IndiaNivesh
Trust......we earn it.

SQS India BFSI Limited (SQS)

Below estimate performance; Long-term outlook intact; Maintain HOLD with TP of Rs.1068…

Q3FY16 Result Update **February 1, 2016**

Current	Previous
CMP : Rs.980	
Rating : HOLD	Rating : HOLD
Target : Rs.1068	Target : Rs.1068

Rs.mn	Q3FY16	Q2FY16	Q3FY15	Q-o-Q %	Y-o-Y %	*INSL est*	*Variance(%)*	*Comments*
Revenue	671	665	538	0.9%	24.7%	738	-9.1%	Below-Est
EBIDTA	126	144	103	-12.5%	22.6%	161	-21.7%	Below-Est
PAT	74	102	66	-27.5%	12.0%	122	-39.3%	Below-Est

Source: Company Filings; IndiaNivesh Research

SQS India BFSI Ltd Q3FY16 result was below our estimate on all fronts. Rupee revenue went-up 0.9% Q/Q to Rs.671 mn (v/s INSL est of Rs.738 mn). Reported, EBITDA during the quarter decreased 12.5% Q/Q to Rs.126 mn (INSL Est. Rs.161 mn) with margin of 18.8% (v/s INSL est. 22.0%). During the quarter, SQS BFSI reported forex loss stood at Rs.7 mn (v/s Forex Gain Rs.23 mn in Q2FY16). As a result, other income (Inc. forex) turned to Rs.1 mn (v/s Rs.25 mn in Q2FY16). Depreciation remain flat at Rs.11 mn (v/s Rs.11 mn in Q2FY16). During the quarter, tax rate stood at 36.2% [to Rs.42 mn] v/s 31.2% [to Rs.32 mn] in Q2FY16. Reported net profit went down 27.5% Q/Q to Rs.74 mn (v/s Rs.102 mn in Q2FY16). Adjusting forex impact, net profit stood at Rs.80 mn (v/s Rs.79 mn in Q2FY16). Long-term outlook on SQS remains intact, as per our analysis J-Curve type growth should be visible soon. Management is geared to deliver high growth over medium-to-long-term on back of increasing presence in US and higher share from parent.

Key Conference Call Takeaways

Growth Across Key Geography

North America went-up 0.6% Q/Q [Cont. 16.0% of Rev] followed by Europe [up 8.2% Y/Y | Cont. 52.6% of Rev]. The revenue growth was partially offset by 14.6% Y/Y de-growth in Asia. During the quarter, the company's domestic/international business de-grew by 11.1%/0.4% Q/Q. On account of muted U.S performance, the company's onsite revenue went-down 3.0% Q/Q [Contr. 61% to Rev]; followed by 2.5% Q/Q [Contr. 38.0%] decline in offshore revenue. The company's contribution from parent (SQS) stood at 10% (v/s 3.0% in FY15) of the total revenue. During the quarter, SQS lost one client in $1.0 mn to $6mn category. The integration between SQS parent and SQS India remains on the track. The actual benefits of integration should be visible in FY17E with J-Curve type growth.

Key Segments Update

The volume growth of 8.3% Q/Q was led by Banking (Cont. 52.5% of Rev | +4.5% Q/Q)and Insurance (Cont. 6.4% of Rev | +19.5% Q/Q). This was partially offset by de-growth in Capital Markets (Cont. 7.5% of Rev | -12.9% Q/Q) and Cards & Payments (Cont. 33.1% of Rev | -9.7% Q/Q).

Top-10 clients Update

SQS's Top-10 client (Cont. 69% of Rev) reported 1.7% Q/Q $-revenue growth followed by 0.7% Q/Q growth in Top-5 clients (Cont. 51% of Rev). During the quarter, Non-Top 10 client account de-grew by 7.2% Q/Qand contributed nearly 31.0% of the overall revenue.

Daljeet S. Kohli
Head of Research

Tel: +91 22 66188826
daljeet.kohli@indianivesh.in

Amar Mourya
Research Analyst

Tel: +91 22 66188836
amar.mourya@indianivesh.in

Outlook

According to management, CY16 will be the year of US. The company's recent US acquisition of Trissential LLC (IT project, program & portfolio management consultancy) and Galmont Consulting LLC (Testing Company) clearly illustrates its focus to diversifying and enhances the geographic revenue split. In our view, this would be key revenue booster for SQS India BFSI Ltd over medium-to-long-term. Long-term outlook on SQS remains intact, as per our analysis J-Curve type growth should be visible soon. Management is geared to deliver high growth over medium-to-long-term on back of increasing presence in US and higher share from parent.

