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EQUITY MARKETS

India	Change %			
	24-Jul	1-day	1-mo	3-mo
Sensex	36,825	0.3	3.8	6.7
Nifty	11,134	0.4	3.5	5.3
Global/Regional indices				
Dow Jones	25,242	0.8	4.1	4.8
Nasdaq Composite	7,841	(0.0)	4.1	12.0
FTSE	7,709	0.7	2.7	4.5
Nikkei	22,637	0.6	1.3	1.9
Hang Seng	28,800	0.5	(0.6)	(5.0)
KOSPI	2,276	(0.2)	(3.5)	(7.1)
Value traded – India				
Cash (NSE+BSE)	380		317	327
Derivatives (NSE)	8,742		7,125	7,131
Deri. open interest	4,051		4,024	4,246

Forex/money market

	Change, basis points			
	24-Jul	1-day	1-mo	3-mo
Rs/US\$	68.9	4	76	193
10yr govt bond, %	8.1	3	5	12

Net investment (US\$ mn)

	23-Jul	MTD	CYTD
FIs	24	(305)	(927)
MFs	(29)	805	11,353

Top movers

Best performers	Change, %			
	24-Jul	1-day	1-mo	3-mo
APNT IN Equity	1,468	2.4	17.1	26.2
GCPL IN Equity	1,356	0.6	16.8	24.0
INFO IN Equity	1,377	1.6	8.2	19.6
YES IN Equity	384	(0.6)	15.0	18.2
NEST IN Equity	10,291	(1.0)	4.0	17.8

Worst performers

HDIL IN Equity	19	4.4	(12.4)	(51.5)
AL IN Equity	113	3.3	(14.6)	(31.3)
UT IN Equity	4	6.2	(1.1)	(25.9)
VEDL IN Equity	216	2.2	(6.2)	(25.5)
RECL IN Equity	97	6.1	(10.4)	(23.4)

JULY 25, 2018

RESULT

Coverage view: **Cautious**

Price (₹): **1,468**

Target price (₹): **1,325**

BSE-30: **36,825**

Decent, ahead-of-expectations, quarter. In a sweet spot. APNT's 1QFY19 earnings print was ahead of expectations on EBITDA and PAT. Healthy yoy comps reflected a favorable base; 2-year CAGRs on EBITDA and PAT were modest even as volume and topline growth trends remain healthy. Even as the company's commentary was guarded on potential benefits from the recent GST rate cuts, we expect the same to be a kicker to earnings for at least the next few quarters. We bake in the surprise in standalone GM and cost control into our estimates and raise FY2019-21E EPS forecasts by around 4% each. Fair value target stands revised to ₹1,325 (from ₹1,275). REDUCE stays.

Company data and valuation summary

Asian Paints

Stock data

52-week range (Rs) (high,low)	1,476-1,082
Market Cap. (Rs bn)	1,407.9

Shareholding pattern (%)

Promoters	52.8
FIs	15.1
MFs	2.9

Price performance (%)

	1M	3M	12M
Absolute	15.8	25.4	27.0
Rel. to BSE-30	12.2	17.9	11.2

Forecasts/Valuations

	2018	2019E	2020E
EPS (Rs)	20.5	27.1	32.6
EPS growth (%)	2.9	32.1	20.3
P/E (X)	71.5	54.1	45.0
Sales (Rs bn)	168.2	198.3	234.4
Net profits (Rs bn)	19.7	26.0	31.3
EBITDA (Rs bn)	32.0	41.2	49.5
EV/EBITDA (X)	43.7	34.0	28.1
ROE (%)	24.6	28.8	30.3
Div. Yield (%)	0.6	0.8	1.0

1QFY19 – a decent quarter even as the healthy headline comps are a tad misleading

- ▶ **Consolidated financials** – revenues grew 15% yoy to ₹43.9 bn, broadly in line with our expectations. Gross margins expanded 40 bps yoy to 43.2%, marginally above our estimated 42.9%. EBITDA (₹8.74 bn, +31% yoy) was 5% above estimate. EBITDA margin expanded 247 bps yoy to 19.9% versus our expected 18.8% on the back of lower-than-expected staff and other expenses. These expenses are generally difficult to forecast on a quarterly basis, we note. The company indicated savings on freight, rent, etc. even as ad spends grew in low double digits. Recurring PAT stood at ₹5.6 bn, +30% yoy and 3% beat. On a 2-year CAGR basis, growth comps were more moderate – 11% revenues, 4% EBITDA and 2% PAT.
- ▶ **Standalone financials** – revenues grew 16% yoy to ₹37.1 bn, largely in line with our estimate. We believe volumes grew in the 13-14% range; company's press release suggested 'good double digit growth'. Gross margins surprised, increasing 86 bps yoy to 44.6%, 60 bps above expectations. EBITDA margins expanded a sharper 361 bps yoy to 22.3%, 205 bps above estimate as staff costs and other expenses grew a modest 5% and 2% yoy, respectively. Recurring net profit grew 35% yoy. 2-year CAGRs were modest for standalone business as well – 11% revenues, 6% EBITDA and 4% PAT.
- ▶ **Aggregate subsidiary performance (consolidated less standalone)** – even as topline growth was a reasonable 12% yoy (off a low base), aggregate subsidiary EBITDA declined 27% yoy as gross margins declined 230 bps yoy and EBITDA margins saw a 390 bps compression. Management called out weakness in Egypt (economy), Ethiopia (currency unavailability), Sri Lanka (one-off heavy rain) and Bangladesh (rain, again)

Standalone GM and cost surprise drive further upward revision in forecasts

Our FY2019-21E EPS estimates go up another 4% each on top of the recent sharp upgrades driven by GST rate reduction for the category. Our target price also stands revised up by around 4% to ₹1,325/share (from ₹1,275). We expect GST rate reduction to be a gift that keeps on giving for the next 2-3 years and expect strong earnings momentum for this phase. Rich valuations prevent a more constructive view on the stock, however. REDUCE stays.

Rohit Chordia

Jaykumar Doshi

Aniket Sethi

Conference call highlights

- ▶ **Commentary on demand**—APNT management indicated that demand conditions remain a bit challenging for the industry. There is some recovery but the pace of improvement is slow.
- ▶ **Commentary on GST rate cuts**—APNT management indicated that it will pass on entire benefit of reduction in GST rate to 18% from 28% to its dealers across all product lines. APNT expects benefit to be entirely passed on to the consumers by dealers; however, it does not intend to control dealer margins. GST rate cut will result in reduction in price gap between unorganized and organized sector. Organized sector should benefit from the GST rate cut. Unorganized sector is 30% of industry in terms of value at present. APNT management has decided to postpone impending price increase (in view of anti-profiteering clause). it will try to offset RM inflation over time.
- ▶ **RM inflation**—the management has hinted at about 10% inflation in RM in 2QFY19. Cumulative price increase of 3.3% (first in March and second in May) will only partly offset the impact of RM inflation.
- ▶ **Commentary on market share**—APNT is witnessing some recovery in Tamil Nadu; competitive intensity in the TN market remains high but overall market conditions have improved.
- ▶ **Capacity expansion**—first phase of Mysore plant will be commissioned in September 2018 and that of the upcoming facility at Vizag will be commissioned in January 2019. New facilities would reduce logistics costs and manufacturing costs to some extent. The ongoing capacity expansion would meet next 4-5 years' volume growth. These new facilities have fiscal benefits from Karnataka and Andhra Pradesh state governments on products sold in the same state.
- ▶ **International business performance**—(1) Sri Lanka and Bangladesh suffered from rains, (2) Ethiopia continued to face challenges pertaining to currency availability, (3) Egypt market was weak due to sluggish economy. Further, profitability was impacted as competition in a few overseas markets did not take price increase to pass on RM inflation; thus APNT also could not increase price in such markets.
- ▶ **Other data points**—(1) consolidated capex in FY2019 would be ₹12-13 bn (₹10 in standalone operations) and ₹2-3 bn in subsidiaries, (2) other income was lower on yoy basis largely due to forex loss in 1QFY19 as against forex gain in the base quarter, (3) Sleek grew 22% yoy and Ess Ess grew 56% yoy on like-for-like basis.

Exhibit 1: Interim consolidated results of Asian Paints (as per Ind-AS), March fiscal year-ends (Rs mn)

	1QFY19	1QFY19E	1QFY18	4QFY18	(% change)			FY2019E	FY2018	(% chg.)	2-Year	
					KIE Est	yoy	qoq				1QFY17	CAGR (%)
Net operating revenue	43,903	44,366	38,152	44,836	(1)	15	(2)	198,332	168,246	18	35,870	11
Material cost	(24,923)	(25,335)	(21,812)	(25,447)	(2)	14	(2)	(113,245)	(96,912)	17	(18,961)	15
Gross profit	18,980	19,030	16,340	19,389	(0)	16	(2)	85,087	71,334	19	16,910	6
Gross margin (%)	43.2	42.9	42.8	43.2	33 bps	40 bps	-2 bps	42.9	42.4	50 bps	47.1	
Employee cost	(3,064)	(3,189)	(2,862)	(2,761)	(4)	7	11	(12,495)	(11,155)	12	(2,636)	8
Other expenditure	(7,171)	(7,507)	(6,825)	(8,229)	(4)	5	(13)	(31,389)	(28,203)	11	(6,112)	8
Total expenditure	(35,158)	(36,032)	(31,499)	(36,437)	(2)	12	(4)	(157,129)	(136,270)	15	(27,709)	13
EBITDA	8,744	8,334	6,654	8,399	5	31	4	41,203	31,976	29	8,162	4
EBITDA margin (%)	19.9	18.8	17.4	18.7	113 bps	247 bps	118 bps	20.8	19.0	176 bps	22.8	
Other income	617	848	783	392	(27)	(21)	57	2,404	2,206	9	719	
Interest	(88)	(100)	(80)	(91)	(12)	10	(4)	(361)	(351)	3	(63)	
Depreciation	(905)	(942)	(905)	(914)	(4)	(0)	(1)	(3,817)	(3,605)	6	(844)	
Pretax profits	8,368	8,140	6,452	7,786	3	30	7	39,428	30,227	30	7,973	2
Tax	(2,770)	(2,686)	(2,160)	(2,877)	3	28	(4)	(13,406)	(10,410)	29	(2,593)	
Recurring PAT	5,599	5,454	4,292	4,909	3	30	14	26,023	19,817	31	5,381	2
Extraordinary items	—	—	25	—				-	700		19	
Minority interest/share of associates	(18)	(60)	(43)	(99)	(70)	(58)	(81)	(16)	(128)	(88)	(50)	
Net profit (reported)	5,580	5,394	4,274	4,810	3	31	16	26,007	20,389	28	5,351	2
Recurring PAT post MI	5,580	5,394	4,249	4,810	3	31	16	26,007	19,689	32	5,331	2
Recurring EPS	5.8	5.6	4.4	5.0	3	31	16	27.1	20.5	32	5.6	2
Income tax rate (%)	33.1	33.0	33.5	37.0	9 bps	-39 bps	-386 bps	34.0	34.4		32.5	
Costs as a % of net operating revenue												
Material cost	56.8	57.1	57.2	56.8	-34 bps	-41 bps	1 bps	57.1	57.6	-51 bps	52.9	
Employee cost	7.0	7.2	7.5	6.2	-21 bps	-53 bps	82 bps	6.3	6.6	-34 bps	7.3	
Other expenditure	16.3	16.9	17.9	18.4	-59 bps	-156 bps	-202 bps	15.8	16.8	-94 bps	17.0	

Source: Company, Kotak Institutional Equities

Exhibit 2: Key changes to consolidated estimates , Asian Paints, March fiscal year-ends, 2019-21E

	Revised			Earlier			Change (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenues (Rs mn)	198,332	234,363	270,222	199,070	235,250	271,256	(0.4)	(0.4)	(0.4)
EBITDA (Rs mn)	41,203	49,542	58,105	39,462	47,487	55,743	4.4	4.3	4.2
EBITDA margin (%)	20.8	21.1	21.5	19.8	20.2	20.5	95 bps	95 bps	95 bps
Net income (Rs mn)	26,007	31,277	36,996	24,902	30,001	35,486	4.4	4.3	4.3
EPS (Rs/share)	27.1	32.6	38.6	26.0	31.3	37.0	4.4	4.3	4.3
Other assumptions									
Gross margin (%)	42.9	43.1	43.4	42.5	42.7	43.0	36 bps	36 bps	36 bps
Volume growth (%)	13.5	14.5	12.0	13.5	14.5	12.0	0 bps	0 bps	0 bps
Realisation growth (%)	2.0	5.0	4.0	2.5	5.0	4.0	-50 bps	0 bps	0 bps

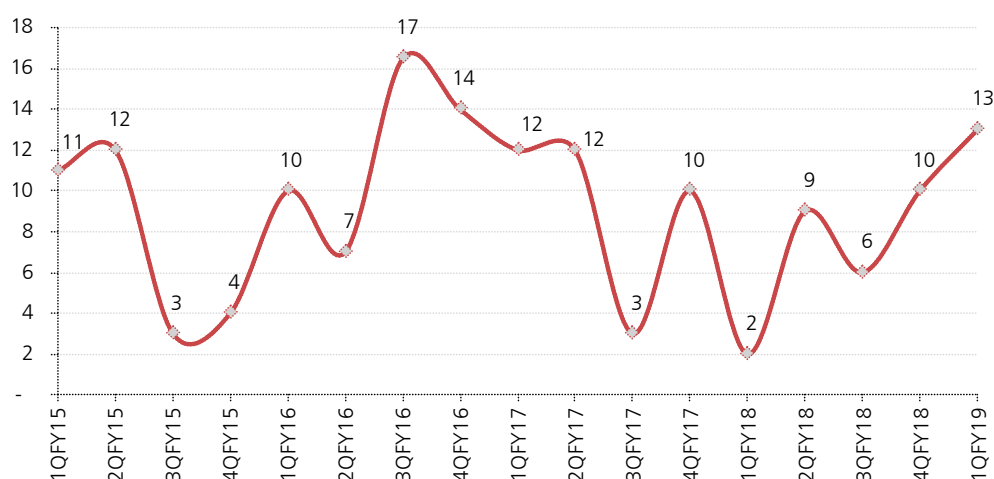
Source: Company, Kotak Institutional Equities estimates

Exhibit 3: Interim standalone results of Asian Paints (as per Ind-AS), March fiscal year-ends (Rs mn)

