

## KPIT TECHNOLOGIES LTD

IT - SERVICES

05 FEB 2018

Flash Note

**BUY**

Target Price: Rs 250

### Value unlocking through complex demerger

Board of Directors of KPIT Tech has approved a composite scheme for (a) amalgamation of Birlasoft (India) with KPIT ("proposed merger"); and (b) demerger of engineering business of KPIT into KPIT Engineering Ltd (KEL), and remaining KPIT-Birlasoft (IT Services business).

**Value neutral merger despite strong growth of Birlasoft:** Shareholders of Birlasoft will receive 22 equity shares of the combined KPIT-Birlasoft for every 9 equity shares of Birlasoft. Both the demerged (KEL and KPIT-Birlasoft) entities would be listed on the exchange and shareholding would be replicated. The existing promoters of the company (KPIT - KEL; Birlasoft - KPIT-Birlasoft) propose to acquire sole control and shareholding subject to compliance with SEBI Regulations 2011. *The deal values Birlasoft at par with KPIT despite strong growth (exhibit: 1, 2)*

CMP : Rs 209  
Potential Upside : 19%

#### MARKET DATA

No. of Shares : 197 mn  
Free Float : 81%  
Market Cap : Rs 41 bn  
52-week High / Low : Rs 216 / Rs 105  
Avg. Daily vol. (6mth) : 2.4 mn shares  
Bloomberg Code : KPIT IB Equity  
Promoters Holding : 19%  
FII / DII : 44% / 7%

**Value triad – Open offer, stronger businesses, and value unlocking:** There will be fresh share issuance of 76.6 mn in the merged entity (total share count: 265.6 mn). Birlasoft promoters would give open offer to KPIT shareholders at Rs 180-182/share, which is much lower than intrinsic value of the combined entity. Moreover, the promoters would buy each other's stake in the respective companies that could trigger open offer, especially when KPIT promoters would buy stake from Birlasoft's promoters in KEL. Further, CEO of KPIT-Birlasoft would be Mr. Anjan Lahiri (co-founder Mindtree) who has strong execution track record, and Mr. Kishore Patil would be CEO of KEL. We see stronger businesses and leadership for both the entities.

**Demerged entity to offer share price of Rs 312/share:** We see value unlocking for KPIT, as the demerged entity would offer higher multiple for KEL, the engineering services businesses, due to strong growth, margin and return ratios, along with low-teen multiple (in line with mid-cap IT) for KPIT-Birlasoft. Our pro-forma forecast for merged-demerged entity indicates intrinsic value of Rs 312/share for KPIT shareholders. The deal is subject to regulatory approvals.

#### Financial summary (Consolidated)

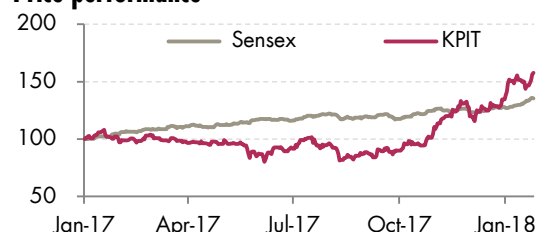
Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	33,234	36,554	41,640	46,552
Adj PAT (Rs mn)	2,123	2,400	3,062	3,807
Con. EPS* (Rs)	-	12	14	17
EPS (Rs)	11	12	15	19
Change YOY (%)	(27.4)	14.4	26.6	24.3
P/E (x)	19.7	17.2	13.6	10.9
RoE (%)	14.3	14.3	16.1	17.4
RoCE (%)	15.8	16.0	19.2	21.5
EV/E (x)	11.7	10.5	8.1	6.4
DPS (Rs)	2	2	2	2

Source: \*Consensus broker estimates, Company, Axis Capital

#### Key drivers

	FY17	FY18E	FY19E	FY20E
USD rev (mn)	494	563	628	702
YoY % growth	1%	14%	12%	12%
EBITDA	10.5%	10.3%	11.5%	12.3%

#### Price performance



**Exhibit 1: Birlasoft contributes ~29% EBITDA to the merged entity (P/L)**

(USD mn)	BirlaSoft FY17	KPIT FY17	Merged Entity FY17	% contribution of Birlasoft
Revenue	145	494	639	
EBITDA	20.7	52	73	28.6%
EBITDA Margin	14.3%	10.5%	11.4%	
Net Profit	13.1	31.6	45	29.2%
Net Income Margin	9.0%	6.4%	7.0%	

Source: Company, Axis Capital \* as per KPIT's disclosure

**Exhibit 2: Birlasoft will hold ~29% stake in the merged entity**

(mn)	Pre-Merger	Post-Merger	Post-Merger (Shareholding)
BirlaSoft	31.4	76.6	28.9%
KPIT	189.0	189.0	71.1%

Source: Company, Axis Capital

**Exhibit 3: KPIT's promoter buyout into KEL may trigger open offer again!**

	Share count (mn)	% holding
KPIT's promoter stake in merged entity	35.8	13.5%
Birlasoft's promoter stake in merged entity	76.6	28.9%

Source: Company, Axis Capital

**Conservative growth estimates**

KPIT has guided for double digit (~12%) revenue growth for FY19, which implies high-teen growth for the engineering services. However, we are factoring ~15% growth over FY18-20E. Moreover, historical growth rate of Birlasoft has been in low-to-mid-teens, but we are factoring only 10% revenue CAGR over FY18-20E for IT Services.

