

## NIIT Technologies Ltd

### A play on tech spend pick-up with cheap valuations; Buy

We initiate coverage on NIIT Technologies (NITEC) with a Buy rating and a December '10 price target of Rs 300/share, a 53% upside from current levels. NITEC is a second-tier Indian IT services company and is a play on the recovery in global technology spending. While its execution track record has been chequered in the past, a rapidly improving technology spending environment, significant order wins in Q4FY10 that would ramp-up over the next 6–9 months, cheap valuations and good corporate governance make the stock attractive in our view. On a sector basis, we continue to favour second-liners given low expectations and cheap valuations. Polaris and NITEC are our top picks in this space.

**A mid-sized plain vanilla Indian IT services play:** NITEC focuses on the BFSI and transportation verticals (73% of revenues) where it provides end-to-end solutions and has established relationships with several large customers such as ING, BA and Singapore Airlines. The company had also tried to differentiate itself though extra focus on Europe (~50% of revenues in 2009). While relationships with large customers and focus on transportation helped NITEC somewhat, excessive Europe focus led to 15% drop in revenues in 2QFY09-1QFY10 period. However business has begun to recover in the last few quarters with steady growth in 2QFY10-4QFY10 period driven by APAC and India revenues and transportation vertical.

**Steady improvement in metrics over last three quarters:** NITEC has focused on operational improvements during the downturn, leading to – 1) A gradual increase in offshore mix, 2) Margin improvement through FY10 with the fiscal's EBITDA margin up 270bps YoY to 20.7%, 3) Steady cash generation (net cash at Rs 1.7bn or Rs 29/share), 4) An inching down of receivable days towards 70 by Q4FY10, 5) Continued uptick in order flows over the last few quarters with a boost from a Rs 2.3bn (~US\$ 50mn) contract from India's Border Security Force (BSF) in Q4FY10.

**Decent business outlook:** The BSF contract is expected to drive growth in H1FY11 followed by stronger traction from other clients. But margins are likely to trend down due to higher salaries, rupee appreciation and a large portion of low-margin hardware business in the BSF contract. We thus expect ~300bps QoQ margin downtick in Q1FY11 followed by a gradual uptick in H2FY11. On the whole, we estimate a 15%/12%/12% revenue/EBITDA/EPS CAGR over FY10-FY12. Although we expect NITEC's growth to continue to lag top-tier names given its smaller size, we do think it will benefit from the overall upturn, leading to accelerated growth.

**Valuations attractive, despite a modest outlook:** The stock is currently at FY11E/FY12E P/E of 8x/7x. We believe this is due to low expectations, limited analyst and investor coverage, and a general scepticism towards IT second-liners. We expect this view to change over the next 9–12 months as NITEC delivers growth ahead of expectations. Further, good return metrics (ROE of 22%, ROIC of 27%, FCF yield of 10%) would provide downside support, in our view.

#### Financial highlights

(Rs mn)	FY09	FY10	FY11E	FY12E
Revenue	9,800	9,138	10,503	12,038
Growth (%)	4.1	(6.8)	14.9	14.6
Adj net income	1,149	1,264	1,381	1,599
Growth (%)	(15.1)	10.0	9.2	15.8
FDEPS (Rs)	19.6	21.5	23.5	27.2
Growth (%)	(15.1)	9.9	9.1	15.8

#### Profitability and return ratios

(%)	FY09	FY10	FY11E	FY12E
EBITDA margin	18.0	20.7	19.5	19.7
EBIT margin	13.7	16.7	15.9	15.5
Adj PAT margin	11.7	13.8	13.1	13.3
ROE	27.7	26.1	22.0	21.9
ROIC	29.4	31.0	27.1	26.2
ROCE	24.3	26.2	21.9	19.5

CMP	TARGET	RATING	RISK
Rs 196	Rs 300	BUY	MEDIUM

BSE	NSE	BLOOMBERG
532541	NIITTECH	NITEC IN

#### Company data

Market cap (Rs mn / US\$ mn)	11,569 / 257
Outstanding equity shares (mn)	59
Free float (%)	56.4
Dividend yield (%)	-
52-week high/low (Rs)	204 / 73
2-month average daily volume	400,735

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
NIIT Tech	196	15.9	15.1	36.9
CNX IT	5,795	(2.6)	4.0	14.4
Sensex	16,984	(5.3)	6.7	3.3