	1QFY19	1QFY19E	1QFY18	4QFY18	(% change)			FY2019E	FY2018	(% chg.)	2-Year	
					KIE Est	yoy	qoq				1QFY17	CAGR (%)
Net operating revenue	37,062	37,356	32,029	37,754	(1)	16	(2)	168,177	141,679	19	29,837	11
Material cost	(20,525)	(20,919)	(18,013)	(20,885)	(2)	14	(2)	(94,247)	(79,969)	18	(15,376)	16
Gross profit	16,537	16,437	14,016	16,869	1	18	(2)	73,930	61,710	20	14,462	7
Gross margin (%)	44.6	44.0	43.8	44.7	62 bps	86 bps	-7 bps	44.0	43.6	40 bps	48.5	
Employee cost	(2,157)	(2,307)	(2,060)	(1,933)	(7)	5	12	(8,745)	(7,911)	11	(1,890)	7
Other expenditure	(6,132)	(6,583)	(5,985)	(7,082)	(7)	2	(13)	(27,245)	(24,593)	11	(5,270)	8
Total expenditure	(28,814)	(29,810)	(26,058)	(29,900)	(3)	11	(4)	(130,237)	(112,472)	16	(22,536)	13
EBITDA	8,248	7,546	5,971	7,854	9	38	5	37,940	29,206	30	7,301	6
EBITDA margin (%)	22.3	20.2	18.6	20.8	205 bps	361 bps	145 bps	22.6	20.6	194 bps	24.5	
Other income	689	948	861	592	(27)	(20)	16	2,798	2,775	1	788	
Interest	(48)	(55)	(43)	(66)	(13)	11	(28)	(193)	(211)	(9)	(42)	
Depreciation	(790)	(825)	(758)	(801)	(4)	4	(1)	(3,355)	(3,111)	8	(740)	
Pretax profits	8,100	7,614	6,032	7,579	6	34	7	37,191	28,660	30	7,307	5
Tax	(2,673)	(2,513)	(2,022)	(2,663)	6	32	0	(12,527)	(9,710)	29	(2,295)	
Recurring PAT	5,426	5,101	4,010	4,916	6	35	10	24,664	18,949	30	5,012	4
Extraordinary items	—	—	—	—	—	—	—	—	—	—	—	
Net profit (reported)	5,426	5,101	4,010	4,916	6	35	10	24,664	18,949	30	5,012	4
Recurring EPS	5.7	5.3	4.2	5.1	6	35	10	25.7	19.8	30	5.2	4
Income tax rate (%)	33.0	33.0	33.5	35.1	0 bps	-53 bps	-214 bps	33.7	33.9	-20 bps	31.4	
Costs as a % of net operating revenues												
Material cost	55.4	56.0	56.2	55.3	-63 bps	-87 bps	6 bps	56.0	56.4	-41 bps	51.5	
Employee cost	5.8	6.2	6.4	5.1	-36 bps	-62 bps	70 bps	5.2	5.6	-39 bps	6.3	
Other expenditure	16.5	17.6	18.7	18.8	-108 bps	-215 bps	-222 bps	16.2	17.4	-116 bps	17.7	

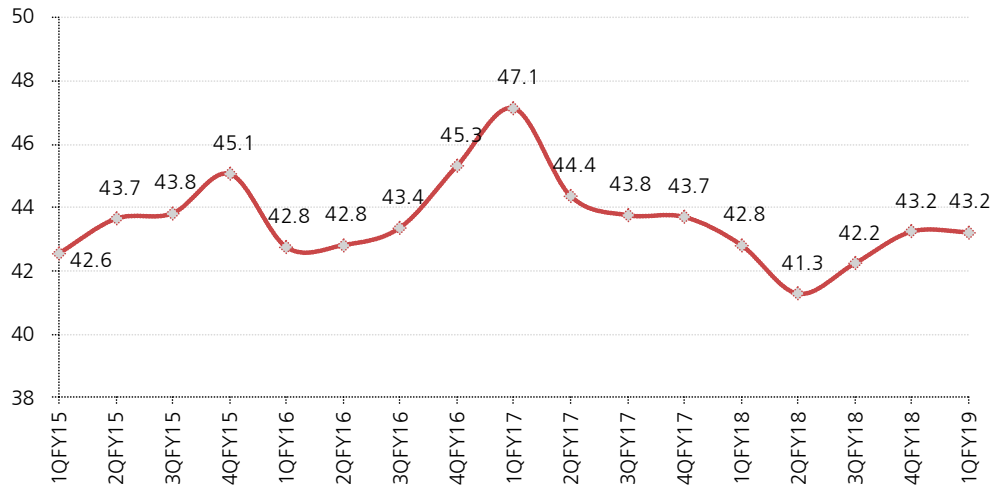
Source: Company, Kotak Institutional Equities

Exhibit 4: APNT delivered 'good double-digit volume growth' – 13%, as per our estimate



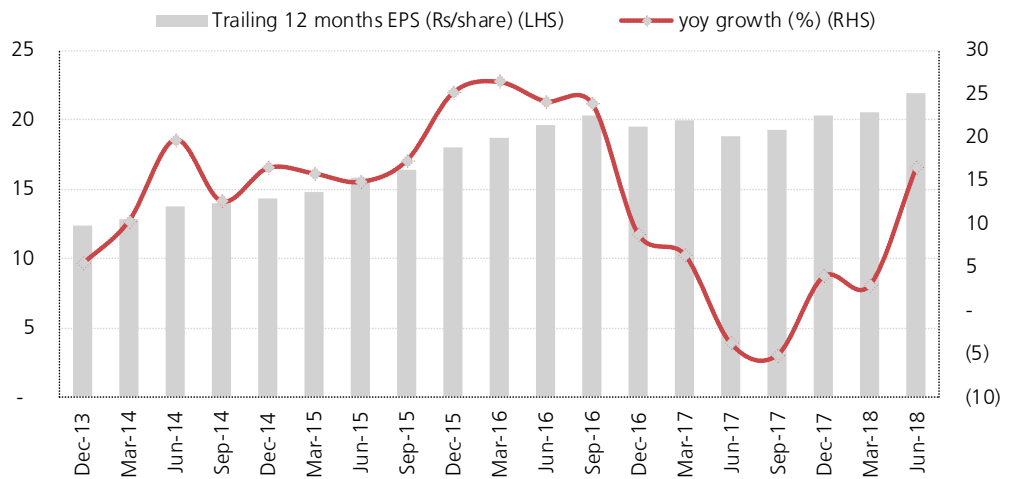
Source: Company, Kotak Institutional Equities

Exhibit 5: Gross margin held well notwithstanding RM inflation



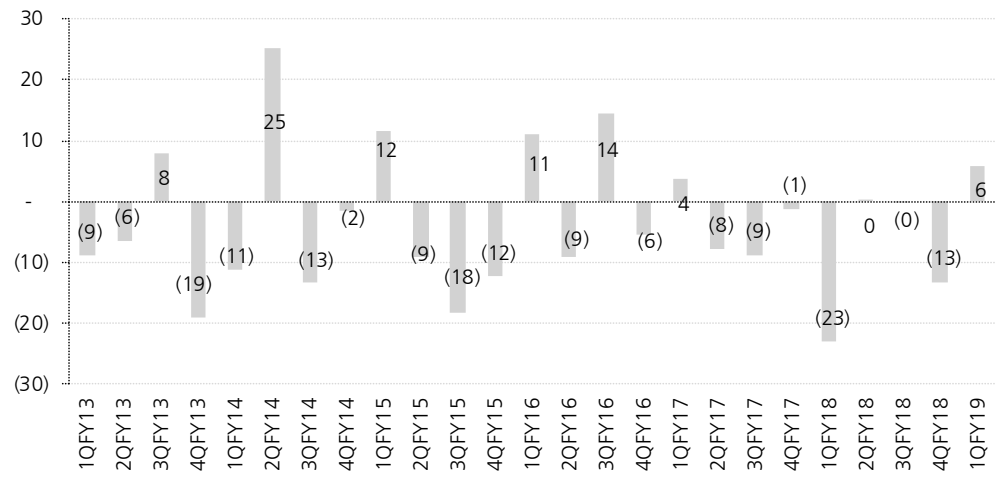
Source: Company, Kotak Institutional Equities

Exhibit 6: TTM EPS growth inched up to mid-teens
TTM EPS growth trend



Source: Company, Kotak Institutional Equities

Exhibit 7: Recurring PAT was above consensus estimates this quarter
 Quarterly earnings surprise trend vs consensus estimates



Source: Company, Kotak Institutional Equities

Exhibit 8: Asian Paints: Consolidated profit model, balance sheet (as per Ind-AS from 2016), March fiscal year-ends, 2014-20E

	IGAAP		Ind-AS					
	2014	2015	2016	2017	2018	2019E	2020E	2021E
Profit model (Rs mn)								
Net sales	127,148	141,828	142,715	150,620	168,246	198,332	234,363	270,222
EBITDA	19,979	22,354	27,692	29,864	31,976	41,203	49,542	58,105
Other income	1,342	1,697	2,134	2,624	2,206	2,404	2,718	3,347
Interest	(422)	(348)	(407)	(300)	(351)	(361)	(309)	(268)
Depreciation	(2,457)	(2,659)	(2,756)	(3,348)	(3,605)	(3,817)	(4,573)	(5,187)
Pretax profits	18,442	21,044	26,663	28,841	30,227	39,428	47,377	55,998
Tax	(5,715)	(6,495)	(8,445)	(9,433)	(10,410)	(13,406)	(16,108)	(19,039)
Minority interest	(440)	(322)	(242)	(272)	(128)	(16)	8	38
Extraordinary items	(100)	(276)	(525)	259	700	—	—	—
Net income	12,188	13,952	17,452	19,394	20,389	26,007	31,277	36,996
Recurring net income	12,288	14,227	17,976	19,136	19,689	26,007	31,277	36,996
Recurring EPS (Rs)	12.8	14.8	18.7	19.9	20.5	27.1	32.6	38.6
Balance sheet (Rs mn)								
Total shareholder's equity	40,392	47,424	65,248	76,039	84,102	96,361	110,417	126,181
Total borrowings	2,400	4,099	3,037	5,455	5,208	4,424	3,924	3,424
Deferred tax liability	1,878	1,799	2,950	3,430	3,975	3,975	3,975	3,975
Minority interest	2,460	2,637	3,837	3,755	3,277	3,292	3,285	3,247
Total liabilities and equity	47,131	55,959	75,072	88,679	96,562	108,053	121,601	136,828
Net fixed assets	24,918	26,102	33,240	33,678	48,101	56,414	59,314	60,286
Goodwill	1,414	2,458	1,990	1,935	3,273	3,273	3,273	3,273
Investments	14,236	15,878	27,121	26,520	21,407	21,407	21,407	21,407
Cash	2,290	2,044	4,242	8,012	4,047	2,837	10,227	21,218
Net current assets	4,274	9,477	8,480	18,534	19,735	24,122	27,380	30,644
Total assets	47,131	55,959	75,072	88,679	96,562	108,053	121,601	136,828
Free cash flow (Rs mn)								
Operating cash flow, excl. working capit	15,705	16,379	20,452	21,301	21,931	29,361	35,142	40,889
Working capital	(1,685)	(4,502)	1,978	(6,028)	(797)	(4,387)	(3,259)	(3,264)
Capital expenditure	(2,354)	(4,377)	(8,022)	(6,672)	(14,088)	(12,131)	(7,473)	(6,158)
Free cash flow	11,667	7,500	14,408	8,601	7,047	12,843	24,411	31,466
Growth								
Revenue growth	16.2	11.5	NM	5.5	11.7	17.9	18.2	15.3
EBITDA growth	15.4	11.9	23.9	7.8	7.1	28.9	20.2	17.3
EPS growth	10.3	15.8	26.4	6.5	2.9	32.1	20.3	18.3
Ratios (%)								
Gross margin (%)	42.3	43.8	43.6	44.7	42.4	42.9	43.1	43.4
EBITDA margin (%)	15.7	15.8	19.4	19.8	19.0	20.8	21.1	21.5
Net profit margin (%)	9.7	10.0	12.6	12.7	11.7	13.1	13.3	13.7
RoE (%)	33.1	32.4	31.9	27.1	24.6	28.8	30.3	31.3
RoCE (%)	36.1	34.7	34.2	28.5	24.4	27.4	29.8	33.2
Key assumptions (%)								
Volume growth (%)	10.5	7.0	12.0	9.5	6.8	13.5	14.5	12.0
Realisation growth (%)	3.8	3.8	(3.4)	(1.8)	(4.8)	2.0	5.0	4.0

Source: Company, Kotak Institutional Equities estimates

JULY 25, 2018

RESULT

Coverage view: **Neutral**

Price (₹): **386**

Target price (₹): **500**

BSE-30: **36,825**

Protection drives VNB even as APE declines. Increase in high-margin protection business and improvement in persistency were key positives of ICICI Prudential Life's 1QFY19 performance, even as APE was down yoy. Incremental focus will be on driving volumes in the savings business and maintaining the momentum in the protection business. A stable persistency performance from here poses upside to VNB margin assumptions as well. The company is well on track on VNB margins and operating RoEV improvements. Retain BUY with a TP of ₹500 (unchanged).

Company data and valuation summary

ICICI Prudential Life

Stock data				Forecasts/Valuations			
				2018	2019E	2020E	
52-week range (Rs) (high,low)	472-347			EPS (Rs)	11.3	12.4	13.3
Market Cap. (Rs bn)	553.8			EPS growth (%)	(3.7)	10.1	7.0
Shareholding pattern (%)				P/E (X)	34.2	31.1	29.0
Promoters	80.7			NII (Rs bn)	120.0	106.8	144.2
FIs	6.5			Net profits (Rs bn)	16.2	17.8	19.1
MFs	2.9			BVPS	45.8	55.7	66.4
Price performance (%)				P/B (X)	8.4	6.9	5.8
Absolute	1M	3M	12M	ROE (%)	25.0	24.5	21.8
	(1.0)	(7.5)	(17.2)	Div. Yield (%)	1.5	0.5	0.6
Rel. to BSE-30	(4.1)	(13.0)	(27.5)				

Weak APE, VNB growth strong

ICICI Prudential Life reported 34% growth in VNB on the back of 48% yoy increase in high-margin protection APE even as the savings business APE declined by 21% to reflect 18% decline in overall APE. Share of protection business increased to 8.2% of APE from 4.5% in 1QFY18 and 5.7% in FY2018; growth in group protection, especially credit life was higher. The company changed tax assumptions (moving to effective tax rates from earlier assumption of normal tax rate of 14.2%) in its VNB calculation from 4QFY18. VNB growth would be about 22% on building in the benefit of effective rate in 1QFY18 as well; for this calculation we assume 100 bps VNB margin benefit of change in tax rate during 1QFY18.

Persistency improves; provides upside to VNB forecasts

ICICI Prudential Life reported stable persistency (retail, excluding single premium) of 85.8% in the 13th month bucket between 2MFY19 and 1QFY18. Persistency improved across all other buckets. The company has currently built in 13th month persistency of 82.5% in its assumptions; it achieved persistency of 85% in FY2018. With improving trends continuing in FY2019E, we find upside to persistency assumptions, leading to higher VNB margins.

Retain BUY with TP of ₹500

We are revising our EVOP forecasts to factor lower APE growth in FY2019E and higher margins largely due to higher share of protection business. We are reflecting the impact of the change in effective tax assumptions in VNB margins—this will be neutral at the EVOP level as the benefit of higher VNB margins will be set off with the reduction in operating variance. Post the revision in estimates, we expect the company to deliver 20% EVOP CAGR during FY2017-21E and 19% medium-term operating RoEV. Increase in share of protection business (that will boost higher margins) and improvement in persistency will provide upside to our estimates. At our TP, the company will trade at 3X EV and 18X EVOP FY2020E. Lower margins in the protection business due to heightened competition and increase in surrenders due to prolonged weakness in capital markets are key risks.