**Exhibit 4: IT Services (Pro-forma)**

(USD m)	FY18E*	FY19E	FY20E	Mkt Cap (12x)
Revenue	485	534	587	
Revenue Gr.	10%	10%	10%	
EBITDA	58	64	70	
EBITDA Margin	12%	12%	12%	
Net Income	44	48	53	633.9
Net Income Margin	9%	9%	9%	

Source: Company, Axis Capital \* as per KPIT's disclosure

**Exhibit 5: Engineering Services (Pro-forma)**

(USD m)	FY18E*	FY19E	FY20E	Mkt Cap (15x)
Revenue	241	278	319	
Revenue Gr.		15%	15%	
EBITDA	39	44	51	
EBITDA Margin	16%	16%	16%	
Net Income	34	39	45	670
Net Income Margin	14%	14%	14%	

Source: Company, Axis Capital \* as per KPIT's disclosure

**Exhibit 6: Intrinsic value of demerged entity Rs312/share**

IT Service Mcap (in USD mn)	634
Engineering Services Mcap (in USD mn)	670
Total Mcap (in USD mn)	1,304
Exchange rate	63.54
Total Mcap (in INR mn)	82,865
Total Share count	265.6
<b>Share Price</b>	<b>312</b>

Source: Company, Axis Capital

**Exhibit 7: Valuation comparison: Peers trade at premium**

<b>Cyient</b>	<b>FY17</b>	<b>FY18E</b>	<b>FY19E</b>	<b>FY20E</b>
USD rev growth	14%	12%	13%	11%
EBITDA %	13%	14%	16%	16%
P/E (x)	20	17	14	13
<b>LTTS</b>	<b>FY17</b>	<b>FY18E</b>	<b>FY19E</b>	<b>FY20E</b>
USD rev growth	3%	19%	19%	16%
EBITDA %	18%	15%	16%	18%
P/E (x)	34	29	25	20

**Midcap IT vendors**

<b>P/E (x)</b>	<b>FY17</b>	<b>FY18E</b>	<b>FY19E</b>	<b>FY20E</b>
L&T Infotech	23	20	17	15
Mphasis	23	21	18	15
Mindtree	31	24	20	17
Persistent	21	18	16	14
NIIT Tech	20	18	15	13
Zensar	18	18	13	11
Tata Elxsi (Engg services)	39	32	28	24

Source: Companies, Axis Capital

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	33,234	36,554	41,640	46,552
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>33,234</b>	<b>36,554</b>	<b>41,640</b>	<b>46,552</b>
Total operating expenses	(6,198)	(6,908)	(7,703)	(8,493)
<b>EBITDA</b>	<b>3,486</b>	<b>3,776</b>	<b>4,776</b>	<b>5,720</b>
EBITDA margin (%)	10	10	11	12
Depreciation	(827)	(791)	(832)	(852)
<b>EBIT</b>	<b>2,659</b>	<b>2,985</b>	<b>3,944</b>	<b>4,867</b>
Net interest	(136)	(104)	(133)	(88)
Other income	207	274	245	263
<b>Profit before tax</b>	<b>2,730</b>	<b>3,155</b>	<b>4,056</b>	<b>5,043</b>
Total taxation	(606)	(745)	(994)	(1,235)
Tax rate (%)	22	24	25	25
Profit after tax	2,124	2,410	3,062	3,807
Minorities	-	(9)	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	2,123	2,400	3,062	3,807
Adj. PAT margin (%)	6	7	7	8
Net non-recurring items	261	26	-	-
Reported net profit	2,384	2,426	3,062	3,807

### Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	376	376	376	376
Reserves & surplus	15,448	17,353	19,837	23,066
Net worth	15,825	17,730	20,214	23,442
Borrowing	3,334	2,584	1,834	1,084
Other non-current liabilities	579	579	579	579
<b>Total liabilities</b>	<b>19,755</b>	<b>20,893</b>	<b>22,627</b>	<b>25,106</b>
Gross fixed assets	13,700	15,004	16,502	18,099
Less: Depreciation	(5,616)	(6,407)	(7,239)	(8,092)
Net fixed assets	8,085	8,597	9,263	10,008
Add: Capital WIP	-	-	-	-
Total fixed assets	8,085	8,597	9,263	10,008
Total Investment	-	-	-	-
Debtors	7,843	8,513	9,469	10,586
Cash & bank	3,902	4,137	4,645	5,646
Loans & advances	-	-	-	-
Current liabilities	5,459	5,776	6,579	7,355
Net current assets	9,173	9,798	10,866	12,600
Other non-current assets	2,498	2,498	2,498	2,498
<b>Total assets</b>	<b>19,755</b>	<b>20,893</b>	<b>22,627</b>	<b>25,106</b>
	-	-	-	-

