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Institutional Equities

# Infotech Enterprises

# ENGINEERED FOR GROWTH

# Infotech Enterprises

26 February 2013

Reuters: INFE.BO; Bloomberg: INFTC IN

Initiating Coverage

## Engineered For Growth

**Infotech Enterprises' (IEL) stock has shed 20% since November 2012. We believe this provides a good buying opportunity on likely acceleration in revenue growth in 2HFY14/FY15, stable-to-higher margins, FY15E cash/share of Rs63 and attractive valuation at 6.3x FY15E EPS (5.7x FY15E EPS after adjusting for cash and interest income). We expect revenue growth to accelerate in 2HFY14/FY15 and forecast 10.9% growth in US dollar terms in 2HFY14E (6.7% in 1HFY14E), and 14.3% in FY15E (8.9% in FY14E). Healthy client adds and long-term relationships with key clients like United Technologies lend confidence to revenue recovery. We expect IEL's cash and liquid investments to top Rs7bn in FY15E (Rs63/share, 38% of current market capitalisation), which provides valuation support to the stock and could also boost dividend payout. We have assigned a Buy rating to IEL with a target price of Rs242, implying a PE of 9x FY15E EPS.**

**Valuation attractive post stock decline:** IEL's stock has shed 20% since November 2012, with disappointing 3QFY13 revenue growth being the key driver for the fall. **We believe this provides a good buying opportunity on likely acceleration in revenue growth in 2HFY14/FY15, stable-to-higher margins, FY15E cash/share of Rs63 (38% of market capitalisation) and attractive valuation at 6.3x FY15E EPS (5.7x FY15E EPS after adjusting for cash and interest income).**

**Acceleration likely in ENGG segment in 2HFY14/FY15 to drive revenue:** IEL witnessed a ramp-down from a hi-tech (semiconductor) client in its engineering (ENGG) segment in 3QFY13, with an impact expected in 4QFY13 also. We expect a bounce back in growth in 2HFY14/FY15, with a 9.2% YoY revenue growth in US dollar terms in 2HFY14E (2.5% in 1HFY14E), and FY15E growth of 13.5% (5.9% in FY14E). **Healthy client addition (23 in 9MFY13 versus 24 in FY12) and strong long-term relationships with clients like United Technologies and Bombardier lend confidence to revenue recovery in 2HFY14. CY13 client prospects also appear decent, with stable-to-growing revenue, EPS and R&D likely.** Given that ENGG contributes 66.1% to IEL's revenue, recovery in growth is key for overall revenue acceleration. We expect the utilities, telecommunications and content engineering (UT&C) segment to continue to grow at a healthy pace, with 15%-16% growth likely in FY14E/FY15E. Thus, we expect 10.9% YoY total revenue growth in US dollar terms in 2HFY14E (6.7% in 1HFY14E) and 14.3% in FY15E (8.9% in FY14E).

**FY15E cash at 38% of market capitalisation, higher dividend likely:** We expect IEL's cash and liquid investments to top Rs7bn in FY15E, which amounts to Rs63/share, or 38% of current market capitalisation. This, we expect, will provide valuation support to the stock. This could also boost the dividend payout ratio, which rose to 17.3% in FY12 from 10.0% in FY11 and in the wake of strong cash flow, a further rise is likely; **we expect the payout ratio to cross 22.0% in FY15E, with FY15E dividend yield at 3.5%.**

**Valuation:** IEL's stock trades at 6.3x FY15E EPS. **We have assigned a Buy rating to the stock with a target price of Rs242, implying a P/E of 9x FY15E EPS.**

| Y/E March (Rsmn) | FY11 | FY12 | FY13E | FY14E | FY15E |
|---|---|---|---|---|---|
| Revenue | 11,883 | 15,531 | 18,798 | 19,636 | 22,013 |
| *YoY (%)* | *24.7* | *30.7* | *21.0* | *4.5* | *12.1* |
| EBITDA | 1,799 | 2,691 | 3,496 | 3,702 | 4,324 |
| *EBITDA (%)* | *15.1* | *17.3* | *18.6* | *18.9* | *19.6* |
| Adj. PAT | 1,397 | 1,614 | 2,357 | 2,478 | 2,993 |
| *YoY (%)* | *(18.3)* | *15.5* | *46.1* | *5.1* | *20.8* |
| FDEPS (Rs) | 12.5 | 14.5 | 21.2 | 22.2 | 26.9 |
| *RoE (%)* | *14.4* | *14.8* | *18.9* | *17.3* | *18.3* |
| *RoCE (%)* | *11.2* | *12.9* | *15.7* | *14.3* | *15.6* |
| P/E (x) | 13.5 | 11.7 | 8.0 | 7.6 | 6.3 |
| EV/EBITDA (x) | 8.3 | 5.2 | 3.9 | 3.5 | 2.7 |

*Source: Company, Nirmal Bang Institutional Equities Research*

## BUY

**Sector:** Information Technology

**CMP:** Rs169

**Target Price:** Rs242

**Upside:** 43%

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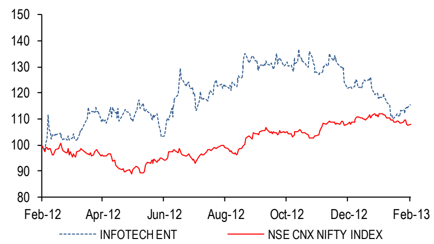
**Key Data**

| | |
|---|---|
| Current Shares O/S (mn) | 111.6 |
| Mkt Cap (Rsbn/US$mn) | 18.9/349.5 |
| 52 Wk H / L (Rs) | 211/140 |
| Daily Vol. (3M NSE Avg.) | 60,323 |

| Share holding (%) | 1QFY13 | 2QFY13 | 3QFY13 |
|---|---|---|---|
| Promoter | 22.4 | 22.4 | 22.4 |
| FII | 52.8 | 54.8 | 58.4 |
| DII | 9.1 | 8.4 | 6.3 |
| Corporate | 8.4 | 7.6 | 6.1 |
| General Public | 7.3 | 6.9 | 6.8 |

**One Year Indexed Stock Performance**




**Price Performance (%)**

| | 1 M | 6 M | 1 Yr |
|---|---|---|---|
| Infotech Ent. | (2.3) | (6.1) | 15.4 |
| Nifty Index | (3.6) | 8.7 | 7.8 |

*Source: Bloomberg*

## Valuation: We have assigned a Buy rating with a target price of Rs242

**We have valued IEL based on a target price-to-earnings (PE) multiple of 9x FY15E EPS.** We believe the recent fall in the stock price offers investors a good buying opportunity in the wake of likely acceleration in revenue growth in 2HFY14/FY15, stable-to-higher margins, FY15E cash per share of Rs63 (38% of market capitalisation) and attractive valuation at 6.3x FY15E EPS (5.7x FY15E EPS adjusting for cash and interest income). The mid-sized information technology (IT) firm's strong long-term relationships with marquee clients like United Technologies, The Boeing Company and Bombardier, along with long-term revenue visibility that typically characterises the ENGG business (five to eight year contract tenures) is likely to ensure revenue stability over the next two-three quarters, while guidance from these clients on prospects for CY13 suggests likely growth acceleration in 2HFY14/FY15. On the other hand, we expect the UT&C segment to continue to post healthy growth rates, in the mid-teens, led by a marquee client base (six of the top seven northern grid companies in the US, TomTom). Cash/share of Rs63 in FY15E is also likely to provide support and could also lead to a higher dividend payout ratio going forward – we expect the dividend payout to increase to over 22.0% in FY15E (Rs6/share) as against 17.3% in FY12 (Rs2.50/share), with FY15E dividend yield at 3.5%.