Valuations

At CMP of Rs.980, the stock is trading at P/E multiple of 27.7x FY16E and 12.8x FY17E earning estimate. The current quarter performance indicates that the new management's strategy to exit non-core low margin business is very well implemented. In our view, the overall benefit of integration and delivery might take few more quarters. We maintain HOLD with previous target price to Rs.1068 on SQS India. In our view, integration period (2 year) is already over, we believe FY17E and FY18E to be bumper year in terms of revenue growth and margin expansion.

Quarterly Performance

Interim Results													
In .Rs Mn	**Q3FY16**	**Q2FY16**	**Q1FY16**	***Q/Q Ch %***	**Q4FY15**	**Q3FY15**	**Q2FY15**	***Y/Y Ch %***	**Q1FY15**	**Q4FY14**	**Q3FY14**	**Q2FY14**	**Q1FY14**
Net Sales	671	665	583	*0.9%*	526	538	564	*24.7%*	513	500	510	504	430
Employee Expenses	433	418	382	*3.6%*	345	350	352	*23.9%*	314	346	300	291	245
As a % of Sales	*64.5%*	*62.9%*	*65.6%*		*65.7%*	*65.0%*	*62.4%*	*-47*	*61.1%*	*69.3%*	*58.8%*	*57.7%*	*57.0%*
Other Expenses (SG&A)	112	103	100	*8.7%*	91	86	95	*30.8%*	98	118	99	97	78
As a % of Sales	*16.7%*	*15.5%*	*17.2%*		*17.2%*	*15.9%*	*16.9%*	*140*	*19.2%*	*23.6%*	*19.4%*	*19.2%*	*18.1%*
Total Expenditure	545	521	482	*4.6%*	436	435	447	*25.2%*	412	464	399	388	323
As a % of Sales	*81.2%*	*78.3%*	*82.7%*		*82.9%*	*80.9%*	*79.3%*	*92.4*	*80.3%*	*92.8%*	*78.2%*	*76.9%*	*75.0%*
EBITDA	126	144	101	*-12.5%*	90	103	117	*22.6%*	101	36	111	117	108
EBITDA Margin	*18.8%*	*21.7%*	*17.3%*	*440.4*	*17.1%*	*19.1%*	*20.7%*	*-92.4*	*19.7%*	*7.2%*	*21.8%*	*23.1%*	*25.0%*
Interest	0	1	1	*-100.0%*	4	4	4	*-100.0%*	4	5	5	5	5
As a % of Sales	*0.0%*	*0.2%*	*0.2%*		*0.7%*	*0.8%*	*0.8%*	*61*	*0.9%*	*1.0%*	*1.0%*	*1.0%*	*1.2%*
Depreciation	11	11	11	*0.0%*	13	13	13	*-14.7%*	13	15	14	14	14
As a % of Sales	*1.6%*	*1.7%*	*1.9%*		*2.4%*	*2.4%*	*2.3%*	*63*	*2.6%*	*2.9%*	*2.7%*	*2.8%*	*3.3%*
Other Income (Inc. forex)	1	25	43	*-96.0%*	-49	12	4	*-91.6%*	11	16	6	50	55
As a % of Sales	*0.1%*	*3.8%*	*7.3%*		*-9.3%*	*2.2%*	*0.7%*	*-307*	*2.1%*	*3.2%*	*1.2%*	*9.9%*	*12.9%*
Earnings before Tax	116	157	131	*-26.1%*	25	98	104	*18.7%*	94	32	99	148	143
PBT Margin	*17.3%*	*23.6%*	*22.4%*	*117.5*	*4.8%*	*18.2%*	*18.4%*	*-523.6*	*18.3%*	*6.5%*	*19.4%*	*29.3%*	*33.3%*
Tax	42	55	44	*-23.6%*	9	32	32	*32.9%*	31	10	29	42	41
As a % of Profit	*36.2%*	*35.0%*	*33.7%*		*34.9%*	*32.3%*	*31.2%*	*-379*	*33.0%*	*31.3%*	*29.0%*	*28.6%*	*28.5%*
Net Income	74	102	87	*-27.5%*	16	66	71	*12.0%*	63	22	70	106	103
Net Margin	*11.0%*	*15.3%*	*14.9%*	*45.7*	*3.1%*	*12.3%*	*12.6%*	*-270.5*	*12.3%*	*4.4%*	*13.8%*	*20.9%*	*23.8%*
EPS - Basic	7.2	10.0	8.5	*-27.5%*	1.6	6.5	7.0	*11.8%*	6.2	2.2	6.9	10.4	10.1
EPS - Diluted	7.0	9.6	8.2	*-27.5%*	1.6	6.3	6.7	*12.0%*	6.0	2.1	6.7	10.3	9.8