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	2,730	3,155	4,056	5,043
Depreciation & Amortisation	827	791	832	852
Chg in working capital	41	(891)	(1,060)	(1,234)
<b>Cash flow from operations</b>	<b>3,182</b>	<b>2,156</b>	<b>2,723</b>	<b>3,251</b>
Capital expenditure	(1,979)	(1,124)	(1,318)	(1,417)
<b>Cash flow from investing</b>	<b>(2,225)</b>	<b>(1,134)</b>	<b>(1,386)</b>	<b>(1,422)</b>
Equity raised/ (repaid)	83	-	-	-
Debt raised/ (repaid)	(611)	(250)	(250)	(250)
Dividend paid	(497)	(521)	(579)	(579)
<b>Cash flow from financing</b>	<b>(1,008)</b>	<b>(788)</b>	<b>(829)</b>	<b>(829)</b>
Net chg in cash	(51)	235	509	1,000

### Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
<b>OPERATIONAL</b>				
FDEPS (Rs)	11	12	15	19
CEPS (Rs)	16	16	20	23
DPS (Rs)	2	2	2	2
Dividend payout ratio (%)	17	18	16	13
<b>GROWTH</b>				
Net sales (%)	3	10	14	12
EBITDA (%)	(20)	8	26	20
Adj net profit (%)	(27)	13	28	24
FDEPS (%)	(27.4)	14.4	26.6	24.3
<b>PERFORMANCE</b>				
RoE (%)	14.3	14.3	16.1	17.4
RoCE (%)	15.8	16.0	19.2	21.5
<b>EFFICIENCY</b>				
Asset turnover (x)	2.4	2.3	2.5	2.6
Sales/ total assets (x)	1.4	1.4	1.5	1.5
Receivable days	86.1	85.0	83.0	83.0
Inventory days	-	-	-	-
Payable days	16.1	15.5	15.7	15.8
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.2	0.2	0.1	-
Current ratio (x)	2.7	2.7	2.7	2.7
Interest cover (x)	19.6	28.8	29.8	55.6
<b>VALUATION</b>				
PE (x)	19.7	17.2	13.6	10.9
EV/ EBITDA (x)	11.7	10.5	8.1	6.4
EV/ Net sales (x)	1.2	1.1	0.9	0.8
PB (x)	2.6	2.3	2.1	1.8
Dividend yield (%)	1.0	1.0	1.2	1.2

Source: Company, Axis Capital

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Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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# KPIT Technologies

**NEUTRAL**
**INDUSTRY** IT

**CMP (as on 01 Feb 2018)** Rs 209

**Target Price** Rs 195

Nifty 11,017

Sensex 35,907

**KEY STOCK DATA**

Bloomberg KPIT IN

No. of Shares (mn) 197

MCap (Rsbn) / (\$ mn) 41/646

6m avg traded value (Rsmn) 347

**STOCK PERFORMANCE (%)**
**52 Week high / low** Rs 223 / 104

3M 6M 12M

Absolute (%) 43.0 61.5 59.8

Relative (%) 36.1 51.3 32.2

**SHAREHOLDING PATTERN (%)**

Promoters 18.93

FIs &amp; Local MFs 8.02

FPIs 44.14

Public &amp; Others 28.91

Source : BSE

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## Value accretive deal

KPIT Tech has re-structured its business to create two entities of IT services and ER&D (separate listing), by first merging with Birlasoft to create ~USD 700mn rev entity, and later demerging the ER&D segment (USD 200mn rev) from it. Despite value unlocking by demerging the ER&D business (higher growth/margin and better valuations), the deal is EPS neutral (but, 15% accretive assuming full acceptance in open offer). Birlasoft valuations is in-line with current midcap IT valuations (9x EV/EBITDA and 20x P/E). The combined value based on our assumptions work out to Rs 240/share (Rs 116 from KPIT-Birlasoft and Rs 124 from KPIT PES).

The deal timelines will be over 12-18 months and will commence with open offer (@Rs 182/share) for 26% of KPIT (51.3mn shares), which is expected in 1QFY19. This will be followed by merger of KPIT Tech with Birlasoft (KPIT-Birlasoft), and subsequent demerger of the ER&D entity from KPIT-Birlasoft.

### Financial Summary

YE March (Rsbn)	3QFY18	3QFY17	YoY (%)	2QFY18	QoQ (%)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	9.13	8.31	9.9	9.16	(0.4)	32.26	33.23	36.44	40.00	44.13
EBITDA	0.99	0.85	17.0	0.90	9.6	4.34	3.49	3.71	4.47	5.24
APAT	0.62	0.54	14.7	0.60	2.6	2.81	2.19	2.49	2.84	3.35
Diluted EPS (Rs)	3.1	2.7	14.7	3.1	2.6	14.2	11.1	12.5	14.4	17.0
P/E (x)						14.7	18.8	16.7	14.5	12.3
EV / EBITDA (x)						9.1	11.8	10.5	8.5	7.0
RoE (%)						21.0	14.8	14.9	15.2	16.1

Source: Company, HDFC sec Inst Research

Synergies in KPIT's IT services with Birlasoft include (1) Service portfolio (high ADM in Birlasoft), (2) Vertical addition (BFSI), (3) Geographical presence (higher Europe presence in Birlasoft), and (4) Limited client overlap between KPIT ITS and Birlasoft (medical device customer with ~1% of rev). Also, there is limited client overlap between KPIT's ITS and its PES division (2-3% client overlap), de-risking the demerger further. Maintain NEUTRAL with TP of Rs 195, 12x Dec-19E EPS.

