BOBCAPS
TRUST | INNOVATION | EXCELLENCE

IT Services

At a crossroads – prefer tier-II players over tier-I

July 2018

BOBCAPS Research | +91 22 6138 9300

research@bobcaps.in

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

IT SERVICES

04 July 2018

At a crossroads – prefer tier-II players over tier-I

With the IT services industry in the throes of transition from traditional to digital solutions, we believe tier-II companies will outpace larger incumbents given a limited drag from legacy revenues and a more level playing field as deal sizes shrink and clients increasingly pick IT vendors for their agile solutions rather than scale of operations. We estimate a 13.2%/20.5% US$ revenue/EBIT CAGR for mid-tier players over FY18-FY21 vs. 9.9%/12.6% for the tier-I bracket. LTI, HEXW and MPHL are our top mid-cap picks; TCS is our only frontline BUY.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Foundation laid for higher IT spends: After two years of single-digit revenue growth, we expect IT services demand to begin a gradual recovery in FY19 led by (1) an improved outlook for western economies (S&P 500 earnings to grow 29% YoY in CY18E per Bloomberg consensus), (2) increased deal activity (aggregate contract value up 11%/16% YoY in the Mar'18/Dec'17 quarters per ISG), and (3) a receding overhang from Brexit (11.4% growth in Europe for tier-I players in FY18).

Digital engagements gaining critical mass: The key function of technology is fast changing from an operational enabler to a core driver of competitive advantage. This paradigm shift in narrative has fuelled divergent growth trends for the IT industry, marked by high demand for digital solutions and a slowdown in traditional services. Initial-stage digital engagements are now gaining critical mass, with Nasscom forecasting a doubling in digital revenue share for India's IT services industry to 38% by FY25 (28% CAGR for FY18-FY25).

Growth recovery to be gradual; expect tier-II players to outperform: While we expect higher IT services demand in FY19, challenges in traditional services will preclude a significant growth recovery. With tier-I players facing price deflation in traditional contracts and shrinking deal sizes helping to level the playing field for smaller vendors, we believe mid-tier companies are well placed to outpace larger peers – L&T Infotech (LTI), Hexaware (HEXW) and Mphasis (MPHL) are our preferred mid-tier stocks. TCS is our only pick from the tier-I pack.

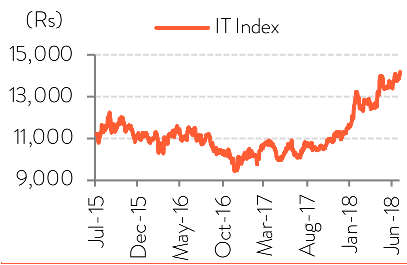
Mid-cap valuation premium here to stay: Barring Persistent Systems (PSYS) and eClerx (ECLX), the mid-cap IT services pack has rerated in the last six months on earnings upgrades and INR/USD depreciation – these stocks are now at a 7% premium to larger counterparts (on market cap weighted average P/E). We believe this premium is here to stay as mid-tier IT continues to outpace frontline players.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
Tier-I			
TCS IN	1,848	2,180	BUY
INFO IN	1,307	1,390	ADD
WPRO IN	261	240	SELL
HCLT IN	926	1,010	ADD
TECHM IN	657	720	ADD
Tier-II			
LTI IN	1,650	1,980	BUY
MPHL IN	1,100	1,270	BUY
MTCL IN	987	1,090	ADD
HEXW IN	458	490	ADD
PSYS IN	811	710	SELL
NITEC IN	1,098	1,225	ADD
Others			
ECLX IN	1,282	1,140	SELL

Price & Target in Rupees, Prices as on 2nd Jul 2018

NIFTY IT INDEX



Source: Bloomberg

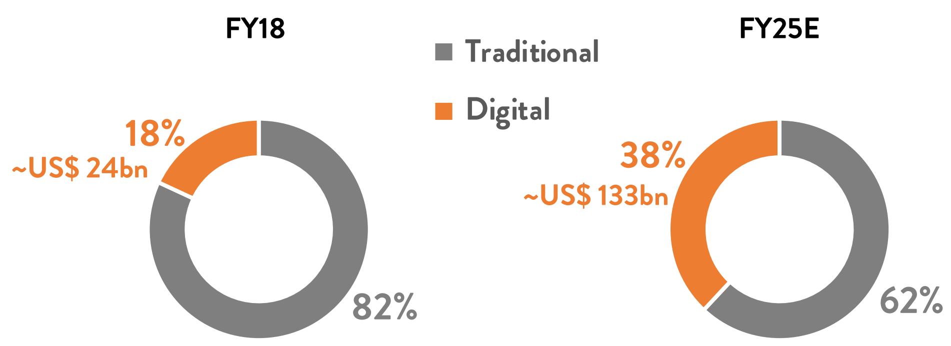
In a nutshell

LARGE DIGITAL MARKET OPPORTUNITY

- India's IT services industry is exhibiting a structural demand shift, with spiralling demand for digital solutions and a weaker appetite for traditional services such as application maintenance and BPO
- **89%** of enterprises have plans to adopt or have already adopted a **Digital-First** business strategy (Source: IDC)

India's digital market

% of total Indian IT services market

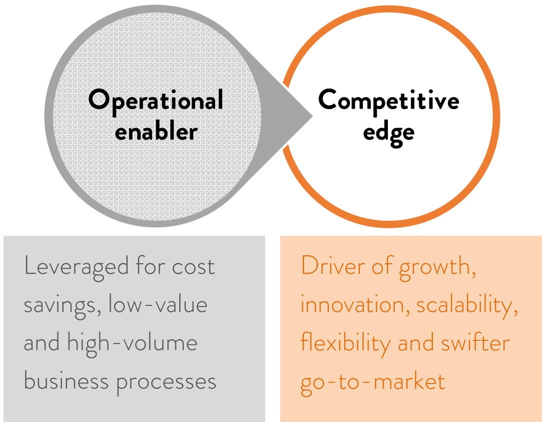


Source: Nasscom

KEY GROWTH DRIVERS

#1 Changing technology narrative

Role of IT services transiting from operational enabler to a source of competitive advantage



- IT is no longer the exclusive domain of the CIO
- Instead, every business leader has to look at how technology can reshape and transform their area

#2 Wide digital divide

'Born-digital' businesses with technology as a core competency (Amazon, Google, Uber) have disrupted various industries

Digital leaders vs. laggards: Key advantages

Source: Harvard Business Study

3-year avg. gross margin of **55%** for digital leaders vs. **37%** for laggards

WHY TIER-II IT SERVICES PLAYERS WILL STEAL A MARCH OVER TIER-I

#1 Price deflation in traditional deals

Average renewal rates are taking place at just ~85% of the original contract value

Source: HFS

#2 Legacy overhang

Large legacy/traditional revenue share for tier-I vs. tier-II implies higher challenges of revenue compression on deal renewal

	Traditional revenue	
	TCS/INFO	LTI/MTCL
FY18	US$ 15bn/8bn	US$ 770mn/480mn

#3 Shrinking deal sizes

Digital contracts at ~US$ 20mn are still much smaller than the tier-I norm of US$ 200mn-300mn+, opening up the field to participation by tier-II vendors

Avg. application deal size on the decline globally

CY17	Q1CY18
–6%	–18%

Source: ISG

#4 Clients opting for solutions over scale

A fast-evolving digital landscape has reshaped longstanding vendor evaluation criteria, enabling the tier-II pack to take on large incumbents

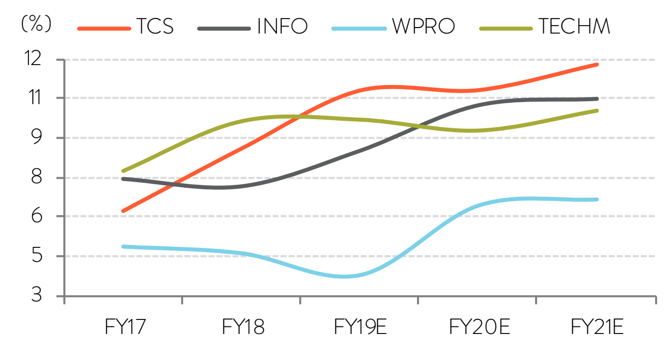
Changing criteria for IT vendor selection

TRADITIONAL	DIGITAL
Scale of vendor's technical resources, infrastructure and expertise in large projects	Capability to deploy the most innovative, flexible and transformative digital solutions

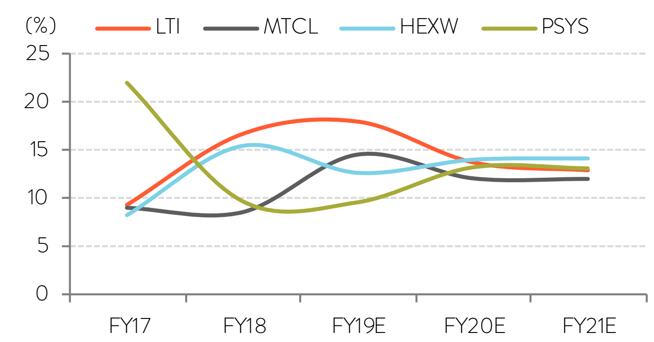
OUTLOOK & TOP PICKS

- We expect US dollar revenues for tier-II players to increase **13.2%** in FY19 vs. **9.9%** for tier-I (12.7% and 8.3% respectively in FY18), against Nasscom's industry growth guidance of 7-9% YoY

Tier-I US$ revenue growth expectations



Tier-II US$ revenue growth expectations



- **TCS (TP: Rs 2,180) is our sole BUY-rated stock among large-caps**
- **Prefer LTI (TP: Rs 1,980), HEXW (TP: Rs 490) and MPHL (TP: Rs 1,270) among mid-caps**

FIG 1 – BOBCAPS INDIAN IT SERVICES VALUATION SUMMARY

Company	Ticker	CMP (Rs)	Rating	Target Price (Rs)	US$ revenue CAGR (%)		EBIT CAGR (%)	EPS (Rs)			P/E (x)			ROE (%)		
					FY15-18	FY18-21E	FY18-21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Tata Consultancy Services	TCS	1,848	BUY	2,180	7.3	11.2	14.5	75.2	87.3	98.8	24.6	21.2	18.7	30.4	30.2	29.2
Infosys	INFO	1,307	ADD	1,390	7.9	9.8	10.4	70.2	79.4	88.4	18.6	16.5	14.8	22.5	23.2	23.5
Wipro	WPRO	261	SELL	240	4.4	5.6	7.9	18.2	19.8	21.3	14.3	13.1	12.3	15.7	15.0	14.1
HCL Technologies	HCLT	926	ADD	1,010	9.6	11.4	12.4	68.0	74.5	83.4	13.6	12.4	11.1	24.5	23.6	23.4
Tech Mahindra	TECHM	657	ADD	720	9.2	9.7	16.0	42.7	46.5	51.5	15.4	14.1	12.8	18.6	18.2	18.1
L&T Infotech	LTI	1,650	BUY	1,980	11.8	14.9	25.0	73.6	86.3	96.9	22.4	19.1	17.0	30.4	30.0	28.4
Mphasis	MPHL	1,100	BUY	1,270	2.4	12.4	16.3	51.0	57.8	67.0	21.6	19.0	16.4	17.3	18.0	19.2
Mindtree	MTCL	987	ADD	1,090	13.2	12.9	26.0	40.3	48.5	55.9	24.5	20.4	17.6	22.6	23.8	23.9
Hexaware Technologies	HEXW*	458	ADD	490	12.9	13.7	15.2	19.1	21.6	24.2	24.0	21.2	18.9	26.7	25.8	24.2
Persistent Systems	PSYS	811	SELL	710	15.1	11.9	20.6	42.9	51.0	60.0	18.9	15.9	13.5	15.3	16.5	17.4
NIIT Tech	NITEC	1,098	ADD	1,225	6.1	12.0	17.6	57.4	68.0	79.2	19.1	16.1	13.9	18.4	19.1	19.5
eClerx Services	ECLX	1,282	SELL	1,140	8.9	11.5	9.1	73.5	81.5	91.1	17.4	15.7	14.1	22.1	22.4	22.9

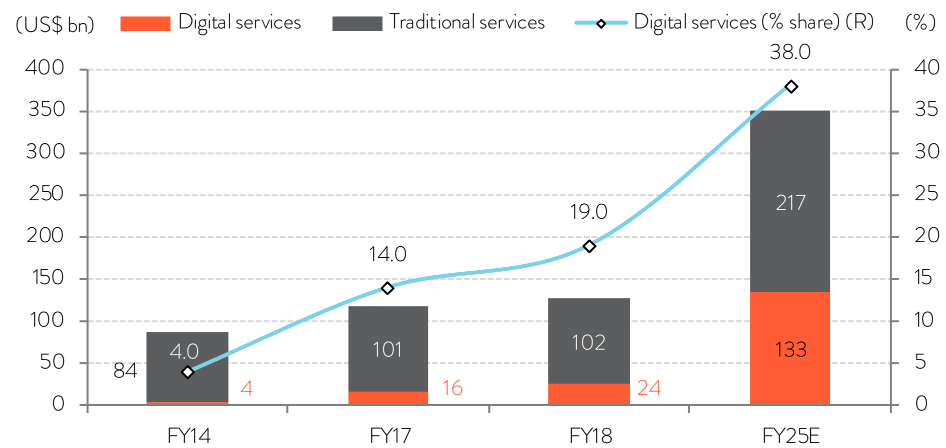
Source: Bloomberg, BOBCAPS Research | Prices as on 2nd Jul 2018 | *FY19 refers to CY18 for Hexaware and so on

Contents

Digital vs. Traditional: The changing narrative of technology

The key function of technology in enterprises is changing from an operational enabler to a core driver of competitive advantage, especially in the face of disruptions from 'born-digital' players such as Amazon, Google, Lyft and Uber. This paradigm shift in technology narrative has fuelled divergent growth trends for the IT services industry, marked by high demand for digital solutions and a slowdown in traditional IT services. Initial-stage digital engagements are now gaining critical mass, with Nasscom forecasting a doubling in digital revenue share for the Indian IT services industry to 38% by FY25.

FIG 2 – DIGITAL REVENUE SHARE TO DOUBLE TO 38% BY FY25E



Source: Nasscom, BOBCAPS Research

From support function to source of competitive advantage

Traditional businesses across sectors are now interested in turning technology into an engine for growth and efficiency, instead of a mere cost-savings tool. We are thus seeing a marked pivot towards investments that accelerate growth, scalability, simplicity, future-looking business models and consumer-focused solutions, plus new value levers such as blockchain, Internet of Things (IoT), artificial intelligence (AI) and automation – all categorised under the mantle of 'digital' solutions.

FIG 3 – TECHNOLOGY NARRATIVE CHANGING

Old narrative	New narrative
▪ Operational enabler ▪ Cost savings ▪ Low-value, high-volume business processes	▪ Source of competitive advantage ▪ Growth and efficiency engine ▪ Scalability, flexibility ▪ Faster go-to-market ▪ Innovation leverage

Source: BOBCAPS Research

The importance and thus intensity of technology across businesses is on the rise. Indeed, the distinction between IT and business units as technology decision-makers is diminishing – Gartner's May'18 survey showed that CEO priorities are shifting to embrace digital business, with 62% of the 460 CEOs surveyed already embarking on some digital initiatives. Today, IT is no longer the exclusive domain of the CIO. Every business leader has to constantly look at how technology can reshape their area and engage with technology to transform.

The great digital divide…

The changing business narrative of technology has been intensified by growing competition following the success of relatively new businesses such as Amazon, Google, Lyft and Uber, all of which are technology companies at the core. In recent years, these born-digital businesses have caused disruptions across the gamut of industries, from retail to media, hospitality, travel and marketing.

According to a Harvard Business School study, the leading digital companies not only record faster growth but also generate better gross margins, better earnings and better net income than organisations in the bottom quarter of digital adopters. Leaders also post a three-year average gross margin of 55% vs. 37% for digital laggards. Their success is fanning a structural change in client consumption patterns, with high demand for digital solutions and a weaker appetite for traditional services such as application maintenance, as client enterprises move faster to adapt.

…opens up a large growth opportunity

As per industry research firm IDC, 89% of enterprises have plans to adopt or have already adopted a digital-first business strategy, with Services (95%), Financial Services (93%) and Healthcare (92%) leading all industries. The growing urgency for traditional enterprises to close the digital divide is also reflected in their recent acquisitions of technology companies.

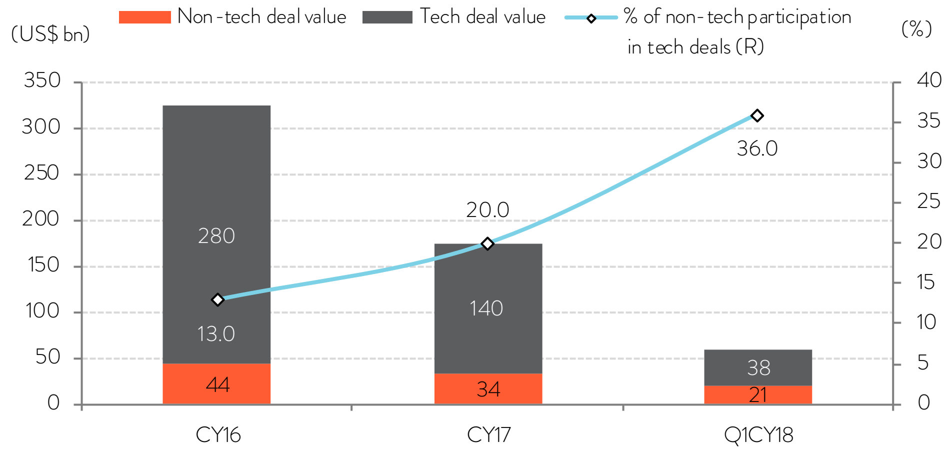
Walmart recently announced the acquisition of Flipkart, while JP Morgan, BNP Paribas, Credit Suisse and TD Bank all made their first fintech buys in CY17. As per PWC, the non-technology participation in technology deals continues to increase – from 13% of overall deal value in CY16 to 20% in CY17. Q1CY18 saw the largest non-tech deal participation in the tech deal market, both in terms of value (US$ 21.1bn) and volume (36% share).

RECENT TECH ACQUISITIONS BY TRADITIONAL ENTERPRISES

Company	Target
GM	Cruise Automation
GM	Lyft (investment)
Unilever	Dollar Shave Club
Target	Shipt
Walt Disney	Century Fox
Walmart	Jet.com, Bonobos, Modcloth, Moosejaw, Flipkart
Goldman Sachs	Financeit, Honest Dollars
Credit Suisse	TradePlus
Deutsche Bank	Quantiguous Solutions

Source: Company

FIG 4 – SHARE OF NON-TECH IN TECH DEALS



Source: PWC deal report Q1CY18, BOBCAPS Research

Apart from acquisitions, the initial digital engagements with IT service providers are now moving beyond mere proof of concepts and gaining critical mass. Industry research pegs the global digital market opportunity for IT service players at US$ 160bn-200bn in FY19 with potential for double-digit growth. Nasscom pegs FY18 digital revenues for the Indian IT services industry at ~US$ 24bn (18-20% share) and forecasts a ~28% CAGR over FY18-FY25 with a doubling to 38% revenue share by FY25.

Indian IT players in the throes of transition

In a bid to align to the changing demand dynamics, Indian IT service players have calibrated business investments around two broad areas: (1) building new digital capabilities and (2) boosting automation in traditional services. Companies have also put in place enterprise-wide reskilling initiatives.

Organic capability-building initiatives include (1) the setup of digital infrastructure – Indian providers have rolled out 20+ industry labs and innovation centres, 30+ design hubs, and customer experience centres to drive collaboration with clients; (2) formation of technology partnerships; (3) collaboration with start-up ecosystems; and (4) innovative in-house IP creation.

To accelerate their digital capabilities, Indian IT players have also acquired niche technology and platform companies, spending US$ 4.4bn (tier-I players) on acquisitions over FY16-FY18. For traditional services, most Indian players have chosen the platform approach to drive hyper automation.

FIG 5 – PLATFORM APPROACH TO AUTOMATION

Company	Platform	Company	Platform
TCS	Ignio	LTI	Mosaic
INFO	Nia	MTCL	CAPE
WPRO	HOLMES	HEXW	RAISE IT (IMS focused)
HCLT	DRYice	MPHL	InfraGenie
TECHM	AQT (Automation Quality Time)	NITEC	Tron SMART AUTOMATION

Source: Company, BOBCAPS Research

Alongside these shifts, the top leadership (CEO) has changed at 4 of 5 tier-I companies and 5 of 7 tier-II companies in the last four years. In a trend shift, tier-II players are now successfully attracting talent from their larger peers, bringing in best practices, a culture refresh and enhanced market reach. For instance, R Srikrishna joined HEXW from HCL Tech (HCLT), Sanjay Jalona joined LTI from Infosys (INFO), Nitin Rakesh joined MPHL from Syntel, and Sudhir Sign joined NIIT Tech (NITEC) from Genpact.

Incumbency challenges for IT majors, a level playing field for tier-II

In our view, the sweeping shift in technology narrative for enterprises is reshaping business dynamics for the Indian IT services industry in far-reaching ways – ways that will firmly ensconce tier-II players in the driver's seat over the next 3-4 years. Key structural shifts include:

1. **Price deflation in traditional IT contracts** – due to higher automation potential and a change in technology consumption patterns
2. **Recasting of deal dynamics** – as enterprises embark on smaller-ticket solutions in the early stages of digitisation, opening up the field to tier-II vendors
3. **Changing vendor evaluation criteria for IT sourcing** – as scale of business and deal-size track record are sidelined in favour of 'solution-oriented' vendors
4. **Tougher competition** – as both clients and vendors restructure businesses to cope with the fast-changing digital landscape

As IT majors grapple with the task of resetting their traditional businesses in tune with the new realities, we believe the more agile among tier-II IT service providers (LTI, HEXW and MPHL) will step into the breach and deliver faster growth, at a 13.2% CAGR in US dollar revenues over FY18-FY21 vs. 9.9% for tier-I players.

#1 Price deflation in traditional deals hurting large players

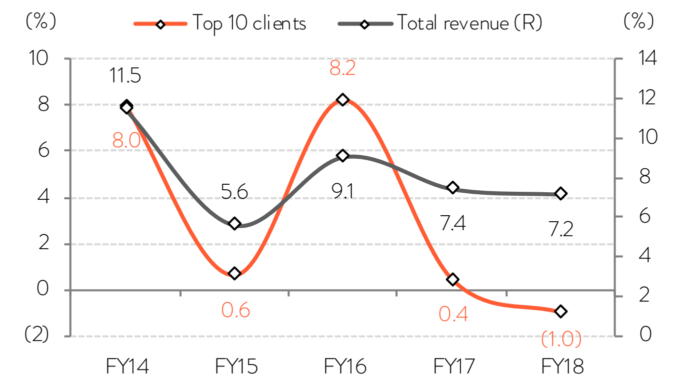
"The narrative for larger vendors and us (mid-tier players) will remain different because our strategy is to attempt a market share shift from them to us. Whenever their deal comes up for renewal, it is going to create a loss in revenue for them. In renewals, the outcome for incumbents is either 100 to 70 or 100 to 0; both aren't good outcomes."
– HEXW CEO, Q3CY17

Traditional or legacy services are facing price deflation due to the confluence of several factors, including automation, cloud adoption, competition, cost optimisation by clients, and reallocation of technology spends to digital initiatives.

As per deal advisory agencies (such as ISG, HFS and Everest), each deal renewal now typically comes with a lower price reset, as clients demand price cuts depending on service lines and nature of work. Pricing pressure is more pronounced for the IMS and BPO verticals due to their higher automation potential. HFS, in its Q1CY18 Market Index report, stated that average renewal rates are taking place at just ~85% of the original contract value.

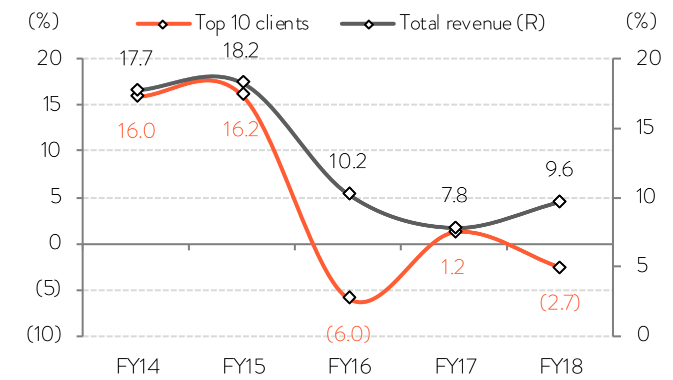
Indeed, the large, mature outsourcing accounts are more prone to pricing pressure and thus pose revenue challenges for incumbent IT service players. The squeeze on pricing is visible in the muted growth of large accounts (Fig 5 & 6).

FIG 6 – INFOSYS: SLOWER TOP 10 CLIENT GROWTH SHOWS PRICE PRESSURE IN MATURE DEALS



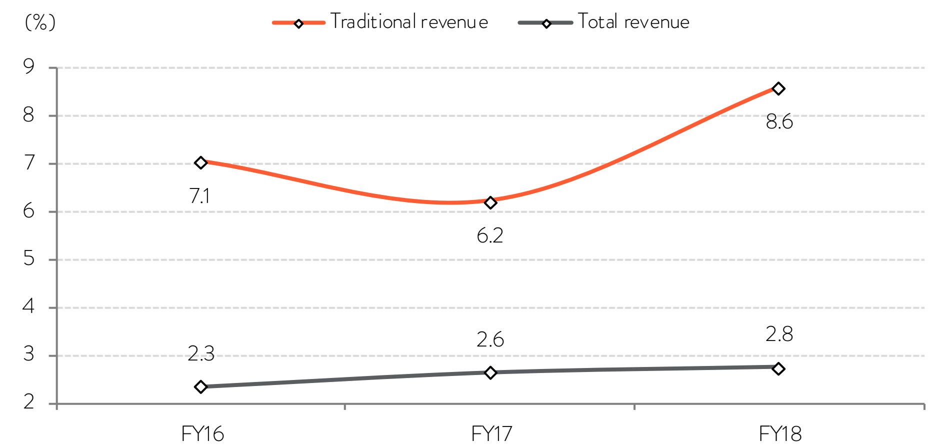
Source: Company, BOBCAPS Research

FIG 7 – TECHM: MUTED GROWTH AT TOP CLIENTS DUE TO PRICE NEGOTIATIONS IN A LARGE ACCOUNT



Source: Company, BOBCAPS Research

FIG 8 – TCS: TRADITIONAL REVENUE GROWTH IN LOW SINGLE DIGITS FOR LAST THREE YEARS



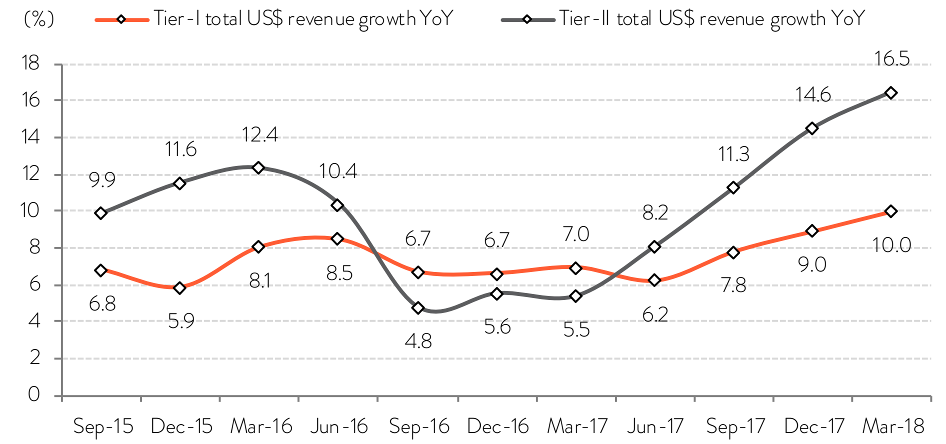
Source: Company, BOBCAPS Research

In our view, this pricing reset is in line with historical trends wherein advances in technology or delivery models have resulted in deflation in certain elements of spend (in this case traditional services) and premium pricing in the newer elements (digital services).

Intense competition further raises the deflationary pressure for incumbents. In addition, the relatively large size of legacy business for tier-I versus tier-II players (US$ 15bn/8bn for TCS/INFO vs. US$ 773mn/478mn for LTI/MTCL in FY18) implies higher challenges of revenue compression for the former on deal renewal.

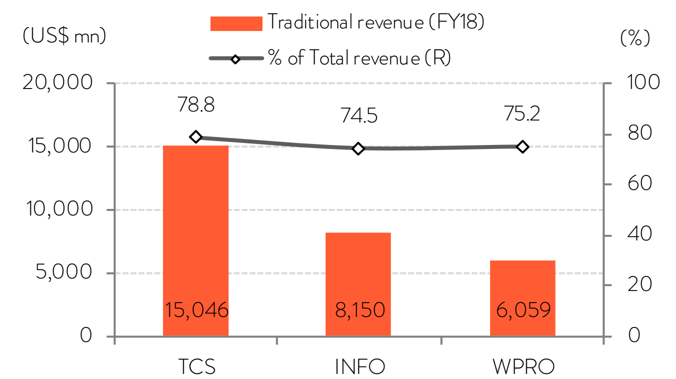
Non-incumbents with little or no baggage in these accounts increasingly approach such engagements with intensive automation offerings. We highlight that HEXW's success in scaling up IMS/BPO offerings was backed by its 'Shrink IT, Grow Digital' strategy (refer Page 108).

FIG 9 – TIER-I AND TIER-II COMPANIES SEEING CONTRASTING US$ REVENUE GROWTH



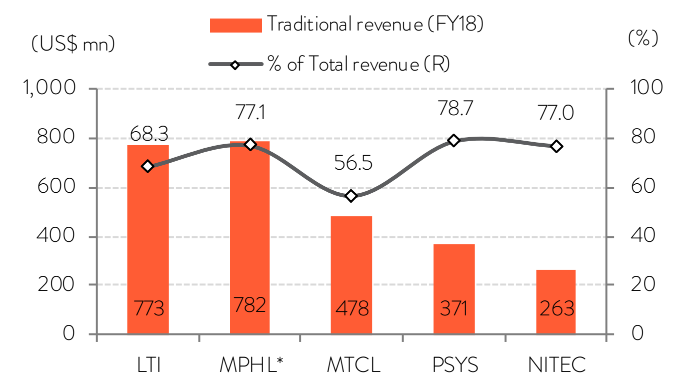
Source: BOBCAPS Research

FIG 10 – TIER-I TRADITIONAL REVENUES



Source: BOBCAPS Research

FIG 11 – TIER-II TRADITIONAL REVENUES



Source: BOBCAPS Research | *Note: NextGen revenues contributed 40% of MPHL's direct core revenues in FY18, implying US$ 349mn of traditional revenues in direct core business

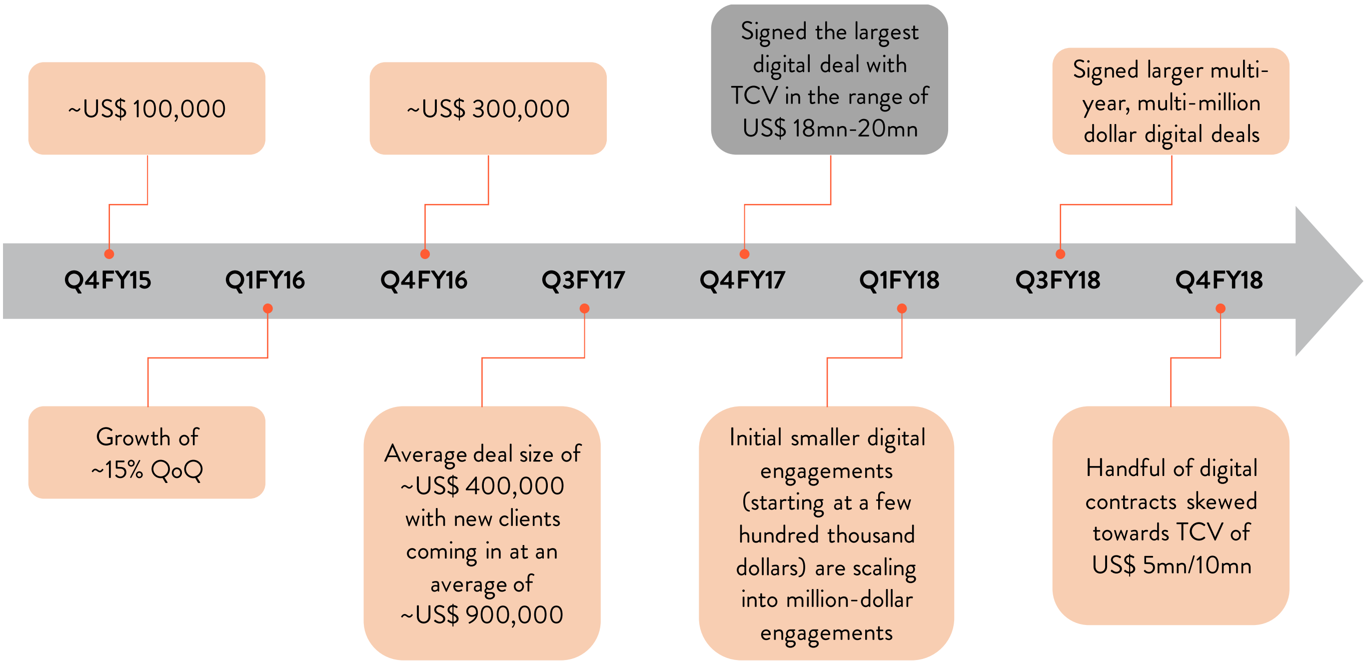
#2 Smaller deal sizes put tier-II players in a sweet spot

> **"(Traditional) deal sizes are definitely smaller… 30-40% less than what they used to be. So we have to win a lot more deals to reach the same TCV levels and create growth. Of course, the reason deal sizes are smaller is… the expectations on automation and optimisation are high; some components are determined with the public cloud in mind."**
>
> **– HCLT CEO, Q1FY18**

In recent years, traditional businesses have embarked on a journey of digital transformation via small pilot projects with IT vendors, which are now graduating into larger deals. Nonetheless, digital contracts are still much smaller than the norm for tier-I IT service players (who typically enjoy a large-deal TCV of US$ 200mn-300mn+), yet sizeable enough for tier-II companies to qualify as large deals (US$ 20mn+).

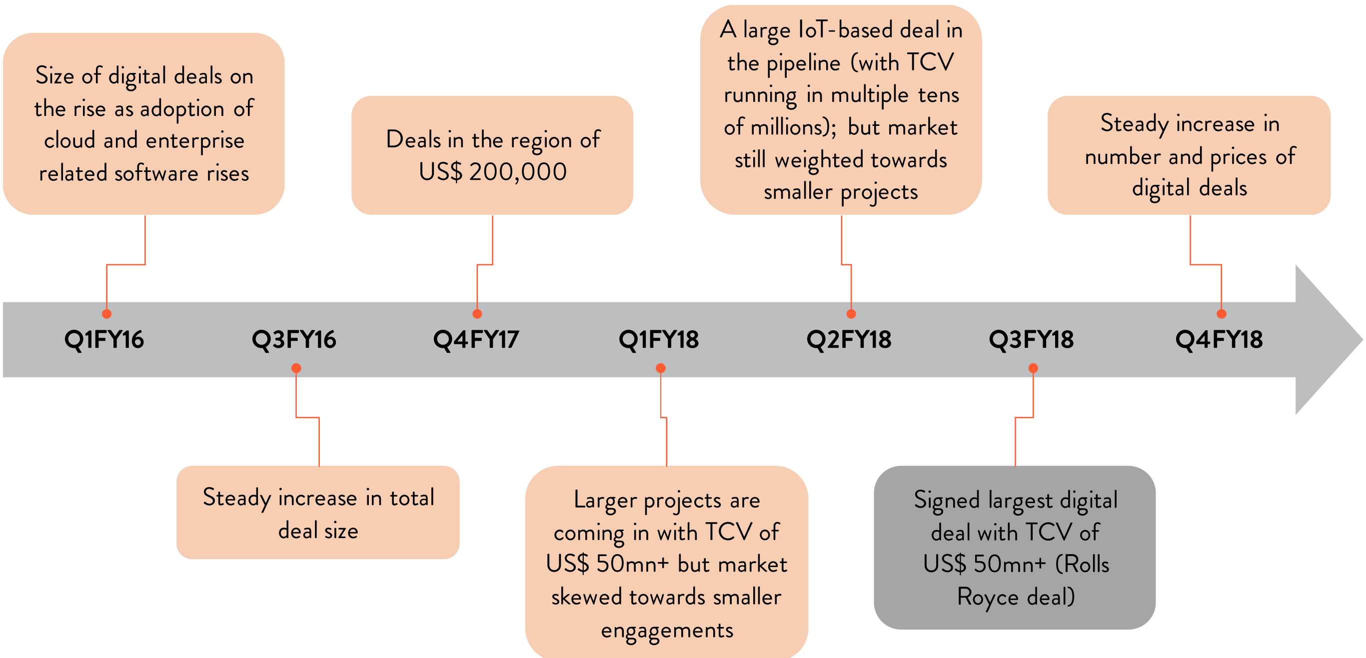
For instance, over FY15-FY18, the average digital deal size for Mindtree (MTCL) moved up from a mere US$ 0.1mn to US$ 5mn-10mn, with its largest contract win at US$ 20mn. For TCS, however, which bagged its largest ever digital deal in the Dec'17 quarter at US$ 50mn, this contract continues to be dwarfed by its overall scale of operations.

FIG 12 – MTCL – MANAGEMENT COMMENTARY ON DIGITAL DEAL SIZES



Source: Company

FIG 13 – TCS – MANAGEMENT COMMENTARY ON DIGITAL DEAL SIZES



Source: Company, BOBCAPS Research

We note that traditional deals are also being scaled down due to increased automation and changes in technology consumption models. ISG, an IT deal advisor, has also attested to this trend, especially in application services. As per ISG, the average application deal size declined by 6.2% YoY in CY17 and ~18%

YoY in Q1CY18, as growth in the number of deals (up 23.5% YoY in CY17 and 49% YoY in Q1CY18) outpaced growth in deal value (up 16% YoY in CY17 and 22% YoY in Q1CY18).

We highlight that lower deal values imply contracts are thrown open for participation by tier-II players, who were hitherto locked out of traditional big-ticket engagements due to their small scale of operations.

FIG 14 – AGGREGATE CONTRACT VALUE (ACV) PER DEAL IN APPLICATION SERVICES DIPPED 6.2% YoY IN CY17

Applications Services	Q1CY16	Q2CY16	Q3CY16	Q4CY16	Q1CY17	Q2CY17	Q3CY17	Q4CY17	Q1CY18	CY16	CY17
No of deals	166	112	97	110	137	164	149	149	204	485	599
Total ACV (US$ bn)	2.1	1.5	1.3	1.4	1.8	1.7	1.8	2	2.2	6.3	7.3
ACV /deal (US$ mn/deal)	12.7	13.4	13.4	12.7	13.1	10.4	12.1	13.4	10.8	13.0	12.2
YoY growth (%)	-	-	-	-	3.9	(22.6)	(9.9)	5.5	(17.9)	-	(6.2)

Source: ISG Index Q1CY18, BOBCAPS Research

#3 Focus on solutions not scale further levels the playing field

The vendor evaluation criteria for IT services has shifted from scale of the technology vendor's technical resources/infrastructure and its expertise in handling large projects to the capability to deploy the most appropriate and innovative digital solutions. This shift in selection criteria along with the emergence of relatively small deals that encourage participation by all players has virtually leveled the playing field for tier-II IT service companies while amplifying competition for tier-I majors.

LTI continues to highlight its growing participation in deals against global and tier-I competition and its successful wins in such instances. For instance, in the Sep'17 quarter, LTI garnered a new client who chose the company as its global SAP MS partner for a TCV of ~US$ 50mn.

Similarly, HEXW is making inroads with new banking clients and has been able to generate healthy deal activity on the back of its automation and robotics-led BPO offerings (that target a 30-50% reduction in headcount). The success of HEXW's 'Shrink IT' strategy is reflected in the 20.8% CAGR in US$ revenues from the company's BFSI vertical over CY15-CY17.

FIG 15 – LTI WON 3 OF ITS 7 LARGE DEALS WITH A NEW LOGO ADDITION IN THE LAST SIX QUARTERS

Quarter	Large wins for LTI
Dec-16	**Three large deals with combined net new TCV of US$ 100mn+**
	▪ **Deal 1:** A strategic transformation project to provide end-to-end infrastructure-managed services and cloud enablement for an international institution – the biggest new account opening engagement in LTI's history outside of India and in the IMS segment, as per management
	▪ **Deal 2:** End-to-end application management services for upstream businesses of a Fortune 10 energy corporation
	▪ **Deal 3:** LTI selected as exclusive partner by a French transnational company for a critical and strategic ERP transformation programme
Sep-17	**Two large deals signed in Q2FY18 which management says will fuel growth in Q2FY19 and Q3FY19**
	▪ **Deal 1:** TCV of ~US$ 50mn over five years. Despite the lack of an existing relationship, LTI was chosen by a European fashion & cosmetics company as global SAP MS partner, covering over 17 locations and providing support across 8 languages
	▪ **Deal 2:** Application development and support for African Bank
Mar-18	**Two large deals with combined net new TCV of US$ 50mn+**
	▪ **Deal 1:** Digitising geoscience content for new Fortune 500 client ExxonMobil by leveraging automation in collaboration with L&T Technology
	▪ **Deal 2:** From an existing large BFS client

Source: Company, BOBCAPS Research

FIG 16 – HEXW HAS WON SEVERAL DEALS AGAINST STRONG COMPETITION

Company details	Offerings
Replaced top Indian-Origin Providers (IOP)	
British Auction House	'RAISE IT' platform led end-to-end infrastructure management
Global GRC Software Company	Second-gen application modernisation, support and product engineering
Specialised Payment Products Provider	Next-gen application modernisation and support
Global Rating and Analytics Advisory	Strategic product engineering partner
Facilities Management & Maintenance	Migration of application landscape to hybrid cloud
Won against top IOPs	
Top 10 Global Steel Company	Automation-led service integration and service management
Global Warranty Provider	Back and front office operations transformation through automation
Publisher, Distributor of Children's Books	Automation-led application management transformation
Large Global Logistics Player	Automation-led procurement, finance and HR shared services
Leading eCommerce Firm	Managing customer experience in the digital channel
Top 10 Pharmacy Benefit Manager	Digital transformation to improve customer experience
Large Fashion E-Commerce Company	Transforming customer experience
Investment Firm in Education	Digital transformation with content management and app development
Largest Serviced Apartments Operator	Building an enterprise-wide digital platform in the Agile model

Source: Company, BOBCAPS Research

FIG 17 – MTCL AND NITEC WINNING DEALS AGAINST TIER-I COMPETITION

Company	Quarter ending	CEO commentary
MTCL	Mar'18	"We are actually winning more volumes from a majority of our customers in the run-the-business (traditional) portfolio. So even in segments where the customer spend declines, we are able to get a higher share of the volumes."
NITEC	Dec'17	"We are particularly happy with the quality of large deals, since all three were secured against tier-1 contenders and in some cases against multiple tier-1 contenders."

Source: Company, BOBCAPS Research

#4 Competitive landscape changing

The competitive landscape is becoming more crowded for large IT incumbents owing to the following factors:

- Global in-house centres (GIC) have become more important in driving clients' digital agendas.
- Small boutique firms for niche/emerging technologies have mushroomed.
- Dynamics of larger competitors are changing: for instance, we now have (1) DXC Technologies – a new competitor shaped from the merger of CSC and HPE's IT services business in 2017; (2) Conduent – which came into existence in 2017 as Xerox divested its Business Services division; (3) Accenture – whose innovation and consultancy-led strategy is accelerating revenue growth; (4) IBM – where the pace of revenue decline in the global services business is slowing; and (5) Capgemini – which revamped its offshore presence with the acquisition of iGate.

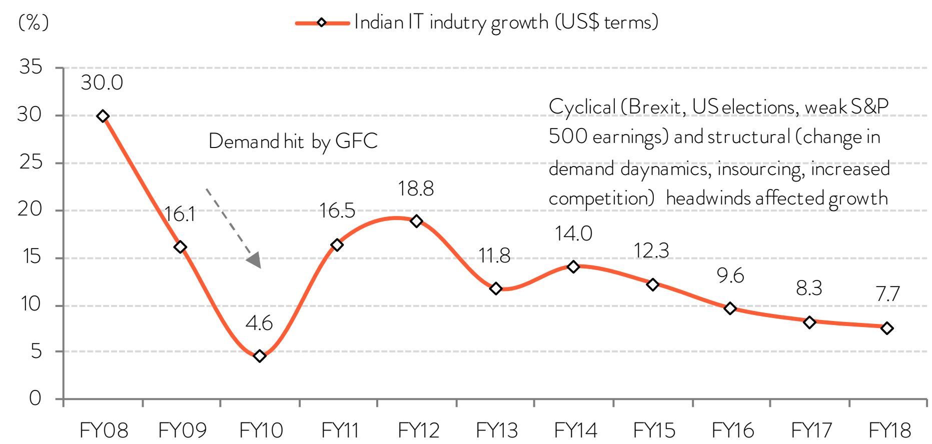
Sharp industry recovery elusive; tier-II the silver lining

While we expect higher IT services demand in FY19, challenges in the traditional portfolio of large incumbents will preclude a significant growth recovery. At the same time, changing industry dynamics amid the ongoing transition in revenue mix toward digital technologies puts mid-tier players in a sweet spot – LTI, HEXW and MPHL are our top picks among mid-caps, with TCS being our only BUY-rated pick among large-caps.

Demand climate improving

We expect India's IT services sector to deliver better revenue growth in FY19 on the back of (1) an improved growth outlook for western economies, (2) increased deal activity, and (3) continued healthy growth in Europe which suggests a receding overhang from Brexit. Despite an improving demand climate, we believe significant industrywide revenue growth acceleration hinges on a larger share of digital services in the mix.

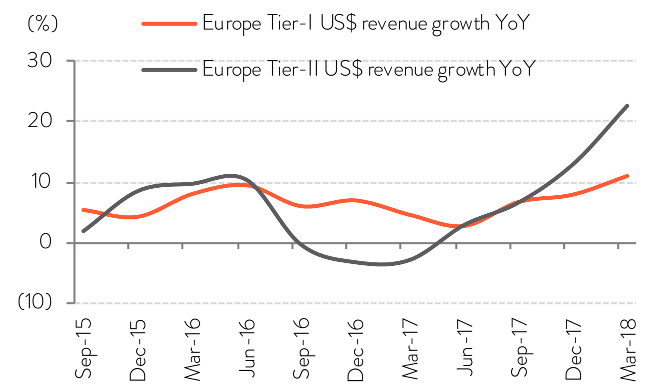
FIG 18 – EXPECT GRADUAL RECOVERY IN INDIA IT SERVICES SECTOR IN FY19



Source: Nasscom, BOBCAPS Research

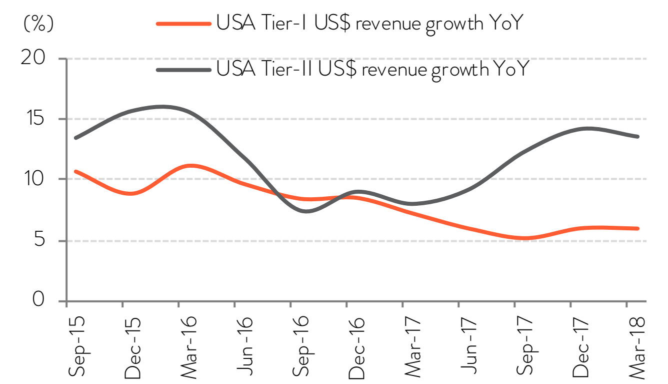
We note that over the last three quarters, tier-II players have posted broad-based growth in the key geographies of North America and Europe. In contrast, the tier-I pack saw a mixed performance with growth skewed towards Europe and a tepid outcome in the US. In our view, this in part reflects the two-speed demand dynamics for IT services, i.e. the slowdown in traditional services for mature engagements and higher growth in digital or newer engagements.

FIG 19 – UPTICK IN EUROPE MARKET GROWTH FOR BOTH TIER-I AND TIER-II PLAYERS...