QUICK NUMBERS

- PAT down 31% yoy; overall APE down 18% yoy and 37% qoq
- 680 bps yoy improvement in VNB margins to 17.5%
- Share of protection APE up 365 bps yoy to 8.2%

Nischint Chawathe

M B Mahesh CFA

Dipanjana Ghosh

PAT down 31% yoy

ICICI Prudential Life reported PAT of ₹2.81 bn, down 31% yoy, largely on the back of new business strain from the protection business and higher expenses (discussed below) during the period. Cash flows to business (post expenses and commissions) improved to ₹15.6 bn from ₹1 bn in 1QFY18; it would, however, be inaccurate to track this on a qoq basis.

Higher expense ratio in 1QFY19

ICICI Prudential Life reported expense to premium ratio of 17.3% in 1QFY19 as compared to 14% in 1QFY18 (13.5% in FY2018). Higher share of protection business and advertising/publicity expenses was the key reasons for the higher expenses ratio. The cost/premium of the savings business increased marginally (13.7% in 1QFY19 from 12.5% in 1QFY18, 11.8% in FY2018). This was largely on account of lower volumes and investments in business; the ratio will likely improve as volumes pick up over the next few months. However, rising share of protection business will keep the ratio at elevated levels.

Commission to premium ratio increased to 5.5% from 4.8% in 1QFY18; 5.5% in FY2018. This was largely due to new policies sold from 2QFY18 that had higher margins and commissions.

Capital consumption high; dividend payouts may decline

ICICI Prudential Life's solvency ratio reduced to 235% in 1QFY19 from 253% in 4QFY18 and 289% in 1QFY18 on the back of high growth in protection business. The company has two tools to manage solvency—(1) stop special dividend payouts and (2) raise tier-II capital up to 25% of net worth. As of now, the company does not envisage capital issuance.

Exhibit 1: ICICI Prudential Life – quarterly summary
March fiscal year-ends, 1QFY18-1QFY19 (Rs mn)

	1QFY19	1QFY18	4QFY18	(% change)		2018
				1QFY18	4QFY18	
Premium	55,179	48,849	87,289	13	(37)	270,688
First	12,587	16,148	20,213	(22)	(38)	73,562
Renewal	37,476	28,510	61,476	31	(39)	178,570
Single	5,116	4,191	5,600	22	(9)	18,556
APE	13,099	16,567	20,773	(21)	(37)	75,417
Net premium	54,378	48,202	86,558	13	(37)	268,107
Commissions (I)	2,796	2,162	4,466	29	(37)	14,033
First	1,996	1,507	3,178	32	(37)	10,245
Renewal	713	612	1,161	17	(39)	3,441
Single	87	43	127	99	(32)	347
Operating expenses (II)	5,952	4,120	6,048	44	(2)	20,299
Expenses of management (I+II)	8,748	6,282	10,513	39	(17)	34,332
Other income and trf. to shareholders	1,122	165	944	579	19	1,453
Provisions and service taxes	1,759	1,388	2,079	27	(15)	6,928
Benefits paid	29,395	39,690	45,555	(26)	(35)	172,808
Net cash flows	15,598	1,008	29,355	1,447	(47)	55,492
Income on investments	23,212	35,177	(16,134)	(34)	NM	112,615
Change in liabilities	35,801	32,220	10,481	11	242	154,475
Surplus/deficit	3,009	3,965	2,740	(24)	10	13,632
Appropriations						
Transfer to shareholders	2,464	3,334	1,967	(26)	25	10,892
FFA	545	632	774	(14)	(30)	2,740
Shareholders account						
Transfer from policyholders	2,464	3,334	1,967	(26)	25	10,892
Total income	1,400	1,040	2,515	35	(44)	7,444
Investment income	1,396	1,038	2,473	34	(44)	7,396
Other expenses	99	91	115	9	(14)	388
Any other item	925	2	753	57,713	23	753
PBT	2,840	4,281	3,613	(34)	(21)	17,196
Tax	24	221	208	(89)	(89)	997
PAT	2,816	4,059	3,406	(31)	(17)	16,198
Tax rate (%)	1	5	6			6

Source: Kotak Institutional Equities estimates

Exhibit 2: Share of protection business up 365 bps yoy to 8.2% in 1QFY19

APE break-up, March fiscal year-ends, 1QFY18-1QFY19 (Rs bn)

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	(% chg.)	2015	2016	2017	2018	(% chg.)
APE	17.0	18.7	20.1	22.1	14.0	(18.1)	47.4	51.7	66.3	77.9	17.6
Savings APE	16.3	18.0	19.3	20.0	12.8	(21.2)	46.7	50.3	63.6	73.5	15.4
Protection APE	0.8	0.7	0.8	2.2	1.1	48.1	0.8	1.4	2.6	4.5	71.9
% of APE	4.5	4.0	3.9	9.8	8.2	365 bps	1.6	2.7	3.9	5.7	181 bps
VNB	1.8	2.4	3.5	4.2	2.4	34.1	2.7	4.1	6.7	12.9	93.1
VNB margin (%)	10.7	12.6	17.5	18.9	17.5	680 bps	5.7	8.0	10.1	16.5	640 bps
IEV	NA	NA	NA	187.9	NA	NA	138.2	139.4	161.8	187.9	16.1

Source: Company

Exhibit 3: ICICI Prudential Life will trade at 3-3.1X EV at our appraisal value-based price target
Calculation of appraisal value for ICICI Prudential Life, March fiscal year-ends, 2020-21E

	2020E	2021E
Embedded value (EV, Rs bn)	246	285
New business value (NBV, Rs bn)	19.5	24.3
New business multiple (NBM, X)	25	25
Structural value (SV= NBV X NBM, Rs bn)	484	602
Appraisal value (AV= EV+SV, Rs bn)	730	887
Appraisal value/EV (X)	3.0	3.1
Value of ICICI Prudential Life (Rs/share)	508	618

Source: Kotak Institutional Equities estimates

Exhibit 4: ICICI Prudential Life trades at 2.3X price/EV FY2020E

Valuation comparison across life insurance companies, March fiscal year-ends, 2017-21E

	TP Rating	Price (Rs)	Market cap. (Rs bn)	EVOP (Rs bn)					Embedded value (Rs bn)					VNB margin (%)					Price/EV (X)					Price/EVOP (X)					Operating RoEV (%)					
				2017	2018	2019E	2020E	2021E	2017	2018	2019E	2020E	2021E	2017	2018	2019E	2020E	2021E	2017	2018	2019E	2020E	2021E	2017	2018	2019E	2020E	2021E	2017	2018	2019E	2020E	2021E	
HDFC Life	SELL	405	480	966	22	27	33	40	49	125	152	185	226	274	22	23	24	24	24	7.8	6.4	5.2	4.3	3.5	43.5	36.1	28.9	23.9	19.9	22	22	22	22	21
ICICI Prudential Life	BUY	500	386	554	23	37	34	40	48	161	188	214	246	285	10	17	17	18	19	3.4	2.9	2.6	2.3	1.9	24.1	15.0	16.5	13.8	11.6	17	23	18	19	19
Max Life	BUY	650	468	126	11	14	15	18	20	66	75	87	101	116	19	20	20	20	20	2.8	2.5	2.2	1.9	1.6	16.7	13.8	12.2	10.7	9.3	20	21	20	20	20
SBI Life	ADD	815	653	653	29	30	36	45	54	165	191	224	266	318	15	16	17	17	17	4.0	3.4	2.9	2.5	2.1	22.6	22.1	17.9	14.7	12.0	23	18	19	20	20

Source: Company, Kotak Institutional Equities estimates

Exhibit 5: We expect 18-19% operating RoEV and VNB margin of ~17-19% for ICICI Prudential Life
Key metrics and RoEV movement, March fiscal year-ends, 2015-21E (Rs bn)

	2015	2016	2017	2018	2019E	2020E	2021E
APE	47.4	51.7	66.3	77.9	89.6	108.4	131.2
Yoy growth (%)		9.0	28.1	17.6	15.0	21.0	21.0
VNB	2.7	4.1	6.7	12.9	15.2	19.5	24.3
Yoy growth (%)		52.7	61.5	93.1	18.5	28.1	24.4
EV movement							
Opening Embedded Value (EV)	117.8	137.0	138.8	161.8	187.9	213.9	245.8
Methodology changes	1.6	1.8	0.0	7.6	0.0	0.0	0.0
Economic assumption change	(4.2)	(0.7)	0.0	0.0	0.0	0.0	0.0
VNB (before over-run)	6.4	4.1	6.7	12.9	15.2	19.5	24.3
Acquisition expense overruns	(3.7)	0.0	0.0	0.0	0.0	0.0	0.0
Expected return in force	11.7	12.6	12.2	13.7	16.3	18.6	21.4
Operating variance	2.1	4.5	4.1	2.6	2.0	2.0	2.0
Tax changes	0.0	0.0	—	—	—	—	—
Investment variance	15.1	(6.2)	5.8	1.1	1.0	1.0	1.0
Dividend payout	(9.8)	(14.4)	(6.3)	(11.9)	(8.6)	(9.2)	(9.9)
Closing EV	137.0	138.8	161.2	187.9	213.9	245.8	284.5
Ratios (%)							
VNB margins	5.7	8.0	10.1	16.5	17.0	18.0	18.5
RoEV	16.4	1.3	16.2	16.5	13.8	14.9	15.8
Operating RoEV	15.4	16.7	16.5	22.7	17.9	18.8	19.4

Source: Company, Kotak Institutional Equities estimates

Exhibit 6: Sensitivities have dropped in FY2018

Sensitivity to VNB and EV, March fiscal year-ends, 2015-18 (%)

	VNB				EV			
	2015	2016	2017	2018	2015	2016	2017	2018
Reference rate up 100 bps	1.7	(5.7)	(5.2)	(4.9)	(2.4)	(2.5)	(2.0)	(2.1)
Reference rate down 100 bps	(3.0)	5.7	5.5	5.2	2.6	2.6	2.1	2.2
Discontinuance rate up 10%	(16.0)	(12.3)	(10.6)	(8.6)	(1.0)	(1.1)	(1.1)	(1.3)
Discontinuance rate down 10%	18.0	12.7	10.9	9.1	1.2	1.2	1.2	1.4
Management expenses up 10%	(5.8)	(6.4)	(5.5)	(3.5)	(0.8)	(1.1)	(1.1)	(1.0)
Management expenses down 10%	5.8	6.4	5.4	3.5	0.8	1.0	1.1	1.0
Mortality up 10%	(5.9)	(3.2)	(6.1)	(5.4)	(0.7)	(0.4)	(0.8)	(1.0)
Mortality down 10%	5.9	3.2	6.1	5.5	0.7	0.4	0.8	1.0

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: We expect protection business at 7-10% of APE

Contribution of APE and VNB of the pure protection business, March fiscal year-ends, 2016-21E

	2016	2017	2018	2019E	2020E	2021E
Protection APE (%)	2.7	3.9	5.7	7.0	8.4	9.6
Protection APE (Rs bn)	1.4	2.6	4.5	6.3	9.1	12.6
YoY (%)	83.9	86.3	71.5	40.3	45.2	39.2
Protections VNB (Rs bn)	1.2	2.2	3.8	5.3	7.7	10.1
YoY (%)	83.9	86.3	71.5	40.3	45.2	31.0
Portection VNB/total VNB (%)	28.8	33.2	29.5	34.9	39.6	41.7

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: ULIPs down 590 bps yoy to 79.8%

Product mix, March fiscal year ends, 2015-18, 1QFY18-1QFY19 (%)

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	(bps change)	2015	2016	2017	2018	(bps change)
Savings	95.5	96.1	96.0	90.2	91.8	-365 bps	98.5	97.3	96.1	94.3	-182 bps
ULIP	85.7	78.3	84.9	79.4	79.8	-589 bps	83.1	80.8	84.1	81.9	-220 bps
PAR	8.3	15.9	10.1	9.2	9.7	141 bps	13.2	14.1	9.6	10.9	126 bps
Non-par	0.5	0.3	0.3	0.9	0.9	40 bps	0.9	0.6	1.1	0.5	-59 bps
Group	0.9	1.6	0.7	0.8	1.4	42 bps	1.3	1.8	1.3	1.0	-30 bps
Protection	4.5	3.9	4.0	9.8	8.2	367 bps	1.5	2.7	3.9	5.7	182 bps

Notes:

(a) Protection includes retail and group protection products.

(b) Group excludes group protection products.

Source: Company

Exhibit 9: Bancassurance rises 700 bps yoy and 280 bps qoq to 55.6% of APE

Channel-wise APE, March fiscal year ends, 2015-18, 1QFY18-1QFY19 (%)

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	(bps change)	2015	2016	2017	2018	(bps change)
Agency	30.5	23.9	25.1	23.0	21.8	-874 bps	24.4	23.8	23.3	25.4	210 bps
Bancassurance	48.6	53.9	53.5	52.8	55.6	700 bps	58.4	57.3	56.9	52.3	-460 bps
Corporate agents and brokers	14.2	14.6	14.6	11.1	11.7	-245 bps	7.0	7.0	6.1	13.5	743 bps
Direct	5.2	5.8	5.6	7.3	6.5	135 bps	8.8	9.9	12.0	6.0	-597 bps
Group	1.5	2.1	1.1	5.8	4.4	284 bps	1.4	2.0	1.7	2.7	103 bps

Source: Company

Exhibit 10: Share of ULIPs has dropped across most channels

Channel-wise product mix, March fiscal year ends, 2015-18, 1QFY19 (%)

	2015	2016	2017	2018
Bancassurance				
ULIP	88.4	88.9	92.1	89.8
Par	10.0	9.1	5.3	7.3
Non-par	0.1	—	0.4	0.2
Protection	1.5	2.0	2.2	2.7
Agency				
ULIP	78.5	76.4	79.5	81.8
Par	19.2	19.6	14.2	13.5
Non-par	1.0	0.8	2.0	0.4
Protection	1.3	3.2	4.3	4.3
Direct				
ULIP	90.5	84.3	85.3	88.0
Par	2.8	7.7	5.0	4.3
Non-par	4.7	3.6	3.2	2.4
Protection	2.0	4.4	6.5	5.3
Corporate agents and brokers				
ULIP	62.0	47.4	46.5	36.8
Par	2.4	0.5	0.4	0.5
Non-par	34.4	49.0	44.1	49.9
Protection	1.2	3.1	9.0	12.8

Source: Company

Exhibit 11: Persistency ratio improvement at ICICI Life across most buckets

Retail persistency (including single premium), March fiscal year ends, 2014-18, 2MFY19 (%)

Persistency (%)	2014	2015	2016	2017	2018	2MFY19
13th month	71.5	79.0	82.4	85.7	86.8	86.9
25th month	68.4	65.9	71.2	73.9	78.3	79.2
37th month	57.3	64.3	61.6	66.8	68.8	69.3
49th month	20.3	54.4	62.2	59.3	64.2	65.1
61st month	12.7	14.5	46.0	56.2	54.5	54.8