### Highlights of the quarter

- 3Q rev came at USD 141.1mn, -0.6/+14.9% QoQ/YoY (FY18E rev guidance at 13-14% YoY). EBITDA% came at 10.8%, +98bps QoQ supplemented by lower SG&A% (+87bps impact). APAT stood at Rs 0.62bn, 2.6/14.7% QoQ/YoY supported by lower ETR% (-310bps lower QoQ). Strategic-20 and Strategic-40 accounts grew 1.6/2.1% QoQ, respectively.
- Near-term outlook:** PES will continue to drive growth and margin.



**PES business at 14% EBITDA% and expected to improve to 16% ahead with ~50% share of KPIT's Strategic 20/40 accounts**

- Birlasoft (CK Birla company) currently has revenue of USD 145mn (>4,000 employees) with 15% EBITDA margin (~8.5% PAT margin) and is debt free (Rs 3bn net cash) with presence in verticals such as BFSI, Manufacturing, Life-science & healthcare and Media & entertainment.
- The combined IT services revenue will be USD 500mn revenue and the KPIT-Birla entity will be headed by Anjan Lahiri as CEO & MD (Mindtree co-founder and former Sasken CEO). The demerged PES/ER&D business (USD 220mn revenue) will be led by Kishor Patil.
- KPIT's PES business currently has EBITDA% of 14% which is expected to be scaled higher to 16%. Among verticals, Automotive is ~95% of PES revenue. PES has ~50% share of KPIT's Strategic-20/40 accounts.

### Valuation Scenario and Assumptions

	KPIT Tech ITS (A)	Birlasoft (B)	KPIT-Birlasoft C = (A+B)	PES (D)	Merged Entity (C + D)
FY18E Revenue (USD mn)	350	145	495	210	705
FY18-20E Revenue CAGR %	8.0%	12.0%	9.2%	15.5%	11.2%
EBITDA%	9.0%	15.0%	10.8%	14.0%	11.8%
PAT CAGR% FY18-20E	7.7%	12.7%	10.0%	24.4%	15.5%
FY20E EPS (Rs)			9.7	6.9	16.6
Target P/E (x)			12.0	18.0	14.1
<b>Value per share (Rs)</b>			<b>116</b>	<b>124</b>	<b>240</b>

Source: Company, HDFC sec Inst Research

### Current KPIT shareholding structure

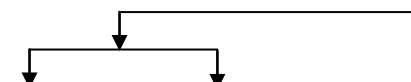
	Shares (mn)	% of total
KPIT Promoter	37	19%
Public	160	81%
<b>Total</b>	<b>197</b>	<b>100%</b>

### Shareholding structure of KPIT-Birlasoft (assuming 26% acceptance in open offer)

	Shares (mn)	% of total
KPIT Promoter	37	16%
Birlasoft Promoter	41	17%
Public	160	67%
<b>Total</b>	<b>238</b>	<b>100%</b>

### Shareholding structure of KPIT-Birlasoft (assuming 0% acceptance in open offer)

	Shares (mn)	% of total
KPIT Promoter	51	19%
Birla Promoter	78	29%
Public	145	53%
<b>Total</b>	<b>274</b>	<b>100%</b>





**Revenue came at USD 141.2mn, -0.6% QoQ and 14.9% YoY and management guided to 13 to 14% growth for FY18E**

**EBITDA% stood at 10.8%, +98bps QoQ and expected to improve ahead**

### Financials Snapshot (Consolidated)

Particulars (Rs bn)	3QFY18	3QFY17	YoY (%)	2QFY18	QoQ (%)
<b>Net Revenues (USD mn)</b>	<b>141.2</b>	<b>122.9</b>	<b>14.9</b>	<b>142.0</b>	<b>(0.6)</b>
<b>Net Revenues</b>	<b>9.13</b>	<b>8.31</b>	<b>9.9</b>	<b>9.16</b>	<b>(0.4)</b>
Employee Costs	5.71	5.31	7.4	5.74	(0.5)
SG&A and Other Operating Expenses	2.43	2.15	13.1	2.52	(3.5)
<b>EBITDA</b>	<b>0.99</b>	<b>0.85</b>	<b>17.0</b>	<b>0.90</b>	<b>9.6</b>
Depreciation	0.20	0.19	6.4	0.19	5.7
<b>EBIT</b>	<b>0.79</b>	<b>0.65</b>	<b>20.1</b>	<b>0.71</b>	<b>10.6</b>
Interest Cost	0.02	0.07	(63.0)	0.03	(6.3)
Other Income	0.03	0.03	(13.2)	0.11	(77.7)
<b>PBT</b>	<b>0.79</b>	<b>0.62</b>	<b>27.4</b>	<b>0.80</b>	<b>(1.5)</b>
Tax	0.17	0.14	17.2	0.19	(14.0)
<b>APAT</b>	<b>0.62</b>	<b>0.54</b>	<b>14.7</b>	<b>0.60</b>	<b>2.6</b>
E/o (adj for tax)	-	0.20	-	-	-
RPAT	0.62	0.74	(15.8)	0.60	2.6