Source: Companies, BOBCAPS Research

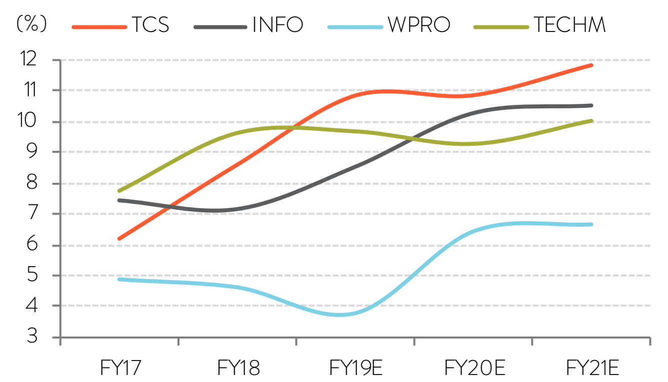
FIG 20 – ...HOWEVER TEPID GROWTH FOR TIER-I PLAYERS IN THE US



Source: Companies, BOBCAPS Research

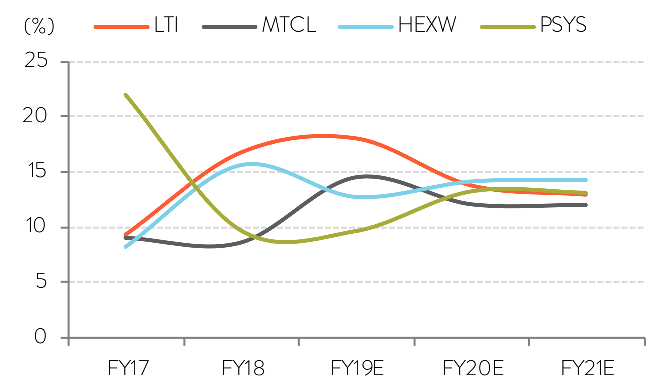
The phase of rotation of revenue portfolios away from traditional services towards digital solutions will be a challenging one for larger players – we expect mid-cap/ tier-II companies to gain ground, supported by favourable business dynamics in the form of rising small-to-midsize deals, change in vendor evaluation criteria and a limited drag from legacy services. As per our estimates, US dollar revenues for tier-II players would increase 13.2% in FY19 vs. 9.9% for tier-I (12.7% and 8.3% respectively in FY18), against Nasscom's industry growth guidance of 7-9% YoY.

FIG 21 – TIER-I US$ REVENUE GROWTH TREND



Source: BOBCAPS Research

FIG 22 – TIER-II US$ REVENUE GROWTH TREND



Source: BOBCAPS Research

Growth leverage, favourable forex movement to support margins

Growth leverage coupled with continued delivery efficiency initiatives such as better utilisation and lean hiring is likely to support margin expansion for Indian IT service players, even as onsite-led growth and capability-building investments continue. In addition, recent INR depreciation (5.4% since Mar'18 end) will add margin tailwinds, with higher gains for tier-II players (20-30bps EBIT margin gains per 1% INR depreciation) than for tier-I (10-20bps per 1% depreciation).

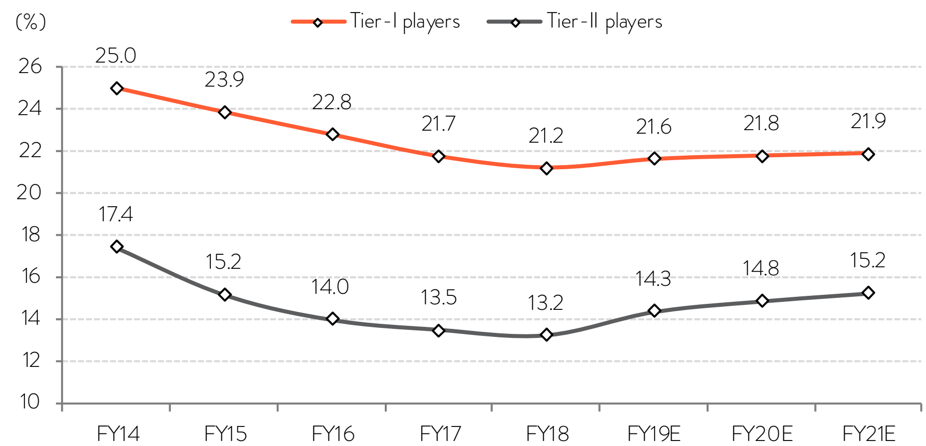
We build in 200bps/70bps EBIT margin improvement for tier-II/tier-I companies over FY18-FY21, leading to a 20.6%/12.6% EBIT CAGR. Our assumptions include a USD/INR exchange rate of 67 for FY19 and 67.5 for both FY20 and FY21.

FIG 23 – RUPEE DEPRECIATED 5.4% IN LAST 3 MONTHS

Exchange rate	Mar'17	Mar'18	Jun'18	QoQ (%)	YoY (%)
USD/INR					
Average	66.5	64.6	67.6	4.6	1.7
Close	64.8	65.0	68.6	5.4	5.8
Euro/USD					
Average	1.07	1.23	1.18	(4.2)	10.8
Close	1.07	1.24	1.16	(6.1)	9.0
GBP/USD					
Average	1.25	1.40	1.34	(4.2)	7.8
Close	1.25	1.42	1.31	(7.6)	5.1

Source: RBI, BOBCAPS Research | Note: Rates as on 29 Jun 2018

FIG 24 – WE BUILD IN 200BPS/70BPS EBIT MARGIN IMPROVEMENT FOR TIER-II/TIER-I COMPANIES OVER FY18-FY21E



Source: Company, BOBCAPS Research

Valuation premium for mid-caps here to stay

Over the last six months, tier-II mid-cap IT companies (excluding PSYS and ECLX) have rerated on the back of earnings upgrades and rupee depreciation against the dollar – these stocks are now trading at a premium over their larger counterparts (7% premium based on market cap weighted average P/E).

We believe this valuation premium is here to stay as the mid-tier IT pack continues to grow at a relatively faster pace. We highlight that EPAM and Globant, two US listed mid-cap companies with a relatively higher growth profile than their larger peers, are currently trading at 18%/37% premium to Accenture.

FIG 25 – BOBCAPS INDIAN IT SERVICES VALUATION SUMMARY

Company	CMP (Rs)	Rating	Target Price (Rs)	US$ revenue CAGR (%)		EBIT CAGR (%)	EPS (Rs)			P/E (x)			ROE (%)		
				FY15-18	FY18-21E	FY18-21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
TCS	1,848	BUY	2,180	7.3	11.2	14.5	75.2	87.3	98.8	24.6	21.2	18.7	30.4	30.2	29.2
INFO	1,307	ADD	1,390	7.9	9.8	10.4	70.2	79.4	88.4	18.6	16.5	14.8	22.5	23.2	23.5
WPRO	261	SELL	240	4.4	5.6	7.9	18.2	19.8	21.3	14.3	13.1	12.3	15.7	15.0	14.1
HCLT	926	ADD	1,010	9.6	11.4	12.4	68.0	74.5	83.4	13.6	12.4	11.1	24.5	23.6	23.4
TECHM	657	ADD	720	9.2	9.7	16.0	42.7	46.5	51.5	15.4	14.1	12.8	18.6	18.2	18.1
LTI	1,650	BUY	1,980	11.8	14.9	25.0	73.6	86.3	96.9	22.4	19.1	17.0	30.4	30.0	28.4
MPHL	1,100	BUY	1,270	2.4	12.4	16.3	51.0	57.8	67.0	21.6	19.0	16.4	17.3	18.0	19.2
MTCL	987	ADD	1,090	13.2	12.9	26.0	40.3	48.5	55.9	24.5	20.4	17.6	22.6	23.8	23.9
HEXW*	458	ADD	490	12.9	13.7	15.2	19.1	21.6	24.2	24.0	21.2	18.9	26.7	25.8	24.2
PSYS	811	SELL	710	15.1	11.9	20.6	42.9	51.0	60.0	18.9	15.9	13.5	15.3	16.5	17.4
NITEC	1,098	ADD	1,225	6.1	12.0	17.6	57.4	68.0	79.2	19.1	16.1	13.9	18.4	19.1	19.5
ECLX	1,282	SELL	1,140	8.9	11.5	9.1	73.5	81.5	91.1	17.4	15.7	14.1	22.1	22.4	22.9

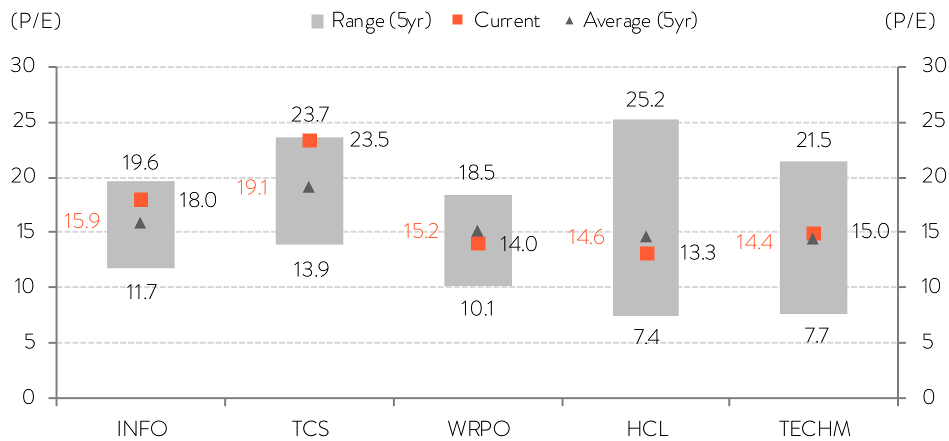
Source: Bloomberg, BOBCAPS Research | Prices as on 2nd Jul 2018 | *FY19 refers to CY18 for Hexaware and so on

FIG 26 – GLOBAL PEER VALUATION SUMMARY

Company	CMP (US$/sh)	Rating	Mkt cap (US$ bn)	US$ revenue CAGR (%)		EBIT CAGR (%)	EPS (US$)			P/E (x)			ROE (%)		
				FY15-18	FY18-21E	FY18-21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Accenture	163	na	104.7	4.9	7.3	7.8	7.3	7.9	9.2	22.5	20.6	17.7	42.9	39.5	35.0
Cognizant	79	na	46.6	13.0	8.8	37.4	4.5	5.1	5.6	17.7	15.6	14.3	20.3	20.8	19.9
DXC Technology	82	na	23.3	(3.4)	(3.2)	45.1	8.1	9.0	9.9	10.1	9.1	8.3	15.4	15.7	14.9
Virtusa	49	na	1.5	28.7	17.0	70.6	2.2	2.7	-	22.4	18.2	-	-	-	-
Luxoft	37	na	1.2	20.3	10.5	44.5	2.3	2.9	3.6	15.9	12.5	10.3	18.7	21.9	21.4
EPAM	124	na	6.6	25.7	22.7	42.8	4.1	5.1	6.0	30.0	24.3	20.7	20.4	19.7	19.4
Globant	57	na	2.0	27.5	20.9	60.5	1.6	2.0	2.5	34.6	28.3	22.6	21.3	20.4	22.2

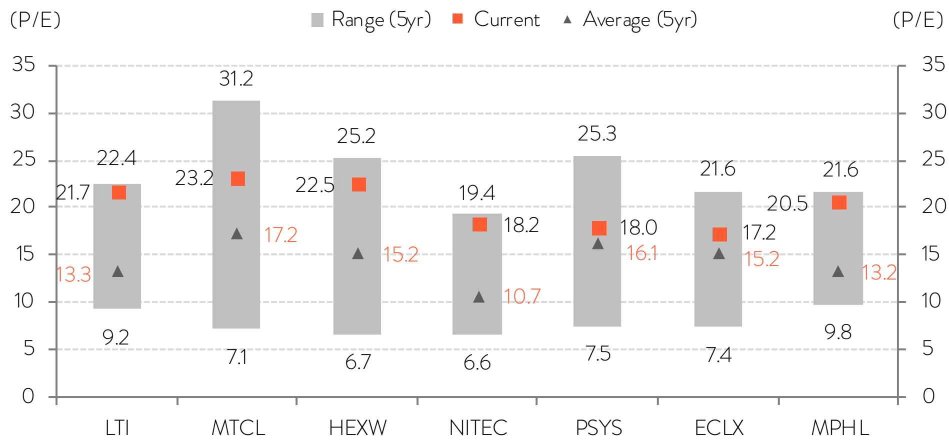
Source: Bloomberg | Prices as on 2nd Jul 2018

FIG 27 – TIER-I P/E RANGE



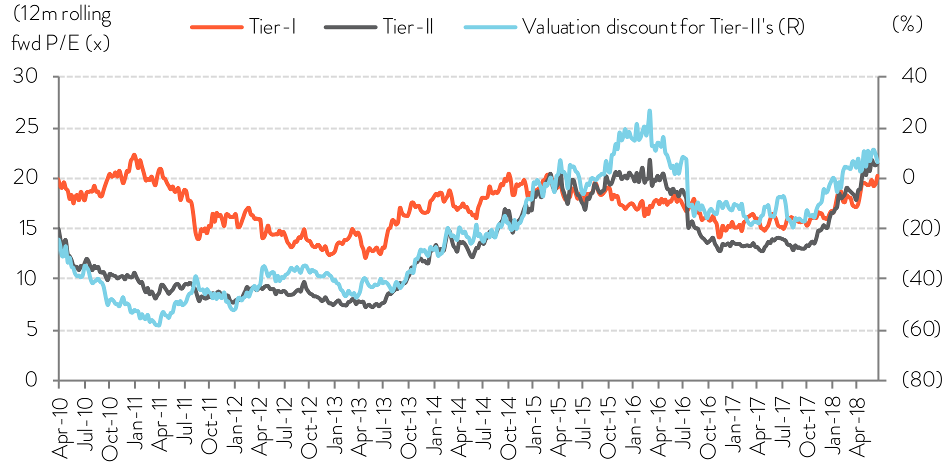
Source: Company, BOBCAPS Research

FIG 28 – TIER-II P/E RANGE



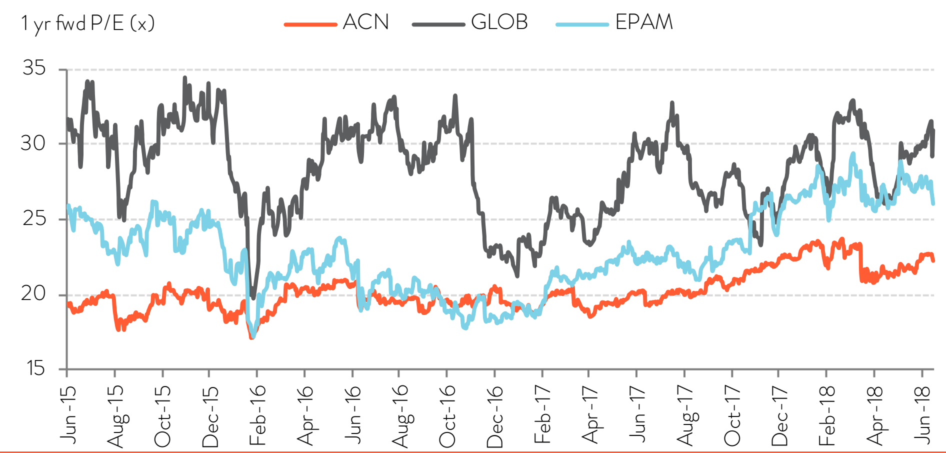
Source: Company, BOBCAPS Research

FIG 29 – MARKET CAP WEIGHTED AVERAGE



Source: Company, BOBCAPS Research

FIG 30 – P/E COMPARISON: ACCENTURE, GLOBANT AND EPAM



Source: Bloomberg, BOBCAPS Research

FIG 31 – CONSENSUS EARNINGS CHANGES FOR TIER-I AND TIER-II COMPANIES

Company	Consensus EPS (Rs)		Revision in 6M (%)		Revision in 12M (%)	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Tier I companies						
TCS	76.9	84.2	3.7	3.6	2.3	2.0
Infosys	70.9	77.6	1.7	4.0	0.6	1.9
Wipro	18.7	20.5	(4.9)	(3.4)	(2.2)	(0.8)
HCL Tech	68.2	74.4	1.1	2.4	0.1	2.2
Tech Mahindra	44.0	49.4	15.1	18.2	18.7	18.5
Tier II companies						
L&T Infotech	76.4	88.3	13.3	21.9	19.0	33.6
Mphasis	52.3	59.4	11.6	15.3	16.1	28.3
Mindtree	40.3	47.9	23.9	28.4	15.2	26.4
Hexaware	19.2	21.7	6.5	10.1	16.0	23.6
Persistent Systems	46.1	54.1	(4.1)	(3.7)	(5.3)	(3.4)
NIIT Tech	56.1	65.7	8.7	15.5	10.4	18.4

Source: Bloomberg, BOBCAPS Research

Top picks: Prefer tier-II over tier-I

In line with our preference for tier-II over tier-I, our preferred India IT service picks are **LTI** (TP: Rs 1,980, BUY), **HEXW** (TP: Rs 490, ADD) and **MPHL** (TP: Rs 1,270, BUY). **TCS** (TP: Rs 2,180) is our sole BUY-rated stock among tier-I companies. While we believe that early and systematic investments by LTI and TCS position them well to leverage the digital opportunity, we like HEXW for its differentiated positioning in IMS driven by its 'Shrink IT, Grow Digital' strategy and MPHL for its high growth visibility.

Companies

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 2,180 | ⮝ 18%

TATA CONSULTANCY SERVICES | IT Services | 04 July 2018

Early digital build-out paying off – initiate with BUY

We initiate coverage on Tata Consultancy Services (TCS) with BUY and a Mar'19 target price of Rs 2,180. TCS is our preferred tier-I IT services pick due to its (1) differentiated digital positioning backed by early, systematic investments in digital assets, talent building and tech alliances, (2) full-service focus, and (3) cohesive leadership and strategy. We expect a robust 30.7% digital revenue CAGR for FY18-FY21. TCS has won projects worth US$ 7bn+ in all in the last six months, belying the dearth of big-ticket deals and lending strong growth visibility.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Stronger focus on digital business...: In FY18, TCS reorganised its operations to sharpen focus on (a) scaling up the digital business and (b) better marketing its full-service strategy of end-to-end digital transformation solutions. To this end, TCS has reskilled close to 450,000 employees and carved out a dedicated digital service practice, supported by 16 innovation labs and its unique Co-Innovation Network (COIN). Post-restructuring, the company won US$7bn+ large deals in last 6 months amid scarcity of such large deals in the market.

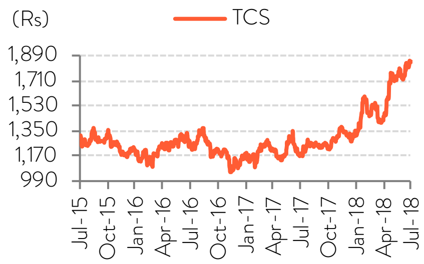
...to drive next leg of growth: The early success of TCS's focused approach is reflected in the steady increases in digital revenues through each quarter in FY18. TCS's digital dollar revenues surged 48.5% YoY in Q4FY18 vs. 22.2% YoY in the year-ago quarter, closing FY18 with ~38% growth vs. 28.7% in FY17. We expect a 30.7% digital revenue CAGR over FY18-FY21 given management's sustained commitment to digital investments. Receding challenges in the BFSI and retail verticals should aid growth from these businesses as well.

Initiate with BUY: TCS is currently trading at 24.6x/21.2x FY19E/FY20E P/E. Our Mar'19 TP of Rs 2,180 is based on 25x FY20E P/E, a 43% premium to closest peer Infosys.

Ticker/Price	TCS IN/Rs 1,848
Market cap	US$ 51.8bn
Shares o/s	1,926mn
3M ADV	US$ 70.4mn
52wk high/low	Rs 1,885/Rs 1,705
Promoter/FPI/DII	72%/17%/11%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	2,62,873	2,58,680	2,89,565	3,36,389	3,80,366
Adj. EPS (Rs)	66.7	67.2	75.2	87.3	98.8
Adj. EPS growth (%)	8.3	0.7	11.9	16.2	13.1
Adj. ROAE (%)	32.4	29.3	30.4	30.2	29.2
Adj. P/E (x)	27.7	27.5	24.6	21.2	18.7
EV/EBITDA (x)	10.9	10.8	9.1	7.8	6.7

Source: Company, BOBCAPS Research

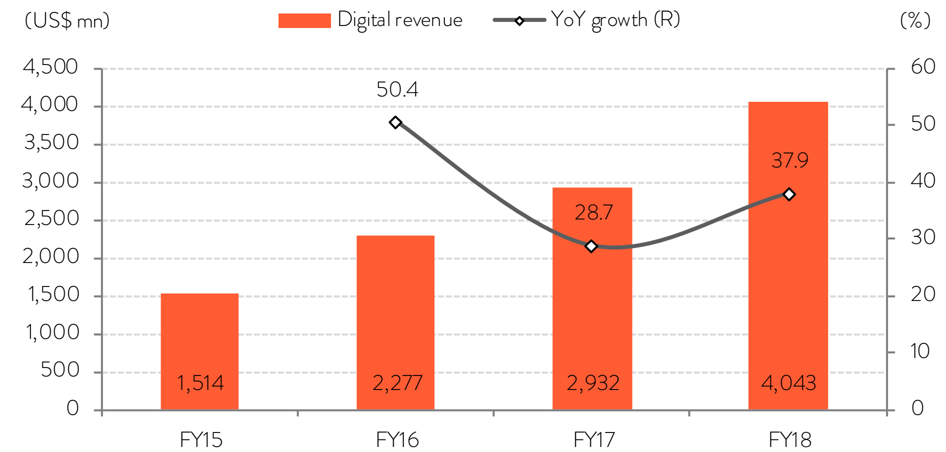
Investment rationale

Early build-up of digital capabilities

While other Indian IT majors are still focused on shaping and recalibrating their digital strategy, we believe TCS has a headstart facilitated by its early investments in digital asset/capability creation, talent development and technology partnerships. The company has created a significant depth of capabilities across big data analytics, digital marketing & channels, cloud & internet of things (IoT) and cyber security, cutting across a number of fast-evolving digital technologies.

Consequently, TCS reported digital revenues of US$ 4bn for FY18 (+38% YoY) and exited the Mar'18 quarter with 23.8% of overall revenues from the digital business vs. less than 10% in FY15.

FIG 1 – HEALTHY TRACTION IN DIGITAL REVENUES

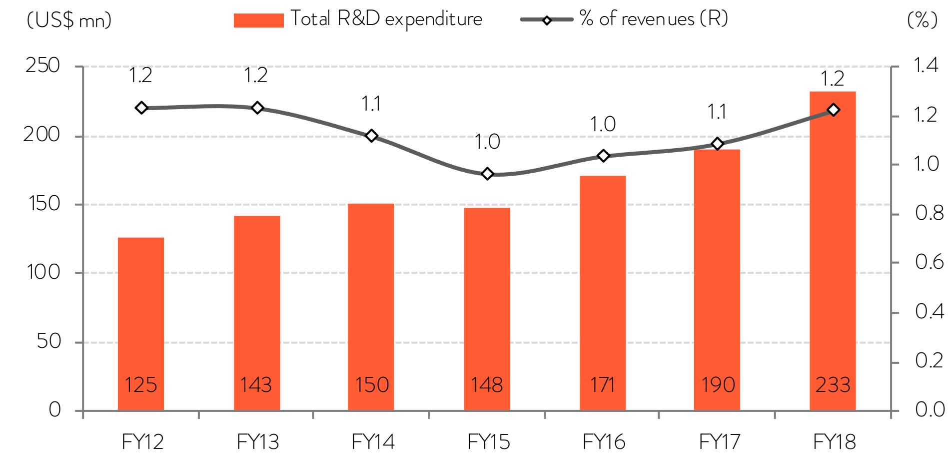


Source: Company, BOBCAPS Research

Key digital initiatives

- **Talent transformation:** TCS has invested in a Digital Learning Platform to reskill its workforce and also recalibrated hiring to cover a broader spectrum of diverse skills. In FY18, the company trained over 245,000 employees on 861,000 digital competencies and more than 200,000 employees on 'Agile' methodologies (aimed at enhancing client software quality via quick release cycles), resulting in over 5.6mn learning days.
- **R&D and innovation:** TCS has nine technology-focused innovation labs, seven vertical/domain-focused innovation labs and seven academic research alliances. In FY18, the company's research and innovation initiatives focused on personalisation of services, new value creation models and ecosystem leverage under three key themes: (1) Digital Spine, (2) Intelligent Enterprise and (3) Experience First.

FIG 2 – R&D SPEND INCREASED AT 16.2% CAGR OVER LAST 3 YEARS



Source: Company, BOBCAPS Research

FIG 3 – R&D THEMES

Digital Spine	Intelligent Enterprise	Experience First
Core modernisation	Big data analytics	Seamless transactions across channels and touchpoints
Digitisation, simplification, automation	Cognitive computing	Virtual, augmented, mixed reality
Robotics	Machine learning	Gamification
Cyber security	Customer insights	Chatbots
Internet of Things (IoT)	Monetisation of data	
Blockchain	Social media	
APIfication		
Cloud		

Source: Company, BOBCAPS Research

FIG 4 – INNOVATION AND R&D INVESTMENTS FUELLING ORGANIC DIGITAL CAPABILITIES

TCS Innovation labs	Research areas
Pune (Tata Research Development and Design Centre, TRDDC)	Software engineering, systems research, process engineering and life sciences, labs / research groups
Hyderabad	Security, open source, computational and systems biology, metagenomics and quantitative finance
Chennai	Sustainability R&D, next-gen web technologies, decision sciences and algorithms, human-centric systems, social media and cyber physical systems
Mumbai	Speech and natural language processing technologies, mobile-based social empowerment and performance engineering
Delhi	Data analytics and information fusion, web intelligence and text mining, multimedia, graphics and robotics, and natural language processing
Bangalore	Cyber physical systems and networks
Kolkata	Cyber physical systems and human systems
Cincinnati, USA	Innovation for Supply Chain Management and manufacturing systems
Peterborough, UK	Collaboration hub between TCS innovation labs across the world and customers. Enables customers to utilise the expertise of the TCS Co-Innovation Network (TCS COIN)

Source: Company, BOBCAPS Research

- **Nurturing technology partnerships and a start-up ecosystem:** TCS leverages a robust network of technology partners and a comprehensive startup ecosystem to offer differentiated solutions. Its Co-Innovation Network (COIN), operational for more than a decade and comprising a network of startups, venture capitalists and academia, enables the company to bring in new technologies at lower risk levels – a highly valued capability for its customers and partners. In FY18, COIN expanded its network to reach over 150 ecosystem partners, 3,000 startups and 50 academic partnerships.
- **Enhancing products and platforms:** TCS continues to enhance its portfolio and currently offers eight well established products and platforms (outlined below) that have enabled it to steadily expand its client base.

FIG 5 – DEEP DOMAIN EXPERTISE MONETISED VIA A PORTFOLIO OF 8 PRODUCTS AND PLATFORMS

TCS BaNCS	**TCS BaNCS** ▪ Holistic suite of solutions for the financial services sector ▪ 29 new wins and 25 go-live projects in FY18 ▪ Launched four new solutions in FY18: Quartz Blockchain Solution, BaNCS Application Development Kit, Analytics and TCS BaNCS Cloud
iON TATA CONSULTANCY SERVICES	**iON™ Assessment** ▪ Collaborative cloud-based learning platform for improved learning outcomes ▪ Over 100mn candidates assessed on iON ▪ Launched the iON Learning Hub in FY18, which offers lifelong learning solutions
ignio	**Ignio™** ▪ World-leading cognitive automation software ▪ Used by 55 Fortune 500 customers
ADD	**TCS's Advanced Drug Development Platform (ADD)** ▪ Data of over 100,000 patients pertaining to over 170 clinical trials processed in FY18 ▪ 14 customers globally; used by 5 of the Top 10 pharma companies
HOBS	**TCS Hosted OSS/BSS Solution (HOBS)** ▪ Comprehensive, pre-integrated suite of hosted OSS/BSS applications and pre-modelled business processes ▪ 30 customers globally
Optumera™	**Optumera™** ▪ Advanced digital merchandising suite ▪ Used by 7 of the world's leading retailers
tap™	**TAP™** ▪ Accounts payable platform ▪ Processed over 40mn invoices and purchase orders in FY18
TCS MasterCraft™	**TCS MasterCraft™** ▪ Digital platform to optimally automate and manage IT processes ▪ 93 active customers at the end of FY18 ▪ Beta version of 'Jile', a scalable agile software lifecycle delivery platform on the cloud, launched in Mar'18

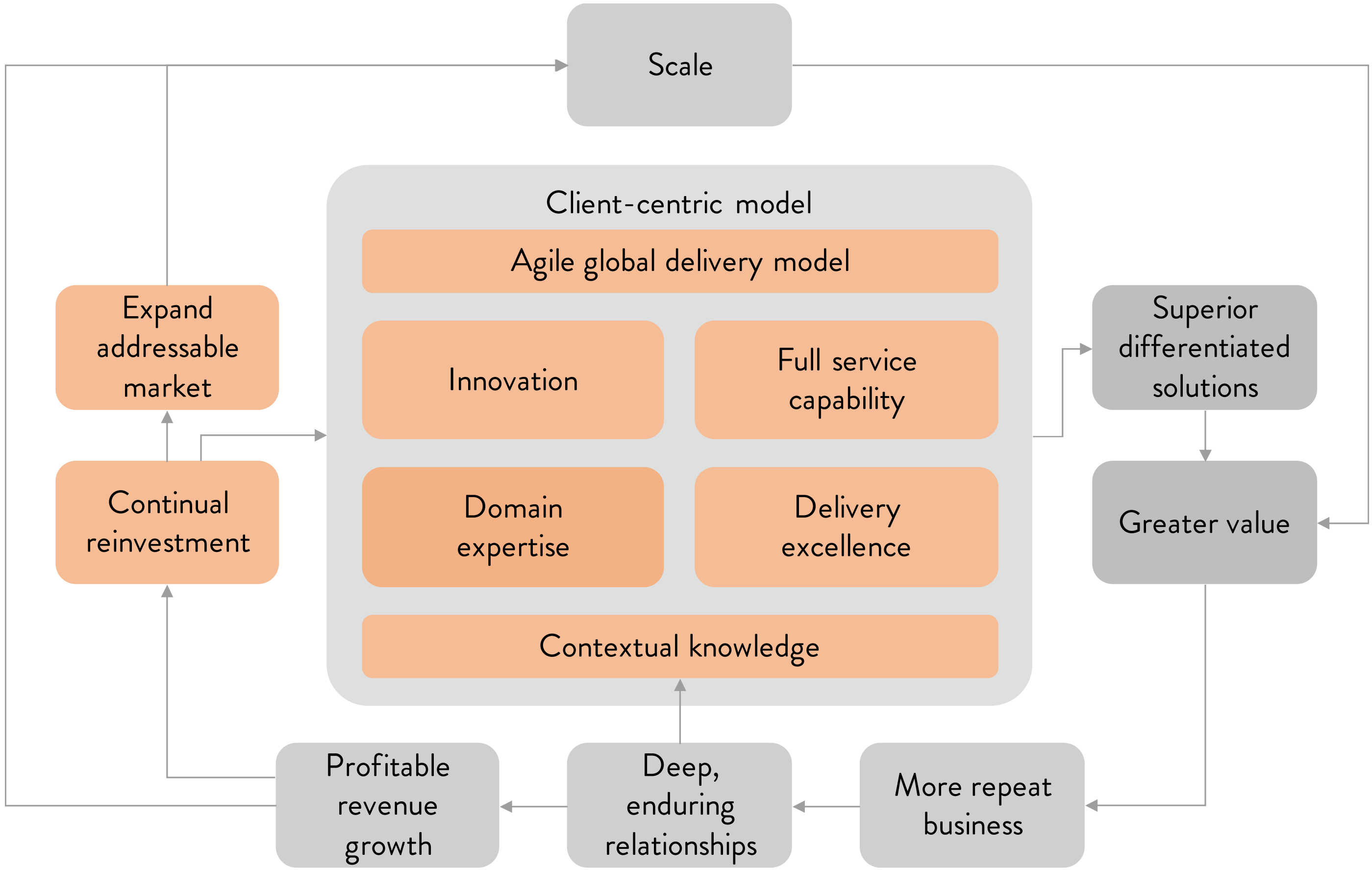
Source: Company, BOBCAPS Research

Honing a differentiated competitive edge

In our view, TCS's full-service capability backed by a rich portfolio of frameworks, products and platforms gives it a differentiated edge over peers when it comes to offering comprehensive digital solutions. In addition, the company extends full accountability and ownership of its solutions, reducing the execution risk for clients.

Management's strategic focus on complete solutions is well aligned with the shift in client preference toward end-to-end digital transformation (and not mere point solutions). Recent large deal wins (see Fig 7) in an era of scarce big-ticket deals are a testament to its differentiated digital capabilities.

FIG 6 – CLIENT-CENTRIC FULL-SERVICE STRATEGY TO DRIVE SCALE IN DIGITAL BUSINESS



Source: Company, BOBCAPS Research

FIG 7 – WON US$ 7BN+ DEALS IN LAST SIX MONTHS

Client	Date	Value (US$ bn)	Role
Transamerica	Jan'18	2.50	Enhance digital capabilities and simplify services into a single integrated modern platform
Scottish Widows	Jan'18	1.00	Provision of end-to-end policy administration services for 4mn customers
M&G Prudential	Jan'18	1.2	Digitally transform the business and deliver enhanced services for UK savings and retirement customers
Marks & Spencer	Jan'18	0.41	Transform the business into a digital-first business
Nielsen	Dec'17	2.25	Professional services relating to IT, including application development and maintenance for BPO, client service knowledge process outsourcing, management sciences, analytics and financial planning

Source: Company, BOBCAPS Research

Reorganisation to sharpen focus on digital scale-up

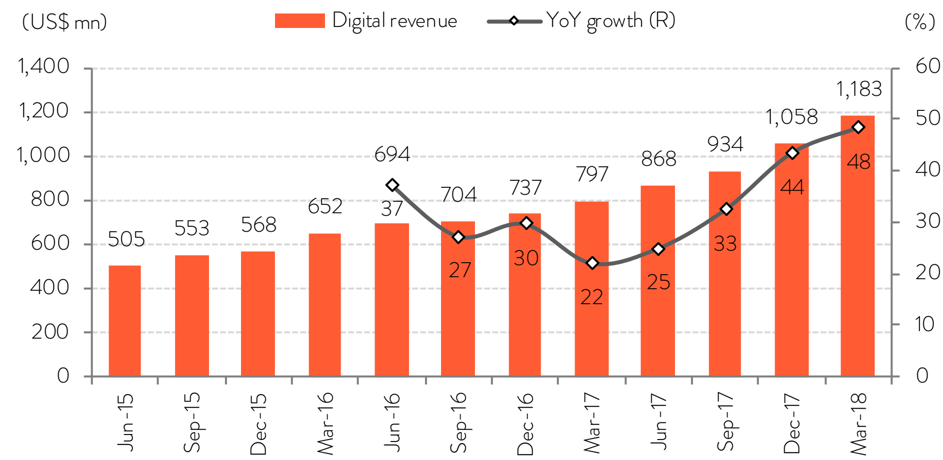
In FY18, TCS reorganised its business operations to sharpen focus on (a) scaling up the digital business and (b) emphasising its full-service strategy to offer end-to-end digital transformation. The reorganisation activity was initiated in the Jun'17 quarter and completed in the Sep'17 quarter. The new structure resulted in a horizontal service unit, named Business and Technology Service (BTS) Group, consisting of three sub-groups:

- **Digital Transformation Services:** Includes newly launched services such as (1) TCS Interactive, (2) Analytics and Insights, (3) IoT, (4) Cloud Services, (5) Digital Assurance, (6) Cyber Security and (7) Enterprise Application Services
- **Cognitive Business Operations:** Includes IT Services and Business Processes
- **Consulting and Systems Integration Group:** Unit serving as an orchestration arm that brings together various service teams to deliver transformational outcomes

The dedicated digital service practice has enhanced market focus and driven accelerated deal wins. In the Dec'17 quarter, TCS won 150 digital engagements including a US$ 50mn+ transformational deal (Rolls Royce IoT).

The early success of TCS's focused approach is further reflected in the acceleration in year-on-year digital revenue growth through each quarter in FY18. In the Mar'18 quarter, TCS's digital revenue (in US$ terms) increased by 48.5% YoY vs. 22.2% YoY in the Mar'17 quarter, rounding off FY18 with ~38% growth vs. 28.7% in FY17. We expect the momentum to continue and build in a 30.7% digital revenue CAGR over FY19-FY21.

FIG 8 – ACCELERATED DIGITAL REVENUE GROWTH IN RECENT QUARTERS



Source: Company, BOBCAPS Research

FIG 9 – PROGRESS OF NEW SERVICE LINES

Service line	Quarter	Comment
Cognitive Business Operations	Jun'17	Over 5 % QoQ growth, led by digital transformation for enterprise processes, cloud adoption, regulatory compliance and TCS platform-based services
	Sep'17	Value proposition around leveraging cognitive technologies to simplify and streamline business operations fast gaining traction. Two large deals drove sales momentum in Q2FY18
	Dec'17	Robust order book closures driven by three large deals in the consumer analytics, oil & gas and telecom industries
Digital Transformation Services	Jun'17	Very high client interest with 20+ initial engagements in the areas of connected home, mobility, energy management and remote monitoring. On the Digital Interactive side, multimillion dollar deal wins from two insurance clients and an energy client.
	Sep'17	IoT practice saw double-digit quarterly growth as mainstreaming of IoT deployments gathered steam, with several wins this quarter
	Dec'17	Robust growth led by public cloud, private cloud and application modernisation services. Digital Interactive, Cyber Security, IoT and Enterprise Application Services also saw steady growth
	Mar'18	Engineering for delivering 'first time right quality' for the Agile & DevOps-led digital business is driving strong demand across geographies and industries. TCS Interactive saw excellent double-digit growth powered by customer experience transformation and product/service design offerings
Consulting & Services Integration	Sep'17	Newly launched strategic offerings which combine consulting and multiple service lines saw more than 10 major wins in Q2 across Enterprise Agility, M&A, Global Shared Services, Supply Chain and Front Office Customer Experience Transformation
	Dec'17	Consulting-led transformations in the areas of M&A, Supply Chain, Future of Finance, and Customer Experience resulted in several marquee deal wins
	Mar'18	Near double-digit growth as TCS remains a trusted advisor to clients; division was instrumental in winning large multi-practice deals of strategic significance for customers

Source: Company, BOBCAPS Research

Strong, stable leadership team ensures cohesive business strategy

Of late, several Indian IT majors have suffered a major churn in top leadership. In contrast, TCS's management transition in FY17 was one of the most seamless among tier-I Indian IT services companies – even amid a change in CEO, the top leadership churn was minimal, limiting volatility within the organisation. Continued commitment to digital investments and a cohesive leadership have helped TCS to adroitly calibrate its strategy to the fast-changing client and industry dynamics.

FIG 10 – LEADERSHIP TEAM OVER THE YEARS

LEGEND: Stable Tenure 4yrs 5yrs | Lateral Promotions in Green

Management team	FY18	FY17	FY16	FY15	FY14
SENIOR MANAGEMENT					
CEO & MD	Rajesh Gopinathan	Rajesh Gopinathan	N Chandrasekaran**	N Chandrasekaran	N Chandrasekaran
COO & ED	N G Subramaniam	N G Subramaniam			
CFO	V Ramakrishnan	V Ramakrishnan	Rajesh Gopinathan	Rajesh Gopinathan	Rajesh Gopinathan
Global Head, Human Resources	Ajoyendra Mukherjee	Ajoyendra Mukherjee	Ajoyendra Mukherjee	Ajoyendra Mukherjee	Ajoyendra Mukherjee
Global Head, Delivery Exc., Governance & Compliance	Aarthi Subramanian	Aarthi Subramanian	Aarthi Subramanian	Aarthi Subramanian	Aarthi Subramanian
Research & Development Head	K Ananth Krishnan	K Ananth Krishnan	K Ananth Krishnan	K Ananth Krishnan	K Ananth Krishnan
Global Head, Marketing	Ravi Viswanathan	John Lenzen	John Lenzen	John Lenzen	John Lenzen
GEOGRAPHY HEADS					
North America, UK & Europe	Surya Kant	Surya Kant	Surya Kant	Surya Kant	Surya Kant
Latin America	Henry Manzano	Henry Manzano	Henry Manzano	Henry Manzano	Henry Manzano
India, Middle-East & Africa		Ravi Viswanathan	Ravi Viswanathan	Ravi Viswanathan	Ravi Viswanathan
Asia Pacific	Girish Ramachandran	Girish Ramachandran	Girish Ramachandran	Girish Ramachandran	
Japan	AS Lakshminarayanan	AS Lakshminarayanan	AS Lakshminarayanan	AS Lakshminarayanan	
STRATEGIC GROWTH UNIT HEADS					
BaNCS	Suresh Muthuswami (BFSI)	Venkateshwaran Srinivasan			
iON	Venguswamy Ramaswamy	Venguswamy Ramaswamy	Venguswamy Ramaswamy	Venguswamy Ramaswamy	Venguswamy Ramaswamy
Financial Solutions	Venkateshwaran Srinivasan		N G Subramaniam	N G Subramaniam	N G Subramaniam
TCS Platforms				Raj Agrawal	Raj Agrawal

Management team	FY18	FY17	FY16	FY15	FY14
INDUSTRY SERVICE UNIT HEADS					
Banking & Financial Services	K Krithivasan	K Krithivasan	K Krithivasan	K Krithivasan	K Krithivasan
Banking & Financial Services	Susheel Vasudevan	Susheel Vasudevan	Susheel Vasudevan	Susheel Vasudevan	Susheel Vasudevan
Banking & Financial Services	Ramanamurthy Magapu	Ramanamurthy Magapu	Ramanamurthy Magapu	Ramanamurthy Magapu	Ramanamurthy Magapu
Insurance & Healthcare	Suresh Muthuswami	Suresh Muthuswami	Suresh Muthuswami	Suresh Muthuswami	Suresh Muthuswami
Retail, Travel & Consumer Products	Pratik Pal	Pratik Pal	Pratik Pal	Pratik Pal	Pratik Pal
Life Sciences, Manufacturing & Energy	Debashis Ghosh	Debashis Ghosh	Debashis Ghosh	Debashis Ghosh	Debashis Ghosh
Manufacturing	Milind Lakkad	Milind Lakkad	Milind Lakkad	Milind Lakkad	Milind Lakkad
Communication, Media & Information Services	Kamal Bhadada	Kamal Bhadada	Kamal Bhadada	Kamal Bhadada	Kamal Bhadada
SERVICE UNIT HEADS					
Enterprise Solutions & Global Consulting Practice		Krishnan Ramanujam	Krishnan Ramanujam	Krishnan Ramanujam	Krishnan Ramanujam and J Rajagopal
Engineering & Industrial Services		Regu Ayyaswamy	Regu Ayyaswamy	Regu Ayyaswamy	Regu Ayyaswamy
Business Process Services	**Service units restructured into business technology solutions**	Dinanath Kholkar	Dinanath Kholkar	Dinanath Kholkar	Abid Ali Neemuchwala
IT Infrastructure Services		P R Krishnan	P R Krishnan	P R Krishnan	P R Krishnan
Assurance Services			Siva Ganesan*	Siva Ganesan	Siva Ganesan
Digital Enterprise Services & Solutions			Satya Ramaswamy	Satya Ramaswamy	Satya Ramaswamy
Business Technology Solutions	Krishnan Ramanujam				
	Regu Ayyaswamy				
	Dinanath Kholkar				
	P R Krishnan				

Source: Company, BOBCAPS Research | * Note: Since Jun'16 Mr. Siva Ganesan has been heading the Travel Transportation and Hospitality unit of TCS.
**Mr. N Chandrasekaran vacated the position to take charge as Chairman of Tata Sons

Receding challenges in BFSI and retail to aid growth

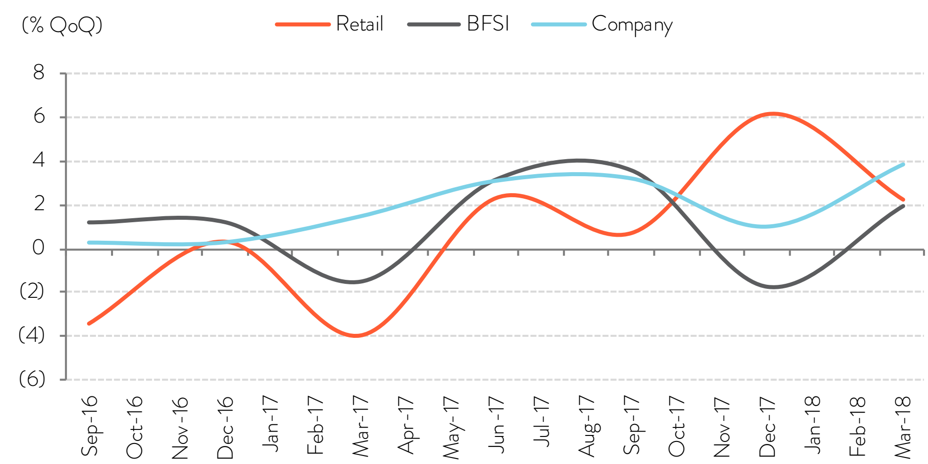
In H2FY17 and FY18, TCS faced challenges in its BFSI (~33% of overall revenues) and retail (~12% of overall revenues) portfolios due to structural weakness at brick-and-mortar retailers and insourcing activities of some large BFS clients in North America. In FY18, the company's BFS revenue increased a mere 4.2% in US$ terms (or 3.2% YoY in CC terms) versus overall revenue growth of 8.6% (6.7% CC). Similarly, retail revenues increased by 2.6% in FY18 (1.5% CC).

However, these challenges are receding and we are observing early signs of a growth recovery. In retail, the revenue growth trajectory has started to improve, with a strong rebound in the Dec'17 quarter and double-digit growth (11.7% YoY) in Q4FY18, despite the transient impact from bankruptcy at one retail client. Management is confident of stronger momentum in the retail vertical in FY19 on the back of (a) recent large deal wins (in Jan'18, TCS was chosen as principal technology partner by Marks & Spencer in a five-year contract) and (b) a healthy deal pipeline.

In the BFS vertical, while management continues to be watchful, commentary turned slightly optimistic in Q4FY18 when TCS stated that the revenue decline from some of its large BFS clients in North America had been arrested and that near-term demand visibility was much stronger than the previous year.

Even as BFS revenues were weak, the company continued to witness healthy traction in the insurance vertical, marked by strong deal wins including a 15-year deal for Dilligenta. We believe that emerging stability in large BFSI clients coupled with continued traction in the rest of the portfolio will support growth ahead. We build in 10.8% YoY US$ revenue growth for FY19E.

FIG 11 – IMPROVED OUTLOOK IN BFS AND RETAIL TO SUPPORT DOUBLE-DIGIT US$ REVENUE GROWTH IN FY19E



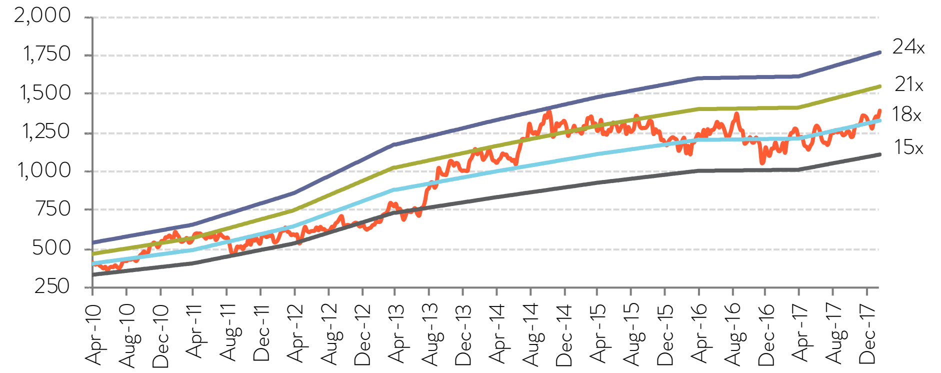
Source: Company, BOBCAPS Research

Valuation methodology

Amid structural challenges in the legacy revenue portfolio of tier-I companies, we believe TCS is well placed to lead growth in the digital business on the back of its (1) differentiated digital positioning backed by early investments in digital assets, talent building and technology alliances, (2) full-service focus, and (3) cohesive leadership and strategy.

