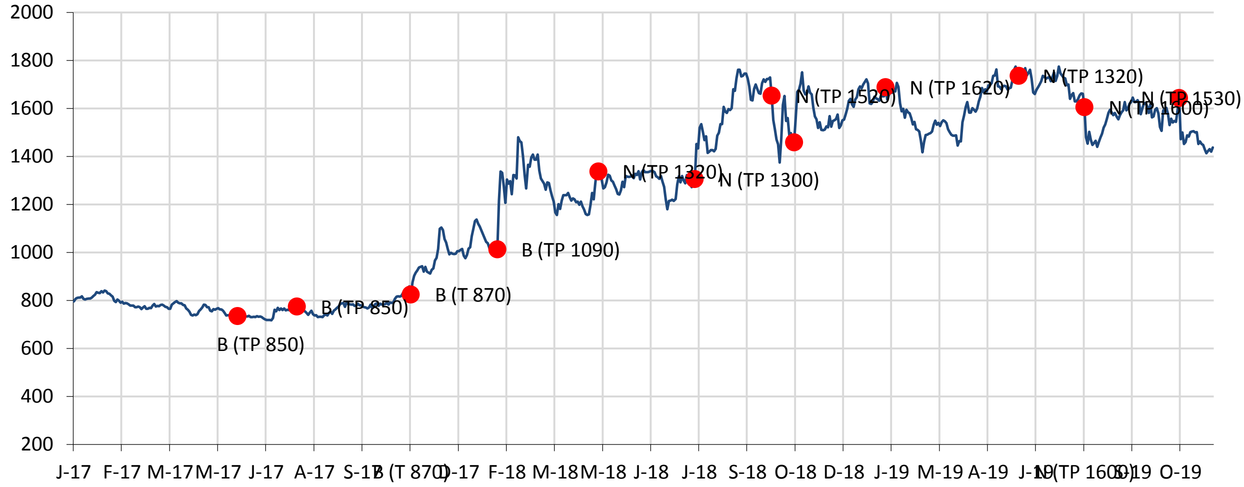
Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	66.8	75.0	88.8	103.2
Growth, %	45.9	12.3	18.4	16.1
Book NAV/share (INR)	338.6	400.8	472.1	557.8
CFPS (INR)	72.4	103.3	104.5	118.1
DPS (INR)	-	15.0	15.0	15.0
Return ratios				
Return on assets (%)	17.0	16.7	16.5	16.3
Return on equity (%)	19.7	18.7	18.8	18.5
Return on capital employed (%)	20.2	19.9	19.7	19.3
Turnover ratios				
Asset turnover (x)	4.0	3.8	3.7	4.3
Sales/Total assets (x)	1.5	1.4	1.4	1.3
Sales/Net FA (x)	9.4	7.8	6.9	9.5
Working capital/Sales (x)	0.2	0.1	0.1	0.1
Receivable days	61.4	65.0	65.0	65.0
Liquidity ratios				
Current ratio (x)	4.7	4.0	4.6	5.3
Quick ratio (x)	4.7	4.0	4.6	5.3
Dividend cover (x)		5.0	5.9	6.9
Total debt/Equity (%)	0.6	0.4	0.3	0.3
Net debt/Equity (%)	(46.1)	(41.9)	(51.4)	(63.2)
Valuation				
PER (x)	22.2	19.8	16.7	14.4
PEG (x) - y-o-y growth	0.5	1.6	0.9	0.9
Price/Book (x)	4.4	3.7	3.1	2.7
Yield (%)	-	1.0	1.0	-
EV/Net sales (x)	2.2	1.9	1.6	1.3
EV/EBITDA (x)	12.6	10.9	8.7	7.0
EV/EBIT (x)	15.6	14.0	10.8	8.5

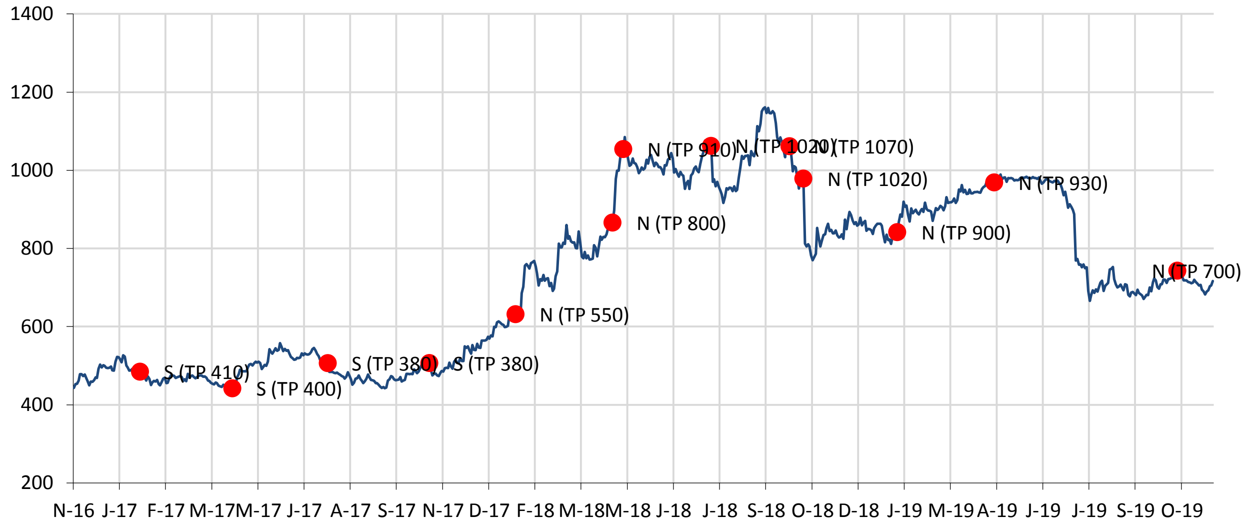
Stock Price, Price Target and Rating History (L&T INFOTECH)