Source: Company, HDFC sec Inst Research

### Margin Analysis

MARGIN ANALYSIS	3QFY18	3QFY17	YoY (bps)	2QFY18	QoQ (bps)
Employee Cost % Net Revenues	62.5	63.9	(142)	62.6	(11)
SG&A and Other Expenses % Net Revenues	26.6	25.9	76	27.5	(87)
<b>EBITDA Margin (%)</b>	<b>10.8</b>	<b>10.2</b>	<b>66</b>	<b>9.9</b>	<b>98</b>
EBIT Margin (%)	8.6	7.9	73	7.8	85
Tax Rate (%)	21.3	23.2	(186)	24.4	(310)
<b>APAT Margin (%)</b>	<b>6.8</b>	<b>6.5</b>	<b>29</b>	<b>6.6</b>	<b>19</b>

Source: Company, HDFC sec Inst Research

**PES SBU led the growth at 2.7% QoQ and automotive & transportation vertical at 1.3% QoQ**

### SBU Split

SBU revenue (USD mn)	3QFY18	3QFY17	YoY (%)	2QFY18	QoQ (%)
Product Engineering Services	55.0	39.1	40.8	53.6	2.7
Integrated Enterprise Solutions	38.0	36.3	4.5	38.3	(1.0)
SAP	28.2	28.8	(1.9)	29.1	(3.1)
Digital Transformation	14.6	14.0	4.5	15.0	(2.9)
Products & Platforms	5.4	4.8	13.4	5.9	(8.4)
<b>Total Revenue</b>	<b>141.2</b>	<b>122.9</b>	<b>14.9</b>	<b>142.0</b>	<b>(0.6)</b>

Source: Company, HDFC Sec Inst Research

### Vertical Split

Verticals revenue (USD mn)	3QFY18	3QFY17	YoY (%)	2QFY18	QoQ (%)
Automotive & Transportation	62.3	48.9	27.5	61.5	1.3
Manufacturing	40.9	45.0	(9.0)	43.3	(5.5)
Energy & Utilities	25.8	17.3	49.3	24.7	4.7
Others	12.2	11.7	3.6	12.5	(2.8)
<b>Total Revenue</b>	<b>141.2</b>	<b>122.9</b>	<b>14.9</b>	<b>142.0</b>	<b>(0.6)</b>

Source: Company, HDFC Sec Inst Research

### Onsite-offshore Revenue Break-up

(% of revenue)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Onsite	58.9	57.3	57.7	56.7	56.4	57.3	57.5
Offshore	41.1	42.7	42.3	43.3	43.6	42.7	42.5
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company, HDFC Sec Inst Research

### Onsite-offshore Revenue Growth

(QoQ, %)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Onsite	(3.2)	0.3	0.2	2.6	4.2	7.4	1.4
Offshore	(4.0)	7.0	(1.3)	6.9	5.5	3.4	0.5
<b>Total</b>	<b>(3.5)</b>	<b>3.0</b>	<b>(0.4)</b>	<b>4.4</b>	<b>4.8</b>	<b>5.7</b>	<b>1.0</b>

Source: Company, HDFC Sec Inst Research

### Onsite-offshore Volume Break-Up

(% of revenue)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Onsite	20.1	19.1	19.1	19.2	18.6	19.6	19.7
Offshore	79.9	80.9	80.9	80.8	81.4	80.4	80.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company, HDFC Sec Inst Research

### Onsite-offshore Volume Growth

(QoQ, %)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Onsite	(1.1)	(0.4)	1.3	2.8	(0.7)	7.1	1.4
Offshore	0.2	6.7	0.9	2.5	2.9	0.5	0.5
<b>Total</b>	<b>(0.0)</b>	<b>5.2</b>	<b>0.9</b>	<b>2.6</b>	<b>2.2</b>	<b>1.7</b>	<b>0.7</b>

Source: Company, HDFC Sec Inst Research

### Headcount, Utilisation Data

(Nos.)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
<b>Total Headcount</b>	<b>11,288</b>	<b>11,666</b>	<b>11,881</b>	<b>12,110</b>	<b>12,261</b>	<b>11,946</b>	<b>12,211</b>
<i>Development Team</i>	<i>10,450</i>	<i>10,816</i>	<i>11,017</i>	<i>11,225</i>	<i>11,368</i>	<i>11,070</i>	<i>11,324</i>
<i>Support</i>	<i>604</i>	<i>608</i>	<i>616</i>	<i>629</i>	<i>635</i>	<i>630</i>	<i>636</i>
<i>Marketing</i>	<i>234</i>	<i>242</i>	<i>248</i>	<i>256</i>	<i>258</i>	<i>246</i>	<i>251</i>
<b>Net Additions</b>	<b>378</b>	<b>378</b>	<b>215</b>	<b>229</b>	<b>151</b>	<b>(315)</b>	<b>265</b>
Onsite Utilisation (%)	89.0	89.6	89.1	89.4	89.4	92.6	93.2
Offshore Utilisation (%)	68.1	69.2	67.8	68.3	68.8	70.2	70.8
Blended Utilisation (%)	71.5	72.3	71.1	71.5	71.9	73.7	74.3