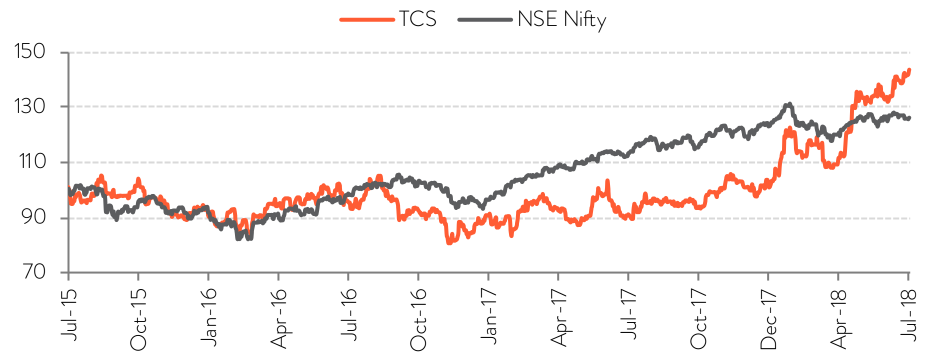
The stock is trading at 24.6x/21.2x FY19E/FY20E P/E. Our Mar'19 target price of Rs 2,180 is based on 25x FY20E P/E, a 43% premium to closest peer Infosys. Initiate with BUY.

FIG 12 – TCS TRADED AT AVERAGE 19.1X 12-MONTH ROLLING FORWARD P/E FOR LAST 5 YEARS



Source: Bloomberg, BOBCAPS Research

FIG 13 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- a sharp decline in IT spending,
- adverse currency movements,
- any inability to refresh service offerings amid the rapidly changing technologies, and
- execution risk in bundled deals.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**11,79,643**	**12,31,040**	**14,17,542**	**15,83,128**	**17,70,300**
EBITDA	3,23,093	3,25,160	3,80,400	4,28,391	4,79,053
EBIT	3,03,223	3,05,020	3,61,187	4,07,397	4,58,059
Other income/(expenses)	41,890	35,900	20,557	35,957	43,159
EBT	3,45,113	3,40,920	3,81,744	4,43,354	5,01,218
Income taxes	81,560	82,120	91,619	1,06,405	1,20,292
Min. int./Inc. from associates	(680)	(120)	(560)	(560)	(560)
Reported net profit	**2,62,873**	**2,58,680**	**2,89,565**	**3,36,389**	**3,80,366**
Adjusted net profit	**2,62,873**	**2,58,680**	**2,89,565**	**3,36,389**	**3,80,366**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Other current liabilities	1,63,830	2,05,190	2,01,951	2,25,541	2,52,207
Debt funds	2,890	2,470	2,470	2,470	2,470
Equity capital	1,970	1,910	1,910	1,910	1,910
Shareholders' fund	8,86,810	8,76,430	10,27,159	12,02,170	13,99,988
Total liabilities and equities	**10,53,530**	**10,84,090**	**12,31,580**	**14,30,182**	**16,54,665**
Cash and cash eq.	35,970	48,830	1,08,833	2,11,721	3,33,098
Accounts receivables	2,26,840	2,49,430	2,91,276	3,25,300	3,63,760
Other current assets	1,21,630	1,22,470	1,35,929	1,51,807	1,69,755
Investments	4,32,440	4,07,310	4,07,310	4,07,310	4,07,310
Net fixed assets	1,17,410	1,16,000	1,56,787	1,95,794	2,34,800
Intangible assets	37,680	38,960	38,960	38,960	38,960
Deferred tax assets, net	28,050	34,230	34,230	34,230	34,230
Other assets	53,510	66,860	58,255	65,060	72,752
Total assets	**10,53,530**	**10,84,090**	**12,31,580**	**14,30,182**	**16,54,665**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income + Depreciation	2,03,980	2,78,940	3,09,338	3,57,943	4,01,920
Interest expenses	(22,310)	(35,900)	(20,557)	(35,957)	(43,159)
Changes in working capital	(6,310)	4,580	(49,938)	(33,117)	(37,434)
Other operating cash flows	76,870	34,199	0	0	0
Cash flow from operations	**2,52,230**	**2,81,819**	**2,38,843**	**2,88,869**	**3,21,326**
Capital expenditures	(19,530)	(18,730)	(60,000)	(60,000)	(60,000)
Change in investments	(1,86,250)	(25,130)	0	0	0
Other investing cash flows	36,830	42,161	20,557	35,957	43,159
Cash flow from investing	**(1,68,950)**	**(1,699)**	**(39,443)**	**(24,043)**	**(16,841)**
Debt raised/repaid	210	0	0	0	0
Interest expenses	(740)	0	0	0	0
Dividends paid	(1,09,730)	(2,67,260)	(1,39,397)	(1,61,938)	(1,83,108)
Cash flow from financing	**(1,10,260)**	**(2,67,260)**	**(1,39,397)**	**(1,61,938)**	**(1,83,108)**
Changes in cash and cash eq.	**(26,980)**	**12,860**	**60,003**	**1,02,888**	**1,21,377**
Closing cash and cash eq.	**35,970**	**48,830**	**1,08,833**	**2,11,721**	**3,33,098**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	66.7	67.2	75.2	87.3	98.8
Adjusted EPS	66.7	67.2	75.2	87.3	98.8
Dividend per share	23.2	24.1	30.1	34.9	39.5
Book value per share	224.9	227.6	266.7	312.1	363.5

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	3.0	2.9	2.4	2.1	1.8
EV/EBITDA	10.9	10.8	9.1	7.8	6.7
Adjusted P/E	27.7	27.5	24.6	21.2	18.7
P/BV	8.2	8.1	6.9	5.9	5.1

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	76.2	75.9	75.9	75.9	75.9
Interest burden (PBT/EBIT)	113.8	111.8	105.7	108.8	109.4
EBIT margin (EBIT/Revenue)	25.7	24.8	25.5	25.7	25.9
Asset turnover (Revenue/Avg TA)	120.0	115.2	122.4	119.0	114.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	32.4	29.3	30.4	30.2	29.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	8.6	4.4	15.1	11.7	11.8
EBITDA	5.3	0.6	17.0	12.6	11.8
Adjusted EPS	8.3	0.7	11.9	16.2	13.1
Profitability & Return ratios (%)					
EBITDA margin	27.4	26.4	26.8	27.1	27.1
EBIT margin	25.7	24.8	25.5	25.7	25.9
Adjusted profit margin	22.3	21.0	20.4	21.2	21.5
Adjusted ROAE	32.4	29.3	30.4	30.2	29.2
ROCE	30.4	27.5	31.4	32.4	33.8
Working capital days (days)					
Receivables	72	71	70	71	71
Payables	72	74	72	68	68
Ratios (x)					
Gross asset turnover	10.0	10.5	10.4	9.0	8.2
Current ratio	2.7	2.4	2.9	3.3	3.7
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

ADD

TP: Rs 1,390 | ⮝ 6%

INFOSYS | IT Services | 04 July 2018

Robust capital return commitment to support valuations – ADD

The leadership churn at Infosys (INFO) – four CEOs in the last six years – has hindered strategy execution amid a crucial period of incumbency challenges and transitioning revenue flows for the IT industry. We expect a gradual growth recovery marked by a revenue/earnings CAGR of 9.8%/6.2% over FY18-FY21, as CEO Salil Parekh's new 'Navigate your Next' agenda scales up. In the interim, management's robust capital return commitment (~7.1% yield) should support the stock price. Initiate with ADD and a Mar'19 target price of Rs 1,390.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Transient leadership hampers strategy execution: INFO's CEO churn coupled with accompanying strategy swings and top-level exits has served to subdue revenue growth (6.1% in FY18 vs. 8.4% in FY17 in CC terms), impede large deal wins and mute revenues from the top 10/25 clients. New CEO Parekh's 'Navigate your Next' agenda is services-oriented as against his predecessor's product-oriented approach. In our view, this mimics strategic priorities at other tier-I peers, but growth acceleration at INFO will hinge on consistent, long-term execution.

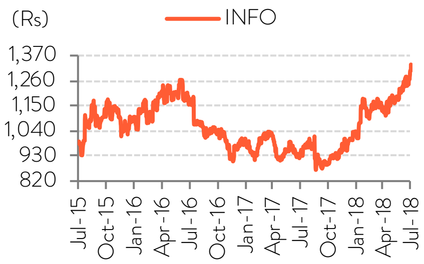
Expect a gradual growth recovery: We expect modest revenue growth in FY19 at 7.3% YoY CC – within the guided 6-8% YoY range – as the company trains its focus on large deal wins and accelerates investments in digital, sales, localisation and reskilling initiatives. On the flip side, these investments are likely to limit operating profit growth. Management has reset its target EBIT margin range for FY19 100bps lower to 22-24%. We expect EBIT margins of ~23.5% over FY19-FY21 and model for an earnings CAGR of 6.2%.

Robust dividend payouts; ADD: In addition to normal dividends (of up to 70% of FCF), the board has committed to return US$ 1.6bn to shareholders – implying a ~7.1% dividend yield, which should support the stock price. Our Mar'19 TP of Rs 1,390 is based on 17.5x FY20E EPS, a 30% discount to TCS.

Ticker/Price	INFO IN/Rs 1,307
Market cap	US$ 41.4bn
Shares o/s	2,174mn
3M ADV	US$ 74.1mn
52wk high/low	Rs 1,358/Rs 860
Promoter/FPI/DII	13%/35%/52%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	1,43,530	1,60,280	1,52,657	1,72,623	1,92,120
Adj. EPS (Rs)	62.8	73.8	70.2	79.4	88.4
Adj. EPS growth (%)	6.4	17.4	(4.8)	13.1	11.3
Adj. ROAE (%)	22.0	23.9	22.5	23.2	23.5
Adj. P/E (x)	20.8	17.7	18.6	16.5	14.8
EV/EBITDA (x)	14.1	13.9	12.4	11.0	9.7

Source: Company, BOBCAPS Research

Navigating choppy waters

Cohesive strategy missing amid a leadership in flux

INFO has had four new CEOs in the last six years, with each transition at the helm accompanied by strategy disruptions and a flurry of top-level exits (Fig 2). The latest leadership change has involved not just the customary slowdown in strategic execution but also the unravelling and reshaping of various initiatives. For instance, the 'Panay/Skava' investments are being retooled in line with new CEO Salil Parekh's preference for a service-oriented approach over his predecessor's platform/product-oriented focus.

The lack of strategic continuity is reflected in the revenue growth guidance cut for FY18 (from 6.5-8.5% to 5.5-6.5% in Oct'17), weak large deal wins and sluggish revenue growth from the top 10/25 clients.

FIG 1 – BUSINESS STRATEGY INCONSISTENT DUE TO LEADERSHIP CHURN

Year	CEO	Strategy	Strategy objectives
FY11-FY13	SD Shibulal	Infosys 3.0	Targeting 1/3rd of revenues from new technologies, 1/3rd from Business IT services (BITS) ADM, IMS, Testing and BPO, and 1/3rd from Consulting & System Integration
FY14	NR Murthy	Large-deal focus	Focus on efficient execution and large competitive outsourcing deals
FY15	Vishal Sikka	Vision 2020, Renew.New	Platform/product focus for new services
FY18	Salil Parekh	Navigate your Next	Service-oriented approach for the digital business

Source: Company, BOBCAPS Research

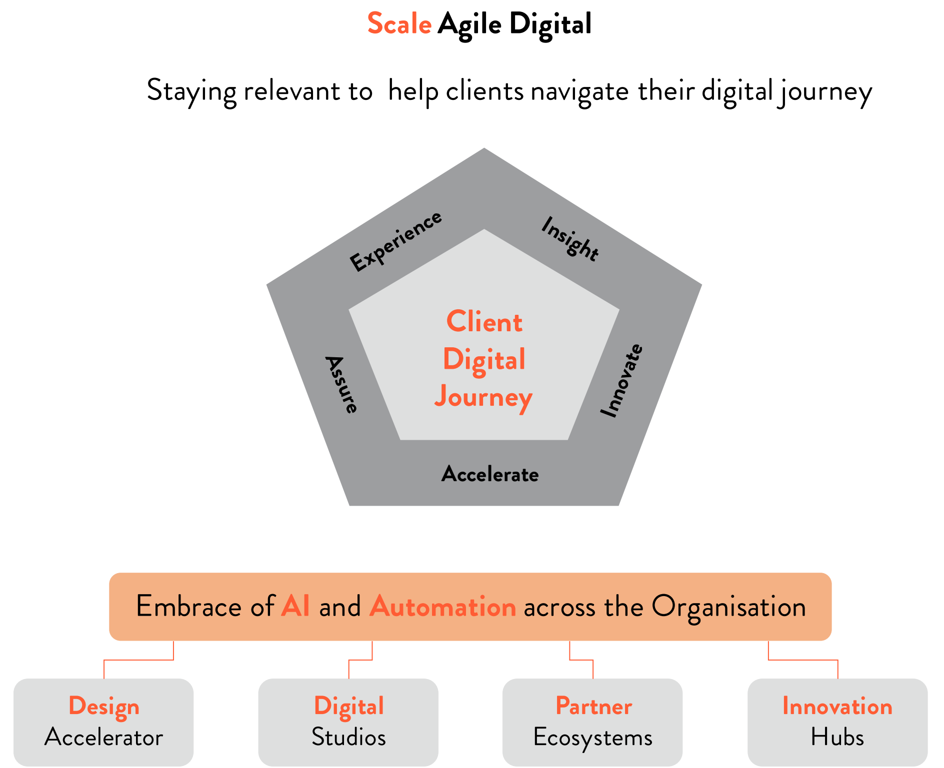
FIG 2 – SLEW OF TOP EXECUTIVE EXITS IN RECENT YEARS

Name	Position held	Resigned in
Sangita Singh	Executive Vice President, Head, Healthcare and Life Science	Jun'18
Nitesh Banga	Senior VP and Global Head of Manufacturing and Edge Products	Jun'18
Rajesh Murthy	President, Head of Europe, Global Head of Energy, Utilities, Telecommunications and Services	Jan'18
Ritika Suri	Executive Vice President, Head, Corporate Development and Mergers & Acquisitions	Jul'17
Yusuf Bashir	Managing Director, Innovation Fund and Vice President, New Products	Jul'17
Anirban Dey	Global Head and Chief Business Officer, EdgeVerve	Jul'17
Sandeep Dadlani	President, Head of Americas, Global Head of Manufacturing, Retail, Consumer Packaged Goods & Logistics	Jun'17
David Kennedy	Executive Vice President, General Counsel, and Chief Compliance Officer	Jan'17
Sanjay Purohit	Executive Vice President, Head, Consulting	Sep'16

Source: Company, BOBCAPS Research

At a broader level, the company's strategy mimics that of other IT service peers, i.e. use of automation in legacy services to limit the impact of deflationary pressure coupled with an innovation-led approach to build digital capabilities. In our view, stable leadership, a consistent business strategy and focused execution will be critical for the company going ahead.

FIG 3 – SUCCESS OF NEW STRATEGY HINGES ON EXECUTION

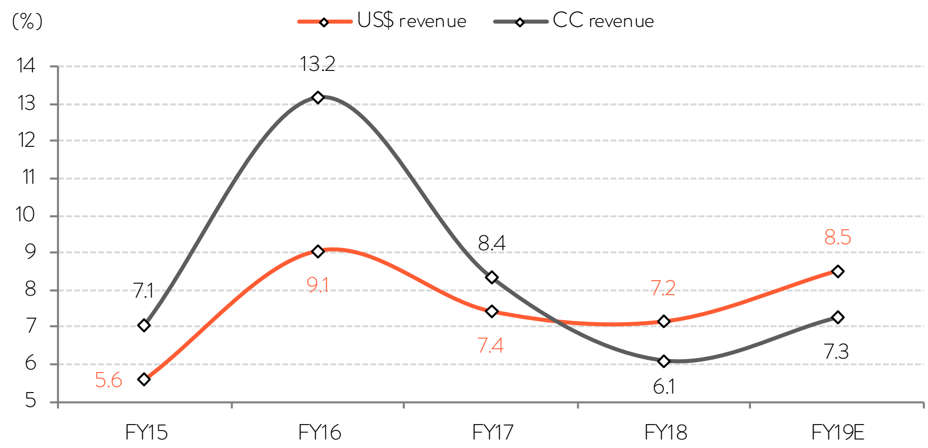


Source: Company, BOBCAPS Research.

Expect a gradual growth recovery

After the dramatic leadership change in FY18, which was followed by a cut in revenue guidance and lower constant-currency revenue growth that year, we expect a modest uptick for FY19. We build in 7.3% YoY CC revenue growth (8.5% YoY US$ growth) – within the guided 6-8% YoY CC range – as the company focuses on large deal wins and growing larger accounts. Over our forecast period of FY18-FY21, we model for a 9.8%/6.2% US$ revenue/earnings CAGR.

FIG 4 – WE EXPECT 7.3% YoY CC REVENUE GROWTH IN FY19E



Source: Company, BOBCAPS Research

FIG 5 – REVENUE SHARE BY VERTICAL AND MANAGEMENT'S OUTLOOK

Vertical-wise revenue share	FY18 (% of revenue)	Management earnings commentary: Q4FY18
BFSI	33.2	▪ Expect better growth in BFS next year due to a diversified portfolio along with a strong presence in Europe
Manufacturing	22.0	▪ Demand in the manufacturing sector remains moderate due to low client spending budgets ▪ The sector is, however, looking towards digitisation of end-to-end processes with a focus on integrating mobile, IoT and back-end systems
Telecom	10.5	▪ Healthy growth in Telecom to continue as clients spend on IoT and security
Retail & CPG	13.8	▪ Retail sector in the US continues to slow, while Europe and Rest of the World are seeing better growth as clients accelerate their digital transformation agenda
Energy & Utilities	5.6	▪ Demand remains strong on the back of opportunities in areas such as analytics in energy and smart meters in utilities
Healthcare & Lifesciences	6.6	▪ Healthcare is witnessing increasing demand driven by population growth, an aging population and increased incidence of ill health ▪ Strong client focus on pay-for-performance with operating models being linked to specific outcomes and technologies, such as personalisation of care ▪ Legacy modernisation, digital health and analytics, and care management are other key drivers

Source: Company, BOBCAPS Research

'Navigate your Next' strategy and the margin impact

INFO's newest 'Navigate your Next' strategy entails a three-year roadmap with the goalposts of 'stabilising' in FY19, 'building momentum' in FY20 and 'accelerating' in FY21. This will be underpinned by four key initiatives: (1) scale Agile Digital, (2) energise the core, (3) reskill, and (4) expand localisation.

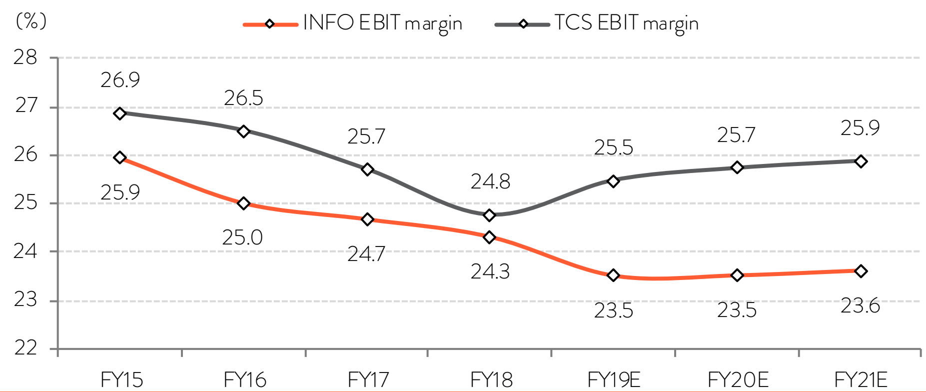
Key investments planned to drive execution focus on the digital business are:

- **Go-to-market:** Scaling large accounts, shaping large deals with deal specialists and differentiated solutions, acquiring new accounts, unlocking agile digital growth, enabling sales through Infosys Sales Academy, and nurturing systems to connect and collaborate
- **Localisation:** Four innovation hubs in North America to be operational in FY19, along with a continued commitment to hire 10,000 Americans (announced in May'17)
- **Digital capabilities:** Reskilling, investments to expand Digital Studios (from 10 currently), partner ecosystems and innovation hubs

While these initiatives at their core resonate with the changing strategic direction of IT service players across the industry, the accompanying investments will take a toll on margins. We note that INFO's operating margin performance has been resilient compared to TCS/WPRO on the back of better utilisation (+280bps YoY in FY18 excluding trainees) and onsite-offshore role rationalisation (offshore revenues up 11.3% YoY vs. onsite revenue growth of 4.9% YoY).

While management stays committed to driving operational efficiencies, the leeway to further optimise these traditional levers is limited. Besides, given plans to accelerate investments in digital, sales, localisation and reskilling initiatives, management has reset its target EBIT margin range for FY19 100bps lower to 22-24%. We expect EBIT margins of 23.5% each for FY19 and FY20.

FIG 6 – INVESTMENT PRIORITY TO WEIGH ON OPERATING MARGINS



Source: Company, BOBCAPS Research

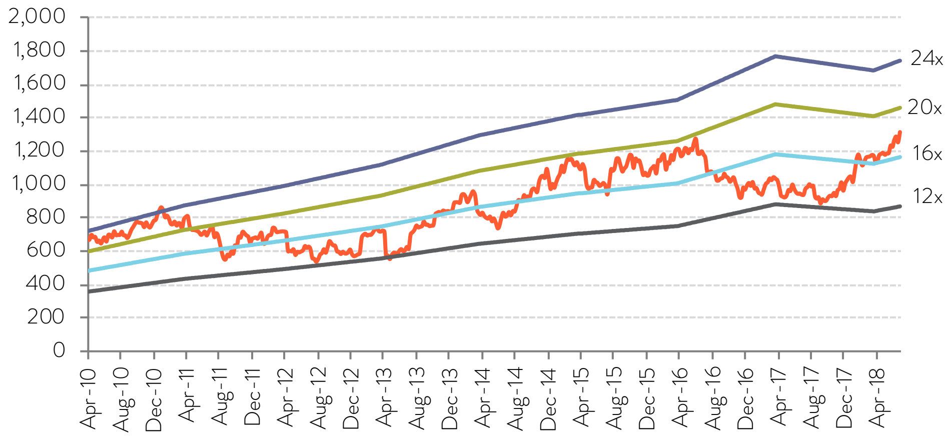
Capital return commitments to support stock price

In addition to normal dividends (of up to 70% of free cash flow), the board has committed to return US$ 2bn to shareholders. Of this, US$ 400mn announced as special dividend was paid in Jun'18 and the remaining amount of US$ 1.6bn will be paid in FY19. This translates into ~7.1% dividend yield, which in our view should support the stock price going ahead.

Valuation methodology

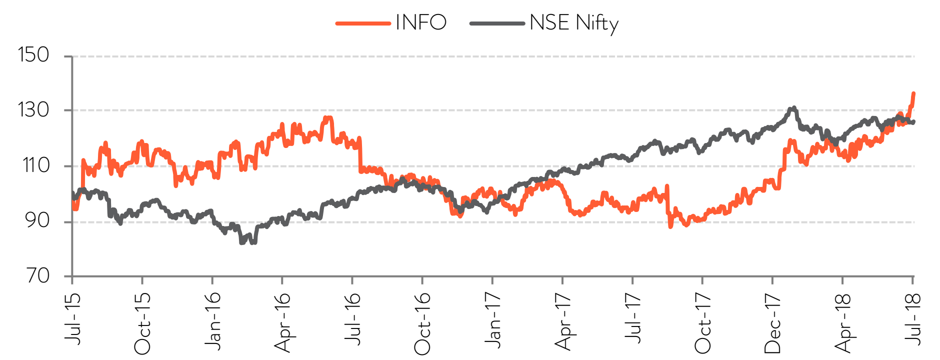
We expect modest growth acceleration over FY18-FY21 as INFO's 'Navigate your Next' strategy shapes up. In the near term, we believe the company's robust capital return commitments in addition to normal payouts will support the stock price. We initiate coverage with ADD and a Mar'19 target price of Rs 1,390, based on a target P/E of 17.5x FY20E EPS, a 30% discount to TCS.

FIG 7 – INFOSYS TRADED AT AVERAGE 15.9X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research

FIG 8 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Downside risks:** Weaker-than-expected demand, more stringent visa regulations, below-expected operating margins for new engagements/ renewals and leadership changes are key downside risks.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**6,84,850**	**7,05,220**	**7,95,412**	**8,83,582**	**9,76,444**
EBITDA	1,86,050	1,90,100	2,05,890	2,27,861	2,51,816
EBIT	1,69,020	1,71,480	1,86,999	2,07,804	2,30,593
Net interest income/(expenses)	26,590	26,130	22,120	28,666	32,585
Other income/(expenses)	30,490	31,220	22,120	28,666	32,585
EBT	1,99,510	2,02,700	2,09,119	2,36,470	2,63,179
Income taxes	55,980	42,420	56,462	63,847	71,058
Reported net profit	**1,43,530**	**1,60,280**	**1,52,657**	**1,72,623**	**1,92,120**
Adjusted net profit	**1,43,530**	**1,60,280**	**1,52,657**	**1,72,623**	**1,92,120**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Other current liabilities	1,39,680	1,44,740	1,67,799	1,86,400	2,05,990
Provisions	4,050	4,920	6,538	7,262	8,026
Equity capital	11,440	10,880	10,880	10,880	10,880
Reserves & surplus	6,78,380	6,38,360	6,99,156	7,67,903	8,44,415
Shareholders' fund	6,89,820	6,49,240	7,10,036	7,78,783	8,55,295
Total liabilities and equities	**8,33,550**	**7,98,900**	**8,84,373**	**9,72,445**	**10,69,310**
Cash and cash eq.	2,26,250	1,98,180	2,87,888	3,43,874	4,07,942
Accounts receivables	1,23,220	1,31,420	1,43,828	1,59,771	1,76,562
Other current assets	36,480	42,610	41,405	45,995	50,829
Investments	1,64,230	1,21,630	1,21,630	1,21,630	1,21,630
Net fixed assets	1,61,440	1,46,010	1,43,869	1,40,688	1,36,340
CWIP	19,650	0	0	0	0
Deferred tax assets, net	5,400	12,820	12,820	12,820	12,820
Other assets	1,16,530	1,46,230	1,32,932	1,47,667	1,63,186
Total assets	**8,33,550**	**7,98,900**	**8,84,373**	**9,72,445**	**10,69,310**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income + Depreciation	1,04,030	1,10,630	1,71,548	1,92,680	2,13,343
Interest expenses	(26,680)	(23,600)	(22,120)	(28,666)	(32,585)
Changes in working capital	(21,560)	840	26,772	(15,943)	(16,791)
Other operating cash flows	59,520	43,780	0	0	0
Cash flow from operations	**1,15,310**	**1,31,650**	**1,76,200**	**1,48,071**	**1,63,966**
Capital expenditures	0	0	(16,750)	(16,875)	(16,875)
Change in investments	(65,390)	20,980	0	0	0
Other investing cash flows	(81,250)	24,350	22,120	28,666	32,585
Cash flow from investing	**(1,46,640)**	**45,330**	**5,370**	**11,791**	**15,710**
Equities issued/Others	0	50	0	0	0
Dividends paid	(69,390)	(2,05,100)	(91,861)	(1,03,876)	(1,15,608)
Cash flow from financing	**(69,390)**	**(2,05,050)**	**(91,861)**	**(1,03,876)**	**(1,15,608)**
Changes in cash and cash eq.	**(1,00,720)**	**(28,070)**	**89,708**	**55,986**	**64,068**
Closing cash and cash eq.	**2,26,250**	**1,98,180**	**2,87,888**	**3,43,874**	**4,07,942**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	62.8	73.8	70.2	79.4	88.4
Adjusted EPS	62.8	73.8	70.2	79.4	88.4
Dividend per share	25.8	43.5	35.1	39.7	44.2
Book value per share	301.9	298.8	326.5	358.2	393.3

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	3.8	3.7	3.2	2.8	2.5
EV/EBITDA	14.1	13.9	12.4	11.0	9.7
Adjusted P/E	20.8	17.7	18.6	16.5	14.8
P/BV	4.3	4.4	4.0	3.6	3.3

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	71.9	79.1	73.0	73.0	73.0
Interest burden (PBT/EBIT)	118.0	118.2	111.8	113.8	114.1
EBIT margin (EBIT/Revenue)	24.7	24.3	23.5	23.5	23.6
Asset turnover (Revenue/Avg TA)	86.3	86.4	94.5	95.2	95.6
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	22.0	23.9	22.5	23.2	23.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	9.7	3.0	12.8	11.1	10.5
EBITDA	8.9	2.2	8.3	10.7	10.5
Adjusted EPS	6.4	17.4	(4.8)	13.1	11.3
Profitability & Return ratios (%)					
EBITDA margin	27.2	27.0	25.9	25.8	25.8
EBIT margin	24.7	24.3	23.5	23.5	23.6
Adjusted profit margin	21.0	22.7	19.2	19.5	19.7
Adjusted ROAE	22.0	23.9	22.5	23.2	23.5
ROCE	32.2	29.6	31.3	35.4	38.2
Working capital days (days)					
Receivables	63	66	63	63	63
Payables	99	101	97	99	99
Ratios (x)					
Gross asset turnover	4.4	4.6	5.5	6.2	7.0
Current ratio	3.5	3.5	3.5	3.6	3.7
Net interest coverage ratio	6.4	6.6	8.5	7.2	7.1
Adjusted debt/equity	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)

Source: Company, BOBCAPS Research

SELL
TP: Rs 240 | ∨ 8%

WIPRO | IT Services | 04 July 2018

Growth recovery elusive – initiate with SELL

We initiate coverage on Wipro (WPRO) with SELL and a Mar'19 target price of Rs 240. Despite several strategic initiatives over the last six years, WPRO's growth recovery remains a work-in-progress. Management's tepid dollar revenue guidance for the Jun'18 quarter (–2% to –0.1% QoQ) points to yet another year of subpar growth and peer underperformance. In our view, patchy execution would continue to hinder a recovery, limiting US$ revenue/ earnings growth to a 5.6%/6.2% CAGR over FY18-FY21E.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Revenue growth momentum weak: Several strategic interventions over the last six years, such as 'non-linearity' and 'hyper-automation', have failed to revive WPRO's growth trajectory. Over FY12-FY18, the company's US$ revenues have increased at a CAGR of just 5.2% vs. 10.1% for other tier-I peers. We expect tepid revenue growth in FY19 as well, given management's soft Q1 outlook – the weakest since FY10 – coupled with frailty in the healthcare vertical due to lingering regulatory uncertainty over the fate of Obamacare.

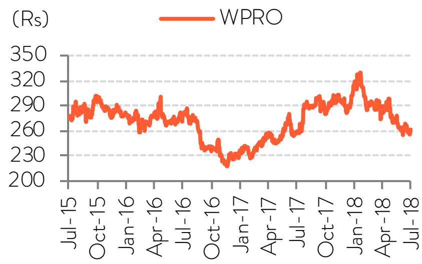
Operating margins remain at risk: Despite a focus on profitability over the past two years, reported IT services EBIT margins have plunged 460bps in FY17-FY18 (360bps adjusted for one-off provisioning due to client insolvency). We build in moderate margin improvement (150bps) over FY18-FY21 but expect pressures to persist amid weak revenue growth and continued pricing deflation in traditional services.

Initiate with SELL: In our view, a growth recovery will continue to elude WPRO, driving downside risks to consensus earnings estimates. We model for a 6.2% earnings CAGR over FY18-FY21 and value the stock at 12x FY20E EPS, a ~10% discount to closest peer HCLT, leading to a Mar'19 TP of Rs 240.

Ticker/Price	WPRO IN/Rs 261
Market cap	US$ 17.1bn
Shares o/s	4,512mn
3M ADV	US$ 10.5mn
52wk high/low	Rs 334/Rs 252
Promoter/FPI/DII	74%/9%/17%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	82,723	80,046	82,147	89,532	95,951
Adj. EPS (Rs)	17.1	17.7	18.2	19.8	21.3
Adj. EPS growth (%)	(5.8)	4.0	2.6	9.0	7.2
Adj. ROAE (%)	16.7	15.9	15.7	15.0	14.1
Adj. P/E (x)	15.3	14.7	14.3	13.1	12.3
EV/EBITDA (x)	11.2	12.0	10.5	9.2	8.6

Source: Company, BOBCAPS Research

Growth revival elusive

Revenue and margin outlook muted despite strategic push

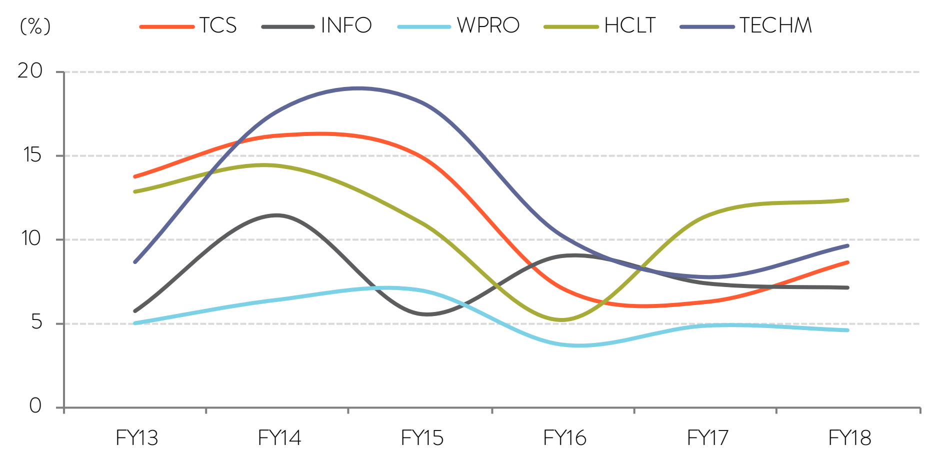
Over the last two years, WPRO has intensified its focus on two key initiatives – non-linearity and hyper-automation – as part of its ambitious Vision 2020 strategy. Vision 2020 targets US$ 15bn in revenues with 23% operating margins (vs. US$ 8bn in revenues with 15.8% IT services EBIT margins achieved in FY18).

- The non-linearity measures aimed at increasing intellectual property (IP) income enabled WPRO to round off FY18 with US$ 100mn+ in IP revenues.
- 'Holmes', an in-house automation platform, led the company's hyper-automation efforts and generated productivity worth ~8,000 level-2 full-time employee equivalents (FTE) in FY18 as it was deployed across 320 customers.

Business growth still lags that of peers

Despite these strategic interventions, WPRO's US dollar revenue growth trajectory continues to lag that of tier-I IT services players. Over the last six years, the company's US$ revenues have increased at a CAGR of 5.2% vs. 10.1% for large peers. WPRO's current strategy focused on client mining, intensive automation and chasing digital growth mimics strategic imperatives at other peers, but progress thus far does not offer confidence for a meaningful growth recovery.

FIG 1 – WIPRO'S US$ REVENUE GROWTH CONTINUES TO LAG PEERS DESPITE STRATEGIC MEASURES

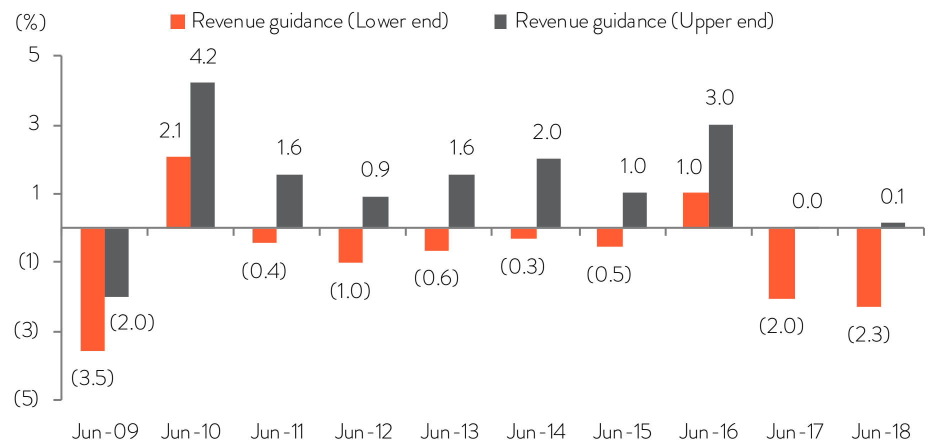


Source: Company, BOBCAPS Research

As against management's indications of matching industry growth by the Mar'18 quarter, WPRO's constant-currency (CC) revenue growth slowed from 7% in FY17 to 3% in FY18 – the slowdown stemmed from revenue leakage due to client bankruptcy in the telecom and energy/utilities verticals, as well as regulatory uncertainty over the US's Affordable Care Act.

A soft start to FY19 with management guiding for revenue growth of –2% to –0.1% QoQ for the Jun'18 quarter – the lowest Q1 guidance since FY10 – implies yet another year of tepid growth for WPRO. We expect the company to deliver 3.8% US$ revenue growth in FY19, with a 5.6% CAGR over FY18-FY21.

FIG 2 – JUN'18 QUARTER REVENUE GUIDANCE THE LOWEST SINCE FY10

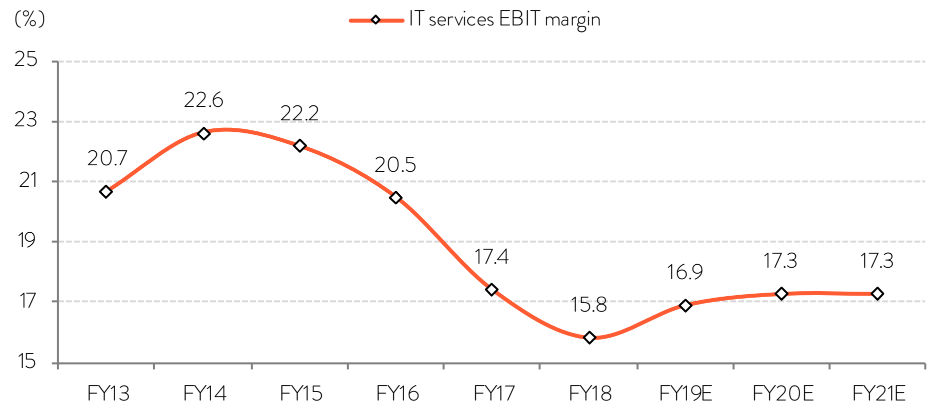


Source: Company, BOBCAPS Research

Margin downslide continues

Despite management's emphasis on non-linearity and hyper-automation over FY17 and FY18, reported EBIT margins in IT services have declined by 460bps over the past two years (down 360bps upon adjusting for one-off provisioning due to client insolvency and consolidation of lower-margin entities). We note that this margin contraction was accompanied by a 230bps drop-off in gross margins, while SG&A investments increased by 130bps (excluding one-off provisions) over FY16-FY18.

FIG 3 – REPORTED IT SERVICES EBIT MARGINS DECLINED 470BPS OVER FY16-FY18



Source: Company, BOBCAPS Research

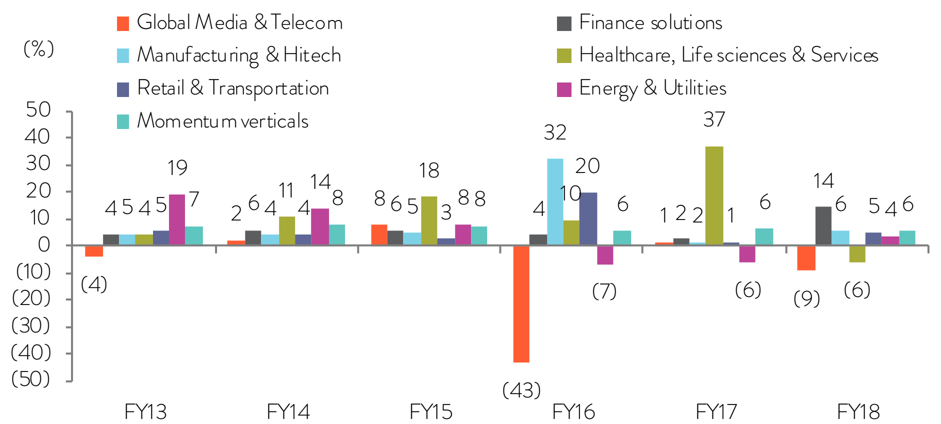
We build in modest EBIT margin improvement (150bps over FY18-FY21 to 17.3%) but expect margin pressure to persist amid weak revenue growth and continued price deflation in traditional services.

Right direction but patchy execution; consensus earnings at risk

WPRO's growth strategy is focused on a total of six core initiatives: (1) digital – invested >US$ 1bn over the last three years toward M&A, (2) client mining – set up a dedicated business unit to mine top clients, (3) geographical expansion – deployed organic and inorganic investments to ramp-up growth outside North America, (4) non-linearity – earned US$ 100mn+ in revenues from non-linear measures in FY18, (5) hyper-automation – launched automation platform Holmes, and (6) partner ecosystem – invested in 11 start-ups.

The company has stayed committed to these investments over the last two years, but patchy execution has led to mixed results. For instance, in FY18, when US$ revenues from the BFSI vertical increased by 14.2% YoY, revenues excluding BFSI increased just 1.3% YoY.

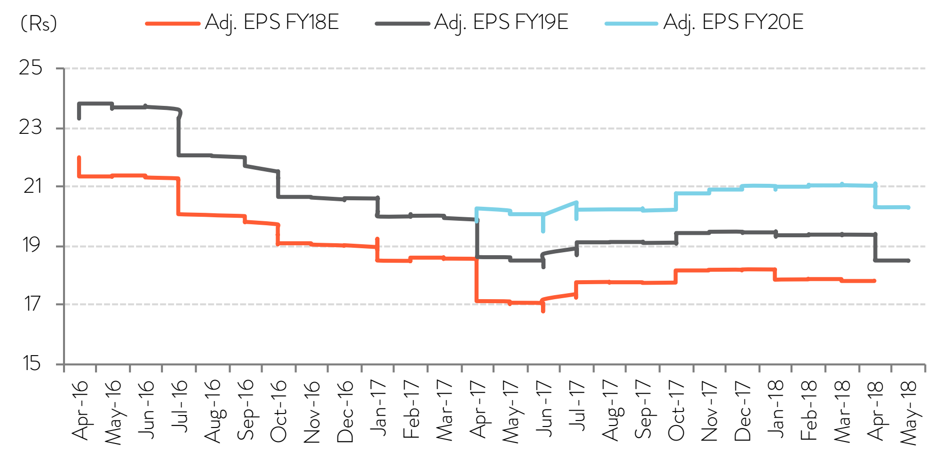
FIG 4 – VERTICAL-WISE REVENUE GROWTH VOLATILE



Source: Company, BOBCAPS Research

Given WPRO's inconsistent performance, wherein growth in a few key focus areas has been diluted by a laggardly performance in others, consensus earnings estimate for FY19 have been downgraded by ~21% over the last two years. The street is currently factoring in a 7.2% CAGR in earnings over FY18-FY21 with 180bps operating margin improvement.

FIG 5 – BLOOMBERG CONSENSUS EARNINGS DOWNGRADED OVER LAST TWO YEARS



Source: BLOOMBERG, BOBCAPS Research

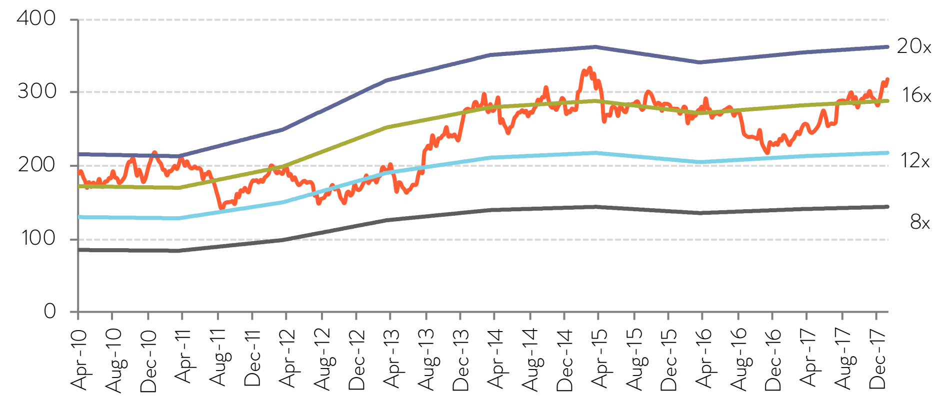
We see downside risks to consensus earnings driven by revenue leakage in the healthcare vertical due to lingering regulatory uncertainty over Obamacare, a lack of broad-based growth and sustained margin pressures. Accordingly, we build in a lower earnings CAGR of 6.2% over FY18-FY21 with best-case 150bps margin gains.

Valuation methodology

Despite several strategic interventions, WPRO has underperformed its tier-I IT service peers in terms of revenues and earnings over the past six years. Management's weak –2% to –0.1% QoQ US$ revenue growth guidance for the Jun'18 quarter implies yet another year of subpar growth. While we acknowledge that the company's strategic moves are steps in the right direction, we believe patchy, inconsistent execution will remain a drag on growth.

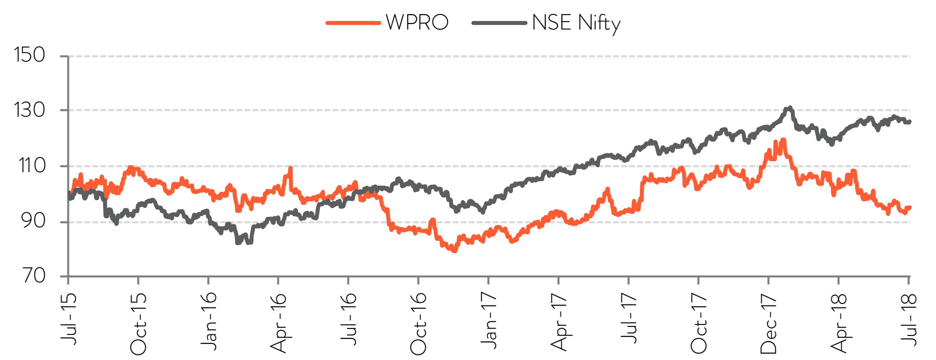
The stock is currently trading at 14.4x/13.2x FY19E/FY20E P/E. Our Mar'19 target price of Rs 240 is based on 12x FY20E EPS, a ~10% discount to closest peer HCL Tech. Initiate with SELL.