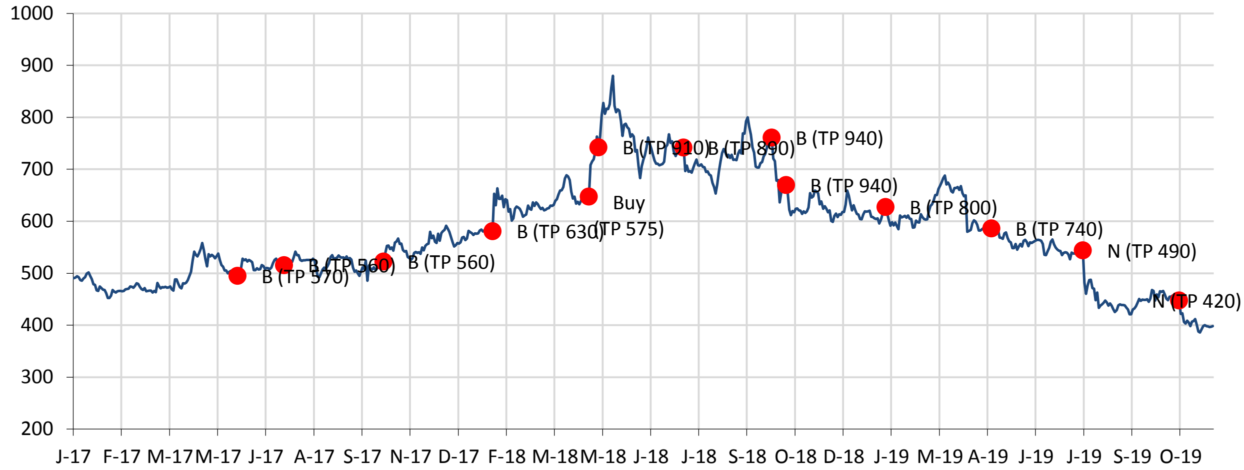
Stock Price, Price Target and Rating History (L&T TECHNOLOGY SERVICES)



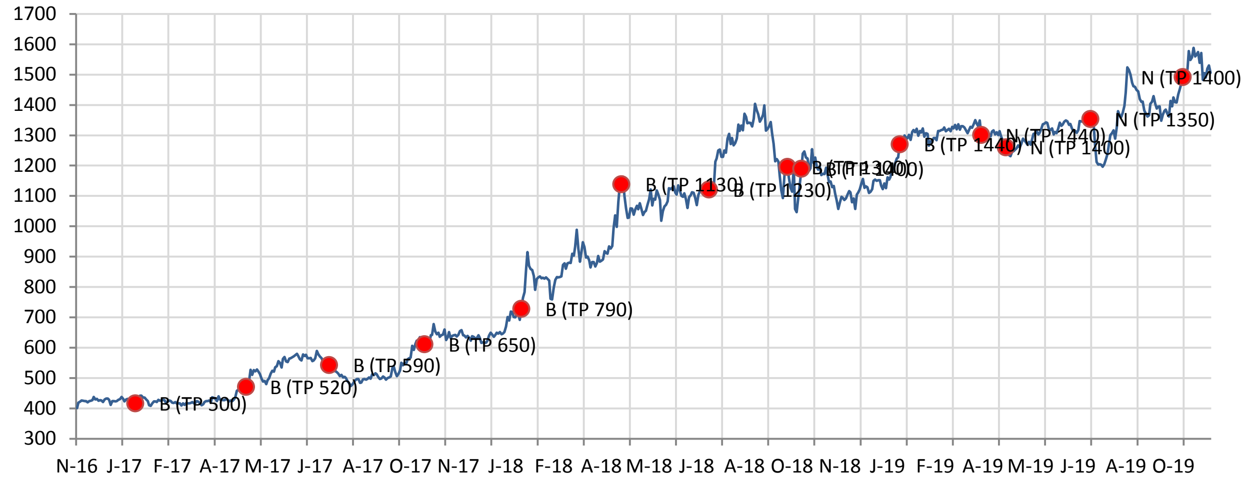
Stock Price, Price Target and Rating History (MINDTREE)



Stock Price, Price Target and Rating History (CYIENT)



Stock Price, Price Target and Rating History (NIIT TECHNOLOGIES)



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year. We have different threshold for large market capitalisation stock and Mid/small market capitalisation stock. The categorisation of stock based on market capitalisation is as per the SEBI requirement.

Large cap stocks

Rating	Criteria	Definition
BUY	>= +10%	Target price is equal to or more than 10% of current market price
NEUTRAL	-10% > to < +10%	Target price is less than +10% but more than -10%
SELL	<= -10%	Target price is less than or equal to -10%.

Mid cap and Small cap stocks

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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