#### Valuation matrix

(x)	FY09	FY10	FY11E	FY12E
P/E @ CMP	10.1	9.1	8.4	7.2
P/E @ Target	15.3	13.9	12.8	11.0
EV/EBITDA	5.6	5.2	4.8	4.2

#### RCML vs consensus

Parameter	FY11E		FY12E	
	RCML	Cons	RCML	Cons
Sales (Rs mn)	10,503	10,930	12,038	12,423
EPS (Rs)	24	26	27	27





Fig 1 - NIIT Tech – Quarterly model

(Rs mn, year-end March)	2010				2011E				2012E				2009	2010	2011E	2012E	2013E
	1Q	2Q	3Q	4Q	1QE	2QE	3QE	4QE	1QE	2QE	3QE	4QE					
<b>Revenue</b>	<b>2,182</b>	<b>2,263</b>	<b>2,301</b>	<b>2,392</b>	<b>2,480</b>	<b>2,569</b>	<b>2,681</b>	<b>2,773</b>	<b>2,866</b>	<b>2,962</b>	<b>3,057</b>	<b>3,153</b>	<b>9,800</b>	<b>9,138</b>	<b>10,503</b>	<b>12,038</b>	<b>13,680</b>
Depreciation	95	90	89	86	85	90	98	106	115	123	132	141	420	360	379	511	672
COGS (Excl. dep)	1,345	1,314	1,324	1,409	1,544	1,595	1,638	1,694	1,766	1,819	1,871	1,924	6,167	5,392	6,471	7,380	8,413
<b>Gross Profit</b>	<b>742</b>	<b>859</b>	<b>888</b>	<b>897</b>	<b>851</b>	<b>884</b>	<b>945</b>	<b>972</b>	<b>986</b>	<b>1,020</b>	<b>1,054</b>	<b>1,088</b>	<b>3,213</b>	<b>3,386</b>	<b>3,653</b>	<b>4,148</b>	<b>4,595</b>
Operating Expense	443	490	470	454	459	488	509	527	545	563	581	599	1,868	1,857	1,983	2,287	2,531
EBIT	299	369	418	443	392	396	436	446	441	457	473	489	1,345	1,529	1,669	1,860	2,064
EBITDA	394	459	507	529	477	486	534	552	556	580	605	630	1,765	1,889	2,049	2,372	2,736
Net Other Income	-84	16	-15	-25	-31	-26	-2	4	41	47	53	59	47	-108	-55	200	270
Pre Tax Profit	215	385	403	418	362	370	434	449	482	504	526	548	1,392	1,421	1,615	2,060	2,334
Tax	37	62	48	-3	51	52	61	63	106	111	116	121	225	144	226	453	514
<b>Net Profit</b>	<b>176</b>	<b>322</b>	<b>353</b>	<b>413</b>	<b>309</b>	<b>316</b>	<b>371</b>	<b>384</b>	<b>374</b>	<b>391</b>	<b>408</b>	<b>426</b>	<b>1,149</b>	<b>1,264</b>	<b>1,381</b>	<b>1,599</b>	<b>1,813</b>
EPS (Rs)	3.0	5.5	6.0	7.0	5.3	5.4	6.3	6.5	6.4	6.7	6.9	7.2	19.6	21.5	23.5	27.2	30.8
<b>Margins (%)</b>																	
Gross Margin	34.0	38.0	38.6	37.5	34.3	34.4	35.2	35.1	34.4	34.4	34.5	34.5	32.8	37.1	34.8	34.5	33.6
Operating Margin	13.7	16.3	18.2	18.5	15.8	15.4	16.2	16.1	15.4	15.4	15.5	15.5	13.7	16.7	15.9	15.5	15.1
EBITDA Margin	18.1	20.3	22.0	22.1	19.2	18.9	19.9	19.9	19.4	19.6	19.8	20.0	18.0	20.7	19.5	19.7	20.0
Net Margin	8.1	14.2	15.3	17.3	12.5	12.3	13.8	13.9	13.1	13.2	13.4	13.5	11.7	13.8	13.1	13.3	13.3
<b>Sequential Growth (%)</b>																	
Revenue	(3.9)	3.7	1.7	4.0	3.7	3.6	4.4	3.4	3.4	3.3	3.2	3.1	4.1	(6.8)	14.9	14.6	13.6
Gross Profit	0.1	15.8	3.4	1.1	(5.2)	3.9	6.9	2.9	1.4	3.5	3.4	3.2	(1.8)	5.4	7.9	13.6	10.8
EBIT	(1.6)	23.4	13.3	6.0	(11.4)	0.9	10.0	2.3	(1.0)	3.6	3.5	3.4	(2.1)	13.7	9.2	11.4	11.0
EBITDA	(2.5)	16.5	10.5	4.3	(9.8)	1.9	9.7	3.4	0.7	4.4	4.3	4.2	0.1	7.0	8.5	15.7	15.4
Net Profit	(33.1)	83.0	9.6	17.0	(25.2)	2.3	17.4	3.5	(2.6)	4.5	4.4	4.2	(15.1)	10.0	9.2	15.8	13.4
EPS	(33.1)	83.0	9.4	17.0	(25.2)	2.3	17.4	3.5	(2.6)	4.5	4.4	4.2	(15.1)	9.9	9.2	15.8	13.4
<b>Y/Y Growth (%)</b>																	
Revenue	(11.2)	(12.5)	(7.4)	5.4	13.7	13.5	16.5	15.9	15.6	15.3	14.0	13.7	4.1	(6.8)	14.9	14.6	13.6
Gross Profit	(6.9)	3.5	5.1	21.1	14.7	2.9	6.4	8.3	15.8	15.4	11.5	11.9	(1.8)	5.4	7.9	13.6	10.8
EBIT	(13.1)	3.9	22.2	45.7	31.2	7.3	4.2	0.6	12.4	15.4	8.6	9.8	(2.1)	13.7	9.2	11.4	11.0
EBITDA	(13.6)	0.0	13.7	30.9	21.1	6.0	5.3	4.3	16.5	19.3	13.4	14.3	0.1	7.0	8.5	15.7	15.4
Net Profit	(49.9)	(12.3)	110.1	57.0	75.6	(1.8)	5.2	(7.0)	21.1	23.7	10.0	10.7	(15.1)	10.0	9.2	15.8	13.4
EPS	(49.9)	(12.3)	109.8	56.8	75.3	(2.0)	5.2	(7.0)	21.1	23.7	10.0	10.7	(15.1)	9.9	9.2	15.8	13.4

