

11 August 2016

Majesco

*Soft quarter, profitability improving; retaining our Buy*Rating: **Buy**

Target Price: ₹750

Share Price: ₹499

While Q1 was steady and revenue growth, order backlog and operating parameters were flattish, the highlights were greater profitability and cash generation. Majesco increased its investments last year and is looking to build profitability this year, supported by revenue growth. It had a setback in terms of one client ramping down in Q2, but looks to offset these pressures with growth in other areas and a strong H2.

Revenue at \$32.9m, up 0.2% qoq, 39% yoy. The company had a slow start to the year with order backlog shrinking to \$64.3m, down 12% qoq and sliding to Q1 FY16 levels and representing 45% of the next twelve-month revenues. Organic growth was ~12% in dollars. Majesco saw a steep decline in its licence revenues (down 45% qoq, 56% yoy) which it expects to recoup in H2, adjusted for cloud.

EBITDA margin 3.5%, up 226bps qoq, down 221bps yoy. Majesco experienced greater profitability with the EBITDA margin at 3.5% (1.2% in Q4 FY16). The gross margin improved 66bps qoq but declined 242bps yoy. SG&A was steady at 32% and the rest of the margin expansion came from lower R&D expenses. Net profit stood at ₹14.6m, compared to a ₹20m loss in Q4 FY16.

Business outlook. Majesco expects Q2 FY17 to be soft as a particular large client has ramped down (project delayed), but expects to recover from this decline with growth in other parts of the business. It expects H2 to be strong, a trend observed in FY16 as well. In Q1 FY17 it had 164 clients.

Cash generation strong. Majesco had a cash balance of ₹2,058m, and debt of ₹1382m, generating net cash of ₹323m. This was driven by receivable days returning to normal (49) after an high Q4 (73 days) and higher EBITDA of ₹77m.

Valuation. We value the stock at 1.7x EV:FY18 sales (the US entity is valued at 2.5x EV: sales) and 36x FY18e PE, applying no holding company discount. **Risk.** Vigorous M&A strategy and potential dilution.

Key data	MJCO IN / MAJC.BO
52-week high / low	₹789 / ₹287
Sensex / Nifty	27775 / 8575
3-m average volume	\$1m
Market cap	₹12bn / \$173m
Shares outstanding	23m

Shareholding pattern (%)	Jun'16	Mar'16	Dec'15
Promoters	49.6	49.9	50.3
- of which, Pledged			
Free Float	50.4	50.1	49.7
- Foreign Institutions	4.3	-	-
- Domestic Institutions	11.0	16.1	17.0
- Public	35.0	34.0	32.7

Financials (YE Mar)	FY17e	FY18e
Sales (₹m)	9,309	10,719
Net profit (₹m)	320	502
EPS (₹)	13.0	20.4
Growth (%)	365.5	56.9
PE (x)	38.3	24.4
PBV (x)	4.0	3.4
RoE (%)	11.0	15.1
RoCE (%)	10.8	17.8
Dividend yield (%)	-	-
Net debt/equity (x)	-0.1	-0.1

Source: Anand Rathi Research

Year-end: Mar	Q1FY17	% qoq	% yoy	FY16	FY15	% yoy
Sales (\$ m)	33	0.2	39.4	115	-	NA
Sales (₹m)	2,201	(0.7)	46.5	7,571	-	NA
EBITDA (₹m)	77	182.0	(10.3)	99	-	NA
EBITDA margin (%)	3.5	226 bps	-221 bps	1.3	-	NA
EBIT (₹m)	17	(259.6)	(38.5)	(79)	-	NA
EBIT margin (%)	0.8	122 bps	-104 bps	(1.0)	-	NA
PBT (₹m)	15	(317.4)	(66.6)	(77)	-	NA
Tax (₹m)	2	(107.0)	(107.4)	150	-	NA
Tax rate (%)	14.00	NA	7703 bps	(194.5)	-	NA
Net Income (₹m)	15	(174.1)	12.0	70	-	NA

Source: Company

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end:Mar	FY14	FY15	FY16	FY17e	FY18e
Net revenues	-	-	7,571	9,309	10,719
Revenue growth (%)	-	-	-	-	-
- Oper. expenses	-	-	7,472	8,744	9,689
EBIDTA	-	-	99	565	1,029
EBITDA margins (%)	-	-	1.3	6.1	9.6
- Interest	-	-	43	43	44
- Depreciation	-	-	179	195	234
+ Other income	-	-	45	82	39
- Tax	-	-	-150	46	162
Effective tax rate (%)	-	-	184.5	12.6	24.3
+ Associates / (minorities)	-	-	-4	-42	-126
Adjusted PAT	-	-	69	320	502
+ Extraordinary items	-	-	-	-	-
Reported PAT	-	-	69	320	502
Adj. FDEPS (₹/ sh)	-	-	2.8	13.0	20.4
Adj. FDEPS growth (%)	-	-	NM	365.5	56.9

