Initiating Coverage

December 15, 2011

NIIT Technologies (NIITEC)

₹ 187

The glass is half empty…

Rating matrix		
Rating	:	**Hold**
Target	:	₹ 170
Target Period	:	12 months
Potential Upside	:	-9%

YoY Growth (%)

	FY10	FY11	FY12E	FY13E
Net Sales	-6.8	34.9	27.3	20.9
EBITDA	7.0	27.3	13.4	20.0
Net profit	10.0	44.3	3.8	9.8
EPS	10.0	42.9	3.0	9.8

Current & target multiple

	FY10	FY11	FY12E	FY13E
PE (x)	8.7	6.1	5.9	5.4
EV to EBITDA(x)	5.4	4.3	3.8	3.1
Price to book (x)	2.0	1.6	1.3	1.1
Target PE	7.9	5.5	5.4	4.9
Target EV/EBITDA	4.9	3.8	3.4	2.8
Target P/BV	2.6	1.7	1.3	1.1

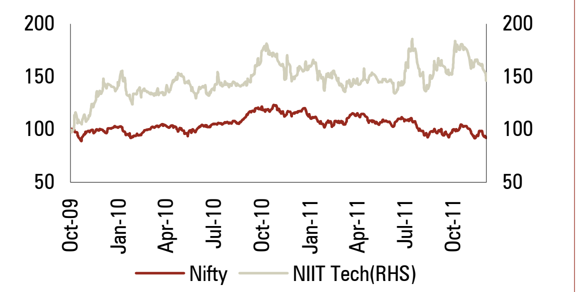
Stock Data

Bloomberg/Reuters Code	NITEC.IN/NITT.NS
Sensex	15858
Average Volumes (yearly)	46690
Market cap (₹ crore)	₹ 1118 Crore
Debt (Sep-11)	₹ 51 Crore
Cash (Sep-11)	₹ 142 Crore
EV	₹ 1027 Crore
52 week H/L (₹)	244/166
Equity capital	59.8
Face value	10.0
DII Holding (%)	12.3
FII Holding (%)	23.7

Comparative return matrix (%)

Returns (%)	1M	3M	6M	12M
NIIT tech	(8.2)	(12.1)	0.0	(0.3)
Polaris	(6.9)	(9.7)	(33.8)	(27.2)
KPIT Cummins	(7.6)	8.2	(7.9)	18.8
Mindtree	0.8	13.9	12.8	(23.2)

Price movement



Analyst's name
Abhishek Shindadkar
abhishek.shindadkar@icicisecurities.com
Aishwariya K PL
aishwariya.kpl@icicisecurities.com

NIIT Technologies (NTL) could have been the only BUY in our coverage universe, apart from TCS and Infosys, for a variety of reasons. Notable reasons include 1) operating margin (EBITDA, OPM) profile and historical composure relative to peers, 2) sticky relationships with top clients coupled with healthy order book yields revenue visibility, 3) attrition, onsite billing rates – comparable to best in the industry for certain verticals and non-linear revenue contribution and 4) compelling valuation multiples relative to similar margin profile companies. Acknowledging that these claims could have been contested frequently, what comforts us is that trading of OPM, from Q2FY12 levels of 14.8%, for revenues is unlikely as management prudence prevails and margins below a preset levels are unacceptable even to the founders. Anecdotally, the 2008-09 recession saw NTL trading at a meagre P/E multiple of 1.9x its trailing 12 month earnings. Were the events to unfold again, investors could be staring at substantial downsides from current levels. Consequently, though we like the operating model, chaotic macro overturns our rationale. We are initiating coverage on the stock with a HOLD rating.

Sticky relationship with top clients coupled with healthy order book improves revenue visibility

NTL's long standing relationships with a majority of its top clients including British Airways, Holcim, SEI, ING group, Sabre, Sita and Deutsche Bank (DB) coupled with healthy order book of US$232 million, as at Q2FY12 end, help improve revenue visibility. Applying historical (March 2006-11) average of 47.9% for ratio of opening next-twelve-month (NTM) order book to revenue billed in NTM on FY11 order book of $169 million yields FY12E revenues of $ 352.5 million, YoY growth of 29.1%.

Valuations

NIIT Tech has one of the best operating models within the midcap space primarily led by 1) revenue growth (growth at 17.9% CAGR during FY09-13E), 2) stable EBITDA margin, which treads the 17-20% band, 3) superior onsite billing rates (US$70-75/hour) and 4) attrition (13.4% Q2FY12 LTM attrition) comparable to Tier-1 players. At current levels, NTL is trading at 5.9x and 5.4x our FY12E and FY13E diluted EPS estimate of ₹ 31.7 and ₹ 34.7, respectively. From a Mcap/sales and EV/EBITDA perspective, it is trading at 0.7x and 3.8x on FY12E and 0.6x and 3.1x on FY13E basis, respectively. We have valued the company at 4.9x its FY13 EPS of ₹ 34.7 (25% discount to its historical 1-year forward PE multiple of 6.5x to account for the uncertain macro) to arrive at our target price of ₹ 170.

Exhibit 1: Valuation Metrics

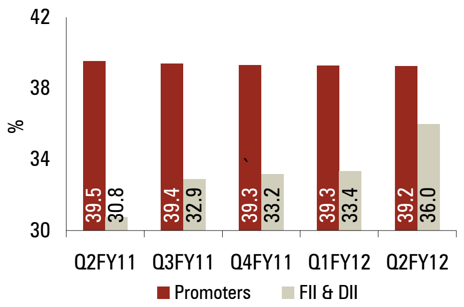
(₹ Crore)	FY09	FY10	FY11	FY12E	FY13E
Net Sales (₹ crore)	980	914	1232	1569	1897
EBITDA (₹ crore)	177	189	240	273	327
Net profit (₹ crore)	115	126	182	189	208
EPS (₹) - Basic	19.6	21.5	30.7	31.7	34.7
PE (x)	9.6	8.7	6.1	5.9	5.4
EV to EBITDA(x)	5.8	5.4	4.3	3.8	3.1
Price to book (x)	3.0	2.0	1.6	1.3	1.1
RoNW (%)	29.6	21.8	24.4	21.3	20.0
ROCE(%)	28.7	29.7	30.6	27.9	27.8

Source: Company, ICICIdirect.com Research

Shareholding pattern (Q2FY12)

Shareholder	Holding (%)
Promoters	39.2
FII	23.7
DII	12.3
Others	24.7

FII & DII holding trend (%)



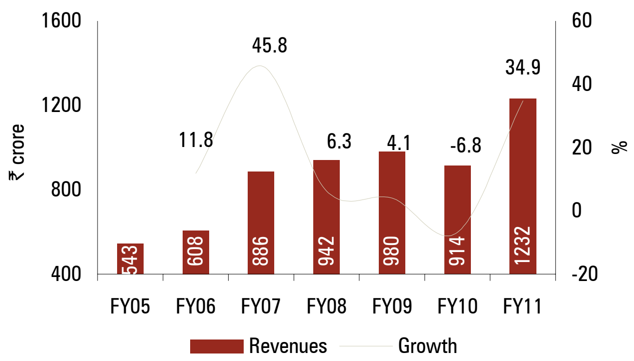
Company background

NIIT Technologies (NTL) was converted into an independent company in 2004 through a spin-off from the parent NIIT Ltd, as software revenue contribution increased in comparison to the education business in 2002. Over time, NTL has built expertise in application development & maintenance (ADM), enterprise solutions including managed services, intellectual property (IP) and business process outsourcing (BPO). The company has also entered into distributorship alliances with global software leaders such as Information Builders Inc., Sybase etc.

Business description

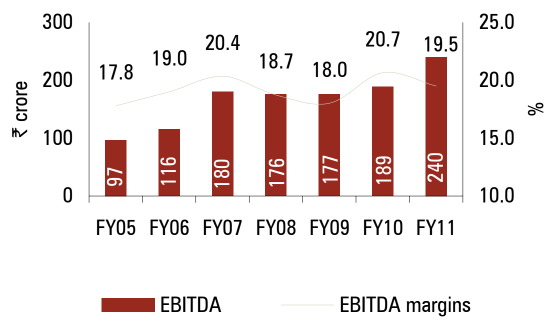
From a vertical perspective, Banking Financial Services & Insurance (BFSI) constitutes 39% of Q2FY12 revenues and counts ING, SEI, AXA, Amlin and Thrivent as some of its largest customers. Travel transportation & logistics (TTL, 36% of Q2FY12 revenues) services clients such as British Airways, Sabre, Virgin Group, DB, Changi airport, etc. Manufacturing & retail contribute 8% while government & others contribute 17% each. Geographically, NIIT Technologies generates 37% of revenues from the US, 38% from Europe Middle East & Africa (EMEA), 13% from Asia Pacific (APAC) and 12% from India. From a service line perspective, ADM constitutes ~60%, managed services - 13%, IP - 14%, geographical information systems (GIS) - 7% and BPO ~5%.