On the margin front, despite rupee appreciation, we expect a stable-to-rising trend mainly due to G&A leverage and bulge mix, with a greater proportion of fresher hiring likely going forward. **IEL expects fresher hiring to touch 40% of total hires (historical range 20%-25%), which is likely to keep wage costs under control. We have factored in an average rupee-US dollar rate of Rs52/$ for FY14E and Rs51/$ for FY15E (Rs54.50 for FY13E). From an EPS perspective, we expect a 12.7% CAGR over FY13E-FY15E. While we expect a 5.1% growth in FY14E, we expect acceleration in FY15E to 20.8% on higher revenue growth and expansion in margins.**

**Exhibit 1: Our IT universe - Comparative valuation table**

| | EPS (Rs) | | *EPS growth (%)* | | *RoE (%)* | | P/E (x) | |
|---|---|---|---|---|---|---|---|---|
| **Company** | **FY14E** | **FY15E** | ***FY14E*** | ***FY15E*** | ***FY14E*** | ***FY15E*** | **FY14E** | **FY15E** |
| TCS | 78.8 | 85.9 | *9.2* | *9.0* | *33.0* | *29.4* | 18.7 | 17.1 |
| Infosys | 179.2 | 191.7 | *7.4* | *7.0* | *24.0* | *21.8* | 16.3 | 15.2 |
| Wipro | 28.9 | 31.2 | *4.6* | *8.0* | *19.5* | *18.4* | 14.5 | 13.4 |
| HCL Technologies | 59.1 | 64.1 | *13.6* | *8.5* | *26.7* | *23.5* | 12.4 | 11.4 |
| Mindtree | 94.0 | 101.1 | *11.6* | *7.5* | *26.6* | *22.8* | 9.2 | 8.6 |
| Hexaware Technologies | 10.7 | 11.9 | *(1.8)* | *11.0* | *25.0* | *24.3* | 8.1 | 7.3 |
| **Infotech Enterprises** | **22.2** | **26.9** | ***5.1*** | ***20.8*** | ***17.3*** | ***18.3*** | **7.6** | **6.3** |

*Note: As Hexaware has a December-ending financial year, FY14E=CY13E and FY15E=CY14E.*

*Source: Bloomberg, Nirmal Bang Institutional Equities Research*

Given the above factors, we assign IEL a 9x PE multiple, at a nearly 50% discount to our target multiple for Tata Consultancy Services (17.5x). **We have assigned a Buy rating to IEL with a target price of Rs242.**

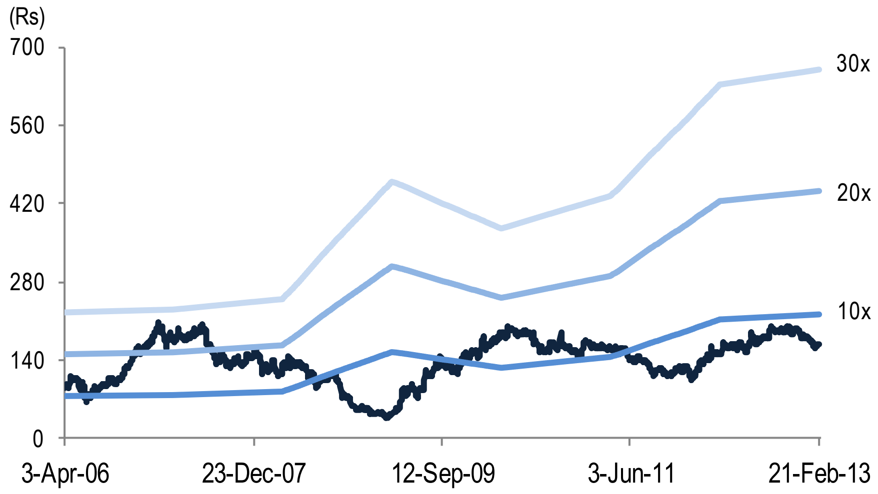
## NBIE v/s Bloomberg consensus projections – Our FY15E EPS is 5% above consensus

**Exhibit 2: Our estimates versus Bloomberg consensus estimates**

| **Particulars** | **Bloomberg cons. estimates** | **NBIE estimates** | ***Diff. (%)*** |
|---|---|---|---|
| | **FY14E** | | |
| Revenue (Rsmn) | 20,921 | 19,636 | *(6.1)* |
| EBITDA (Rsmn) | 3,844 | 3,702 | *(3.7)* |
| *EBITDA margin (%)* | *18.4* | *18.9* | *48bps* |
| EPS (Rs) | 22.7 | 22.2 | *(2.0)* |
| | **FY15E** | | |
| Revenue (Rsmn) | 23,517 | 22,013 | *(6.4)* |
| EBITDA (Rsmn) | 4,111 | 4,324 | *5.2* |
| *EBITDA margin (%)* | *17.5* | *19.6* | *216bps* |
| **EPS (Rs)** | **25.7** | **26.9** | ***4.7*** |

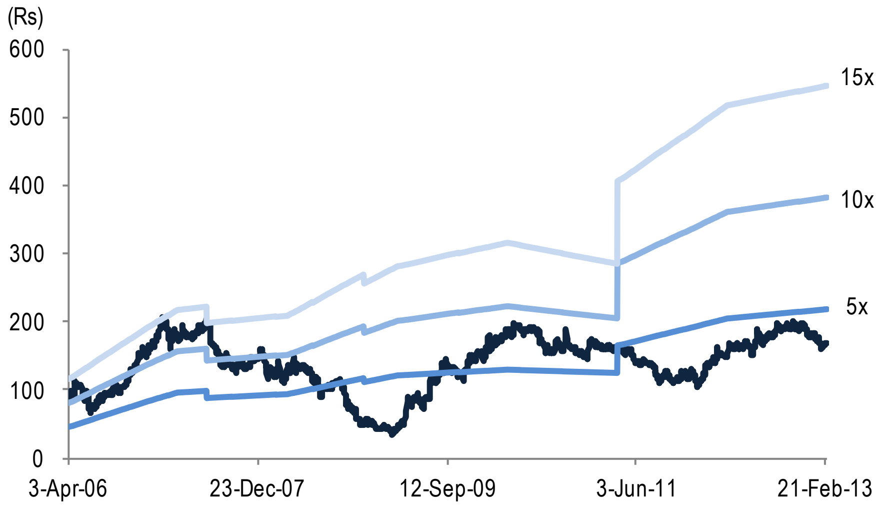
*Source: Bloomberg, Nirmal Bang Institutional Equities Research*

**Exhibit 3: P/E band**




*Source: C-line, Nirmal Bang Institutional Equities Research*

**Exhibit 4: EV/EBITDA band**




*Source: C-line, Nirmal Bang Institutional Equities Research*

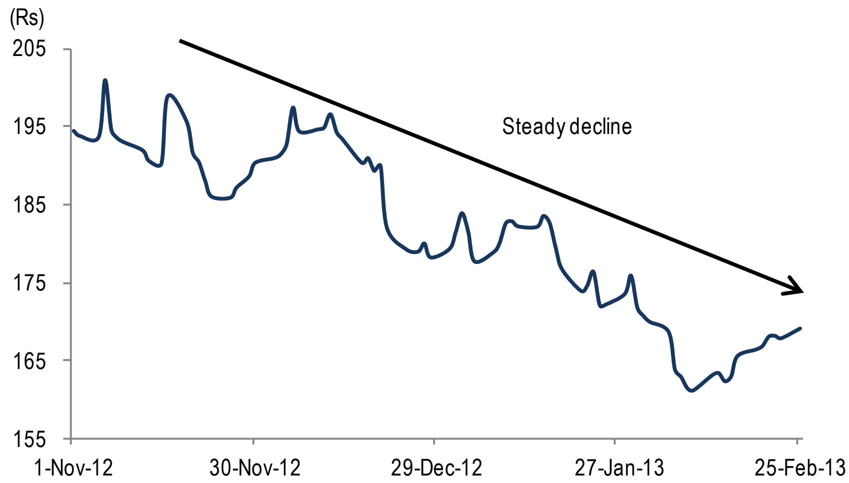
## Investment Arguments

### Valuation attractive post decline in stock price, cash/share to provide support

IEL's stock has shed 20% since November 2012, after a sharp run-up following good revenue growth in 2QFY13, with disappointing 3QFY13 revenue growth being the key driver for the slide **We believe this provides a good buying opportunity on likely revenue acceleration in 2HFY14/FY15, stable-to-higher margins, FY15E cash/share of Rs63 (nearly 40% of market capitalisation) and attractive valuation at 6.3x FY15E EPS (5.7x FY15E EPS adjusting for cash and interest income).**

It should be noted that **in rupee terms, our FY14E revenue growth estimate is relatively subdued, at 4.5% YoY, owing partly to single-digit revenue growth in US dollar terms (8.9% YoY) and rupee appreciation, as we have taken the rate of Rs52/$ for conversion as against Rs54.50/$ for FY13E**. As stated above and detailed subsequently in this report, **we expect revenue growth to accelerate in FY15E, with dollar revenue growth at 14.3% YoY and rupee revenue growth at 12.1% YoY**.