Source: Company

Exhibit 12: Persistency ratio improved across most channels in FY2018

Channel-wise persistency, March fiscal year ends, 2014-18 (%)

	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
Agency						Bancassurance				
13 th month	70	78	85	88	90	75	80	81	84	85
25 th month	65	63	69	NA	NA	72	70	72	NA	NA
37 th month	45	60	58	NA	NA	76	68	65	NA	NA
49 th month	20	42	58	56	59	18	75	66	63	65
61 st month	12	15	35	NA	NA	13	12	64	NA	NA
Corporate agency						Direct sales				
13 th month	62	71	80	80	89	75	86	88	88	88
25 th month	71	59	66	66	NA	70	70	79	79	NA
37 th month	42	68	56	56	NA	47	66	65	65	NA
49 th month	20	37	67	67	58	31	42	64	64	63
61 st month	14	14	30	30	NA	13	24	34	34	NA

Source: Company

Exhibit 13: Cost to average AUM ratio up 47 bps yoy

March fiscal year ends, 1QFY18-1QFY19 (Rs mn)

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY (%)	2016	2017	2018	YoY (%)
Key financials (Rs mn)										
Premium	48,849	65,994	68,556	87,289	55,179	13	191,644	223,540	270,688	21
First year	16,148	17,862	19,339	20,213	12,587	(22)	49,244	63,446	73,562	16
Renewal	28,510	43,194	45,390	61,476	37,476	31	123,986	144,907	178,570	23
Single	4,191	4,939	3,827	5,600	5,116	22	18,414	15,187	18,556	22
APE	16,567	18,356	19,722	20,773	13,099	(21)	51,085	64,965	75,417	16
Commission (I)	2,162	3,632	3,773	4,466	2,796	29	6,200	7,589	14,033	85
First year	1,507	2,733	2,828	3,178	1,996	32	3,744	4,601	10,245	123
Renewal	612	823	845	1,161	713	17	2,402	2,903	3,441	19
Single	43	77	100	127	87	99	53	85	347	308
Operating expenses (II)	4,120	4,921	5,211	6,048	5,952	44	18,884	23,572	20,299	(14)
Expenses of management (I)+(II)	6,282	8,553	8,984	10,513	8,748	39	25,083	31,161	34,332	10
AUM (Rs bn)	1,266	1,306	1,383	1,395	1,427	13	1,039	1,229	1,395	14
Key calculated ratios (%)										
Cost/premium	13.94	13.90	13.80	12.78	17.30	336 bps	14.33	14.85	13.52	-133 bps
Cost/average AUM	2.01	2.66	2.67	3.03	2.48	47 bps	2.46	2.75	2.62	-13 bps
Net commission ratio	4.80	5.90	5.79	5.43	5.53	73 bps	3.54	3.62	5.52	191 bps
First year	13.39	20.34	19.51	22.09	22.21	882 bps	12.59	11.96	19.08	711 bps
Renewal	2.15	1.91	1.86	1.89	1.90	-24 bps	1.94	2.00	1.93	-8 bps
Single	1.04	1.55	2.62	2.27	1.69	66 bps	0.29	0.56	1.87	131 bps

Notes:

- (a) Net commission ratio: commission/(total premium-0.9 X single premium).
- (b) Cost/average AUM: annualised expenses of management/average AUM during the period.

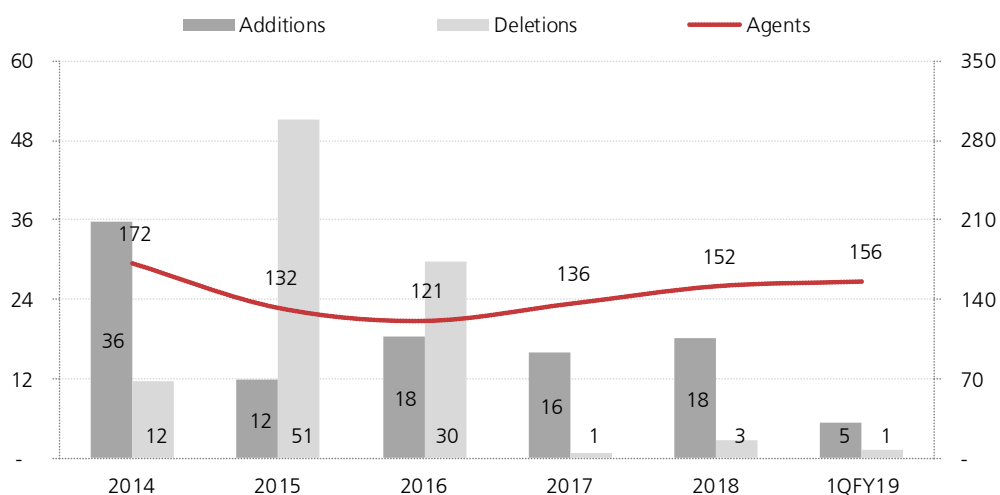
Source: Company

Exhibit 14: Debt maintains share in AUM mix yoy at 53%
March fiscal year ends, 2015-18, 1QFY18-1QFY19 (Rs bn)

	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY (%)	2015	2016	2017	2018	YoY (%)
Linked mix	1,266	1,306	1,383	1,395	1,427	13	1,002	1,039	1,229	1,395	14
Linked	901	923	983	975	997	11	748	753	879	975	11
Non linked	365	382	400	420	429	18	254	286	350	420	20
Equity mix	1,266	1,306	1,383	1,395	1,427	13	1,002	1,039	1,229	1,395	14
Equity	588	705	719	656	671	14	481	481	575	656	14
Debt	678	601	664	740	756	12	521	558	654	740	13

Source: Company

Exhibit 15: Net individual agents continue to ramp up in scale
Individual agents, March fiscal year ends, 2014-18, 1QFY19 (# '000)



Source: LIC Council

Exhibit 16: New and old estimates

Comparison of old and new EV estimates, March fiscal year-ends, 2019-21E (Rs bn)

	New estimates			Old estimates			New versus old (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Opening Embedded value (EV)	188	214	246	188	214	245	0	0	0
Methodology/ assumption changes									
Economic assumption change									
VNB	15	20	24	15	19	24	2	5	3
Expected return in force	16	19	21	16	19	21	0	0	0
Operating variance	2	2	2	2	2	2	(9)	(9)	(9)
Tax changes	0	0	0	0	0	0			
Economic/investment variance	1	1	1	1	1	1	0	0	0
Dividend payout	(9)	(9)	(10)	(9)	(9)	(10)	0	0	0
Closing EV	214	246	285	214	245	283	0	0	1
EVOP	34	40	48	33	39	47	0	2	1
RoEV (%)	14	15	16	14	15	16	6 bps	32 bps	20 bps
Operating RoEV (%)	18	19	19	18	18	19	6 bps	31 bps	19 bps
APE	90	108	131	95	115	139	(6)	(6)	(6)
VNB post overrun	15	20	24	15	19	24	2	5	3
VNB margins post overrun (%)	17	18	19	16	16	17	130 bps	180 bps	160 bps

Source: Kotak Institutional Equities estimates

JULY 25, 2018

RESULT

Coverage view: **Cautious**

Price (₹): **496**

Target price (₹): **435**

BSE-30: **36,825**

Weaker than expected. Hexaware reported 4.7% qoq and 9.9% yoy revenue growth in c/c, weaker than expected. EBITDA margin was unchanged despite a weaker Rupee as lower utilization and higher visa costs neutralized the benefits. Growth theme was similar to earlier quarters i.e. IMS and BPO forming the bedrock of growth and contributing 50% to incremental revenues. The stock trades at expensive 21.7X CY2019E earnings. Maintain SELL rating; EPS estimates remain largely unchanged.

Company data and valuation summary

Hexaware Technologies

Stock data

52-week range (Rs) (high,low) 558-239

Market Cap. (Rs bn) 147.3

Shareholding pattern (%)

Promoters 71.2

FIs 14.6

MFs 6.4

Price performance (%)

	1M	3M	12M
Absolute	12.3	16.5	104.7
Rel. to BSE-30	8.8	9.5	79.2

Forecasts/Valuations

	2018	2019E	2020E
EPS (Rs)	16.5	19.6	23.1
EPS growth (%)	20.2	18.4	18.0
P/E (X)	30.0	25.3	21.5
Sales (Rs bn)	39.4	46.6	54.9
Net profits (Rs bn)	5.0	5.9	7.0
EBITDA (Rs bn)	6.6	7.4	9.2
EV/EBITDA (X)	21.6	19.0	15.0
ROE (%)	26.6	27.4	27.8
Div. Yield (%)	0.8	1.6	1.6

Revenue growth solid but tad lower than expectations

Revenues grew 3.8% qoq to US\$168.3 mn in 2QCY18 and were 1% lower than our estimate. In c/c terms, revenues grew 4.7% qoq and 9.9% yoy. Revenue growth was led by IMS and BPO that grew by 8.9% each and contributed 50% to incremental revenues in the quarter. Growth was broad-based across various client categories. EBITDA margin of 15.6% was flat despite 98 bps tailwind from Rupee depreciation (52 bps in COR line and 46 bps in SG&A). Rupee gain was offset by 40-50 bps headwind from additional visa costs and 310 bps decline in utilization rates. Fx gains were strong at Rs290 mn due to a mix of translation and hedge gains. Strong Fx gains drove 5.8% net profit beat despite a 5% miss at the EBITDA line. Net profit grew 25% yoy to Rs1.54 bn.

CY2018 revenue guidance raised on expected lines

Hexaware raised CY2018 revenue growth guidance to 12-13% from 10-12% earlier. Achieving upper end of the guidance band requires 3.8% CQGR for the next two quarters. Most of Hexaware's challenge segments, viz. professional services and manufacturing & consumers have turned around. Enterprise solutions could require a couple of more quarters to stabilize. Net new deal wins of US\$41 mn in 2QCY18 and US\$69 mn in 1HCY18 remained flattish compared to the corresponding period in the prior year. However the more meaningful announcement was signing of two deals of US\$100 mn each with existing clients. One large deal from an existing customer is largely incremental whereas a win from another client had some renewal component. Hexaware has guided for EPS growth of 13-14% in USD terms for CY2018.

Expensive valuations underpin our cautious stance

We cut CY2018 revenue estimate by a percent and retain CY2019 and CY2020E revenue estimates. We incorporate KIE economist's revised currency rates as detailed in Exhibit 2 resulting in 0.7-3.9% EPS upgrade. Roll over and marginal EPS change results in increase in target price to Rs435 from Rs420 earlier. We value Hexaware at 18X June 2020E earnings. We like Hexaware's excellent management team, strategy and capabilities to build a large IMS and BPO practice. However the current valuation at 21.7X CY2019E earnings is extremely expensive. We maintain SELL rating.

Kawaljeet Saluja

Jaykumar Doshi

Key highlights from earnings call

- ▶ **Revenue and EPS guidance.** Management revised revenue growth guidance for CY2018 to 12-13% up from 10-12%. The company also increased its USD EPS growth guidance from 10-12% to 13-14%. Management aims to deliver EPS growth through revenue growth rather than margin expansion.
- ▶ **Forex gains.** Hexaware reported forex gains of US\$4.3 mn for the quarter compared to US\$3 mn in 1QCY18. Rebasing of current assets contributed substantially to the high forex gains. Forex gains are expected to decline in the near term due to Rupee depreciation. Management expects forex gains of US\$0.76 mn in 3QCY18 and US\$0.59 mn in 4QCY18 at an exchange rate of INR 68.47/USD.
- ▶ **Revenue walk through.** US\$ revenues for the quarter grew by 3.76% to US\$168.3 mn. Growth was led by (1) 490 bps tailwind from volume growth, partially offset by (2) 92 bps impact from cross currency headwinds and (3) 22 bps headwind from bill rates.
- ▶ **Margin walk through.** EBITDA margin remained flattish sequentially at 15.6%. Tailwinds include (1) 84 bps from calendar, (2) 98 bps from Rupee depreciation, and (3) 71 bps from SG&A leverage. Headwinds were due to (1) 97 bps from project efficiency gain in 1QCY18, (2) 74 bps from utilisation, (3) 51 bps from H1B visa cost, (4) 12 bps from revenue mix and (5) 14 bps from bill rates.
- ▶ **Accelerated deal ramp up in Q1.** Hexaware completed a cloud migration project for an APAC client in the travel and transportation vertical, ahead of schedule in 1QCY18. Earlier ramp up of the deal led to sequential revenue decline for APAC region and the travel & transportation vertical in the current quarter.
- ▶ **Commentary on geographies.** (1) America- Despite healthy qoq growth of 5.2%, tepid yoy growth of 6.2% is due to softness in large accounts in earlier quarters. The company expects revenues to normalize from 4QCY18. (2) Europe- The region is witnessing strong growth. Cross currency movements caused lower revenue growth in reported currency. (3) APAC- Accelerated ramp up of cloud migration deal caused revenue decline in the quarter.
- ▶ **Utilisation.** Utilisation fell by 3% sequentially to 78.2%. Lower utilisation was due to increased hiring of freshers. Hexaware added 2,200 people in 1HCY18, an increase of 700 from last year. The company plans to reduce just-in-time hiring and reduce utilisation to (1) improve responsiveness to customers and (2) improve cost structure and margins in the medium term.
- ▶ **Client mining in Baring portfolio.** Hexaware has won an application development and testing deal with an analytics and data company partially owned by Baring, the company is a minor partner in the deal.