Exhibit 2: Historical revenue growth trends



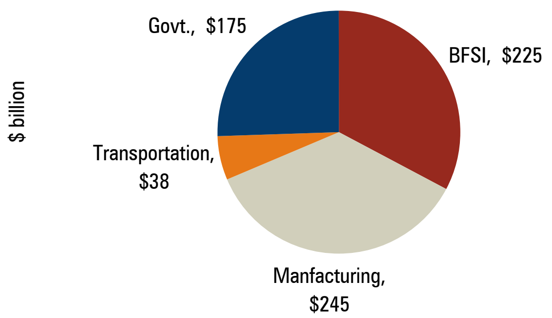
Source: Company, ICICIdirect.com Research

Exhibit 3: Historical EBITDA & EBITDA margin trends



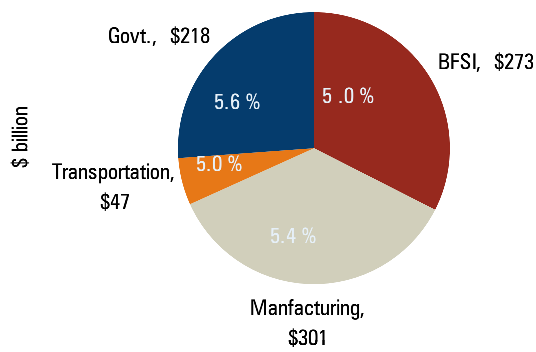
Source: Company, ICICIdirect.com Research

Exhibit 4: CY10 IT spend by verticals



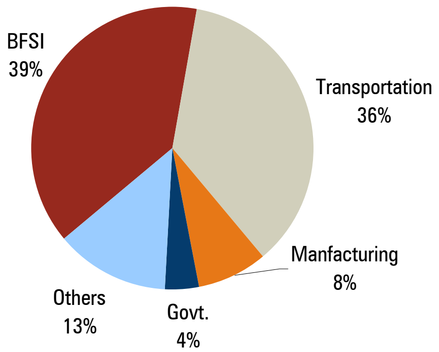
Source: NASSCOM, ICICIdirect.com Research

Exhibit 5: CY14E IT spending by vertical and CY10-14E CAGR



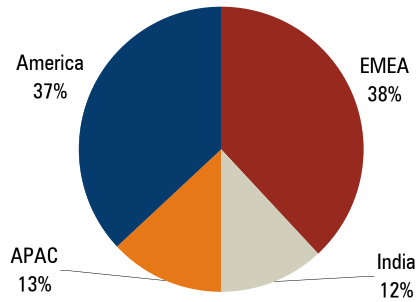
Source: NASSCOM, ICICIdirect.com Research

Exhibit 6: Revenue by vertical as of Q2FY12



Source: Company, ICICIdirect.com Research

Exhibit 7: Geographic revenue mix (Q2FY12, ex BSF bought outs deals)

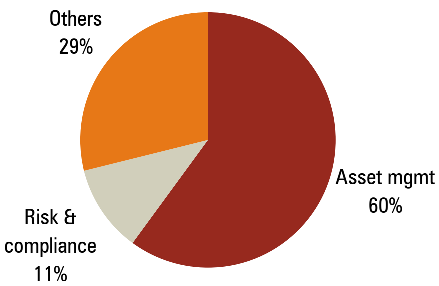


Source: Company, ICICIdirect.com Research, BSF – Border security force

Banking financial services & insurance revenues {41% of FY11 revenues (excluding BSF bought outs) or ₹ ~460 crore. Banking financial services (BFS) is 15% while 26% is insurance} were earned from 50+ clients and grew 16% YoY in FY11. The company primarily offers ADM, data warehousing & business intelligence, enterprise solutions (package implementation, managed services) and BPO services. With 1500+ BFSI resources, the company works closely with clients in the areas of:

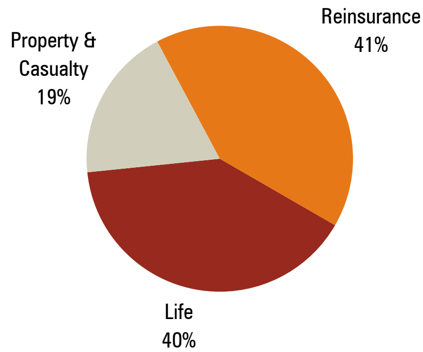
1. Risk & compliance offerings – Basel II compliance, anti money laundering, Sarbanes Oxley compliance, payment card industry data security standard (PCI DSS) compliance
2. Retail/wholesale/investment banking – loan origination & processing, mortgage processing, corporate finance, trade finance, risk management, reconciliation & settlement and regulatory reporting
3. Intellectual property led solutions & solution accelerators –
    a. IP led solutions – Subscribe (policy administration system), Exact Advantage – risk exposure, Acumen advantage (data warehouse solution), RFS (financial & regulatory reporting solution)
    b. Solution accelerators – SOA based accelerators for commercial insurers, services-oriented for life insurers, insurance testing, knowledge management

Exhibit 8: Sub vertical wise break-up – BFS (FY11)



Source: Company, ICICIdirect.com Research

Exhibit 9: Sub vertical wise break-up – Insurance (FY11)



Source: Company, ICICIdirect.com Research

Exhibit 10: NIIT Tech's BFS Offering

BFS@ NIIT Technologies

Domain
- ✓ Retail banking
- ✓ Wholesale banking
- ✓ Securities & capital markets
- ✓ Funds management

Channels
- ✓ Branches
- ✓ ATM
- ✓ Portal
- ✓ Call centre
- ✓ Agencies
- ✓ Mobiles

Operations
- ✓ Front office
- ✓ Middle office
- ✓ Back Office

Infrastructure
- ✓ Security
- ✓ Appliances
- ✓ Hardware
- ✓ Administrator
- ✓ Networks
- ✓ Service requests

Interfaces
- ✓ SWIFT
- ✓ Clearing houses
- ✓ Central bank
- ✓ Market feeds

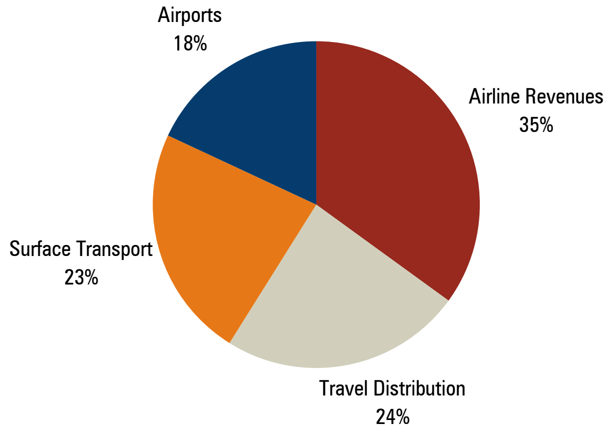
General
- ✓ Risk management
- ✓ Compliances
- ✓ Reports & analytics
- ✓ Research

Source: Company, ICICIdirect.com Research

Travel transportation & logistics vertical accounts for 32 %(excluding BSF bought outs) of FY11 revenues (₹ 394 crore), grew 25% YoY in FY11 and has 50+ clients. The 1200+ professionals provide application development, maintenance, migration, re-engineering, software-as-a-service (SAAS), BPO and GIS solutions. Sub-vertical wise airlines contribute 35% of TTL revenues, travel distribution 24%, surface transportation 23% and airports 18%.

