Equity Research
March 28, 2012
BSE Sensex: 17257

INDIA

NIIT Technologies

BUY

Re-rating on the cards

Rs240

Reason for report: Initiating coverage

Technology

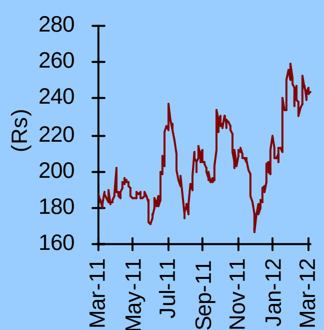
Target price Rs313

Shareholding pattern

	Jun '11	Sep '11	Dec '11
Promoters	38.9	39.0	39.2
Institutional investors	31.1	31.6	35.9
MFs/UTI/FI's	6.2	7.6	11.0
Insurance Cos.	-	-	1.4
FIIs*	24.9	24.0	23.5
Others	30.0	29.4	24.9

Source: www.nseindia.com
*Includes Foreign VCs

Price chart



We initiate coverage on NIIT Technologies (NIIT Tech) with BUY recommendation and target price of Rs313, implying an upside of 30%, based on 8x average of FY13-14E EPS. We believe that the company's recent large deal wins and strong executable order book lend increased revenue visibility to it among mid-cap IT peers amid current global macro uncertainties. Improvement in margins of these large deals led by increased offshoring and non-occurrence of transition costs would aid margin performance in FY13E, besides the traditional margin levers. Whereas the stock has historically traded at ~7x one year forward EPS owing to perceived low revenue visibility and quality of earnings, we believe the stock is likely to re-rate on the back of (a) improved revenue visibility (9MFY12 fresh order bookings up 140% YoY and 12-month executable order book up 80% YoY), (b) consistent industry-leading performance – revenue and PAT registered 31% and 26% CAGR over FY10-12E, (c) change in business mix – increase in the share of so-called non-linear revenue from 25% to 30% over the next one year, (d) maintenance / improvement in EBITDA margin from the current level of 17-18%, and (e) the company turning FCF positive in FY13E.

- **Large order wins and strong order book lend better revenue visibility** amid current global macro uncertainties. NIIT Tech 9MFY12 fresh order bookings are up 140% YoY to US$360mn and the 12-month executable order book is up 80% YoY to US$245mn. Historically, the company has been booking revenue in the ratio of 1.8-2x its orderbook and our FY13E revenue estimate of US$392mn conservatively factors this ratio at 1.6x.
- **Strategy to focus on select verticals paying off:** Long-term (10-15 years) relationship with key clients and domain execution capabilities in select verticals of travel and transportation and insurance (60%+ of revenue) provide stickiness to its annuity-based revenue.
- **Margins to sustain at current level,** despite factoring wage inflation and impact of rupee appreciation, if any. Increased offshoring and non-occurrence of transition costs in some of the recent large deals would cushion margin erosion in FY13E. Higher proportion of non-linear revenue (IP-based revenue plus IMS), change in employee pyramid, and rationalisation of S,G&A costs are other margin levers.
- **Valuations at 6.4xFY13E P/E and 3.8xEV/E undemanding,** given healthy sustainable 17-18% EBITDA margin, consistent +20% RoE and ex-cash RoEs of 30% and attractive dividend yield of 3.1% (Rs7.5-8/share). We factor in revenue/EBITDA CAGR of 15% and EPS CAGR of 10% over FY12-14E.

Market Cap	Rs14.1bn/US$276mn
Reuters/Bloomberg	NITT.NS/NITEC.IN
Shares Outstanding (mn)	59
52-week Range (Rs)	260/167
Free Float (%)	60.8
FII (%)	23.5
Daily Volume (US$'000)	569
Absolute Return 3m (%)	35.0
Absolute Return 12m (%)	30.0
Sensex Return 3m (%)	9.7
Sensex Return 12m (%)	(8.9)

Year to March	FY11	FY12E	FY13E	FY14E
Revenue (Rs mn)	12,323	15,764	19,291	20,881
Net Income (Rs mn)	1,822	2,018	2,204	2,431
EPS (Rs)	30.9	34.0	37.2	41.0
% Chg YoY	44.3	10.1	9.2	10.3
P/E (x)	7.8	7.0	6.4	5.8
CEPS (Rs)	36.3	40.0	45.1	49.8
EV/E (x)	5.3	4.7	3.8	3.5
Dividend Yield (%)	3.1	3.1	3.1	3.1
RoCE (%)	23.3	17.8	18.9	17.3
RoE (%)	24.4	22.2	20.5	19.2

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Large order wins and strong order book lend better revenue visibility

NIIT Tech's 9MFY12 fresh order bookings are up 140% YoY to US$360mn, whereas next 12-month executable order book is up 80% YoY to US$245mn versus FY11 and 9MFY12 revenues of US$245mn and US$242mn respectively. Historically, the company has been booking revenue in the ratio of 1.8-2x its next 12-month executable orderbook and our FY13E revenue estimate of US$392mn conservatively factors this ratio at 1.6x. Some of the recent large deal wins by the company have been tabulated below:

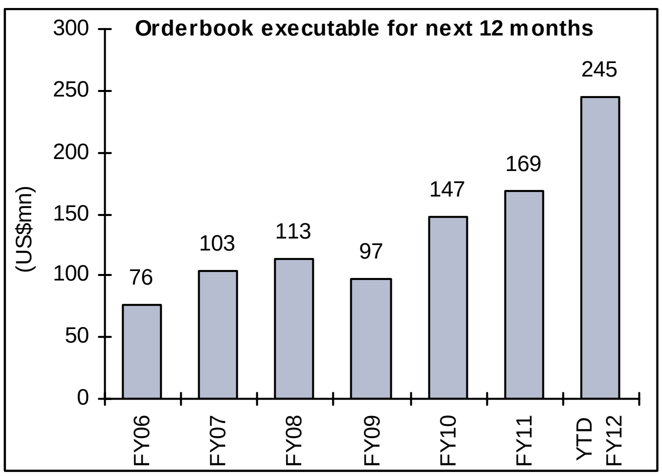
Table 1: Recent large deal wins by NIIT Tech

Clients	Period	Size (US$mn)	Tenure (years)
Eurostar	Q1FY12	~25	5
JV with Morris Communications	Q2FY12	85	5
CCTNS – Tamil Nadu and Jharkhand	Q2FY12	45	2
Leading European Airline (renewal)	Q3FY12	~30	N.A.
CCTNS – Uttar Pradesh, India	Q4FY12	15	2
Total		**200**	

Source: Company data, I-Sec research

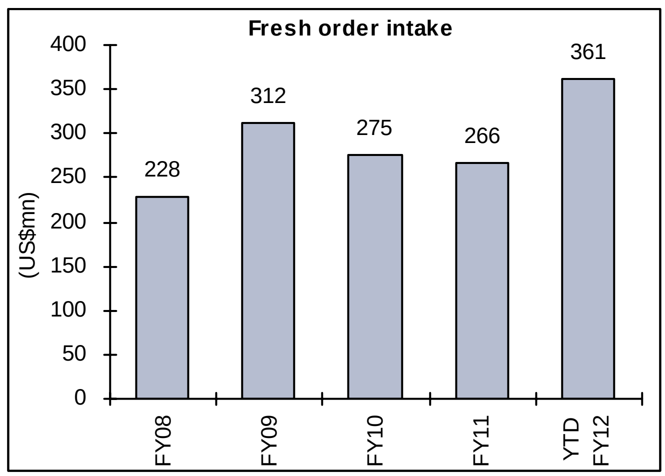
Many of these deals have been won in the face of stiff competition both from global and Indian majors, demonstrating NIIT Tech's vast experience and domain expertise.

Chart 1: Healthy executable orderbook



Source: Company data, I-Sec research

Chart 2: Strong new order bookings



Source: Company data, I-Sec research

Eurostar deal – estimated at US$25mn+ over five years

NIIT Tech won a remote infrastructure management services (RIMS) deal from Eurostar, the high-speed train services between the UK and mainland Europe in Q1FY12. Its scope includes design and setting up a new WAN connecting all Eurostar offices and stations. NIIT Tech would provide multi-lingual support in UK, France, Belgium, Switzerland and the Netherlands. 17 transformational projects would be executed resulting in gearing up of IT infrastructure in time for the London Olympics 2012. This SLA based outsource service would result in increasing the share of non-linear revenues for NIIT Tech.

Morris deal – joint venture – US$85mn over five years

NIIT Tech entered into a joint venture (JV) with Morris Communications (Morris), a US-based privately held media company, to provide integrated IT and Business Process Outsourcing (BPO) services for US$85mn over five years. Since Morris wanted its patents to stay under its purview, the JV mode was adopted.

How much will it cost NIIT Tech?

- The JV (NMTL) entails an investment of US$3.2mn by NIIT Tech for 60% ownership, whereas the remaining 40% will be owned by Morris which has transferred its IT assets (including patents) and ~100 employees to the JV.
- NMTL has incurred a one-time expense of US$2.5mn in Q2FY12 towards professional fees (advisor's fees) and transition expenses.

What is there for NIIT Tech?