Revenues analysis (%)	2014				2015				2016		
Geography	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
N.America	$1.5	$1.6	$1.5	$2.3	$1.9	$2.2	$2.0	$1.7	$1.5	$1.6	$1.6
Europe	$3.3	$4.1	$4.1	$2.5	$4.3	$4.4	$3.7	$3.9	$4.4	$4.9	$5.4
Asia	$2.6	$2.3	$2.7	$3.3	$2.4	$2.7	$3.1	$2.9	$3.3	$3.7	$3.2
Q-O-Q GROWTH	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
N.America	-20.5%	1.4%	-0.8%	46.5%	-16.6%	18.5%	-11.4%	-13.4%	-14.7%	11.1%	0.6%
Europe	54.3%	23.6%	-0.2%	-38.4%	69.1%	2.7%	-17.0%	5.8%	14.5%	11.6%	8.2%
Asia	-9.3%	-9.4%	14.7%	24.2%	-27.9%	12.9%	12.4%	-6.0%	13.8%	14.4%	-14.6%
% OF TOTAL	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
N.America	20.5%	19.3%	18.4%	27.7%	21.9%	23.8%	22.7%	20.2%	15.9%	15.7%	16.0%
Europe	44.8%	51.4%	49.3%	31.2%	50.0%	47.1%	42.1%	45.8%	48.4%	48.0%	52.6%
Asia	34.7%	29.2%	32.2%	41.1%	28.1%	29.1%	35.2%	34.0%	35.7%	36.3%	31.4%

Revenue By Practice	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Banking	$3.5	$3.2	$4.0	$4.2	$4.0	$4.8	$4.9	$4.8	$4.8	$5.1	$5.3
Capital Markets & Tresury	$1.2	$1.3	$1.1	$1.7	$1.4	$1.4	$1.1	$1.0	$1.1	$0.9	$0.8
Cards & Payments	$2.5	$3.3	$3.2	$2.0	$2.9	$2.9	$2.4	$2.0	$2.7	$3.7	$3.4
Insurance	$0.3	$0.2	$0.1	$0.3	$0.3	$0.3	$0.4	$0.6	$0.6	$0.6	$0.7
Q-O-Q GROWTH	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Banking	-2.3%	-8.4%	23.6%	5.9%	-4.5%	19.8%	1.8%	-1.2%	0.5%	5.5%	4.5%
Capital Markets & Tresury	-19.1%	11.2%	-15.5%	54.2%	-16.0%	-1.6%	-20.9%	-5.0%	1.3%	-16.8%	-12.9%
Cards & Payments	48.8%	33.1%	-4.5%	-38.0%	45.6%	-0.4%	-17.2%	-13.8%	31.3%	39.5%	-9.7%
Insurance	25.4%	-28.2%	-36.9%	106.1%	5.5%	3.0%	12.0%	56.6%	5.1%	0.2%	19.5%
% OF TOTAL	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Banking	46.8%	39.8%	47.3%	51.5%	46.6%	51.2%	56.1%	57.0%	52.9%	49.6%	52.5%
Capital Markets & Tresury	15.5%	16.0%	13.0%	20.6%	16.4%	14.8%	12.6%	12.3%	11.5%	8.5%	7.5%
Cards & Payments	33.5%	41.4%	38.0%	24.2%	33.4%	30.5%	27.2%	24.1%	29.2%	36.2%	33.1%
Insurance	4.2%	2.8%	1.7%	3.6%	3.6%	3.4%	4.1%	6.6%	6.4%	5.7%	6.9%