Airline (35%) and travel distributions (24%) are the highest revenue generators in the TTL vertical, which contributes ~36% to NIIT Tech's revenues

Exhibit 11: TTL sub vertical wise break-up for FY11



Source: Company, ICICIdirect.com Research

NIIT Tech derives ~14% of revenues from platform based solutions, which grew 14% YoY in FY11. IPs include

A. Owned

1) Subscribe – covers all non-life commercial lines in both subscription and primary markets and is a modular, multi-currency insurance and reinsurance policy administration platform supporting full lifecycle of policies and associated reinsurance. Further it includes comprehensive audit and compliance functionality and the loss manager and EDI modules facilitate an end-to-end business process. Notably, 28% of Lloyd's premium (~£1.6 billion as of January 2008) passes through Subscribe. Note Lloyd's market in London is the world's leading specialist insurance market providing cover for assets in areas of marine, aviation, catastrophe, motor and professional indemnity. ACE, Advent, Atrium, Hardy, Marketform, Talbot Underwriting and Watkins Syndicate among others are current users of this solution
2) Acumen Advantage – provides reliable base for standardising data across organisations and has been developed for the non-life commercial insurance market
3) RFS - facilitates the production of fully reconciled financial reports at all levels of granularity for multinationals including their operational and domiciled jurisdiction
4) Exact Advantage - Exact Advantage supports detailed risk assessment of onshore and offshore risk using a risk aggregation engine and a powerful Geographical Information Systems (GIS) mapping interface. Aggregation engine generates potential loss figures for disaster scenarios, or real events, using detailed policy data taking into account the combination of perils, limits, sub-limits and reinsurance coverage for each policy impacted by the simulated loss event
5) IPF[3] development framework – a flexible solution with system integration capabilities, modular architecture and user interface that enables tailoring of business processes with precision
6) Monalisa – is a comprehensive solution with revenue accounting system, route cost analyser, log book management, aircraft allocation and crew control & movement
7) Route profitability analyser (RPA) – is an airline solution, which helps analyse and optimise routes to maximise profitability

B. In partnership

8) Cosys IS (CIS) – is specifically designed to provide tailor-made e-freight compliant solutions to cargo handling agents and carriers. The solution was first developed by Singapore Airport Terminal Services (SATS) and has jointly been marketed and implemented by NTL since March 2010
9) GeBiz – is an e-Government procurement solution to support eGovernance initiatives. NTL has productised the application (developed by Singapore's Defence Science and Technology Agency, DSTA) and continues to market the solution to other governments in South Asia, Middle East and Central Europe

Management Profile

Rajendra Pawar, Chairman & Managing Director. Rajendra, a pioneer of the IT training segment, has spearheaded several initiatives in the IT industry. He is also a part of the panel of six experts in the newly constituted Prime Minister's National Council on Skill Development, chaired by the Prime Minister of India. In 1999, Rajendra was conferred the Ernst & Young's Master Entrepreneur of the Year Award for his contribution to the sector.

Arvind Thakur, Chief Executive Officer. Arvind serves as the joint managing director on the board. Arvind joined NIIT Ltd in 1985 as a member of the core team and has held various senior positions since then. He was president of its software business before it was demerged to form NIIT Technologies Ltd. He serves on the boards of the company's overseas subsidiaries and domestic joint venture with ESRI Inc., a global technology leader in the GIS domain. He is also a Director in an innovative venture, Hole-in-the-wall Education Ltd that enables technology to be deployed to educate the masses. He is the Chairman and Managing Director of the BPO subsidiary NIIT Smart Serve Ltd. Recently, Mr Thakur was appointed on the Board of Management of NIIT University, a not for profit institution established in Rajasthan, India. Arvind started his career as an industrial engineer with BHEL after completing his engineering from the Indian Institute of Technology and post graduation in industrial engineering from NITIE.

Pratibha Advani, Chief Financial Officer. Pratibha is an alumnus of SRCC and a chartered accountant (CA) with six sigma certification and LEAN training. She has 25 years of rich experience in financial strategy, risk and governance, legal, secretarial, finance and accounts, tax planning, and acquisitions. In her last assignment, Pratibha was the CFO at Barclays Shared Services Pvt Ltd (a subsidiary of Barclays Bank Plc). Prior to this, she was the VP Finance and CFO at GE-SBI Cards and also Sourcing and Productivity Leader at GE Money, India. She joined NTL in 2010.

Arvind Mehrotra, President, Asia Pacific. Arvind is the President, Asia Pacific region and overlooks the business operations of all markets. He has been with NIIT Technologies for over a decade and has played a key role in the growth of the organisation over the years, spearheading company-wide strategy and related initiatives to strengthen the solutions and services offerings of the company across the world. Arvind has over 25 years of corporate experience during which he has held various middle and senior management positions across the IT services and the publications sectors.

Lalit Dhingra, President, NIIT Technologies Inc. Lalit heads the company's North American operations as president of NIIT Technologies Inc. Lalit was instrumental in setting up the company's software development labs in India during its early years as well as in initiating business development activities in the US, Europe and Singapore. An alumnus of IIT Delhi, Lalit has been with the company for over two decades and has in the past worked at HCL and C-DoT.

John Pierce, Senior Vice President (SVP), Insurance. John was the Managing Director of Strategic Technology Architects (STA Group) and has worked with Zurich American Insurance, Insurance Information Technologies and Patni Computers Systems in the past. He has over 36 years of experience and joined NTL in June 2011.

Deepak Khosla, Global Head of Sales & Marketing. Deepak was the President – SAARC at Patni Computers Systems and has also worked with organisations such as HCL Ltd, SAS Inc, Digital Equipment Corporation

(DEC) and Dun & Bradstreet. He has over 22 years of experience and joined NTL in May 2011.

Sunil Surya, President Europe. Prior to NIIT Tech, Sunil was the head of European operations for Hexaware with revenue, profits and business growth responsibilities. He has also managed Hexaware's global travel & transportation practice and joined NTL in September 2010.

S Sridhar, President & COO NIIT GIS Ltd. Sridhar was the head of Integrated Engineering Services business for L&T's Chennai and Bangalore centres and has worked with HCL, Silicon Graphics, Autodesk and Magnasoft in the past. He has total experience of over 30 years.

Sujan Kotian, Vice President & Regional Leader Central Europe. Sujan has worked with HCL Technologies as Head of CPG & Retail practice for Central Europe and as client partner with IBM Global Business Services in the past. He joined in May 2011.

Ravi Nimmagadda, Head, US Banking Financial Services vertical. Prior to NTL, Ravi has worked with Mahindra Satyam as Vice President, Financial Services and with Wipro Technologies as Global Client Partner. Ravi joined in January 2011.

DV Subramaniam, Vice President and Country Manager, Netherlands. Subramaniam joined NTL in February 2011 from Mastek. At Mastek, he was the Client Services Director, while his earlier assignments include stints as CEO at Dorian Technology Solutions Ltd and Executive Director at Synergy Log-In Systems Ltd.

Investment Rationale

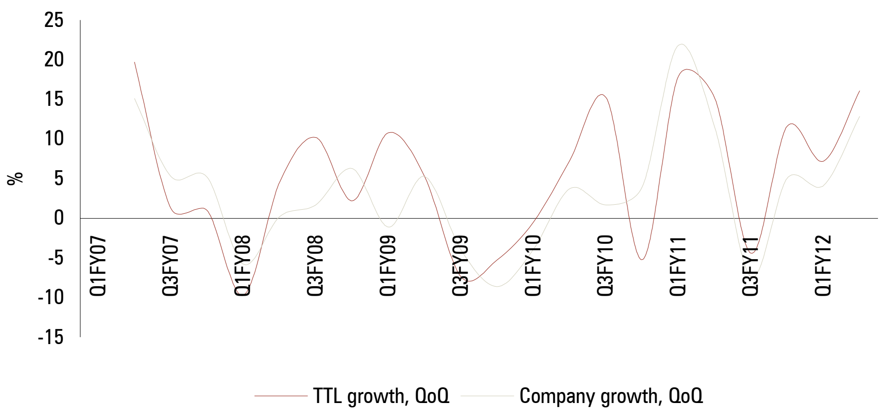
We expect a healthy order book, sticky relationships with a majority of its top clients and bought-out deals to be the key contributors for revenue growth. From an operational perspective, we expect rationalisation of the employee pyramid and shift in onshore-offshore effort to be key levers to offset the impact of bought-out deals and help sustain superior EBITDA margins relative to midcap peers. We are modelling revenues will grow 27.3% and 20.9% YoY in FY12E and FY13E, respectively. Also, we are modelling EBITDA margins will decline 210 bps in FY12E primarily led by bought-out deals and could decline by a modest 20 bps in FY13E as rationalisation efforts kick in and bought-out deals contribution subsides. Finally, though we acknowledge attractive PE valuations (5.4x our FY13E EPS estimate of ₹ 34.7) relative to peers coupled with healthy dividend yield, chaotic macro overturns our investment thesis.

NTL's TTL practice has been rated the best in an independent survey, above a similar practice of one of the largest Indian IT outsourcing vendors

Niche offering in transportation space

NIIT Tech's travel transportation & logistics (TTL) practice, 36% of Q2FY12 revenues, was rated the best in the TTL industry in an independent survey, above a similar practice of one of the largest Indian IT vendors. The TTL vertical grew at 4.6% compounded quarterly growth rate (CQGR) during Q1FY07-Q2FY12, marginally below the company average of 5.4% and has generally grown in line with the company average on a quarterly basis (Exhibit 12). NTL offers IP solutions, managed services and ADM services using Transaction Processing Facility (TPF) and Quantas Intelligent Keypad (QIK) architecture. Further, large TTL vertical engagements are sticky given that the contact points include chief executive officer (CEOs) and chief strategy officer (CXOs) vs. traditional chief information officer (CIO). Finally, premium pricing coupled with 1/3 contribution to revenues helps lift the average portfolio pricing.