FIG 6 – WIPRO TRADED AT AVERAGE 15.2X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: Bloomberg, BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates include:

- a sharper recovery in demand than expected,
- stronger-than-estimated large deal wins, and
- sharp, favourable currency movements.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**5,54,179**	**5,46,359**	**5,57,566**	**5,94,397**	**6,34,466**
EBITDA	1,12,904	1,05,418	1,12,377	1,21,793	1,29,920
EBIT	89,797	84,294	91,191	99,208	1,05,812
Net interest income/(expenses)	13,521	18,169	15,749	17,324	19,056
Other income/(expenses)	4,867	0	0	0	0
EBT	1,08,185	1,02,463	1,06,940	1,16,532	1,24,868
Income taxes	25,214	22,390	24,593	26,800	28,717
Min. int./Inc. from associates	248	27	200	200	200
Reported net profit	**82,723**	**80,046**	**82,147**	**89,532**	**95,951**
Adjusted net profit	**82,723**	**80,046**	**82,147**	**89,532**	**95,951**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	1,20,521	1,33,177	1,23,734	1,31,907	1,40,799
Provisions	1,274	799	1,375	1,466	1,564
Debt funds	1,42,412	1,38,259	1,38,259	1,38,259	1,38,259
Other liabilities	6,614	3,059	3,059	3,059	3,059
Equity capital	4,861	9,048	9,048	9,048	9,048
Reserves & surplus	5,17,834	4,76,298	5,48,758	6,27,716	7,12,319
Shareholders' fund	5,22,695	4,85,346	5,57,806	6,36,764	7,21,367
Total liabilities and equities	**7,93,516**	**7,60,640**	**8,24,233**	**9,11,455**	**10,05,049**
Cash and cash eq.	52,710	44,925	1,28,798	1,99,518	2,75,808
Accounts receivables	98,844	1,00,990	1,00,820	1,07,480	1,14,725
Inventories	3,915	3,370	4,583	4,885	5,215
Other current assets	1,12,296	1,45,107	1,22,970	1,31,093	1,39,930
Investments	2,99,133	2,59,200	2,59,200	2,59,200	2,59,200
Net fixed assets	69,794	64,443	65,258	66,673	67,565
CWIP	8,951	15,166	15,166	15,166	15,166
Intangible assets	1,41,718	1,35,697	1,35,697	1,35,697	1,35,697
Deferred tax assets, net	15,106	6,908	6,908	6,908	6,908
Total assets	**7,93,516**	**7,60,640**	**8,24,233**	**9,11,455**	**10,05,049**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	82,803	1,01,197	1,03,532	1,12,317	1,20,259
Interest expenses	0	(18,169)	(15,749)	(17,324)	(19,056)
Changes in working capital	4,511	(22,231)	12,227	(6,821)	(7,421)
Other operating cash flows	5,459	23,436	0	0	0
Cash flow from operations	**92,773**	**84,233**	**1,00,010**	**88,172**	**93,782**
Capital expenditures	(19,646)	(28,522)	(22,000)	(24,000)	(25,000)
Change in investments	(83,684)	(39,933)	0	0	0
Other investing cash flows	(12,373)	(7,784)	15,749	17,324	19,056
Cash flow from investing	**(1,15,703)**	**(76,239)**	**(6,251)**	**(6,676)**	**(5,944)**
Debt raised/repaid	0	(4,153)	0	0	0
Interest expenses	(14,018)	0	0	0	0
Dividends paid	(8,734)	(5,430)	(9,886)	(10,775)	(11,548)
Cash flow from financing	**(22,752)**	**(9,583)**	**(9,886)**	**(10,775)**	**(11,548)**
Changes in cash and cash eq.	**(45,682)**	**(1,589)**	**83,873**	**70,720**	**76,290**
Closing cash and cash eq.	**52,710**	**44,925**	**1,28,798**	**1,99,518**	**2,75,808**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	17.1	17.7	18.2	19.8	21.3
Adjusted EPS	17.1	17.7	18.2	19.8	21.3
Dividend per share	2.0	1.0	1.8	2.0	2.1
Book value per share	107.8	107.6	123.6	141.1	159.9

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	2.3	2.3	2.1	1.9	1.8
EV/EBITDA	11.2	12.0	10.5	9.2	8.6
Adjusted P/E	15.3	14.7	14.3	13.1	12.3
P/BV	2.4	2.4	2.1	1.8	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	76.5	78.1	76.8	76.8	76.8
Interest burden (PBT/EBIT)	120.5	121.6	117.3	117.5	118.0
EBIT margin (EBIT/Revenue)	16.2	15.4	16.4	16.7	16.7
Asset turnover (Revenue/Avg TA)	73.0	70.3	70.4	68.5	66.2
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.5	1.5	1.4
Adjusted ROAE	16.7	15.9	15.7	15.0	14.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	7.3	(1.4)	2.1	6.6	6.7
EBITDA	1.1	(6.6)	6.6	8.4	6.7
Adjusted EPS	(5.8)	4.0	2.6	9.0	7.2
Profitability & Return ratios (%)					
EBITDA margin	20.4	19.3	20.2	20.5	20.5
EBIT margin	16.2	15.4	16.4	16.7	16.7
Adjusted profit margin	14.9	14.7	14.7	15.1	15.1
Adjusted ROAE	16.7	15.9	15.7	15.0	14.1
ROCE	16.0	14.0	15.8	17.2	18.1
Working capital days (days)					
Receivables	66	67	66	64	64
Inventory	4	3	3	3	3
Payables	96	100	101	94	94
Ratios (x)					
Gross asset turnover	8.2	8.1	8.6	9.0	9.5
Current ratio	2.2	2.2	2.9	3.3	3.8
Net interest coverage ratio	6.6	4.6	5.8	5.7	5.6
Adjusted debt/equity	0.2	0.2	0.0	(0.1)	(0.2)

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 1,010 | ⮝ 9%

HCL TECHNOLOGIES | IT Services | 04 July 2018

IMS headwinds priced in – initiate with ADD

HCL Tech (HCLT) is the cheapest stock in our IT services universe, with current valuations at 13.6x/12.4x FY19E/FY20E P/E baking in IMS business challenges, in our view. Management's FY19 guidance of 9.5-11.5% CC revenue growth coupled with resilient margins lends strong near-term visibility. ROE at 25% is the second-best among the tier-I pack, surpassing the 15.9%/21% levels clocked by WPRO/TECHM in FY18. Initiate coverage with ADD and a Mar'19 target price of Rs 1,010.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

IMS challenges captured in valuations: We believe that HCLT's current valuations factor in revenue challenges in the IMS business arising from automation and changes in the pattern of technology consumption. About 50% of the company's IMS revenue (38% of revenues) is vulnerable to these risks, though growth prospects for the remainder of the business are strong.

IP partnership – a bold and differentiated strategy: As part of its 'Mode 3' initiative, HCLT has invested ~US$ 1.2bn to forge IP partnerships over the last two years. As with its pioneering venture into the IMS business about a decade ago, the IP partnership approach is a bold, differentiated strategy that should drive strong growth in 'Mode 2&3' revenues (+41% in FY18 to 23.4% revenue share).

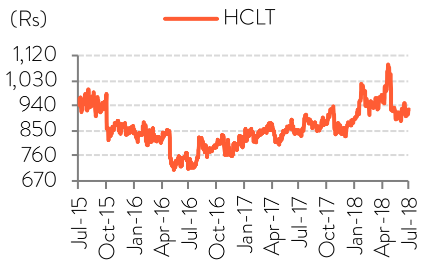
Strong near-term revenue visibility, resilient margins: Management's FY19 guidance of 9.5-11.5% YoY CC revenue growth lends strong near-term visibility and is backed by a long streak of inorganic moves. Further, HCLT's robust execution capabilities are reflected in a stable operating margin performance over the last two years, within management's target EBIT range of 19.5-20.5%.

Initiate with ADD: We have a Mar'19 TP of Rs 1,010 set at a target P/E multiple of 13.5x FY20E, a 20% discount to peers. ADD on cheap valuations.

Ticker/Price	HCLT IN/Rs 926
Market cap	US$ 19.1bn
Shares o/s	1,414mn
3M ADV	US$ 28.8mn
52wk high/low	Rs 1,108/Rs 825
Promoter/FPI/DII	60%/27%/13%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	84,570	87,820	96,246	1,05,314	1,17,991
Adj. EPS (Rs)	59.8	62.1	68.0	74.5	83.4
Adj. EPS growth (%)	48.4	3.8	9.6	9.4	12.0
Adj. ROAE (%)	27.7	25.0	24.5	23.6	23.4
Adj. P/E (x)	15.5	14.9	13.6	12.4	11.1
EV/EBITDA (x)	12.6	11.3	9.3	8.2	7.1

Source: Company, BOBCAPS Research

Investment rationale

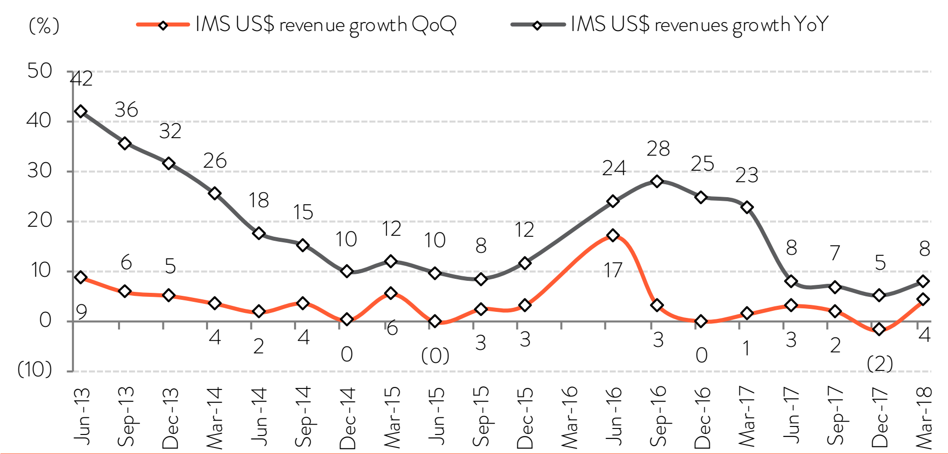
Valuations attractive; challenges in IMS business priced in

At 13.6x/12.4x FY19E/FY20E P/E, HCLT is the cheapest stock in our IT coverage universe, with valuations fully factoring in the weakness in its IMS business, in our view. Despite growth concerns around IMS, HCLT is one of only two tier-I companies where we expect a double-digit revenue CAGR, at 11.4% in US$ terms, over FY18-FY21. Its ROE is also currently the second highest amongst peers at 25%.

In recent years, growth in HCLT's IMS business (~37% revenue share) has moderated due to automation, cloud adoption and renewal pressure, especially in its data centre business (about half of the segment's topline as per management). Receding India business will also affect revenues in FY19 (~100bps headwinds). Cognizant of the challenges, management is pursuing growth opportunities in markets with modest IMS penetration, such as Germany and Australia.

Barring the data centre business, management remains optimistic on growth prospects for IMS. We highlight that Gartner's Q1CY18 report estimates that cloud services would grow from US$ 22bn in CY16 to US$ 102bn in CY22, a CAGR of 29%.

FIG 1 – IMS REVENUE GROWTH HAS DECLINED IN RECENT QUARTERS



Source: Company, BOBCAPS Research

FIG 2 – CHEAP VALUATIONS PRICE IN CHALLENGES IN IMS BUSINESS

Company	CMP (Rs)	Rating	Target Price (Rs)	US$ revenue CAGR (%)		EBIT CAGR (%) FY18-21E	EPS (Rs)			P/E (x)			ROE (%)		
				FY15-18	FY18-21E		FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
TCS	1,851	BUY	2,180	7.3	11.2	14.5	75.2	87.3	98.8	24.6	21.2	18.7	30.4	30.2	29.2
INFO	1,335	ADD	1,390	7.9	9.8	10.4	70.2	79.4	88.4	19.0	16.8	15.1	22.5	23.2	23.5
WPRO	261	SELL	240	4.4	5.6	7.9	18.2	19.8	21.3	14.3	13.1	12.3	15.7	15.0	14.1
HCLT	926	ADD	1,010	9.6	11.4	12.4	68.0	74.5	83.4	13.6	12.4	11.1	24.5	23.6	23.4
TECHM	657	ADD	720	9.2	9.7	16.0	42.7	46.5	51.5	15.4	14.1	12.8	18.6	18.2	18.1

Source: Company, Bloomberg, BOBCAPS Research | Prices as on 2nd Jul 2018

Strong near-term growth visibility with resilient margins

Management's FY19 guidance of 9.5-11.5% YoY CC revenue growth lends strong near-term visibility and is backed by a long streak of inorganic moves. The guidance builds in ~525bps of contribution from inorganic revenues and thus implies organic revenue growth of ~4.25-6.25% for FY19 (baking in ~100bps of headwinds from receding India business).

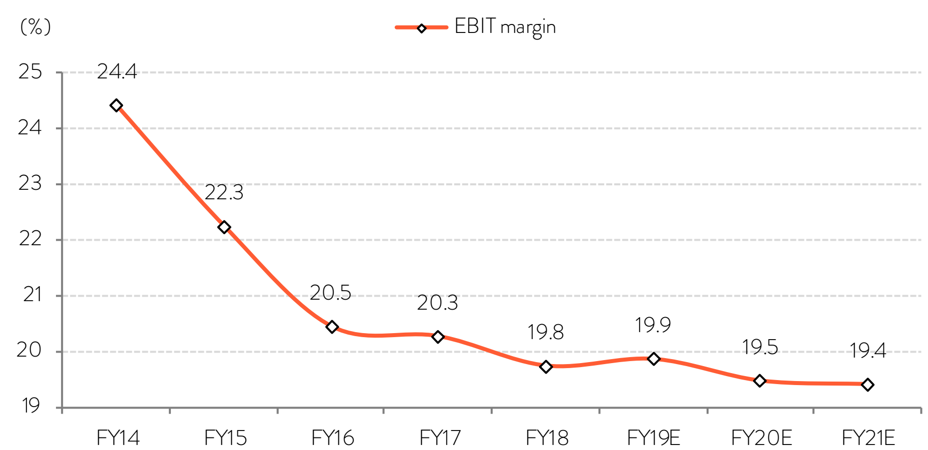
We note that HCLT has posted resilient EBIT margins over the last three years, with only 70bps of decline vs. a 160bps drop on average for tier-I peers over the same period. Management has retained its EBIT margin guidance of 19.5-20.5% for FY19. We estimate margins of 19.9% for FY19 (up 10bps YoY).

FIG 3 – RESILIENT EBIT MARGINS OVER LAST THREE YEARS

(%)	FY16	FY17	FY18	FY16-18 chg (bps)	FY19 guidance
TCS	26.5	25.7	24.8	(170)	Unchanged at 26-28%
INFO	25.0	24.7	24.3	(70)	Cut to 22-24% from 23-25%
WPRO	18.7	16.2	15.4	(330)	No guidance shared. Following the margin decline over the last two years, we (including consensus) build in ~100bps EBIT margin improvement in F19 (despite pressures amid weak revenue growth)
HCLT	**20.5***	**20.3**	**19.8**	**(70)**	**Unchanged at 19.5-20.5%**
TECHM	13.3	11.0	11.8	(150)	Management expects gradual EBIT margin improvement after the sharp decline seen in FY17
Combined EBIT margins for tier-I players	**22.8**	**21.7**	**21.2**	**(160)**	-

Source: Company, BOBCAPS Research | *FY16 refers to a 9-month period ending Mar'16 as the company changed its year-end from Jun to Mar

FIG 4 – MARGINS WITHIN HCLT'S TARGET RANGE OF 19.5-20.5% OVER LAST THREE YEARS



Source: Company, BOBCAPS Research | FY16 refers to a 9-month period ending Mar'16 as the company changed its year-end from Jun to Mar

FIG 5 – FY19 REVENUE GUIDANCE BACKED BY STRING OF ACQUISITIONS

Name of acquired company	Date of acquisition	Consideration	EV/sales (x)
Trygstad	Jul'15	US$ 9.8mn	na
Concept to Silicon Systems (C2SiS)	Oct'15	<US$ 10mn	na
Volvo's IT business	Oct'15	US$ 138mn	0.7
PowerObjects	Oct'15	US$ 46mn	1.2
P2P	Jan'16	GBP 8mn	0.9
HCL Training and Staffing Services Private Limited (HCLTSS)	Feb'16	US$ 355	na
Geometric	Apr'16	~US$ 190mn	1.4
Butler America Aerospace LLC	Oct'16	US$ 85mn	1.0
Urban Fulfillment Services LLC	Apr'17	US$ 30mn	0.6
C3i Solutions	Apr'18	US$ 60mn	0.3
Actian Corp	Apr'18	US$ 330mn	1.1
H&D International	Jun'18	Euro30mn	0.4

Source: Company, BOBCAPS Research

IP partnership – a bold and differentiated strategy

As part of its 'Mode 3: Products & Platforms' initiative, HCLT has invested ~US$ 1.2bn to forge seven IP-based partnerships over the last two years, with the aim being to offer integrated solutions (apart from intellectual property creation). Its alliance partner selection criteria is based on financial fit and overlap with service strengths and capabilities. The business roadmap for these partnerships includes systematic modernisation of acquired IPs focused around (1) ease of installation and cloud enabling, (2) user interface enhancement and (3) openness (enhance compatibility in different operating environments).

The IP business partner is responsible for the primary sale but HCLT is gradually setting up a direct sales team for these products as it continues to expand its IP portfolio. As with its pioneering venture into the IMS business about a decade ago, the IP partnership approach is a bold, differentiated strategy that should drive strong growth in 'Mode 2&3' revenues (+41% in FY18 to 23.4% revenue share).

FIG 6 – HCLT HAS INVESTED ~US$ 1.2BN IN IP PARTNERSHIPS IN THE LAST TWO YEARS

Quarter	IP
Dec'17	Remote management, application release automation & governance, endpoint lifecycle management, forms development application
Sep'17	Product development & modernisation, maintenance and professional services of core banking products, Notes, Domino, Smart Cloud Notes, Verse and Sametime
Jun'17	Marketing automation, systems software portfolio & operating tools, application modernisation
Mar'17	Information management, database management systems
Dec'16	Application security, B2B data transformation, testing automation, mainframe management tools
Sep'16	API/web services enablement for mainframes, automation and DevOps solutions
Jun'16	Automation and DevOps solutions

Source: Company, BOBCAPS Research

FIG 7 – MODE 2+3 COMPRISE ~23% OF REVENUE AND GREW ~41% IN FY18 SUPPORTED BY IP INVESTMENTS

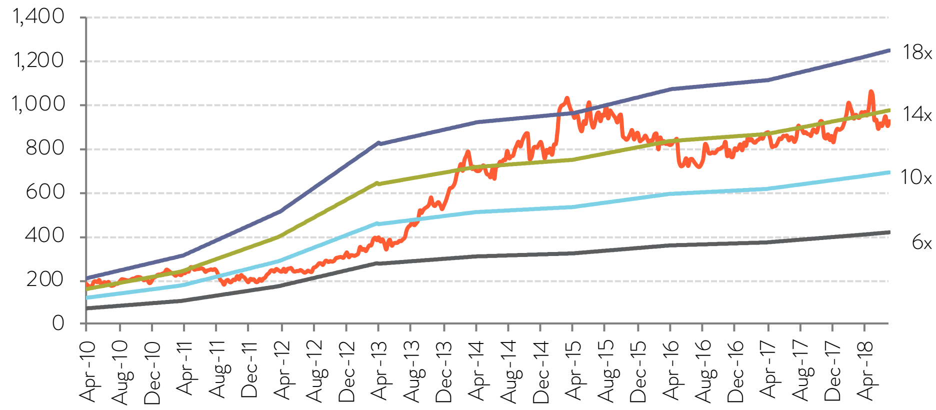
Revenues (US$ mn)	FY16*	FY17	FY18	CAGR FY16-18
Mode 1: Core Services				
% of revenues	84.1	81.4	76.6	-
Revenues	5,268	5,678	6,004	6.8
YoY change	-	7.8	5.7	-
Mode 2: Next-Gen Services				
% of revenues	12.3	12.8	14.7	-
Revenue	770	893	1,152	22.3
YoY change	-	15.9	29.0	-
Mode 3: Products & Platforms				
% of revenues	3.6	5.8	8.7	-
Revenue	225	405	682	73.9
YoY change	-	79.4	68.5	-

Source: Company, BOBCAPS Research | Note: Based on annualised revenues for FY16

Valuation methodology

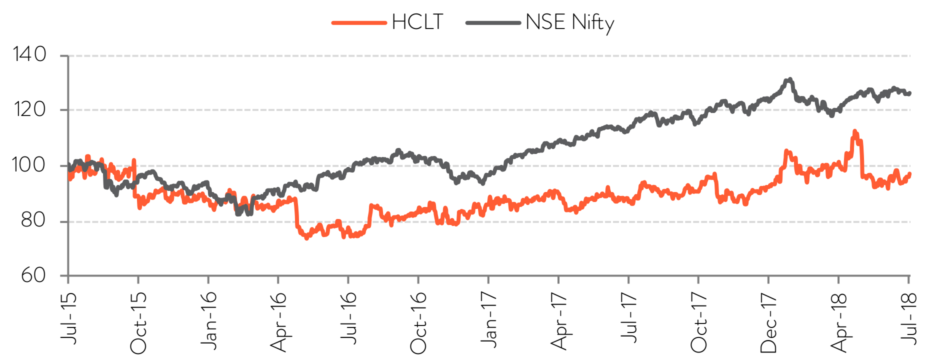
At 13.6x/12.4x FY19E/FY20E P/E, the stock is the cheapest in our coverage universe. We believe that HCLT's current valuations adequately capture challenges in its IMS business, even as management's FY19 CC revenue growth guidance of 9.5-11.5% lends strong near-term visibility. We initiate coverage with ADD and a Mar'19 target price of Rs 1,010, based on a P/E multiple of 13.5x on FY20E EPS, a ~20% discount to the average target multiple for tier-I peers.

FIG 8 – HCLT TRADED AT AVERAGE 13.7X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research Note: Based on annualised EPS for FY16

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- above-expected revenue contraction in IMS due to automation,
- an inability to renew existing contracts,
- a sharp decline in IT demand, and
- adverse currency movement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**4,67,220**	**5,05,700**	**5,87,824**	**6,58,209**	**7,30,516**
EBITDA	1,03,090	1,14,400	1,35,382	1,47,946	1,62,742
EBIT	94,750	99,880	1,16,817	1,28,221	1,41,853
Other income/(expenses)	9,340	11,110	8,178	8,551	11,383
EBT	1,04,090	1,10,990	1,24,995	1,36,772	1,53,235
Income taxes	19,520	23,170	28,749	31,457	35,244
Reported net profit	**84,570**	**87,820**	**96,246**	**1,05,314**	**1,17,991**
Adjusted net profit	**84,570**	**87,820**	**96,246**	**1,05,314**	**1,17,991**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	1,11,477	1,06,460	1,23,443	1,38,224	1,53,408
Provisions	12,525	5,300	11,756	13,164	14,610
Debt funds	5,417	4,370	4,370	4,370	4,370
Equity capital	2,812	2,812	2,812	2,812	2,812
Reserves & surplus	3,32,092	3,65,348	4,15,281	4,69,918	5,31,131
Shareholders' fund	3,34,904	3,68,160	4,18,093	4,72,730	5,33,943
Total liabilities and equities	**4,64,323**	**4,84,290**	**5,57,662**	**6,28,488**	**7,06,332**
Cash and cash eq.	13,165	16,930	56,469	1,03,673	1,58,338
Accounts receivables	1,08,026	1,22,570	1,41,722	1,58,692	1,76,124
Other current assets	29,832	25,190	38,209	42,784	47,484
Investments	1,13,653	86,040	86,040	86,040	86,040
Net fixed assets	73,254	1,18,646	1,16,831	1,13,981	1,09,966
CWIP	6,061	0	0	0	0
Intangible assets	89,274	77,244	77,244	77,244	77,244
Other assets	37,118	37,670	41,148	46,075	51,136
Total assets	**4,64,322**	**4,84,290**	**5,57,662**	**6,28,488**	**7,06,332**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	93,639	1,02,340	1,14,812	1,25,039	1,38,881
Interest expenses	(7,811)	(11,110)	(8,178)	(8,551)	(11,383)
Changes in working capital	3,207	(22,696)	(12,209)	(10,283)	(10,564)
Other operating cash flows	870	18,263	0	0	0
Cash flow from operations	**89,905**	**86,797**	**94,425**	**1,06,206**	**1,16,935**
Capital expenditures	(11,682)	(65,972)	(16,750)	(16,875)	(16,875)
Change in investments	(4,756)	(27,613)	0	0	0
Other investing cash flows	(22,301)	(12,992)	8,178	8,551	11,383
Cash flow from investing	**(38,738)**	**(1,06,577)**	**(8,572)**	**(8,324)**	**(5,492)**
Equities issued/Others	2	0	0	0	0
Debt raised/repaid	(3,959)	(1,047)	0	0	0
Interest expenses	(7,522)	0	0	0	0
Dividends paid	(33,852)	(13,613)	(46,314)	(50,677)	(56,777)
Cash flow from financing	**(45,331)**	**(14,660)**	**(46,314)**	**(50,677)**	**(56,777)**
Changes in cash and cash eq.	**5,836**	**(34,441)**	**39,539**	**47,204**	**54,665**
Closing cash and cash eq.	**13,165**	**16,930**	**56,469**	**1,03,673**	**1,58,338**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	59.8	62.1	68.0	74.5	83.4
Adjusted EPS	59.8	62.1	68.0	74.5	83.4
Dividend per share	24.0	8.0	27.2	29.8	33.4
Book value per share	236.8	260.3	295.6	334.2	377.5

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	2.8	2.6	2.1	1.8	1.6
EV/EBITDA	12.6	11.3	9.3	8.2	7.1
Adjusted P/E	15.5	14.9	13.6	12.4	11.1
P/BV	3.9	3.6	3.1	2.8	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	81.2	79.1	77.0	77.0	77.0
Interest burden (PBT/EBIT)	109.9	111.1	107.0	106.7	108.0
EBIT margin (EBIT/Revenue)	20.3	19.8	19.9	19.5	19.4
Asset turnover (Revenue/Avg TA)	108.9	106.6	112.8	111.0	109.5
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.3	1.3	1.3
Adjusted ROAE	27.7	25.0	24.5	23.6	23.4

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	50.1	8.2	16.2	12.0	11.0
EBITDA	51.3	11.0	18.3	9.3	10.0
Adjusted EPS	48.4	3.8	9.6	9.4	12.0
Profitability & Return ratios (%)					
EBITDA margin	22.1	22.6	23.0	22.5	22.3
EBIT margin	20.3	19.8	19.9	19.5	19.4
Adjusted profit margin	18.1	17.4	16.4	16.0	16.2
Adjusted ROAE	27.7	25.0	24.5	23.6	23.4
ROCE	29.6	23.2	24.9	26.7	29.0
Working capital days (days)					
Receivables	72	83	82	83	84
Inventory	1	0	0	0	0
Payables	99	102	93	94	94
Ratios (x)					
Gross asset turnover	7.9	5.3	5.0	5.7	6.5
Current ratio	1.5	1.8	2.1	2.3	2.6
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 720 | ⮝ 10%

TECH MAHINDRA | IT Services | 04 July 2018

Telecom business holds the key – initiate with ADD

We expect Tech Mahindra's (TECHM) telecom division to post modest growth in FY19 post pruning of lossmaking businesses and the conclusion of contract renegotiations. The stock has rallied 40%+ in the last six months and is pricing in the EBIT margin upswing seen over the past year – we see scope for further margin upsides, but any renewed uptick in stock price would hinge on a strong recovery in telecom backed by 5G capex, even as we expect the enterprise business to sustain above-market growth. Initiate with ADD and a Mar'19 target price of Rs 720.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Telecom likely to see modest recovery: Price negotiations with a large client and the pruning of less profitable businesses hit telecom revenues in FY18 (48% share, US$ revenue down 0.6%). We expect a modest recovery in FY19 (+4%) due to the absence of these constraints. A potential rebound in the telecom vertical backed by clients' 5G capex drive remains a key stock trigger.

Enterprise business growing ahead of industry: Enterprise revenues (57% share in FY18) logged a CAGR of 18% over FY16-FY18, buttressing growth for TECHM at a time when telecom posted a largely flattish performance. Backed by a strong exit rate in FY18 and optimistic management commentary, we estimate 14% US$ revenue growth for the enterprise segment in FY19.

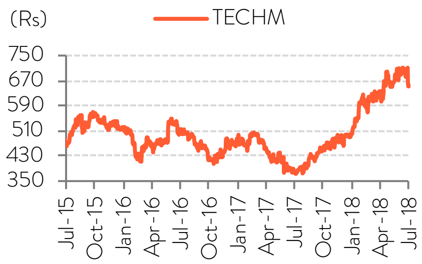
Further room for margin expansion: Apart from ongoing efforts to raise utilisation and downsize bleeding businesses, management intends to focus on margin levers such as automation, profit augmentation at acquired entities, onsite-offshore role rationalisation and pyramid optimisation. We build in 150bps EBIT margin improvement over FY19-FY21.

Initiate with ADD: TECHM is trading at 15.4x/14.1x FY19E/FY20E P/E. Our Mar'19 TP of Rs 720 is based on 15.5x FY20E EPS vs. 16.7x (avg) for tier-I peers.

Ticker/Price	TECHM IN/Rs 657
Market cap	US$ 8.5bn
Shares o/s	891mn
3M ADV	US$ 33.7mn
52wk high/low	Rs 730/Rs 369
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	28,410	38,001	38,066	41,457	45,865
Adj. EPS (Rs)	31.9	42.7	42.7	46.5	51.5
Adj. EPS growth (%)	(7.6)	33.6	0.2	8.9	10.6
Adj. ROAE (%)	18.1	21.0	18.6	18.2	18.1
Adj. P/E (x)	20.6	15.4	15.4	14.1	12.8
EV/EBITDA (x)	13.8	12.4	10.1	8.7	7.6

Source: Company, BOBCAPS Research

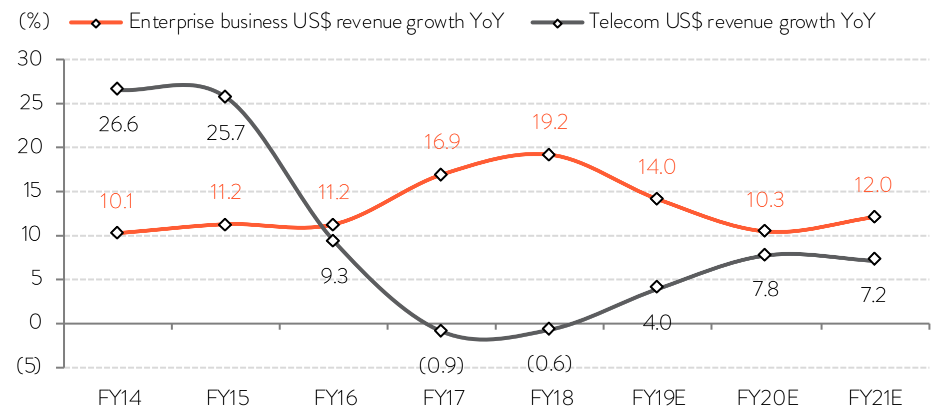
Investment rationale

Absence of revenue pruning to support modest growth in telecom business

TECHM's telecom business (43% revenues share) declined 0.9%/0.6% in FY17/FY18, affected by the pruning of unprofitable businesses, price renegotiations with a large client and operational challenges in the telecom industry. As the company's restructuring process nears an end, we expect telecom revenues to post modest growth of 4% in FY19.

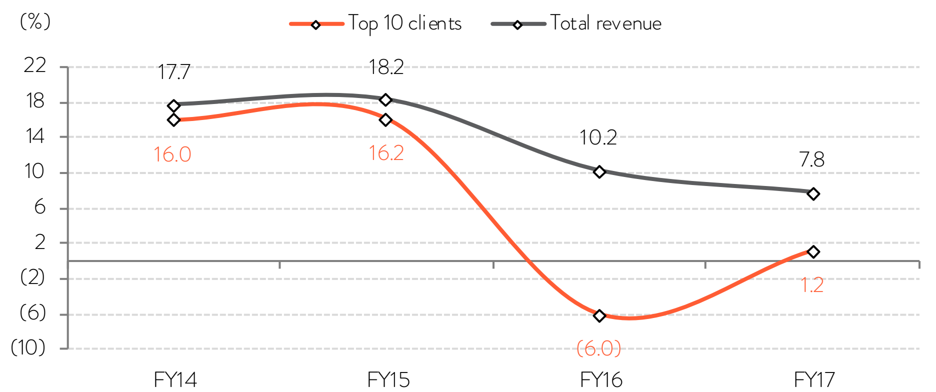
Amid challenges in telecom, we acknowledge TECHM's strength in the enterprise business (57% of revenues –18% CAGR over FY16-FY18). Backed by a high exit rate in FY18 and optimistic management commentary, we estimate 14% US$ revenue growth for the enterprise segment in FY19. Nonetheless, a more sustainable rebound in the telecom business backed by clients' 5G capex is critical for broad-based growth going ahead.

FIG 1 – EXPECT MODEST GROWTH RECOVERY IN TELECOM IN FY19E DUE TO ABSENCE OF REVENUE PRUNING AT LLC



Source: Company, BOBCAPS Research

FIG 2 – TEPID TOP 10 CLIENT PERFORMANCE DUE TO PRICE RENEGOTIATIONS & OPERATIONAL CHALLENGES IN TELECOM INDUSTRY



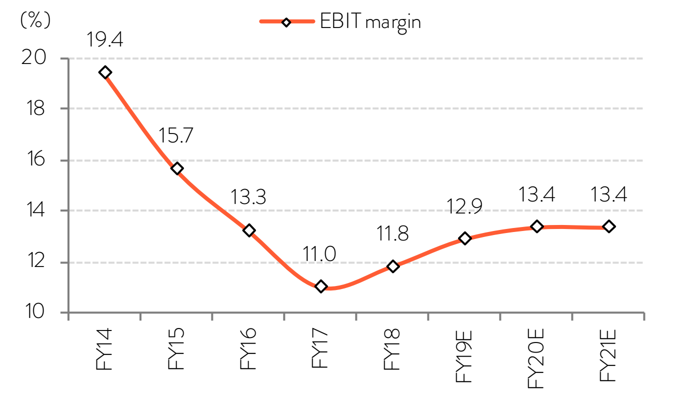
Source: Company, BOBCAPS Research

Further room for margin expansion

After an EBIT margin decline of 420bps QoQ to 8.2% in the Mar'17 quarter, TECHM's focused initiatives have resulted in 560bps margin expansion over the last four quarters, closing at 13.8% for the Mar'18 quarter and rounding off FY18 at 11.8%.

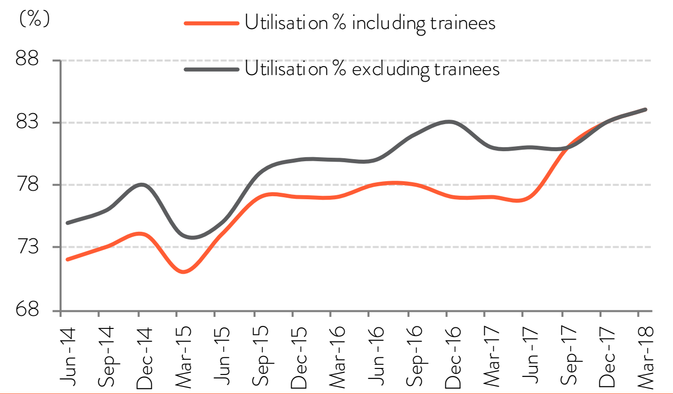
Apart from ongoing efforts to raise utilisation and downsize bleeding businesses, management intends to focus on margin levers such as automation, improving the profitability of acquired entities, onsite-offshore role rationalisation and pyramid optimisation. We thus see further room for expansion and build in 150bps EBIT margin improvement over FY19-FY21.

FIG 3 – MANAGEMENT STAYS COMMITTED TO DRIVING FURTHER OPERATING MARGIN GAINS



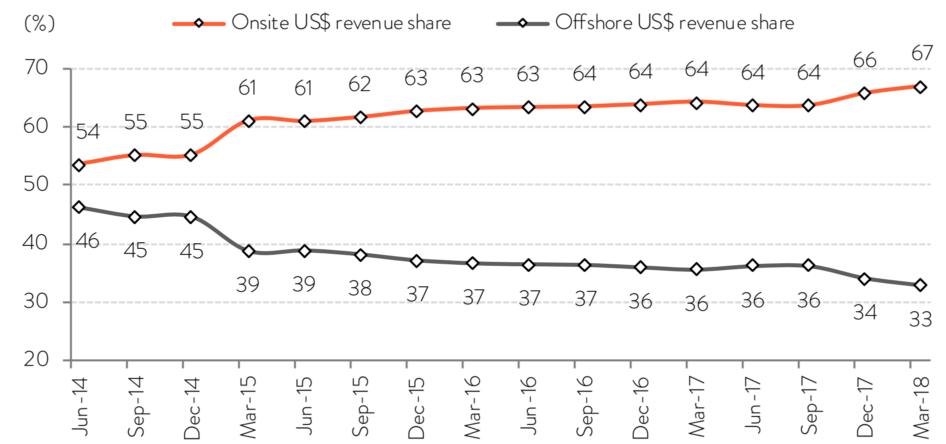
Source: Company, BOBCAPS Research

FIG 4 – UTILISATION (EX-TRAINEES) UP 300BPS IN LAST 4 QTRS; LIMITED SCOPE FOR FURTHER UPTICK



Source: Company, BOBCAPS Research

FIG 5 – MANAGEMENT FOCUSED ON IMPROVING ONSITE-OFFSHORE REVENUE MIX TO SUPPORT OPERATING MARGINS

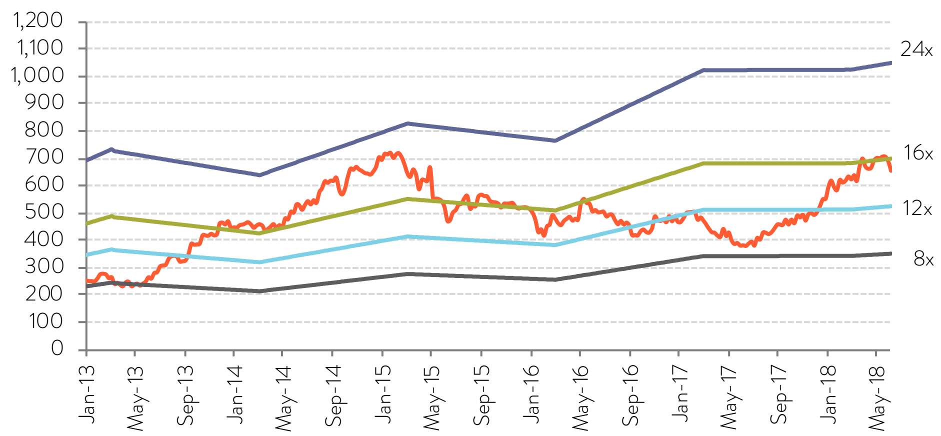


Source: Company, BOBCAPS Research

Valuation methodology

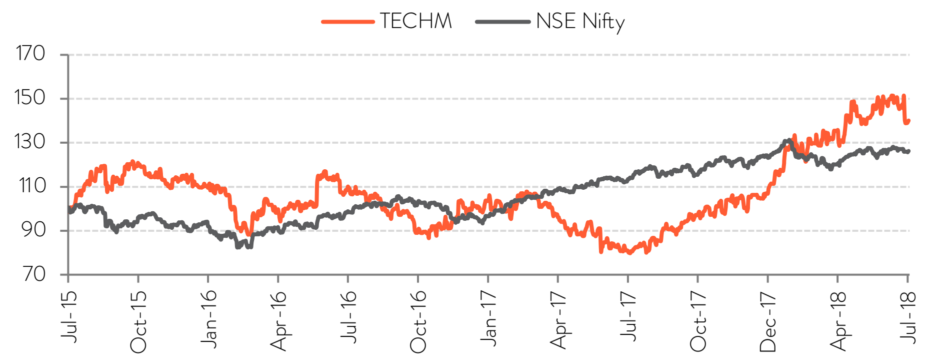
The TECHM stock has rallied 40%+ in the last six months and, at current valuations of 15.3x/14.1x FY19/20 P/E, is pricing in the EBIT margin upswing seen over the past year– we see scope for further margin upsides, but any renewed uptick in stock price would hinge on a strong recovery in telecom backed by 5G capex, even as we expect the enterprise business to sustain above-market growth. Our Mar'19 TP of Rs 720 is based on 15.5x FY20E EPS vs. average 16.7x for tier-I peers and offers 9.8% upside. Initiate with ADD.

FIG 6 – TECHM TRADED AT AVERAGE 14.4X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- prolonged challenges in the telecom vertical,
- inability to sustain growth momentum in the enterprise business, and
- adverse currency movement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**2,91,408**	**3,07,729**	**3,50,601**	**3,86,002**	**4,24,698**
EBITDA	41,843	47,169	57,692	64,661	71,143
EBIT	32,062	36,320	45,160	51,537	56,703
Net interest income/(expenses)	(1,286)	(1,624)	(1,250)	(1,250)	(1,250)
Other income/(expenses)	7,776	14,093	6,845	4,989	5,700
EBT	38,552	48,789	50,755	55,276	61,153
Income taxes	9,785	10,925	12,689	13,819	15,288
Min. int./Inc. from associates	(357)	137	0	0	0
Reported net profit	**28,410**	**38,001**	**38,066**	**41,457**	**45,865**
Adjusted net profit	**28,410**	**38,001**	**38,066**	**41,457**	**45,865**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	57,082	71,708	57,633	63,452	69,813
Provisions	10,071	9,581	20,172	22,208	24,435
Debt funds	12,195	17,260	17,260	17,260	17,260
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,388	4,417	4,417	4,417	4,417
Reserves & surplus	1,64,625	1,89,102	2,11,127	2,35,114	2,61,652
Shareholders' fund	1,69,013	1,93,519	2,15,544	2,39,531	2,66,069
Total liabilities and equities	**2,60,665**	**3,04,372**	**3,22,913**	**3,54,756**	**3,89,881**
Cash and cash eq.	20,013	19,661	20,883	41,002	64,663
Accounts receivables	53,533	65,117	69,160	76,143	83,776
Inventories	611	659	659	659	659
Other current assets	79,376	76,857	89,165	93,529	98,300
Investments	37,139	59,595	59,595	59,595	59,595
Net fixed assets	67,319	76,717	77,686	78,062	77,122
CWIP	3,729	2,399	2,399	2,399	2,399
Intangible assets	26,279	27,727	27,727	27,727	27,727
Deferred tax assets, net	2,674	5,766	5,766	5,766	5,766
Total assets	**2,60,665**	**3,04,372**	**3,22,913**	**3,54,756**	**3,89,881**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	37,516	48,713	50,597	54,581	60,304
Interest expenses	38	(15,717)	(8,095)	(6,239)	(6,950)
Changes in working capital	5,438	5,023	(19,835)	(3,492)	(3,817)
Other operating cash flows	(2,313)	0	0	0	0
Cash flow from operations	**40,679**	**38,019**	**22,668**	**44,850**	**49,538**
Capital expenditures	(7,603)	(20,129)	(13,500)	(13,500)	(13,500)
Change in investments	(10,629)	22,456	0	0	0
Other investing cash flows	(10,663)	15,717	8,095	6,239	6,950
Cash flow from investing	**(28,895)**	**18,044**	**(5,405)**	**(7,261)**	**(6,550)**
Equities issued/Others	345	0	0	0	0
Debt raised/repaid	(2,551)	0	0	0	0
Interest expenses	(1,111)	0	0	0	0
Dividends paid	(12,392)	(14,884)	(16,041)	(17,470)	(19,327)
Cash flow from financing	**(15,709)**	**(14,884)**	**(16,041)**	**(17,470)**	**(19,327)**
Changes in cash and cash eq.	**(3,925)**	**41,179**	**1,222**	**20,120**	**23,660**
Closing cash and cash eq.	**20,013**	**19,661**	**20,883**	**41,002**	**64,663**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	31.9	42.7	42.7	46.5	51.5
Adjusted EPS	31.9	42.7	42.7	46.5	51.5
Dividend per share	9.0	14.0	15.0	16.3	18.0
Book value per share	190.0	217.3	242.0	268.9	298.7

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	2.0	1.9	1.7	1.5	1.3
EV/EBITDA	13.8	12.4	10.1	8.7	7.6
Adjusted P/E	20.6	15.4	15.4	14.1	12.8
P/BV	3.5	3.0	2.7	2.4	2.2

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	73.7	77.9	75.0	75.0	75.0
Interest burden (PBT/EBIT)	120.2	134.3	112.4	107.3	107.8
EBIT margin (EBIT/Revenue)	11.0	11.8	12.9	13.4	13.4
Asset turnover (Revenue/Avg TA)	117.6	108.9	111.8	113.9	114.1
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.5	1.5	1.5
Adjusted ROAE	18.1	21.0	18.6	18.2	18.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	10.0	5.6	13.9	10.1	10.0
EBITDA	(2.0)	12.7	22.3	12.1	10.0
Adjusted EPS	(7.6)	33.6	0.2	8.9	10.6
Profitability & Return ratios (%)					
EBITDA margin	14.4	15.3	16.5	16.8	16.8
EBIT margin	11.0	11.8	12.9	13.4	13.4
Adjusted profit margin	9.7	12.3	10.9	10.7	10.8
Adjusted ROAE	18.1	21.0	18.6	18.2	18.1
ROCE	15.9	15.0	15.8	17.1	18.5
Working capital days (days)					
Receivables	70	70	70	69	69
Inventory	1	1	1	1	1
Payables	69	90	81	69	69
Ratios (x)					
Gross asset turnover	5.0	4.3	4.5	5.0	5.5
Current ratio	2.3	2.0	2.3	2.5	2.6
Net interest coverage ratio	(24.9)	(22.4)	(36.1)	(41.2)	(45.4)
Adjusted debt/equity	0.0	0.0	0.0	(0.1)	(0.2)

Source: Company, BOBCAPS Research

BUY
TP: Rs 1,980 | ⮝20%

L&T INFOTECH | IT Services | 04 July 2018

Preferred mid-cap pick – initiate with BUY

L&T Infotech (LTI) is our preferred pick among mid-cap IT service players as (1) recent large deal wins (US$ 300mn+ TCV in six quarters) should fuel above-industry growth in FY19, (2) an 'outcome-focused' service strategy and revamped sales practice equip LTI to adapt in a fluid digital landscape, and (3) a steady stream of Fortune 500 client adds (7 in FY18 alone) augments long-term growth visibility. We model for a robust ~15%/25% US$ revenue/EBIT CAGR over FY18-FY21. Initiate with BUY and a Mar'19 target price of Rs 1,980.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Slew of digital deal wins against formidable rivals: Over the past six quarters, LTI has bagged deals worth US$ 300mn+ in TCV (as of Mar'18), despite stiff competition from tier-I names. Key wins include two large contracts during the Mar'18 quarter with a combined net new TCV of US$ 50mn+ (one from energy giant Exxon) and three large deals won in the Dec'16 quarter with a total net new TCV of >US$ 100mn (one from a Fortune 10 energy corporation).

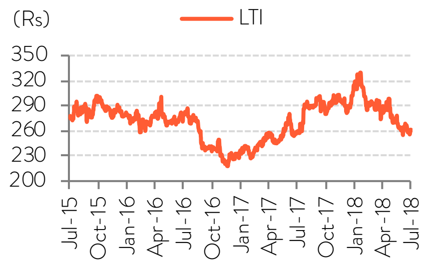
Industry growth leader amid favourable business landscape: We believe LTI is well aligned to the shift in industry dynamics toward smaller deal sizes and new vendor-selection criteria (expertise over scale). Proactive investments in focused service offerings, sales talent infusion and client mining initiatives supported industry-leading US$ revenue growth of 9.3%/16.7% in FY17/FY18. Over FY16-FY18, US$ revenues from the top 5/top 20 clients rose at a healthy 11.9%/10.9% CAGR and LTI's active client base surged from 232 to 300, including 16 new Fortune 500 companies (7 added in FY18 alone).

Our top pick among mid-caps: LTI is currently trading at 22.4x/19.1x FY19E/FY20E EPS. We build in an industry-leading 15%/25% US$ revenue/EBIT CAGR for LTI over FY18-FY21 and assign the stock a premium FY20E P/E multiple of 23x to arrive at our Mar'19 TP of Rs 1,980. BUY.

Ticker/Price	LTI IN/Rs 1,650
Market cap	US$ 4.2bn
Shares o/s	175mn
3M ADV	US$ 2.9mn
52wk high/low	Rs 1,759/Rs 1,502
Promoter/FPI/DII	83%/7%/10%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	9,711	11,124	12,887	15,110	16,963
Adj. EPS (Rs)	69.2	63.5	73.6	86.3	96.9
Adj. EPS growth (%)	18.1	(8.2)	15.8	17.2	12.3
Adj. ROAE (%)	37.6	31.8	30.4	30.0	28.4
Adj. P/E (x)	23.8	26.0	22.4	19.1	17.0
EV/EBITDA (x)	23.2	24.0	17.5	14.1	11.8

Source: Company, BOBCAPS Research

Investment rationale

Besting formidable competitors to bag digital deals

Amid the imperatives of digital transformation and combating disruptive entrants, clients are looking for technology partners with innovative expertise over scale. LTI meets this brief well, having proactively invested in 'outcome-focused' solutions and services that align with both, the evolving client needs and shrinking digital deal sizes.

Further, strategic initiatives such as 'Digital WoW' (way of working) which is anchored on client centricity and 'Mosaic', an end-to-end technology platform, have ably positioned LTI to compete alongside larger competitors – ranging from global majors to Indian peers – in the race for digital deals, especially from Fortune 500 and Fortune 1000 customers.

Over the past two years, LTI has stolen a march over tier-I players, bagging deals worth TCV of US$300mn+ in last 6 quarters as of Mar'18 – these include (1) two large contracts won during the Mar'18 quarter with a combined net new TCV of US$ 50mn+, one from energy giant Exxon; and (2) three large deals in the Dec'16 quarter with a cumulative net new TCV in excess of US$ 100mn, including one from a Fortune 10 energy corporation.