Export v/s Import	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Domestic	0.3	0.2	0.7	0.4	0.7	0.6	0.5	0.5	0.6	0.8	0.7
International	7.1	7.8	7.7	7.7	7.9	8.8	8.2	7.9	8.5	9.5	9.4
Q-O-Q GROWTH	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Domestic	-17.9%	-20.5%	168.4%	-33.1%	47.7%	-16.4%	-11.8%	4.2%	24.6%	30.5%	-11.1%
International	9.0%	8.9%	-1.3%	-0.1%	3.1%	11.2%	-6.8%	-3.1%	7.3%	11.2%	-0.4%
% OF TOTAL	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Domestic	4.2%	3.1%	8.0%	5.5%	7.7%	5.9%	5.6%	6.0%	6.9%	8.0%	7.20%
International	95.8%	96.9%	92.0%	94.5%	92.3%	94.1%	94.4%	94.0%	93.1%	92.0%	92.8%

Client contribution to revenue	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Top 5		5	4	4	4	5	5	4	5	5	5
Top 10		6	6	6	6	7	6	6	6	7	7
Non-Top 10		2	2	2	2	3	2	2	3	3	3
Q-O-Q GROWTH	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Top 5			-10.3%	3.1%	-4.4%	18.1%	-1.7%	-8.0%	6.3%	10.3%	0.7%
Top 10			-2.8%	-5.4%	13.1%	6.1%	-5.8%	-6.7%	3.8%	10.9%	1.7%
Non-Top 10			26.6%	4.3%	-12.1%	17.8%	-10.5%	8.5%	19.6%	16.1%	-7.2%
% OF TOTAL	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Top 5		58%	50%	53%	48%	52%	55%	52%	51%	50%	51%
Top 10		77%	72%	70%	75%	73%	74%	71%	68%	67%	69%
Non-Top 10		23%	28%	30%	25%	27%	26%	29%	32%	33%	31%

Cutomer Profile	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Number of million dollar clients											
Rev 0.5 to 1Mn $	6	4	4	4	6	6	6	4	6	10	10
Rev 1.0 to 6Mn $	8	9	8	7	8	9	10	11	10	9	8
Number of clients											
Active	48	52	63	59	57	59	54	60	64	64	70
Added during the period	9	7	19	8	9	9	5	12	7	8	3
Opening	54	48	52	63	59	57	59	54	60	64	64
Dropped	15	3	8	12	11	7	10	6	3	8	9

Income Statement

Y E March (Rs m)	FY13	FY14	FY15	FY16e	FY17e
Net sales	1,614	1,944	2,142	2,709	5,372
Y/Y Ch %	*32.9*	*20.4*	*10.1*	*26.5*	*98.3*
COGS	966	1,182	1,361	1,722	3,036
SG&A	347	365	365	433	1,128
EBITDA	**302**	**397**	**416**	**553**	**1,208**
Y/Y Ch %	*134.7*	*31.6*	*4.6*	*33.2*	*118.3*
EBITDA Margin %	*18.7*	*20.4*	*19.4*	*20.4*	*22.5*
Interest	15	20	16	13	13
Deprecaition	46	57	52	56	92
EBIT	**241**	**320**	**347**	**484**	**1,103**
EBIT Margin %	*14.9*	*16.5*	*16.2*	*17.9*	*20.5*
Other Income (Inc Forex)	24	102	-27	17	15
Extra Ordinary Exps/(Income)	0	0	0	0	0
PBT	**265**	**422**	**320**	**501**	**1,118**
Tax	70	122	104	140	335
Effective tax rate %	*26.6*	*28.9*	*32.4*	*28.0*	*30.0*
Reported PAT	**194**	**300**	**216**	**361**	**783**
Y/Y Ch %	*70.8*	*54.5*	*-28.0*	*66.8*	*116.9*
Forex Gain	10	77	-45	-	-
Adj. PAT (APAT)	**184**	**223**	**261**	**361**	**783**
RPAT Margin %	*11.4*	*11.5*	*12.2*	*13.3*	*14.6*
Y/Y Ch %	*183.2*	*21.4*	*16.8*	*38.4*	*116.9*