Exhibit 12: QoQ revenue growth in TTL vertical & company since Q1FY07



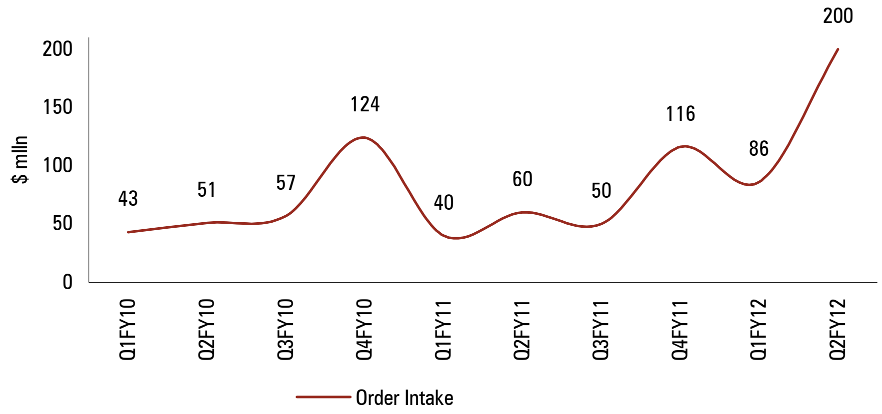
Source: Company, ICICIdirect.com Research

NTL has enjoyed decade-long relationships with few of its top clients

Sticky relationship with top 10 clients coupled with healthy order book yields revenue visibility

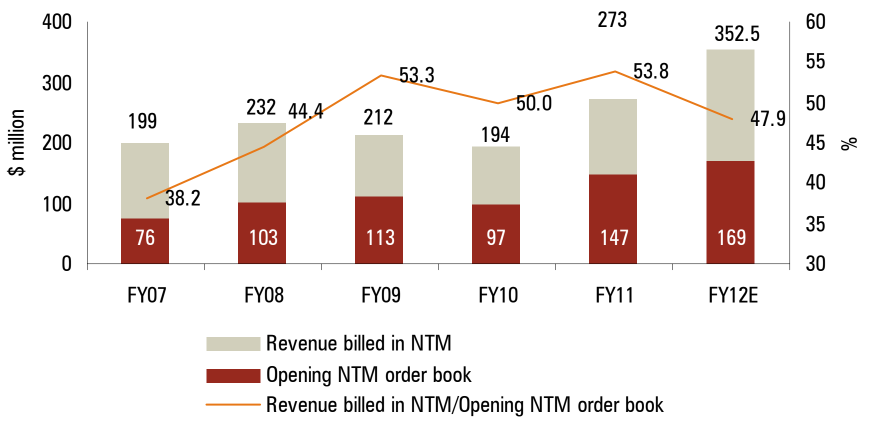
NTL has had long standing relationships with a majority of its top clients including British Airways, Holcim, SEI, Cathay Pacific, Sabre, Sita, Virgin Airlines, ING group, Toyota, AXA, DB. As at Q2FY12 end, NTL had an order backlog of US$232 million, which grew 16% QoQ and 65% YoY while the same at FY11 end was $169 million. Analysing the booking data since March 2006 suggests that the ratio of opening NTM order book to revenue billed in NTM stood in the 38-54%range (Exhibit 14). Applying historical (March 2006-11) average of 47.9% on FY11 order book of $169 million yields FY12E revenues of $352.5 million, YoY growth of 29.1%. We believe sticky relationships with key accounts coupled with healthy orders help improve revenue visibility in an uncertain macroeconomic environment.

Exhibit 13: Order intake at its highest in Q2FY12



Source: Company, ICICIdirect.com Research

Exhibit 14: Revenue billed in NTM has been average 2.1x initial NTM order book



Source: Company, ICICIdirect.com Research

Non-linear revenue margins are almost twice that of ADM services and help sustain superior operating margin profile

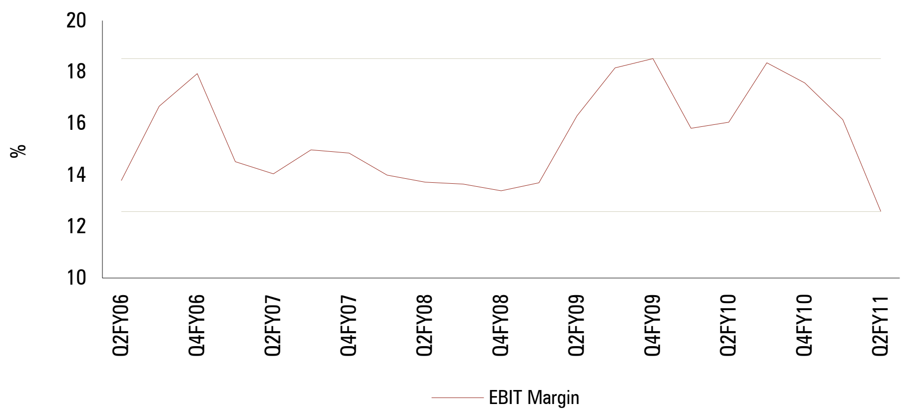
Non-linear revenue contribution may accelerate to 30% vs. current 27%

In FY11, NTL earned ~27% of its revenues from non-linear initiatives such as managed services (13% of FY11 revenues), platform based solutions (14%) and cloud computing. Platform based services contribution is driven by Room Solutions (11%, Room Solutions has been renamed as NIIT Insurance Technologies Ltd, UK) along with Cosys (2%) and Softec (1%). NTL's exposure to managed services dates back to 2005 wherein it took over the data centre operations for Holcim's Asia-Pacific region and it continues to work till date with Holcim and ACC. Recent deal wins at Eurostar in the transportation vertical and Morris in the media space could likely drive non-linear revenue contribution to 30% in FY12. We believe NTL's non-linear revenue contribution is higher relative to peers and could help sustain a superior operating margin profile.

Commendable operating margin composure over time

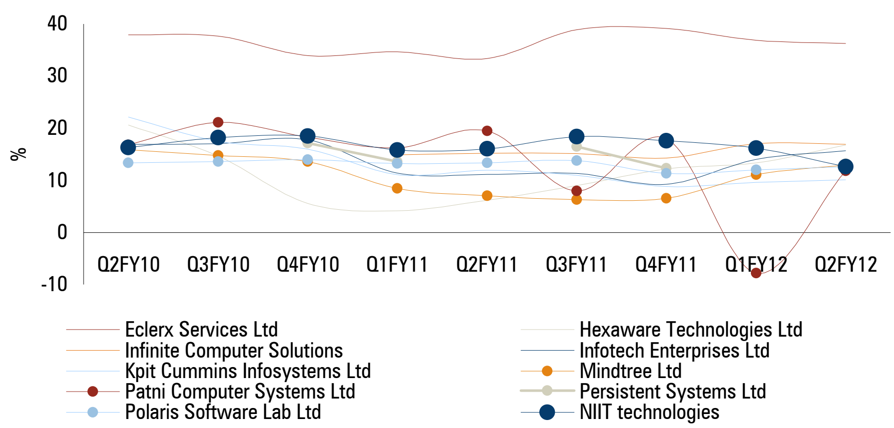
The historical margin performance at NTL is laudable given the composure since Q1FY06. NTL's EBITDA margins have been stable in the 17-20% band, except Q2FY12 wherein margins were 14.8% led by one-time payment of ₹ 11.9 crore for the Morris acquisition, compared to the volatile profile for some of it peers. Noticeably, though the EBITDA margins declined 72 bps to 18% in FY09, they expanded sharply by 266 bps to 20.7% in FY10 led by employee & SG&A rationalisation, despite a modest 4.1% and -6.8% growth in revenue in FY09 and FY10, respectively.

