

SELL

TP: Rs 1,800 | ▼ 7%

NIIT TECHNOLOGIES

IT Services

30 January 2020

Risk-reward unfavourable; cut to SELL

NIIT Tech's (NITEC) Q3FY20 performance was mixed with a miss on operating margins (-20bps QoQ to 18.1%) but healthy deal wins. Management is optimistic on growth prospects and reiterated its target FY20 EBIT margin of ~18% (excl. one-offs). We tweak estimates and roll forward to a revised Mar'21 TP of Rs 1,800 (vs. Rs 1,600). While we acknowledge the improvement in operating performance led by management's initiatives toward predictable and profitable growth, risk-reward looks unfavourable at current valuations – cut from ADD to SELL.

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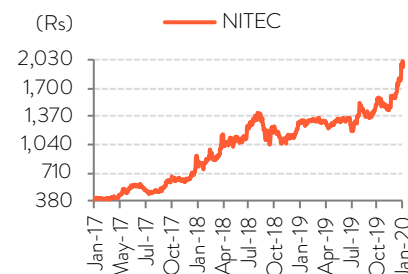
In-line revenue, miss on margins: Q3 revenue was up 2% QoQ CC to US\$ 150.3mn (ex-hedging gains), in line with our expectations. EBITDA margins declined 20bps QoQ to 18.1% (vs. 19.5% expected), mainly due to large-deal transition costs and furloughs. PAT at Rs 1.2bn (+3.2% QoQ, 23% YoY) met estimates aided by a below-expected tax rate (20.7% vs. 24% est.).

Ticker/Price	NITEC IN/Rs 1,941
Market cap	US\$ 1.7bn
Shares o/s	62mn
3M ADV	US\$ 13.1mn
52wk high/low	Rs 2,060/Rs 1,178
Promoter/FPI/DII	70%/13%/17%

Source: NSE

Deal wins and executable orders continue to trend up: Fresh order intake at US\$ 218mn rose for the tenth straight quarter, supported by strong deal wins in RoW at US\$ 66mn. 9MFY20 order intake at US\$ 569mn was up 19.5% YoY, again largely led by RoW markets. The 12-month executable order book stood at US\$ 424mn (+13% YoY), rising for the ninth quarter in a row.

STOCK PERFORMANCE



Source: NSE

Large deals make a comeback: After a lull in H1FY20, NITEC won four large deals in insurance, travel and BFS. Three of these are net new engagements. The deal pipeline is healthy even after four large closures in Q3, per management.

Valuations full: The stock is already trading above the maximum price set for the ensuing buyback (Rs 1,725/sh) and has rallied 34% since the Dec'19 buyback intimation. At 21.4x/18.4x FY21E/FY22E P/E, valuations are the highest among mid-cap IT services players and at 73% premium to its 5Y average. Cut to SELL.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	29,914	36,762	41,641	46,866	52,696
EBITDA (Rs mn)	5,012	6,453	7,243	8,575	9,642
Adj. net profit (Rs mn)	2,802	4,089	4,508	5,595	6,507
Adj. EPS (Rs)	45.4	66.2	73.0	90.6	105.3
Adj. EPS growth (%)	3.5	45.9	10.2	24.1	16.3
Adj. ROAE (%)	15.3	20.3	18.6	19.9	20.3
Adj. P/E (x)	42.8	29.3	26.6	21.4	18.4
EV/EBITDA (x)	23.3	18.0	15.7	12.7	10.8