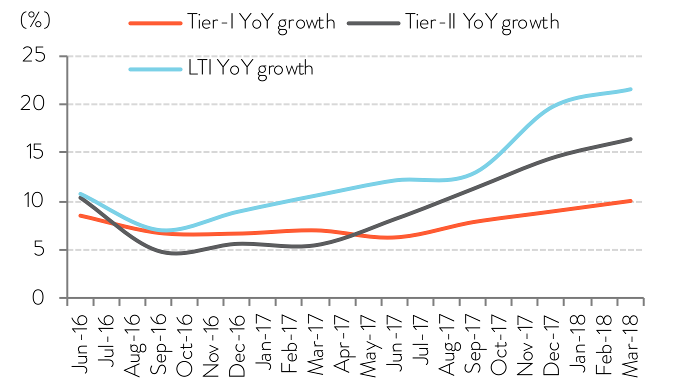
FIG 1 – REVENUE GROWTH VISIBILITY BACKED BY RECENT LARGE DEAL WINS

Quarter	Large wins
Dec-16	**3 large deals with combined net new TCV of US$ 100mn+**
	▪ **Deal 1:** A strategic transformation project to provide end-to-end infrastructure-managed services and cloud enablement for an international institution – the biggest new account opening engagement in LTI's history outside of India and in the IMS segment, as per management
	▪ **Deal 2:** End-to-end application management services for upstream businesses of a Fortune 10 energy corporation
	▪ **Deal 3:** LTI selected as exclusive partner by a French transnational company for a critical and strategic ERP transformation programme
Sep-17	**Two large deals signed in Q2FY18 which management says will fuel growth in Q2FY19 and Q3FY19**
	▪ **Deal 1:** TCV of ~US$ 50mn over five years. Despite the lack of an existing relationship, LTI was chosen by a European fashion & cosmetics company as global SAP MS partner, covering over 17 locations and providing support across 8 languages
	▪ **Deal 2:** Application development and support for African Bank
Mar-18	**2 large deals with combined net new TCV of US$ 50mn+**
	▪ **Deal 1:** Digitising geoscience content for new Fortune 500 client ExxonMobil by leveraging automation in collaboration with L&T Technology
	▪ **Deal 2:** From an existing large BFS client

Source: Company, BOBCAPS Research

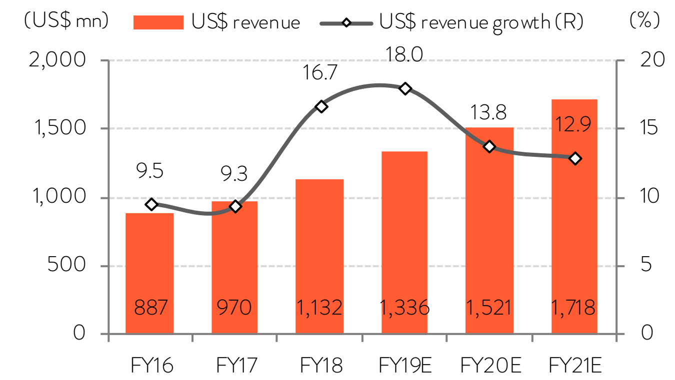
Whereas tier-I IT majors are facing incumbency challenges and shrinking revenues, LTI has posted industry-leading US$ revenue growth of 9.3% and 16.7% in FY17 and FY18 respectively. In our view, the recent deal wins position LTI well to repeat this feat for the third consecutive year in FY19. We expect healthy client traction and smart investments in digital initiatives to drive sustainable long-term growth, at a 14.9% US$ revenue CAGR over FY18-FY21.

FIG 2 – LTI LEADS INDUSTRY US$ REVENUE GROWTH



Source: Company, BOBCAPS Research

FIG 3 – EXPECT BROAD-BASED GROWTH IN FY19



Source: Company, BOBCAPS Research

Key capabilities that set the company apart in the race for large deals are:

- **Enterprise solutions:** An area of strength for LTI augmented by proactive investment in building sales and consulting, along with implementation capabilities around new-edge products such as SAP, Oracle, Duck Creek, Guidewire and Salesforce.
- **Application and Infrastructure management**: Innovative, automation-driven offering leveraging the company's 'Mosaic' platform to deliver an outcome-based, enhanced customer experience.

Steady stream of Fortune 500 clients aids revenue visibility

In FY18, LTI added 7 new Fortune 500 clients to its roster, taking its client count in the category to 59, spread across different verticals. Over the last three financial years, the company's active client base has increased from 232 to 300, including 16 new Fortune 500 companies.

This lends strong revenue visibility to LTI, especially given the company's track record of ramping up clients to higher buckets backed by a strong focus on client mining initiatives such as Minecraft (mining the top 50 clients), ADEA (Analytics and Digital in Every Account) and Million Dollar Club (increasing the US$ 1mn+ revenue client count).

FIG 4 – LTI COUNTS 59 FORTUNE 500 NAMES AMONG ITS ACTIVE CLIENTS

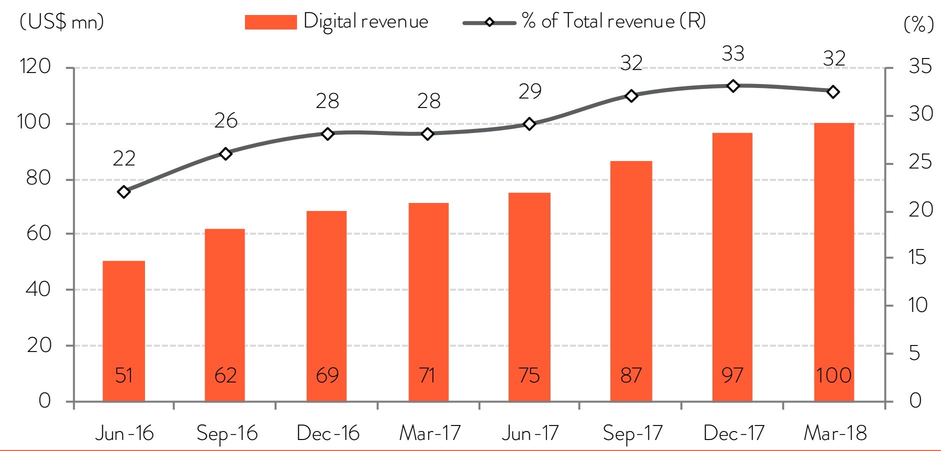
Vertical	Fortune 500 logo additions in FY18
BFS	2
Insurance	2
Manufacturing	1
CPG	1
Pharma	1
Total	**7**

Source: Company, BOBCAPS Research

Differentiated, outcome-based digital offerings

LTI's digital offerings are driven by the ethos of 'amplifying outcomes for clients' which aligns well with the increased client urgency to bridge the digital divide with competitors. The company has posted strong growth in service lines such as Analytics, AI & Cognitive (up 39.8% YoY in FY18) and Enterprise Integration & Mobility (up 26.2% YoY), which testifies to its client-relevant service enhancement. Digital revenues have also increased at an 8.9% CQGR over the last eight quarters and accounted for a third of revenues at the end of Q4FY18.

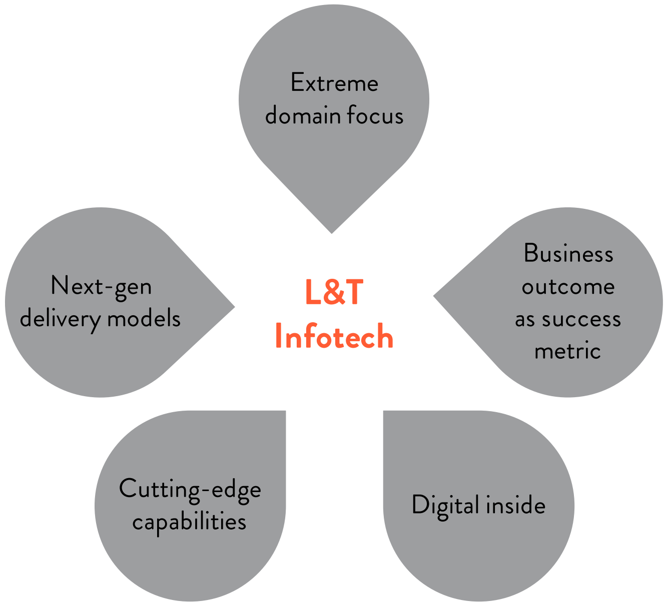
FIG 5 – 'OUTCOME-FOCUSED' OFFERINGS DRIVING STRONG DIGITAL REVENUE GROWTH



Source: Company, BOBCAPS Research

Clients are now prioritising technology investments that: (1) drive revenue growth, (2) foster newer revenue channels, (3) enhance user experience, and (4) establish newer ways of client engagement. In line with these objectives, LTI has adopted a client-focused 'Digital WoW' approach that emphasises cutting-edge technological capabilities, next-generation delivery models (such as Agile, DevOps), extreme domain focus and business outcomes as success metrics. In addition, LTI has embraced and internalised a digital culture within the organisation.

FIG 6 – LTI'S DIGITAL 'WAY OF WORKING' (WOW)

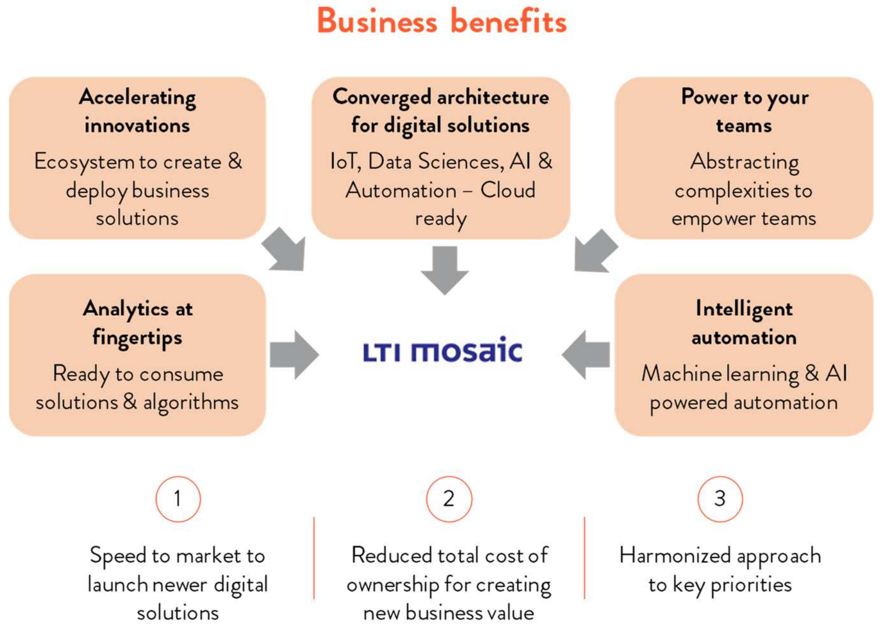


Source: Company, BOBCAPS Research

Management's key focus areas for growth include digital solutions around analytics, Industrial IoT, cloud apps and automation. To strengthen capabilities in these areas, the company has made proactive investments towards:

- **Building organic expertise:** LTI continues to consolidate and enhance in-house expertise under 'Mosaic' – a converged platform to accelerate digital transformation. As at end-FY18, the company had six offerings on the Mosaic platform, including the recently launched Mosaic Security. Its industrial IoT platform (Mosaic Things) featured alongside GE Predix in Gartner's list of top IoT platforms in 2017.
- **Inorganic augmentation:** LTI acquired Augment IQ in FY17 and Synchordis in FY18 to augment its analytics and digital banking offerings.
- **Creating a tech ecosystem:** The company is forging partnerships and alliances to augment its service offerings – notable among these are the Enterprise Ethereum Alliance, Microsoft, Nutanix, Duck Creek, GE Digital, Pega and Coupa tie-ups. LTI engages with 300+ start-ups and 10+ top academic institutes through its NILE (new innovative LTI ecosystem).
- **Co-creation with customers:** The company launched its first offering co-created with a client in FY18, named REDaxis – an account receivable and analytics suite.

FIG 7 – LTI'S MOSAIC – A CONVERGED PLATFORM TO ACCELERATE DIGITAL TRANSFORMATION



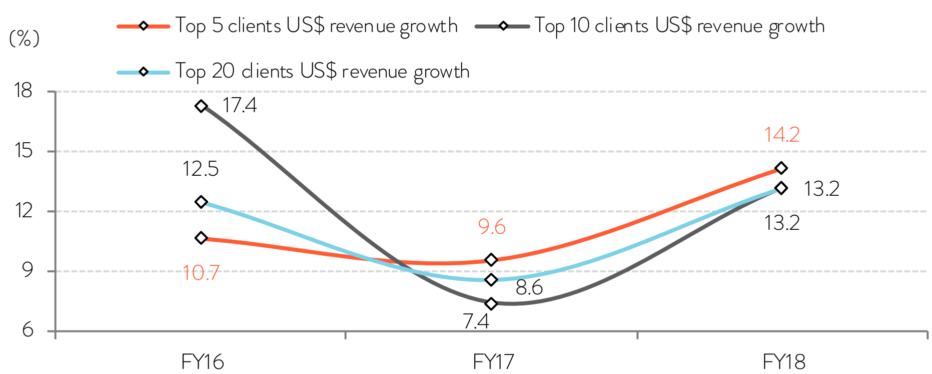
Source: Company, BOBCAPS Research

Client mining initiatives driving traction in top-tier accounts

Client mining has been a central linchpin of LTI's growth strategy and its success is reflected in the 11.9% and 10.9% CAGR in US$ revenues from the top 5 and top 20 clients respectively over FY16-FY18. The top 20 clients accounted for 65% of revenues in the Mar'18 quarter and growth traction remains strong led by the following client mining initiatives:

- **ADEA** (Analytics and Digital in Every Account)**:** Since inception, this initiative has marked ~88% coverage in top accounts, and analytics contributes ~33% of revenues.
- **Minecraft:** This is focused on mining the top 50 accounts; management aims to further enhance investments here.

FIG 8 – HEALTHY GROWTH IN REVENUES FROM TOP CLIENTS



Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIG 9 – FOCUSED CLIENT MINING APPROACH HELPS MOVE ACCOUNTS TO HIGHER REVENUE BUCKET

Client metrics	FY16	FY17	FY18	FY16 change	FY17 change	FY18 change
>US$ 1mn	85	96	109	3	11	13
>US$ 5mn	35	35	44	2	0	9
>US$ 10mn	17	23	23	(3)	6	0
>US$ 20mn	10	11	13	2	1	2

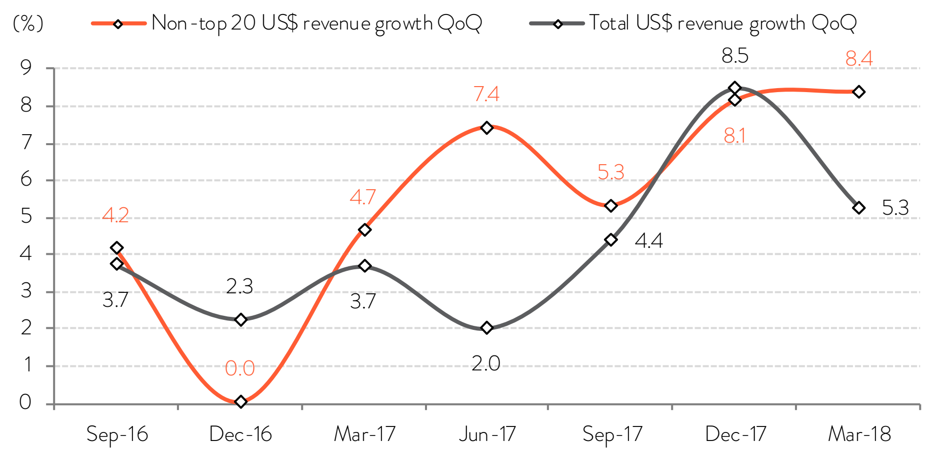
Source: Company, BOBCAPS Research

Cognizant of the revenue concentration risk, management ensures prompt intimation of likely challenges at top clients and has rolled out the following initiatives to foster broad-based revenue growth:

- **Million-dollar club:** This initiative aims to selectively mine tail accounts. In FY18, the company added 13 clients to the US$ 1mn+ revenue bucket and closed the year with 109 clients.
- **Focused new logo addition:** With 56 new additions, the active client roster featured 300 clients at the end of FY18 (including 7 Fortune 500 additions).

With these measures, US$ revenues from the company's non-top 20 clients increased by 24.2% YoY in FY18.

FIG 10 – FOCUSSED INITIATIVES TO DRIVE BROAD-BASED GROWTH



Source: Company, BOBCAPS Research

Robust sales engine

LTI's sales team has an infusion of fresh talent (~65% of sales people recruited in the last two years), and the company is tapping premier business schools to recruit domain experts that can further bolster lead sales. In addition, multiple alliances with advisors such as ISG and Everest to enhance market presence are supporting deal pipeline generation.

FIG 11 – SOLID SALES ENGINE SUPPORTING LTI'S GROWTH LEADERSHIP

Top 50 accounts	New logo	Proactive pipeline generation	Tail accounts	Digital	Agile pre sales	Best place to learn & grow	Frictionless sales
Minecraft	Targeted Account List	Aspire	Million Dollar Club	ADEA	Customer Success Team	Dream Team	Sales Helpdesk

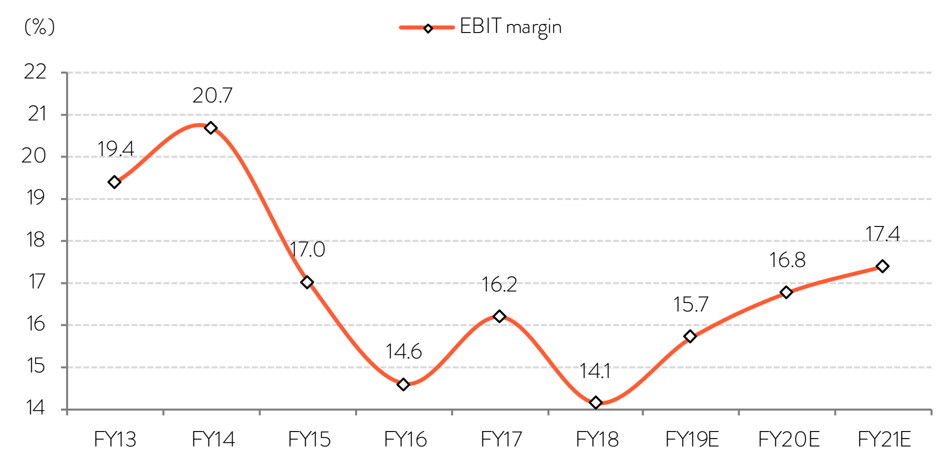
Source: Company, BOBCAPS Research

Growth leverage, favourable currency to support margins

In FY18, investments toward localisation, large deals and service enhancements, along with 3.7% INR appreciation against the USD, resulted in 120bps YoY EBIT margin contraction for the company. We expect this trend to reverse in FY19 backed by operating leverage, favourable currency movement (the INR has depreciated 4.8% vs. the USD since Mar'18 end) and a differentiated hedging policy (whereby LTI fixes an INR/US$ rate for the subsequent four quarters).

We estimate 160bps expansion in EBIT margin to 15.7% in FY19 and 110bps expansion to 16.8% in FY20. Management has guided for 14-15% net margins for FY19.

FIG 12 – EBIT MARGINS LIKELY TO IMPROVE



Source: Company, BOBCAPS Research

Valuation methodology

Premium growth deserves premium multiple – BUY

We expect LTI to deliver industry-leading US$ revenue growth for the third consecutive year in FY19, at 18%, on the back of recent large deal wins, healthy client traction and a focus on mining the top 50 accounts. Notably, even without any further sequential revenue growth through the next three quarters, LTI will deliver a 9.2% YoY uptick in US$ revenue for the fiscal.

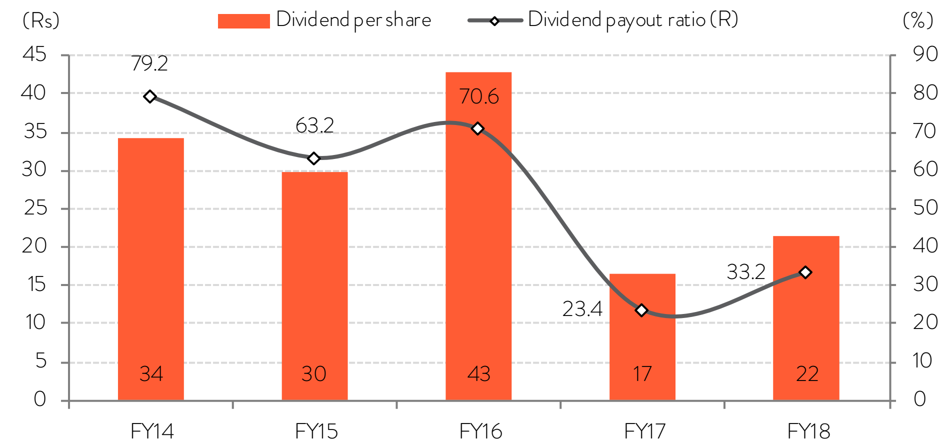
In our view, the company is on the right track for sustainable, high growth as it continues to benefit from favourable business dynamics for mid-cap/tier-II companies and proactively invests to meet evolving client needs. We estimate a 15%/25% US$ revenue/EBIT CAGR over FY18-FY21.

LTI is currently trading at 22.4x/19.1x FY19E/FY20E EPS. We assign a P/E multiple of 23x FY20E EPS for LTI's premium growth vs. an average of 20.3x for tier-II peers, leading to a Mar'19 target price of Rs 1,980 – initiate with BUY.

Best ROE among mid-cap names

LTI's ROE at 30.4% is one of the best amongst Indian IT service companies, supported by a higher dividend payout ratio. In FY18, the company paid 33.2% dividend vs. 23.4% in FY17. In the absence of M&A activity, dividend payout is likely to inch up further, in our view.

FIG 13 – HIGH DIVIDEND PAYOUT



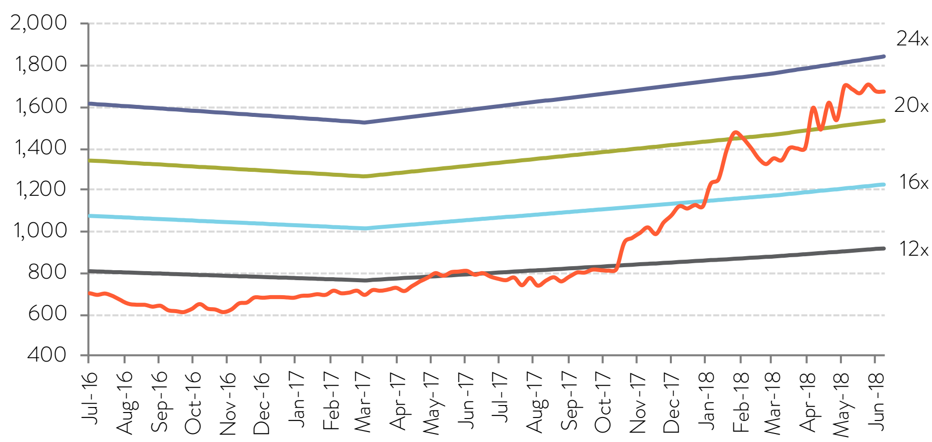
Source: Company, BOBCAPS Research

FIG 14 – VALUATION SUMMARY

Company	CMP (Rs)	Rating	Target Price (Rs)	US$ revenue CAGR (%)		EBIT CAGR (%)	EPS (Rs)			P/E (x)			ROE (%)		
				FY15-18	FY18-21E	FY18-21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
TCS	1,848	BUY	2,180	7.3	11.2	14.5	75.2	87.3	98.8	24.6	21.2	18.7	30.4	30.2	29.2
INFO	1,307	ADD	1,390	7.9	9.8	10.4	70.2	79.4	88.4	18.6	16.5	14.8	22.5	23.2	23.5
WPRO	261	SELL	240	4.4	5.6	7.9	18.2	19.8	21.3	14.3	13.1	12.3	15.7	15.0	14.1
HCLT	926	ADD	1,010	9.6	11.4	12.4	68.0	74.5	83.4	13.6	12.4	11.1	24.5	23.6	23.4
TECHM	657	ADD	720	9.2	9.7	16.0	42.7	46.5	51.5	15.4	14.1	12.8	18.6	18.2	18.1
LTI	1,650	BUY	1,980	11.8	14.9	25.0	73.6	86.3	96.9	22.4	19.1	17.0	30.4	30.0	28.4
MPHL	1,100	BUY	1,270	2.4	12.4	16.3	51.0	57.8	67.0	21.6	19.0	16.4	17.3	18.0	19.2
MTCL	987	ADD	1,090	13.2	12.9	26.0	40.3	48.5	55.9	24.5	20.4	17.6	22.6	23.8	23.9
HEXW*	458	ADD	490	12.9	13.7	15.2	19.1	21.6	24.2	24.0	21.2	18.9	26.7	25.8	24.2
PSYS	811	SELL	710	15.1	11.9	20.6	42.9	51.0	60.0	18.9	15.9	13.5	15.3	16.5	17.4
NITEC	1,098	ADD	1,225	6.1	12.0	17.6	57.4	68.0	79.2	19.1	16.1	13.9	18.4	19.1	19.5
ECLX	1,282	SELL	1,140	8.9	11.5	9.1	73.5	81.5	91.1	17.4	15.7	14.1	22.1	22.4	22.9

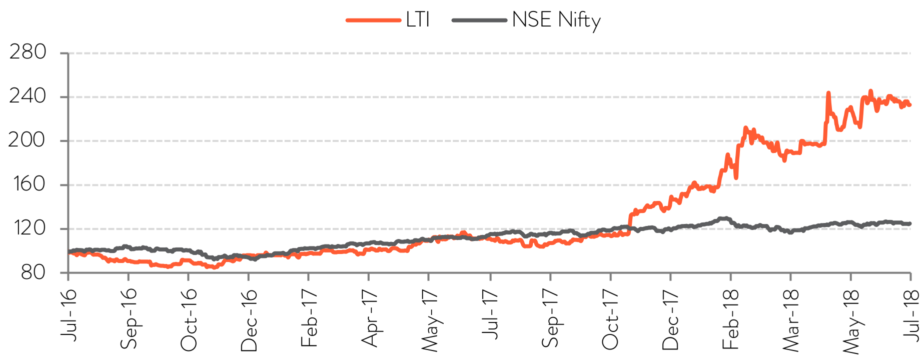
Source: Bloomberg, BOBCAPS Research | Prices as on 2nd Jul 2018 | *FY19 refers to CY18 for Hexaware and so on

FIG 15 – LTI TRADED AT AVERAGE 13.3X 12-MONTH ROLLING FORWARD P/E SINCE LISTING IN JUL'16



Source: BLOOMBERG, BOBCAPS Research

FIG 16 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Currency risk:** A sharp fluctuation in exchange rates may materially impact the company's operating profits.
- **Leadership flux:** LTI suffered from a leadership flux in the past (prior to FY14) – a repeat of this situation would pose a risk to our thesis.
- **Inability to sustain large deal momentum:** Steady large deal wins is critical for the company to sustain its strong growth traction. An inability to do so may derail growth.
- **Benchmarking clause:** Some of LTI's client contracts contain benchmarking clauses (22% of revenues in FY16) and most favoured customer provisions (29% of revenues in FY16) which, if triggered, could result in lower contractual revenues and profitability in future.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**65,009**	**73,064**	**89,542**	**1,02,650**	**1,15,934**
EBITDA	12,295	11,875	15,927	19,357	22,584
EBIT	10,515	10,312	14,047	17,201	20,149
Other income/(expenses)	1,844	4,102	2,690	2,421	1,881
EBT	12,359	14,414	16,736	19,623	22,030
Income taxes	2,648	3,290	3,849	4,513	5,067
Reported net profit	**9,711**	**11,124**	**12,887**	**15,110**	**16,963**
Adjusted net profit	**9,711**	**11,124**	**12,887**	**15,110**	**16,963**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	11,122	12,960	15,319	17,562	19,834
Provisions	1,771	2,123	2,439	2,796	3,158
Other liabilities	0	132	132	132	132
Equity capital	171	171	171	171	171
Reserves & surplus	31,280	38,439	45,895	54,638	64,453
Shareholders' fund	31,451	38,610	46,066	54,809	64,624
Total liabilities and equities	**44,344**	**53,825**	**63,957**	**75,299**	**87,749**
Cash and cash eq.	3,761	3,633	9,982	16,101	23,210
Accounts receivables	11,697	22,327	15,946	18,280	20,646
Other current assets	8,423	7,121	11,285	12,937	14,611
Investments	9,406	12,643	12,643	12,643	12,643
Net fixed assets	5,432	5,281	5,639	6,050	6,514
CWIP	4	0	0	0	0
Deferred tax assets, net	1,434	2,821	2,821	2,821	2,821
Other assets	4,191	0	5,642	6,468	7,305
Total assets	**44,344**	**53,826**	**63,958**	**75,300**	**87,750**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	9,029	12,687	14,767	17,265	19,398
Interest expenses	5	(745)	(1,071)	(1,178)	(1,296)
Changes in working capital	1,606	(2,947)	(749)	(2,213)	(2,242)
Other operating cash flows	3,043	(284)	0	0	0
Cash flow from operations	**13,683**	**8,711**	**12,947**	**13,874**	**15,860**
Capital expenditures	(754)	(1,425)	(2,239)	(2,566)	(2,898)
Change in investments	(8,783)	(3,237)	0	0	0
Other investing cash flows	(67)	322	1,071	1,178	1,296
Cash flow from investing	**(9,604)**	**(4,340)**	**(1,168)**	**(1,388)**	**(1,602)**
Equities issued/Others	4	0	0	0	0
Interest expenses	(747)	0	0	0	0
Dividends paid	(1,610)	(4,533)	(5,431)	(6,367)	(7,148)
Cash flow from financing	**(2,353)**	**(4,533)**	**(5,431)**	**(6,367)**	**(7,148)**
Changes in cash and cash eq.	**1,726**	**(162)**	**6,349**	**6,119**	**7,109**
Closing cash and cash eq.	**3,761**	**3,633**	**9,982**	**16,101**	**23,210**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	69.2	63.5	73.6	86.3	96.9
Adjusted EPS	69.2	63.5	73.6	86.3	96.9
Dividend per share	16.6	21.5	25.8	30.2	33.9
Book value per share	224.2	220.5	263.1	313.0	369.0

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	4.4	3.9	3.1	2.7	2.3
EV/EBITDA	23.2	24.0	17.5	14.1	11.8
Adjusted P/E	23.8	26.0	22.4	19.1	17.0
P/BV	7.4	7.5	6.3	5.3	4.5

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	78.6	77.2	77.0	77.0	77.0
Interest burden (PBT/EBIT)	117.5	139.8	119.1	114.1	109.3
EBIT margin (EBIT/Revenue)	16.2	14.1	15.7	16.8	17.4
Asset turnover (Revenue/Avg TA)	164.8	148.9	152.0	147.4	142.2
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.4	1.4	1.4
Adjusted ROAE	37.6	31.8	30.4	30.0	28.4

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	11.2	12.4	22.6	14.6	12.9
EBITDA	19.9	(3.4)	34.1	21.5	16.7
Adjusted EPS	18.1	(8.2)	15.8	17.2	12.3
Profitability & Return ratios (%)					
EBITDA margin	18.9	16.3	17.8	18.9	19.5
EBIT margin	16.2	14.1	15.7	16.8	17.4
Adjusted profit margin	14.9	15.2	14.4	14.7	14.6
Adjusted ROAE	37.6	31.8	30.4	30.0	28.4
ROCE	44.1	32.8	39.4	45.8	50.1
Working capital days (days)					
Receivables	66	85	78	61	61
Payables	24	12	11	11	12
Ratios (x)					
Gross asset turnover	10.8	13.6	16.4	17.6	18.5
Current ratio	2.2	2.2	2.4	2.6	2.9
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

BUY
TP: Rs 1,270 | ⮝ 15%

MPHASIS | IT Services | 04 July 2018

Strong growth visibility – initiate with BUY

We initiate coverage on Mphasis (MPHL) with BUY and a Mar'19 target price of Rs 1,270. In our view, MPHL offers high growth visibility (12.4%/15% US$ revenue/ earnings CAGR for FY18-FY21E) given (1) a stronger HP/DXC relationship post-restructuring at HP, (2) a large business opportunity from Blackstone's portfolio companies (estimated at US$ 1.5bn), and (3) robust deal wins (at US$ 552mn in FY18, +51% YoY). Improving Europe operations and an expected turnaround in Digital Risk would further support growth.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

HP/DXC – from growth impediment to growth catalyst: After six years of decline, MPHL's DXC/HP dollar revenues grew 22% in FY18. We expect robust ~19% YoY growth in FY19 led by restructuring initiatives at HP – especially at DXC Technology which contributes 86% of DXC/HP channel revenues – and the transformation of HP-MPHL's relationship following Blackstone ownership.

Blackstone to rejuvenate direct business: Post-acquisition by Blackstone in FY17, MPHL has differentiated access to the PE firm's portfolio of companies, where management estimates an IT services opportunity of US$ 1.5bn. MPHL closed FY18 with a TCV of US$ 158mn from this client base. We build in a US$ revenue CAGR of 13.4% for the direct business (ex-Digital Risk) over FY18-FY21 backed by strong deal wins (US$ 552mn in FY18), a rising share of NextGen contracts (83% vs. 61% in FY17) and traction in the Blackstone opportunity.

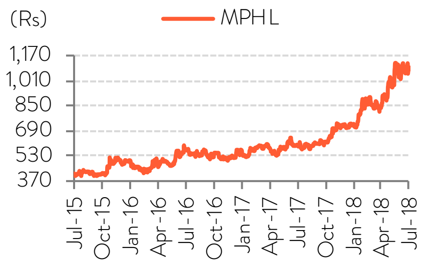
Digital Risk turning around: We expect a growth recovery in FY19 on the back of a strong exit rate (+14% QoQ in Q4FY18) and improving deal traction – in turn supporting a 7% revenue CAGR for Digital Risk over FY19-FY21E.

Initiate with BUY: Given robust growth prospects, we assign an FY20E P/E of 22x, ~8% premium to the average for tier-II peers, yielding a TP of Rs 1,270.

Ticker/Price	MPHL IN/Rs 1,100
Market cap	US$ 3.1bn
Shares o/s	193mn
3M ADV	US$ 11.1mn
52wk high/low	Rs 1,155/Rs 526
Promoter/FPI/DII	60%/23%/17%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	7,914	8,507	9,847	11,160	12,937
Adj. EPS (Rs)	37.6	44.1	51.0	57.8	67.0
Adj. EPS growth (%)	25.3	17.1	15.8	13.3	15.9
Adj. ROAE (%)	12.7	14.6	17.3	18.0	19.2
Adj. P/E (x)	29.2	25.0	21.6	19.0	16.4
EV/EBITDA (x)	21.5	19.9	16.7	14.6	12.4

Source: Company, BOBCAPS Research

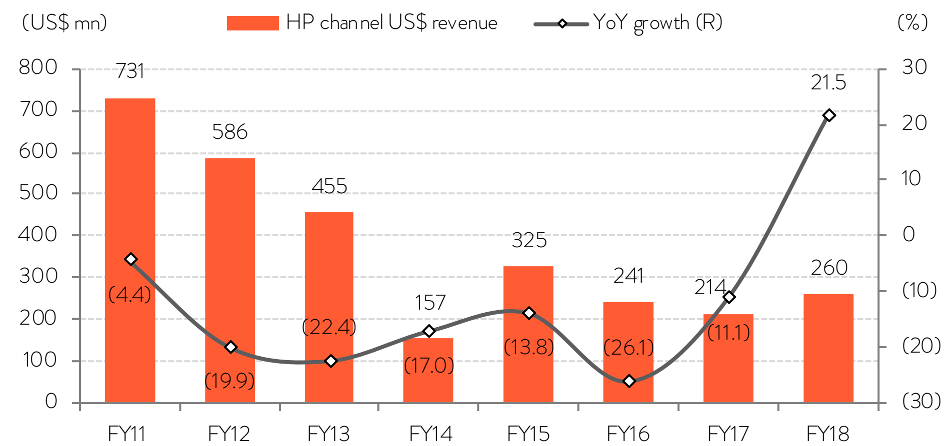
Investment rationale

Brisk turnaround in HP/DXC channel

After six years of declining revenues, MPHL's HP/DXC business (26% revenue share) has turned from growth impediment to growth catalyst. In FY18, revenues from this channel increased 22% YoY in US$ terms. Unlike consensus expectations of normalised growth for the DXC/HP channel, we believe this business will roll ahead at a smart clip of ~19% YoY in FY19.

Growth would be fuelled by the convergence of restructuring initiatives at four HP entities – especially at DXC Technology which contributes 86% of DXC/HP channel revenues – and the transformation of HP-MPHL's relationship post Blackstone ownership.

FIG 1 – TRANSFORMED RELATIONSHIPS SUPPORTING STRONG GROWTH

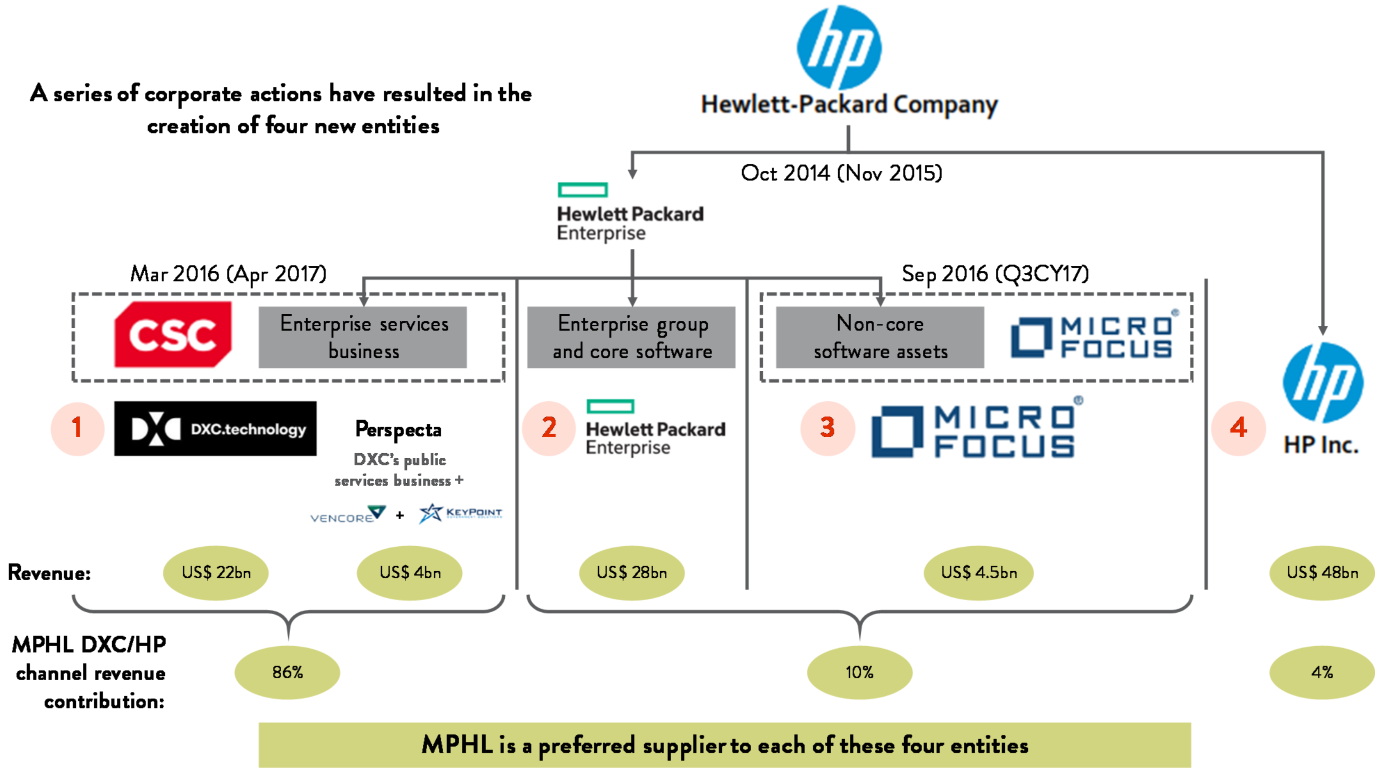


Source: Company, BOBCAPS Research | Note: FY11-FY13 had year-end Oct, FY14 consisted of five months ending Mar'14, FY15 onwards have year-end Mar

Post-restructuring at HP, MPHL now has four distinct strategic accounts within the channel, namely (1) DXC Technology, (2) HP Enterprise, (3) Microfocus and (4) HP Inc (with Perspecta being a possible fifth). We highlight that DXC Technology's turnaround strategy prioritises margin improvement along with the generation of ~US$ 400mn in incremental cost savings for FY19. In keeping with these goals, DXC signed a partnership deal with MPHL in May'17 for application modernisation and cloud migration across its client base.

MPHL is focused on improving wallet share across HP entities and on expanding into other geographies within the partnership, with a renewed thrust on Europe, the UK and Asia Pacific, besides North America.

FIG 2 – SIGNIFICANT OPPORTUNITY TO IMPROVE WALLET SHARE IN STRATEGIC HP ACCOUNTS



Source: Company, BOBCAPS Research

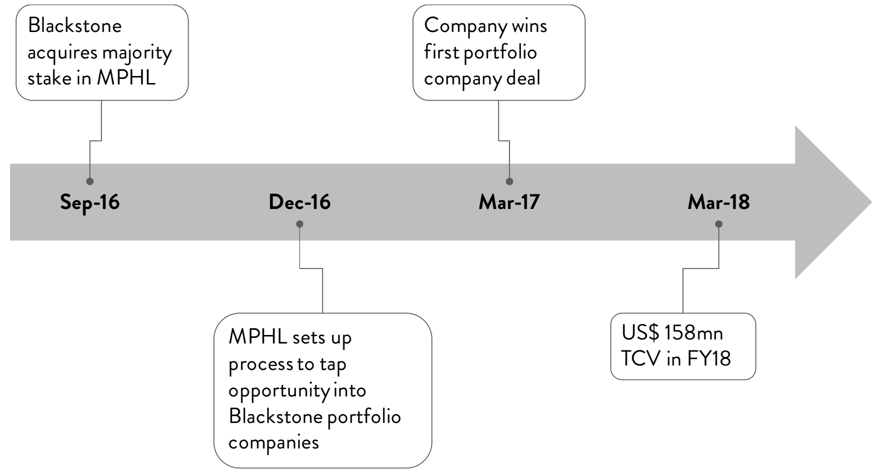
Blackstone portfolio – a new engine for direct channel growth

Blackstone's Sep'16 acquisition of a majority stake in MPHL has given the latter differentiated access to the PE firm's portfolio of companies, whose annual IT spend is pegged at US$ 1.5bn. In FY17, MPHL began to institutionalise a process to tap into this large opportunity and identified 20 companies within Blackstone's portfolio (out of ~70) based on size and overlap with its areas of expertise.

MPHL won its first Blackstone portfolio deal in the Mar'17 quarter and thereafter closed FY18 with a TCV of US$ 158mn from this client base. While these deals are evaluated and won on merit, common ownership by Blackstone lends MPHL an edge in terms of early engagement in the sales process and hence swift alignment of its marketing initiatives.

Blackstone has successfully leveraged a similar opportunity in its BPO investment company Intelenet which derived 27% of its overall revenues from portfolio companies. We believe that this differentiated revenue channel will continue to support growth in MPHL's direct channel business.

FIG 3 – MPHL WON DEALS WORTH US$ 158MN FROM BLACKSTONE PORTFOLIO COMPANIES IN FY18



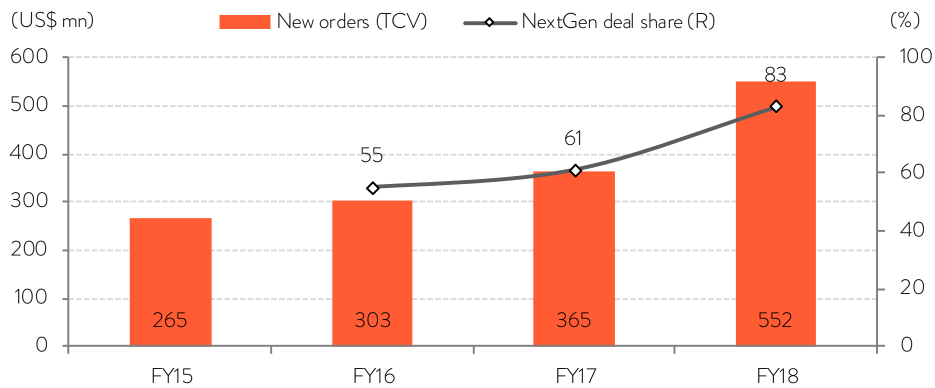
Source: Company, BOBCAPS Research

Direct core business set to grow ahead of industry

We believe MPHL is well positioned to deliver above-industry growth in the direct channel business backed by (1) strong deal wins coupled with an increasing proportion of NextGen contracts, (2) traction in the Blackstone portfolio opportunity, (3) an enhanced footprint in Europe where a new business leader has been inducted in the Dec'17 quarter, and (4) focused strategic account mining initiatives.

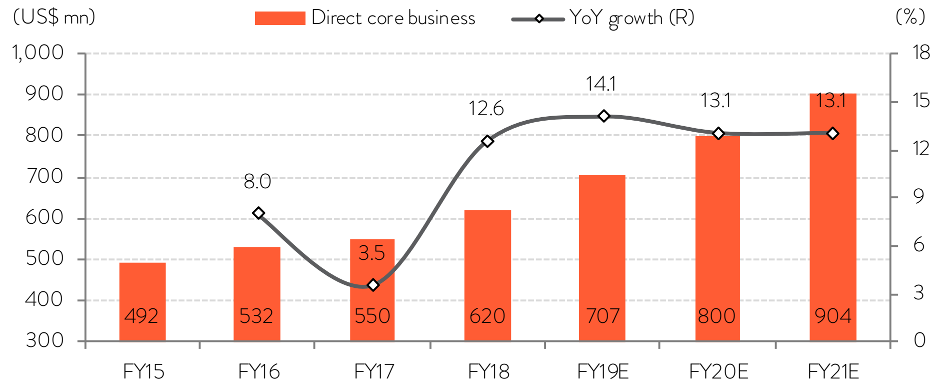
Management has prioritised the consolidation of innovation and capability-building initiatives under research arm NextLabs along with the enhancement of go-to-market efforts to aid direct channel growth. In FY18, MPHL won new deals worth US$ 552mn (+51% YoY) with an 83% share of NextGen services vs. new deal TCV worth US$ 365mn with 61% of NextGen services in FY17. The Blackstone portfolio wins (TCV of US$ 158mn) would support revenue growth in FY19 as the deals ramp up. We build in a US$ revenue CAGR of 13.4% for the company's direct core business excluding Digital Risk over FY18-FY21E.

FIG 4 – 100%+ GROWTH IN NEXT-GEN DEAL WINS IN FY18



Source: Company, BOBCAPS Research

FIG 5 – EXPECT 13.4% US$ REVENUE CAGR FOR DIRECT CHANNEL BUSINESS (EX-DIGITAL RISK) OVER FY18-FY21E



Source: Company, BOBCAPS Research

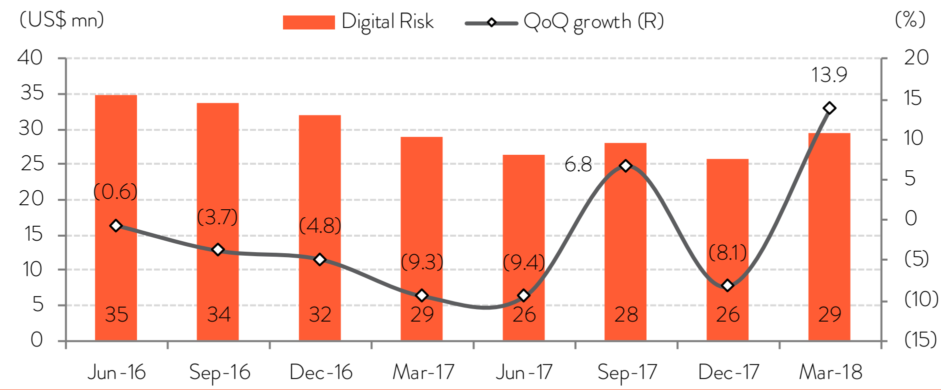
Digital Risk on the path to recovery

MPHL's Digital Risk subsidiary (engaged in the mortgage origination business) declined at a 15.4% CAGR over FY15-FY18 (in US$ terms) due to rising interest rates in the US. In an effort to revive growth and reduce volatility, management is focused on lowering the dependence on interest-sensitive business areas by (1) adding new clients, (2) expanding capabilities in newer adjacencies, and (3) pursuing technology-backed cross-pollination deals.