Exhibit 15: Operating margin stability and composure laudable



Source: Company, ICICIdirect.com Research

Exhibit 16: EBIT margin for peers



Source: Company, ICICIdirect.com Research

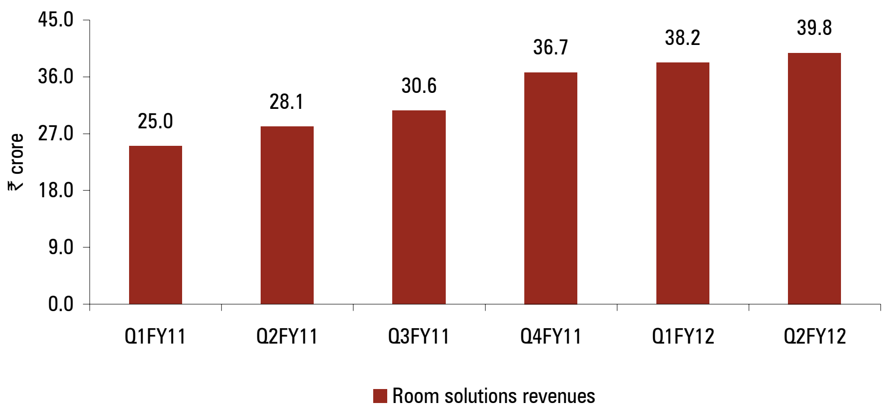
Operating margins at Room Solutions have almost trebled since the acquisition

Room acquisition continues to deliver

Recall, NTL had acquired a 51% stake in Room Solutions, a UK based insurance solutions provider for $25 million, in May 2006. At the time of acquisition, Room Solutions had revenues of ~$24 million (₹ 108 crore at ₹/$ rate of 45) with 120 employees and operating margin and net margin of 8% and 4%, respectively. As of Q2FY12, Room Solutions had trailing 12 month revenues of $32.3 million (₹ 145.3 crore at ₹/$ rate of 45) and operating margins of 27%. Noticeably, despite rationalising cost through offshoring, which helped improve margins, NTL has managed to sustain

Room Solution's revenues led in part by 1) increased license sales to existing platforms, 2) merger & acquisition integration work led by NTL's acquisitions. Note, apart from Subscribe, Acumen advantage and Exact advantage platforms, which were part of Room's acquisition, NTL is introducing an end-to-end insurance platform (IPF[3]) in the commercial line business using service oriented architecture (SOA). Migration of existing customers to an all-new platform IPF[3] should help sustain revenue growth momentum at Room Solutions.

Exhibit 17: Room Solutions revenues continue to grow



Source: Company, ICICIdirect.com Research

NTL entered into a 5- year (estimated at $ 40 million) managed services agreement with Eurostar. Post transition period, such deals typically have higher EBITDA margins relative to company average. Discussions with management suggest that Eurostar could be no different.

Could this be a precedent for Proyecta Sistemas, Eurostar?

NTL acquired Proyecta Sistemas de Informacion SA for ~$7 million in August 2011 at 0.7x CY10 sales ($10 million) and 7x CY10 EBITDA ($1 million). With >100 consultants Proyecta serves travel (2/3rd of its revenues from airline vertical) and financial services customers and has capabilities in business intelligence web and mobility applications. Proyecta's elite client list includes Iberia, Merrill Lynch & Banco Santander. Note, Iberia represents cross-sell/up-sell and offshoring opportunity given that British Airways (existing NTL relationship) and Iberia merged in January 2011 to form International Airlines Group (IAG). Our channel checks suggest that Proyecta's operating margins have modestly improved in Q3 while CY11 revenue growth could be flat at best. However, the internal target pegs CY12E revenue growth in excess of 18% with further expansion in operating margins.

Hiring of senior executives from peers has energised the sales function

Payoffs from focused reinvestments in sales & marketing effort

Hiring of 15-20 senior sales executives from midcap peers in the last 18 months took the sales function, including pre-sales, strength at NTL to 100. In sales parlance, the hiring was focused on 'hunters' rather than 'farmers'. Noticeably, healthy competition from new hires along with compensation (variable pays and Esops) has reinvigorated the old hands in the team. We believe focused hiring of individuals with deep client relationship has started to yield the likely pay-offs as reflected in the improved order book in the last 18 months.

GIS business adds directly to profit before tax

NTL's geographic information systems (GIS) practice is a strategic JV between NTL (89%) and ESRI Inc. US (11%). The company collaborated with ESRI Inc. US in 1985 to resell and support its ArcGIS software (ArcInfo earlier, sole distributor) and later formed a JV in 1996. Further, the JV is also the exclusive distributor of the ITT Visual Information System's (ITTVIS) ENVI suite of image processing software (ENVIEX) products for India, Nepal, Bhutan and Sri Lanka. Licensing sales of integrated (ESRI & ENVIEX) products adds directly to the PBT level and lifts the margins while services, custom application & maintenance revenues help sustain revenue momentum. GIS business revenues, EBITDA and PAT grew at 35.9%, 43.9% and 38.9% CAGR during FY09-FY11 period, respectively.

Exhibit 18: GIS Business from FY09-FY11 period

GIS	FY09	FY10	FY11
Revenue	45.5	50.6	84.1
EBITDA	17.1	13.4	35.5
% Revenue	*37.7*	*26.4*	*42.2*
PAT	15.1	11.7	29.1
% Revenue	*33.1*	*23.2*	*34.6*

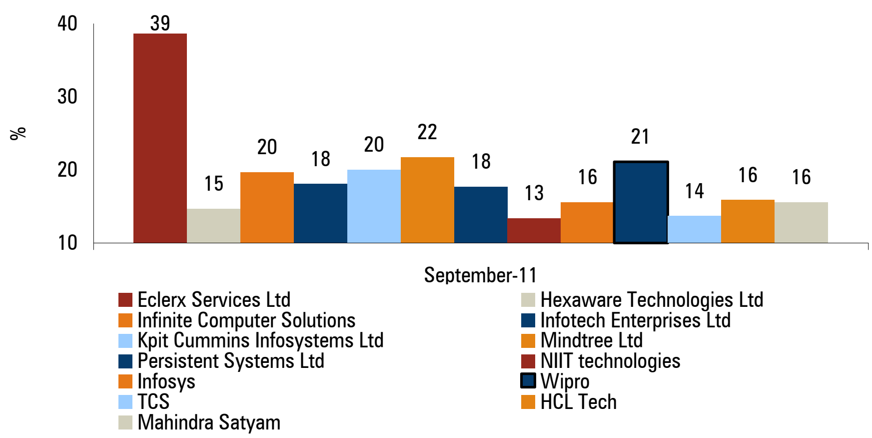
Source: Company, ICICIdirect.com Research

The employee pyramid continues to be skewed towards laterals. Increased fresher hiring could help flatten the employee pyramid and yield EBITDA/EBIT margin expansion

Opportunity exists for employee pyramid rationalisation

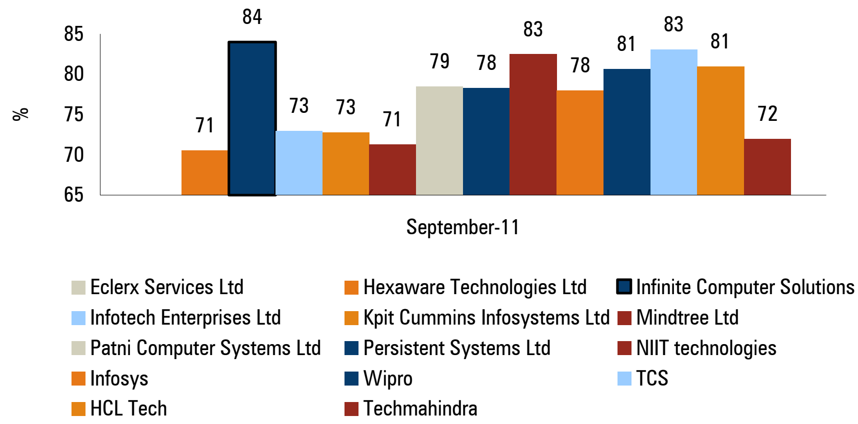
Discussions with the management suggest that employees with 0-3 year experience constitute 30% of the total employee base while 70% of the workforce has >3 years of experience taking the average experience of employees to greater than five years. On the flip side, attrition is lower thanks to higher age of employees. At 13.4%, the company's LTM attrition is among the lowest in the industry. Typical employee pyramid structure in an IT services company has ~45-55% of their employees in the 0-3 year band. However, freshers constituted 1/3rd of the total hiring in the previous two quarters & this suggests a shift in the hiring strategy. Employee pyramid rationalisation could help sustain the operating margin profile.

Exhibit 19: Attrition levels at end of Q2FY12



Source: Company, ICICIdirect.com Research

Exhibit 20: Utilisation levels at end of Q2FY12



Source: Company, ICICIdirect.com Research,

Valuation attractive relative to similar margin profile peers but macro is uncertain

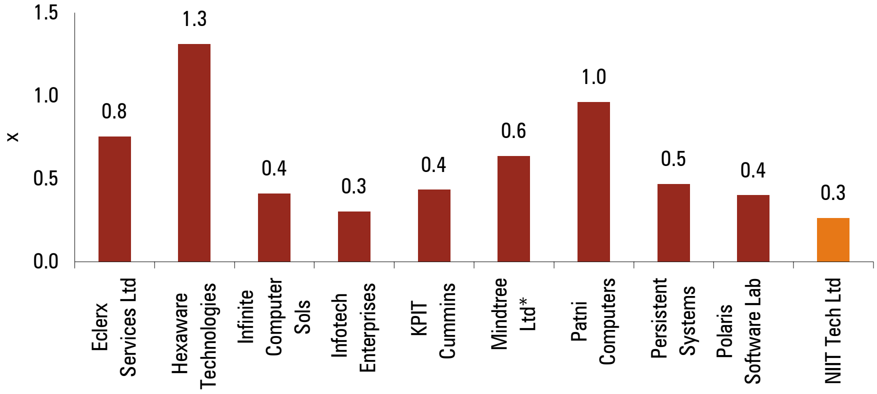
NTL is trading at one of the cheapest valuations relative to similar margin profile peers. On Mcap/sales metric, the stock is trading at 0.7x and 0.6x its FY12E and FY13E sales vs. peer group average of 1.4x and 1.2x, respectively. Further, on EV/EBITDA metric, NTL is trading at 3.5x and 2.9x its FY12E and FY13E EBITDA vs. peer group average of 6x and 5x. NTL is trading at 2.3x and 0.3x PEG based on FY12E and FY13E estimates relative to the peer group average of 0.3x and 4.9x. Finally, NTL is trading at Mcap/operating cash flow ratio of 16.5x vs. 30x for peers for FY11.