Exhibit 1: Hexaware – consolidated quarterly results, December year-ends (Rs mn)

	2QCY18	2QCY18E	2QCY17	1QCY18	% chg.			CY2018E	CY2017	% chg.
					KIE	yoy	qoq			
Revenue (US\$ mn)	168.3	170.1	152.6	162.2	(1.1)	10.3	3.8	688.4	607.4	13.3
Revenues	11,367	11,422	9,836	10,490	(0.5)	15.6	8.4	46,640	39,420	18.3
Software development costs	(7,659)	(7,471)	(6,404)	(6,949)	2.5	19.6	10.2	(31,098)	(25,700)	21.0
Gross profit	3,708	3,951	3,432	3,541	(6.1)	8.1	4.7	15,543	13,720	13.3
Total SG&A expenses	(1,935)	(2,075)	(1,834)	(1,915)	(6.8)	5.5	1.0	(8,143)	(7,166)	13.6
EBITDA	1,773	1,875	1,598	1,626	(5.4)	11.0	9.1	7,400	6,554	12.9
Depreciation	(182)	(170)	(157)	(151)	6.9	15.8	20.4	(700)	(633)	10.6
EBIT	1,591	1,705	1,441	1,475	(6.7)	10.4	7.9	6,700	5,921	13.1
Other income	327	113	146	204	188.7	124.0	60.3	766	484	
Profit before tax	1,918	1,819	1,587	1,679	5.5	20.9	14.3	7,466	6,405	16.6
Provision for tax	(384)	(366)	(363)	(336)				(1,552)	(1,411)	
Net profit	1,534	1,452	1,224	1,343	5.6	25.4	14.2	5,914	4,994	18.4
Extraordinary items	—	—	—	—				—	3	
Share of profit in associate	2	—	—	(1)				—	—	-
Net profit - reported	1,536	1,452	1,224	1,342	5.8	25.5	14.4	5,914	4,997	18.3
Recurring EPS (Rs/share)	5.1	4.8	4.1	4.5	5.8	25.5	14.1	19.6	16.5	18.8
No. of shares outstanding (mn)	302	302	302	302				302	303	
As % of revenues										
Gross margin	32.6	34.6	34.9	33.8				33.3	34.8	
EBITDA margin	15.6	16.4	16.2	15.5				15.9	16.6	
EBIT margin	14.0	14.9	14.7	14.1				14.4	15.0	
SG&A expenses	17.0	18.2	18.6	18.3				17.5	18.2	

Source: Company, Kotak Institutional Equities, Kotak Institutional Equities estimates

Exhibit 2: Key changes in CY2018-20E estimates

	New			Old			Change (%)		
	CY2018E	CY2019E	CY2020E	CY2018E	CY2019E	CY2020E	CY2018E	CY2019E	CY2020E
Revenues (US\$ mn)	688	790	887	693	789	886	(0.7)	0.1	0.1
Revenue growth (%)	13.3	14.7	12.3	14.1	13.8	12.3			
Revenues (Rs mn)	46,640	54,894	61,647	46,408	53,547	60,922	0.5	2.5	1.2
EBITDA (Rs mn)	7,400	9,170	10,232	7,692	8,853	10,159	(3.8)	3.6	0.7
EBITDA Margin (%)	15.9	16.7	16.6	16.6	16.5	16.7			
Recurring EPS (Rs/ share)	19.6	23.1	25.4	19.8	22.2	25.3	(0.9)	3.9	0.7
Re/ US\$ rate	67.8	69.5	69.5	67.0	67.9	68.8	1.2	2.4	1.1

Source: Kotak Institutional Equities estimates

Exhibit 3: Revenue growth across geographies, verticals and service lines (June-2018)

	Revenues (US\$ mn)	Growth (%)		Contribution to revenues (%)
		qoq	yoy	
Total revenues	168.3	3.8	10.3	100.0
Geographical split of revenues				
Americas	129.6	6.1	5.1	77.0
Europe	21.4	5.4	25.1	12.7
Asia Pacific	17.3	(12.4)	42.0	10.3
Vertical split of revenues				
Banking and Financial services	72.0	1.6	9.0	42.8
Travel & Transportation	18.7	(12.1)	(8.6)	11.1
Healthcare & Insurance	28.8	10.9	20.9	17.1
Mfg, consumer & others	27.1	10.6	32.5	16.1
Professional services	21.7	10.6	(0.5)	12.9
Service line split of revenues				
ADM	61.6	5.8	10.6	36.6
EAS	17.7	(0.0)	(0.2)	10.5
Testing / QATS	31.0	(0.0)	3.0	18.4
Business intelligence & analytics	22.7	(1.4)	6.3	13.5
BPO	12.1	8.3	10.3	7.2
IMS	23.2	10.1	38.4	13.8
Delivery split of revenues				
Onsite	109.7	3.4	11.1	65.2
Offshore (incl nearshore)	58.6	4.4	8.7	34.8
Client metrics				
Top 5 clients	71.4	4.5	1.4	
Top 10 clients	88.9	3.8	3.1	

Source: Company, Kotak Institutional Equities

Exhibit 4: Top accounts show signs of revival in growth

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	8 qtr
											CQGR (%)
Revenues (US\$ mn)											
Top client	NA	NA	NA	NA	NA						
Top-5 clients	52	56	64	64	66	70	67	67	68	71	3.1
Top-10 clients	67	72	79	80	82	86	84	83	86	89	2.7
Non Top-10 accounts	54	58	56	59	63	66	70	74	77	79	4.0
Growth (%)											
Top client	NA	NA	NA	NA	NA						
Top-5 clients	(0.3)	7.1	13.7	1.2	2.6	6.6	(4.8)	(0.3)	2.2	4.5	
Top-10 clients	(0.9)	6.4	10.1	1.2	2.9	5.1	(2.1)	(2.2)	3.7	3.8	
Non Top-10 accounts	(3.2)	6.8	(2.9)	5.0	5.9	5.9	4.9	5.6	4.1	3.8	

Source: Company, Kotak Institutional Equities

Exhibit 5: Onsite-centric growth continues

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	8 qtr CQGR (%)
Revenues (US\$ mn)											
Onsite	77	80	85	86	93	99	101	102	106	110	4.1
Offshore	45	50	50	53	51	54	53	54	56	59	2.0
Growth (%)											
Onsite	(0.7)	3.7	7.3	0.6	8.5	5.8	2.0	0.9	4.4	3.4	
Offshore	(4.0)	11.5	(0.6)	6.4	(3.0)	4.9	(1.1)	2.2	3.0	4.4	

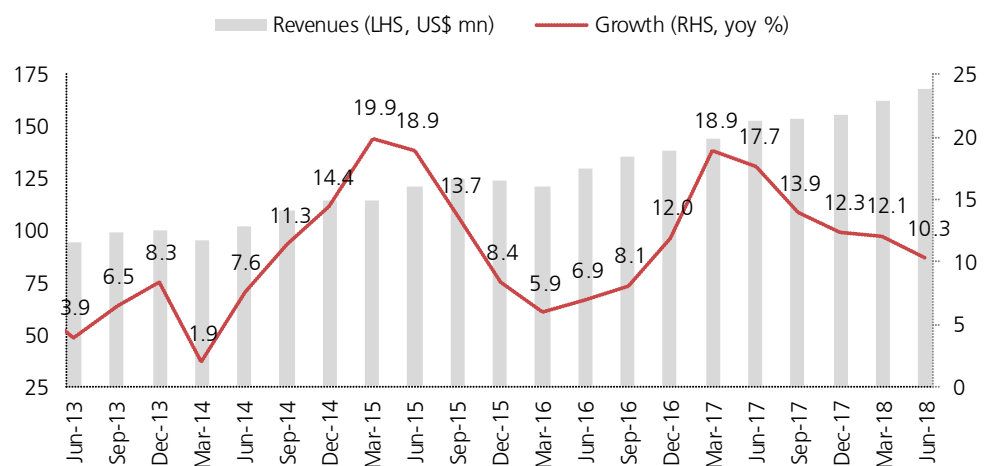
Source: Company, Kotak Institutional Equities

Exhibit 6: Strong growth from IMS and BPO

	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	10 quarter CAGR
IMS revenues (US\$ mn)														
IMS revenues (US\$ mn)	8	9	9	9	10	12	13	15	17	17	17	18	21	23
IMS as % of revenues	6.7	6.9	7.3	7.3	8.0	8.7	9.1	10.7	11.0	11.3	11.7	13.0	13.8	
Growth in IMS (qoq)	18	6	5	(2)	17	13	7	22	8	4	5	15	10	9.9
Growth in IMS (yoy)	15	21	24	29	28	36	40	74	62	48	44	36	38	
BPO revenues (US\$ mn)														
BPO revenues (US\$ mn)	6	7	7	7	8	9	9	9	11	11	11	11	12	
BPO as % of revenues	5.2	5.7	5.7	5.8	6.5	6.8	6.8	6.4	7.2	7.3	7.0	6.9	7.2	
Growth in BPO (qoq)	14	13	(1)	(0)	19	9	3	(2)	19	2	(3)	2	8	5.5
Growth in BPO (yoy)	55	54	44	28	34	29	34	31	30	22	16	21	10	
BPO+ IMS contribution to incremental revenues														
BPO+ IMS revenues (US\$ mn)	2	1	0	(0)	3	2	1	3	3	1	1	3	3	
Incremental revenues (US\$ mn)	6.4	3.8	(1.0)	(2.4)	8.0	5.5	3.7	5.8	7.9	1.4	2.1	6.1	6.1	
BPO+ IMS as % of incremental revenues (%)	32	35	(37)	8	36	39	30	46	38	61	26	51	50	

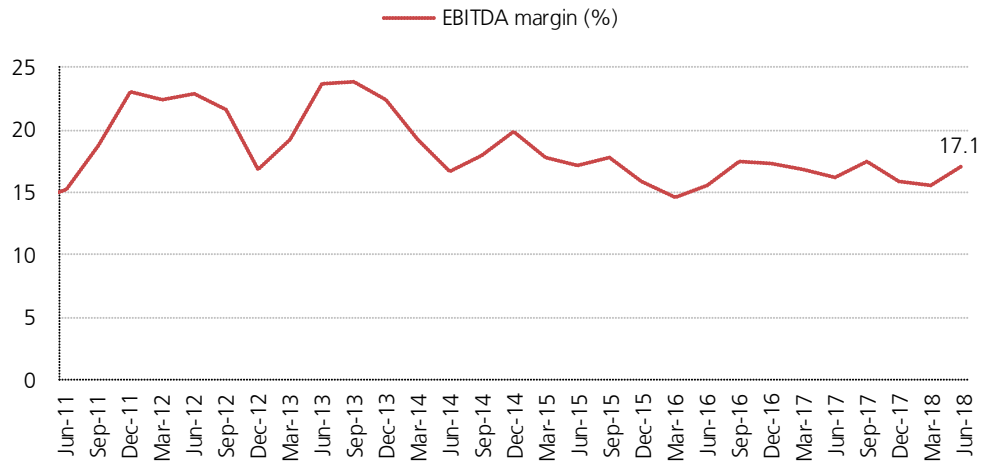
Source: Company, Kotak Institutional Equities

Exhibit 7: Hexaware: yoy growth has decelerated



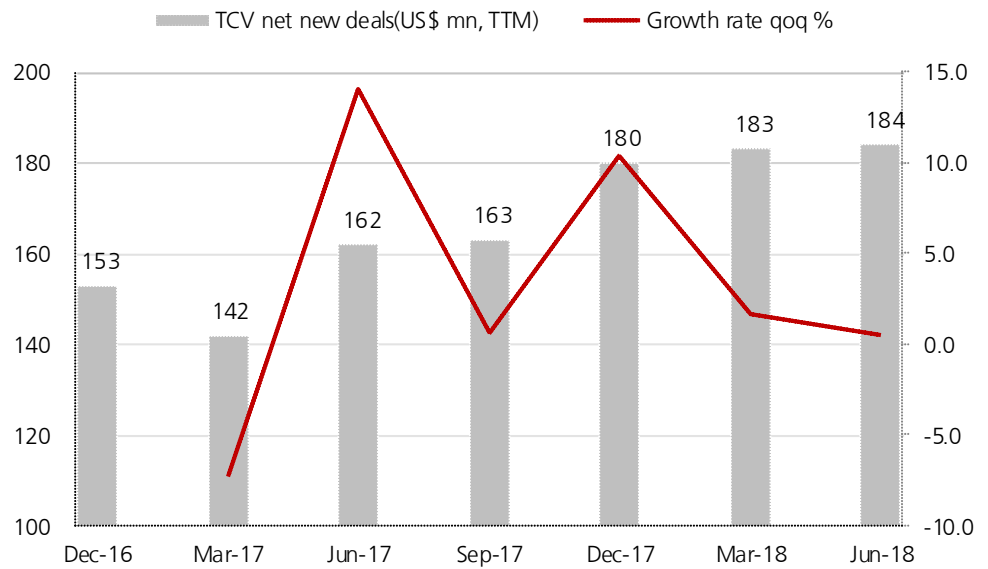
Source: Company, Kotak Institutional Equities

Exhibit 8: EBITDA margin has remained flattish over the past few quarters



Source: Company, Kotak Institutional Equities

Exhibit 9: TCV of net new deal wins has steadied in the last 3 quarters



Source: Company, Kotak Institutional Equities

Exhibit 10: Hexaware: key operational metrics

Hexaware: key operational metrics

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Revenues (US\$ mn)	122	130	135	139	145	153	154	156	162	168
qoq growth (%)	(1.9)	6.6	4.3	2.7	4.1	5.5	0.9	1.3	3.9	3.8
Revenues (Rs mn)	8,202	8,696	9,041	9,409	9,605	9,836	9,931	10,048	10,490	11,367
Exchange rate	67.40	67.05	66.85	67.72	66.38	64.5	64.5	64.4	64.7	67.5
Revenue by verticals (%) - new classification										
Banking and Financial services	39.2	40.0	41.6	42.1	42.7	43.3	43.4	44.4	43.7	42.8
Travel & Transportation	15.3	14.5	14.5	13.2	13.6	13.4	13.2	12.0	13.1	11.1
Healthcare & Insurance	17.5	17.1	16.0	16.5	15.7	15.6	16.6	16.7	16.0	17.1
Mfg, consumer & others	28.0	28.4	27.9	28.2	13.6	13.4	13.4	13.9	15.1	16.1
Professional services					14.4	14.3	13.4	13.0	12.1	12.9
Revenue by service lines (%) - new classification										
ADM	37.7	36.5	36.0	36.4	36.1	36.5	36.3	37.2	35.9	36.6
EAS	13.7	13.3	13.0	12.7	12.1	11.6	11.3	10.8	10.9	10.5
Testing / QATS	20.3	20.1	20.3	20.9	20.9	19.7	20.0	19.5	19.1	18.4
Business intelligence & analytics	15.2	15.6	15.2	14.1	13.8	14.0	13.8	13.8	14.2	13.5
BPO	5.8	6.5	6.8	6.8	6.4	7.2	7.3	7.0	6.9	7.2
IMS	7.3	8.0	8.7	9.1	10.7	11.0	11.3	11.7	13.0	13.8
Revenue by geographies (%) - new classification										
Americas	81.4	80.9	82.0	82.5	81.6	80.8	79.1	77.7	75.3	77.0
Europe	12.0	12.5	11.6	11.1	11.0	11.2	11.3	12.1	12.5	12.7
Asia Pacific	6.6	6.6	6.4	6.4	7.4	8.0	9.6	10.2	12.2	10.3
Onsite-Offshore mix (%)										
Onsite	63.1	61.4	63.2	61.9	64.5	64.7	65.4	65.1	65.4	65.2
Offshore	36.9	38.6	36.8	38.1	35.5	35.3	34.6	34.9	34.6	34.8
Client metrics										
Repeat business (%)	94.7	95.2	95.4	95.4	93.8	93.7	95.3	94.3	94.3	94.3
Clients billed	229	226	222	220	222	220	218	221	224	226
Clients added	10	6	7	7	6	9	8	8	5	7
Revenue concentration (%)										
Top 1 client										
Top 5 clients	42.9	43.1	47.0	46.3	45.6	46.1	43.5	42.8	42.1	42.4
Top 10 clients	55.3	55.2	58.3	57.4	56.7	56.5	54.8	52.9	52.8	52.8
Client size (ttm)										
> US\$1 mn	73	76	77	78	81	81	82	88	89	93
Between US\$1 mn - US\$5 mn	58	62	63	64	67	66	64	71	69	71
Between US\$5 mn - US\$10 mn	6	6	6	6	6	7	9	7	10	12
Between US\$10 mn - US\$20 mn	5	3	3	3	3	3	4	6	6	6
> US\$20 mn	4	5	5	5	5	5	5	4	4	4
Employee metrics										
Total employees (consolidated)	11,599	11,875	11,819	12,115	12,734	13,098	13,488	13,705	14,619	15,357
Utilization (%)	69.6	70.0	74.1	78.6	78.9	80.8	79.7	80.9	81.3	78.2
Attrition rate (%) LTM	16.0	16.6	16.5	16.1	14.9	13.8	13.7	13.1	13.4	14.4
DSO - Billed	49	46	50	43	46	45	47	49	47	47
DSO - including unbilled accrual	78	74	75	68	74	70	72	71	74	75