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end:Mar	FY14	FY15	FY16	FY17e	FY18e
Share capital	-	-	115	115	115
Reserves & surplus	-	-	2,644	2,964	3,467
Net worth	-	-	2,759	3,080	3,582
Total debt	-	-	919	919	919
Minority interest	-	-	723	765	891
Def. tax liab. (net)	-	-	-380	-380	-380
Capital employed	-	-	4,021	4,383	5,012
Net fixed assets	-	-	331	369	402
Intangible assets	-	-	2,262	2,363	2,463
Investments	-	-	144	152	161
- of which, Liquid	-	-	120	126	132
Working capital	-	-	132	415	623
Cash	-	-	1,152	1,085	1,362
Capital deployed	-	-	4,021	4,383	5,012
Working capital (days)	-	-	6.3	16.3	21.2
Book value (₹/ sh)	-	-	112.3	125.4	145.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

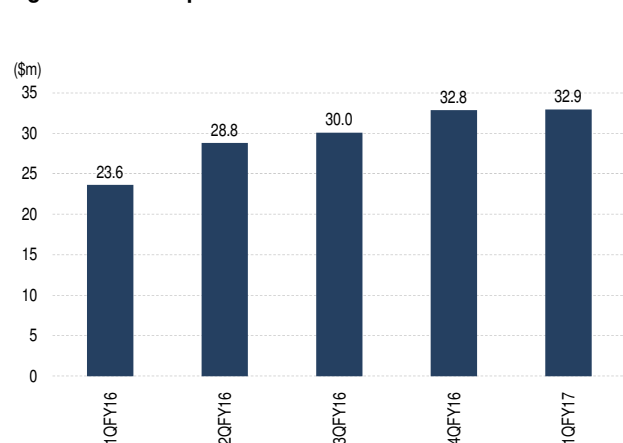
Year-end:Mar	FY14	FY15	FY16	FY17e	FY18e
Adjusted PAT	-	-	69	320	502
+ Non-cash items	-	-	179	195	234
Cash profit	-	-	247	515	737
- Incr./ (decr.) in WC	-	-	132	283	209
Operating cash-flow	-	-	116	232	528
- Capex	-	-	2,772	333	368
Free cash-flow	-	-	-2,656	-101	160
- Dividend	-	-	-	-	-
+ Equity raised	-	-	3,413	42	126
+ Debt raised	-	-	539	-	-
- Investments	-	-	144	8	9
- Misc. items	-	-	-	-	-
Net cash-flow	-	-	1,152	-67	277
+ Op. cash & bank bal.	-	-	-	1,152	1,085
Cl. Cash & bank bal.	-	-	1,152	1,085	1,362

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹499

Year-end:Mar	FY14	FY15	FY16	FY17e	FY18e
P/E (x)	-	-	178.2	38.3	24.4
Cash P/E (x)	-	-	49.6	23.8	16.6
EV/EBITDA (x)	-	-	120.2	21.2	11.3
EV/sales (x)	-	-	1.6	1.3	1.1
P/B (x)	-	-	4.4	4.0	3.4
RoE (%)	-	-	5.0	11.0	15.1
RoCE (%)	-	-	-1.7	10.8	17.8
Dividend yield (%)	-	-	-	-	-
Dividend payout (%)	-	-	-	-	-
Net debt/equity (x)	-	-	-0.1	-0.1	-0.1
Debtor (days)	-	-	99	97	96
Inventory (days)	-	-	-	-	-
Payables (days)	-	-	9	10	10
CFO: PAT	-	-	-205.2	52.4	97.5
CFO: Sales	-	-	-2.0	2.0	5.7