Exhibit 21: Peer valuation

Name	Price (₹)	Diluted EPS (₹)			P/E (x)			EV/EBIDTA (x)			PEG (x)		Mcap/Rev (x)		
		FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY12E	FY13E	FY11	FY12E	FY13E
Eclerx Services Ltd	719.6	40.7	51.9	60.1	17.7	13.9	12.0	10.0	10.7	8.9	0.5	0.8	6.1	4.6	3.6
Hexaware Technologies	82.7	5.7	8.1	8.7	14.5	10.2	9.5	16.5	8.1	6.4	0.2	1.3	2.3	1.7	1.4
Infinite Computer Sols	64.1	24.3	27.1	28.6	2.6	2.4	2.2	1.6	1.3	1.3	0.2	0.4	0.3	0.3	0.2
Infotech Enterprises	120.0	12.5	12.9	16.1	9.6	9.3	7.5	5.3	4.0	3.5	3.2	0.3	1.1	0.9	0.7
KPIT Cummins	148.8	11.3	14.5	17.4	13.1	10.2	8.5	7.7	5.9	4.7	0.4	0.4	1.3	1.0	0.8
Mindtree Ltd*	400.0	24.9	39.8	45.4	16.1	10.0	8.8	8.4	6.2	5.0	0.2	0.6	1.1	0.9	0.8
Patni Computers	445.9	46.4	30.7	34.8	9.6	14.5	12.8	7.6	8.4	6.9	-0.4	1.0	1.9	1.7	1.5
Persistent Systems	309.6	34.9	32.2	37.8	8.9	9.6	8.2	5.6	4.5	3.7	-1.2	0.5	1.6	1.3	1.1
Polaris Software Lab	125.1	5.8	21.4	24.2	21.7	5.8	5.2	21.9	4.5	3.9	0.0	0.4	2.8	0.6	0.5
Average					**12.6**	**9.5**	**8.3**	**9.4**	**6.0**	**4.9**	**0.3**	**0.6**	**2.1**	**1.4**	**1.2**
NIIT Tech Ltd	186.9	30.5	31.3	37.2	6.1	6.0	5.0	3.9	3.5	2.9	2.3	0.3	0.9	0.7	0.6

Source: Bloomberg Estimates, ICICIdirect.com Research

Exhibit 22: Trading at 0.3 x PEG, a discount relative to peer group average of 0.6 x

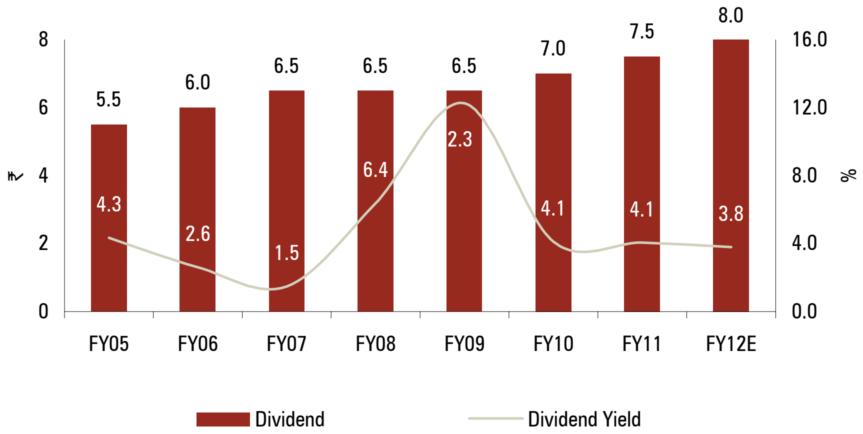


Source: Company, ICICIdirect.com Research, based on FY13E estimates

Consistent dividend payment but weak CFO generation

NTL continues to generate healthy operating and free cash flow (FCF) and had cash balance of ₹ 142.2 crore as at the end of Q2FY11. During FY05-FY11, operating cash flows (CFO) have declined at a CAGR of 0.1% vs. 14.6%, 15.7% and 8.0% CAGR growth in revenues, EBIT and earnings per share, respectively. Note that the company has paid dividend every year since FY04, which has grown at a CAGR of 5.3%. We are modelling FY12E dividend of ₹ 8/share which represents an attractive yield of 4% at the current market price.

Exhibit 23: Dividend and yields for FY05-FY12E period



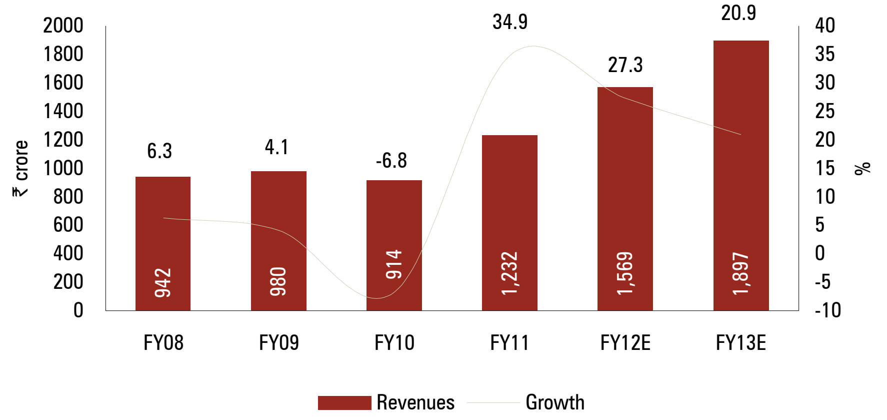
Source: Company, ICICIdirect.com Research

Financials

Modelling 27.3% & 20.9% revenue growth in FY12E & FY13E, respectively

We are modelling FY12E and FY13E revenues to grow 27.3% and 20.9% YoY to ₹ 1569 crore and ₹ 1897 crore, respectively. The growth would be driven by strength in enterprise application and package implementation aided by mining of existing customers. From a quarterly perspective, we are modelling revenue growth of 11.1% QoQ in Q3 and 10.5% QoQ in Q4FY12.

Exhibit 24: Revenue growth forecasts for FY12-FY13E period

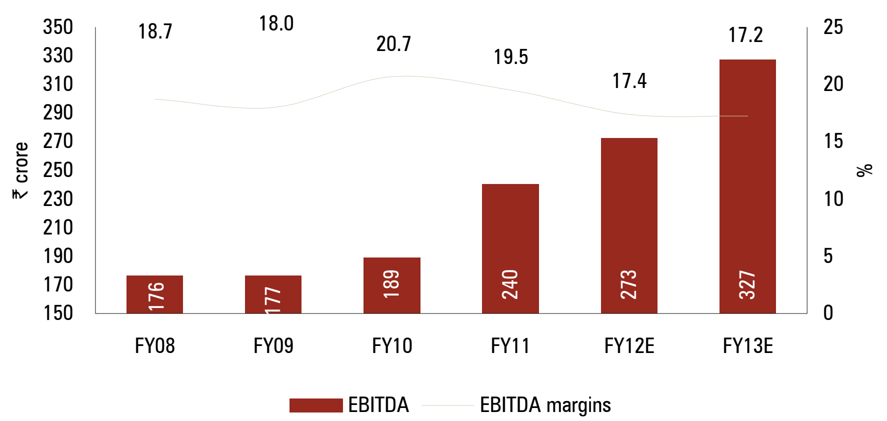


Source: Company, ICICIdirect.com Research

Modelling EBITDA margin decline in FY12E; flat in FY13E

We are modelling EBITDA margins will decline 210 bps in FY12E primarily led by bought-out deals and may decline by a modest 20 bps in FY13E as rationalisation efforts kick-in and bought-out deals contribution subsides. On a quarterly basis, we expect the EBITDA margin to increase in Q3FY12 by 268 bps (17.5% vs.14.8% in Q1FY12). Note that margins in Q2FY12 declined 370 bps from Q1FY12 due to the one-time costs to be paid for Morris Communication.