Source: Company, BOBCAPS Research

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Earnings call highlights

- **Top clients:** Furloughs led to broader weakness during Q3FY20, especially among the top 10 clients. Also, one of NITEC's top clients from the BFS vertical witnessed a ramp-down, which added to the seasonal weakness. We highlight that this was the same account where management had indicated client-specific challenges. This account-specific weakness has bottomed out and the company expects growth to turn around on the back of large deal wins in Q3. Management stated that the company has gained market share from competing vendors in this account.
- **Operating margins:** Management reiterated its FY20 EBITDA margin guidance of ~18% (excluding one-off expenses reported in Q1FY20). Transition costs for large deals affected operating margins in Q3. Management does not expect recurrence of these expenses in Q4.
- **Payouts:** NITEC announced a second interim dividend of Rs 10/sh. This is in addition to the buyback worth Rs 3.37bn (for up to 3.1% of equity) announced in Dec'19. The company awaits shareholder approval for the buyback; in the interim, the stock is trading at 12.5% premium to the buyback price. The Board will decide the new course of action to deal with this unusual situation post conclusion of e-voting mid-February.
- **Europe:** NITEC's Europe exposure is concentrated around airlines, airports and insurance (specialty insurance). Brexit is not a cause for worry for the company (37% of revenue from Europe) – instead, it is looking to leverage the event as an opportunity to expand in continental Europe. Accordingly, it has invested to strengthen leadership and sales team in the region.
- **RoW:** Investments to strengthen the leadership in Australia and Singapore are yielding initial success. Over Q2-Q3FY20, NITEC has bagged US\$ 136mn worth of fresh orders from RoW markets (vs. US\$ 62mn over the same period last year), including a large deal win in Q3. Management pointed to similarity of RoW engagement terms to those in the US and Europe (on onsite/offshore mix and profitability).
- **Leadership:** NITEC continued to strengthen its leadership team, adding three senior executives, viz. (1) CFO, (2) Sales Head and (3) Digital Business Head.

FIG 1 – DEAL WINS

Date of deal win	No. of large deals (TCV)	Remarks
Dec'19	4 large deals (US\$ 20mn+)	1 each in insurance, travel, BFS verticals and APAC region
Sep'19	No large deal win	
Jun'19	3 (US\$ 10mn+ TCV deals)	2 in insurance vertical and 1 in travel
Mar'19	2 (US\$ 20mn+)	1 each in travel & transportation and insurance verticals
Dec'18	2 (US\$ 20mn+)	1 each in BFS and insurance verticals
Sep'18	2 (US\$20mn+ TCV deals) +3 (US\$10mn+ TCV deals)	<ul style="list-style-type: none"> ▪ US\$ 23mn deal with an existing BFS customer in the US ▪ US\$ 24mn deal with an existing insurance customer in the US ▪ 2 US\$ 10mn+ deals in the travel vertical ▪ US\$ 10mn+ deal from a commercial leasing and lending client
Jun'18	3 (US\$ 10mn+ TCV deals)	<ul style="list-style-type: none"> ▪ Onboarding and wealth management support expansion for a BFS client ▪ Driving data and digital transformation initiatives for one of the largest European airlines ▪ Product development support mandate from a key travel major
Mar'18	2 (US\$ 20mn+)	<ul style="list-style-type: none"> ▪ US\$ 35mn managed services contract from a new London-based client ▪ Deal win from an existing BFSI client
Dec'17	3 (US\$ 20mn+)	3 large deals in the US against tier-I competition, including 2 from the insurance vertical
Sep'17	1 (US\$ 20mn+)	Bagged a large contract from an existing US travel client
Jun'17	1 (US\$ 20mn+)	Signed a large multi-year engagement with an existing travel client in the US