Source: Company, HDFC Sec Inst Research

### Key Assumptions

Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Volume Growth (%)	10.6	7.6	7.8	8.9	6.8	8.4	10.3
Pricing Change (%)	(2.1)	2.6	(7.2)	(7.4)	7.0	0.4	0.0
<b>USD Revenue Growth (%)</b>	<b>8.3</b>	<b>10.1</b>	<b>0.3</b>	<b>0.8</b>	<b>13.9</b>	<b>9.3</b>	<b>10.3</b>
USD/INR Rate	60.63	61.14	65.80	67.22	64.73	65.00	65.00
<b>EBITDA Margin (%)</b>	<b>15.5</b>	<b>10.8</b>	<b>13.5</b>	<b>10.5</b>	<b>10.2</b>	<b>11.2</b>	<b>11.9</b>

Source: Company, HDFC Sec Inst Research

### Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
<b>FY19E</b>			
Revenue (USD mn)	607.5	615.3	1.3
Revenue (Rs bn)	39.49	40.00	1.3
EBITDA (Rs bn)	4.42	4.47	1.2
EBITDA margin (%)	11.2	11.2	(1)bps
EPS (Rs)	14.1	14.4	1.7
<b>FY20E</b>			
Revenue (USD mn)	671.5	678.9	1.1
Revenue (Rs bn)	43.65	44.13	1.1
EBITDA (Rs bn)	5.29	5.24	(0.9)
EBITDA margin (%)	12.1	11.9	(23)bps
EPS (Rs)	17.1	17.0	(0.9)

Source: Company, HDFC Sec Inst Research

### Peer Valuation

Company	Mcap (Rsbn)	CMP (Rs)	Rating	Target (Rs)	EPS (Rs)				P/E (x)				RoE (%)			
					FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E
LTI	222	1,294	BUY	1,400	56.9	64.7	73.3	81.9	22.7	20.0	17.7	15.8	36.9	32.1	30.6	29.3
Mphasis	170	878	BUY	980	38.8	42.8	49.2	57.1	22.7	20.5	17.9	15.4	13.4	14.3	16.6	17.7
LTT	133	1,305	BUY	1,130	41.8	44.0	55.3	66.9	31.2	29.6	23.6	19.5	33.3	28.2	27.4	27.2
Mindtree	127	754	BUY	735	24.9	27.1	37.7	44.9	30.3	27.8	20.0	16.8	16.8	20.6	23.3	24.5
Hexaware *	112	382	BUY	380	13.9	17.3	19.0	22.4	27.5	22.1	20.2	17.1	26.7	27.1	25.2	25.7
Cyient	72	641	BUY	670	32.9	37.5	43.1	49.4	19.5	17.1	14.9	13.0	17.4	19.6	19.3	19.9
Persistent	63	784	BUY	875	38.8	42.2	48.2	56.9	20.2	18.6	16.3	13.8	17.0	16.7	16.9	17.7
eClerx	60	1,558	SELL	1,145	87.8	72.8	79.0	91.0	17.8	21.4	19.7	17.1	30.8	26.4	26.6	27.7
<b>KPIT Tech</b>	<b>41</b>	<b>209</b>	<b>NEU</b>	<b>195</b>	<b>11.1</b>	<b>12.5</b>	<b>14.4</b>	<b>17.0</b>	<b>18.8</b>	<b>16.7</b>	<b>14.5</b>	<b>12.3</b>	<b>14.8</b>	<b>14.9</b>	<b>15.2</b>	<b>16.1</b>
Zensar	43	945	BUY	1,050	51.6	52.8	65.6	77.9	18.3	17.9	14.4	12.1	16.7	15.0	16.5	17.1
Sonata	31	297	BUY	300	14.6	15.7	18.8	22.1	20.3	18.9	15.8	13.4	31.2	30.6	33.1	34.5