Exhibit 25: EBITDA margin trends for FY08-FY13E period



Source: Company, ICICIdirect.com Research

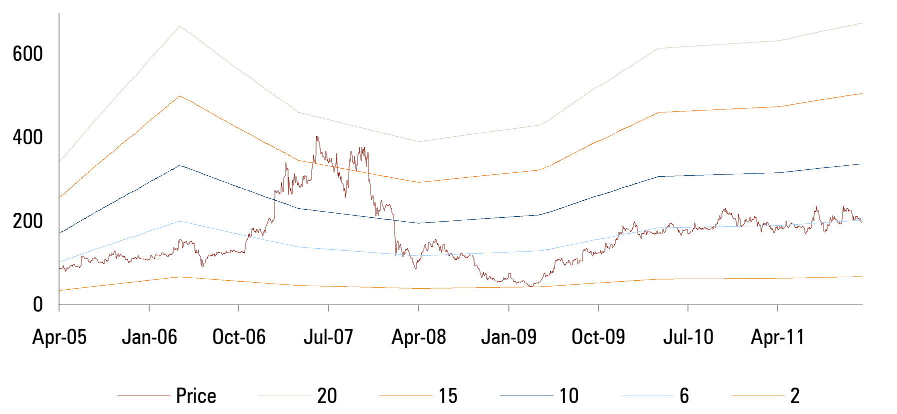
Valuations

Though we like NTL's operating model, chaotic macro overturns our rationale and influences our **HOLD** rating

NTL has one of the best operating models within the midcap space primarily led by 1) revenue growth (growth of 17.9% CAGR during FY09-FY13E), 2) stable EBITDA margin, which treads the 17-20% band, 3) superior onsite billing rates (US$70-75/hour) and 4) attrition (13.4% Q2FY12 LTM attrition) comparable to a majority of Tier-1 players. At current levels, NTL is trading at 5.9x and 5.4x our FY12E and FY13E diluted EPS estimate of ₹ 31.7 and ₹ 34.7, respectively. From a Mcap/sales and EV/EBITDA perspective, it is trading at 0.7x and 3.8x on FY12E and 0.6x and 3.1x on FY13E basis, respectively. Though we like NTL's operating model and could be buyers on sharp sell-offs, chaotic macro overturns our rationale. Consequently, we value the company at 4.9x its FY13 EPS of ₹ 34.7 (25% discount to its historical 1-year forward PE multiple of 6.5x to account for the uncertain macro) to arrive at our target price of ₹ 170 and initiate coverage on the stock with a **HOLD** rating.

At current levels, NTL is trading at 5.9x and 5.4x our FY12E and FY13E diluted EPS estimate of ₹ 31.7 and ₹ 34.7, respectively

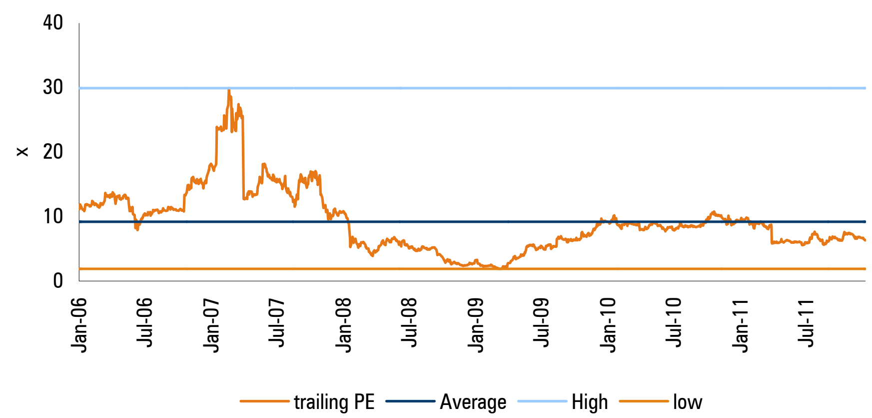
Exhibit 26: One year forward PE(x) chart



Source: Company, ICICIdirect.com Research

NTL is trading at 6.1x trailing twelve month (TTM) EPS, vs. historical average of 9.6x

Exhibit 27: Trades at 6.1x TTM EPS vs. historical average of 9.6x



Source: Company, ICICIdirect.com Research

Risk & concerns

Bought deals good for revenue growth but pressurise margins

NTL recently signed a ₹ 196-crore deal to implement Crime and Criminal Tracking Network & Systems (CCTNS) in two of the six states where pilot projects were initiated and IT vendors were selected. CCTNS is a ₹ 2,000-crore Government of India (GoI) initiative, mandatory across all states. Of the ₹ 196 crore, hardware constitutes ~₹ 130 crore (65%) while the rest is software (₹ 70 crore, 35%). We expect the company to bag at-least one or two incremental states in CY12 when IT vendors for additional six states would be selected. These contracts are similar to the ₹ 228-crore BSF contract won last year and in line with the management commentary of doing few such contracts every year. However, we note that buying low margin revenue could pressurise operating margins and jeopardise the rationale of NTL being a worthy candidate for premium valuations relative to peers. Consequently, we reiterate that PE multiple expansion necessitates sustainable revenue growth coupled with stable operating margins.

Higher taxes to bite in FY12E, FY13E taxes should be little light

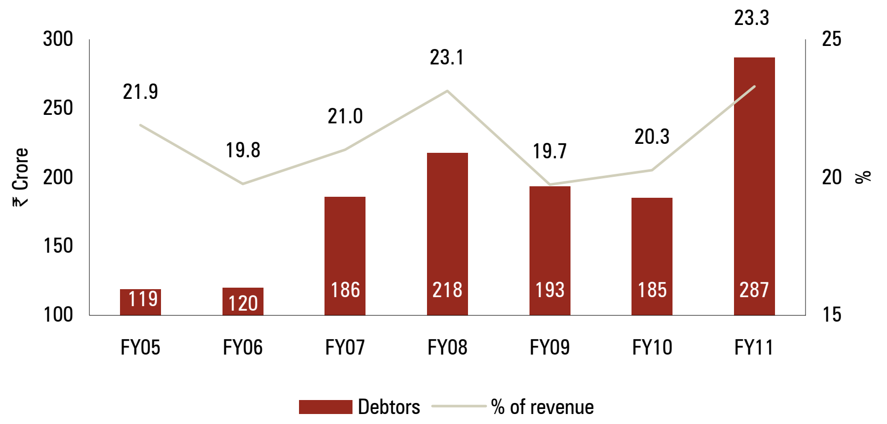
NTL's FY11 tax rates were a modest 14.8% vs. average 26.2% for H1FY12 led by the sunset of STPI benefits in FY11. Recall, NTL spent ~₹ 150 crore to build the phase-I (total three phases) of the SEZ facility in Noida. Phase-I completion added an incremental 3,500 seats while the seating capacity would get ramped up to 12,000 when fully operational. With 1,000 seats already filled in, we expect the company to exhaust the new capacity by second half of CY12. This implies SEZ revenue contribution for FY12E could be minimal and NTL could still end FY12E with tax rates of ~27%. Note that NTL would have to grow an incremental 18% to offset the impact of rising taxes on earnings. However, as SEZ contribution to revenue increases, FY13E tax rates could taper to ~24-25% level.

Buyouts skew not only accounts receivables but unbilled revenues also

Analysing balance sheet metrics suggest account receivables (A/R) increased 55% to ₹ 287 crore in FY11 vs. ₹ 185 crore in FY10 while unbilled revenues increased 433% to ₹ 80 crore in FY11 vs. ₹ 15 crore in FY10. This could be primarily attributed to the BSF bought deal where the company has received ~₹ 104 crore of the total ₹ 140 crore despite concluding a majority of the projects in Q4FY11. Q2FY12 day sales outstanding (DSO) of 94 days were higher vs. 78 days in Q1FY12, supplemented by Morris debtors. However, we reiterate that government bought deals typically have higher A/R and skew the overall DSO for the company.