**Exhibit 5: IEL stock price – Downward trend owing to disappointing 3QFY13 results**

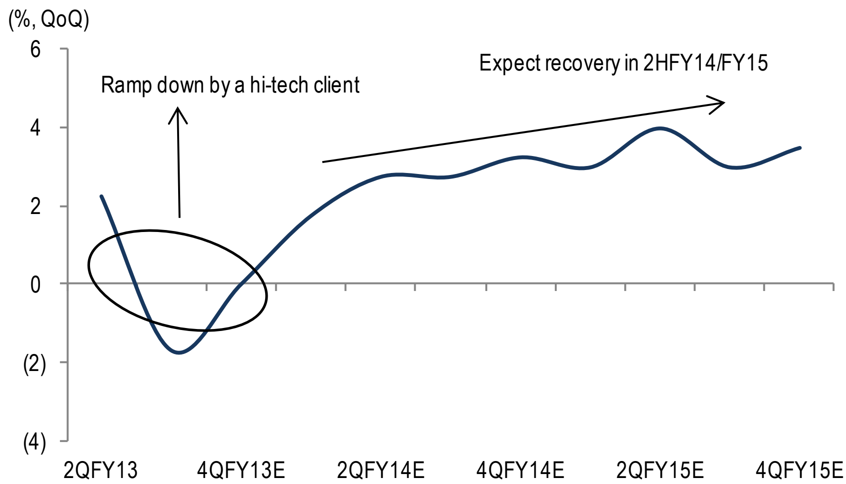



*Source: C-line*

### ENGG segment to drive 2HFY14/FY15 growth led by client addition, long-term relationships

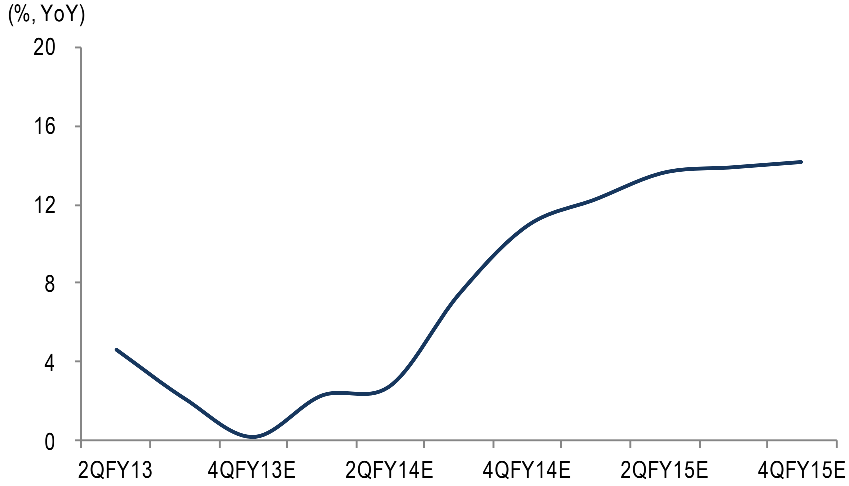
IEL saw a ramp-down from a hi-tech (semiconductor) client in the ENGG segment in 3QFY13, with an impact expected in 4QFY13 also. We expect growth to resume in the ENGG segment from 2HFY14/FY15 with a 9.2% YoY dollar growth in 2HFY14E (2.5% in 1HFY14E), and FY15E growth of 13.5% (5.9% in FY14E). **Healthy client adds (23 clients in 9MFY13 versus 24 in FY12), and IEL's strong long-term relationships with key clients with long-term revenue visibility lend confidence about a recovery in 2HFY14. Given the fact that this segment contributes over 66% to IEL's revenue, recovery in growth is critical for overall revenue growth acceleration.**

**Exhibit 6: ENGG segment – QoQ dollar revenue growth**



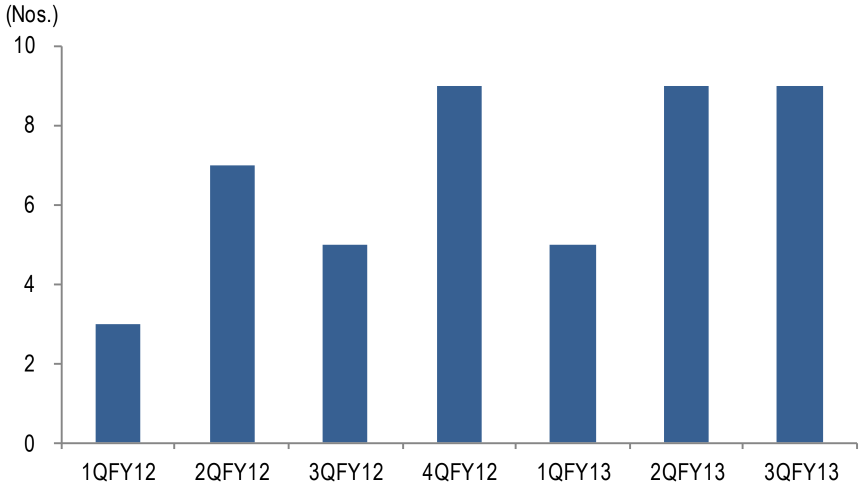

*Source: Company, Nirmal Bang Institutional Equities Research*

**Exhibit 7: ENGG segment – YoY dollar revenue growth**




*Source: Company, Nirmal Bang Institutional Equities Research*

**Exhibit 8: ENGG client addition to drive revenue going forward**




*Source: Company*

**Within ENGG, we expect the transportation and aerospace sub-segments to drive growth. IEL counts global aerospace and rail transportation majors like Pratt & Whitney, Sikorsky, UTC Aerospace Systems (all part of the United Technologies Group), The Boeing Company, The European Aeronautic Defence and Space Company (EADS, Airbus) and Bombardier Transportation as its clients in these sub-segments and has a long and successful track record of working with these entities.** To cite an example, it has a 12-year-long relationship with Pratt & Whitney, a global major in the design and manufacture of aircraft engines and equipment, an eight-year relationship with The Boeing Company, a leading civil and military aircraft manufacturer and the second-largest aerospace and defense contractor globally, and a nine-year relationship with Bombardier Transportation, the rail equipment division of Canada-based Bombardier, one of the world's largest rail equipment manufacturing and servicing companies.

Typically, ENGG work is sticky and long-term in nature, with the contract tenure being five-eight years. Thus, revenue visibility is high in this segment, with a major portion (75%-80%) as annuity business. **We expect this factor along with the long-term relationships IEL has with its key ENGG clients and recent client addition to drive uptick in the ENGG business from 2HFY14.**

**Exhibit 9: ENGG segment – Key clients, scope of work**

| Client | Scope of work | Relationship tenure |
|---|---|---|
| United Technologies Group (Pratt & Whitney, Sikorsky, UTC Aerospace Systems) | Engineering, maintenance, repair & overhaul (MRO), SAP, engine design, avionics | 12 years |
| The Boeing Company | Wing structures, cabin electronics, in-flight entertainment, mood lighting (avionics) | 8 years |
| Bombardier | Railway signalling, rolling stock (bogie design) | 9 years |

*Source: Company*

**Exhibit 10: ENGG segment - Key client profile**

| Client | Industry | CY12 revenue | CY12 operating profit | CY12 R&D expenditure |
|---|---|---|---|---|
| Pratt & Whitney* | Leader in the design and manufacture of aircraft engines, gas turbines | US$13,964mn | US$1,589mn | US$2,371mn |
| Sikorsky* | Leader in helicopter design and manufacture | US$6,791mn | US$712mn | US$2,371mn |
| UTC Aerospace Systems* | Leader in the design and manufacture of aerospace, industrial products | US$8.334mn | US$944mn | US$2,371mn |
| Bombardier Transportation# | Rail transportation | US$8,140mn | US$290mn | US$299mn |
| The Boeing Company | Aerospace - civil and military aircraft, defense | US$81,698mn | US$13,054mn | US$3,298mn |
| EADS (Airbus)@ | Aerospace - civil and military aircraft, defense | €25,919mn | €826mn | €1,672mn |