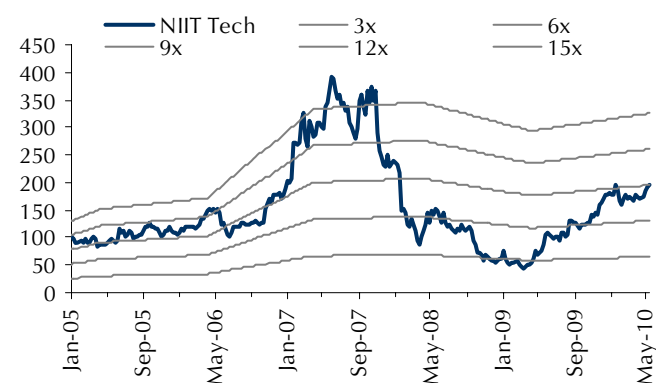
Source: Company, RCML Research



## Valuation

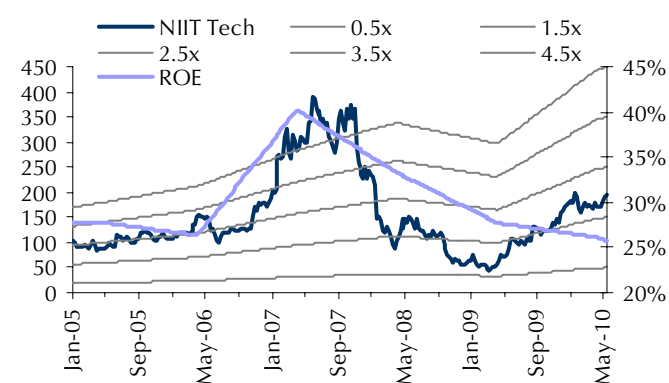
Our December '10 price target of Rs 300 is based on 11x 12-month forward EPS, which is slightly below our other mid cap target multiples mainly due to NITEC's smaller market cap and slower EPS growth trajectory of 12% over the next two years. On a DCF basis, the December '10 fair value is Rs 325, assuming a 10-year revenue CAGR of 10%, a long-term EBIT margin of 15%, average ROIC of 27% and a WACC of 11.1%. We have assumed terminal growth of 3%.