Emerging revenue stability (revenues in the range of US$ 26mn-29mn over the last four quarters) and operating margin improvement (to double digits in H2FY18) highlight the early results of management's initiatives to energise revenue growth. Notably, in Jan'18, MPHL won an engagement with CitiMortgage on Digital Risk's LoanFx platform to provide a fully digital, integrated mortgage origination platform.

We expect a growth turnaround for Digital Risk in FY19 on the back of a strong exit rate and improving deal traction. Accordingly, we build in 8% US$ revenue growth for FY19 and a CAGR of 7% over FY18-FY21.

FIG 6 – INITIAL SIGNS OF GROWTH REVIVAL IN DIGITAL RISK BUSINESS

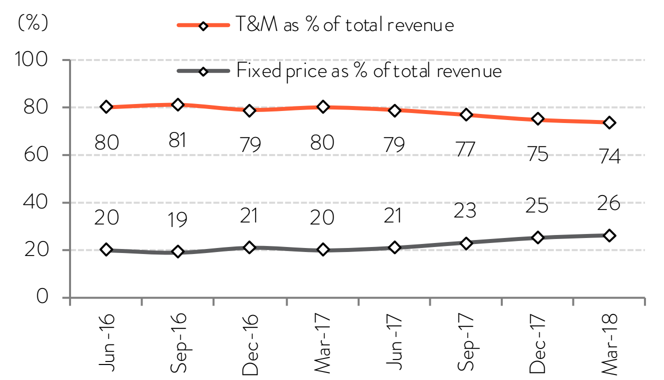


Source: Company, BOBCAPS Research

Margin levers in place

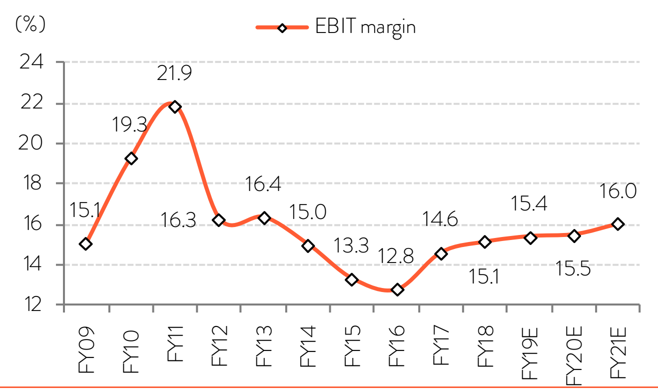
While lower hedging gains may limit the margin benefits from rupee depreciation in the near term, we expect growth leverage coupled with tighter efficiency to aid 100bps EBIT margin improvement over FY18-FY21 to 16%. MPHL's operational efficiency initiatives include (1) repurposing sales investments by creating an integrated go-to-market plan around key accounts and building a centralised structure for key sales support areas such as marketing bid management, (2) improving the fixed price mix, and (3) optimising the employee pyramid.

FIG 7 – MANAGEMENT FOCUSED ON IMPROVING FIXED-PRICE REVENUE MIX



Source: Company, BOBCAPS Research

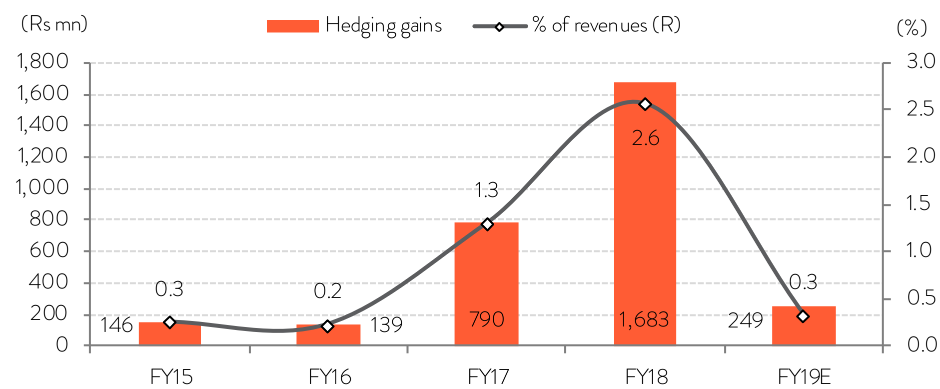
FIG 8 – EBIT MARGINS TO IMPROVE GRADUALLY ON GROWTH LEVERAGE & OPERATIONAL EFFICIENCY



Source: Company, BOBCAPS Research | Note: EBIT margins are inclusive of hedging gains/losses. FY09 consisted of seven months ending Oct'09

Management has revised its target operating (EBIT) margin range to 15-17% in the Mar'18 quarter vs. 14-16% earlier. We expect EBIT margins for the year to settle towards the lower end of the target range due to lower hedging gains (flowing through revenues). The company's elevated hedging book at US$ 569mn with an effective hedge rate of Rs 67.7/US$ amid rupee depreciation against the dollar will limit the flow-through of currency depreciation gains in FY19. We build in hedging gains of Rs 249mn in FY19 (0.3% of revenues) vs. Rs 1.7bn in FY18 (2.6% of revenues).

FIG 9 – LOWER HEDGING GAINS TO LIMIT MARGIN EXPANSION IN FY19E

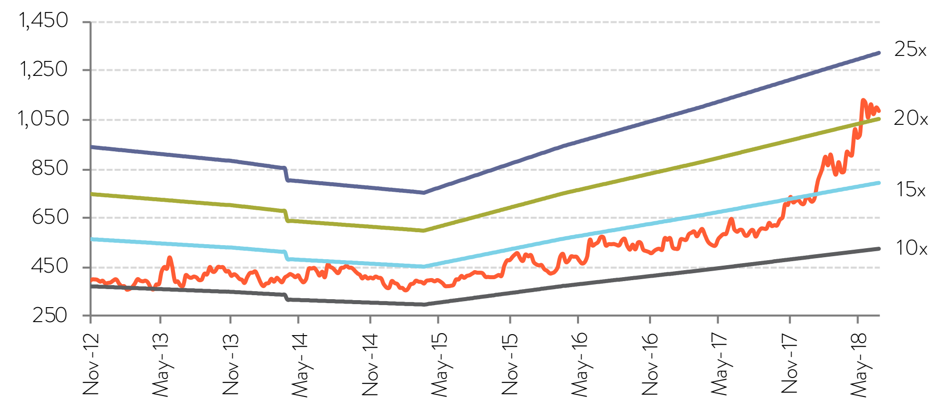


Source: Company, BOBCAPS Research

Valuation methodology

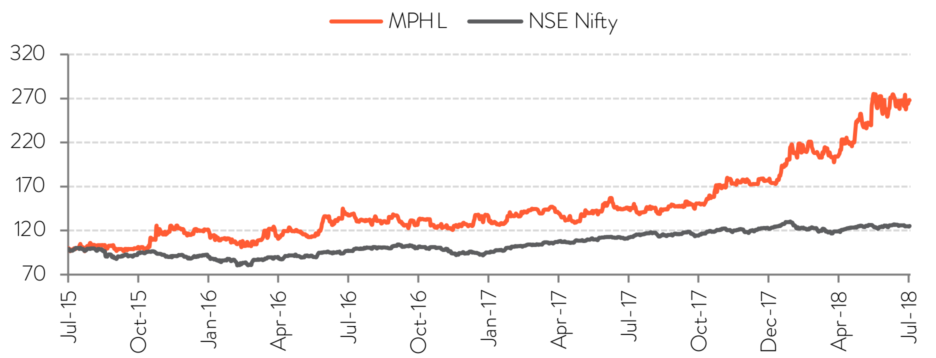
We believe that management's focused initiatives to leverage MPHL's differentiated revenue channels, namely HP/DXC and Blackstone portfolio companies, enhances near-to-medium term growth visibility for the company. We model for a 12.4%/15% revenue/earnings CAGR over FY18-FY21 and value the stock at P/E multiple of 22x FY20E (~8% premium over average target multiple for mid-tier IT companies), leading to a Mar'19 target price of Rs 1,270. Initiate with BUY.

FIG 10 – MPHL TRADED AT AVERAGE 13.2X 12-MONTH ROLLING FORWARD P/E OVER LSAT 5 YEARS



Source: Bloomberg, BOBCAPS Research Note: Reporting has been changed from Oct end to Mar end from FY14

FIG 11 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Downside risks:** In the past, MPHL had suffered adversely due to high HP/DXC channel revenue concentration. Unfavourable changes in HP/DXC and Blackstone portfolio company relations could pose downside risks to our estimates. Inability of the company to arrest the sharp decline in Digital Risk revenues, adverse currency movements, and a steep decline in IT spending of other clients could also adversely impact financial performance.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**60,764**	**65,459**	**76,279**	**86,306**	**97,299**
EBITDA	9,689	10,626	12,513	14,139	16,344
EBIT	8,896	9,917	11,765	13,392	15,596
Other income/(expenses)	2,246	1,490	1,364	1,488	1,653
Exceptional items	(152)	0	0	0	0
EBT	10,990	11,407	13,129	14,879	17,249
Income taxes	3,076	2,900	3,282	3,720	4,312
Reported net profit	**7,914**	**8,507**	**9,847**	**11,160**	**12,937**
Adjusted net profit	**7,914**	**8,507**	**9,847**	**11,160**	**12,937**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	6,705	10,842	12,539	14,187	15,994
Provisions	2,183	245	209	236	267
Debt funds	2,602	3,898	3,898	3,898	3,898
Other liabilities	158	49	49	49	49
Equity capital	2,104	1,932	1,932	1,932	1,932
Reserves & surplus	59,420	52,883	57,395	62,508	68,436
Shareholders' fund	61,524	54,815	59,327	64,440	70,368
Total liabilities and equities	**73,172**	**69,849**	**76,022**	**82,811**	**90,576**
Cash and cash eq.	6,255	4,641	7,106	10,409	14,239
Accounts receivables	6,310	8,127	9,613	10,877	12,262
Other current assets	16,435	10,923	12,748	14,424	16,261
Investments	23,956	26,245	26,245	26,245	26,245
Net fixed assets	2,620	1,843	2,240	2,787	3,498
CWIP	387	19	19	19	19
Intangible assets	14,069	17,014	17,014	17,014	17,014
Deferred tax assets, net	3,527	1,056	1,056	1,056	1,056
Total assets	**73,172**	**69,849**	**76,022**	**82,811**	**90,576**

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	9,033	9,216	10,595	11,907	13,684
Interest expenses	(307)	(1,490)	(1,364)	(1,488)	(1,653)
Changes in working capital	(1,045)	5,894	(1,650)	(1,264)	(1,386)
Other operating cash flows	(918)	(6,290)	0	0	0
Cash flow from operations	**6,763**	**7,330**	**7,580**	**9,156**	**10,646**
Capital expenditures	(1,150)	(300)	(1,144)	(1,295)	(1,459)
Change in investments	(1,261)	(2,289)	0	0	0
Other investing cash flows	5,077	(288)	1,364	1,488	1,653
Cash flow from investing	**2,666**	**(2,877)**	**220**	**193**	**193**
Equities issued/Others	3	0	0	0	0
Debt raised/repaid	(3)	(1,296)	0	0	0
Interest expenses	(2,045)	0	0	0	0
Dividends paid	(5,055)	(4,649)	(5,335)	(6,046)	(7,009)
Cash flow from financing	**(7,100)**	**(5,945)**	**(5,335)**	**(6,046)**	**(7,009)**
Changes in cash and cash eq.	**2,329**	**(1,492)**	**2,465**	**3,303**	**3,830**
Closing cash and cash eq.	**6,255**	**4,641**	**7,106**	**10,409**	**14,239**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	37.6	44.1	51.0	57.8	67.0
Adjusted EPS	37.6	44.1	51.0	57.8	67.0
Dividend per share	36.9	20.0	23.0	26.0	30.2
Book value per share	292.5	283.9	307.3	333.8	364.5

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	3.4	3.2	2.7	2.4	2.1
EV/EBITDA	21.5	19.9	16.7	14.6	12.4
Adjusted P/E	29.2	25.0	21.6	19.0	16.4
P/BV	3.8	3.9	3.6	3.3	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	72.0	74.6	75.0	75.0	75.0
Interest burden (PBT/EBIT)	123.5	115.0	111.6	111.1	110.6
EBIT margin (EBIT/Revenue)	14.6	15.1	15.4	15.5	16.0
Asset turnover (Revenue/Avg TA)	79.8	91.5	104.6	108.7	112.2
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.3	1.3	1.3
Adjusted ROAE	12.7	14.6	17.3	18.0	19.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	(0.1)	7.7	16.5	13.1	12.7
EBITDA	7.7	9.7	17.8	13.0	15.6
Adjusted EPS	25.3	17.1	15.8	13.3	15.9
Profitability & Return ratios (%)					
EBITDA margin	15.9	16.2	16.4	16.4	16.8
EBIT margin	14.6	15.1	15.4	15.5	16.0
Adjusted profit margin	13.0	13.0	12.9	12.9	13.3
Adjusted ROAE	12.7	14.6	17.3	18.0	19.2
ROCE	10.9	13.2	16.0	17.6	19.8
Working capital days (days)					
Receivables	39	40	42	43	43
Payables	54	63	78	76	76
Ratios (x)					
Gross asset turnover	25.6	29.3	37.4	34.3	31.0
Current ratio	3.3	2.1	2.3	2.5	2.6
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	0.0	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 1,090 | ⮝ 10%

MINDTREE | IT Services | 04 July 2018

On course for accelerated growth – initiate with ADD

We expect Mindtree's (MTCL) operational performance to rebound in FY19 as challenges at top clients recede, new deals ramp up and recovery in the digital business gathers pace. Emerging stability at Bluefin and Magnet 360 is a further positive. We estimate a robust EBIT CAGR of 26% for MTCL over FY18-FY21 as accelerated revenue growth (12.9% CAGR) invigorates margins (+340bps). However, stock price upsides look limited following the 60% rally in the last three months – initiate with ADD and a Mar'19 target price of Rs 1,090.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Receding top client challenges: After six quarters of decline, YoY revenue growth from MTCL's top 2-5 clients turned positive in H2FY18 (+2.3% YoY in US$ terms), indicating signs of stability. We model for a 12.9% revenue CAGR for MTCL over FY18-FY21 backed by the improving outlook at top clients, deal wins worth US$ 1bn+ in FY18 and accelerating traction in the digital business.

Drag from Bluefin and Magnet 360 reducing: Initiatives to target annuity-based deals, engage channel partners, revamp market focus and rebrand operations have slashed operational losses at Bluefin and Magnet 360 in H2FY18, per management – in turn relieving the drag on MTCL's margins.

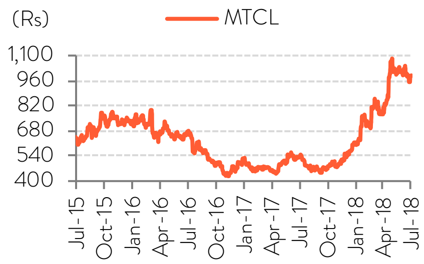
Robust operational performance: We model for EBIT margins of 13.6% in FY20 vs. 10.4% in FY18 led by strong revenue traction, enhanced operational stability at Bluefin and Magnet 360, and favourable currency movement. MTCL's EBIT/earnings are thus projected to clock a 26%/17.3% CAGR over FY18-FY21.

Initiate with ADD: MTCL is trading at 24.5x/20.4x FY19E/FY20E P/E. While we expect a rebound in revenue growth coupled with margin recovery, the recent stock rally would cap price upsides. Valuing MTCL at 22.5x FY20E P/E, (~11% premium to average for mid-tier peers), we have a Mar'19 TP of Rs 1,090.

Ticker/Price	MTCL IN/Rs 991
Market cap	US$ 2.4bn
Shares o/s	164mn
3M ADV	US$ 29.3mn
52wk high/low	Rs 1,101/Rs 439
Promoter/FPI/DII	13%/42%/45%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	4,186	5,701	6,625	7,972	9,196
Adj. EPS (Rs)	24.8	34.7	40.3	48.5	55.9
Adj. EPS growth (%)	(24.8)	39.5	16.2	20.3	15.4
Adj. ROAE (%)	16.8	21.4	22.6	23.8	23.9
Adj. P/E (x)	39.9	28.6	24.6	20.4	17.7
EV/EBITDA (x)	22.5	22.0	15.6	13.0	11.2

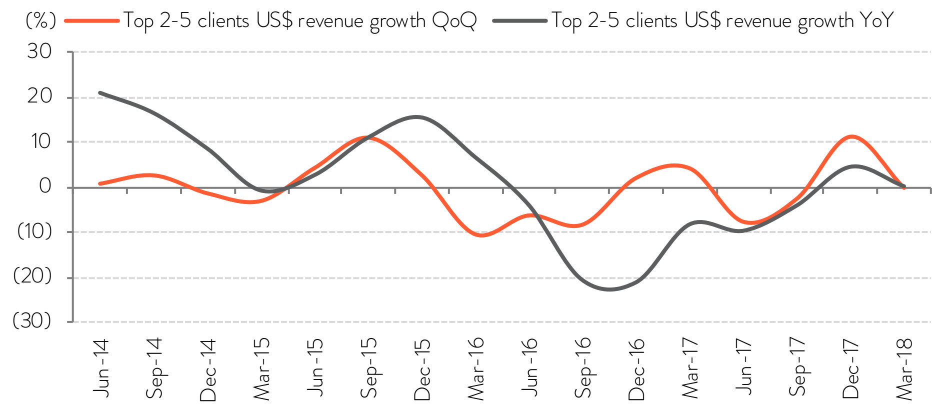
Source: Company, BOBCAPS Research

Investment rationale

Receding challenges at top clients

Challenges at MTCL's top 2-5 clients (14% revenue share) appear to be bottoming out. After six quarters of decline over Jun'16 to Sep'17, the YoY downslide in US$ revenues from these clients was arrested in H2FY18 (+2.3% YoY). Management is optimistic on an improving growth trajectory for top clients going ahead. In addition, the company's top 10 bracket now features several new names due to the ramp-up of recent engagements. We expect the improving outlook at key clients and richer account mining to support accelerated growth for MTCL in FY19.

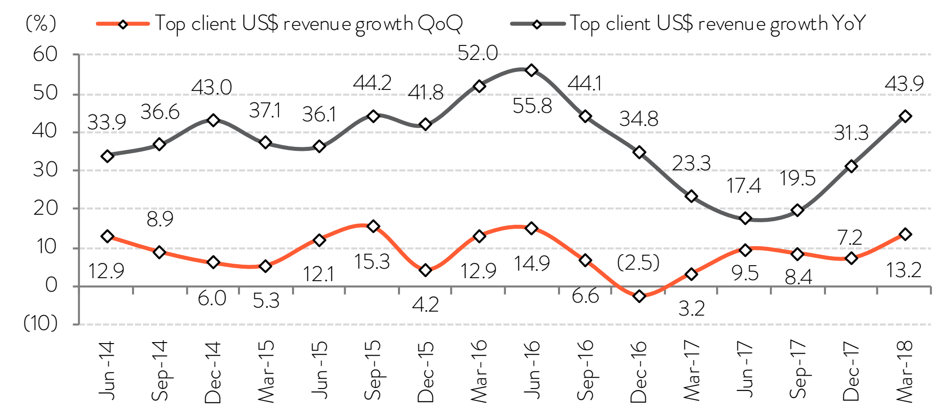
FIG 1 – US$ REVENUES FROM TOP 2-5 CLIENTS STABILISING



Source: Company, BOBCAPS Research

MTCL's top client continues to grow at a rapid pace, logging 28% YoY US$ revenue growth in FY18 and a 36.9% CAGR over FY14-FY18. Management continues to see growth opportunities with its top client while remaining conscious of the concentration risk. We highlight that MTCL's synergistic engagement with this client lends added growth visibility.

FIG 2 – SCOPE FOR FURTHER INROADS IN TOP CLIENT DRIVES MANAGEMENT'S GROWTH OPTIMISM



Source: Company, BOBCAPS Research

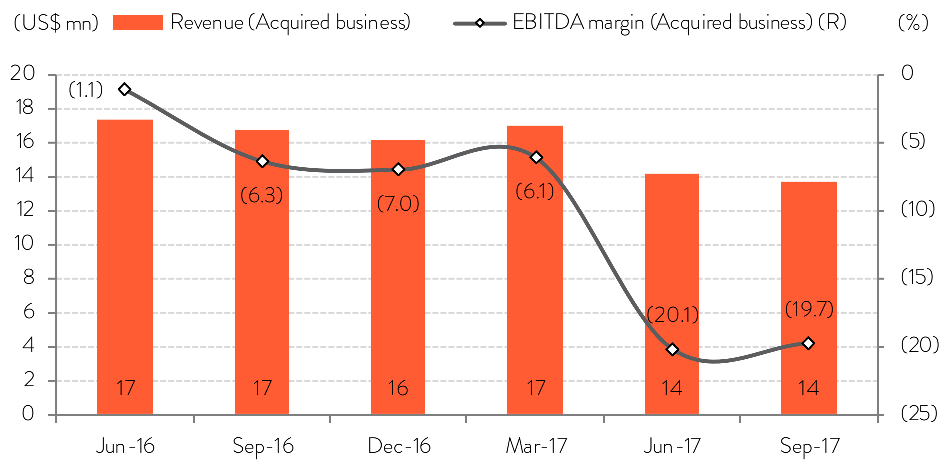
Improved operational stability at Bluefin and Magnet 360

Bluefin (acquired in Jul'15) and Magnet 360 (acquired in Jan'16) now exhibit better operational stability after emerging from challenges through FY17 and FY18, when Bluefin suffered due to Brexit and delayed integration owing to a cultural mismatch, while recalibration to curtail long-tail clients affected Magnet 360.

MTCL's management has indicated a significant reduction in operational losses for these two entities in H2FY18 backed by restructuring initiatives – viz. a revamped deal focus (to ensure a higher annuity component), stronger channel partner engagement, sales team reorientation and a key geography focus. Bluefin has also been rebranded as a package solution business and Magnet 360 as a Salesforce practice.

While MTCL continues to leverage cross-sale opportunities (with the enhanced SAP HANA database management system and Salesforce capabilities of Bluefin and Magnet 360 respectively), better profitability at these two businesses will support operating margin gains for the company.

FIG 3 – SIGNIFICANT REDUCTION IN OPERATIONAL LOSSES AT BLUEFIN AND MAGNET 360 IN H2FY18 AS PER MANAGEMENT



Source: Company, BOBCAPS Research | Note: Management has discontinued separate disclosures for Bluefin and Magnet 360 from Dec'17 quarter.

Added depth to leadership

MTCL has inducted three industry veterans into its top leadership in FY18 and elevated two employees to the top rungs following an internal reshuffle. The newly inducted leaders are (1) Sreedhar Bhagavatheeswaran – inducted from TCS to head MTCL's Digital business, (2) Satya Ramaswamy – also an ex-TCS veteran who will lead the Enterprise Re-imagination business, and (3) Balaji Thirumalai – appointed as Head of Technology, Media & Services.

FIG 4 – RECENT HIRING OF TOP-LEVEL EXECUTIVES

Name	Designation	Date	Profile
Satya Ramaswamy	Executive Vice President, Enterprise Re-imagination Business	Jan'18	Prior to his current role in MTCL, Dr. Satya was Senior Vice President and Global Head of Digital business in TCS, where he built the Digital business from the ground up to a fully scaled global organisation over a seven-year period and helped TCS win several recognitions.
Sreedhar Bhagavatheeswaran	SVP and Global Head of Digital Business	Aug'17	Sreedhar has ~20 years of experience at TCS with diverse experience in the Banking and Financial Services industry. He has worked with several global financial services institutions, helping them innovate with digital technologies.
Balaji Thirumalai	Head, Technology, Media & Services	Mar'17	Prior to joining MTCL, Balaji managed SunEdison's Commercial and Industrial business in the Asia Pacific. Prior to that, he co-founded an education technology start-up. He has spent over 17 years in the semiconductor industry in various leadership roles across engineering, product management, business development, strategy and general management at companies such as AMD, Altera, Xilinx and Cypress Semiconductor.

Source: Company, BOBCAPS Research

FIG 5 – EXECUTIVE RESHUFFLE

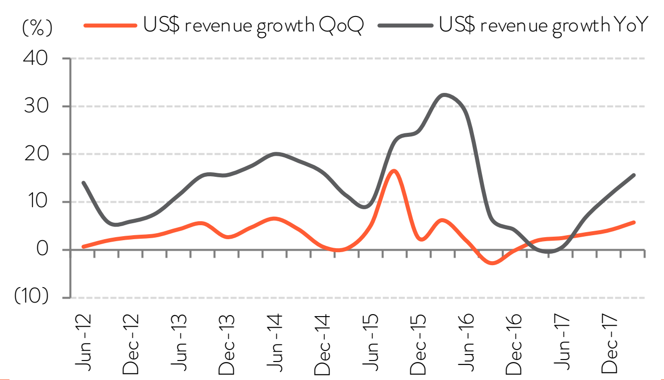
Name	Date	New position	Earlier position
Nalin Vij	Sep'17	Vice President & Global Head – Travel, Transportation & Hospitality Industry	Microsoft Head
Anil Gandharve	Apr'17	Global Head of Retail, CPG & Manufacturing	Head, Europe

Source: Company, BOBCAPS Research

Robust growth visibility

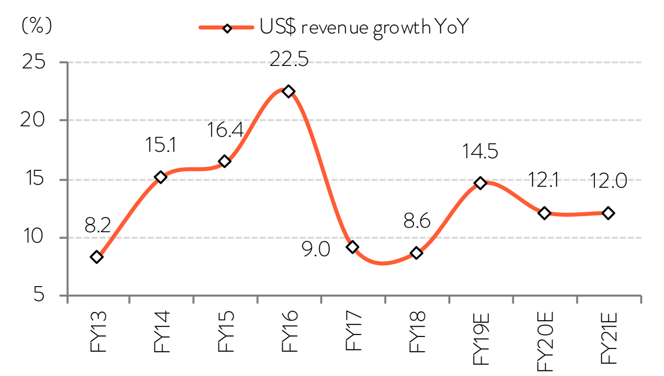
In FY18, MTCL won deals worth US$ 1bn+ in TCV and ended FY18 with a strong implied exit growth rate of 6.8% YoY in revenues for FY19E vs. 0.3% for last year. Ramp up of new deals coupled with accelerating traction in the digital business (marked by five consecutive quarters of growth), receding challenges at top clients and improved stability at Bluefin and Magnet 360 should support estimated US$ revenue growth of 14.5% in FY19 as against the 8.6% rate clocked in FY18. We accordingly model for a 12.9% revenue CAGR over FY18-FY21.

FIG 6 – STRONG MAR-18 EXIT RATE SETS FOUNDATION FOR ACCELERATED GROWTH IN FY19E



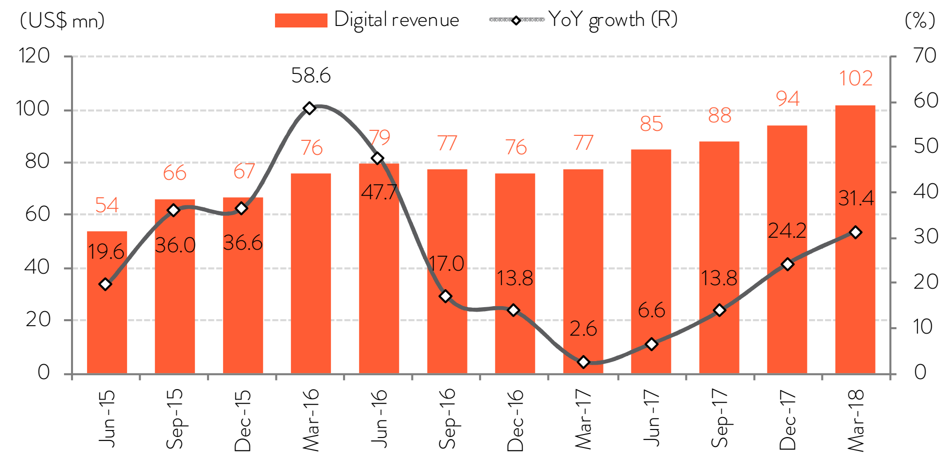
Source: Company, BOBCAPS Research

FIG 7 – WE EXPECT 14.5% YoY US$ REVENUE GROWTH IN FY19E



Source: Company, BOBCAPS Research

FIG 8 – DIGITAL BUSINESS SHOWING STRONG GROWTH MOMENTUM

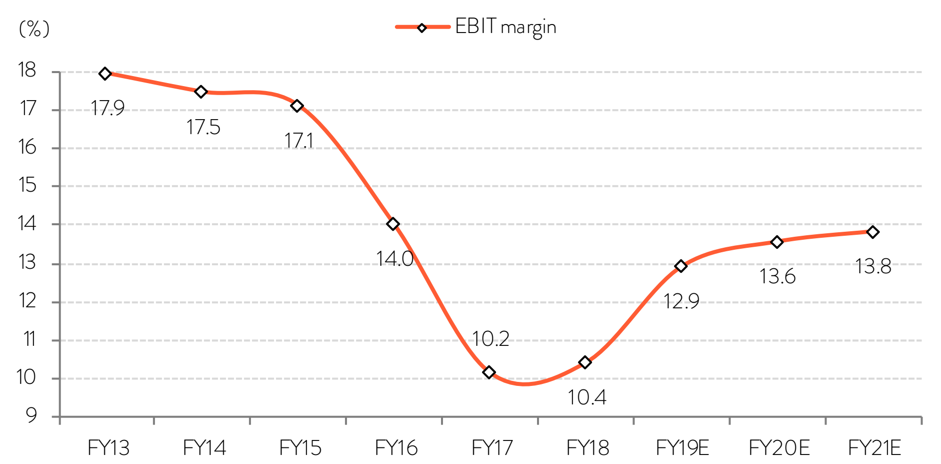


Source: Company, BOBCAPS Research

After weakness through FY17 and FY18, we expect EBIT margins to improve to 13.6% in FY20 vs. 10.4% in FY18 supported by accelerated revenue growth, a reduced drag from Bluefin & Magnet 360 and favourable currency movement (rupee depreciation vs. the US dollar). Operational efficiency gains in FY18, namely utilisation improvement and a higher offshore mix, were largely neutralised by rupee appreciation.

The recent INR depreciation (5.4% since Mar'18 end) will help MTCL to recoup operating margins in the near term even as we see limited scope to further push up utilisation (which stood at 75.2% ex-trainees in the Mar'18 quarter, up 250bps YoY). We expect margin gains to support an EBIT/earnings CAGR of 26%/17.3% over FY18-FY21.

FIG 9 – MARGINS TO IMPROVE ON THE BACK OF STRONGER GROWTH AND RECENT INR DEPRECIATION



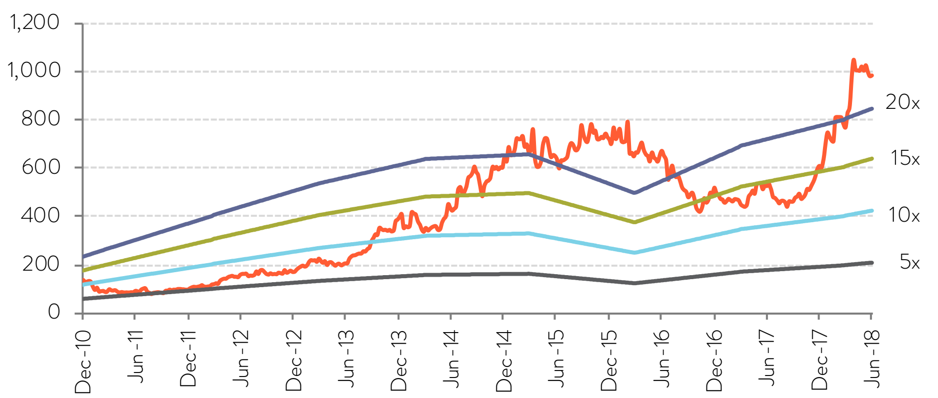
Source: Company, BOBCAPS Research

Valuation methodology

We expect MTCL's revenue and operating margins to rebound in FY19, fuelling a 17.3% earnings CAGR over FY18-FY21. With proven client mining capabilities and our assessment of favourable business dynamics for mid-cap IT companies, we do not rule out the possibility of earnings upgrades. However, we believe the 60% upmove in the stock during the last three months will limit price upsides.

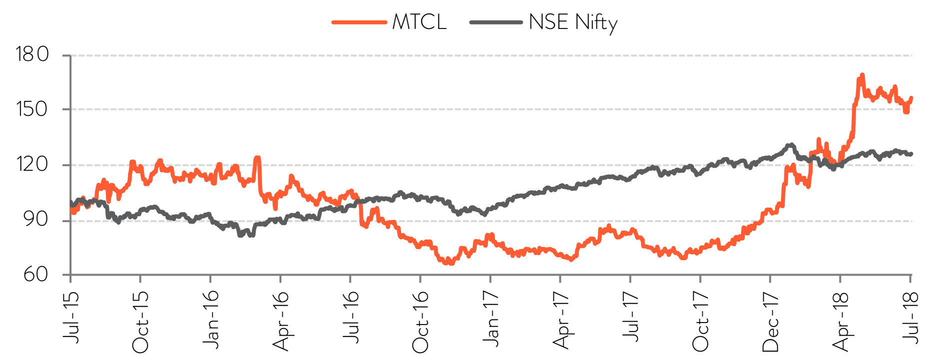
MTCL is currently trading at 24.5x/20.4x FY19E/FY20E P/E. We value the stock at 22.5x FY20E P/E, ~11% premium to our average multiple for other mid-tier peers, leading to a Mar'19 target price of Rs 1,090 – initiate with ADD.

FIG 10 – MTCL TRADED AT AVERAGE 17.2X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research

FIG 11 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- adverse currency movement,
- a sharp decline in IT services demand, and
- renewed challenges at top clients.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**52,364**	**54,628**	**64,985**	**73,382**	**82,202**
EBITDA	7,181	7,405	10,158	11,852	13,420
EBIT	5,323	5,690	8,390	9,953	11,370
Net interest income/(expenses)	(191)	(169)	0	0	0
Other income/(expenses)	417	1,902	686	968	1,227
EBT	5,549	7,423	9,076	10,920	12,597
Income taxes	1,363	1,722	2,450	2,948	3,401
Reported net profit	**4,186**	**5,701**	**6,625**	**7,972**	**9,196**
Adjusted net profit	**4,186**	**5,701**	**6,625**	**7,972**	**9,196**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	5,065	5,733	6,766	7,640	8,558
Provisions	1,105	1,218	1,424	1,608	1,802
Debt funds	978	3,000	3,000	3,000	3,000
Equity capital	1,680	1,639	1,639	1,639	1,639
Reserves & surplus	24,091	25,775	29,610	34,223	39,546
Shareholders' fund	25,771	27,414	31,249	35,862	41,185
Total liabilities and equities	**32,919**	**37,365**	**42,438**	**48,111**	**54,544**
Cash and cash eq.	2,508	3,289	7,621	11,608	16,253
Accounts receivables	8,962	10,155	12,107	13,671	15,314
Other current assets	2,601	3,888	4,451	5,026	5,630
Investments	5,927	7,264	7,264	7,264	7,264
Net fixed assets	10,412	9,660	8,897	8,213	7,513
CWIP	192	92	92	92	92
Intangible assets	4,470	4,539	4,539	4,539	4,539
Deferred tax assets, net	624	318	318	318	318
Other assets	1,885	2,791	1,780	2,010	2,252
Total assets	**32,919**	**37,365**	**42,438**	**48,111**	**54,544**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	4,273	7,416	8,393	9,871	11,246
Interest expenses	87	(1,733)	(686)	(968)	(1,227)
Changes in working capital	1,217	(2,605)	(265)	(1,311)	(1,377)
Other operating cash flows	958	2,566	0	0	0
Cash flow from operations	**6,535**	**5,644**	**7,442**	**7,592**	**8,642**
Capital expenditures	(846)	(740)	(1,005)	(1,215)	(1,350)
Change in investments	(3,279)	(1,337)	0	0	0
Other investing cash flows	(463)	2,078	686	968	1,227
Cash flow from investing	**(4,588)**	**1**	**(319)**	**(247)**	**(123)**
Equities issued/Others	8	(1,406)	0	0	0
Debt raised/repaid	552	2,022	0	0	0
Interest expenses	(2)	0	0	0	0
Dividends paid	(1,934)	(2,177)	(2,791)	(3,358)	(3,873)
Cash flow from financing	**(1,376)**	**(1,561)**	**(2,791)**	**(3,358)**	**(3,873)**
Changes in cash and cash eq.	**571**	**4,084**	**4,332**	**3,987**	**4,645**
Closing cash and cash eq.	**2,508**	**3,289**	**7,621**	**11,608**	**16,253**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	24.8	34.7	40.3	48.5	55.9
Adjusted EPS	24.8	34.7	40.3	48.5	55.9
Dividend per share	10.0	11.0	14.1	17.0	19.6
Book value per share	153.0	166.7	190.0	218.1	250.5

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	3.1	3.0	2.4	2.1	1.8
EV/EBITDA	22.5	22.0	15.6	13.0	11.2
Adjusted P/E	39.9	28.6	24.6	20.4	17.7
P/BV	6.5	5.9	5.2	4.5	4.0

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	75.4	76.8	73.0	73.0	73.0
Interest burden (PBT/EBIT)	104.2	130.5	108.2	109.7	110.8
EBIT margin (EBIT/Revenue)	10.2	10.4	12.9	13.6	13.8
Asset turnover (Revenue/Avg TA)	157.9	155.4	162.9	162.1	160.2
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.4	1.3	1.3
Adjusted ROAE	16.8	21.4	22.6	23.8	23.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2^{nd} July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	12.1	4.3	19.0	12.9	12.0
EBITDA	(12.5)	3.1	37.2	16.7	13.2
Adjusted EPS	(24.8)	39.5	16.2	20.3	15.4
Profitability & Return ratios (%)					
EBITDA margin	13.7	13.6	15.6	16.2	16.3
EBIT margin	10.2	10.4	12.9	13.6	13.8
Adjusted profit margin	8.0	10.4	10.2	10.9	11.2
Adjusted ROAE	16.8	21.4	22.6	23.8	23.9
ROCE	22.4	22.1	31.1	36.8	41.1
Working capital days (days)					
Receivables	65	64	63	64	64
Payables	44	42	42	43	43
Ratios (x)					
Gross asset turnover	4.6	5.4	7.0	8.6	10.5
Current ratio	2.6	2.9	3.2	3.5	3.8
Net interest coverage ratio	(27.9)	(33.7)	NA	NA	NA
Adjusted debt/equity	(0.1)	0.0	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 490 | ⮝ 6%

HEXAWARE TECHNOLOGIES | IT Services | 04 July 2018

Standing tall – initiate with ADD

HEXW is one of our top mid-cap IT picks as management's automation-led strategy coupled with favourable industry dynamics (smaller deal sizes, changing vendor criteria) fuel (1) deal wins against larger peers (US$ 183mn in 12 months) and (2) industry-leading growth in traditional services (44%/28% in IMS/BPO, CY15-CY17). The recent infusion of senior talent, many drawn from tier-I rivals, will further bolster growth. We expect HEXW to outdo its 10-12% US$ revenue growth guidance for CY18. Initiate with ADD and a Mar'19 target price of Rs 490.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Automation edge a key differentiator: HEXW's 'Shrink IT. Grow Digital' strategy – aimed in part at replacing traditional offerings with hyper-automated solutions – promises substantial cost savings (~30% reduction) and focused outcomes to clients. As tier-I players struggle to reset their legacy portfolios, HEXW has been able to evolve and grow its IMS/BPO businesses (combined 18% revenue share) at a 44%/28% CAGR (US$ terms) over CY15-CY17.

Robust deal wins: In the last 12 months, HEXW has won net new deals worth US$ 183mn (+29% YoY), implying strong growth visibility. Notably, most of these wins have seen the company either replacing larger incumbents or overcoming competition from tier-I players.

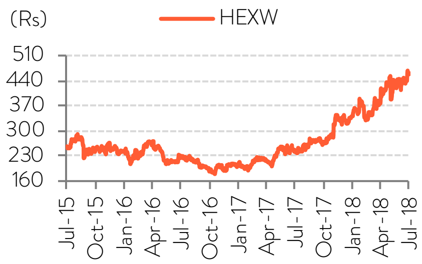
Revamped strategy, stronger leadership to support growth: We build in 13% US$ revenue growth in CY18 and a 13%/13.9% revenue/earnings CAGR over CY17-CY20, with stable margins. In our view, the recent strategic refresh at HEXW (focus on automation, cloud and customer) complemented by the induction of 10 senior executives in the last 18 months lays the ground for long-term growth.

Initiate with ADD: We ascribe a premium P/E multiple of 22.5x FY20E to HEXW (vs. 20.3x for the mid-cap pack), leading to a Mar'19 TP of Rs 490.

Ticker/Price	HEXW IN/Rs 461
Market cap	US$ 2.0bn
Shares o/s	301mn
3M ADV	US$ 9.5mn
52wk high/low	Rs 475/Rs 400
Promoter/FPI/DII	71%/15%/14%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Dec	CY16A	CY17A	CY18E	CY19E	CY20E
Adj. net profit (Rs mn)	4,171	4,993	5,756	6,516	7,286
Adj. EPS (Rs)	13.7	16.6	19.1	21.6	24.2
Adj. EPS growth (%)	5.9	21.1	15.3	13.2	11.8
Adj. ROAE (%)	26.5	26.9	26.7	25.8	24.2
Adj. P/E (x)	33.7	27.8	24.1	21.3	19.1
EV/EBITDA (x)	23.4	20.4	17.4	14.5	12.3

Source: Company, BOBCAPS Research

Investment rationale

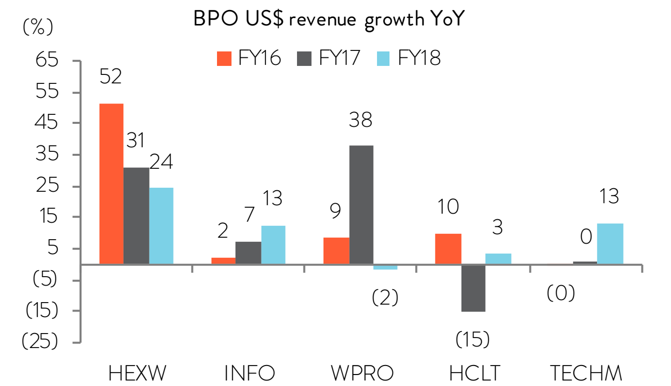
Automation edge driving healthy growth in challenging service lines

HEXW has been able to successfully leverage growth opportunities at the intersection of new-edge technologies and traditional IT services by enabling intensive automation across its service lines.

Over the past five years, as management began investing across service lines, the company was able to build new, highly automated solutions in the areas of application support and maintenance (ASM), infrastructure management (IMS) and business process services (BPO) – in turn positioning these as superior substitutes for the traditional offerings of incumbents.

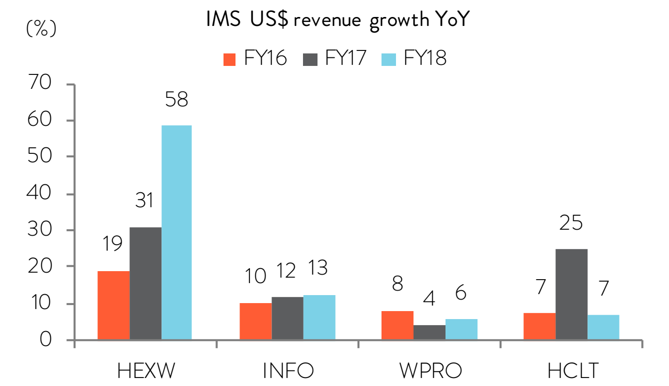
Indeed, the company's 'Shrink IT. Grow Digital' strategy – aimed in part at replacing traditional offerings with hyper-automated solutions – promises substantial cost savings (~30% reduction) and focused outcomes to clients. The success of this strategy is reflected in the 44% and 28% dollar revenue CAGR of HEXW's IMS and BPO services (11% and 7% revenue share respectively) over CY15-CY17, which is in stark contrast to the soft performance of tier-I players in these service lines.

FIG 1 – STRONG BPO REVENUE GROWTH BACKED BY INTENSE AUTOMATION FOCUS



Source: Company, BOBCAPS Research

FIG 2 – 'SHRINK IT' PROPOSITION DRIVING ROBUST GROWTH IN IMS REVENUES



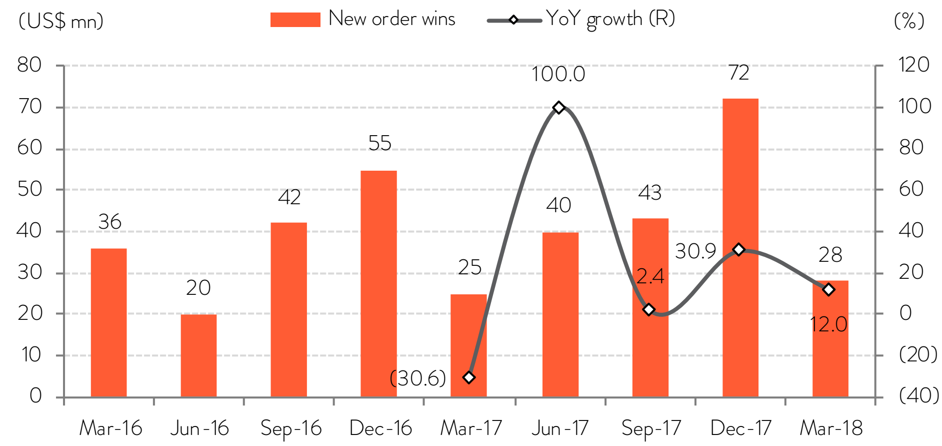
Source: Company, BOBCAPS Research

Winning new business against formidable competition

In the last 12 months, HEXW has won net new deals worth US$ 183mn, an increase of 29% YoY, implying strong growth visibility in the near-to-medium term. Notably, most of these wins have seen the company either replacing larger incumbents or overcoming tough competition from tier-I players (Fig 4).

HEXW has also been able to swiftly ramp up new accounts – in the Mar'17 quarter, two of the three new clients featuring in HEXW's top 20 list had come on board in the preceding 15 months. We expect the traction in deal wins and new clients to fuel above-industry revenue growth for HEXW.