** Revenue and operating profit are for the respective divisions, while R&D expenditure is for the entire United Technologies Group.*

*# R&D expenditure is for the entire Bombardier Corporation.*

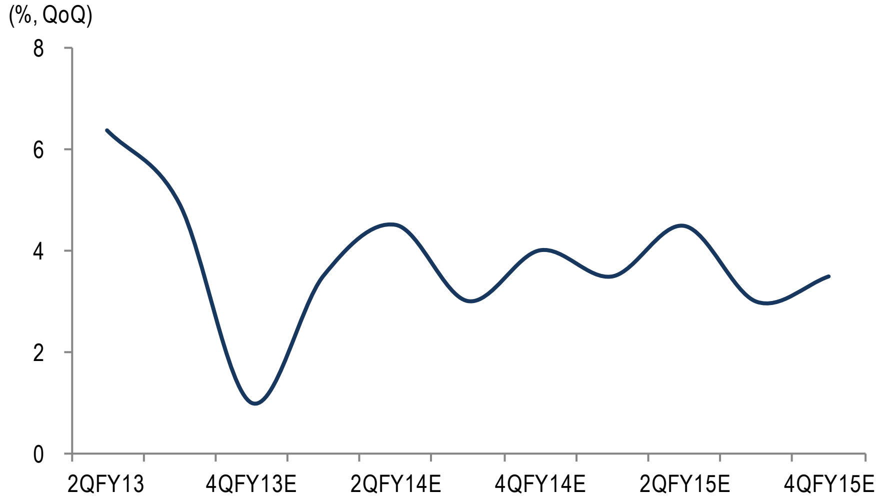
*@ Data is for 9MCY12 period, with 4QCY12 results scheduled to be announced on 27 February 2013.*

*Source: Respective companies*

**CY13 prospects of IEL's clients also appear stable. The Boeing Company, for example, has given guidance of around 4% revenue growth, 4%-7% EPS growth and R&D expenditure of US$3.4bn, up 3% over CY12, while United Technologies has given guidance of CY13E revenue growth of 11%-13% and EPS growth of 9%-15%. Bombardier Transportation has given guidance of high single-digit revenue growth for CY13. This is an indication that CY13 is likely to be a stable-to-growing year for its key clients, which is undoubtedly a positive factor for the ENGG business in FY14**.

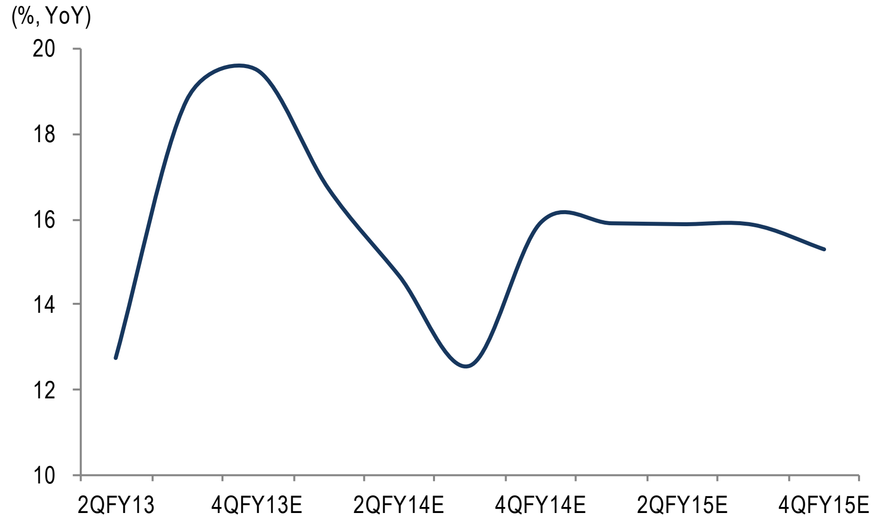
On the other hand, we expect the UT&C segment to continue to grow at a healthy pace, with around 15%-16% growth in FY14E/FY15E. Thus, on an overall basis, we expect 10.9% YoY dollar revenue growth in 2HFY14E (6.7% in 1HFY14E) and 14.3% growth in FY15E (8.9% in FY14E).

**Exhibit 11: UT&C segment – QoQ dollar revenue growth**




*Source: Company, Nirmal Bang Institutional Equities Research*

**Exhibit 12: UT&C segment – YoY dollar revenue growth**

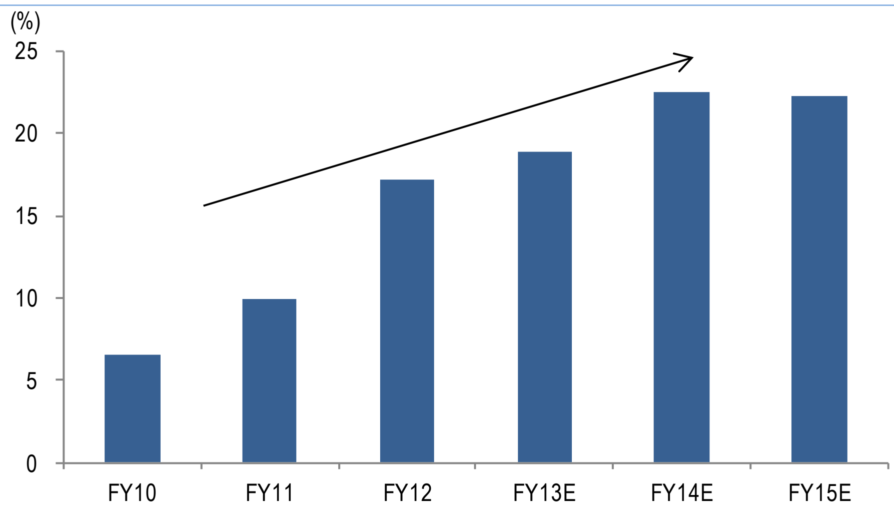



*Source: Company, Nirmal Bang Institutional Equities Research*

### FY15E cash at 38% of market capitalisation to provide support, higher dividend likely

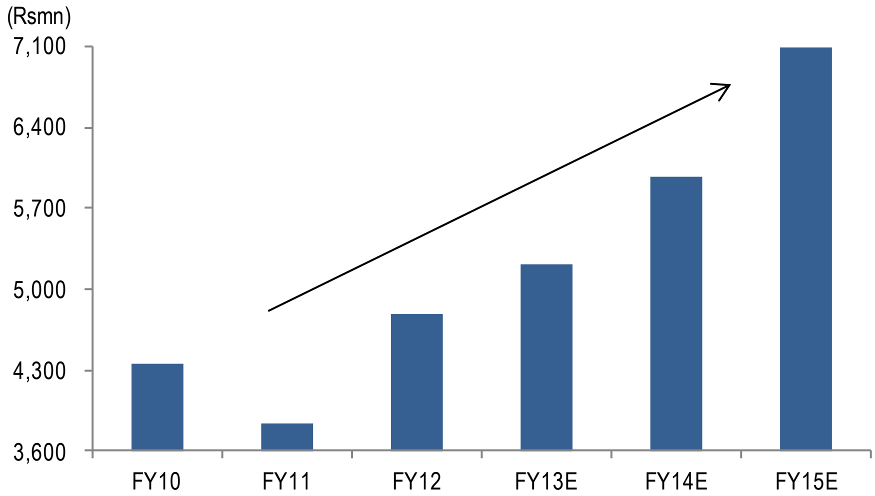
We expect IEL's cash and liquid investments to top Rs7bn in FY15E, which amounts to Rs63/share, or 38% of market capitalisation. This, we expect, will provide valuation support to the stock. It is also likely to further boost the dividend payout ratio, which has risen to 17.3% in FY12 from 10.0% in FY11 and in the wake of strong cash flow, a further increase is likely; we expect the dividend payout ratio to rise to over 22.0% in FY15E, with FY15E dividend yield at 3.5%.