Source:Company filings; IndiaNivesh Research

Balance Sheet

Y E March (Rs m)	FY13	FY14	FY15	FY16e	FY17e
Share Capital	101	103	106	106	106
Reserves & Surplus	781	980	913	1,164	1,708
Net Worth	**882**	**1,082**	**1,018**	**1,269**	**1,813**
Minority	0	0	0	0	0
Long-term loans	114	96	73	73	73
Others	0	0	-1	0	0
Total Liabilities	**996**	**1,179**	**1,090**	**1,342**	**1,887**
Gross Block	457	483	511	836	1,481
Less Depreciation	146	202	254	310	402
Net Block	**312**	**281**	**257**	**526**	**1,079**
Capital Work in Progress	1	0	0	0	0
Investments	0	0	0	0	0
Defered tax (net)	10	6	7	7	7
Others	12	25	3	4	8
Current Assets	**952**	**1,157**	**1,383**	**1,477**	**2,124**
Sundry Debtors	413	558	567	712	1,411
Cash & Bank Balance	387	502	684	598	385
Loans & advances	151	97	132	167	328
Others	0	0	0	0	0
Current Liabilities	**170**	**195**	**254**	**284**	**563**
Provisions	119	95	306	387	767
Net Current Assets	**663**	**867**	**823**	**806**	**794**
Total assets	**996**	**1,179**	**1,090**	**1,342**	**1,887**

Source:Company filings; IndiaNivesh Research

Cash Flow

Y E March (Rs m)	FY13	FY14	FY15	FY16e	FY17e
Operaing Profit	255	340	364	497	1,116
Depreciation	46	57	52	56	92
Interest Exp	-15	-20	-16	-13	-13
Changes in Working Capital	2	60	275	-51	-190
Cash Flow After Chang in WCapital	**289**	**437**	**674**	**489**	**1,005**
Tax	-70	-122	-104	-140	-335
Others	0	0	0	0	1
Cash flow from operations	**219**	**316**	**570**	**349**	**671**
Capital expenditure (net)	-279	-82	-80	-325	-645
Free Cash Flow	**-60**	**234**	**490**	**24**	**26**
Other income	0	0	0	0	0
Investments	0	0	0	0	0
Cash flow from investments	**-279**	**-82**	**-80**	**-325**	**-645**
Long-Term Debt (Decrease) Increase	114	-17	-21	0	0
Dividend paid (incl tax)	-60	-81	-66	-110	-238
Share Issue / Repurchase & Others	-7	-19	-220	1	0
Cash flow from Financing	**47**	**-117**	**-307**	**-109**	**-238**
Net change in cash	**-13**	**117**	**183**	**-85**	**-212**
Cash at the beginning of the year	**401**	**387**	**502**	**684**	**598**
Cash at the end of the year	**387**	**502**	**684**	**598**	**385**

Source:Company filings; IndiaNivesh Research

Key Ratios

Y E March	FY13	FY14	FY15	FY16e	FY17e
Adj.EPS (Rs)	18.0	21.9	25.5	35.3	76.6
Cash EPS (Rs)	23.6	34.9	26.3	40.8	85.6
DPS (Rs)	5.9	9.0	6.5	10.8	23.3
BVPS	87.1	106.0	99.2	123.8	177.1
ROCE %	25.6	28.9	33.3	37.0	59.2
ROE %	22.0	27.8	21.3	28.5	43.3
ROIC %	24.6	22.8	22.8	25.4	31.6
EBITDA Margin %	18.7	20.4	19.4	20.4	22.5
Net Margin %	11.4	11.5	12.2	13.3	14.6
PER (x)	51.5x	33.3x	46.3x	27.7x	12.8x
P/BV (x)	11.4x	9.2x	9.8x	7.9x	5.5x
P/CEPS (x)	41.6x	28.0x	37.3x	24.0x	11.4x
EV/EBITDA (x)	32.3x	24.5x	23.4x	17.6x	8.1x
Dividend Yield %	0.3	0.6	0.9	0.7	1.1
m cap/sales (x)	6.2x	5.1x	4.7x	3.7x	1.9x
net debt/equity (x)	-0.3x	-0.4x	-0.6x	-0.4x	-0.2x
net debt/ebitda (x)	-0.9x	-1.0x	-1.5x	-0.9x	-0.3x
Debtors (Days)	73	91	96	96	96
Creditors (Days)	37	34	38	38	38
Cash Conversion Cycle (Days)	36	57	58	58	58

Source:Company filings; IndiaNivesh Research