FIG 3 – NET NEW BUSINESS WORTH US$ 183MN IN LAST FOUR QUARTERS



Source: Company, BOBCAPS Research

FIG 4 – WINNING AGAINST STRONG COMPETITION

Company details	Offerings
Replaced top Indian-Origin Providers (IOP)	
British Auction House	'RAISE IT' platform led end-to-end infrastructure management
Global GRC Software Company	Second-gen application modernisation, support and product engineering
Specialised Payment Products Provider	Next-gen application modernisation and support
Global Rating and Analytics Advisory	Strategic product engineering partner
Facilities Management & Maintenance	Migration of application landscape to hybrid cloud
Won against top IOPs	
Top 10 Global Steel Company	Automation-led service integration and service management
Global Warranty Provider	Back and front office operations transformation through automation
Publisher, Distributor of Children's Books	Automation-led application management transformation
Large Global Logistics Player	Automation-led procurement, finance and HR shared services
Leading eCommerce Firm	Managing customer experience in the digital channel
Top 10 Pharmacy Benefit Manager	Digital transformation to improve customer experience
Large Fashion E-Commerce Company	Transforming customer experience
Investment Firm in Education	Digital transformation with content management and app development
Largest Serviced Apartments Operator	Building an enterprise-wide digital platform in the Agile model

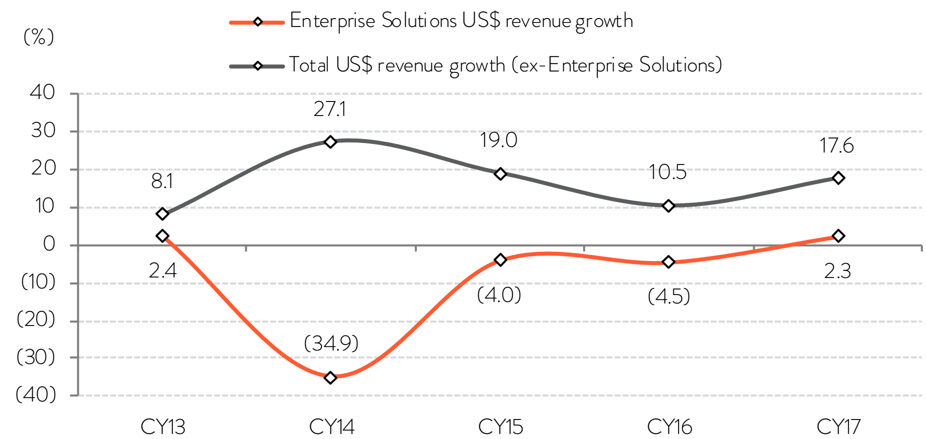
Source: Company, BOBCAPS Research

Improving outlook in enterprise solutions business

HEXW's enterprise solutions business (~11% of revenues in CY17) was hit by the rapid wave of migration to cloud-based services. In a bid to arrest the revenue decline and tap into the large cloud migration opportunity the company has (1) transformed its service offerings to focus around cloud-based solutions such as Salesforce, SAP, Oracle and Workday, and (2) inducted industry veteran Prasan Prabhakaran (ex-Cognizant Tech) in May'17 to head the business.

Early results of these initiatives are visible in the 2.3% YoY growth in enterprise solution revenues (in US$ terms) in CY17 after a prolonged revenue decline at a 15.8% CAGR over the preceding three years. We highlight that excluding the enterprise solutions business, HEXW's US$ revenues have risen at a CAGR of 18.4% over the last five years (CY13-CY17).

FIG 5 – DECLINE IN ENTERPRISE SOLUTIONS BUSINESS ARRESTED; POISED FOR GROWTH

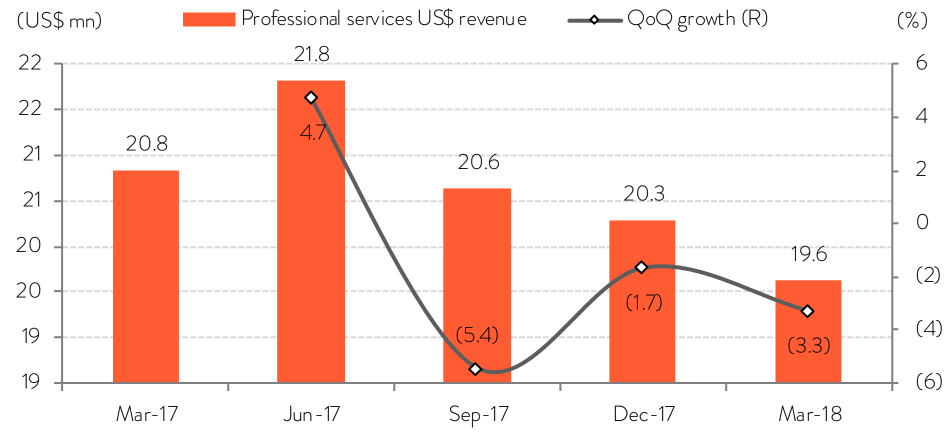


Source: Company, BOBCAPS Research

New professional services vertical to broaden revenue mix

In CY17, HEXW launched a dedicated offering for the 'professional services' group. Management aims to leverage its deep domain expertise in the vertical garnered over decades of servicing global leader in this space. The company's value offerings in the professional services vertical extend to a host of business segments, including tax, audit & accounting, advisory & consulting, legal, risk & compliance, people & talent management, and information services & platforms. Challenges at HEXW's top client in H2CY17 dampened the overall performance of this vertical, which reported a decline at a 3.5% CQGR for CY17. However, management is optimistic about growth opportunities over the medium-to-long term. The company added a new client in this vertical in Q1CY18, with a foray into the legal services segment (a net new IMS deal win from a global law firm).

FIG 6 – PERFORMANCE IN PROF. SERVICES DAMPENED BY TOP CLIENT CHALLENGES; MANAGEMENT OPTIMISTIC ON GROWTH



Source: Company, BOBCAPS Research

Levers for sustainable long-term growth in place

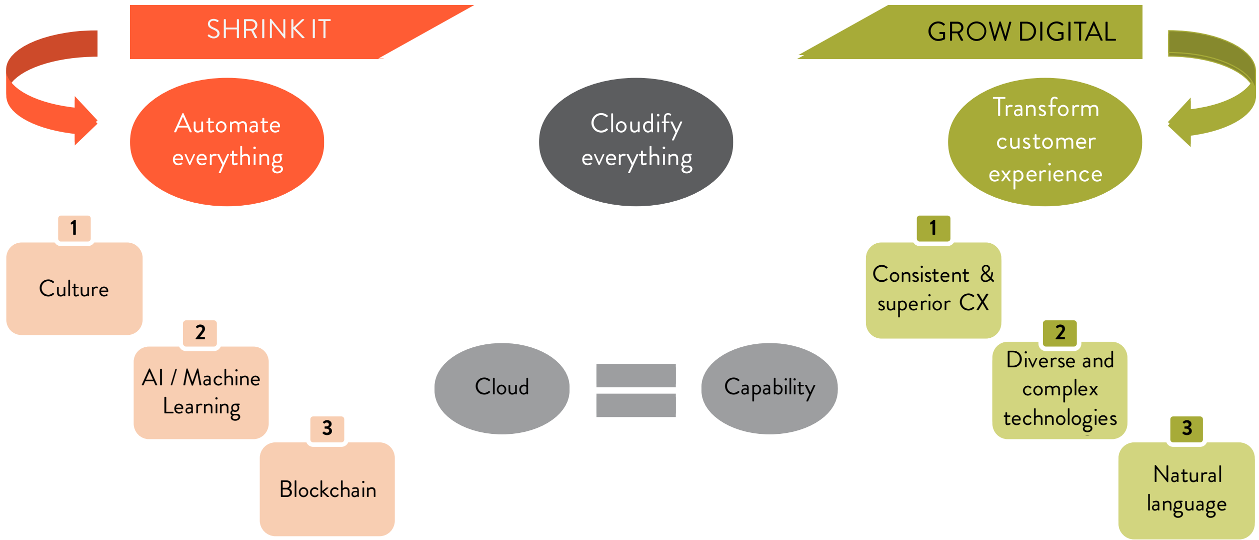
In CY17, HEXW evolved its 'Shrink IT. Grow Digital' strategy into a three-pronged roadmap to nurture long-term growth. The strategic refresh was complemented by the induction of 10 senior executives across businesses in the last 18 months, many drawn from tier-I rivals.

Strategic revamp...

Management has expanded its 'Shrink IT. Grow Digital' vision to cover the following themes:

- **Automate everything:** Focus on the enterprise-wide automation opportunity (vs. a technology silo focus earlier), with extensive application of Machine Learning and Artificial Intelligence (AI)
- **Cloudify everything:** Tap into the large enterprise-wide cloud migration opportunity. (Gartner estimates a 29% CAGR over CY16-CY22 from US$ 22bn to US$ 102bn),
- **Transform customer experience:** Change the way the enterprises interact with customers.

FIG 7 – REVAMPED STRATEGY AIMED AT LONG-TERM SUSTAINABLE GROWTH



Source: Company, BOBCAPS Research

...complemented by the induction of industry stalwarts

HEXW has added depth to its leadership team with the induction of 10 senior executives over the past year-and-a-half, who bring in robust expertise in their respective areas along with a proven track record of managing large-scale businesses. The company has also instituted an aggressive stock option plan for the senior and mid-level management team, entirely linked to the achievement of revenue and profit targets over the long term

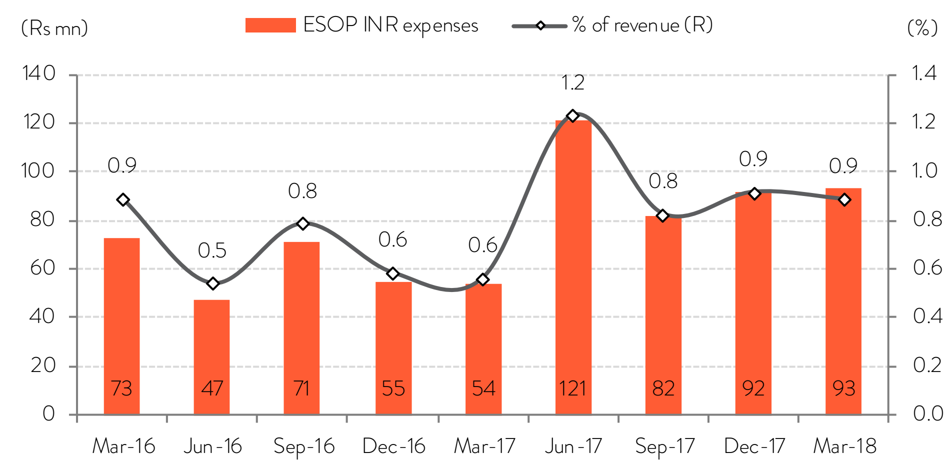
FIG 8 – 10 NEW LEADERS INDUCTED IN LAST 18 MONTHS

Name	Designation	Date of joining	Experience
Sandeep Dhar	President & Global Head, Customer Experience Transformation	Feb'18	▪ 30 years of experience across multiple industries such as Banking, Retail, IT and Business Process Management ▪ Worked directly with or as a vendor for leading brands such as Citibank, Capital-One, JP Morgan, Morgan Stanley, Abbey Bank/Santander, ABN Amro, Toronto Dominion, State Bank of India, Zurich Financial Services, Tesco and Capgemini
Anurag Gupta	Senior Vice President – Sales	Dec'17	▪ Previously MD, EdgeRock Technology Partners ▪ 25+ years of experience in IT services in various capacities, including direct sales and sales management, managing P&L, marketing & business development and program management across North America, Malaysia, Indonesia, Singapore and India
Gopi Santhanam	Global Delivery Head – Professional Services	Sep'17	▪ Led the Custom Software Development practice at Capgemini ▪ Was also associated with Satyam, J P Morgan Chase and HP across various responsibilities
Rupesh Mithani	Vice President & Global Head – Digital Customer	Jul'17	▪ Previously Senior Director, CloudERP Consulting Inc ▪ 22 years of experience working with consulting organisations providing services to their end-clients

Name	Designation	Date of joining	Experience
Arun Ramchandran	Executive Vice President & Global Head – Professional Services	Jul'17	▪ Previously with Capgemini where he spent close to six years, initially as a member of the Applications Services' Executive Board leading the Strategic Large Deals team globally, and then as Head of Sales and Client Relations in North America for the Technology & Engineering Services Unit
Alexander Meuller Herbst	Vice President – Europe Sales	May'17	▪ Previously Partner, International Services Group ▪ Also worked with DHL, Computer Sciences Corporation, Siemens, Delta Lloyd and is the founder of Eracon AG
Prasan Prabhakaran	Senior Vice President & Global Head – Enterprise Solutions	May'17	▪ Worked with Cognizant Technologies for over 10 years wearing multiple hats, including heading their New Growth Platforms in the Enterprise Applications area, which was instrumental in incubating multiple Enterprise Cloud products, and heading their Oracle Solutions Practice
Aravind Kashyap	Senior Vice President & Global Head – Manufacturing & Consumer	Mar'17	▪ Was instrumental in the growth of Wipro's Consumer (Retail, CPG, Media, Travel and Public Services) Business Unit, acquiring large outsourcing and transformational relationships with Fortune 100 companies
Sastry PKV	Global Delivery Head – Manufacturing & Consumer, Travel & Transportation	Jan'17	▪ Previously Chief Operating Officer of CIGNEX Datamatics ▪ Was also associated with TCS and HCL Technologies
Krishna Kumar	Chief Technology Officer	Jan'17	▪ Over 25 years of experience in the software industry including with several startup companies in the networking, search and big data space, as well as in IT services and web companies ▪ Prior experience includes web search, big data and cloud infrastructure
Ravi Srinivasan	Senior Vice President & Global Delivery Head – Banking & Financial Services	Jan'17	▪ More than a decade's experience in dealing with BFSI clientele ▪ Was associated with Polaris and Citi in earlier engagements

Source: Company, BOBCAPS Research

FIG 9 – ESOP PROGRAM ALIGNED TO FOSTER GROWTH

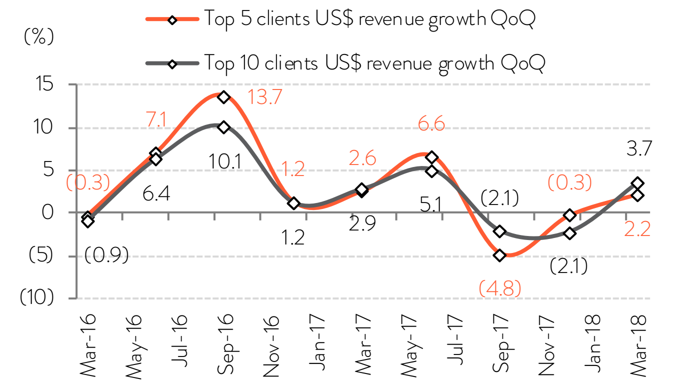


Source: Company, BOBCAPS Research

Poised for robust double-digit growth

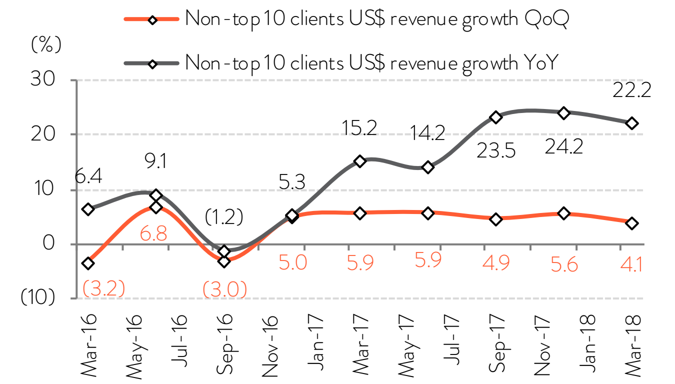
Despite the lingering margin headwinds (250-300bps for the year) arising from challenges at two of HEXW's top clients, HEXW's management has guided for 10-12% YoY US$ revenue (and EPS) growth for CY18. We expect the company to report revenue growth ahead of guidance, at 12.7% YoY, led by (1) a strong start to the year (3.9% QoQ growth in the Mar'18 quarter, i.e. Q1CY18), (2) likely ramp-up of recent deal wins (US$ 70mn of net new deals announced in Q4CY17 which will ramp up over Q2 to Q3CY18), and (3) strong traction in non-top 10 clients (21% growth over last 12 months).

FIG 10 – CHALLENGES IN TWO OF THE TOP CLIENTS HIT REVENUES IN SEP'17 AND DEC'17 QUARTERS



Source: Company, BOBCAPS Research

FIG 11 – STRONG TRACTION IN NON-TOP 10 CLIENTS CONTINUES

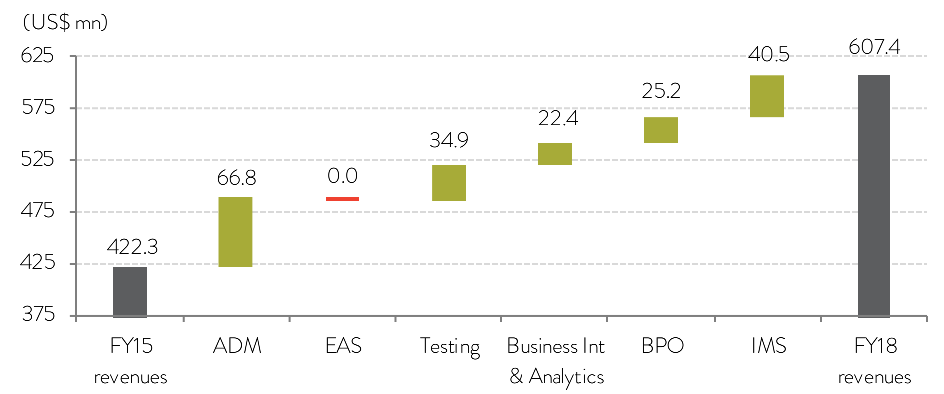


Source: Company, BOBCAPS Research

Broad-based growth to drive revenues over CY17-CY20

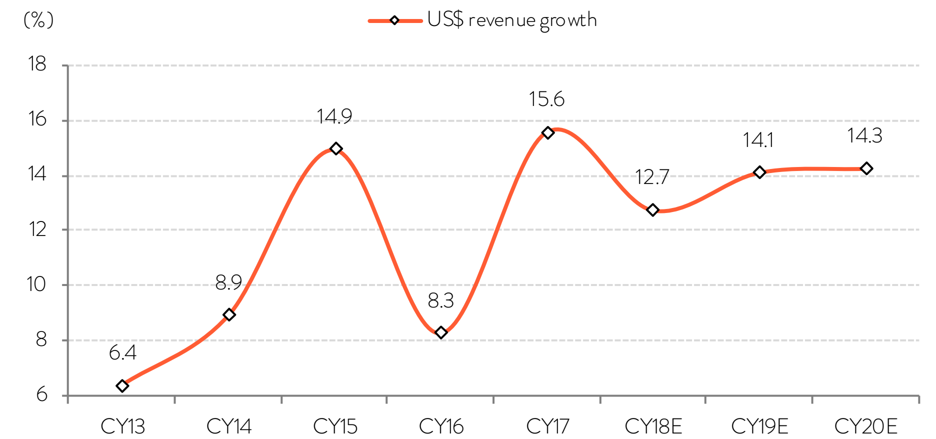
We build in a revenue CAGR of 13.7% over CY17-CY20 as focused initiatives are expected to drive broad-based growth across the manufacturing & consumer vertical (15% of revenue in Q1CY18), the new professional services vertical scales up (12% of revenues), while BFS and healthcare & insurance (combined ~60% of revenues) continue their healthy traction.

FIG 12 – WITH IMPROVING OUTLOOK IN ENTERPRISE SOLUTIONS BUSINESS, WE EXPECT MORE BROADBASED GROWTH



Source: Company, BOBCAPS Research

FIG 13 – WE BUILD IN A REVENUE CAGR OF 13.7% OVER CY17-CY20



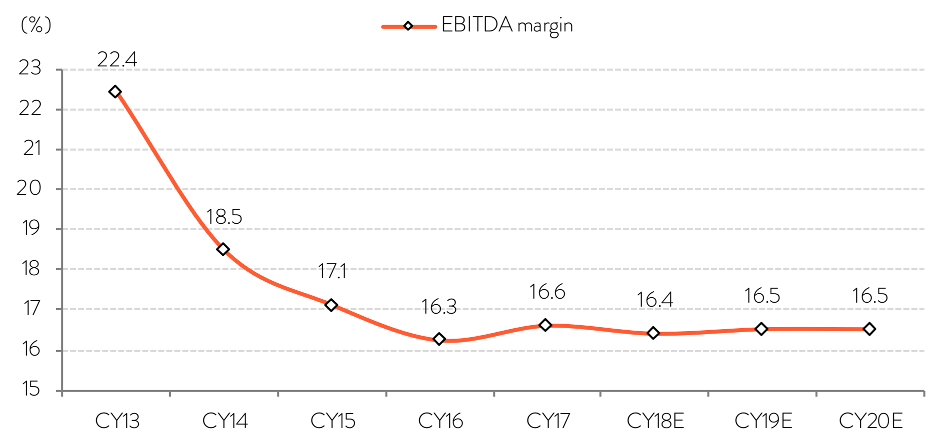
Source: Company, BOBCAPS Research

Profitability to remain stable as management focuses on growth

Management proactively reinvests gains from operating leverage and efficient operations back into the business to nurture long-term sustainable growth. The company is investing towards (1) localisation especially in Europe, (2) building capabilities for 'customer experience transformation', and (3) expanding account and delivery management capabilities to scale up marquee logos added over the last three years. Given the growth focus, we expect EBIT margins to remain stable at ~15% levels over CY17-CY20, enabling an earnings CAGR of 12.7%.

We highlight that in CY17 utilisation improved by 700bps YoY to 80.1%, but EBITDA margins at 16.6% expanded only 30bps (albeit a higher onsite revenue mix and rupee appreciation also played a role in limiting operating margin expansion). Growth leverage over the medium term could drive margin upsides.

FIG 14 – EBITDA MARGINS EXPECTED TO REMAIN STABLE

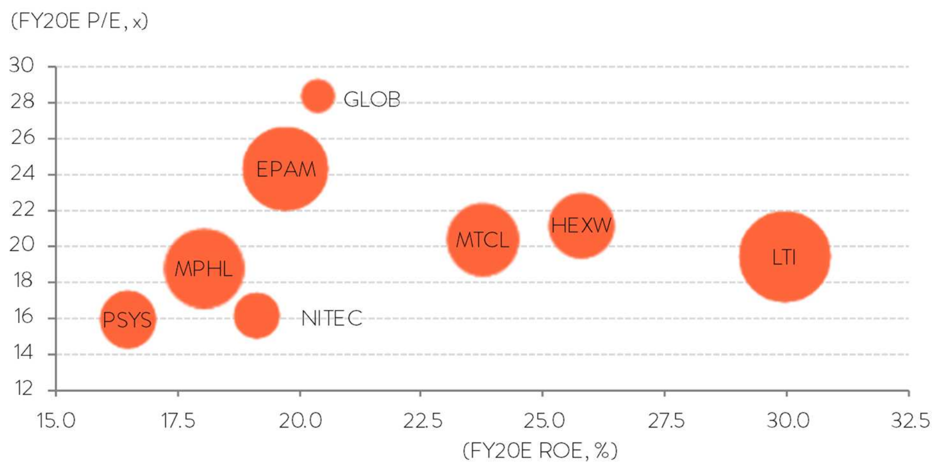


Source: Company, BOBCAPS Research

Valuation methodology

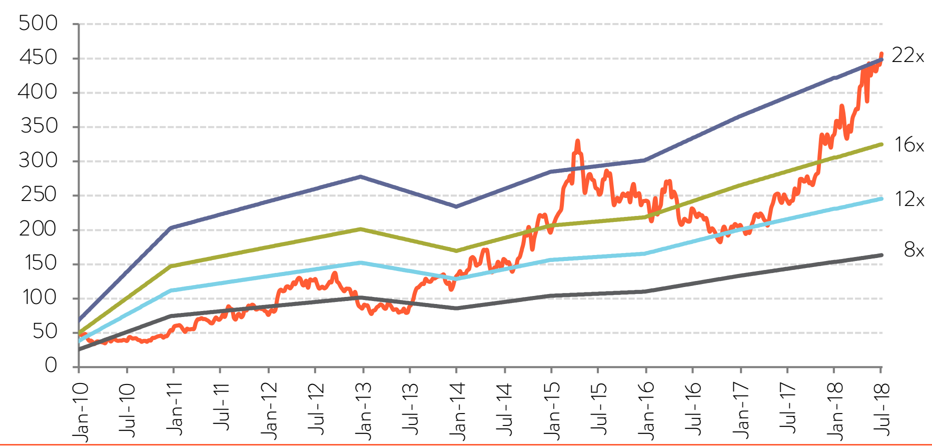
HEXW is our joint top pick along with LTI from our mid-cap IT coverage universe, as we believe the company's revamped strategy, differentiated competitive positioning (led by automation), efficient execution and strong leadership will continue to fuel growth. In our view, the stock merits a valuation premium to peers – we ascribe a P/E multiple of 22.5x on CY19E earnings (vs. 23x for LTI and 20.3x for the mid-cap pack), leading to a Mar'19 target price of Rs 490. Initiate with ADD.

FIG 15 – ROE AND P/E COMPARISONS FOR PEERS, FY20E



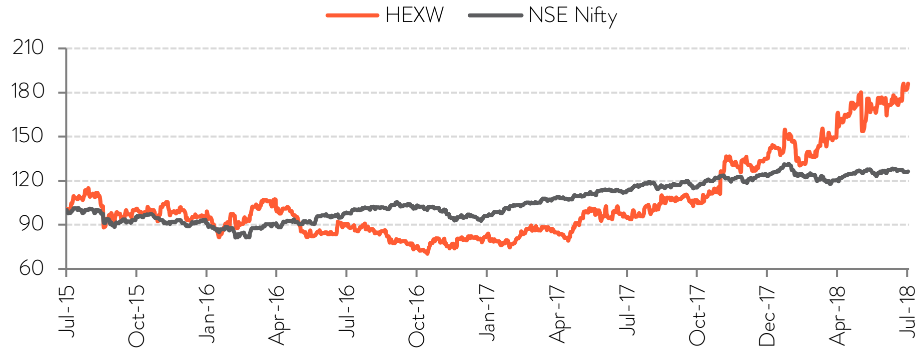
Source: Company, BOBCAPS Research Note: Hexaware has CY reporting

FIG 16 – HEXW TRADED AT AVERAGE 15.2X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research

FIG 17 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- persisting challenges in HEXW's top clients,
- sharp adverse currency movements, and
- an inability to replicate success in newly launched services.

FINANCIALS

Income Statement

Y/E 31 Dec (Rs mn)	CY16A	CY17A	CY18E	CY19E	CY20E
Total revenue	**35,349**	**39,419**	**45,504**	**52,741**	**60,260**
EBITDA	5,747	6,553	7,473	8,721	9,964
EBIT	5,188	5,920	6,774	7,903	9,041
Other income/(expenses)	394	484	492	345	182
EBT	5,582	6,404	7,265	8,249	9,223
Income taxes	1,411	1,411	1,509	1,732	1,937
Reported net profit	**4,171**	**4,993**	**5,756**	**6,516**	**7,286**
Adjusted net profit	**4,171**	**4,993**	**5,756**	**6,516**	**7,286**

Balance Sheet

Y/E 31 Dec (Rs mn)	CY16A	CY17A	CY18E	CY19E	CY20E
Other current liabilities	4,527	4,463	4,987	5,780	6,604
Provisions	1,745	887	3,117	3,612	4,127
Other liabilities	29	31	31	31	31
Equity capital	604	594	594	594	594
Reserves & surplus	16,504	19,479	22,383	26,944	32,045
Shareholders' fund	17,108	20,074	22,978	27,539	32,639
Total liabilities and equities	**23,409**	**25,454**	**31,112**	**36,962**	**43,402**
Cash and cash eq.	4,294	5,298	8,655	12,125	16,178
Accounts receivables	4,376	5,360	5,984	6,936	7,925
Other current assets	5,569	5,269	6,483	7,514	8,585
Investments	210	213	213	213	213
Net fixed assets	8,557	7,977	8,440	8,838	9,164
CWIP	3,233	2,563	2,563	2,563	2,563
Intangible assets	1,761	1,656	1,656	1,656	1,656
Deferred tax assets, net	405	1,336	1,336	1,336	1,336
Total assets	**23,411**	**25,453**	**31,111**	**36,961**	**43,400**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Dec (Rs mn)	CY16A	CY17A	CY18E	CY19E	CY20E
Net income + Depreciation	4,709	5,626	6,456	7,333	8,209
Interest expenses	(4)	(484)	(492)	(345)	(182)
Changes in working capital	(197)	(1,607)	917	(694)	(721)
Other operating cash flows	388	1,228	0	0	0
Cash flow from operations	**4,897**	**4,762**	**6,881**	**6,294**	**7,306**
Capital expenditures	(2,223)	(681)	(1,163)	(1,215)	(1,249)
Change in investments	221	0	0	0	0
Other investing cash flows	28	(1,652)	492	345	182
Cash flow from investing	**(1,974)**	**(2,333)**	**(671)**	**(870)**	**(1,067)**
Equities issued/Others	13	0	0	0	0
Interest expenses	(1)	0	0	0	0
Dividends paid	(2,506)	(1,425)	(2,853)	(1,955)	(2,186)
Cash flow from financing	**(2,494)**	**(1,425)**	**(2,853)**	**(1,955)**	**(2,186)**
Changes in cash and cash eq.	**429**	**1,004**	**3,358**	**3,469**	**4,054**
Closing cash and cash eq.	**4,294**	**5,298**	**8,655**	**12,125**	**16,178**

Per Share

Y/E 31 Dec (Rs)	CY16A	CY17A	CY18E	CY19E	CY20E
Reported EPS	13.7	16.6	19.1	21.6	24.2
Adjusted EPS	13.7	16.6	19.1	21.6	24.2
Dividend per share	5.5	3.9	8.0	5.4	6.0
Book value per share	56.1	66.6	76.3	91.4	108.4

Valuations Ratios

Y/E 31 Dec (x)	CY16A	CY17A	CY18E	CY19E	CY20E
EV/Sales	3.8	3.4	2.9	2.4	2.0
EV/EBITDA	23.4	20.4	17.4	14.5	12.3
Adjusted P/E	33.7	27.8	24.1	21.3	19.1
P/BV	8.2	6.9	6.0	5.0	4.3

DuPont Analysis

Y/E 31 Dec (%)	CY16A	CY17A	CY18E	CY19E	CY20E
Tax burden (Net profit/PBT)	74.7	78.0	79.2	79.0	79.0
Interest burden (PBT/EBIT)	107.6	108.2	107.3	104.4	102.0
EBIT margin (EBIT/Revenue)	14.7	15.0	14.9	15.0	15.0
Asset turnover (Revenue/Avg TA)	161.7	161.3	160.9	155.0	150.0
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.3	1.3	1.3
Adjusted ROAE	26.5	26.9	26.7	25.8	24.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Dec	CY16A	CY17A	CY18E	CY19E	CY20E
YoY growth (%)					
Revenue	13.2	11.5	15.4	15.9	14.3
EBITDA	7.3	14.0	14.0	16.7	14.3
Adjusted EPS	5.9	21.1	15.3	13.2	11.8
Profitability & Return ratios (%)					
EBITDA margin	16.3	16.6	16.4	16.5	16.5
EBIT margin	14.7	15.0	14.9	15.0	15.0
Adjusted profit margin	11.8	12.7	12.6	12.4	12.1
Adjusted ROAE	26.5	26.9	26.7	25.8	24.2
ROCE	33.1	33.4	36.8	41.9	44.7
Working capital days (days)					
Receivables	45	45	45	45	45
Payables	53	50	45	45	45
Ratios (x)					
Gross asset turnover	4.7	4.8	5.5	6.1	6.7
Current ratio	2.3	3.0	2.6	2.8	3.0
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)

Source: Company, BOBCAPS Research

SELL
TP: Rs 710 | ⋎ 12%

PERSISTENT SYSTEMS | IT Services | 04 July 2018

Vulnerable to volatility – initiate with SELL

We initiate coverage on Persistent Systems (PSYS) with SELL and a Mar'19 target price of Rs 710. Non-linear initiatives at PSYS – namely IP, Accelerite and in part Alliance – though steps in the right direction, continue to induce volatility in revenues. In addition, challenges persist in the ISV segment, which accounts for 40% of the topline. We expect a 12%/14% US$ revenue/earnings CAGR over FY18-FY21. Our earnings estimates are 5-7% below consensus and build in limited scope for margin expansion.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

High revenue volatility: Non-linear initiatives at PSYS limit the predictability of its business performance. Also, the unexpected setback in its IBM-IoT alliance in the Mar'18 quarter, which led to a 20% QoQ drop in IP revenues, highlights the company's dependence on partners for IP business growth (25% revenue share). While normalisation of IoT revenues and traction in new products such as Sentient, Share Insights and Neuro should support IP revenues in FY19 after a muted 0.2% YoY rise in FY18 (US$ terms), we remain wary of the volatility inherent in PSYS's business model.

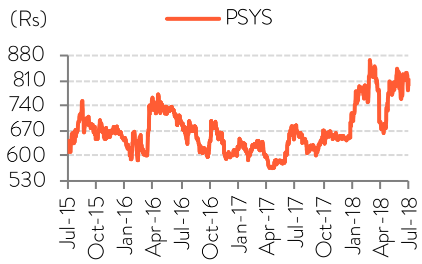
Margin improvement agenda still a work in progress: Despite management's focus on building margins in recent years, PSYS's EBITDA margins have slipped successively each year, from 25.8% in FY14 to 15.5% in FY18, due to hurdles in the ISV business and a higher onsite mix. We build in only ~90bps margin expansion over FY19-FY21 (as IBM-IoT alliance operations recover) vs. 140bps by consensus given the growing need for sales & marketing investments.

Initiate with SELL: Though we expect a normalisation of PSYS's operating performance in the Jun'18 quarter, we are cautious on the company due to its volatile revenue profile. We assign the stock a P/E multiple of 14x FY20E vs. 20.3x on average for tier-II peers, which yields a Mar'19 TP of 710.

Ticker/Price	PSYS IN/Rs 811
Market cap	US$ 944.8mn
Shares o/s	80mn
3M ADV	US$ 1.9mn
52wk high/low	Rs 868/Rs 733
Promoter/FPI/DII	30%/26%/44%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	3,015	3,231	3,431	4,082	4,804
Adj. EPS (Rs)	37.7	40.4	42.9	51.0	60.0
Adj. EPS growth (%)	1.4	7.1	6.2	19.0	17.6
Adj. ROAE (%)	17.0	16.0	15.3	16.5	17.4
Adj. P/E (x)	21.5	20.1	18.9	15.9	13.5
EV/EBITDA (x)	14.0	13.3	10.9	9.1	7.7

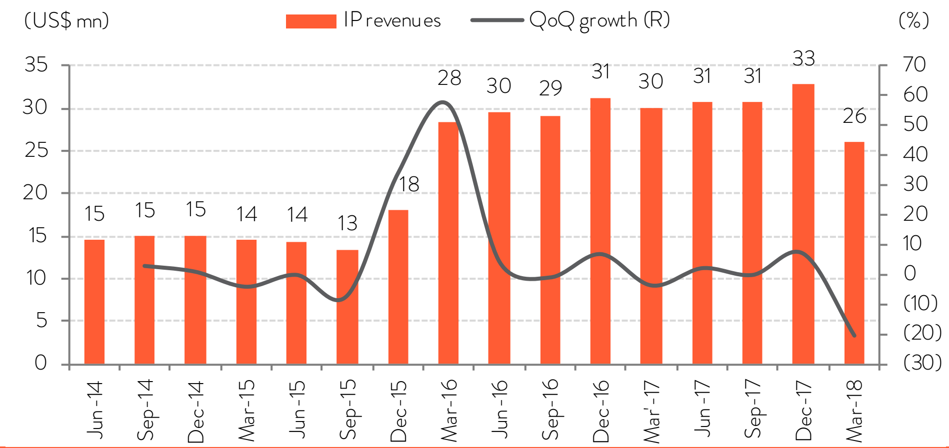
Source: Company, BOBCAPS Research

FIG 1 – PROACTIVE DIVERSIFICATION AND STRONG TRACTION SEEN IN ENTERPRISE BUSINESS, BUT THE OUTLOOK FOR A MAJORITY OF PSYS'S REVENUE PORTFOLIO (ISV AND IP) STAYS CONSTRAINED

Revenue by industry classifications (US$ mn)	FY15	FY16	FY17	FY18	CAGR over FY15-18
ISV (%)	**58.5**	**52.4**	**43.5**	**39.9**	**-**
Revenues	181	184	187	188	-
YoY growth (%)	-	2.0	1.3	0.6	1.3
Enterprise (%)	**22.3**	**26.5**	**28.5**	**34.5**	**-**
Revenues	69	93	122	162	-
YoY growth (%)	-	35.3	31.1	32.9	33.1
IP Led (%)	**19.2**	**21.1**	**28.0**	**25.6**	**-**
Revenues	59	74	120	120	-
YoY growth (%)	-	25.7	61.8	0.2	26.8
Total (%)	**100.0**	**100.0**	**100.0**	**100.0**	**-**
Revenues	309	352	429	471	15.1
YoY growth (%)	-	14.0	22.0	9.7	-

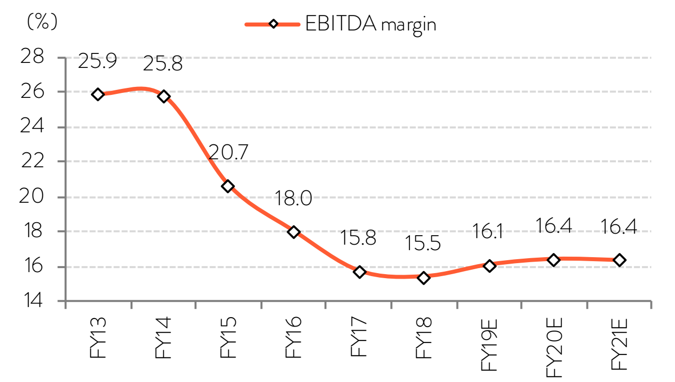
Source: Company, BOBCAPS Research

FIG 2 – UNEXPECTED SETBACK IN IBM-IoT REVENUES LED TO 20% QoQ DECLINE IN IP REVENUES IN MAR'18 QUARTER



Source: Company, BOBCAPS Research

FIG 3 – MARGIN IMPROVEMENT AGENDA STILL A WORK IN PROGRESS



Source: Company, BOBCAPS Research

FIG 4 – WE ESTIMATE LIMITED SCOPE FOR MARGIN IMPROVEMENT ON HIGHER S&M NEEDS

(Rs mn)	Bloomberg Consensus		BOBCAPS Research	
	FY19E	FY20E	FY19E	FY20E
Revenue	34,070	38,223	34,546	39,399
EBITDA	5,540	6,390	5,573	6,479
EBITDA Margins (%)	16.3	16.7	16.1	16.4
Net Profit	3,679	4,328	3,431	4,082
EPS	46.0	53.9	42.9	51.0
EPS % deviation vs. Consensus	-	-	(6.7)	(5.3)

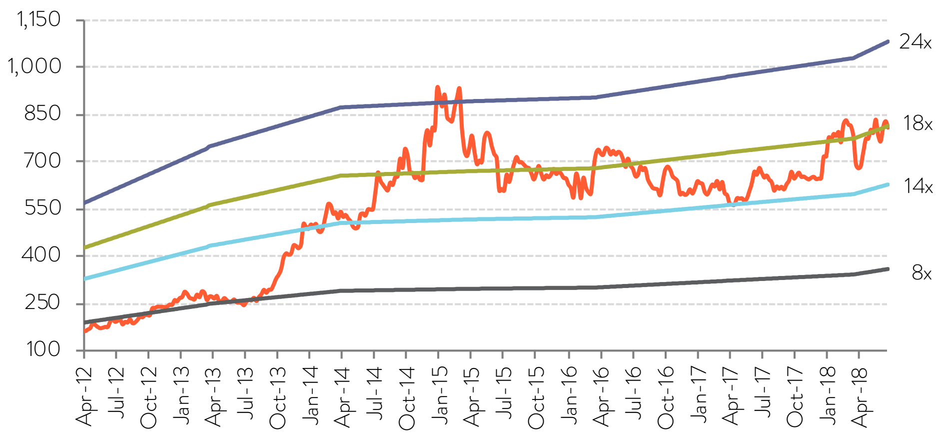
Source: Bloomberg, BOBCAPS Research

Valuation methodology

We expect PSYS to post a muted revenue/earnings CAGR of 12%/14% over FY18-FY21. Our EPS estimates for this period are 5-7% below consensus as we factor in limited scope for margin improvement given sales & marketing needs. Continued challenges in the ISV segment (40% of revenues) and volatility in the IP-led business (~25% of revenues) constrain our outlook on the company.

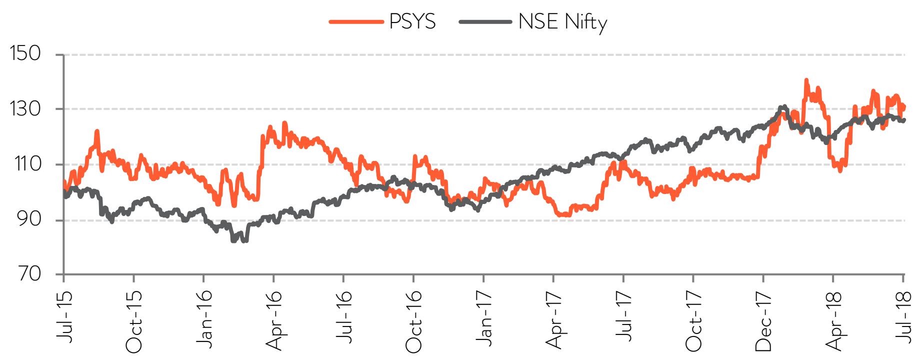
PSYS is trading at 18.9x/15.9x FY19E/FY20E P/E. We value the stock at 14x FY20E EPS (vs. 20.3x for tier-II peers), which leads to a Mar'19 target price of Rs 710. Initiate with SELL.

FIG 5 – PSYS TRADED AT AVERAGE 16.1X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Upside risks:** These include a sharp recovery in the ISV business and above-expected operating margin improvement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**28,784**	**30,337**	**34,546**	**39,399**	**44,557**
EBITDA	4,539	4,687	5,573	6,479	7,298
EBIT	3,049	3,102	3,850	4,618	5,437
Other income/(expenses)	958	1,190	787	899	1,055
EBT	4,007	4,293	4,637	5,517	6,491
Income taxes	992	1,062	1,206	1,434	1,688
Reported net profit	**3,015**	**3,231**	**3,431**	**4,082**	**4,804**
Adjusted net profit	**3,015**	**3,231**	**3,431**	**4,082**	**4,804**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	2,912	3,270	3,691	4,210	4,761
Provisions	1,537	1,754	1,893	2,159	2,441
Debt funds	22	17	17	17	17
Other liabilities	0	270	270	270	270
Equity capital	800	800	800	800	800
Reserves & surplus	18,193	20,472	22,665	25,273	28,342
Shareholders' fund	18,993	21,272	23,465	26,073	29,142
Total liabilities and equities	**23,464**	**26,583**	**29,336**	**32,729**	**36,632**
Cash and cash eq.	1,461	2,413	3,934	6,160	8,799
Accounts receivables	4,754	4,847	5,679	6,477	7,324
Other current assets	3,531	4,583	5,205	5,937	6,714
Investments	7,761	8,925	8,925	8,925	8,925
Net fixed assets	5,573	5,097	4,874	4,512	4,151
CWIP	290	52	52	52	52
Intangible assets	76	77	77	77	77
Deferred tax assets, net	306	642	642	642	642
Total assets	**23,464**	**26,583**	**29,336**	**32,729**	**36,632**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	4,450	4,816	5,154	5,944	6,665
Interest expenses	(144)	(1,190)	(787)	(899)	(1,055)
Changes in working capital	(1,062)	(570)	(894)	(745)	(791)
Other operating cash flows	(382)	1,157	0	0	0
Cash flow from operations	**2,862**	**4,212**	**3,473**	**4,300**	**4,819**
Capital expenditures	7	(1,327)	(1,500)	(1,500)	(1,500)
Change in investments	(177)	(1,164)	0	0	0
Other investing cash flows	(2,049)	194	787	899	1,055
Cash flow from investing	**(2,219)**	**(2,296)**	**(713)**	**(601)**	**(445)**
Debt raised/repaid	(5)	0	0	0	0
Interest expenses	(100)	0	0	0	0
Dividends paid	(480)	(963)	(1,239)	(1,474)	(1,734)
Cash flow from financing	**(584)**	**(963)**	**(1,239)**	**(1,474)**	**(1,734)**
Changes in cash and cash eq.	**59**	**953**	**1,521**	**2,225**	**2,640**
Closing cash and cash eq.	**1,461**	**2,413**	**3,934**	**6,160**	**8,799**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	37.7	40.4	42.9	51.0	60.0
Adjusted EPS	37.7	40.4	42.9	51.0	60.0
Dividend per share	9.0	10.0	12.9	15.3	18.0
Book value per share	237.5	265.9	293.4	326.0	364.3

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	2.2	2.1	1.8	1.5	1.3
EV/EBITDA	14.0	13.3	10.9	9.1	7.7
Adjusted P/E	21.5	20.1	18.9	15.9	13.5
P/BV	3.4	3.1	2.8	2.5	2.2

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	75.2	75.3	74.0	74.0	74.0
Interest burden (PBT/EBIT)	131.4	138.4	120.5	119.5	119.4
EBIT margin (EBIT/Revenue)	10.6	10.2	11.1	11.7	12.2
Asset turnover (Revenue/Avg TA)	129.3	121.2	123.6	127.0	128.5
Leverage (Avg TA/Avg Equity)	1.3	1.2	1.2	1.3	1.3
Adjusted ROAE	17.0	16.0	15.3	16.5	17.4

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	24.5	5.4	13.9	14.0	13.1
EBITDA	8.8	3.3	18.9	16.3	12.6
Adjusted EPS	1.4	7.1	6.2	19.0	17.6
Profitability & Return ratios (%)					
EBITDA margin	15.8	15.5	16.1	16.4	16.4
EBIT margin	10.6	10.2	11.1	11.7	12.2
Adjusted profit margin	10.5	10.6	9.9	10.4	10.8
Adjusted ROAE	17.0	16.0	15.3	16.5	17.4
ROCE	14.1	12.7	14.6	17.1	19.7
Working capital days (days)					
Receivables	57	58	56	56	57
Payables	47	44	44	44	44
Ratios (x)					
Gross asset turnover	5.7	5.7	6.9	8.4	10.3
Current ratio	2.2	2.4	2.7	2.9	3.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 1,225 | ▲ 12%

NIIT TECHNOLOGIES | IT Services | 04 July 2018

New leadership reshaping growth – initiate with ADD

Revamped leadership, a deeper domain focus and sharpened sales & delivery are reshaping growth at NIIT Tech (NITEC) – instituted in FY18, these initiatives have led to more deal wins (TCV of US$ 507mn in FY18, +11% YoY) at larger ticket sizes (seven US$ 20mn+ wins), higher logo additions (31 vs. 15 in FY17), and increased US$ 1mn accounts. While we like NITEC's new growth trajectory, valuations at 19.3x/16.3x carry limited upside post the 70% upmove in stock price in the last six months – initiate with ADD and a Mar'19 target price of Rs 1,225.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Leadership and organisation refresh to drive sustainable growth: In FY18, NITEC inducted a new CEO and several new leaders from tier-I peers. This leadership refresh was accompanied by an organisation-wide restructuring drive to move from geographically-aligned business units to vertical-focused units. The company also carved out dedicated units for cloud, robotics process automation (RPA) and data services, besides honing front-end sales to better leverage on its deep expertise in the travel, insurance and wealth management verticals.

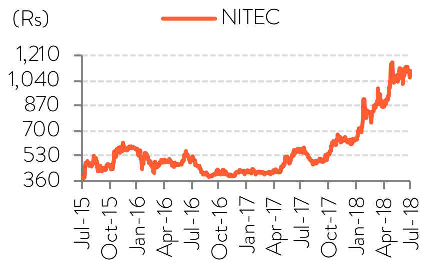
Deal wins lend confidence on growth: In FY18, NITEC won deals worth a TCV of US$ 507mn (+11% YoY on a strong base of FY17). These included 7 large wins in FY18 with a TCV of US$ 20mn+ vs. 5 in FY17, some against tier-I peers. New logo addition also gathered pace with 31 clients added in FY18, double that in FY17. Building on this traction, we believe that NITEC is on track for double-digit revenue growth in FY19, at 13.7% (in US$ terms ex-hedging gains/losses).

Initiate with ADD: We expect NITEC to post a US$ revenue/EBIT CAGR of 12%/17.6% for FY18-FY21. While we acknowledge that the business restructuring is playing a positive role in reshaping growth, valuation upsides look limited given the 70% uptick in stock price in the past six months. Our Mar'19 TP of Rs 1,225 is based on 18x FY20E P/E, a ~10% discount to peers.

Ticker/Price	NITEC IN/Rs 1,098
Market cap	US$ 988.1mn
Shares o/s	62mn
3M ADV	US$ 20.4mn
52wk high/low	Rs 1,156/Rs 972
Promoter/FPI/DII	31%/41%/28%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	2,707	2,802	3,547	4,203	4,893
Adj. EPS (Rs)	43.8	45.4	57.4	68.0	79.2
Adj. EPS growth (%)	(2.8)	3.5	26.6	18.5	16.4
Adj. ROAE (%)	15.4	15.3	18.4	19.1	19.5
Adj. P/E (x)	25.1	24.2	19.1	16.1	13.9
EV/EBITDA (x)	13.6	12.0	9.3	7.8	6.4

Source: Company, BOBCAPS Research

Investment rationale

Organisation restructuring to streamline growth

In FY18, NITEC instituted an extensive leadership refresh along with an organisation-wide restructuring drive to lay the foundation for sustainable growth. The company brought Genpact COO Sudhir Singh on board in May'17 and he took charge as CEO in Jan'18. This change at the helm was accompanied by the induction of several top executives over the last 12-15 months to augment and deepen the leadership team.