- Revenues of US$85mn over the next five years wherein NIIT Tech will take the processes offshore w.e.f Q1FY13E and bill the JV, which in turn will bill Morris.
- The JV has opportunity to cross-sell beyond Morris.
- Margins will improve from Q1FY13E when the transition of work to offshore will be completed. Almost 100 onsite employees of the JV would be replaced by NIIT Tech's offshore employees and margins would be retained at company level rather than at JV.
- We expect EBITDA margin in excess of 20% from Q1FY13E in Morris deal.

Crime and Criminal Tracking Network & Systems (CCTNS) deal – US$60mn over the next two years

CCTNS is one of the most important mission mode programmes under the National e-Governance Plan (NeGP), Government of India. NIIT Tech has leveraged its experience of successful implementation of IT solutions for defence and paramilitary forces to develop this system. After setting up a similar system for the Border Security Force, CCTNS is now being implemented for individual states. As of now, NIIT Tech has won bid for three states – Tamil Nadu, Jharkhand, and Uttar Pradesh comprising a deal size of ~US$60mn to be executed over four phases of six months each.

What is there for NIIT Tech?

In general, these deals comprise 70% hardware / pass through revenues, which can impact both the margins and the working capital of NIIT Tech. We believe that NIIT Tech has made back-to-back arrangement for credit with some of its vendors, whereas the remaining would be funded through internal accruals. Further, leveraging its experience in the BSF deal, the whole deal is structured into four phases of six months each so that receivable days do not exceed beyond 180 days.

Acquisition – Proyecta Sistemas – US$10mn

In August 2011, NIIT Tech acquired Proyecta Sistemas (Proyecta), a Spanish IT services company, to expand its European footprint in travel and finance industry. With annual revenues of ~US$10mn and EBITDA margin at ~10%, Proyecta has an employee base of ~100.

How much will it cost NIIT Tech?

- The enterprise value is set at 0.7x revenues i.e.US$7mn. Of this, 80% has been paid upfront whereas the balance will be performance-related payouts to the incumbent management over the period of next two years.

What is there for NIIT Tech?

- Proyecta derives 68% of its revenues from the travel segment and 23% from the BFSI vertical.
- Proyecta has given NIIT Tech an entry into marquee clientele like Iberia (which got merged with British Airways to form IAG i.e. International Airlines Group) and travel related companies like Solimat and Pullmantur. Within BFSI, its clients comprise Merrill Lynch and Spanish banks like Satander and BBVA.
- Proyecta's expertise in Customer Relationship Management (CRM), business Intelligence, revenue / yield management, web applications, mobility etc would be accretive to service capabilities of NIIT Tech.
- Proyecta contributed Rs75mn during Q2FY12 wherein its revenues were recognised for a month and a half. The contribution doubled QoQ during Q3FY12 to Rs151mn owing to impact of full quarter. As Q3FY12 is a seasonally strong quarter, we expect the contribution to decline QoQ to Rs128mn during Q4FY12.

Table 2: Break-up of revenue

(Rs mn)

	Q1FY12	Q2FY12	Q3FY12	Q4FY12E	FY12E	FY13E	FY14E
Eurostar	50	63	63	63	238	251	250
Morris	-	75	243	245	563	907	798
Proyecta	-	75	151	128	354	530	511
CCTNS	12	-	89	160	261	1,320	1,500
NIIT Insurance - ROOM	382	398	426	383	1,589	1,545	1,626
GIS (15%)	199	264	231	300	994	1,167	1,251
Managed services	427	482	541	553	2,003	2,335	2,515
BPO	164	130	152	155	601	636	657
Other IT Services	2,054	2,225	2,435	2,449	9,162	10,601	11,773
Total revenue	**3,288**	**3,711**	**4,330**	**4,435**	**15,764**	**19,291**	**20,881**
Change (%)		*12.9*	*16.7*	*2.4*		*22.4*	*8.2*
Total Revenue (US$mn)	**73.8**	**82.4**	**85.4**	**87.6**	**329.2**	**391.9**	**444.3**
Change (%)		*11.7*	*3.6*	*2.7*		*19.0*	*13.4*

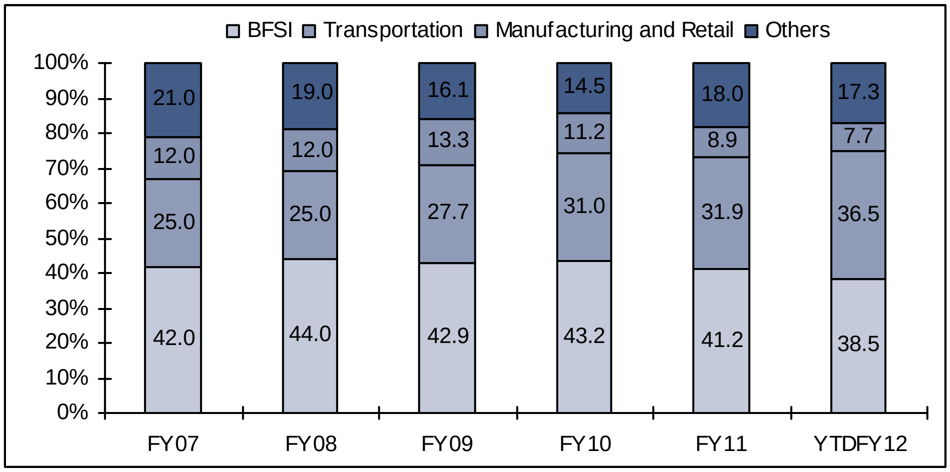
Source: Company data, I-Sec research

Strategy to focus on select verticals paying off

Travel and transportation and insurance gaining increased traction

While many of the other mid-cap IT companies have carved a niche for themselves in terms of their offerings such as Infotech Enterprise for Product Engineering, Persistent Systems for Outsourced Products Development, and Hexaware Technologies for Enterprise Applications, NIIT Tech has chosen to focus on select verticals of BFSI, Travel and Transportation, and Manufacturing. The combined share of these verticals has gradually increased from 79% to 83% over past 5-6 year.

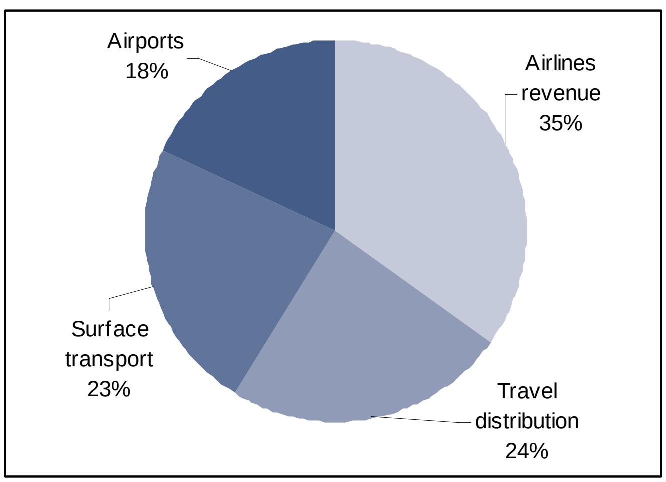
Chart 3: Share of focussed verticals inching up



Source: Company data, I-Sec research

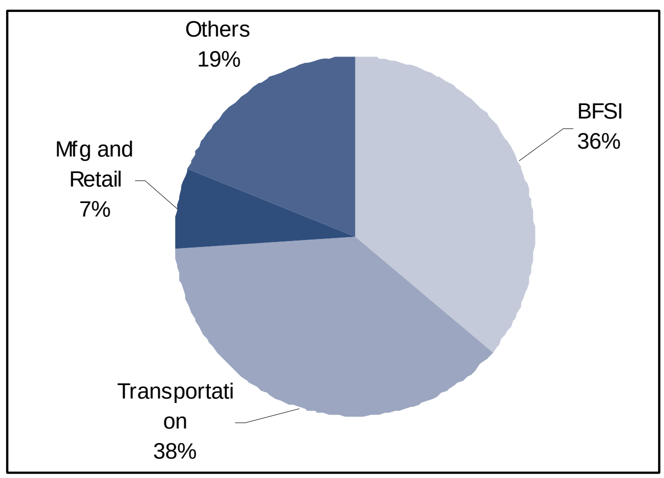
Within travel and transportation (which contributes 38% of revenue in Q3FY12), NIIT Tech has strongly positioned itself into airline (35%), airports(18%), travel distributors (24%) and surface transport (23%). The above contribution is slated to go up with Proyecta's acquisition, which brings Iberia (merged with British Airways) as a client and further scope to penetrate other airlines within Europe.