Source: Company, Kotak Institutional Equities

Exhibit 11: Consolidated financials for Hexaware, December year-ends, 2013-20E (Rs mn)

	2013	2014	2015	2016	2017	2018E	2019E	2020E
Profit model								
Total income	22,854	25,817	31,235	35,348	39,420	46,640	54,894	61,647
EBITDA	5,124	4,776	5,355	5,746	6,554	7,400	9,170	10,232
Depreciation and amortisation	(386)	(434)	(482)	(559)	(633)	(700)	(797)	(928)
Other income	58	(90)	173	394	484	766	374	407
Pretax profits	4,797	4,253	5,047	5,582	6,406	7,467	8,748	9,710
Tax	(1,004)	(980)	(1,114)	(1,411)	(1,411)	(1,552)	(1,769)	(2,036)
Profit after tax	3,793	3,273	3,933	4,171	4,995	5,915	6,979	7,674
Diluted recurring EPS (Rs/share)	12.6	10.8	12.9	13.8	16.6	19.6	23.1	25.4
Balance sheet								
Total equity	11,992	12,906	14,332	17,409	20,073	23,090	27,170	31,223
Deferred taxation liability	48	(175)	(256)	(1,252)	(1,336)	(1,336)	(1,336)	(1,336)
Current liabilities	6,044	4,630	5,873	5,701	5,380	5,724	6,176	6,377
Total liabilities and equity	18,084	17,361	19,949	21,858	24,118	27,478	32,011	36,265
Cash	6,389	4,716	4,428	4,453	5,487	6,980	9,371	11,810
Other current assets	6,320	7,151	8,989	9,364	10,630	12,109	13,814	15,156
Tangible fixed assets	5,371	5,489	6,489	8,020	7,977	8,364	8,802	9,274
Total assets	18,084	17,361	19,949	21,858	24,118	27,478	32,011	36,265
Free cash flow								
Operating cash flow, excl. WC	3,337	4,454	4,865	4,687	5,397	6,116	7,532	8,338
Working capital changes	140	(309)	(595)	(197)	(901)	(1,136)	(1,252)	(1,141)
Capital expenditure	(393)	(604)	(1,482)	(2,217)	(954)	(1,088)	(1,235)	(1,400)
Free cash flow	3,084	3,542	2,789	2,273	3,542	3,892	5,044	5,797
Ratios (%)								
EBITDA margin	22.4	18.5	17.1	16.3	16.6	15.9	16.7	16.6
ROE	31.6	26.3	28.9	26.3	26.6	27.4	27.8	26.3
ROCE	31.2	26.8	27.9	24.4	24.6	24.6	26.6	25.2

Source: Company, Kotak Institutional Equities estimates

JULY 25, 2018

RESULT

Coverage view:

Price (₹): 2,784

Target price (₹): 1,785

BSE-30: 36,825

Volumes recover, but at lower pricing. TeamLease's staffing segment volumes (associates + apprentices) grew 17% yoy, broadly in line with estimates. Margins, however, disappointed on account of lower priced contracts, and higher wage costs of own employees. Higher margins on apprentice staffing is positive, though our FY2019-20 EPS estimates still get revised down by 1-2%. The stock is pricing in strong volume and margin growth, optimistic in our view. Roll-forward leads to a new TP of ₹1,785 (from ₹1,750). SELL stays.

Company data and valuation summary

TeamLease Services

Stock data

52-week range (Rs) (high,low) 3,310-1,270

Market Cap. (Rs bn) 47.6

Shareholding pattern (%)

Promoters 42.3

FIs 33.6

MFs 5.8

Price performance (%)

Absolute (11.3) 12.8 104.8

Rel. to BSE-30 (14.0) 6.0 79.3

Forecasts/Valuations

	2018	2019E	2020E
EPS (Rs)	43.1	57.9	74.6
EPS growth (%)	28.0	34.2	29.0
P/E (X)	64.6	48.1	37.3
Sales (Rs bn)	36.2	45.5	54.9
Net profits (Rs bn)	0.7	1.0	1.3
EBITDA (Rs bn)	0.7	0.9	1.2
EV/EBITDA (X)	67.2	48.8	37.2
ROE (%)	18.2	20.1	21.1
Div. Yield (%)	0.0	0.0	0.0

Revenue growth in line, margins disappoint

TeamLease reported revenue growth of 19% yoy, broadly in line with estimates. EBITDA of ₹202 mn, however, missed estimates by 18% primarily due to (1) sequential decline in employee mark-up and higher wage costs of own employees in the temporary staffing segment, and (2) hiring of new employees in Evolve leading to higher costs and lower margins in the specialized staffing segment. Higher other income led to lower PAT miss of 11%.

Associate employee count recovers, NETAP apprentice count addition remains strong

TeamLease added 5,412 associate employees in 1QFY19, compared to 5,860 associate employees added in all of FY2018. The improved run-rate is certainly positive, though at 6% yoy the associate employee count growth remains below the previously achieved 14-15% growth rates. NETAP apprentice count continued to grow well, and at 69% yoy growth pulled up the overall associate + apprentice count growth to a healthy 17% yoy.

Lower pricing and higher wages pull down staffing segment margins

The staffing segment posted EBIT margin of 1.6% in 1QFY19, lower than 1.7-2.0% posted in 3Q-4QFY18. The decline was surprising given TeamLease's employee efficiency improved further to 232 associates + apprentices staffed per own employee, from 204 in 1QFY18. We believe the key reason for lower margin was on account of new contracts signed at lower pricing, also reflected in the 2.5% qoq decline in TeamLease's average monthly mark-up per associate employee.

Strong macro fully priced in; SELL

Revival in growth in associate staffing segment is a positive, though 1QFY19 is reflective of the fact that future growth may come in at lower pricing. We acknowledge that TeamLease may still have margin expansion levers, as it invests in automation and sourcing. That said, we do tweak our margin estimates for associate staffing segment, resulting in 1-2% EPS cut over FY2019-20. Higher margins in apprentice staffing results in nil EPS impact to FY2021 estimates. TP gets revised to ₹1,785 (from ₹1,750) on roll-forward to June 2020E. SELL stays.

Garima Mishra

Exhibit 1: Steady volume growth driven by NETAP and productivity improvement drive strong operating performance
Quarterly results snapshot of TeamLease, March fiscal year-ends

	1QFY19	1QFY19E	1QFY18	4QFY18	Change (%)			FY2019E	FY2018	Yoy growth	
					KIE	yoy	qoq			(%)	FY2017
Revenue from operations	10,213	10,126	8,530	9,775	0.9	19.7	4.5	45,528	36,241	25.6	30,413
Employee benefits expense	(9,683)	(9,682)	(8,227)	(9,314)	0.0	17.7	4.0	(43,723)	(34,712)	26.0	(29,413)
Other expenses	(329)	(199)	(172)	(233)	65.3	90.8	40.7	(861)	(841)	2.4	(629)
Total Expenses	(10,012)	(9,881)	(8,399)	(9,547)	1.3	19.2	4.9	(44,584)	(35,553)	25.4	(30,043)
EBITDA	202	245	130	227	(17.8)	54.9	(11.3)	944	688	37.2	370
Finance Costs	(11)	(3)	(2)	(11)	257.6	332.2	(3.7)	—	(25)	(100.0)	(11)
Depreciation and amortization expense	(27)	(28)	(20)	(28)	(4.7)	33.0	(3.5)	(109)	(92)	18.5	(61)
Other income	52	31	58	12	69.1	(10.2)	343.4	154	156	(1.4)	217
PBT	217	245	166	200	(11.7)	30.5	8.2	989	728	35.9	515
Tax expense	3	—	(2)	15	na	na	na	—	9	(100.0)	61
Net profit	218	245	164	212	(11.1)	33.1	2.8	989	737	34.2	576
Operational metrics											
Number of associate employees	137,735	138,323	129,787	132,323	(0.4)	6.1	4.1	150,517	132,323	13.8	123,946
Number of NETAP apprentices	47,493	46,052	28,051	43,052	3.1	69.3	10.3	59,868	46,052	30.0	19,427
Number of specialized associates	6,407	5,950	1,423	5,948	7.7	350.2	7.7	—	—	—	—
Total associates and trainees	191,635	190,325	159,261	181,323	0.7	20.3	5.7	210,385	178,375	17.9	
Mark-up per general staffing associate per month	736	755	729	755	(2.5)	1.0	(2.5)	733	708	3.5	691
Mark-up per NETAP trainee per month	590	—	544	544	na	8.5	8.5	—	—	—	—
Key ratios (%)											
Employee cost as proportion of sales	94.8	95.6	96.5	95.3	—	—	—	96.0	95.8	—	96.7
Other cost as proportion of sales	3.2	2.0	2.0	2.4	—	—	—	1.9	2.3	—	2.1
EBITDA margin	2.0	2.4	1.5	2.3	—	—	—	2.1	1.9	—	1.2
Tax rate	(1.2)	2	1	(7)	—	—	—	—	(1)	—	(12)
Segmental performance											
Revenues											
Staffing and allied services	9,161	9,467	8,165	8,830	(3.2)	12.2	3.7	42,328	34,761	21.8	29,453
Specialized staffing services	750	614	246	728	22.1	204.6	3.0	1,150	1,058	8.7	508
Other HR services	303	105	118	217	188.2	155.6	39.3	2,050	1,171	75.1	452
Total operating income	10,213	10,186	8,530	9,775	0.3	19.7	4.5	45,528	36,990	23.1	30,413
EBIT											
Staffing and allied services	147	—	124	154	—	18.4	(4.2)	—	582	(100.0)	—
Specialized staffing services	54	—	27	53	—	99.0	2.0	—	175	(100.0)	—
Other HR services	22	—	7	26	—	231	(12.8)	—	36	(100.0)	—
Unallocated	3	—	11	(24)	—	(76.0)	(110.5)	—	(42)	(100.0)	—
Total	226	—	169	208	—	34.0	8.5	—	750	(100.0)	—
Less: finance costs	(11)	—	(2)	(11)	—	332.2	(3.7)	—	(25)	(100.0)	—
PBT	215	—	166	197	—	29.6	9.2	—	725	(100.0)	—

Source: Company, Kotak Institutional Equities estimates

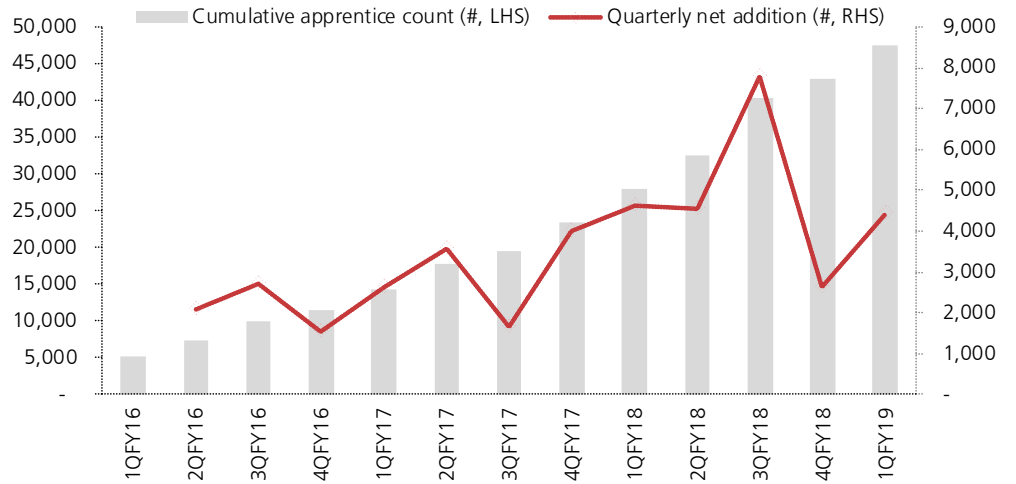
Key takeaways from results conference call

- ▶ Temporary staffing volumes. Volumes have recovered as the company is aggressively focusing on new deal wins and building a healthy pipeline for future quarters. Growth is fairly broad based, from a diverse set of industries. E-commerce-driven growth should contribute more to 2Q and 3Q volumes. Volume growth is backed by demand from both existing and new clients.
- ▶ GST impact. While GST had promised compliance loop closures, the same hasn't resulted into volume growth for organized players. In that sense, the organized sector growth is simply a function of economic activity. Shift from unorganized sector is still to happen.
- ▶ Margins and pricing. TeamLease is focusing on new deal wins, and hence will not shy away from taking contracts with pricing lower than existing contracts, as long as the contract adds to overall margins. Pitches to clients are made on variable pricing model, though proportion of variable has remained stagnant at ~26-27% of total contracts. TeamLease remains extremely focused on its working capital cycle, and has seen an improvement in the proportion of contracts on collect at pay to 84% from 80% earlier.
- ▶ Apprentice staffing. This segment continues to grow well, with strong future pipeline. Margins in this segment expanded on account of improved pricing, some of which would be transferred to TeamLease by TLSU.

- ▶ HR services. The other services vertical pertains to mostly revenues from government skilling. This has been growing well on account of government initiatives.
- ▶ Telecom staffing (Evolve). Margins of 4-5% are lower than the initially guided range of 6-8% primarily due to higher people cost (hiring of senior management).