Besides the management reshuffle, the organisational restructuring launched at NITEC in May'18 has created vertical-focused business units (vs. geographically aligned units earlier), along with dedicated service divisions for cloud, robotics process automation (RPA) and data to enable innovative solutions.

FIG 1 – NEW LEADERSHIP

Name	Date of Joining	Designation	Profile
Ananth Basavaraju	Nov'17	Senior Vice President & BU Head, Australia and Asia	Prior to joining NITEC, Ananth was Director, Digital Solutions, Fujitsu Australia. He has also worked in Accenture, iGate and TCS. Ananth has an in-depth understanding of outsourcing and large & strategic deals backed by his decade-long Australia experience.
Anurag Chauhan	Oct'17	Global Head, Insurance	Before joining NITEC, Anurag was with Accenture and led the Technology Consulting and Implementation Services Sales and Delivery for global Accenture clients, including large insurance and BFS majors. In addition, Anurag was a part of the Accenture Cloud Global Senior Executive Committee. With 23 years of industry experience, he has deep expertise in consulting, delivery, sales, servicing, large deals and strategic partnerships.
Gautam Samanta	Sep'17	Head of Europe	Gautam joined NITEC from Infosys where he served as Vice President & Global Client Partner – Financial Services, and managed the fastest growing portfolio of Accounts in Europe. He is an alumnus of IIT Kharagpur and IIM Calcutta. With over 24 years of experience, Gautam has a deep understanding of the technology and business consulting landscape acquired through working in a leading financial services institution, a leading software product company as well as two large global consulting and technology services organisations.
Sudhir Singh	May'17	CEO	Sudhir joined NITEC from Genpact where he was the Chief Operating Officer of the IT Services & Capital Markets Business. Prior to Genpact, Sudhir spent close to a decade with Infosys in the US in various sales and client portfolio management roles as part of their Banking and Capital Markets Business leadership team. He founded and headed Infosys' Global Payments and Cards Practice and was an invitee to the Infosys Management Committee.

Name	Date of Joining	Designation	Profile
Joel Lindsey	Jan'17	Global Head of Digital Services	Prior to NITEC, Joel was leading digital transformation globally for Hewlett-Packard Enterprise. Previously, he led next-generation digital offerings and corporate strategy for Electronic Data Systems. Apart from these large corporations, Joel also spent time with two Silicon Valley digital start-ups focused on e-commerce (Open Market, Inc.) and cloud computing (Loudcloud Systems).
Adrian Morgan	Jan'17	Head, NIIT Insurance Technologies (NITL)	Adrian joined NITEC from CSC where he was the UK Digital Transformation Practice Head and most recently held the position of UK Head of Digital for Insurance. Prior to that, Adrian was Head of Insurance Software at Xchanging where he established and led Xuber, a software and services supplier to the broking, commercial insurance and re-insurance markets.
Vic Gupta	Oct'17	Global Head, Cloud	Prior to joining NITEC, Vic was co-founder and CTO at Sharp-N India. He was also associated with Microsoft, Citi Corp and Advance Incorporated.
Behzad Ilchi	Jun'17	Head, Media Business	Prior to joining NIIT Tech, Behzad was Managing Partner at Cognizant. He was also associated with Virtusa, Interactive Broadband Consulting Group, Capgemini, Cognizant Technology Solutions, Bearing Point, The Washington Post and Time Life Inc.

Source: Company, BOBCAPS Research

Revamped sales engine accelerating deal wins

Driven by its "Change for Growth" strategy, NITEC has honed its front-end sales practice to emphasise on domain focus, closer-to-client leadership presence, and centralised deal structuring in order to better leverage technology partnerships. Management's strategy also includes tapping into NITEC's deep domain expertise in the travel, insurance and asset & wealth management verticals to offer differentiated solutions.

The company's renewed sales efforts are being supplemented by a revamped reward and compensation structure to incentivise larger deals (~2.5x variable pay), build revenues and improve margins. Already, the number of large deal wins has increased to 7 in FY18 from 5 in FY17, accompanied by the addition of new names to the client roster.

FIG 2 – PACE OF LARGE DEAL WINS HAS INCREASED

Date of deal win	No. of large deals	Remarks
Mar'18	2	▪ Won a US$ 35mn managed services contract from a new London-based client ▪ The second win was from an existing BFSI client
Dec'17	3	▪ Won three large deals in the US against tier-I competition ▪ Two of these were from the insurance vertical
Sep'17	1	▪ Bagged a large contract from an existing US travel client
Jun'17	1	▪ Signed a large multi-year engagement with an existing travel client in the US

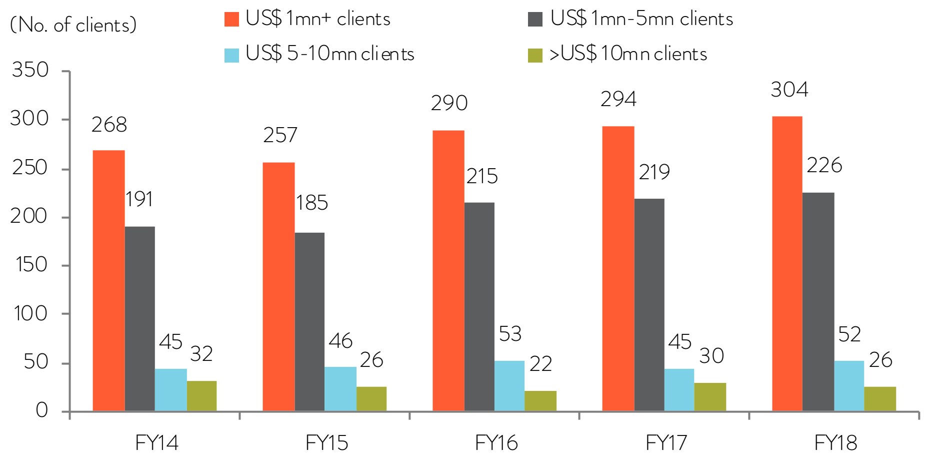
Source: Company, BOBCAPS Research

Morris slippage arrested; expect pick-up in top client revenue

While NITEC enjoyed reasonable success in increasing the number of US$ 1mn+ revenue clients in FY18 (7 clients added), its performance in scaling up the US$ 10mn+ bracket was patchy. This coincided with a weak top 20 client performance in FY18, reflecting ramp-down at a European travel client in H1FY18 and slippages in the Morris business in H2FY18 due to a change in the latter's ownership.

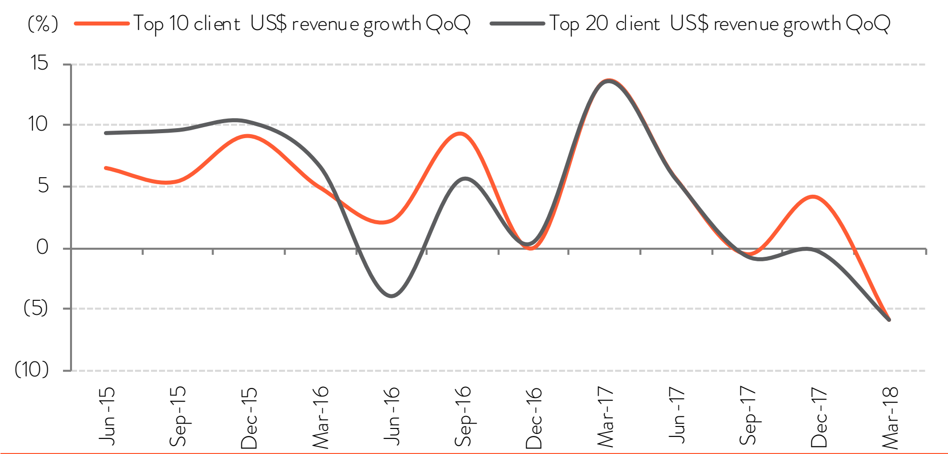
With residual Morris slippages concluding in the Jun'18 quarter, we expect better traction in the company's top 20 client revenues as recent deal wins ramp up. In addition, management in May'18 indicated increased budgetary spends at the top 20 clients.

FIG 3 – NEW CLIENTS ADDED TO LOWER REVENUE BUCKETS BUT PERFORMANCE IN US$ 10MN+ REVENUE BUCKET WAS PATCHY IN FY18



Source: Company, BOBCAPS Research

FIG 4 – AS MORRIS ENGAGEMENT BOTTOMS OUT IN JUN'18 QUARTER, WE EXPECT SEQUENTIAL GROWTH RECOVERY IN TOP 20 CLIENT REVENUES



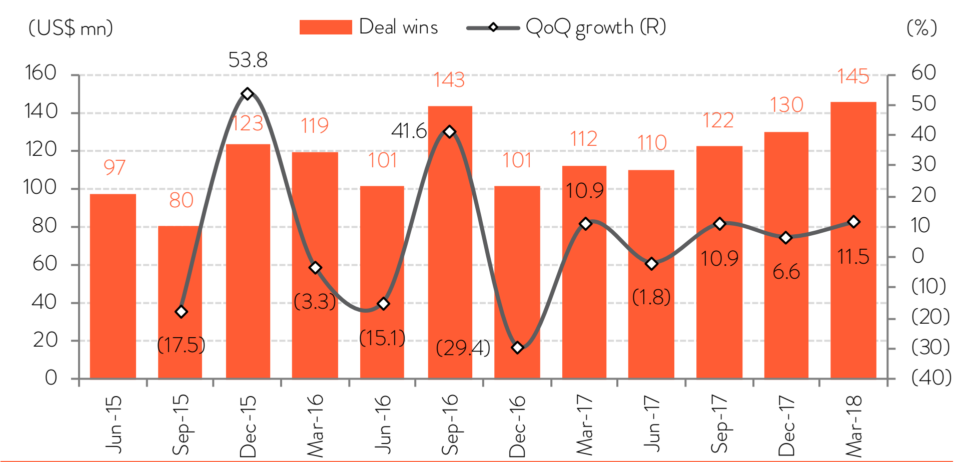
Source: Company, BOBCAPS Research

Deal traction to drive earnings

In FY18, NITEC won deals worth a TCV of US$ 507mn, up 11% YoY on a strong base of FY17 which had included the company's largest contract worth US$ 63mn. The FY18 engagements included 7 large deals (TCV US$ 20mn+) versus 5 in FY17, some won against tier-I peers. The company's new logo addition also gathered pace with 31 new clients inducted in FY18 from 15 in FY17. Digital business grew 29% YoY and accounted for 24% of full-year revenues.

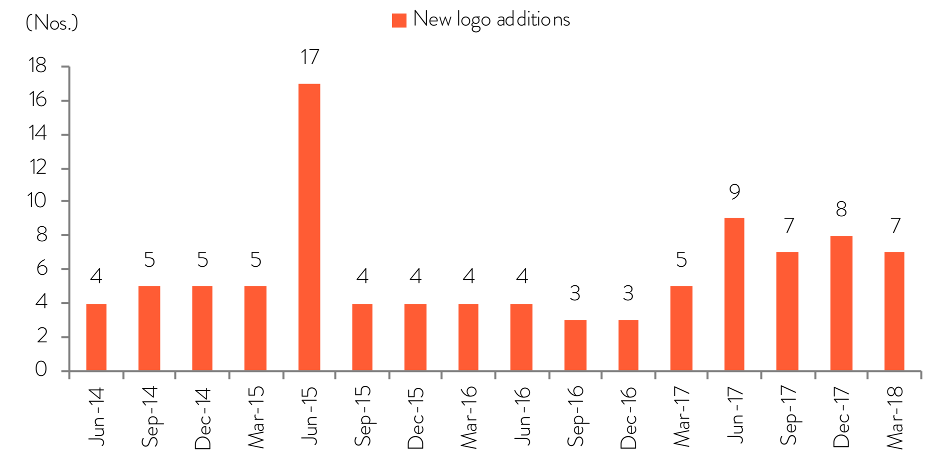
Building on this traction, we believe that NITEC is on track for double-digit revenue growth in FY19 – we bake in a 13.7% increase in US$ revenues for the year (excluding hedging gains/losses) and a 12% CAGR over FY18-FY21.

FIG 5 – STEADY RISE IN DEAL WINS LENDS CONFIDENCE ON GROWTH



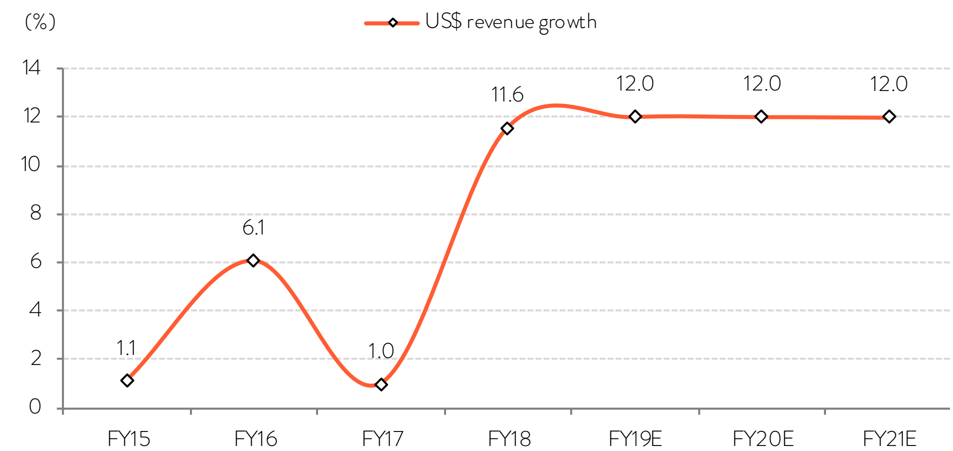
Source: Company, BOBCAPS Research

FIG 6 – NITEC ADDED 31 NEW LOGOS IN FY18 VS. 15 IN FY17



Source: Company, BOBCAPS Research

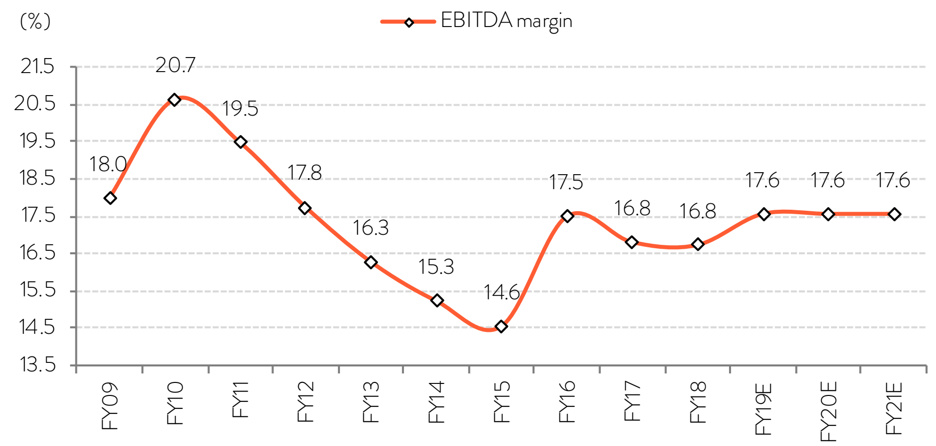
FIG 7 – EXPECT 12% US$ REVENUE CAGR OVER FY18-FY21E



Source: Company, BOBCAPS Research

Over the past year, management has made delivery process interventions such as intensive automation, cloud adoption and role rationalisation to drive operational efficiency. We model for ~100bps operating margin expansion for NITEC in FY19 on the back of growth leverage, delivery efficiency and rupee depreciation against the dollar. Over our forecast period of FY18-FY21, we expect a 17.6%20.4% EBIT/EPS CAGR backed by the 12% US$ revenue CAGR and healthy margins.

FIG 8 – EBITDA MARGINS EXPECTED TO EXPAND 80BPS OVER FY18-FY21E

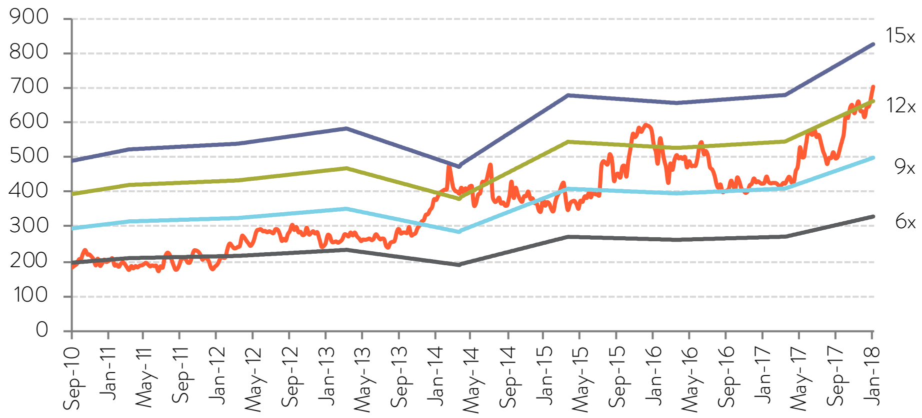


Source: Company, BOBCAPS Research

Valuation methodology

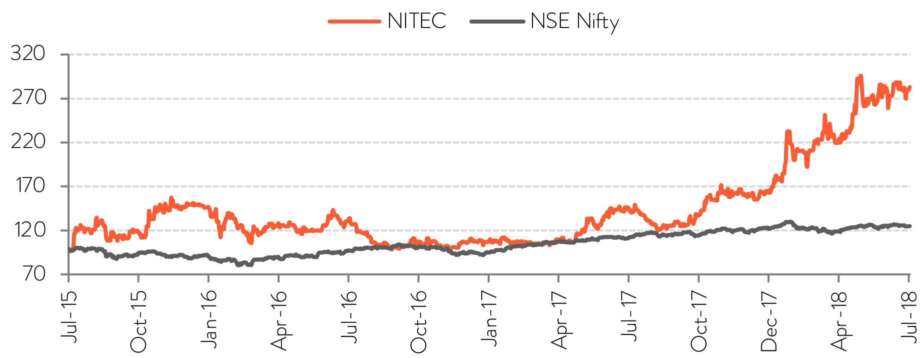
We acknowledge that the recent leadership refresh and organisation restructuring are playing a positive role in reshaping growth at NITEC. However, upsides to current valuations of 19.1x/16.1x FY19E/FY20E EPS look capped after the ~70%/94% upmove in stock price in the last 6/12 months. We have a Mar'19 target price of Rs 1,225 for the stock based on 18x FY20E P/E, a ~10% discount to mid-tier peers, and initiate coverage with ADD.

FIG 9 – NITEC TRADED AT AVERAGE 10.7X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: BLOOMBERG, BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our earnings estimates include:

- challenges at the company's top clients,
- a sharp decline in demand, and
- adverse currency movement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**27,864**	**29,914**	**34,787**	**39,257**	**43,966**
EBITDA	4,689	5,012	6,118	6,905	7,733
EBIT	3,413	3,739	4,719	5,388	6,082
Other income/(expenses)	160	298	509	709	928
EBT	3,212	4,037	5,228	6,097	7,010
Income taxes	646	950	1,281	1,494	1,717
Extraordinary items	(361)	0	0	0	0
Min. int./Inc. from associates	220	285	400	400	400
Reported net profit	**2,346**	**2,802**	**3,547**	**4,203**	**4,893**
Adjusted net profit	**2,707**	**2,802**	**3,547**	**4,203**	**4,893**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	4,087	5,115	6,004	6,776	7,589
Provisions	1,500	2,943	3,431	3,872	4,336
Debt funds	74	224	224	224	224
Other liabilities	387	455	455	455	455
Equity capital	2,112	615	615	615	615
Reserves & surplus	16,488	17,348	19,887	22,821	26,170
Shareholders' fund	18,600	17,963	20,502	23,436	26,785
Total liabilities and equities	**24,648**	**26,700**	**30,616**	**34,763**	**39,389**
Cash and cash eq.	4,075	8,057	11,132	14,496	18,406
Accounts receivables	4,903	5,911	6,957	7,851	8,793
Inventories	3	0	0	0	0
Other current assets	3,062	2,701	3,145	3,549	3,975
Investments	3,158	0	0	0	0
Net fixed assets	8,476	8,800	8,151	7,635	6,984
CWIP	0	7	7	7	7
Deferred tax assets, net	971	1,231	1,231	1,231	1,231
Total assets	**24,648**	**26,700**	**30,616**	**34,762**	**39,389**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	5,004	5,310	6,628	7,614	8,660
Interest expenses	(51)	(298)	(509)	(709)	(928)
Non-cash adjustments	941	490	(113)	(86)	(90)
Changes in working capital	(1,171)	(950)	(1,281)	(1,494)	(1,717)
Cash flow from operations	**4,723**	**4,552**	**4,724**	**5,325**	**5,925**
Capital expenditures	(855)	(1,034)	(750)	(1,000)	(1,000)
Change in investments	(2,284)	0	0	0	0
Other investing cash flows	(292)	298	509	709	928
Cash flow from investing	**(3,431)**	**(736)**	**(241)**	**(291)**	**(72)**
Equities issued/Others	70	0	0	0	0
Debt raised/repaid	0	(150)	0	0	0
Interest expenses	(1)	0	0	0	0
Dividends paid	(738)	(1,115)	(1,409)	(1,669)	(1,943)
Cash flow from financing	**(669)**	**(1,265)**	**(1,409)**	**(1,669)**	**(1,943)**
Changes in cash and cash eq.	**623**	**2,551**	**3,075**	**3,365**	**3,910**
Closing cash and cash eq.	**3,502**	**8,057**	**11,132**	**14,496**	**18,406**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	38.0	45.4	57.4	68.0	79.2
Adjusted EPS	43.8	45.4	57.4	68.0	79.2
Dividend per share	12.5	15.0	18.9	22.5	26.1
Book value per share	301.0	290.7	331.7	379.2	433.4

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	2.3	2.0	1.6	1.4	1.1
EV/EBITDA	13.6	12.0	9.3	7.8	6.4
Adjusted P/E	25.1	24.2	19.1	16.1	13.9
P/BV	3.6	3.8	3.3	2.9	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	84.3	69.4	67.8	68.9	69.8
Interest burden (PBT/EBIT)	94.1	108.0	110.8	113.2	115.3
EBIT margin (EBIT/Revenue)	12.2	12.5	13.6	13.7	13.8
Asset turnover (Revenue/Avg TA)	118.2	116.5	121.4	120.1	118.6
Leverage (Avg TA/Avg Equity)	2.0	2.1	2.3	2.3	2.3
Adjusted ROAE	15.4	15.3	18.4	19.1	19.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	3.8	7.4	16.3	12.9	12.0
EBITDA	(0.3)	6.9	22.1	12.9	12.0
Adjusted EPS	(2.8)	3.5	26.6	18.5	16.4
Profitability & Return ratios (%)					
EBITDA margin	16.8	16.8	17.6	17.6	17.6
EBIT margin	12.2	12.5	13.6	13.7	13.8
Adjusted profit margin	9.7	9.4	10.2	10.7	11.1
Adjusted ROAE	15.4	15.3	18.4	19.1	19.5
ROCE	12.1	14.6	22.8	27.3	32.5
Working capital days (days)					
Receivables	71	66	68	69	69
Payables	94	107	128	128	127
Ratios (x)					
Gross asset turnover	3.3	3.5	4.1	5.0	6.0
Current ratio	2.2	2.1	2.3	2.4	2.6
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.2)	(0.4)	(0.5)	(0.6)	(0.7)

Source: Company, BOBCAPS Research

SELL
TP: Rs 1,140 | ∀ 11%

ECLERX SERVICES | IT Services | 04 July 2018

Margin reset to weigh on earnings – initiate with SELL

We initiate coverage on eClerx Services (ECLX) with SELL and a Mar'19 target price of Rs 1,140. While receding challenges in top accounts should aid a revenue recovery at 11.5% CAGR over FY18-FY21, the ongoing shift in ECLX's business model from offshore to onsite delivery is spurring a structural decline in operating margins (–800bps to 23.3% in FY18). Limited support from currency hedging is an added downside risk to profitability. We expect EBIT margins to shed 90bps through to FY21, leading to a tepid 6.9% earnings CAGR.

BOBCAPS Research
+91 22 6138 9300
research@bobcaps.in

Receding challenges in top accounts...: US$ revenues from top 10 clients, which account for over two-thirds of ECLX's topline, increased 1.4% QoQ in Q4FY18, marking a break from the weakness seen over the preceding eight quarters. We factor in a recovery to 8.6% YoY US$ revenue growth in FY19 on the back of emerging stability at top 10 clients and continued traction in emerging clients.

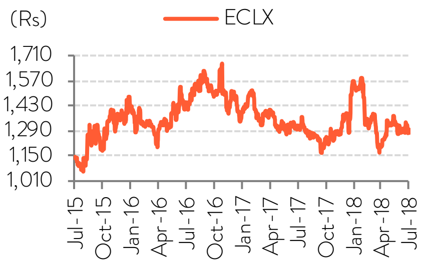
...but change in business mix spurring downward margin reset: Demand dynamics are changing in favour of nearshore/onshore execution, which offers structurally lower EBIT margins for IT service players than offshore-based delivery. ECLX is in the midst of aligning to this new dynamic – onsite revenues rose 500bps YoY to 18.8% share in FY18, which caused reported EBIT margins to plunge 800bps to 23.3%. As this transition continues, we model for further margin contraction of 90bps over FY18-FY21, also exacerbated by limited hedging support due to recent INR depreciation vs. the USD.

Initiate with SELL: The stock has underperformed the IT index by ~40% in the last 18 months, and trades at ~16.5x/14x FY19E/FY20E P/E based on consensus estimates. But we see downside risk to consensus earnings as margins get reset to a lower trajectory (our estimates are 8%/12% below the street). Our Mar'19 TP of Rs 1,140 is set at 14x FY20E EPS, a discount of ~30% to peers.

Ticker/Price	ECLX IN/Rs 1,282
Market cap	US$ 723.4mn
Shares o/s	39mn
3M ADV	US$ 0.4mn
52wk high/low	Rs 1,368/Rs 1,251
Promoter/FPI/DII	50%/25%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	3,541	2,887	2,850	3,160	3,530
Adj. EPS (Rs)	88.4	74.5	73.5	81.5	91.1
Adj. EPS growth (%)	0.5	(15.7)	(1.3)	10.9	11.7
Adj. ROAE (%)	30.8	23.6	22.1	22.4	22.9
Adj. P/E (x)	14.5	17.2	17.4	15.7	14.1
EV/EBITDA (x)	9.8	12.6	11.6	10.4	9.3

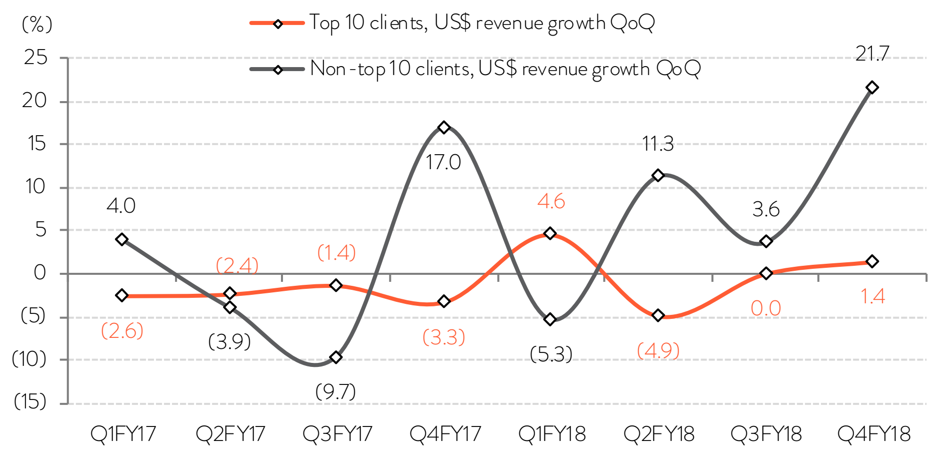
Source: Company, BOBCAPS Research

Revenues reviving but margins at risk

Receding top-client challenges to support growth recovery…

After a challenging run in FY17 and H1FY18, when US$ revenues from ECLX's top 10 clients (> two-third revenue share) declined ~4% YoY each, we are seeing emerging signs of stability. Top 10 US$ revenues increased by 1.4% QoQ in the Mar'18 quarter, marking a break from the weakness seen over the preceding eight quarters. We believe that a pickup in large accounts coupled with continued traction in non-top 10 clients will support a revenue growth recovery to 8.6% in FY19 vs. 2.3% in FY18.

FIG 1 – GREEN SHOOTS VISIBLE IN TOP 10 CLIENT PERFORMANCE



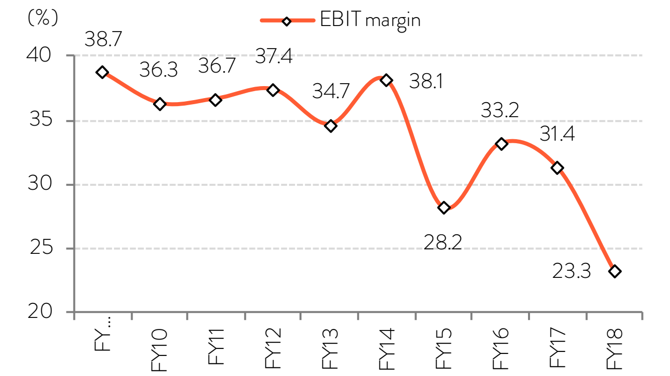
Source: Company, BOBCAPS Research

…but changing business mix to depress margins

ECLX's strong operating margins over FY13-FY17 – average EBIT margins of 33% vs. those in the high-teens for mid-cap IT services peers – were largely supported by its offshore-centric delivery model. As demand dynamics change in favour of nearshore/onshore execution, the company's business is undergoing a structural shift from pure offshore-based delivery to a mix of offshore and onsite delivery.

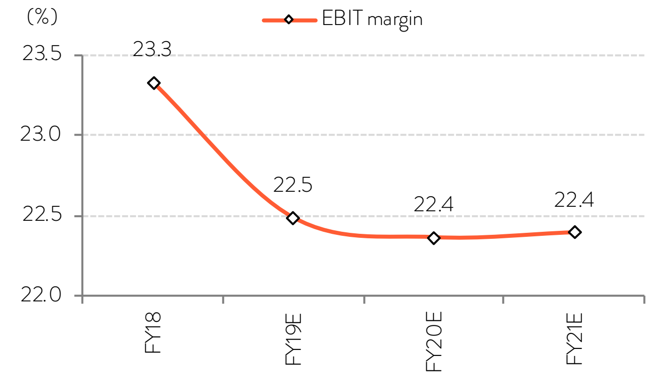
ECLX's onsite business accounted for 23% of overall revenue in the Mar'18 quarter vs. less than 13% in the Mar'16 quarter. In FY18, onsite revenues increased by 42.7% YoY vs. 4% YoY growth for the relatively higher-margin offshore business. The shift in mix induced an 800bps YoY drop in EBIT margin to 23.3%. We expect onsite demand to continue to pose margin challenges for the company and hence build in 90bps EBIT margin contraction to 22.4% over FY18-FY21 vs. largely flat expectations of consensus.

FIG 2 – ECLX'S ABOVE-INDUSTRY MARGINS LARGELY LED BY OFFSHORE-CENTRIC DELIVERY MODEL



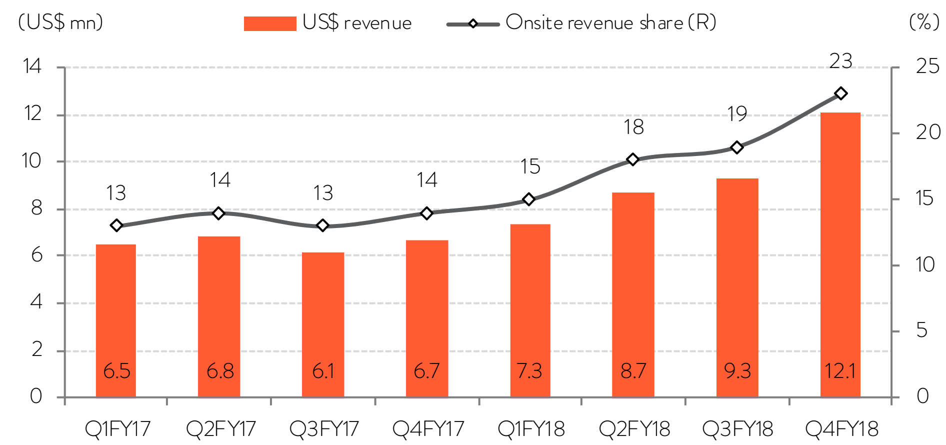
Source: Company, BOBCAPS Research | Note: EBIT margins include hedging gains from FY17 onwards

FIG 3 – INCREASING ONSITE MIX NOW DRIVING OPERATING MARGIN CONTRACTION



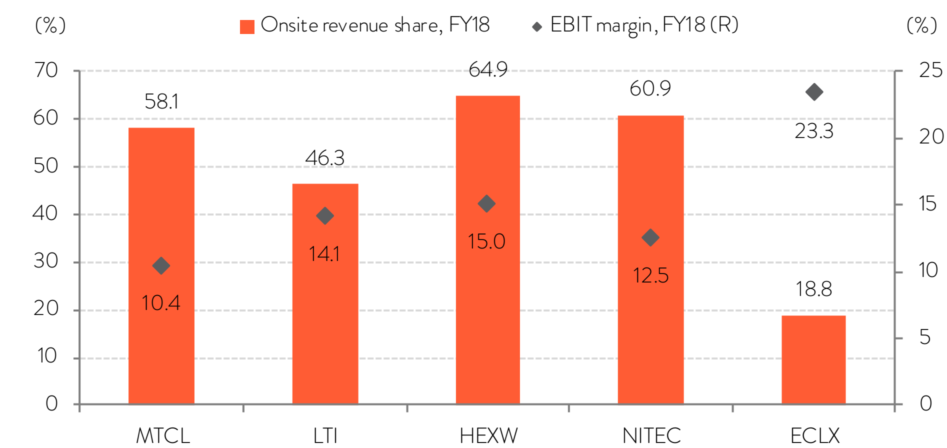
Source: Company, BOBCAPS Research | Note: EBIT margins are inclusive of hedging gains

FIG 4 – ONSITE REVENUE SHARE ON THE RISE



Source: Company, BOBCAPS Research

FIG 5 – SHIFTING REVENUE MIX TO NARROW MARGIN OUTPERFORMANCE



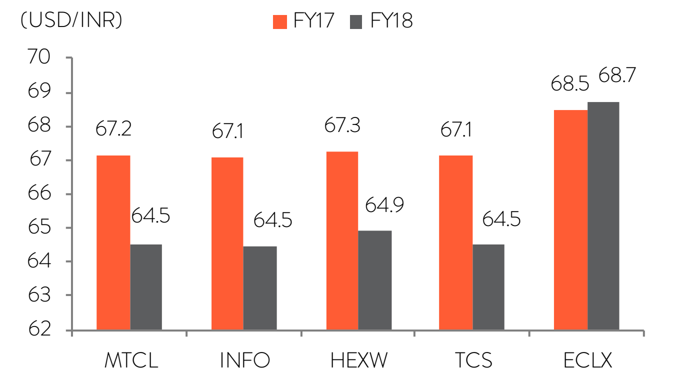
Source: Company, BOBCAPS Research

Limited hedging support amid rupee depreciation

In FY18, ECLX's industry-leading 23.3% EBIT margins were in part supported by ~Rs 856mn or 630bps of hedging gains flowing through revenues (realised INR/USD rate of Rs 68.7 vs. ~Rs 64.5 for peers). With the recent INR depreciation versus the USD (~4.8% since Mar'18 end), the company will have limited hedging gains in FY19, at an estimated Rs 209mn – a fourth of the hedging gains clocked in FY18.

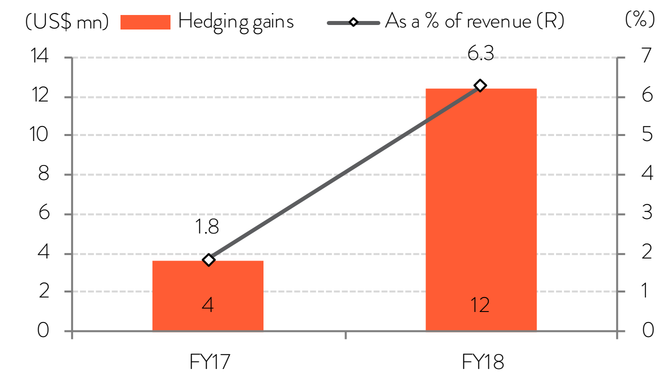
Consequently, ECLX's reported EBIT margins could come under pressure, even as we expect other mid-tier IT service companies to witness margin expansion supported by INR depreciation (albeit a transient benefit).

FIG 6 – HIGH INR REALISATION RATE BOLSTERED MARGINS



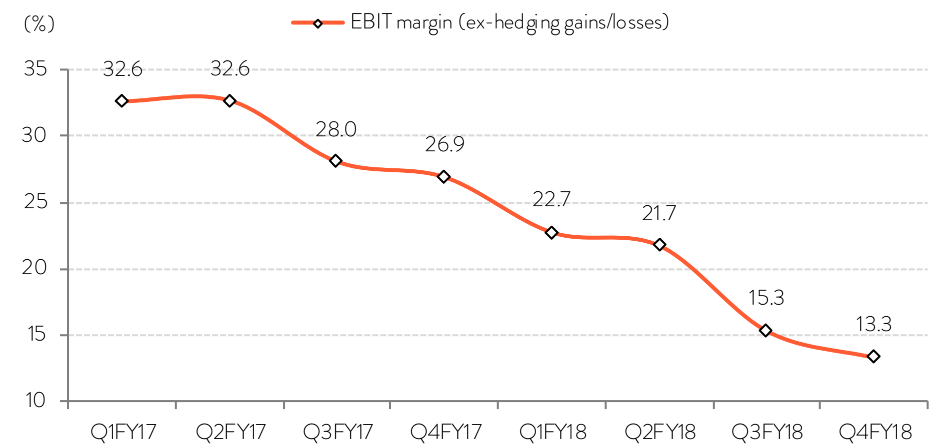
Source: Company, BOBCAPS Research

FIG 7 – HEDGING GAINS UNLIKELY TO MATCH THOSE SEEN IN FY18



Source: Company, BOBCAPS Research

FIG 8 – ADJ. EBIT MARGINS SHOW A SHARP DECLINE



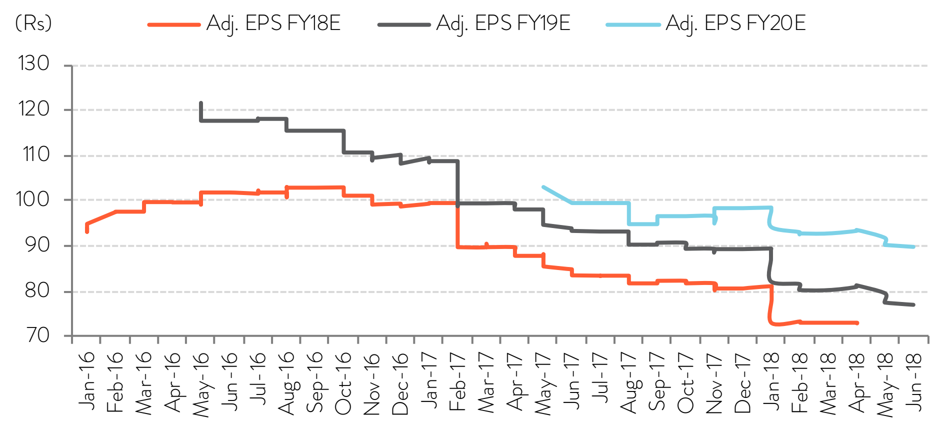
Source: Company, BOBCAPS Research

Valuation methodology

We believe ECLX's changing business mix in favour of onsite delivery will continue to put downward pressure on operating margins. Consequently, our projections show a muted earnings CAGR of 6.9% over FY18-FY21 despite a likely recovery in revenue growth at a 11.5% CAGR. In our view, the street is not adequately factoring in the risk to margins – we are currently 7.8% below consensus earnings for FY19.

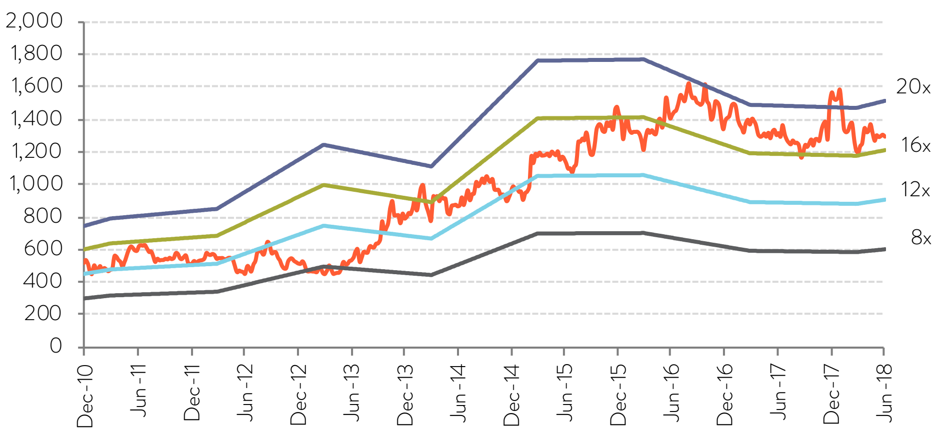
We value the stock at a target P/E multiple of 14x FY20E EPS, a ~30% discount to other mid-cap peers, leading to a Mar'19 target price of Rs 1,140. Initiate with SELL.

FIG 9 – CONSENSUS EPS EARNINGS DOWNGRADE OVER LAST TWO YEARS



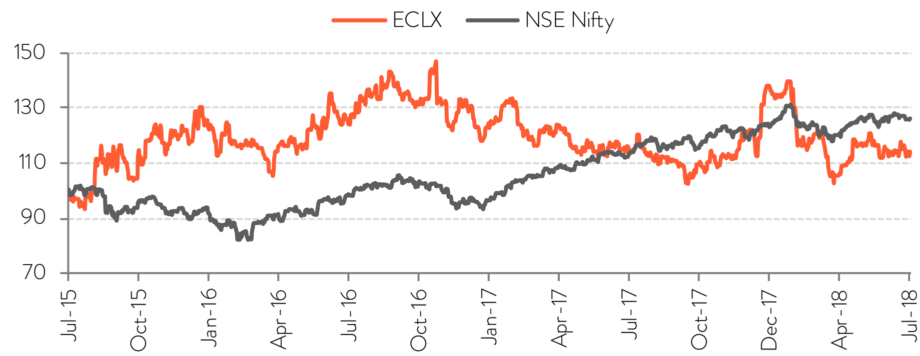
Source: BLOOMBERG, BOBCAPS Research

FIG 10 – ECLX TRADED AT AVERAGE 15.2X 12-MONTH ROLLING FORWARD P/E OVER LAST 5 YEARS



Source: Company, BOBCAPS Research

FIG 11 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our earnings estimates include:

- a sharper recovery in demand especially for the offshore business,
- stronger-than-expected traction in large accounts, and
- sharp favourable currency movements.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	**13,300**	**13,651**	**15,030**	**16,555**	**18,453**
EBITDA	4,688	3,668	3,916	4,288	4,718
EBIT	4,170	3,185	3,380	3,702	4,132
Other income/(expenses)	188	390	420	511	574
Exceptional items	0	213	0	0	0
EBT	4,358	3,787	3,800	4,213	4,706
Income taxes	819	896	950	1,053	1,177
Min. int./Inc. from associates	(1)	4	0	0	0
Reported net profit	**3,541**	**2,887**	**2,850**	**3,160**	**3,530**
Adjusted net profit	**3,541**	**2,887**	**2,850**	**3,160**	**3,530**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Other current liabilities	1,595	1,646	1,812	1,996	2,225
Provisions	49	75	82	91	101
Debt funds	11	11	11	11	11
Other liabilities	170	170	170	170	170
Equity capital	397	384	384	384	384
Reserves & surplus	11,758	11,961	13,096	14,355	15,761
Shareholders' fund	12,155	12,346	13,481	14,739	16,145
Total liabilities and equities	**13,980**	**14,246**	**15,555**	**17,006**	**18,651**
Cash and cash eq.	3,557	3,453	4,145	4,976	5,865
Accounts receivables	2,138	2,169	2,388	2,631	2,932
Other current assets	2,714	2,805	3,088	3,402	3,792
Investments	2,191	2,191	2,191	2,191	2,191
Net fixed assets	869	1,117	1,231	1,296	1,360
CWIP	19	150	150	150	150
Intangible assets	2,429	2,429	2,429	2,429	2,429
Deferred tax assets, net	82	82	82	82	82
Total assets	**13,980**	**14,246**	**15,555**	**17,006**	**18,651**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18P	FY19E	FY20E	FY21E
Net income + Depreciation	4,730	3,374	3,386	3,746	4,115
Interest expenses	(126)	(390)	(420)	(511)	(574)
Changes in working capital	(469)	(45)	(329)	(364)	(453)
Other operating cash flows	(1,011)	0	0	0	0
Cash flow from operations	**3,124**	**2,940**	**2,637**	**2,871**	**3,089**
Capital expenditures	(296)	(731)	(650)	(650)	(650)
Change in investments	(304)	0	0	0	0
Other investing cash flows	(1,153)	390	420	511	574
Cash flow from investing	**(1,754)**	**(342)**	**(230)**	**(139)**	**(76)**
Equities issued/Others	82	(2,580)	0	0	0
Interest expenses	(2,494)	0	0	0	0
Dividends paid	(41)	(121)	(1,715)	(1,901)	(2,124)
Cash flow from financing	**(2,453)**	**(2,701)**	**(1,715)**	**(1,901)**	**(2,124)**
Changes in cash and cash eq.	**(1,083)**	**(103)**	**692**	**831**	**889**
Closing cash and cash eq.	**3,556**	**3,453**	**4,145**	**4,976**	**5,865**

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	88.4	74.5	73.5	81.5	91.1
Adjusted EPS	88.4	74.5	73.5	81.5	91.1
Dividend per share	1.0	1.0	37.0	41.0	45.8
Book value per share	313.3	318.2	347.4	379.9	416.1

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	3.5	3.4	3.0	2.7	2.4
EV/EBITDA	9.8	12.6	11.6	10.4	9.3
Adjusted P/E	14.5	17.2	17.4	15.7	14.1
P/BV	4.1	4.0	3.7	3.4	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	81.2	76.2	75.0	75.0	75.0
Interest burden (PBT/EBIT)	104.5	118.9	112.4	113.8	113.9
EBIT margin (EBIT/Revenue)	31.4	23.3	22.5	22.4	22.4
Asset turnover (Revenue/Avg TA)	99.9	96.7	100.9	101.7	103.5
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	30.8	23.6	22.1	22.4	22.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets | Prices as at end of 2nd July 2018.

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
YoY growth (%)					
Revenue	1.2	2.6	10.1	10.1	11.5
EBITDA	(3.7)	(21.8)	6.8	9.5	10.0
Adjusted EPS	0.5	(15.7)	(1.3)	10.9	11.7
Profitability & Return ratios (%)					
EBITDA margin	35.2	26.9	26.1	25.9	25.6
EBIT margin	31.4	23.3	22.5	22.4	22.4
Adjusted profit margin	26.6	21.2	19.0	19.1	19.1
Adjusted ROAE	30.8	23.6	22.1	22.4	22.9
ROCE	50.6	35.6	36.3	38.0	40.4
Working capital days (days)					
Receivables	55	58	55	55	55
Payables	62	59	57	57	56
Ratios (x)					
Gross asset turnover	14.5	13.7	12.8	13.1	13.9
Current ratio	5.1	4.9	5.1	5.3	5.4
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.3)	(0.3)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

Rating distribution

As of 04 July 2018, out of 62 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 34 have BUY ratings, 17 are rated ADD, 4 are rated REDUCE and 7 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance, wealth management and portfolio management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020.

BOBCAPS generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.