Chart 4: Break-up of revenue in transportation



Source: Company data, I-Sec research

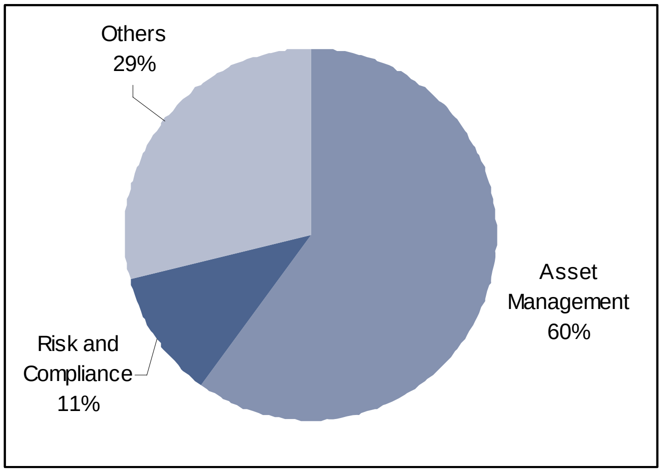
Chart 5: Vertical-wise break-up of revenue



Q3FY12, Source: Company data, I-Sec research

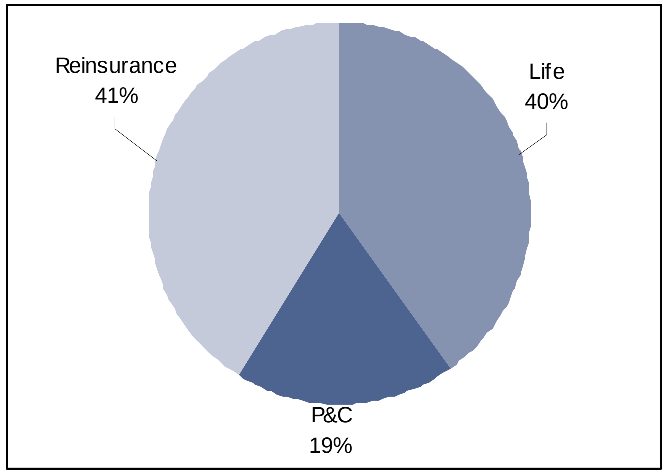
Though the company has presence in the overall BFSI space (which contributes 36% of revenue in Q3FY12), it has a strong foothold in insurance (2/3rd of BFSI revenue). Within the insurance vertical, the company has built expertise in areas of life insurance, pensions, annuity, non-life insurance, policy administration, claims management, and reinsurance by working with global insurance providers. Reinsurance and life companies contribute 41% and 40% respectively.

Chart 6: Break-up of revenue in BFS



Source: Company data, I-Sec research

Chart 7: Break-up of revenue in insurance



Source: Company data, I-Sec research

In the BFS segment, asset management comprises 60%, with risk and compliance forming just 11%.

Strengthening the front-end sales team

NIIT Tech has strengthened its sales and marketing team over the past 12 months by hiring senior sales personnel from competition like iGATE Patni, Mahindra Satyam and Hexaware Technologies. The sales and marketing team has been ramped up to 80+ employees from ~70 employees over the past 12-18 months.

Table 3: Strengthening the front-end sales team

Name	Designation	Date of joining	Previous organisation
John Pierce	SVP-Insurance and Healthcare	Q1FY12	STA Group
Deepak Khosla	Global head – Sales and Marketing	Q1FY12	Patni Computers
Sujan Kotian	Vice President and Regional Leader-Central Europe	Q1FY12	HCL Technologies
DV Subramaniam	Vice President and Country Manager – Netherlands	Q4FY11	Mastek
Carlos Ramirez	Country Manager, Belgium	Q4FY11	AXA Insurance
Ravi Nimmagadda	BFS Head, US	Q4FY11	Mahindra Satyam
Sunil Surya	President, Europe	Q2FY11	Hexaware

Source: Company data, I-Sec research

Long-term relationship with clients

NIIT Tech has always been adept at maintaining and mining clients. Keeping its focus on its niche verticals, it has developed long-term partnerships with clients like British Airways, Holcim, SATS, Sabre, and SEI Corporation and the strategy has paid off over years. Even in troubled times (in 2008, post Lehman crisis), the partners remained loyal to NIIT Tech and relationship has strengthened over time. Some of the company's clients who share strong relationship with it are listed below.

- British Airways (15 years)
- SEI (14 years)
- SATS (11 years)
- Toyota (9 years)
- DB (5 years)
- Thrivent (5 years)
- Holcim (12 years)
- ING (13 years)
- SABRE (8 years)
- Virgin group (6 years)
- Amlin (5 years)
- AXA (5 years)

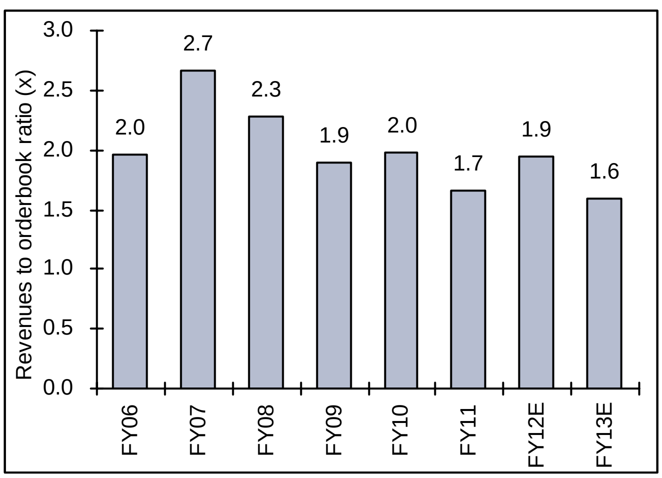
Table 4: Revenue contribution of top clients

% contribution	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Top 5	31	33	30	29
Top 10	45	47	44	44
Top 20	62	61	60	58

Source: Company data, I-Sec research

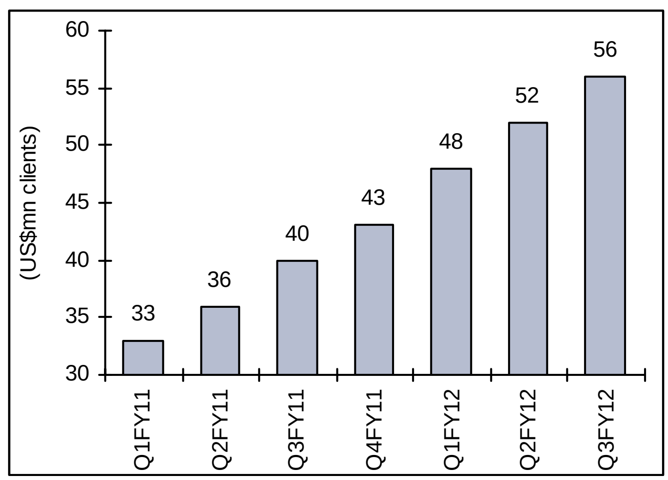
Besides, client mining as improved as the number of US$1mn clients has consistently improved from 33 in Q1FY11 to 56 in Q3FY12.

Chart 8: Revenues to orderbook remains robust



Source: Company data, I-Sec research

Chart 9: Client mining improving as well



Source: Company data, I-Sec research

Historically, the company has been booking revenue in the ratio of 1.8-2x its orderbook and our FY13E revenue estimate of US$392mn factors in this ratio at a conservative 1.6x.

Share of non-linear revenue to increase

We believe the share of non-linear revenue (IP-based revenue plus IMS) would increase from 25% to 30%+ over the next 12 months after the ramp up of recently won large deals.

Table 5: Break-up of non-linear revenues

Service line	% contribution to revenues	Type of work
Managed services	13	IMS, network management services etc.
Insurance platform – ROOM	10	Platform based business operations, solutions and services to the reinsurance market in UK
Other platform based solutions	2	Other platforms developed and acquired by NIIT Tech

Source: Company data, I-Sec research

Table 6: List of IPs / platform-based solutions of NIIT Tech

Service line	Type of work
Subscribe	A policy administration system
GeBIZ	Government electronic business portal
IPF3	Development framework
Exact	A risk exposure management solution
RFS	A financial and regulatory reporting solution
Cosys	Cargo management platform
Acumen	An enterprise-wide data warehouse solution
RPA (Route Profitability Analyser)	data mining, reporting and a powerful 'what if' forecast feature using scenario builds
Monalisa	Comprehensive revenue accounting system, route cost analyser, and log book management for Airlines

Source: Company data, I-Sec research

Using these patents to penetrate more companies in the same verticals has allowed NIIT Tech to expand its presence and being in an industry where experience matters more than the size. This has also helped NIIT Tech to offer tough competition to the bigger players and also an easy choice for clients.

NIIT Tech also implements IP/platform-based solutions in partnership with other organizations, such as the cargo handling solution COSYS, for which NIIT Tech has partnered with Singapore Airport Terminal Services (SATS) to globally implement and market the COSYS (cargo operations system) to other ground handlers and airlines. Recently, NIIT Tech implemented COSYS at Vietnam's largest airport.

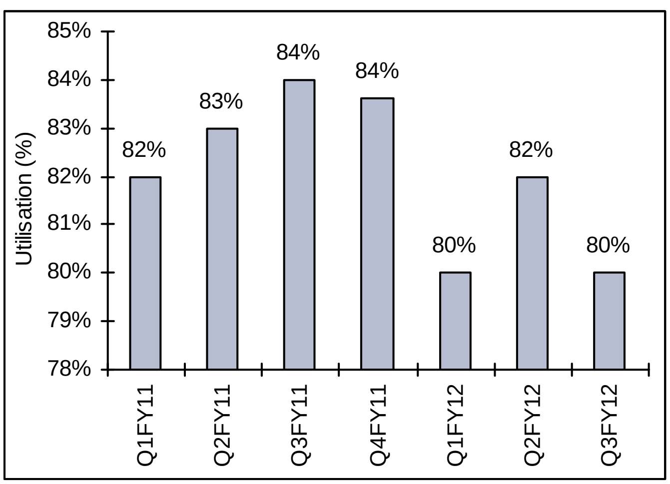
Given the strong growth trajectory of ROOM Solutions and NIIIT Tech strengthening its capabilities in the Managed Services over time via new large deals, we expect non-linear business to increase from 25% to 30%+ over the next 12 months, thereby adding to the overall company's margins and annuity business.