Source: HDFC sec Inst Research \* YE Dec

## Consolidated Income Statement

Year ending March (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
<b>Net Revenues (USD mn)</b>	<b>490.3</b>	<b>494.4</b>	<b>563.0</b>	<b>615.3</b>	<b>678.9</b>
<b>Growth (%)</b>	<b>0.3</b>	<b>0.8</b>	<b>13.9</b>	<b>9.3</b>	<b>10.3</b>
<b>Net Revenues</b>	<b>32.26</b>	<b>33.23</b>	<b>36.44</b>	<b>40.00</b>	<b>44.13</b>
<b>Growth (%)</b>	<b>7.9</b>	<b>3.0</b>	<b>9.6</b>	<b>9.8</b>	<b>10.3</b>
Employee Expenses	19.34	20.91	22.60	24.57	26.76
SG&A Expenses	8.59	8.84	10.14	10.95	12.13
<b>EBITDA</b>	<b>4.34</b>	<b>3.49</b>	<b>3.71</b>	<b>4.47</b>	<b>5.24</b>
<b>EBITDA (%)</b>	<b>13.5</b>	<b>10.5</b>	<b>10.2</b>	<b>11.2</b>	<b>11.9</b>
<b>EBITDA Growth (%)</b>	<b>33.9</b>	<b>(19.7)</b>	<b>6.4</b>	<b>20.6</b>	<b>17.1</b>
Depreciation	0.69	0.83	0.79	0.90	0.98
<b>EBIT</b>	<b>3.65</b>	<b>2.66</b>	<b>2.91</b>	<b>3.57</b>	<b>4.26</b>
Other Income	0.17	0.47	0.50	0.37	0.39
Interest	0.17	0.14	0.16	0.16	0.18
<b>PBT</b>	<b>3.65</b>	<b>2.99</b>	<b>3.26</b>	<b>3.78</b>	<b>4.47</b>
Tax (incl deferred)	0.85	0.61	0.77	0.95	1.12
Minority Interest and associate profit	-	-	-	-	-
<b>RPAT</b>	<b>2.81</b>	<b>2.39</b>	<b>2.49</b>	<b>2.84</b>	<b>3.35</b>
<b>APAT</b>	<b>2.81</b>	<b>2.19</b>	<b>2.49</b>	<b>2.84</b>	<b>3.35</b>
<b>APAT Growth (%)</b>	<b>18.5</b>	<b>(22.0)</b>	<b>13.6</b>	<b>14.1</b>	<b>18.1</b>
<b>EPS</b>	<b>14.2</b>	<b>11.1</b>	<b>12.5</b>	<b>14.4</b>	<b>17.0</b>
<b>EPS Growth (%)</b>	<b>17.5</b>	<b>(22.0)</b>	<b>12.7</b>	<b>14.9</b>	<b>18.1</b>

Source: Company, HDFC sec Inst Research

## Consolidated Balance Sheet

Year ending March (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
<b>SOURCES OF FUNDS</b>					
Share Capital - Equity	0.38	0.38	0.38	0.38	0.38
Reserves	13.43	15.45	17.24	19.26	21.68
<b>Total Shareholders' Funds</b>	<b>13.81</b>	<b>15.82</b>	<b>17.61</b>	<b>19.63</b>	<b>22.05</b>
Minority Interest	-	0.02	0.02	0.02	0.02
<b>Total Debt</b>	<b>2.17</b>	<b>3.20</b>	<b>3.56</b>	<b>3.97</b>	<b>4.46</b>
Net Deferred Taxes	(0.52)	(0.52)	(0.52)	(0.52)	(0.52)
Long-term Provisions & Others	0.52	0.71	0.78	0.86	0.94
<b>TOTAL SOURCES OF FUNDS</b>	<b>15.97</b>	<b>19.23</b>	<b>21.45</b>	<b>23.96</b>	<b>26.96</b>
<b>APPLICATION OF FUNDS</b>					
Net Block	1.96	2.07	2.18	2.36	2.57
CWIP	0.04	0.74	0.77	0.84	0.92
Goodwill & Other Intangible Assets	4.87	5.27	5.33	5.43	5.55
Investments	0.26	0.40	0.42	0.45	0.49
LT Loans & Advances, Others	1.52	2.12	2.23	2.41	2.63
<b>Total Non-current Assets</b>	<b>8.65</b>	<b>10.60</b>	<b>10.92</b>	<b>11.50</b>	<b>12.17</b>
Inventories	0.27	0.43	0.30	0.33	0.36
Debtors	6.86	7.84	8.59	9.42	10.40
Cash & Equivalents	3.95	4.02	5.75	7.23	9.03
Other Current Assets	1.70	1.79	1.88	2.03	2.22
<b>Total Current Assets</b>	<b>12.78</b>	<b>14.09</b>	<b>16.51</b>	<b>19.02</b>	<b>22.01</b>
Creditors	1.23	1.31	1.43	1.56	1.71
Other Current Liabilities & Provns	4.22	4.15	4.55	4.99	5.51
<b>Total Current Liabilities</b>	<b>5.46</b>	<b>5.46</b>	<b>5.98</b>	<b>6.56</b>	<b>7.22</b>
<b>Net Current Assets</b>	<b>7.32</b>	<b>8.63</b>	<b>10.53</b>	<b>12.46</b>	<b>14.79</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>15.97</b>	<b>19.23</b>	<b>21.45</b>	<b>23.96</b>	<b>26.96</b>