**Exhibit 13: Dividend pay-out ratio – On the upswing…**




*Source: Company, Nirmal Bang Institutional Equities Research*

**Exhibit 14: ...aided by improving cash and liquid investments**




*Source: Company, Nirmal Bang Institutional Equities Research*

## Key risks to our call

- Any further client-specific issues in the ENGG segment, leading to slower revenue growth compared with our estimates
- Protectionist rhetoric in the US leading to greater scrutiny of visa applications and potentially higher costs/employee owing to the need to hire a greater number of more expensive onsite resources
- A significantly worsening economic situation in the Eurozone area where a number of IEL's key clients are based, leading to slower-than-expected volume growth as compared with our estimates
- Currency volatility leading to forex losses and adversely impacting profitability
- Higher-than-expected wage-cost inflation adversely impacting margins, particularly if not justified by higher revenue growth.

## Sensitivity analysis

We have done a sensitivity analysis for IEL and assessed the impact of key operating parameters like volume, billing rate and the rupee-US$ rate on the IT firm's revenue, EBITDA, margin and EPS. Given the sensitivity of any IT firm, including IEL, to the rupee's movement owing to their offshore-centric business model and higher costs in rupee terms as well as scope for leverage in case of higher-than-expected revenue growth, any given percentage change in either the rupee-US$ rate or in revenue growth typically has a more-than-proportionate impact on EBITDA and net profit. To cite an example, a 2% change in the rupee-US$ rate impacts rupee revenue by 2.0%, EBITDA by 5.1% and EPS by 3.0%, with the EPS impact lower than EBITDA impact owing to higher forex losses/gains.

**Exhibit 15: Dollar revenue sensitivity to volume and billing rate changes**

| | (US$mn) | | IT service volumes (hours, mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | **-4%** | **-2%** | **0%** | **2%** | **4%** |
| | | **(FY15E)** | **14.6** | **14.9** | **15.2** | **15.5** | **15.8** |
| **Blended billing rates (US$/hour)** | **-4%** | **27.3** | 398 | 406 | 414 | 423 | 431 |
| | **-2%** | **27.9** | 406 | 415 | 423 | 431 | 440 |
| | **0%** | **28.4** | 414 | 423 | **432** | 440 | 449 |
| | **2%** | **29.0** | 423 | 431 | 440 | 449 | 458 |
| | **4%** | **29.6** | 431 | 440 | 449 | 458 | 467 |

*Source: Nirmal Bang Institutional Equities Research*

### Exhibit 16: Dollar revenue sensitivity in percentage terms

| | Chg. (%) | | IT service volumes (hours, mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 14.6 | 14.9 | 15.2 | 15.5 | 15.8 |
| Blended billing rates (US$/hour) | -4% | 27.3 | (7.8) | (5.9) | (4.0) | (2.1) | (0.2) |
| | -2% | 27.9 | (5.9) | (4.0) | (2.0) | (0.0) | 1.9 |
| | 0% | 28.4 | (4.0) | (2.0) | **0.0** | 2.0 | 4.0 |
| | 2% | 29.0 | (2.1) | (0.0) | 2.0 | 4.0 | 6.1 |
| | 4% | 29.6 | (0.2) | 1.9 | 4.0 | 6.1 | 8.2 |

*Source: Nirmal Bang Institutional Equities Research*

### Exhibit 17: Rupee revenue sensitivity to dollar revenue and average rupee-dollar rate change

| | (Rsmn) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | 20,288 | 20,710 | 21,133 | 21,556 | 21,978 |
| | -2% | 50.0 | 20,710 | 21,142 | 21,573 | 22,005 | 22,436 |
| | 0% | 51.0 | 21,133 | 21,573 | **22,013** | 22,454 | 22,894 |
| | 2% | 52.0 | 21,556 | 22,005 | 22,454 | 22,903 | 23,352 |
| | 4% | 53.0 | 21,978 | 22,436 | 22,894 | 23,352 | 23,810 |

*Source: Nirmal Bang Institutional Equities Research*

### Exhibit 18: Rupee revenue sensitivity in percentage terms

| | Chg. (%) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | (7.8) | (5.9) | (4.0) | (2.1) | (0.2) |
| | -2% | 50.0 | (5.9) | (4.0) | (2.0) | (0.0) | 1.9 |
| | 0% | 51.0 | (4.0) | (2.0) | **0.0** | 2.0 | 4.0 |
| | 2% | 52.0 | (2.1) | (0.0) | 2.0 | 4.0 | 6.1 |
| | 4% | 53.0 | (0.2) | 1.9 | 4.0 | 6.1 | 8.2 |

*Source: Nirmal Bang Institutional Equities Research*

### Exhibit 19: EBITDA sensitivity to dollar revenue and average rupee-dollar rate change

| | (Rsmn) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | 3,375 | 3,607 | 3,884 | 4,141 | 4,317 |
| | -2% | 50.0 | 3,607 | 3,888 | 4,104 | 4,321 | 4,578 |
| | 0% | 51.0 | 3,796 | 4,060 | **4,324** | 4,588 | 4,853 |
| | 2% | 52.0 | 4,050 | 4,319 | 4,544 | 4,769 | 5,060 |
| | 4% | 53.0 | 4,293 | 4,536 | 4,809 | 5,060 | 5,312 |

*Source: Nirmal Bang Institutional Equities Research*

### Exhibit 20: EBITDA sensitivity in percentage terms

| | Chg. (%) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | (22.0) | (16.6) | (10.2) | (4.2) | (0.2) |
| | -2% | 50.0 | (16.6) | (10.1) | (5.1) | (0.1) | 5.9 |
| | 0% | 51.0 | (12.2) | (6.1) | **0.0** | 6.1 | 12.2 |
| | 2% | 52.0 | (6.4) | (0.1) | 5.1 | 10.3 | 17.0 |
| | 4% | 53.0 | (0.7) | 4.9 | 11.2 | 17.0 | 22.8 |

*Source: Nirmal Bang Institutional Equities Research*

**Exhibit 21: EBITDA margin sensitivity**

| | EBITDA margin (%) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | 16.6 | 17.4 | 18.4 | 19.2 | 19.6 |
| | -2% | 50.0 | 17.4 | 18.4 | 19.0 | 19.6 | 20.4 |
| | 0% | 51.0 | 18.0 | 18.8 | **19.6** | 20.4 | 21.2 |
| | 2% | 52.0 | 18.8 | 19.6 | 20.2 | 20.8 | 21.7 |
| | 4% | 53.0 | 19.5 | 20.2 | 21.0 | 21.7 | 22.3 |

*Source: Nirmal Bang Institutional Equities Research*

**Exhibit 22: EPS sensitivity to dollar revenue and average rupee-dollar rate change**

| | EPS (Rs) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | 21.4 | 23.0 | 24.9 | 26.6 | 27.9 |
| | -2% | 50.0 | 22.6 | 24.5 | 26.0 | 27.5 | 29.3 |
| | 0% | 51.0 | 23.6 | 25.2 | **26.9** | 28.5 | 30.1 |
| | 2% | 52.0 | 24.5 | 26.2 | 27.7 | 29.1 | 31.0 |
| | 4% | 53.0 | 25.7 | 27.3 | 29.0 | 30.6 | 32.2 |

*Source: Nirmal Bang Institutional Equities Research*

**Exhibit 23: EPS sensitivity in percentage terms**

| | Chg. (%) | | US dollar revenue (US$mn) | | | | |
|---|---|---|---|---|---|---|---|
| | | | -4% | -2% | 0% | 2% | 4% |
| | | (FY15E) | 414 | 423 | 432 | 440 | 449 |
| Average rupee-dollar rate (Re/US$) | -4% | 49.0 | (20.4) | (14.5) | (7.5) | (0.9) | 3.8 |
| | -2% | 50.0 | (15.7) | (8.7) | (3.2) | 2.4 | 9.0 |
| | 0% | 51.0 | (12.2) | (6.1) | **0.0** | 6.1 | 12.2 |
| | 2% | 52.0 | (8.7) | (2.4) | 3.0 | 8.4 | 15.3 |
| | 4% | 53.0 | (4.2) | 1.5 | 7.9 | 13.8 | 19.8 |