Margins to sustain at current level

A commendable aspect of NIIT Tech is its margin profile and its ability to improve / sustain margins even during troubled times (in 2008, post Lehman crisis) when some midcap peers witnessed a significant fall in their margins. Even though we expect pressure on the company's margins in the near term driven by transition costs in Eurostar and Morris deals, lower margins in Proyecta, and other hardware / pass through revenues in the government related business, the margins would still be ahead of peers. We believe the company would be able to sustain, if not improve, margins at current levels, despite wage inflation and impact of rupee appreciation owing to:

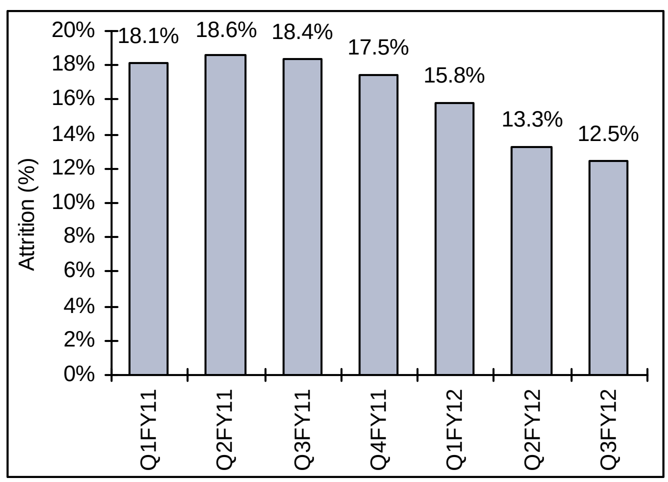
- **Non-occurrence of transitions costs and advisory fees** pertaining to large deals.
- **Margins in Morris deal would improve** from Q1FY13E when the transition of work to offshore will be completed. Almost 100 onsite employees would be replaced by NIIT Tech's offshore employees.
- **Share of non-linear revenue to increase** to 30%+ from 25% over the next 12 months after the ramp up of recently won large deals, thereby improving the company's margin profile.
- **Broadening of employee pyramid.** Only 30% of the current employee base holds less than three years' experience. This share is likely to inch up, as more freshers are likely to be inducted over the coming years.
- **Rationalisation of S,G&A costs.** With higher revenue growth (backed by firm orderbook), operating leverage would play out, which would result in S,G&A expenses coming down as a percentage of revenue.
- **Improvement in utilisation.** NIIT Tech has operated between the utilisation of 80-84% over a period of time. Currently, it is operating at utilisation of 80%, which leaves room for improvement going ahead. Attrition at 12.5% is the lowest in past seven quarters.

Chart 10: Utilisations likely to improve



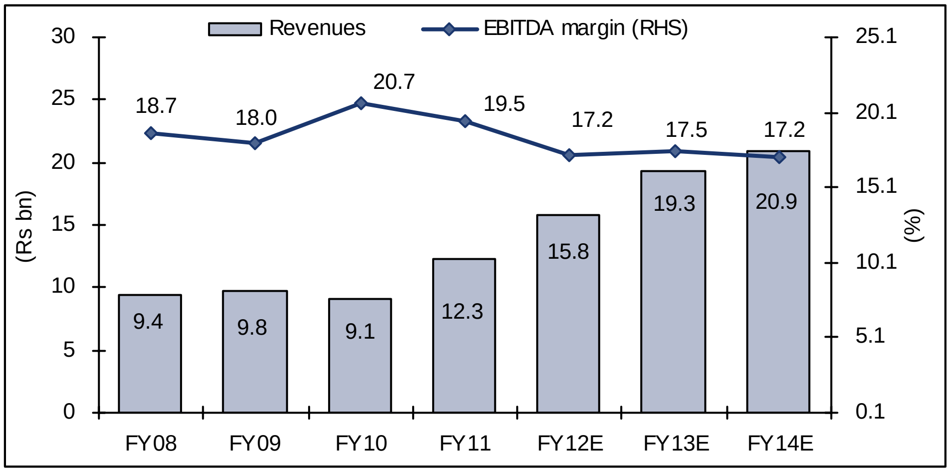
Source: Company data, I-Sec research

Chart 11: Attrition under control



Source: Company data, I-Sec research

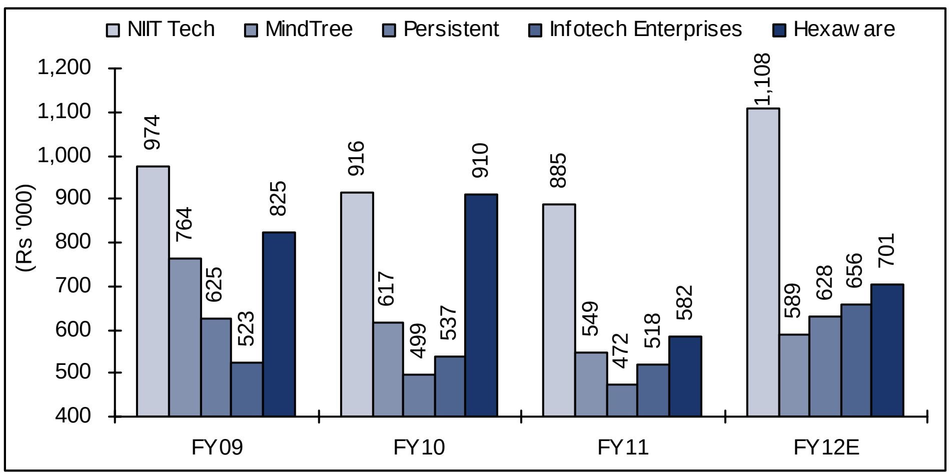
Chart 12: Revenue growth and margins robust



Source: Company data, I-Sec research

A key differentiator for NIIT Tech vis-à-vis its midcap peers is its ability to operate with low-cost resources owing to larger proportion of maintenance revenue. This allows NIIT Tech to make peer-leading margins.

Chart 13: Gross profit per employee higher than most of the peers



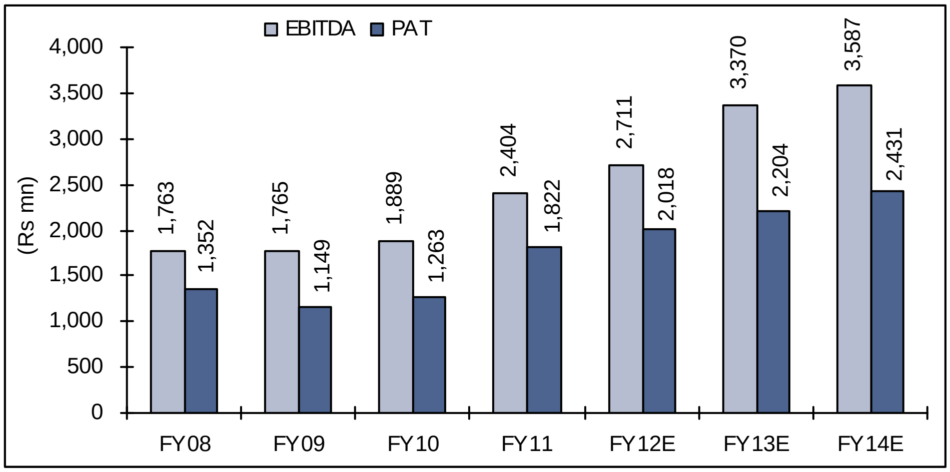
Source: Company data, I-Sec research

Strong financial performance

Revenue and EBITDA CAGR of 15% over FY12-14E

We expect NIIT Tech to post revenue / EBITDA CAGR of 15% and EPS CAGR of 11% over FY12-14E. During FY10-12E, the company displayed a healthy revenue CAGR of 30.8%, higher than most of its peers.

Chart 14: EBITDA and PAT growing steadily



Source: Company data, I-Sec research

Better performance versus peers

Table 7: NIIT Tech leads versus many peers

(%)

	FY08-10 CAGR	FY10-12E CAGR	FY12-14E CAGR	FY10-14E CAGR
Revenues				
NIIT Tech	(1.5)	31.3	15.1	22.9
MindTree	32.4	22.1	15.5	18.7
Persistent	19.0	28.4	13.2	20.6
Infotech Enterprises	18.9	27.7	14.3	20.9
Hexaware	(0.1)	18.2	18.1	18.1
KPIT (Unrated)	12.0	38.9	21.2	29.8
EBITDA				
NIIT Tech	3.5	19.8	15.0	17.4
MindTree	39.9	6.5	12.5	9.5
Persistent	26.6	22.2	9.1	15.5
Infotech Enterprises	30.7	12.7	8.3	10.4
Hexaware	49.9	14.4	20.1	17.2
KPIT (Unrated)	48.4	12.1	28.3	20.0
EPS				
NIIT Tech	(3.6)	26.0	9.8	17.6
MindTree	41.3	(5.5)	9.7	1.8
Persistent	13.7	7.2	7.3	7.2
Infotech Enterprises	40.1	(8.4)	16.3	3.2
Hexaware	10.2	39.7	9.5	23.7
KPIT (Unrated)	26.6	23.4	20.5	21.9

Source: Company data, Bloomberg for Unrated, I-Sec research

NIIT Tech is expected to post revenue, EBITDA and PAT CAGR of 23%, 17.4% and 17.6% respectively during FY10-14E – higher than many of its peers. This has been made possible with tight margin maintenance and focus on topline growth.