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Revenue (US\$ mn)	151.2	134.8	12.2	148.7	1.7	438.5	390.1	12.4
Revenue (Rs mn)	10,734	9,717	10.5	10,385	3.4	30,746	27,040	13.7
Operating Expenditure	8,794	7,912	11.1	8,487	3.6	25,519	22,294	14.5
Cost of revenues	7,069	6,280	12.6	6,796	4.0	20,239	17,614	14.9
as % of sales	65.9	64.6	-	65.4	-	65.8	65.1	-
SG&A expenses	1,725	1,632	5.7	1,691	2.0	5,280	4,680	12.8
as % of sales	16.1	16.8	-	16.3	-	17.2	17.3	-
EBITDA	1,940	1,805	7.5	1,898	2.2	5,227	4,746	10.1
Depreciation	449	314	43.0	447	0.4	1,297	945	37.2
EBIT	1,491	1,491	-	1,451	2.8	3,930	3,801	3.4
Other Income	130	4	-	76	-	378	429	-
PBT	1,621	1,495	8.4	1,527	6.2	4,308	4,230	1.8
Total Tax	336	445	(24.5)	276	21.7	930	1,108	(16.1)
Adjusted PAT	1,285	1,050	22.4	1,251	2.7	3,378	3,122	8.2
(Profit)/loss from JV's/Ass/MI	52.0	49.0	-	56.0	-	130	144	-
APAT after MI	1,233	1,001	23.2	1,195	3.2	3,248	2,978	9.1
Extra ordinary items	0	0	-	0	-	57	0	-
Reported PAT	1,233	1,001	23.2	1,195	3.2	3,305	2,978	11.0
Reported EPS	19.8	16.2	22.2	19.3	2.4	52	48	8.7
Margins (%)			(bps)		(bps)			(bps)
EBITDA	18.1	18.6	(50)	18.3	(20)	17.0	17.6	(55)
EBIT	13.9	15.3	(145)	14.0	(8)	12.8	14.1	(127)
EBT	15.1	15.4	(28)	14.7	40	14.0	15.6	(163)
PAT	11.5	10.3	119	11.5	(2)	10.6	11.0	(45)
Effective Tax rate	20.7	29.8	(904)	18.1	265	21.6	26.2	(461)

Source: Company, BOBCAPS Research

FIG 3 – QUARTERLY OPERATING METRICS

Particulars	Q3FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Revenue by Geography			
North America	48	1.3	8.2
Europe	37	3.4	23.9
RoW	37	10.7	(7.9)
Revenue by Vertical			
Banking and Financial Services	16	(2.7)	17.8
Insurance	30	0.0	10.5
Transportation	29	7.1	23.2
Manufacturing & Retail	25	7.7	(4.8)
Revenue Mix			
Offshore	36	9.4	13.6
Onsite	64	0.2	8.8
Client Concentration			
Top 5	27	(3.8)	6.5
Non-Top 5 client	73	6.3	12.0
Top 10	36	(4.6)	(0.6)
Top 20	50	(0.6)	2.3
Non-Top 20 client	50	7.7	20.1
Number of employees	10,849	49	705
Attrition (%)	11.9	(40bps)	20bps
Utilisation	79.3	(140bps)	30bps
DSO	67	(6Days)	(2Days)
	Q3FY20	Q2FY20	Q3FY19
Significant New Customer Addition			
USA	6	7	8
Europe	2	1	0
ROW	2	2	2
Total	10	10	10
Fresh Order Intake (US\$ mn)			
USA	90	65	96
Europe	62	41	42
ROW	66	70	27
Total	218	176	165
Executable Order over next twelve months (US\$ mn)	424	405	375

Source: Company, BOBCAPS Research

Valuation methodology

Post the Dec'19 quarter results, we marginally raise FY21/FY22 EPS estimates by ~1% each. Rolling valuations forward, we have a revised Mar'21 target price of Rs 1,800 (vs. Rs 1,600 earlier), based on an unchanged one-year forward P/E multiple of 17x. While we acknowledge the improvement in operating performance led by management's initiatives toward predictable and profitable growth, we find risk-reward unfavourable at current valuations.

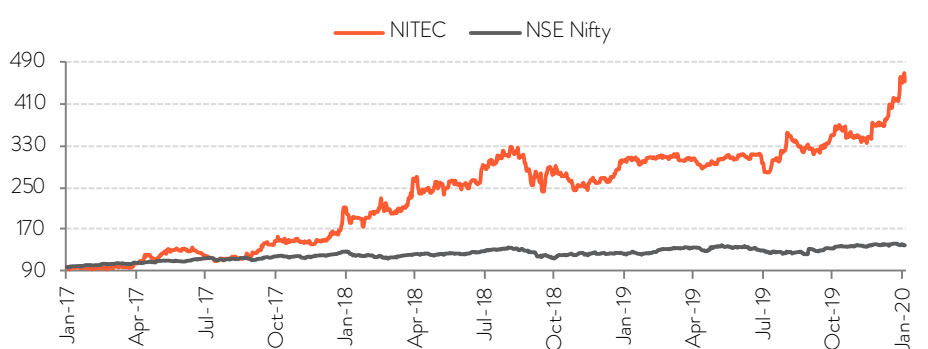
At the CMP of Rs 1,941, the stock is already trading above the maximum price set for the ensuing buyback (Rs 1,725/sh) and has rallied 34% since the Dec'19 buyback intimation. At 21.4x/18.4x FY21E/FY22E P/E, valuations are currently the highest amongst mid-cap IT services players and at ~25% and 73% premium to its average P/E under Baring ownership and five-year mean respectively. We downgrade the stock from ADD to SELL on full valuations.