*Source: Nirmal Bang Institutional Equities Research*

**Exhibit 24: Comparative analysis**

| Particulars (FY15E/CY14E) | Infotech Ent. | Hexaware Tech. | Mindtree | KPIT Cummins Info. |
|---|---|---|---|---|
| *Revenue growth (%, FY15E/CY14E)* | *12.1* | *10.2* | *11.3* | *13.6* |
| *EBITDA margin (%, FY15E/CY14E)* | *19.6* | *19.4* | *20.7* | *15.5* |
| *Net profit growth (%, FY15E/CY14E)* | *20.8* | *11.0* | *7.5* | *14.9* |
| Revenue (Rsmn, FY15E/CY14E) | 22,013 | 22,754 | 28,483 | 28,697 |
| EBITDA (Rsmn, FY15E/CY14E) | 4,324 | 4,416 | 5,903 | 4,453 |
| Net profit (Rsmn, FY15E/CY14E) | 2,993 | 3,572 | 4,196 | 2,836 |
| Revenue/employee (US$, FY12/CY12) | 35,855 | 41,928 | 39,189 | 43,461 |
| EBITDA/employee (US$, FY12/CY12) | 6,212 | 8,696 | 6,001 | 6,319 |
| Net profit/employee (US$, FY12/CY12) | 3,725 | 7,052 | 4,475 | 4,211 |
| *RoE (%, FY15E/CY14E)* | *18.3* | *24.3* | *22.8* | *20.8* |
| *RoCE (%, FY15E/CY14E)* | *15.6* | *21.0* | *20.9* | *17.8* |
| PE (x, FY15E/CY14E) | 6.3 | 7.3 | 8.6 | 7.4 |

*Note: For Infotech Enterprises, Hexaware Technologies and Mindtree, FY15/CY14 estimates are Nirmal Bang Institutional Equities Research estimates, while for KPIT Cummins Infosystems we have taken Bloomberg consensus estimates.*

*Source: Respective companies, Nirmal Bang Institutional Equities Research*

## Financial performance

**3QFY13 – Disappointing revenue growth, forex gains boost net profit**

**Revenue**

For 3QCY12, IEL reported a marginal 0.5% QoQ rise in revenue at US$87.6mn, while in rupee terms it posted a 0.4% QoQ decline at Rs4,751mn. Volume was impacted due to furloughs in its heavy engineering clients and ramp-down in an engagement from a hi-tech client. Segment-wise, UT&C grew at a healthy 4.9% QoQ (in US$ terms), while the ENGG business reported a 1.7% QoQ decline. From a sub-segment perspective, within ENGG, aerospace grew 0.9% QoQ in US dollar terms, while heavy engineering, transportation and hi-tech declined 5% QoQ. Within UT&C, utilities and telecom grew by a healthy 7.8% QoQ, while content declined 1.1% QoQ.

**Margins**

IEL posted a slight 15bps QoQ decline in EBITDA margin in 3QFY13, despite a 179bps QoQ drop in gross margin, owing to cost control measures on the SG&A side (down 151bps QoQ as a percentage of revenue).

**Net profit**

IEL registered a 22.9% QoQ rise in its 3QFY13 net profit at Rs618mn, despite the decline in margins, because of forex gains of Rs54mn versus a forex loss of Rs106mn in 2QFY13.

**Exhibit 25: 3QFY13, 9MFY13 performance**

| Y/E March (Rsmn) | 3QFY12 | 2QFY13 | 3QFY13 | *QoQ (%)* | *YoY (%)* | 9MFY12 | 9MFY13 | *Chg (%)* |
|---|---|---|---|---|---|---|---|---|
| Revenue | 4,165 | 4,771 | 4,751 | *(0.4)* | *14.1* | 11,358 | 14,086 | *24.0* |
| Employee costs | 2,464 | 2,788 | 2,857 | *2.5* | *16.0* | 6,990 | 8,408 | *20.3* |
| Other expenses | 845 | 1,091 | 1,013 | *(7.1)* | *19.9* | 2,491 | 3,054 | *22.6* |
| EBITDA | 857 | 892 | 881 | *(1.2)* | *2.8* | 1,877 | 2,624 | *39.8* |
| Depreciation | 142 | 145 | 162 | *11.8* | *13.5* | 381 | 440 | *15.6* |
| EBIT | 714 | 747 | 719 | *(3.7)* | *0.7* | 1,497 | 2,184 | *45.9* |
| Interest costs | 3 | 5 | 3 | *(32.6)* | *6.9* | 10 | 8 | *(19.6)* |
| Other income | (231) | (43) | 162 | *(475.9)* | *(170.3)* | (181) | 298 | *(264.6)* |
| Income before income tax | 481 | 699 | 879 | *25.6* | *82.8* | 1,305 | 2,474 | *89.5* |
| Tax | 172 | 226 | 278 | *22.7* | *61.9* | 452 | 796 | *76.3* |
| Associates' profit share | 30 | 30 | 17 | *(42.8)* | *(42.4)* | 62 | 109 | *76.3* |
| Minority interest | (1) | 0 | 0 | - | - | 0 | 0 | - |
| Exceptional items | 0 | 0 | 0 | - | - | 0 | (18) | - |
| Net profit | 340 | 503 | 618 | *22.9* | *82.1* | 915 | 1,768 | *93.2* |
| Diluted EPS (Rs) | 3.0 | 4.5 | 5.5 | *22.9* | *82.1* | 8.2 | 15.9 | *93.2* |
| *EBITDA margin (%)* | *20.6* | *18.7* | *18.5* | - | - | *16.5* | *18.6* | - |
| *EBIT margin (%)* | *17.2* | *15.7* | *15.1* | - | - | *13.2* | *15.5* | - |
| *Net profit margin (%)* | *8.2* | *10.5* | *13.0* | - | - | *8.1* | *12.6* | - |