Table 8: Peer comparison

(Rs mn)

	FY10	FY11	FY12E	FY13E	FY14E
Revenues					
NIIT Tech	9,138	12,323	15,764	19,291	20,881
MindTree	12,960	15,091	19,318	22,729	25,752
Persistent	6,012	7,758	9,916	11,301	12,714
Infotech Enterprises	9,531	11,880	15,550	18,358	20,330
Hexaware	10,386	10,545	14,505	17,756	20,228
KPIT	7,316	10,230	14,118	17,779	20,738
EBITDA					
NIIT Tech	1,889	2,404	2,711	3,370	3,587
MindTree	2,456	1,777	2,785	3,206	3,526
Persistent	1,464	1,583	2,184	2,430	2,602
Infotech Enterprises	2,083	1,804	2,643	2,965	3,098
Hexaware	2,023	937	2,646	3,561	3,819
KPIT	1,614	1,522	2,030	2,619	3,342
EBITDA Margin (%)					
NIIT Tech	20.7	19.5	17.2	17.5	17.2
MindTree	18.9	11.8	14.4	14.1	13.7
Persistent	24.3	20.4	22.0	21.5	20.5
Infotech Enterprises	21.9	15.2	17.0	16.2	15.2
Hexaware	19.5	8.9	18.2	20.1	18.9
KPIT	22.1	14.9	14.4	14.7	16.1
EPS (Rs)					
NIIT Tech	21.4	30.9	34.0	37.2	41.0
MindTree	54.4	27.3	48.6	50.9	58.4
Persistent	29.5	34.1	33.9	35.9	39.0
Infotech Enterprises	15.9	12.2	13.3	17.0	18.0
Hexaware	4.7	2.3	9.1	10.1	10.9
KPIT	11.0	11.8	16.7	20.0	24.3

Source: Company data, Bloomberg for Unrated, I-Sec research

Table 9: Relative comparison

(Rs mn)

Company	Revenues FY13E	EBITDA FY13E	EV FY13E	Market Cap Current
NIIT Tech	19,291	3,370	12,683	14,200
MindTree	22,729	3,206	14,920	19,500
Persistent	11,301	2,430	8,255	12,700
Infotech Enterprises	18,358	2,965	11,640	16,700
Hexaware	17,756	3,561	28,824	33,400
KPIT	17,779	2,619	17,267	16,500

Source: Company data, Bloomberg for Unrated, I-Sec research

RoE remains >20% and dividend yield healthy at 3.1%

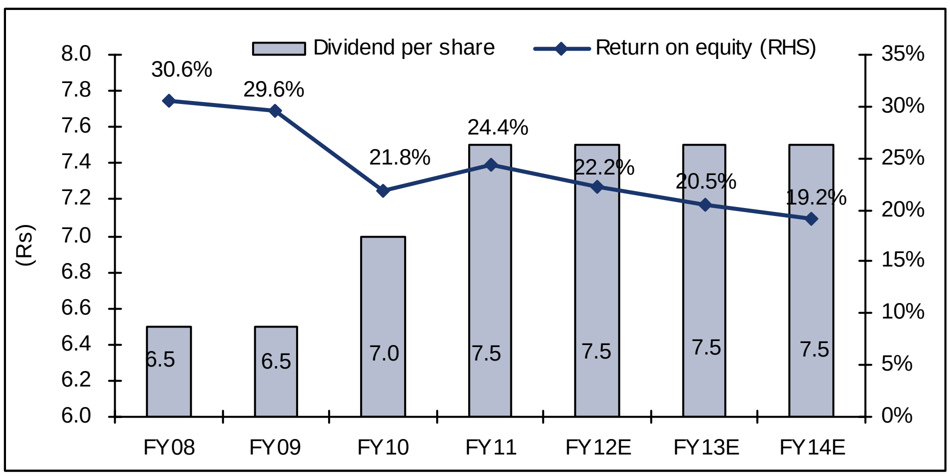
Even the return profile of NIIT Tech remains strong when compared to most of its peers. Strong focus on cost management has helped the company maintain high profitability.

Table 10: Strong return profile of NIIT Tech

	FY10	FY11	FY12E	FY13E	FY14E
ROCE (%)					
NIIT Tech	22.7	23.3	17.8	19.2	17.7
MindTree	15.5	9.2	14.7	14.1	13.1
Persistent	8.2	13.8	14.2	13.0	12.8
Infotech Enterprises	20.6	13.9	13.5	15.0	13.8
Hexaware	21.0	6.6	20.6	23.3	20.1
ROE (%)	**FY10**	**FY11**	**FY12E**	**FY13E**	**FY14E**
NIIT Tech	21.8	24.4	22.2	20.3	19.4
MindTree	34.2	15.1	23.1	19.9	18.8
Persistent	18.0	18.7	16.5	14.4	13.8
Infotech Enterprises	20.9	14.0	13.5	15.1	13.8
Hexaware	17.8	7.2	26.6	26.6	24.0

Source: Company data, I-Sec research

Chart 15: Healthy return profile



Source: Company data, I-Sec research

The effective tax rate is expected to decline going forward, as the company starts taking incremental business to its Noida SEZ facility. We expect a 100bps YoY drop in tax rate during both FY13E and FY14E. The above will incrementally add to its EPS growth.

Company to turn FCF positive in FY13E

NIIT Tech's working capital cycle worsened owing to BSF (government) deal in FY11 and higher capex in FY12E (including acquisitions) overall impacted FCF in both the years. In Q4FY12, NIIT Tech has received Rs320mn out of the Rs360mn outstanding from the BSF deals.

We believe that NIIT Tech has made back-to-back arrangement for credit with some of its vendors to deliver hardware in the recently win government deals (CCTNS), whereas the remaining would be funded through internal accruals. Further, leveraging its experience in the BSF deal, the whole deal is structured into four phases of six months each, so that receivable days do not exceed beyond 180 days.

Capex for the next phase of SEZ, which would house more than 4,000 seats, is likely to be Rs2bn which would be spent over two-three years. Accordingly, even after factoring in higher receivable days for the government deals and the capex of Rs1.2bn, we expect NIIT Tech to generate FCF of Rs520mn in FY13E.

Table 11: NIIT Tech to turn FCF positive in FY13-14E

(Rs mn, year ending March)

	FY11	FY12E	FY13E	FY14E
Operating cash flow before working capital changes	**2,012**	**1,966**	**2,606**	**2,788**
Working capital inflow / (outflow)	(1,620)	(689)	(886)	(896)
Capex	(505)	(1,287)	(1,200)	(1,300)
Free cash flow	**(113)**	**(10)**	**520**	**592**

Source: Company data, I-Sec research

Valuations attractive

Whereas the stock has historically traded at ~7x one year forward EPS owing to perceived low revenue visibility and quality of earnings, we believe, it is likely to re-rate on the back of (a) better revenue visibility (9MFY12E fresh order bookings up 140% YoY and 12-month executable order book up 80% YoY), (b) consistent industry-leading performance – revenue and PAT registered 31% and 26% CAGR over FY10-12E, (c) change in business mix - increase in the share of so-called non-linear revenue from 25% to 30% over the next one year, (d) maintenance / improvement in EBITDA margin from the current level of 17-18%, and (e) the company turning FCF positive in FY13E.

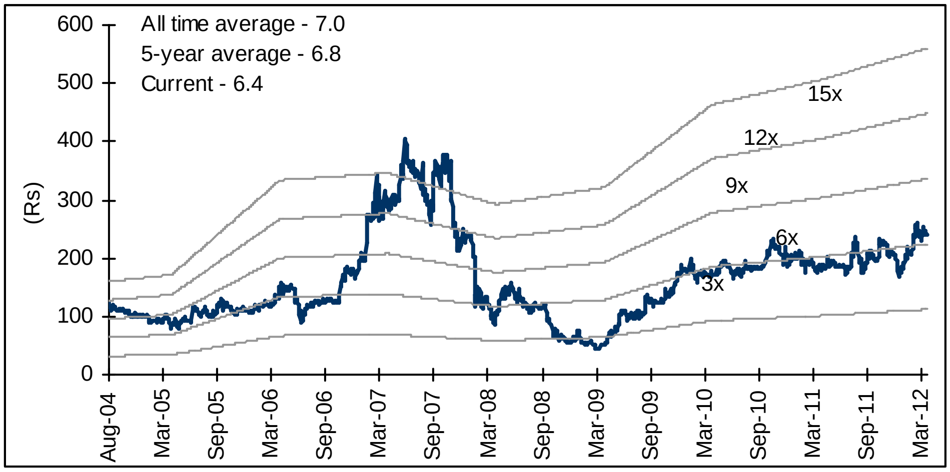
We factor in revenue/EBITDA CAGR of 15% and EPS CAGR of 10% over FY12-14E. With healthy sustainable 17-18% EBITDA margin, consistent +20% RoE and ex-cash RoEs of 30% and attractive dividend yield of 3.3% (Rs7.5-8/share), we find valuations at 6.4xFY13E P/E and 3.8xEV/E undemanding. We are initiating coverage on NIIT Tech with BUY recommendation and target price of Rs313 based on 8x average of FY13-14E EPS. Our target price implies ~55% and ~40% discount to our target multiple for Infosys and HCL Technologies respectively.