FIG 4 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	591	594	0.6	663	670	1.1	745	753	1.0
YoY growth (%)	11.9	12.5	-	12.1	12.7	-	12.5	12.4	-
Revenues	41,264	41,641	0.9	46,377	46,866	1.1	52,154	52,696	1.0
EBITDA	7,273	7,243	(0.4)	8,486	8,575	1.1	9,543	9,642	1.0
EBITDA margins (%)	17.6	17.4	-	18.3	18.3	-	18.3	18.3	-
Net Profits	4,509	4,508	0.0	5,528	5,595	1.2	6,431	6,507	1.2
EPS (Rs)	73.0	73.0	0.0	89.5	90.6	1.2	104.1	105.3	1.2

Source: BOBCAPS Research

FIG 5 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks include:

- sharp rupee depreciation, and
- above-expected growth acceleration

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	29,914	36,762	41,641	46,866	52,696
EBITDA	5,012	6,453	7,243	8,575	9,642
Depreciation	1,273	1,248	1,727	1,798	1,944
EBIT	3,739	5,205	5,516	6,777	7,698
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	298	476	580	1,110	1,398
Exceptional items	0	0	0	0	0
EBT	4,037	5,681	6,096	7,887	9,096
Income taxes	950	1,404	1,368	1,932	2,228
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	285	188	220	360	360
Reported net profit	2,802	4,089	4,508	5,595	6,507
Adjustments	0	0	0	0	0
Adjusted net profit	2,802	4,089	4,508	5,595	6,507

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	5,115	6,345	7,187	8,089	9,095
Provisions	2,943	3,626	4,107	4,622	5,197
Debt funds	224	224	224	224	224
Other liabilities	455	455	455	455	455
Equity capital	615	615	615	615	615
Reserves & surplus	17,348	21,625	25,610	29,342	33,625
Shareholders' fund	17,963	22,240	26,225	29,957	34,240
Total liabilities and equities	26,700	32,890	38,198	43,348	49,212
Cash and cash eq.	4,102	8,726	13,344	17,774	22,890
Accounts receivables	5,911	7,352	8,328	9,373	10,539
Inventories	0	0	0	0	0
Other current assets	2,701	3,324	3,765	4,237	4,764
Investments	3,955	3,955	3,955	3,955	3,955
Net fixed assets	8,800	8,302	7,575	6,777	5,833
CWIP	7	7	7	7	7
Intangible assets	0	0	0	0	0
Deferred tax assets, net	1,231	1,231	1,231	1,231	1,231
Other assets	0	0	0	0	0
Total assets	26,700	32,890	38,198	43,348	49,212

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	4,199	5,525	6,455	7,753	8,811
Interest expenses	(34)	(476)	(580)	(1,110)	(1,398)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(128)	(151)	(94)	(100)	(112)
Other operating cash flows	(213)	0	0	0	0
Cash flow from operations	3,824	4,898	5,781	6,543	7,302
Capital expenditures	(879)	(750)	(1,000)	(1,000)	(1,000)
Change in investments	(290)	0	0	0	0
Other investing cash flows	(1,311)	476	580	1,110	1,398
Cash flow from investing	(2,480)	(274)	(420)	110	398
Equities issued/Others	66	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(810)	0	(744)	(2,222)	(2,584)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(744)	0	(744)	(2,222)	(2,584)
Changes in cash and cash eq.	600	4,624	4,618	4,431	5,115
Closing cash and cash eq.	4,102	8,726	13,344	17,774	22,890