Source: Company, HDFC sec Inst Research

## Consolidated Cash Flow

Year ending March (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	3.65	2.99	3.26	3.78	4.47
Non-operating & EO items	0.99	(0.62)	(0.05)	(0.15)	(0.17)
Interest expenses	0.17	0.14	0.16	0.16	0.18
Depreciation	0.69	0.83	0.79	0.90	0.98
Working Capital Change	0.70	(1.24)	(0.18)	(0.45)	(0.53)
Tax paid	(0.85)	(0.61)	(0.77)	(0.95)	(1.12)
<b>OPERATING CASH FLOW ( a )</b>	<b>5.35</b>	<b>1.49</b>	<b>3.21</b>	<b>3.31</b>	<b>3.82</b>
Capex	(1.25)	(1.94)	(1.03)	(1.25)	(1.39)
Free cash flow (FCF)	4.11	(0.46)	2.18	2.05	2.42
Investments	1.31	(0.78)	0.82	-	-
Non-operating income	-	-	-	-	-
<b>INVESTING CASH FLOW ( b )</b>	<b>0.07</b>	<b>(2.72)</b>	<b>(0.21)</b>	<b>(1.25)</b>	<b>(1.39)</b>
Debt Issuance/(payment)	(2.29)	1.03	0.36	0.41	0.49
Interest expenses	(0.17)	(0.14)	(0.16)	(0.16)	(0.18)
FCFE	1.66	0.44	2.39	2.30	2.73
Share capital Issuance	0.02	-	-	-	-
Dividend	(0.51)	(0.51)	(0.70)	(0.82)	(0.93)
<b>FINANCING CASH FLOW ( c )</b>	<b>(2.95)</b>	<b>0.38</b>	<b>(0.50)</b>	<b>(0.57)</b>	<b>(0.62)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>2.48</b>	<b>(0.85)</b>	<b>2.50</b>	<b>1.48</b>	<b>1.80</b>
<b>Closing Cash &amp; Equivalents</b>	<b>3.95</b>	<b>4.02</b>	<b>5.75</b>	<b>7.23</b>	<b>9.03</b>

Source: Company, HDFC sec Inst Research

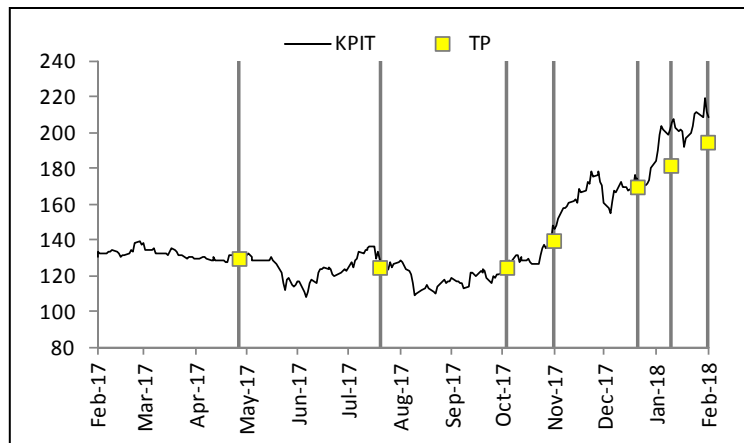
## Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
<b>PROFITABILITY (%)</b>					
EBITDA Margin	13.5	10.5	10.2	11.2	11.9
APAT Margin	8.7	7.2	6.8	7.1	7.6
RoE	21.0	14.8	14.9	15.2	16.1
RoIC or Core RoCE	16.4	11.6	11.1	12.7	14.1
RoCE	17.6	14.2	12.8	13.0	13.7
<b>EFFICIENCY</b>					
Tax Rate (%)	23.1	20.3	23.6	25.0	25.0
Fixed Asset Turnover (x)	7.6	6.9	6.9	6.8	6.7
Inventory (days)	0	3	3	5	3
Debtors (days)	91	85	78	86	86
Payables (days)	14	16	14	14	14
Cash Conversion Cycle (days)	78	72	67	77	75
Net Debt/EBITDA (x)	(0.4)	(0.2)	(0.6)	(0.7)	(0.9)
Net Debt/Equity (x)	(0.1)	(0.1)	(0.1)	(0.2)	(0.2)
Interest Coverage (x)	22.1	19.6	18.4	21.9	23.4
<b>PER SHARE DATA</b>					
EPS (Rs/sh)	14.2	11.1	12.5	14.4	17.0
CEPS (Rs/sh)	17.7	15.3	16.6	18.9	21.9
DPS (Rs/sh)	2.2	2.2	3.0	3.5	4.0
BV (Rs/sh)	69.9	80.1	89.2	99.4	111.7
<b>VALUATION</b>					
P/E	14.7	18.8	16.7	14.5	12.3
P/BV	3.0	2.6	2.3	2.1	1.9
EV/EBITDA	9.1	11.8	10.5	8.5	7.0
OCF/EV (%)	13.6	3.6	8.2	8.7	10.4
FCF/EV (%)	10.4	(1.1)	5.6	5.4	6.6
FCFE/mkt cap (%)	4.0	1.1	5.8	5.6	6.6
Dividend Yield (%)	1.1	1.1	1.4	1.7	1.9

Source: Company, HDFC sec Inst Research



## RECOMMENDATION HISTORY



Date	CMP	Reco	Target
28-Apr-17	129	NEU	130
20-Jul-17	130	NEU	125
4-Oct-17	123	NEU	125
2-Nov-17	146	NEU	140
21-Dec-17	172	NEU	170
10-Jan-18	202	NEU	182
1-Feb-18	209	NEU	195

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**BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period  
**NEUTRAL** : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period  
**SELL** : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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