Table 12: Valuation metrics

Company	EPS (Rs)			P/E (x)			EV/E(x)		
	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E
Tata Consultancy Service	55.7	64.6	69.3	20.8	18.0	16.7	14.5	12.4	11.1
Infosys Technologies	147.5	163.1	172.1	19.4	17.5	16.6	12.9	11.4	10.2
Wipro	23.2	26.5	28.4	18.2	16.0	14.9	13.1	11.1	10.1
HCL Technologies*	33.3	37.3	40.7	14.4	12.9	11.8	8.4	7.6	6.7
Mahindra Satyam	8.4	8.3	9.1	9.6	9.7	8.7	6.4	4.7	3.8
Tech Mahindra	65.9	69.9	70.8	11.0	10.4	10.2	9.4	8.1	7.8
MphasiS **	34.1	38.8	N.A.	12.7	11.2	N.A.	6.8	5.7	N.A.
MindTree	50.6	50.0	54.3	9.5	9.6	8.9	5.8	4.9	4.5
Infotech Enterprises	13.0	16.9	18.4	11.6	8.9	8.2	4.8	4.1	3.5
Hexaware#	9.1	10.1	10.9	12.6	11.4	10.5	11.0	7.7	6.6
NIIT Tech	34.0	37.2	41.0	7.0	6.4	5.8	4.7	3.8	3.5

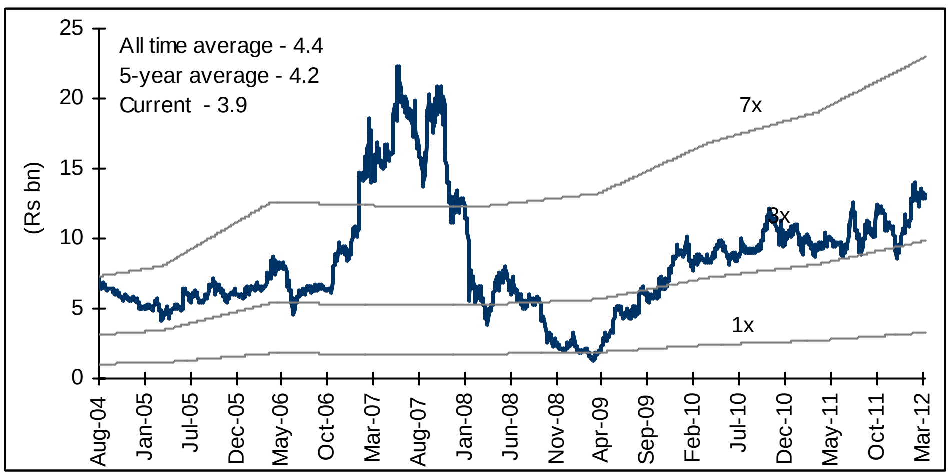
*Jun end, ** Oct end, # Dec end
Source: Company data, I-Sec research,

Chart 16: P/E Bands (1-year forward earnings)



Source: Company data, I-Sec research

Chart 17: EV/E Bands (1-year forward EBITDA)



Source: Company data, I-Sec research

Key Risks

- **Slowdown in developed economy** especially in key markets and verticals can impact NIIT Tech substantially given the recent thrust on topline growth and deal wins at NIIT Tech.
- **Significant adverse rupee / exchange rate** movement can impact NIIT Tech to a large extent even despite the healthy hedges taken by the company.
- **Inconsistent financial track record** – even though consistency in margin maintenance and EPS growth have been NIIT Tech's key focus, any inconsistency hereon, especially in the wake of multiple deal ramp ups and an acquisitions therein, can distort the consistency.
- **Margins could remain under pressure** given that recent deal wins will take a couple of more quarters to reach a steady state and there might be further transition related costs that NIIT Tech might incur. Further, hardware revenues are already a drag on margins.
- **Higher DSO / working capital strain** can lead to deterioration in cash flow metrics versus our expectation of the company turning FCF positive in FY13E.
- **More of generic company versus any niche** – However the company has demonstrated domain capabilities in its focus vertical of travel and transportation and insurance.

Company overview

Background

NIIT Tech was spun off from NIIT in 2004 and formed as a pure play IT services company. NIIT Tech serves financial services, insurance, travel, transportation manufacturing, healthcare, and government sectors with its technology offerings viz. ADM, Managed Services, Cloud Services, and BPO. The company has strong (in some cases, more than a decade old) relationship with some of its top clients viz. the Holcim group, British Airways, and Toyota.

The company derives 37% of its revenue from the Americas and 39% from Europe. India contributed 15.7% to its revenue in FY11, an increase of 500bps YoY, led by revenue from the BSF deal. However, once the hardware revenues went away, the contribution fell to 11% currently. We expect India's contribution to gain once the CCTNS deal pass through revenues pick up Q4FY12 onwards. Asia Pacific (APAC) has been growing steadily and contributes 13% to the company's revenue.

Chart 18: Geography-wise break-up

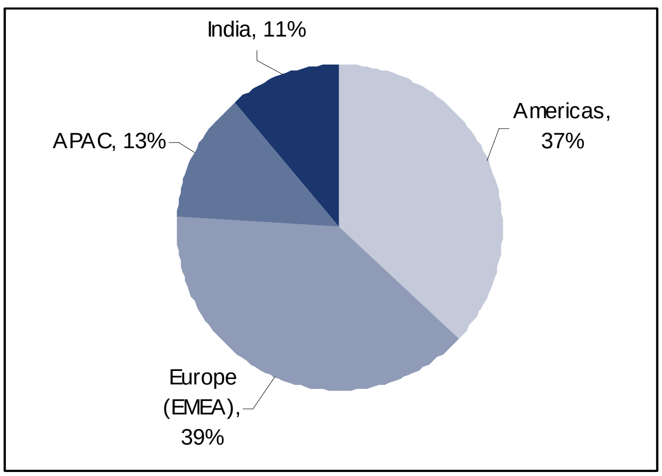
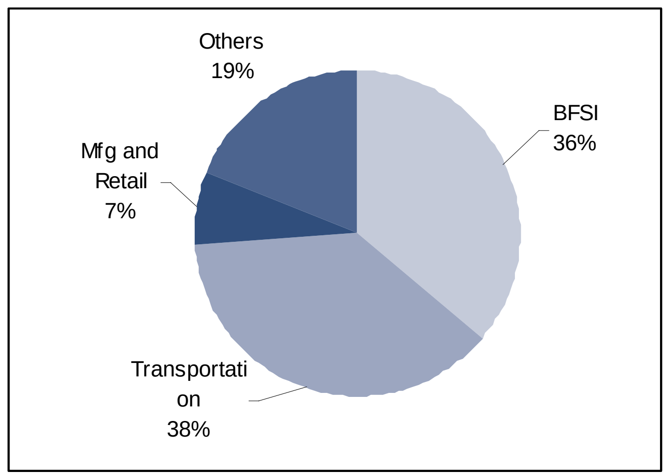
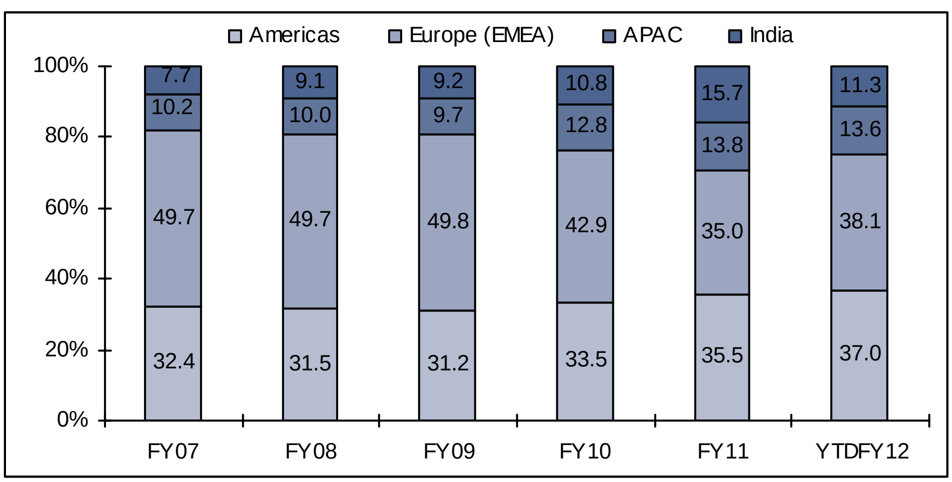