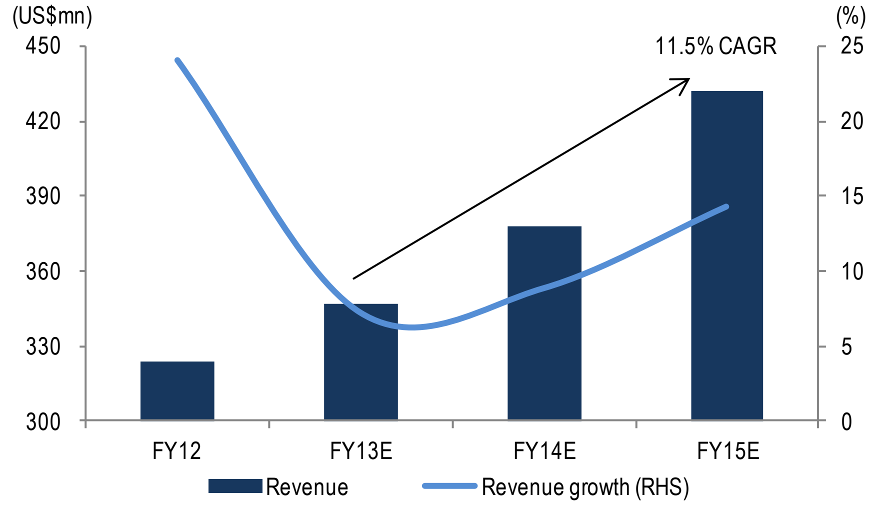
*Source: Company*

## Key assumptions

### Revenue

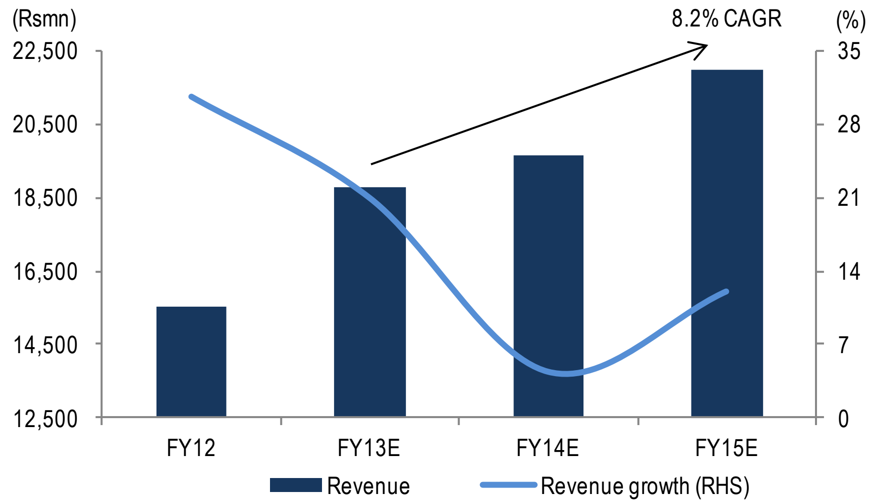
**We forecast an 11.5% CAGR in US dollar revenue over FY13E-FY15E (US$432mn in FY15E versus US$347mn in FY13E). We forecast volume CAGR of 11.8% over the same period, with blended pricing expected to post a marginal compounded decline of 0.3%. We expect revenue acceleration in 2HFY14 and FY15, as client-specific issues get resolved and IEL's long-term relationships with marquee clients stand it in good stead, with a 14.3% growth expected in FY15E (8.9% in FY14E). In rupee terms, we expect revenue to post 8.2% CAGR (Rs22.0bn in FY15E versus Rs18.8bn in FY13E), as we forecast rupee appreciation over the period, with Rs52/$ rate taken for FY14E and Rs51/$ for FY15E.**

**Exhibit 26: Dollar revenue, growth forecasts**




*Source: Company, Nirmal Bang Institutional Equities Research*

**Exhibit 27: Rupee revenue, growth forecasts**

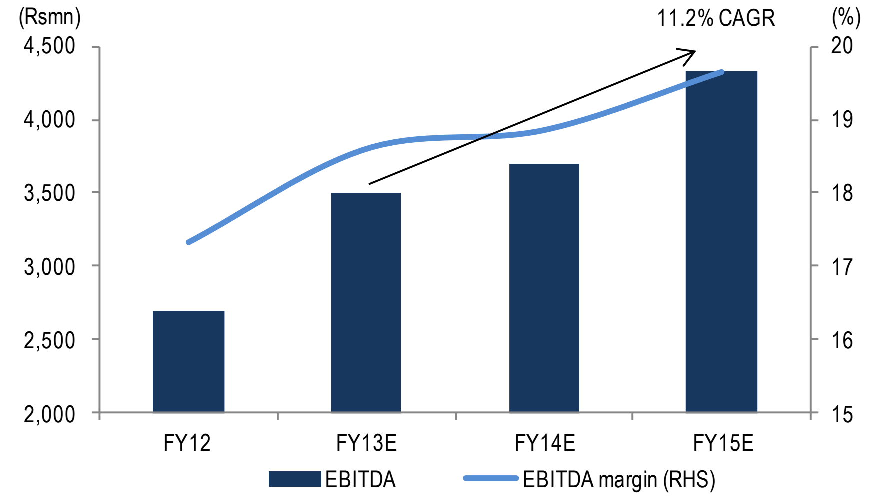



*Source: Company, Nirmal Bang Institutional Equities Research*

### Margins

**We forecast a slight expansion in margins over FY13E-FY15E, despite rupee appreciation, led by G&A leverage and employee pyramid, with 40% fresher hiring likely going forward as against 20%-25% historically, thereby keeping wage costs in check. We factor in a 19.6% EBITDA margin for FY15E as against 18.6% for FY13E. In absolute terms, we forecast 11.2% CAGR in EBITDA over FY13E-FY15E.**

**Exhibit 28: EBITDA, margin forecasts**

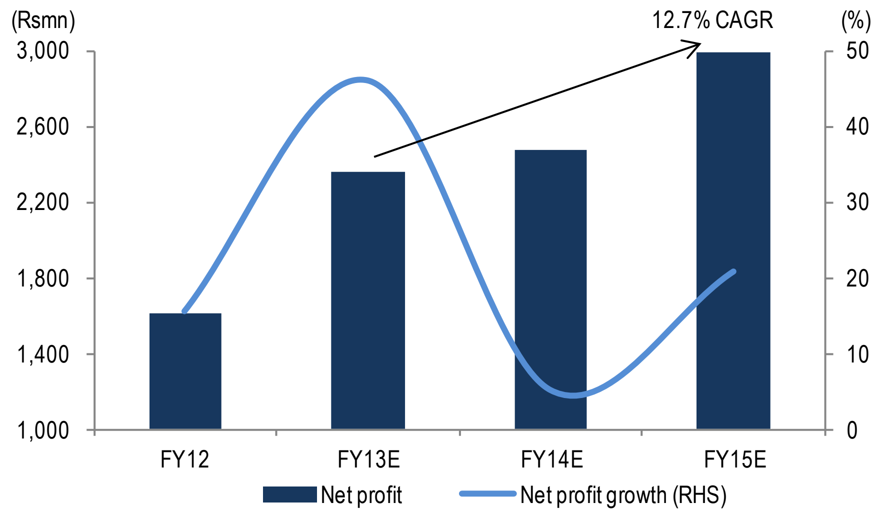



*Source: Company, Nirmal Bang Institutional Equities Research*

### Net profit

**We forecast a 12.7% CAGR in IEL's net profit over FY13E-FY15E. We expect acceleration in net profit growth in FY15E (20.8% growth versus 5.1% in FY14E), aided by higher revenue growth and expansion in margins. We expect net profit growth to be slower in FY14E due to slower revenue growth and rupee appreciation of 4%.**

**Exhibit 29: Net profit, growth forecasts**




*Source: Company, Nirmal Bang Institutional Equities Research*

## Company background

IEL is a mid-sized IT services company with revenue of US$324mn in FY12. The company has a focus on two major segments - engineering services (ENGG) and utilities, telecom and content (UT&C). IEL services several sub-segments. In the ENGG vertical, IEL provides services such as mechanical design, electronic design, technical publications, engineering software development and product lifecycle management (PLM) to clients across aerospace, rail transportation, heavy engineering and hi-tech sub-segments. The company counts marquee names like United Technologies, The Boeing Company, EADS (Airbus) and Bombardier as its clients. On the other hand, in the UT&C sub-segment, IEL provides digital photogrammetry, geographic information system (GIS) data management, consultancy, data digitisation and asset utilisation services to its clients. The company counts names such as TomTom, British Telecom and six of the top seven US northern grid companies as its UT&C clients. Geographically, IEL derives a major portion of its revenue from North America (60.7% in 3QFY13), with Europe forming the second-largest chunk (25.3%). The company has shown consolidated revenue, EBITDA and net profit CAGRs of 23.4%, 18.9% and 14.0%, respectively, over FY07-FY12 and had a total of 10,134 employees on its rolls as of 31 December 2012.