Fig 2 - NIIT Tech – 12m Fwd P/E bands



Source: Company data, RCML Research

Fig 3 - NIIT Tech – 12m Fwd P/B bands



Source: Company data, RCML Research



## Consolidated financials

### Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
<b>Revenues</b>	<b>9,138</b>	<b>10,503</b>	<b>12,038</b>	<b>13,680</b>
Growth (%)	(6.8)	14.9	14.6	13.6
<b>EBITDA</b>	<b>1,889</b>	<b>2,049</b>	<b>2,372</b>	<b>2,736</b>
Growth (%)	7.0	8.5	15.7	15.4
Depreciation & amortisation	360	379	511	672
EBIT	1,529	1,669	1,860	2,064
Growth (%)	13.7	9.2	11.4	11.0
Interest	-	-	-	-
Other income	(108)	(55)	200	270
EBT	1,421	1,615	2,060	2,334
Income taxes	144	226	453	514
Effective tax rate (%)	10.1	14.0	22.0	22.0
Extraordinary items	-	-	-	-
Min into / inc from associates	(13)	(8)	(8)	(8)
Reported net income	1,264	1,381	1,599	1,813
Adjustments	-	-	-	-
<b>Adjusted net income</b>	<b>1,264</b>	<b>1,381</b>	<b>1,599</b>	<b>1,813</b>
Growth (%)	10.0	9.2	15.8	13.4
Shares outstanding (mn)	58.8	58.8	58.8	58.8
<b>FDEPS (Rs) (adj)</b>	<b>21.5</b>	<b>23.5</b>	<b>27.2</b>	<b>30.8</b>
Growth (%)	9.9	9.1	15.8	13.4

### Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	1,624	1,760	2,110	2,484
Non-cash adjustments	0	0	0	0
Changes in working capital	(1,832)	(143)	(143)	(162)
Cash flow from operations	(208)	1,617	1,967	2,322
Capital expenditure	(343)	(488)	(595)	(763)
Change in investments	0	0	0	0
Other investing cash flow	328	0	0	0
Cash flow from investing	(15)	(488)	(595)	(763)
Issue of equity	1	(0)	(0)	(0)
Issue/repay debt	(131)	0	0	0
Dividends paid	0	(441)	(441)	(441)
Other financing cash flow	663	(0)	(0)	0
Change in cash & cash eq	310	688	931	1,119
Closing cash & cash eq	1,895	2,583	3,513	4,632

### Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	11.1	11.1	11.1	11.1
ROIC (%)	31.0	27.1	26.2	27.2
Invested capital (Rs mn)	5,062	5,450	5,831	6,249
EVA (Rs mn)	1,004	870	878	1,006
EVA spread (%)	19.8	16.0	15.1	16.1

### Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	1,895	2,583	3,513	4,632
Accounts receivable	1,851	2,146	2,440	2,773
Inventories	0	0	0	0
Other current assets	1,250	1,449	1,648	1,873
Investments	0	0	0	0
Gross fixed assets	4,465	4,953	5,548	6,311
Net fixed assets	3,140	3,249	3,333	3,424
CWIP	0	0	0	0
Intangible assets	0	0	0	0
Deferred tax assets, net	0	0	0	0
Other assets	107	107	107	107
<b>Total assets</b>	<b>8,243</b>	<b>9,533</b>	<b>11,041</b>	<b>12,809</b>
Accounts payable	0	0	0	0
Other current liabilities	2,200	2,550	2,900	3,296
Provisions	0	0	0	0
Debt funds	217	217	217	217
Other liabilities	28	28	28	28
Equity capital	588	588	588	588
Reserves & surplus	5,210	6,150	7,308	8,680
Shareholder's funds	5,798	6,738	7,896	9,268
<b>Total liabilities</b>	<b>8,243</b>	<b>9,533</b>	<b>11,041</b>	<b>12,809</b>
BVPS (Rs)	99	115	134	158

### Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
<b>Profitability &amp; Return ratios (%)</b>				
EBITDA margin	20.7	19.5	19.7	20.0
EBIT margin	16.7	15.9	15.5	15.1
Net profit margin	13.8	13.1	13.3	13.3
ROE	26.1	22.0	21.9	21.1
ROCE	26.2	21.9	19.5	18.6
<b>Working Capital &amp; Liquidity ratios</b>				
Receivables (days)	73.9	74.6	74.0	74.0
Inventory (days)	n.m	n.m	n.m	n.m
Payables (days)	n.m	n.m	n.m	n.m
Current ratio (x)	2.3	2.4	2.6	2.8
Quick ratio (x)	1.7	1.9	2.1	2.2
<b>Turnover &amp; Leverage ratios (x)</b>				
Gross asset turnover	2.1	2.2	2.3	2.3
Total asset turnover	1.1	1.2	1.2	1.1
Interest coverage ratio	n.m	n.m	n.m	n.m
Adjusted debt/equity	0.0	0.0	0.0	0.0
<b>Valuation ratios (x)</b>				
EV/Sales	1.1	0.9	0.8	0.7
EV/EBITDA	5.2	4.8	4.2	3.6
P/E	9.1	8.4	7.2	6.4
P/BV	2.0	1.7	1.5	1.2