Chart 19: Vertical-wise revenue contribution



Source: Company data, I-Sec research

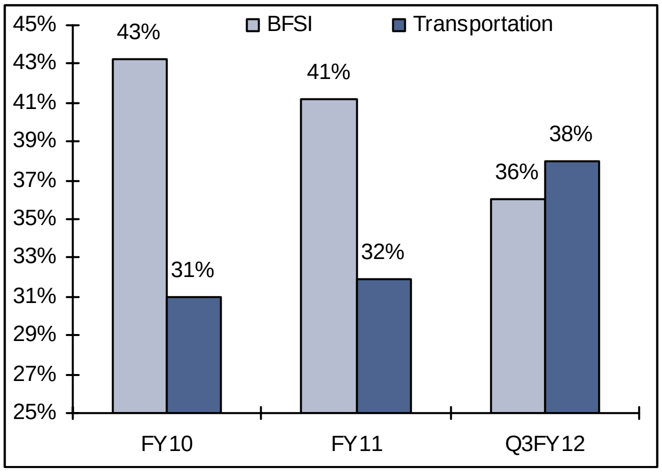
Chart 20: Geography-wise break-up of revenues



Source: Company data, I-Sec research

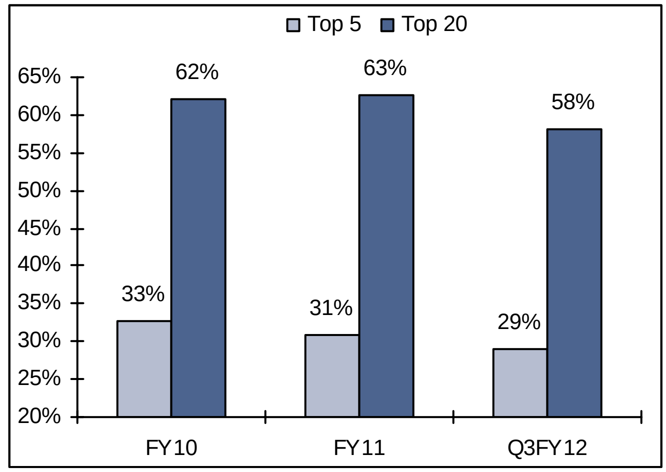
Travel and transportation now contribute 38% of the overall revenue post the consolidation of Proyecta and ramp-up of Eurostar deal (one of the large deals won by NIIT Tech). However, BFSI's contribution has come down to 36% from 41.2% just three quarters back, which can be partly ascribed to the ramp-down in one of the large BFSI client (restructuring exercise at ING).

Chart 21: BFSI contribution declining



Source: Company data, I-Sec research

Chart 22: Client concentration dropping



Source: Company data, I-Sec research

Client mix

The company has been slowly diversifying its revenue base and reducing the concentration of top clients in its overall revenue. The contribution of the top five clients to the overall revenue has come down to 29% as against 31% in FY11 and 33% in FY10. In a similar way, the contribution of top-20 clients has dropped to 58% of the overall revenue as against 63% in FY11. We expect the company to further reduce the client concentration and expand the revenue base.

Revenue and people mix

Onsite revenue contribution remains as high as 63% (higher than peers like Hexaware Technologies at 55% and MindTree at 34%). We expect onsite contribution to go down after a couple of quarters, as work from the Morris and other large deal starts moving offshore and as offshore component increases at Proyecta. We also expect direct people mix to change in tandem with the business.

Chart 23: Revenue-mix

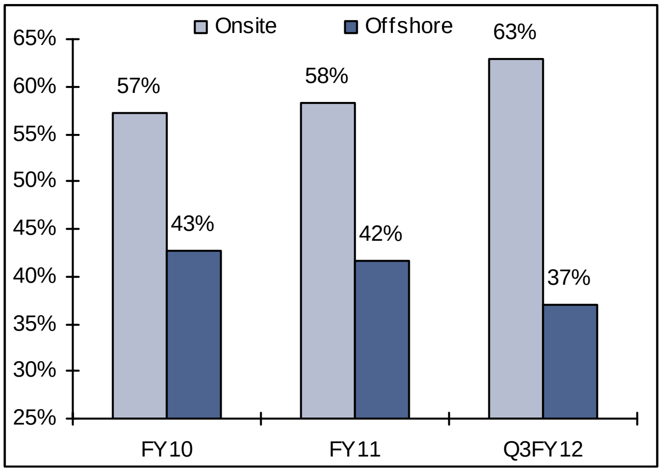
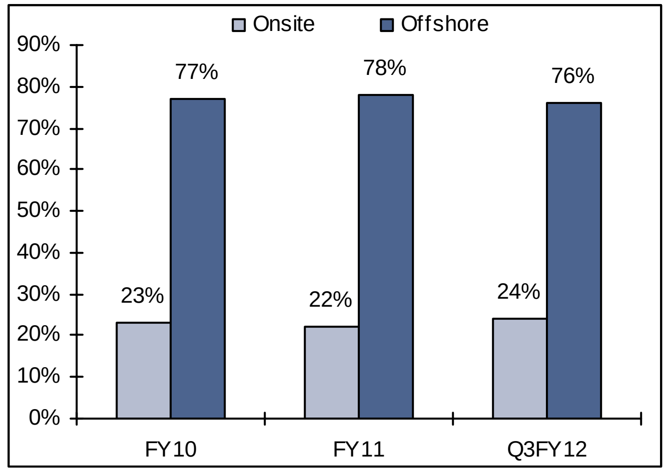


Chart 24: Direct people-mix



Source: Company data, I-Sec research

Acquisitions

NIIT Tech acquired UK-based ROOM Solutions in 2006-07 to gain a platform advantage in insurance market of the UK. The company has done a laudable job for ROOM Solutions, with the latter's standalone margin currently standing at 27%, which is a CQGR of 9.3% over the past six quarters. However, we expect some near-term pain in ROOM Solutions due to hefty losses to the insurance sector against the backdrop of the current macroeconomic scenario and natural calamities in Thailand and Japan.

In 2008, NIIT Tech acquired German-based SofTec operating in airline revenue accounting and operations space. The acquisition further strengthened NIIT Tech's foothold in the airline and transportation vertical. SofTec had a sound market presence as it served around 40 small to medium airlines within Europe.

NIIT Tech also acquired Proyecta Systemas in 2011-12, which has helped open doors for other transportation companies in Europe for NIIT Tech. Given the niche strength of NIIT Tech in transportation, where it has served British Airways for more than a decade and now managed to strike the Eurostar deal, Proyecta's acquisition falls completely in line with the company's strategy to further strengthen its capabilities in the vertical.

Table 13: Management overview

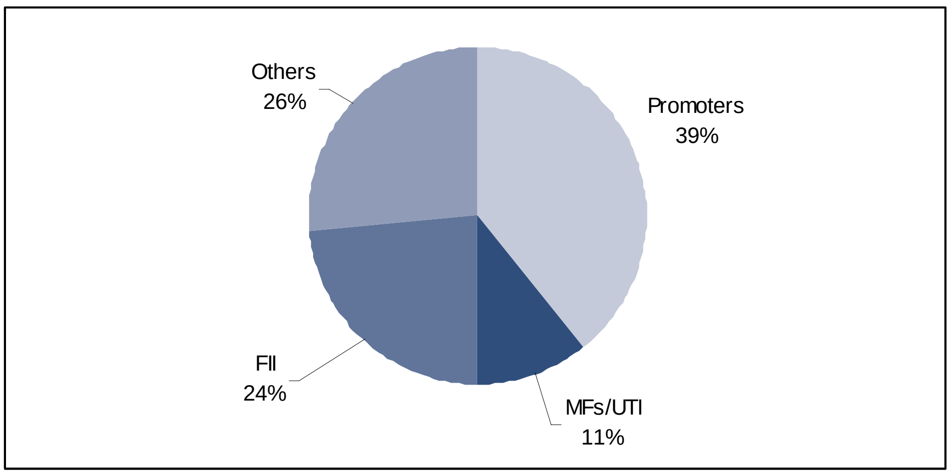
	Name	Designation	Qualification and experience
1	Rajendra Pawar	Chairman & Managing Director	Mr Pawar has spearheaded several IT industry initiatives. His role within the Indian Prime Minister's Task Force for IT and Software Development and his contribution to the FICCI and CII IT committees has established him as an industry veteran.
2	Arvind Thakur	CEO & Joint MD	Mr Thakur is the Chief Executive Officer of NIIT Tech and serves as the Joint Managing Director on its board. He joined NIIT in 1985 as a member of the core team and has since been handling key organisational roles. He was the President of its software business before it was demerged to form NIIT Tech.
3	Vijay Thadani	Director	Mr Thadani is the Chief Executive Officer of NIIT, a leading global talent development corporation. He serves on the board of NIIT Tech. He has also been actively engaged with many industry associations. He has served as the president of the Indian IT Industry Association and MAIT and has also chaired the Indian government's committee on National Information Infrastructure Policy.
4	Pratibha Advani	CFO	She joined NIIT Tech from Barclays Shared Services Pvt. Ltd. (a subsidiary of Barclays Bank Plc.) where she was Chief Financial Officer

Source: Company Data, I-Sec research

Ownership structure

The promoters own 39.2% of the company while FII investment stands at 23.5%.

Chart 25: Ownership structure



Source: Company Data, I-Sec research

We believe NIIT Ltd, owning 25% stake in NIIT Tech, has stated intention of selling its stake in NIIT Tech to a strategic partner at an appropriate time and valuations.