Source: Company, Anand Rathi Research

Fig 5 – Revenue performance


Source: Company

Fig 6 – Price movement


Source: Bloomberg

Result Highlights

Q1FY17 Results at a Glance

Fig 7 – Q1 FY17 financial results

	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17	QoQ%	YoY%	
Revenues (\$m)	29	30	33	33	0.2	39	YoY growth is not representative due to Coveral and Agile acquisitions. Organic growth is estimated to be ~12%
Majesco - US Revenues (\$m)	28	30	32	33	0.8	41	
YoY growth %	47.9	37.1	48.8	40.5			
Order backlog (\$m)	55.2	64.0	73.1	64.3	-12.0	0	
Revenues (₹m)	1,874	1,980	2,216	2,201	-0.7	47	
Eff. exchange rate	65.1	65.9	67.5	66.9	-0.9	5	
Employees (EoP)	2,164	2,242	2,465	2,487	0.9	19	
Revenue Productivity (US\$ 000/employee)	13.3	13.4	13.3	13.2	-0.7	17	
Utilization % (Total)	84.5	84.0	85.9	85.9	0bps	300bps	
CoR (excluding D&A)	(1,284)	(1,387)	(1,402)	(1,487)	6.1	51	
As % of Revenues	-69	-70	-63	-68	-430bps	-214bps	Just a reclassification thing between CoR and SG&A
CoR - Majesco US As % of Rev	-68	-69	-67	-66	161bps	-304bps	
SG&A	(576)	(620)	(787)	(637)	-19.0	47	
As % of Revenues	-31	-31	-36	-29	655bps	-6bps	
SG&A - Majesco US As % of Rev	-33	-35	-32	-32	-5bps	-7bps	
EBITDA	13	(27)	27	77	182.0	-10	
EBITDA margins %	0.7	-1.4	1.2	3.5	226bps	-221bps	
EBIT	-27	-69	-10	17	-259.6	-39	
EBIT margins %	-1	-3	0	1	122bps	-104bps	
Other Income	-5.6	5.5	21.8	22.3	2.3	-4	
PBT	-42	-74	-7	15	-317.4	-67	
PBT margins %	-2	-4	0	1	99bps	-231bps	
Taxes	34	175	(30)	2	-107.0	-107	Tax refund this quarter
ETR %	-81	-238	436	14	NA	7703bps	
PAT	(8)	101	(37)	17	-146.2	3	
PAT Margin %	0	5	-2	1	245bps	-33bps	
Minority Interest	2	(22)	17	(3)	-114.5	NA	
Net Income	(6)	79	(20)	15	-174.1	-12	
Balance Sheet Data							
Gross Debt	641	805	919	1,382			
Cash & Equivalents	1,224	1,513	1,272	2,058			
Net Debt (cash)	(583)	(708)	(353)	(676)			
Movement in net debt		125	(355)	323			

Source: Company, Anand Rathi Research

Factsheet

Fig 8 – Revenue Split by region

(%)	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
North America	85	88	87	89	89
UK	9	8	8	7	7
APAC	6	4	5	4	4
Total	100	100	100	100	100

Source: Company, Anand Rathi Research

Note: Q2FY16 Growth rates have been adjusted for cover all and are therefore representative of organic growth

Fig 9 – Revenue (\$m)

	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
North America	20	25	26	29	29
UK	2	2	2	2	2
APAC	1	1	2	1	1
Total	23.6	28.8	30.0	32.8	32.9

Source: Company, Anand Rathi Research

Fig 10 – Revenue (QoQ Growth)

(%)	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
North America	1	3	11	0
UK	8	4	-2	1
APAC	-19	30	-10	1
Total	1	4	9	0

Source: Company, Anand Rathi Research

Fig 11 – Revenue Split by LOB

(%)	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
P&C	76.3	77.1	80.9	77.0	79.7
L&A	19.9	19.7	16.7	20.6	18.2
Non-insurance	3.8	3.2	2.4	2.4	2.1
Total	100	100	100	100	100

Source: Company, Anand Rathi Research

Fig 12 – Revenue (\$m)

	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
P&C	18.0	22.2	24.3	25.3	26.2
L&A	4.7	5.7	5.0	6.7	6.0
Non-insurance	0.9	0.9	0.7	0.8	0.7
Total	23.6	28.8	30.0	32.8	32.9

Source: Company, Anand Rathi Research

Fig 13 – Revenue (QoQ Growth)

(%)	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
P&C	1	10	4	4
L&A	-1	-12	35	-11
Non-insurance	3	-22	10	-13
Total	1	4	9	0

Source: Company, Anand Rathi Research

Fig 14 – Revenue Split by nature

(%)	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
License	8.7	5.2	7.9	5.5	3.0
Professional Services	62.6	64.3	58.4	62.0	61.9
Cloud	17.7	14.4	18.4	19.2	18.4
Support	11.0	16.1	15.3	13.3	16.7
Total	100	100	100	100	100