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	45.4	66.2	73.0	90.6	105.3
Adjusted EPS	45.4	66.2	73.0	90.6	105.3
Dividend per share	15.0	0.0	10.0	29.9	34.8
Book value per share	290.8	360.0	424.5	484.9	554.2

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	3.9	3.2	2.7	2.3	2.0
EV/EBITDA	23.3	18.0	15.7	12.7	10.8
Adjusted P/E	42.8	29.3	26.6	21.4	18.4
P/BV	6.7	5.4	4.6	4.0	3.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	69.4	72.0	73.9	70.9	71.5
Interest burden (PBT/EBIT)	108.0	109.1	110.5	116.4	118.2
EBIT margin (EBIT/Revenue)	12.5	14.2	13.2	14.5	14.6
Asset turnover (Revenue/Avg TA)	116.5	123.4	117.2	114.9	113.9
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.4
Adjusted ROAE	15.3	20.3	18.6	19.9	20.3

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	7.4	22.9	13.3	12.5	12.4
EBITDA	6.9	28.8	12.2	18.4	12.4
Adjusted EPS	3.5	45.9	10.2	24.1	16.3
Profitability & Return ratios (%)					
EBITDA margin	16.8	17.6	17.4	18.3	18.3
EBIT margin	12.5	14.2	13.2	14.5	14.6
Adjusted profit margin	9.4	11.1	10.8	11.9	12.3
Adjusted ROAE	15.3	20.3	18.6	19.9	20.3
ROCE	12.6	18.1	19.8	25.6	30.8
Working capital days (days)					
Receivables	66	66	69	69	69
Inventory	0	0	0	0	0
Payables	107	132	128	127	129
Ratios (x)					
Gross asset turnover	3.5	4.3	5.2	6.5	8.4
Current ratio	1.6	1.9	2.3	2.5	2.7
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

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

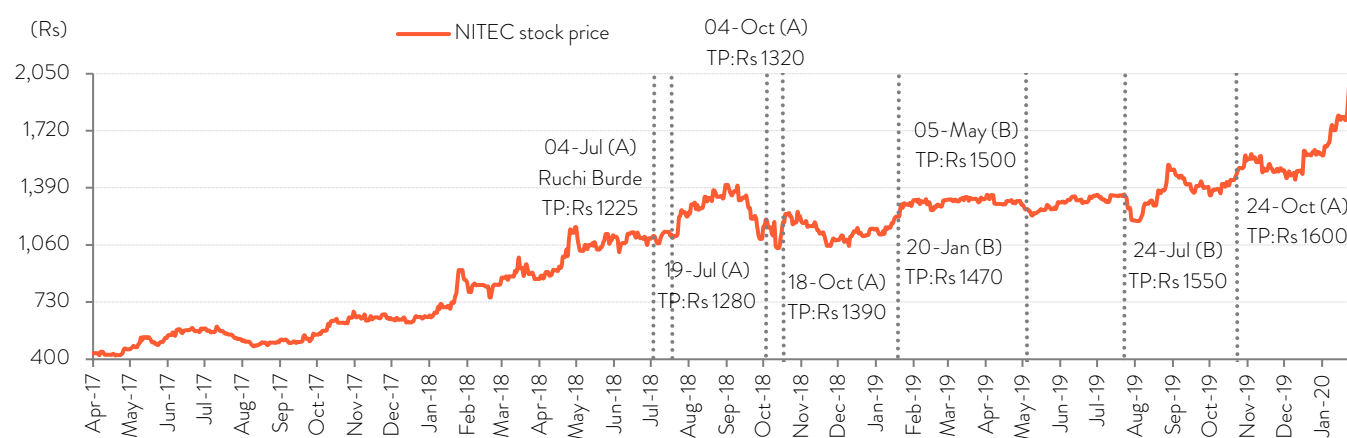
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: NIIT TECHNOLOGIES (NITEC IN)



B – Buy, A – Add, R – Reduce, S – Sell

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