Financials

Table 14: Profit & Loss statement (consolidated)

(Rs mn, year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
Revenues (US$mn)	**192**	**245**	**329**	**392**	**444**
Revenues	**9,138**	**12,323**	**15,764**	**19,291**	**20,881**
Growth YoY (%)	*(6.8)*	*34.9*	*27.9*	*22.4*	*8.2*
Cost of revenues	5,389	7,768	9,872	12,285	13,385
% of sales	*59.0*	*63.0*	*62.6*	*63.7*	*64.1*
Growth YoY (%)	*(12.6)*	*44.2*	*27.1*	*24.5*	*8.9*
Gross profit	**3,749**	**4,555**	**5,892**	**7,006**	**7,496**
Gross margin (%)	*41.0*	*37.0*	*37.4*	*36.3*	*35.9*
Growth YoY (%)	*3.2*	*21.5*	*29.4*	*18.9*	*7.0*
Selling, General & Administrative Expenses	1,860	2,151	3,182	3,636	3,909
% of sales	*20.4*	*17.5*	*20.2*	*18.8*	*18.7*
Growth YoY (%)	*(0.4)*	*15.6*	*47.9*	*14.3*	*7.5*
Total operating expenses	**7,249**	**9,919**	**13,053**	**15,921**	**17,294**
% of sales	*79.3*	*80.5*	*82.8*	*82.5*	*82.8*
Growth YoY (%)	*(9.8)*	*36.8*	*31.6*	*22.0*	*8.6*
EBITDA	**1,889**	**2,404**	**2,711**	**3,370**	**3,587**
EBITDA margin (%)	***20.7***	***19.5***	***17.2***	***17.5***	***17.2***
Growth yoy (%)	*7.0*	*27.3*	*12.8*	*24.3*	*6.4*
Depreciation & amortisation	360	315	355	468	522
EBIT	**1,529**	**2,089**	**2,356**	**2,901**	**3,065**
EBIT margin (%)	*16.7*	*17.0*	*14.9*	*15.0*	*14.7*
Growth YoY (%)	13.9	36.6	12.8	23.2	5.6
PBDT	**1,889**	**2,404**	**2,711**	**3,370**	**3,587**
Other Income	(109)	89	337	67	165
% of PBT	*(7.7)*	*4.1*	*12.5*	*2.2*	*5.1*
PBT	**1,420**	**2,178**	**2,693**	**2,968**	**3,230**
PBT margin (%)	*15.5*	*17.7*	*17.1*	*15.4*	*15.5*
Provision for taxation	144	323	696	742	775
ETR (%)	*10.1*	*14.8*	*25.8*	*25.0*	*24.0*
Minority interest	*13*	*33*	*(21)*	*22*	*24*
Recurring net profit	**1,263**	**1,822**	**2,018**	**2,204**	**2,431**
PAT margin (%)	*13.8*	*14.8*	*12.8*	*11.4*	*11.6*
Growth yoy (%)	*9.9*	*44.3*	*10.7*	*9.2*	*10.3*
Extraordinary income/(Expense)					
Reported net profit	**1,263**	**1,822**	**2,018**	**2,204**	**2,431**
PAT margin (%)	*13.8*	*14.8*	*12.8*	*11.4*	*11.6*
Growth yoy (%)	*9.9*	*44.3*	*10.7*	*9.2*	*10.3*

Source: Company data, I-Sec research

Table 15: Balance sheet (consolidated)

(Rs mn, year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
Sources of funds					
Shareholders funds					
Share capital	588	593	594	594	594
Reserves and surplus	5,210	6,885	8,489	10,173	12,084
Net worth	**5,798**	**7,478**	**9,083**	**10,767**	**12,678**
Loan funds	217	110	599	599	599
Minority interest	28	43	121	143	167
Deferred tax liability	-	-	-	-	-
Total liabilities	**6,043**	**7,631**	**9,803**	**11,509**	**13,444**
Application of funds					
Fixed assets					
Gross block	5,241	5,596	8,087	9,287	10,587
Less: Depreciation	3,388	3,703	4,058	4,526	5,048
Net block	**1,853**	**1,893**	**4,029**	**4,761**	**5,539**
Capital work in progress	1,287	1,437	233	233	233
Goodwill					
Investments	-	-	-	-	-
Deferred tax asset	107	143	213	213	213
Current assets, loans & advances					
Inventories	-	-	-	-	-
Debtors and unbilled revenue	1,851	2,871	4,017	4,915	5,664
Cash & bank balances	1,895	1,637	2,118	2,206	2,467
Loans & advances	-	-	-	-	-
Other current assets	1,250	2,158	2,593	2,991	3,367
Total current assets	**4,996**	**6,666**	**8,728**	**10,112**	**11,498**
Current liabilities	1,647	1,918	2,809	3,219	3,448
Provisions	553	590	590	590	590
Net current assets	**2,796**	**4,158**	**5,328**	**6,302**	**7,459**
	901	2,521	3,210	4,096	4,992
Miscellaneous expenditure	-	-	-	-	-
Total assets	**6,043**	**7,631**	**9,803**	**11,509**	**13,444**

Source: Company data, I-Sec research

Table 16: Cashflow statement (consolidated)

(Rs mn, year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
EBIT	**1,529**	**2,089**	**2,356**	**2,901**	**3,065**
Adjustments for					
Depreciation and amortisation	360	315	355	468	522
Other adjustments	(13)	(33)	21	(22)	(24)
Change in deferred tax	328	(36)	(70)	-	-
Direct taxes paid	(144)	(323)	(696)	(742)	(775)
Operating profit before working capital changes	**2,060**	**2,012**	**1,966**	**2,606**	**2,788**
Adjustments for					
Trade and other receivables	84	(1,020)	(1,146)	(899)	(748)
Loans and advances	-	-	-	-	-
Change in other current assets	(164)	(908)	(435)	(397)	(376)
Trade and other payables	(1,786)	270	892	410	229
Change in provisions	34	38	-	-	-
Working Capital Changes	(1,832)	(1,620)	(689)	(886)	(896)
Cash generated from operations (A)	**228**	**392**	**1,277**	**1,720**	**1,892**
Cash flow from investing activities					
Capex (net)	(343)	(505)	(1,287)	(1,200)	(1,300)
Other investments/sales of assets					
Net cash from investing activities (B)	**(343)**	**(505)**	**(1,287)**	**(1,200)**	**(1,300)**
Cash flow from financing activities					
Proceeds from issue of share capital	1,148	390	186	22	24
Proceeds/ repayments from borrowings (net)	(131)	(107)	489	-	-
Dividends paid	(483)	(517)	(520)	(520)	(520)
Interest paid on borrowings	-	-	-	-	-
Other Income	(109)	89	337	67	165
Net cash from financing activities (C)	**425**	**(145)**	**492**	**(432)**	**(331)**
Exchange fluctuation reserve on acc. of consolidation					
Net increase in cash or equivalents [A + B + C]	**310**	**(258)**	**481**	**88**	**261**
Cash or cash equivalents at the start of the year	**1,585**	**1,895**	**1,637**	**2,118**	**2,206**
Cash or cash equivalents at the close of the year	**1,895**	**1,637**	**2,118**	**2,206**	**2,467**

Source: Company data, I-Sec research

Table 17: Key ratios (consolidated)

(Year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
Asset based ratios (%)					
ROCE	22.7	23.3	17.8	18.9	17.3
ROIC	40.4	35.1	25.5	25.6	23.0
ROE	21.8	24.4	22.2	20.5	19.2
ROE (excl Cash & investments)	32.4	31.2	29.0	25.7	23.8
Growth ratios (%)					
Sales - Overall	(6.8)	34.9	27.9	22.4	8.2
EBITDA	7.0	27.3	12.8	24.3	6.4
EPS	9.9	44.3	10.1	9.2	10.3
CEPS	3.2	31.7	10.4	12.6	10.5
Gearing (x)					
Debt/Equity	0.04	0.02	0.08	0.07	0.06
Per share (Rs)					
EPS					
CEPS	21.4	30.9	34.0	37.2	41.0
EPS(diluted)	27.5	36.3	40.0	45.1	49.8
BV	21.4	30.9	34.2	37.4	41.2
DPS	98.4	126.9	153.2	181.6	213.8
	7.0	7.5	7.5	7.5	7.5
Margins (%)					
EBITDA					
Gross Margin	20.7	19.5	17.2	17.5	17.2
PAT	41.0	37.0	37.4	36.3	35.9
Tax rate	13.8	14.8	12.8	11.4	11.6
Dividend payout ratio	10.1	14.8	25.8	25.0	24.0
	38.2	28.4	25.8	23.6	21.4
Valuations (x)					
P/E	11.2	7.8	7.0	6.4	5.8
P/CEPS	8.7	6.6	6.0	5.3	4.8
P/BV	2.4	1.9	1.6	1.3	1.1
Dividend Yield	2.9	3.1	3.1	3.1	3.1
EV/EBITDA	6.6	5.3	4.7	3.8	3.5
EV/ Sales	1.4	1.0	0.8	0.7	0.6
(Rs mn)					
Market Cap	14,147	14,147	14,147	14,147	14,147
Debt	245	153	720	742	766
Cash	1,895	1,637	2,118	2,206	2,467
Net Debt	(1,650)	(1,484)	(1,398)	(1,464)	(1,701)
EV	12,497	12,663	12,749	12,683	12,447
Receivable days (no.s)	74	85	93	93	99
Payable days (no.s)	83	71	79	74	73

Source: Company data, I-Sec research

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