## Financials

### Exhibit 30: Income statement

| Y/E March (Rsmn) | FY11 | FY12` | FY13E | FY14E | FY15E |
|---|---|---|---|---|---|
| **Net sales** | **11,883** | **15,531** | **18,798** | **19,636** | **22,013** |
| *% growth* | *24.7* | *30.7* | *21.0* | *4.5* | *12.1* |
| **Total expenditure** | **10,085** | **12,840** | **15,302** | **15,934** | **17,689** |
| **EBITDA** | **1,799** | **2,691** | **3,496** | **3,702** | **4,324** |
| *% growth* | *(13.7)* | *49.6* | *29.9* | *5.9* | *16.8* |
| *EBITDA margin (%)* | *15.1* | *17.3* | *18.6* | *18.9* | *19.6* |
| Finance & other income | 272 | 175 | 422 | 507 | 524 |
| Finance expenses | 10 | 7 | 11 | 9 | 7 |
| **Gross profit** | **2,061** | **2,859** | **3,907** | **4,200** | **4,842** |
| *% growth* | *(18.1)* | *38.7* | *36.7* | *7.5* | *15.3* |
| Depreciation & amortisation | 486 | 494 | 605 | 700 | 602 |
| **Profit before tax** | **1,575** | **2,365** | **3,302** | **3,500** | **4,240** |
| *% growth* | *(24.3)* | *50.2* | *39.6* | *6.0* | *21.1* |
| Tax | 270 | 835 | 1,054 | 1,102 | 1,335 |
| *Effective tax rate (%)* | *17.1* | *35.3* | *31.9* | *31.5* | *31.5* |
| **Profit after tax** | **1,305** | **1,530** | **2,248** | **2,397** | **2,904** |
| *% growth* | *(17.1)* | *17.2* | *47.0* | *6.6* | *21.1* |
| Exceptional items | 23 | (16) | (18) | - | - |
| Profit in associate co. | 70 | 100 | 127 | 80 | 88 |
| Minority Interest | 1 | - | - | - | - |
| **Reported net profit** | **1,397** | **1,614** | **2,357** | **2,478** | **2,993** |
| *% growth* | *(18.3)* | *15.5* | *46.1* | *5.1* | *20.8* |
| **EPS (Rs)** | **12.5** | **14.5** | **21.2** | **22.2** | **26.9** |
| *% growth* | *(18.3)* | *15.5* | *46.1* | *5.1* | *20.8* |

*Source: Company, Nirmal Bang Institutional Equities Research*

### Exhibit 31: Balance sheet

| Y/E March (Rsmn) | FY11 | FY12 | FY13E | FY14E | FY15E |
|---|---|---|---|---|---|
| Equity capital | 556 | 557 | 557 | 557 | 557 |
| Reserves & surplus | 9,737 | 11,018 | 12,854 | 14,679 | 16,889 |
| Net worth | 10,293 | 11,575 | 13,411 | 15,236 | 17,446 |
| Deferred tax liability | 11 | 33 | 33 | 33 | 33 |
| Long- term provisions & others | 440 | 493 | 493 | 493 | 493 |
| Short-term loans | 13 | 34 | 34 | 34 | 34 |
| Long-term loans | 0 | 0 | 0 | 0 | 0 |
| Total loans | 13 | 34 | 34 | 34 | 34 |
| **Total liabilities** | **10,757** | **12,135** | **13,971** | **15,797** | **18,007** |
| Goodwill | 471 | 209 | 209 | 209 | 209 |
| Other intangible assets | 273 | 352 | 221 | 90 | 90 |
| Gross block | 4,526 | 4,966 | 5,718 | 6,455 | 7,225 |
| Depreciation | 1,890 | 2,171 | 2,645 | 3,213 | 3,815 |
| Net block | 2,637 | 2,796 | 3,074 | 3,242 | 3,410 |
| Capital work In progress | 13 | 108 | 108 | 108 | 108 |
| Investments | 579 | 244 | 244 | 244 | 244 |
| Deferred tax asset - net | 25 | 63 | 63 | 63 | 63 |
| Long-term loans and advances | 635 | 735 | 735 | 735 | 735 |
| Other non-current assets | 25 | - | - | - | - |
| Debtors | 2,910 | 4,262 | 5,665 | 6,725 | 7,840 |
| Cash & bank balance | 3,507 | 4,560 | 4,992 | 5,752 | 6,869 |
| Loans & advances | 373 | 353 | 353 | 353 | 353 |
| Current investments | 334 | 222 | 222 | 222 | 222 |
| Other current assets | 72 | 132 | 132 | 132 | 132 |
| Total current assets | 7,196 | 9,529 | 11,365 | 13,184 | 15,417 |
| Total current liabilities | 1,096 | 1,901 | 2,048 | 2,078 | 2,269 |
| Net current assets | 6,100 | 7,628 | 9,317 | 11,106 | 13,148 |
| **Total assets** | **10,757** | **12,135** | **13,971** | **15,797** | **18,007** |

*Source: Company, Nirmal Bang Institutional Equities Research*

### Exhibit 32: Cash flow statement

| Y/E March (Rsmn) | FY11 | FY12` | FY13E | FY14E | FY15E |
|---|---|---|---|---|---|
| EBIT | 1,313 | 2,197 | 2,891 | 3,002 | 3,722 |
| (Inc.)/dec. in working capital | (609) | (506) | (1,257) | (1,029) | (925) |
| **Cash flow from operations** | **703** | **1,691** | **1,635** | **1,972** | **2,798** |
| Other income | 272 | 175 | 422 | 507 | 524 |
| Depreciation & amortisation | 486 | 494 | 605 | 700 | 602 |
| Financial expenses | (10) | (7) | (11) | (9) | (7) |
| Tax paid | (431) | (734) | (1,054) | (1,102) | (1,335) |
| Dividends paid | (112) | (279) | (521) | (652) | (783) |
| **Net cash from operations** | **908** | **1,340** | **1,075** | **1,416** | **1,799** |
| Capital expenditure | (647) | (790) | (752) | (736) | (770) |
| **Net cash after capex** | **262** | **550** | **323** | **680** | **1,029** |
| Inc./(dec.) in ST borrowings | 13 | 21 | 0 | 0 | 0 |
| Inc./(dec.) in LT borrowings | (44) | 0 | 0 | 0 | 0 |
| **Inc./(dec.) in borrowings** | **(31)** | **21** | **0** | **0** | **0** |
| (Inc.)/dec. in investments | 753 | 97 | 0 | 0 | 0 |
| Equity issue/(buyback) | 24 | 17 | 0 | 0 | 0 |
| **Cash from financial activities** | **747** | **135** | **0** | **0** | **0** |
| Others | 162 | 368 | 109 | 80 | 88 |
| **Opening cash** | **2,337** | **3,507** | **4,560** | **4,992** | **5,752** |
| **Closing cash** | **3,507** | **4,560** | **4,992** | **5,752** | **6,869** |
| **Change in cash** | **1,170** | **1,052** | **433** | **760** | **1,117** |

*Source: Company, Nirmal Bang Institutional Equities Research*

### Exhibit 33: Key ratios

| Y/E March | FY11 | FY12` | FY13E | FY14E | FY15E |
|---|---|---|---|---|---|
| **Return ratios (%)** | | | | | |
| RoE | 14.4 | 14.8 | 18.9 | 17.3 | 18.3 |
| RoCE | 11.2 | 12.9 | 15.7 | 14.3 | 15.6 |
| **Operating ratios (%)** | | | | | |
| Revenue growth | 24.7 | 30.7 | 21.0 | 4.5 | 12.1 |
| EBITDA margin | 15.1 | 17.3 | 18.6 | 18.9 | 19.6 |
| EBITDA growth | (13.7) | 49.6 | 29.9 | 5.9 | 16.8 |
| Net profit growth | (18.3) | 15.5 | 46.1 | 5.1 | 20.8 |
| Revenue/employee (US$) | 31,894 | 35,855 | 35,456 | 35,678 | 38,083 |
| EBITDA/employee (US$) | 4,827 | 6,212 | 6,594 | 6,726 | 7,481 |
| Net profit/employee (US$) | 3,749 | 3,725 | 4,446 | 4,502 | 5,177 |
| Volume growth | 27.6 | 20.8 | 14.3 | 9.7 | 14.0 |
| Blended billing rate growth | 1.6 | 2.7 | (6.2) | (0.8) | 0.3 |
| Volume (mn, hours) | 8.8 | 10.6 | 12.1 | 13.3 | 15.2 |
| Blended billing rate (US$/hour) | 29.7 | 30.5 | 28.6 | 28.4 | 28.4 |
| **Valuation ratios (x)** | | | | | |
| PER | 13.5 | 11.7 | 8.0 | 7.6 | 6.3 |
| P/BV | 1.8 | 1.6 | 1.4 | 1.2 | 1.1 |
| Price/sales | 1.6 | 1.2 | 1.0 | 1.0 | 0.9 |
| EV/EBITDA | 8.3 | 5.2 | 3.9 | 3.5 | 2.7 |
| Dividend payout (%) | 10.0 | 17.3 | 18.9 | 22.5 | 22.4 |

*Source: Company, Nirmal Bang Institutional Equities Research*

## Disclaimer

**Stock Ratings Absolute Returns**

BUY > 15%

HOLD 0-15%

SELL < 0%

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