Source: Company, Anand Rathi Research

Fig 15 – Revenue (\$m)

	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
License	2	1	2	2	1
Professional Services	15	19	18	20	20
Cloud	4	4	6	6	6
Support	3	5	5	4	5
Total	23.6	28.8	30.0	32.8	32.9

Source: Company, Anand Rathi Research

Fig 16 – Revenue (QoQ Growth)

(%)	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
License	-27	59	-24	-45
Professional Services	5	-5	16	0
Cloud	-1	33	14	-4
Support	1	-1	-5	26
Total	1	4	9	0

Source: Company, Anand Rathi Research

Fig 17 – Client Buckets

	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
Active Clients	152	155	159	164	164
Client Addition	7	3	4	5	0

Source: Company, Anand Rathi Research

Fig 18 – Client's Contribution (Based on LTM)

(%)	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
Top 5	29.7	28.4	26.7	30.0	28.3
Top 10	46.5	43.9	40.7	43.0	42.2

Source: Company, Anand Rathi Research

Fig 19 – Employee(EOP)

	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17
Technical	1,903	1,967	2,031	2,251	2,253
Technical Support	77	75	80	89	102
Marketing	46	55	53	83	90
Support	69	67	78	42	42
Total	2,095	2,164	2,242	2,465	2,487
Utilization % (Total)	83	85	84	86	86

Source: Company, Anand Rathi Research

Valuation

Since Majesco India has a 70% stake in Majesco US, the multiple turns out to be 1.7x FY18 EV: sales, compared to an implied 2.5x FY18 EV: sales for Majesco US, a multiple similar to that for Intellect Design Arena. This is so because the Indian entity is fully consolidating Majesco US's earnings while owning only 70%; the balance 30% is shown in the accounts as minority interest.

We reckon good scope exists for Majesco to catch up on valuations if it delivers on its revenue and margin goals. It is currently on a good trajectory and if it can execute well without losing market share, the underlying asset can trade at 2.5x FY18 EV/sales by the end of next year (Mar'17).

We are not applying any holding company discount or premium to Majesco India as we do not believe there is a case of premium at all. However, the stock is currently trading at ~30% premium.

Risks

■ Execution miss

The company has in the past shown more volatility than a typical IT services company on account of it being on the discretionary side of the business (software purchases or upgrades). Also, it operates in a highly competitive arena and competes with larger entities. Therefore, execution needs to be flawless.

■ Vigorous M&A strategy

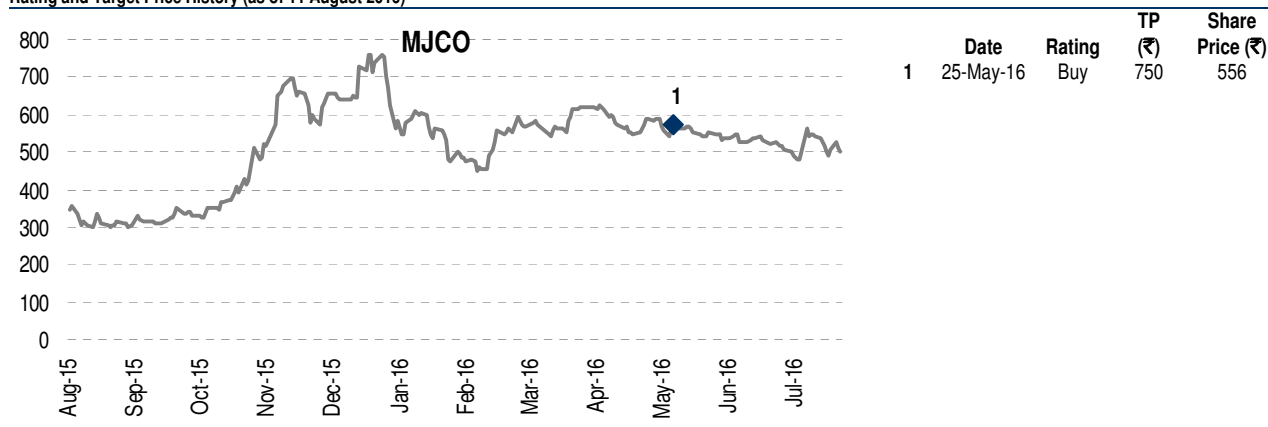
Majesco has relied on its M&A strategy to gain scale fast. This inherently brings about risks (cultural and technical integration) and to the balance sheet (due to upfront payments). The balance sheet currently doesn't leave any scope for Majesco to go wrong on this front.

Appendix

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