Exhibit 2: Apprentice addition sustained at a rapid pace

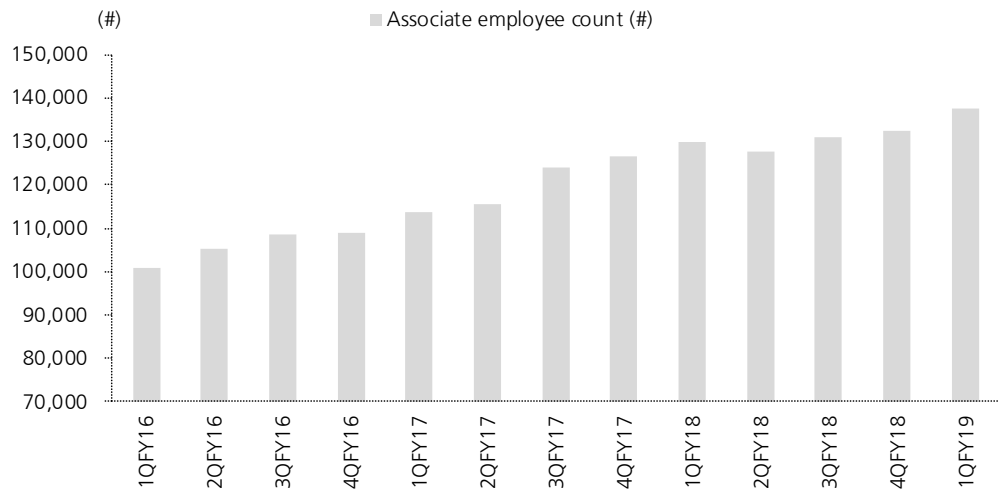
Cumulative apprentice count and net additions (#)



Source: Company, Kotak Institutional Equities

Exhibit 3: Associate employee count recovered in 1Q

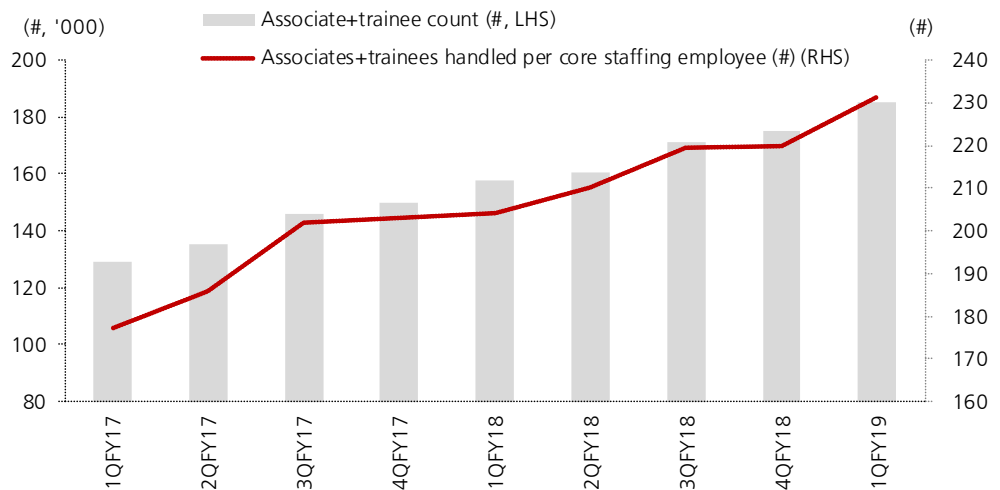
Associate employee count for TeamLease, March fiscal year-ends (#)



Source: Company, Kotak Institutional Equities

Exhibit 4: Core employee productivity has steadily improved

Associates and trainees handled per core staffing employee, March fiscal year-ends



Source: Company, Kotak Institutional Equities

Exhibit 5: Summary of changes to assumptions for TeamLease, March fiscal year-ends

	New estimates			Old estimates			% revision		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Total									
Sales (Rs mn)	45,528	54,948	66,065	45,528	54,936	66,046	0.0	0.0	0.0
Sales growth (%)	25.6	20.7	20.2	25.6	20.7	20.2			
EBITDA (Rs mn)	944	1,213	1,521	966	1,224	1,525	(2.3)	(0.8)	(0.2)
EBITDA margin (%)	2.1	2.2	2.3	2.1	2.2	2.3			
EBIT (Rs mn)	835	1,088	1,375	858	1,098	1,378	(2.6)	(0.9)	(0.3)
PBT (Rs mn)	989	1,276	1,642	1,013	1,288	1,649	(2.3)	(1.0)	(0.4)
Tax rate (%)	—	—	—	—	—	—			
Net Profit (Rs mn)	989	1,276	1,642	1,013	1,288	1,649	(2.3)	(1.0)	(0.4)
EPS (Rs)	57.9	74.6	96.1	59.2	75.4	96.5	(2.3)	(1.0)	(0.4)
EPS growth (%)	34	29	29	37	27	28			
Temporary staffing									
Temporary staff count (#)	150,517	170,837	193,046	150,517	170,837	193,046	—	—	—
Salary per employee (Rs)	274,984	294,233	314,829	274,984	294,233	314,829	—	—	—
Fee per employee per month (Rs)	733	758	785	736	766	796	(0.5)	(1.0)	(1.4)
Revenue (Rs mn)	42,036	50,999	61,602	42,042	51,014	61,628	(0.0)	(0.0)	(0.0)
EBITDA (Rs mn)	510	696	908	521	709	924	(2.0)	(1.8)	(1.7)
EBITDA margin (%)	1.2	1.4	1.5	1.2	1.4	1.5			
IT Staffing									
Revenue (Rs mn)	1,150	1,252	1,364	1,150	1,252	1,364	—	—	—
EBITDA (Rs mn)	165	180	196	165	180	196	—	—	—
EBITDA margin (%)	14.3	14.3	14.4	14.3	14.3	14.4			
Apprentice staffing									
Apprentice count (#)	59,868	77,828	97,285	59,868	77,828	97,285	—	—	—
Average monthly fee per apprentice (Rs)	460	483	493	450	450	450	2.2	7.3	9.5
Revenue (Rs mn)	292	399	518	286	372	473	2.2	7.3	9.5
EBITDA (Rs mn)	146	200	259	143	186	236	2.2	7.3	9.5
EBITDA margin (%)	50.0	50.0	50.0	50.0	50.0	50.0			
Other HR services									
Revenue (Rs mn)	804	925	1,067	804	925	1,067	0.0	0.0	0.0
EBITDA (Rs mn)	24	28	33	24	28	33	0.0	0.0	0.0
EBITDA margin (%)	3.0	3.1	3.1	3.0	3.1	3.1			
Evolve									
Revenue (Rs mn)	1,246	1,373	1,514	1,246	1,373	1,514	0.0	0.0	0.0
EBITDA (Rs mn)	87	96	106	110	119	129	(20.5)	(19.2)	(17.7)
EBITDA margin (%)	7.0	7.0	7.0	8.8	8.7	8.5			

Source: Kotak Institutional Equities estimates

Exhibit 6: DCF-based valuation of TeamLease's core staffing business of Rs1,744 per share

DCF-based valuation of core business, March fiscal year-ends (Rs mn)

	2017	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2035E
Net sales	34,885	41,670	51,693	62,520	75,305	89,952	106,548	125,141	145,726	168,241	191,710	215,961	240,040	263,204	349,579
Yoy growth (%)	22	19	24	21	20	19	18	17	16	15	14	13	11	10	4
EBIT	309	556	752	995	1,272	1,583	1,949	2,390	2,899	3,482	4,121	4,793	5,496	6,210	8,248
EBIT margin (%)	0.9	1.3	1.5	1.6	1.7	1.8	1.8	1.9	2.0	2.1	2.1	2.2	2.3	2.4	2.4
EBIT*(1-tax rate)	346	542	736	974	1,239	1,534	1,879	1,912	1,913	2,298	2,720	3,164	3,627	4,099	5,444
Depreciation/Amortisation	61	90	105	122	143	174	202	233	268	306	347	363	347	321	263
(Inc.)/Dec. in working capital	(19)	459	(835)	(256)	(155)	(389)	(405)	(441)	(473)	(500)	(552)	(618)	(614)	(590)	(355)
Capital expenditure	(839)	(400)	(110)	(165)	(181)	(179)	(203)	(227)	(252)	(275)	(287)	(297)	(361)	(347)	(209)
Free cash flows	(451)	691	(104)	676	1,046	1,140	1,473	1,476	1,457	1,829	2,228	2,612	3,000	3,482	5,143
Years discounted	—	—	—	—	1	2	3	4	5	6	7	8	9	10	15
Discount factor	—	—	—	1.00	0.89	0.79	0.70	0.62	0.55	0.49	0.44	0.39	0.35	0.31	0.17
Discounted cash flow	—	—	—	676	930	901	1,034	922	808	902	977	1,018	1,039	1,072	879
Associate employee count (#)	126,463	132,323	150,517	170,837	192,192	216,120	240,865	266,035	291,175	315,779	337,725	356,806	371,613	385,176	409,742
Risk-free rate	6.5														
Risk premium	6.0														
Beta (X)	1.0														
Cost of equity (%)	12.5														
WACC (%)	12.5														
Terminal growth rate (%)	5.0														
Sum of free cash flow	15,147														
Terminal value	12,304														
Enterprise value	27,451														
Investments	—														
Net debt	(2,362)														
Equity value	29,813														
No. of shares (mn)	17														
Equity value per share (Rs)	1,744														

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: SoTP-based target price of Rs1,785

Description	Rs/share
DCF based valuation of general and IT staffing businesses	1,744
Valuation of Evolve (telecom vertical staffing) at 7X EV/EBITDA	35
Valuation of Schoolguru at 1X invested capital	8
SOTP based target price	1,786

Source: Kotak Institutional Equities estimates

Exhibit 8: Consolidated income statement, balance sheet and cash flow, March fiscal year-ends, 2011-21E (Rs mn)

	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Income statement											
Total operating income	6,868	9,258	12,507	15,296	20,071	25,049	30,413	36,241	45,528	54,948	66,065
Associate employee expenses	(6,351)	(8,627)	(11,755)	(14,432)	(18,990)	(23,773)	(28,643)	(33,814)	(42,698)	(51,626)	(62,182)
Gross profit	518	632	752	865	1,081	1,276	1,770	2,427	2,829	3,322	3,882
EBITDA	(390)	(207)	(111)	120	241	258	370	688	944	1,213	1,521
Depreciation	(66)	(38)	(36)	(19)	(27)	(30)	(61)	(92)	(109)	(126)	(147)
EBIT	(456)	(245)	(147)	101	213	228	309	596	835	1,088	1,375
Other income	115	83	110	79	114	154	217	156	154	189	268
Financial charges	(2)	(3)	(5)	(2)	(1)	(4)	(11)	(25)	—	—	—
Pre-tax profit	(343)	(165)	(43)	178	326	378	515	728	989	1,276	1,642
Taxation	—	—	—	—	(18)	(130)	61	9	—	—	—
Net income (recurring)	(343)	(165)	(43)	178	308	248	576	737	989	1,276	1,642
Exceptional items	(53)	—	—	—	—	—	—	—	—	—	—
Net income (reported)	(395)	(165)	(43)	178	308	248	576	737	989	1,276	1,642
Weighted average number of shares (mn)	12	15	15	15	15	16	17	17	17	17	17
EPS (Rs)	(33.2)	(10.8)	(2.8)	11.6	20.1	15.9	33.7	43.1	57.9	74.6	96.1
Balance sheet											
Equity share capital	4	5	5	5	5	171	171	171	171	171	171
Reserves & surplus	215	1,042	1,005	1,183	1,483	2,945	3,493	4,246	5,235	6,511	8,154
Shareholders funds	219	1,047	1,010	1,188	1,488	3,116	3,663	4,417	5,406	6,682	8,325
Loan funds	29	81	121	8	—	194	11	73	—	—	—
Total source of funds	247	1,127	1,131	1,197	1,488	3,309	3,686	4,490	5,406	6,682	8,325
Net fixed assets	211	195	107	107	95	111	1,069	1,378	1,379	1,418	1,452
Investments	—	0	0	0	0	0	103	593	593	593	593
Cash balances	180	822	780	847	1,147	2,590	1,602	1,424	1,505	2,486	3,939
Current assets	574	952	1,355	1,478	1,827	3,039	3,224	4,045	5,207	6,435	7,736
Inventories	15	9	5	2	2	2	—	—	—	—	—
Sundry debtors	345	543	618	595	813	1,205	1,729	2,235	2,932	3,690	4,436
Other current assets	76	114	340	367	498	1,054	1,062	1,283	1,612	1,945	2,339
Loans and advances	139	286	392	515	514	778	433	527	663	800	961
Current liabilities and provisions	718	842	1,112	1,236	1,638	2,476	3,091	4,371	4,698	5,670	6,817
Total application of funds	247	1,127	1,131	1,197	1,488	3,309	3,686	4,490	5,406	6,682	8,325
Cash flow statement											
Operating cash flow before WC changes	(390)	(207)	(111)	120	222	45	351	697	944	1,213	1,521
Change in working capital/ other adjustments	144	(255)	(133)	1	53	(150)	(19)	459	(835)	(256)	(155)
Capital expenditure	(293)	61	161	60	99	(22)	(917)	(734)	44	24	86
Free cash flow	(539)	(400)	(83)	181	375	(127)	(585)	422	153	981	1,453

Source: Company, Kotak Institutional Equities estimates

JULY 25, 2018

RESULT, CHANGE IN RECO.

 Coverage view: **Cautious**

 Price (₹): **582**

 Target price (₹): **590**

 BSE-30: **36,825**

Subpar start to FY2019. UNSP's 1QFY19 earnings print missed our estimates on EBITDA and PAT despite broadly in-line revenues and gross profit. Adspends and other expenses came in higher than estimate. Headline yoy comps look healthy off a low base; however, 2-year CAGRs (flattish revenues, 6% gross profit, 3% EBITDA) are weak despite the perfect concoction of qualitative tailwinds (mix, pricing, franchising, RM movement). Subdued volume growth mitigated all these positives. We tweak our forecasts marginally, raise fair value TP to ₹590 (from ₹560) and upgrade rating a notch to REDUCE from SELL noting the sharp recent correction.

Company data and valuation summary

United Spirits

Stock data

52-week range (Rs) (high,low)	801-468
Market Cap. (Rs bn)	423.0

Shareholding pattern (%)

Promoters	58.5
FIs	23.3
MFs	4.1

Price performance (%)	1M	3M	12M
Absolute	(14.5)	(18.4)	10.2
Rel. to BSE-30	(17.2)	(23.3)	(3.5)

Forecasts/Valuations

	2018	2019E	2020E
EPS (Rs)	7.6	10.2	13.4
EPS growth (%)	39.1	34.7	30.9
P/E (X)	76.5	56.8	43.4
Sales (Rs bn)	81.7	90.5	99.9
Net profits (Rs bn)	5.5	7.4	9.7
EBITDA (Rs bn)	10.2	13.3	16.1
EV/EBITDA (X)	44.1	33.1	26.8
ROE (%)	24.9	24.2	22.7
Div. Yield (%)	0.0	0.0	0.3

1QFY19 earnings print – below expectations on EBITDA and PAT

Net operating revenues grew 13% yoy to ₹20.1 bn, broadly in line with our expected ₹20.3 bn. Gross profit of ₹9.9 bn, +21% yoy, was again broadly in line with estimate. Gross margins expanded 312 bps yoy to 49.1% (KIE: 48.5%) on the back of an improved mix, favorable pricing and RM tailwinds. Adjusted EBITDA of ₹2.28 bn (+34% yoy) fell 16% short of our estimate on account of higher adspends (+30% yoy to ₹2.11 bn; 17% higher than estimate) and other expenses. Adjusted EBITDA margin stood at 11.3% (+178 bps yoy, 200 bps below estimate). Recurring adjusted PAT of ₹1.05 bn, +45% yoy, was 26% below our estimate. ETR stood at 34.3%. The company attributed higher adspends partly to higher activations during IPL and FIFA world cup. Adjusted EBITDA reflects adjustments for one-off restructuring costs of ₹360 mn in 1QFY19 and ₹130 mn in the base quarter.