BSF bought out deal likely skewed FY11 debtors, which rose to 23.3% of revenues vs. historical average of 21.3%

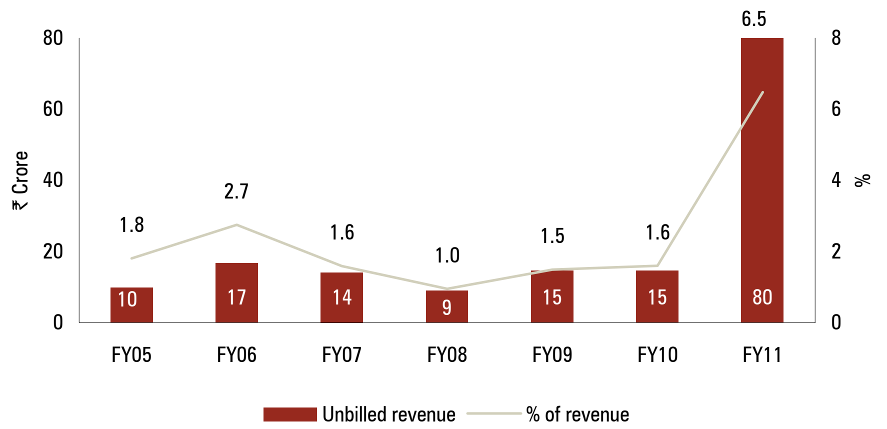
Exhibit 28: Debtors for FY05-FY11



Source: Company, ICICIdirect.com Research

FY11 unbilled revenue increased significantly to 6.5% of revenues vs. 1.6% in FY10

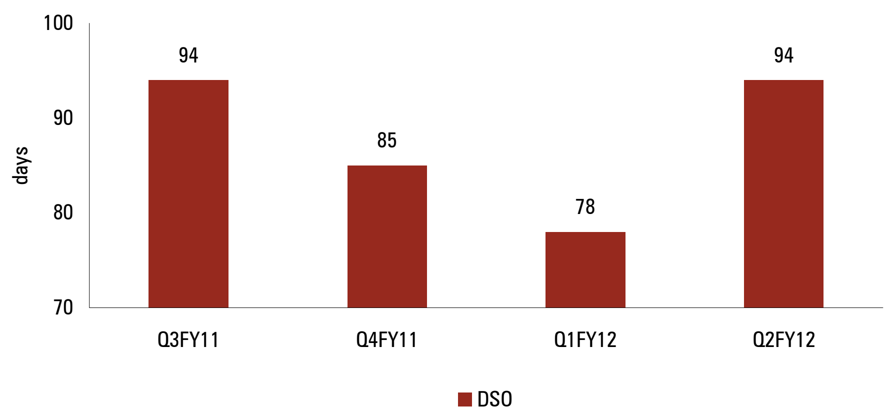
Exhibit 29: Unbilled revenues for FY05-FY11



Source: Company, ICICIdirect.com Research

Q2FY12 DSOs increased by 16 days to 94 vs. 78 days in Q1 supplemented by Morris debtors

Exhibit 30: DSO days over last four quarters



Source: Company, ICICIdirect.com Research

Tables and ratios

Exhibit 31: Profit & loss account

(₹crore)	FY09	FY10	FY11	FY12E	FY13E
Total Revenues	980.0	913.8	1,232.3	1,569.0	1,896.9
Growth (%)	-	(6.8)	34.9	27.3	20.9
Total Operating Expenditure	705.6	724.9	991.9	1,296.5	1,569.8
EBITDA	176.5	188.9	240.4	272.5	327.1
Growth (%)	-	7.0	27.3	13.4	20.0
Depreciation	42.3	36.0	31.5	33.6	42.6
Other Income	4.7	(10.9)	8.9	17.5	(1.2)
PBT before Exceptional Items	138.9	142.0	217.8	256.4	283.3
Less: Exceptional Items	-	-	-	-	-
PBT	138.9	142.0	217.8	256.4	283.3
Growth (%)		2.2	53.4	17.7	10.5
Total Tax	22.5	14.4	32.3	66.8	71.6
PAT before MI	116.4	127.6	185.5	189.6	211.8
Minority Interest	1.6	1.3	3.2	0.3	4.0
PAT	114.8	126.3	182.3	189.3	207.8
Growth (%)	-	10.0	44.3	3.8	9.8
EPS	19.6	21.5	30.7	31.7	34.7
EPS (Growth %)	-	10.0	42.9	3.0	9.8

Source: Company, ICICIdirect.com Research

Exhibit 32: Balance sheet

	FY09	FY10	FY11	FY12E	FY13E
Equity	58.7	59.3	59.3	59.8	59.8
Reserves & Surplus	328.9	521.0	688.5	828.6	980.4
Networth	387.6	579.8	747.8	888.4	1,040.2
Minority Interest	2.2	2.8	4.3	12.3	16.3
Loans	34.8	21.7	11.0	47.1	39.1
Source of funds	424.6	604.3	763.1	947.8	1,095.6
Net Block	210.5	185.3	189.3	367.9	384.8
CWIP	105.2	128.7	143.7	16.3	26.8
Debtors	193.5	185.1	287.1	412.2	435.1
Cash & Cash equivalents	158.5	185.1	163.7	187.5	289.2
Other Current Assets(OCA)	108.6	125.0	215.7	301.1	315.7
Current liabilities	(395.2)	(220.0)	(250.8)	(355.8)	(374.5)
Deferred tax assets (DTA)	43.5	10.7	14.4	18.5	18.5
Application of funds	424.6	604.3	763.1	947.8	1,095.6

Source: Company, ICICIdirect.com Research

Exhibit 33: Cash flow statement

	FY09	FY10	FY11	FY12E	FY13E
Net profit before Tax	138.9	142.0	217.8	256.4	283.3
Depreciation	42.3	36.0	31.5	33.6	42.6
(inc)/dec in Current Assets	20.8	(3.8)	(184)	(210.5)	(37.5)
(inc)/dec in current Liabilities	(16.4)	5.1	49.9	-	-
CF from operations	150.4	147.5	250.1	115.4	236.8
Other Investments	140.3	(45.2)	6.0	-	-
(Purchase)/Sale of Fixed Assets	(117)	(49.0)	(50.2)	(29.7)	(70.0)
CF from investing Activities	8.0	(92.5)	(37.4)	(24.0)	(66.0)
Inc / (Dec) in Equity Capital	0.2	0.6	6.5	-	-
Inc / (Dec) in sec.loan Funds	(10.8)	(10.7)	(11.7)	(36.1)	(8.0)
Dividend & Divendend tax	(49.9)	(48.8)	(48.7)	(56.0)	(56.0)
Interest Paid on Loans	(4.0)	(0.8)	(0.7)	(3.3)	(5.2)
CF from Financial Activities	(80.4)	(60.7)	(54.9)	(23.2)	(69.1)
Cash generating during the year	78.0	(5.7)	(25.9)	68.2	101.6
Opening Balance Adjustments	-	-	-	-	-
Cash on Account of New Subsidiaries	-	-	-	-	-
Effect of Exchange Rates	14.5	(9.8)	143.0	-	-
Opening cash balance	66.0	158.5	143.0	119.4	187.5
Closing cash	158.5	143.0	119.4	187.5	289.2

Source: Company, ICICIdirect.com Research

Exhibit 34: Key ratios

	FY09	FY10	FY11	FY12E	FY13E
Per Share Data					(₹)
EPS	19.6	21.5	30.7	31.7	34.7
Cash EPS	8.0	7.5	7.0	7.0	7.2
BV	66	99	126	149	174
Operating profit per share	6.9	7.1	6.8	7.5	8.2
Operating Ratios					(%)
EBITDA/Total Revenues	18.0	20.7	19.5	17.4	17.2
PBT/Total Revenues	14.2	15.5	17.7	16.3	14.9
PAT/ Total Revenues	11.7	13.8	14.8	12.1	11.0
Return Ratios					(%)
RoNW	29.6	21.8	24.4	21.3	20.0
RoCE	28.7	29.7	30.6	27.9	27.8
RoIC	27.0	20.9	23.9	20.0	19.0
	FY09	FY10	FY11E	FY12E	FY13E
Valuation Ratios					(x times)
P/E	9.6	8.7	6.1	5.9	5.4
EV / EBITDA	5.8	5.4	4.3	3.8	3.1
Price to Book Value	3.0	2.0	1.6	1.3	1.1
EV/Total Revenues	1.0	1.1	0.8	0.7	0.5
MCap/Total Revenues	1.1	1.2	0.9	0.7	0.6
Total Revenues/ Equity	16.7	15.4	20.8	26.2	31.7
Turnover Ratios					(x times)
Inventory Turnover	-	-	-	-	-
Debtors Turnover Ratio	-	4.8	5.2	4.5	4.5
Creditors Turnover Ratio	-	-	-	-	-
Fixed Asset Turnover ratio	-	4.6	6.6	5.6	5.0
Solvency Ratios					(x times)
Debt / Equity	0.1	0.0	0.0	0.1	0.0
Current Ratio	1.2	2.3	2.7	2.5	2.8
Quick Ratio	1.2	2.3	2.7	2.5	2.8
Debt / EBITDA	0.2	0.1	0.0	0.2	0.1

Source: Company, ICICIdirect.com Research

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Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICIdirect.com Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No. 7, MIDC,
Andheri (East)
Mumbai – 400 093

research@icicidirect.com

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