**Quarterly trend**

Particulars	Q2FY10	Q3FY10	Q4FY10	Q1FY11E	Q2FY11E
Revenue (Rs mn)	2,263	2,301	2,392	2,480	2,569
YoY growth (%)	(12.5)	(7.4)	5.4	13.7	13.5
QoQ growth (%)	3.7	1.7	4.0	3.7	3.6
EBITDA (Rs mn)	369	418	443	392	396
EBITDA margin (%)	16.3	18.2	18.5	15.8	15.4
Adj net income (Rs mn)	322	353	413	309	316
YoY growth (%)	(12.3)	110.1	57.0	75.6	(1.8)
QoQ growth (%)	83.0	9.6	17.0	(25.2)	2.3

**DuPont analysis**

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	82.5	89.0	85.5	77.6	77.7
Interest burden (PBT/EBIT)	103.5	92.9	96.7	110.8	113.1
EBIT margin (EBIT/Revenues)	13.7	16.7	15.9	15.5	15.1
Asset turnover (Revenues/Avg TA)	1.3	1.1	1.2	1.2	1.1
Leverage (Avg TA/Avg equitiy)	1.9	1.7	1.4	1.4	1.4
<b>Return on equity</b>	<b>27.7</b>	<b>26.1</b>	<b>22.0</b>	<b>21.9</b>	<b>21.1</b>

**Company profile**

NIIT Technologies is a mid-sized plain vanilla Indian IT services play with a focus on the BFSI and transportation verticals. NITEC provides end-to-end solutions in these domains and has built relationships with several large customers such as ING, BA and Singapore Airlines.

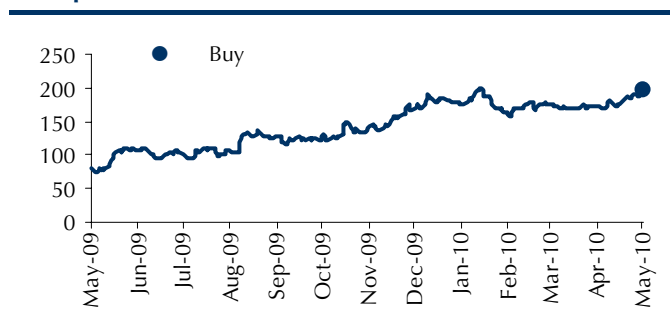
**Shareholding pattern**

(%)	Sep-09	Dec-09	Mar-10
Promoters	39.6	39.6	39.6
FIIIs	11.7	15.4	18.2
Banks & FIIs	8.1	10.4	9.8
Public	40.6	34.5	32.4

**Recommendation history**

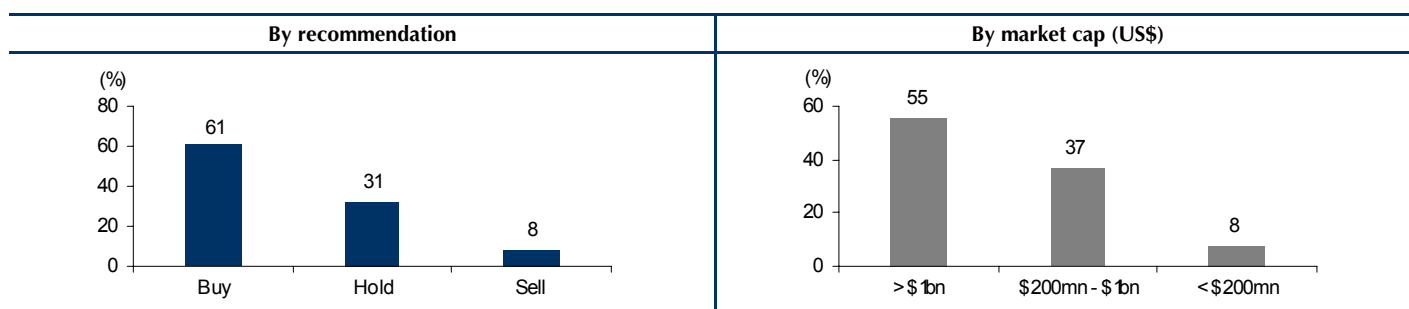
Date	Event	Reco price	Tgt price	Reco
10-May-10	Initiating Coverage	196	300	Buy

**Stock performance**





### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

### Religare Capital Markets Ltd

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