2-year CAGRs (versus 1QFY17 print) weak despite several tailwinds

1QFY19 yoy comps look healthy but need to be seen in the context of the extremely favorable base; 1QFY18 was impacted heavily by the highway ban impact. A better comparison in this backdrop is versus 1QFY17 print. 2-year CAGR on revenue stands at -1%, on gross profit at 6%, on EBITDA at 3% and on PAT at 12% (on the back of a sharp 34% per annum fall in net interest cost). We note that there have been several positive tailwinds in the past two years – (a) continued mix improvement; P&A segment formed 65% of sales in 1QFY19 versus 58% in 1QFY17, (b) franchising of popular volumes; this is EBITDA accretive, in our view, (c) generally favorable pricing environment and (d) benign input cost trends. The reason why all of these did not add up to a better earnings trajectory is the subdued volume trajectory – 3% decline per annum (underlying, overall, per our math) and a modest 1.6% CAGR even in P&A.

Tweak forecasts marginally; raise fair value target and upgrade a notch to REDUCE from SELL

We tweak our forecasts marginally, raise fair value TP to ₹590 (from ₹560) and upgrade rating a notch to REDUCE from SELL noting the sharp recent correction. Delivery needs to consistently start backing the narrative for us to turn constructive at the current rich valuations.

Rohit Chordia

Jaykumar Doshi

Aniket Sethi

Exhibit 1: Interim standalone results of United Spirits (as per Ind-AS), March fiscal year-ends (Rs mn)

	1QFY19	1QFY19E	1QFY18	4QFY18	(% change)			FY2019E	FY2018	% chng	1QFY17	2-year CAGR (%)
					KIE Est	yoy	qoq					
Gross revenues	64,152	64,714	58,168	69,004	(1)	10	(7)	286,976	260,691	10	58,531	5
Less: excise duty	(44,033)	(44,376)	(40,350)	(47,267)	(1)	9	(7)	(196,473)	(178,990)	10	(38,126)	
Net operating income	20,119	20,338	17,818	21,737	(1)	13	(7)	90,504	81,701	11	20,405	(1)
Cost of materials	(10,232)	(10,480)	(9,619)	(11,134)	(2)	6	(8)	(46,042)	(42,891)	7	(11,557)	
Gross profit	9,887	9,857	8,199	10,603	0	21	(7)	44,461	38,810	15	8,848	6
Gross margin (%)	49.1	48.5	46.0	48.8	67 bps	312 bps	36 bps	49.1	47.5	162 bps	43.4	
Staff cost	(1,688)	(1,691)	(1,528)	(1,853)	(0)	10	(9)	(6,997)	(6,601)	6	(1,802)	(3)
Advertising and promotion	(2,112)	(1,806)	(1,627)	(2,207)	17	30	(4)	(8,751)	(7,882)	11	(1,673)	12
Other expenditure	(3,804)	(3,650)	(3,340)	(3,802)	4	14	0	(15,374)	(14,112)	9	(3,239)	8
Total other expenditure	(7,604)	(7,147)	(6,495)	(7,862)	6	17	(3)	(31,123)	(28,595)	9	(6,714)	
EBITDA	2,283	2,710	1,704	2,741	(16)	34	(17)	13,339	10,215	31	2,134	3
EBITDA margin (%)	11.3	13.3	9.6	12.6	-198 bps	178 bps	-127 bps	14.7	12.5	223 bps	10.5	
Depreciation	(339)	(370)	(321)	(367)	(8)	6	(8)	(1,426)	(1,351)	6	(261)	
Interest	(559)	(575)	(703)	(591)	(3)	(20)	(5)	(1,999)	(2,611)	(23)	(1,030)	
Other income	214	355	309	1,210	(40)	(31)	(82)	1,369	2,060	(34)	241	
Pretax profits	1,599	2,121	989	2,993	(25)	62	(47)	11,283	8,313	36	1,084	21
Tax	(548)	(700)	(266)	(1,126)	(22)	106	(51)	(3,836)	(2,786)	38	(253)	
Recurring PAT	1,051	1,421	723	1,867	(26)	45	(44)	7,447	5,527	35	831	12
Extraordinary	(238)	1,000	(94)	243				4,000	90		(393)	
Reported PAT	813	2,421	629	2,110	(66)	29	(61)	11,447	5,617	104	438	36
Recurring EPS	1.4	2.0	1.0	2.6	(26)	45	(44)	10.2	7.6	35	1.1	12
Excise as % of gross revenues	68.6	68.6	69.4	68.5	6 bps	-73 bps	13 bps	68.5	68.7		65.1	
Income tax rate (%)	34.3	33.0	26.9	37.6	129 bps	738 bps	-333 bps	34.0	33.5	48 bps	23.3	
Cost as a % of sales												
Cost of materials	50.9	51.5	54.0	51.2	-68 bps	-313 bps	-37 bps	50.9	52.5	-163 bps	56.6	
Staff cost	8.4	8.3	8.6	8.5	7 bps	-19 bps	-14 bps	7.7	8.1	-35 bps	8.8	
Advertising and promotion	10.5	8.9	9.1	10.2	161 bps	136 bps	34 bps	9.7	9.6	2 bps	8.2	
Other expenditure	18.9	17.9	18.7	17.5	96 bps	16 bps	141 bps	17.0	17.3	-29 bps	15.9	

Source: Company, Kotak Institutional Equities

Exhibit 2: Key changes to standalone earnings model, UNSP, March fiscal year-ends, 2019-21E (Rs mn)

	Revised			Earlier			Change (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenues (Rs mn)	90,504	99,880	109,278	89,891	98,693	107,954	0.7	1.2	1.2
EBITDA (Rs mn)	13,339	16,054	18,437	13,571	15,996	18,387	(1.7)	0.4	0.3
EBITDA (%)	14.7	16.1	16.9	15.1	16.2	17.0			
Recurring PAT (Rs mn)	7,447	9,749	12,136	7,768	9,896	12,314	(4.1)	(1.5)	(1.4)
Adj. EPS (Rs/share)	10.2	13.4	16.7	10.7	13.6	16.9	(4.1)	(1.5)	(1.4)

Source: Company, Kotak Institutional Equities estimates

Highlights from concall

- ▶ **Overall business performance.** Management believes that 1QFY19 illustrated strength of the underlying business as regulatory challenges are now largely behind. They believe that the business momentum is coming back and the company will capitalize on it in times to come.
- ▶ **Segment-wise takeaways.** Prestige segment posted 19% yoy growth in revenues (aided by 13% volume growth) and now represents 52% of total volumes. Strong growth in the Prestige segment was led by robust growth in its scotch portfolio – Jonnie Walker, Black & White and Black Dog. Higher activations during IPL and the Fifa World Cup aided connect with the younger adults. The Popular segment posted 3% yoy decline in net sales due to 9% yoy decline in volumes – underlying net sales were flat yoy. Management seemed satisfied with the results of its premiumization strategy and the franchise income was also in line with expectations (expect annual income of ₹1.5 bn).
- ▶ **Acquisition of 26% stake in HipBar.** Management explained that HipBar (a tech startup in the alcoholic beverage space) seeks to solve the logistics issues at the consumer end in the alcoholic beverage industry. Currently, it operates in the key cities of Bangalore and Chennai and UNSP would like to support its expansion in other cities.
- ▶ **Adspends guidance.** While adspends in 1QFY19 increased 30% yoy and stood at 10.5% of net operating revenues, management highlighted that they expect adspends to remain in the range of 9-10%. Adspends in 1Q were higher given high spending during IPL and FIFA. Management did acknowledge that its brands were under-supported in the past and they have now managed to improve their share of voice.
- ▶ **Comments on margin expansion.** EBITDA margin for 1QFY19 expanded 178 bps yoy to 11.3. However, this remains well short of the management's medium-term guidance of expansion of its EBITDA margins to mid-high teens. Management explained that they are relatively satisfied with the gross margins levels (inflationary but manageable RM likely going ahead) and are also rationalizing some of their overhead costs. However, bulk of the margin expansion will be the back of higher volume-led operating leverage benefits.
- ▶ **Other takeaways.** (1) The company's ambition remains double-digit topline growth and mid-to-high teens EBITDA margin in the medium term (we still have no idea of what the management defines medium term as). (2) Good support from the UP excise department. They are looking to do the right things to support the industry in the state. (3) Cost inflation of 4-5% yoy can be assumed in overhead expenses for the next few years.

Exhibit 3: United Spirits – quarterly volume trends

	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	FY17	FY18
Volume breakup											
Volumes (mn cases)											
Prestige and above segments	9.2	8.9	10.2	8.5	8.4	9.1	9.9	9.8	9.5	36.8	37.2
Regular and below segments	13.0	13.1	14.3	12.8	9.6	9.4	11.2	11.1	8.7	53.2	41.3
Total	22.2	22.0	24.5	21.3	18.0	18.5	21.1	20.9	18.2	90.0	78.5
Growth, yoy (%)											
Prestige and above segments	10	11	5	5	(9)	2	(3)	15	13		1
Regular and below segments	(6)	(5)	(11)	(16)	(26)	(28)	(22)	(13)	(9)		(22)
Total	(0)	1	(5)	(9)	(19)	(16)	(14)	(2)	1		(13)
% of total volumes											
Prestige and above segments	41.4	40.5	41.6	39.9	46.7	49.2	46.9	46.9	52.2	40.9	47.4
Regular and below segments	58.6	59.5	58.4	60.1	53.3	50.8	53.1	53.1	47.8	59.1	52.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, Kotak Institutional Equities

Exhibit 4: Standalone profit model, balance sheet, cash model of United Spirits (based on Ind-AS), March fiscal year-ends, 2016-21E

	2016	2017	2018	2019E	2020E	2021E
Profit model						
Net revenues	82,482	85,476	81,701	90,504	99,880	109,278
EBITDA	8,864	9,710	10,215	13,339	16,054	18,437
Other income	1,057	1,111	2,060	1,369	1,888	2,822
Interest expense	(4,469)	(3,690)	(2,611)	(1,999)	(1,517)	(1,065)
Depreciation	(1,017)	(1,323)	(1,351)	(1,426)	(1,540)	(1,666)
Pretax profits	4,435	5,808	8,313	11,283	14,884	18,528
Extraordinaries	(1,280)	(2,273)	90	4,000	5,000	5,000
Tax	(1,936)	(1,836)	(2,786)	(3,836)	(5,135)	(6,392)
Reported PAT	1,219	1,699	5,617	11,447	14,749	17,136
Adj. PAT	2,499	3,972	5,527	7,447	9,749	12,136
Adj. earnings per share (Rs)	3.4	5.5	7.6	10.2	13.4	16.7
Balance sheet						
Total shareholder equity	17,140	19,378	25,038	36,485	49,484	64,433
Total borrowings	42,040	40,710	28,962	22,962	16,962	11,435
Deferred tax liability	(1,539)	(1,241)	(856)	(856)	(856)	(856)
Total liabilities and equity	57,641	58,847	53,144	58,591	65,590	75,012
Net fixed assets	13,211	12,723	11,001	11,325	11,785	12,307
Total investments	9,924	9,354	9,354	9,354	9,354	9,354
Cash	127	523	1,198	5,027	10,348	18,431
Net current assets	34,379	36,247	31,591	32,884	34,104	34,919
Total assets	57,641	58,847	53,144	58,591	65,590	75,012
Free cash flow						
Operating cash flow, excl. working capital	8,026	6,433	7,862	9,502	10,919	12,045
Working capital changes	(6,073)	(1,868)	4,656	(1,293)	(1,220)	(816)
Capital expenditure	(2,456)	(835)	371	(1,750)	(2,000)	(2,188)
Free cash flow	(502)	3,730	12,889	6,459	7,699	9,041
Ratios						
Gross revenue growth (%)		9.8	2.3	10.7	11.7	10.6
Net operating revenue growth (%)		3.6	(4.4)	10.8	10.4	9.4
EBITDA growth (%)		9.5	5.2	30.6	20.4	14.8
Recurring PAT growth (%)		59.0	39.1	34.7	30.9	24.5
Gross margin (%)	41.3	42.9	47.5	49.1	49.6	49.7
EBITDA margin(%)	10.7	11.4	12.5	14.7	16.1	16.9
RoAE (%)	13.7	21.8	24.9	24.2	22.7	21.3
RoACE (%)	12.1	14.4	15.8	21.3	23.4	23.9
Key assumptions						
Total core volumes (mn cases)	93.1	90.1	78.5	81.5	85.5	89.6
-Prestige and Above	34.2	36.8	37.2	40.4	43.6	46.9
-Popular	58.9	53.3	41.3	41.1	41.9	42.7
Blended Realisation (Rs/case)	872	937	1,009	1,079	1,135	1,187

Source: Company, Kotak Institutional Equities estimates

JULY 25, 2018

RESULT, CHANGE IN RECO.

 Coverage view: **Cautious**

 Price (₹): **1,354**

 Target price (₹): **1,425**

 BSE-30: **36,825**

Recovery across segments. INFOE reported revenue growth of 17% yoy, in line with expectations. Naukri reported steady revenue growth of 15% and healthy margins of 57%. 99acres business reported 30%+ yoy revenue growth for the third straight quarter. Overall EBITDA beat of 5% was driven by a higher-than-expected reduction in ad-spends. After a sharp run-up in stock price we downgrade rating to ADD and revise target price to ₹1,425 (from ₹1,390 earlier).

Company data and valuation summary

Info Edge

Stock data

52-week range (Rs) (high,low)	1,460-919
Market Cap. (Rs bn)	165.1

Shareholding pattern (%)

Promoters	41.4
FIIs	32.8
MFs	14.7

Price performance (%)

	1M	3M	12M
Absolute	12.9	9.8	37.2
Rel. to BSE-30	9.4	3.2	20.2

Forecasts/Valuations

	2018	2019E	2020E
EPS (Rs)	22.5	25.9	33.0
EPS growth (%)	33.3	14.9	27.5
P/E (X)	60.1	52.4	41.1
Sales (Rs bn)	9.2	10.7	12.6
Net profits (Rs bn)	2.7	3.1	4.0
EBITDA (Rs bn)	3.0	3.7	4.9
EV/EBITDA (X)	50.3	39.3	29.7
ROE (%)	13.4	13.2	14.3
Div. Yield (%)	0.4	0.6	0.6

Revenue growth of 17% aided by strong growth in Naukri and 99acres

INFOE reported revenue growth of 17% yoy, in line with expectations. This was driven by Naukri's revenue growth normalizing to 15% yoy (from 13% in 4QFY18), and 99acres registering strong revenue growth of 34%. Revenue growth of others segment (comprising Jeevansathi and Shiksha) came in at a modest 7%. EBITDA beat of 5% was driven by lower ad-spends in Naukri and Jeevansathi businesses.

Operating leverage and lower ad-spends drive margin expansion for Naukri

Naukri's revenue growth was driven by a healthy 11.5% increase in unique customers and 3.3% increase in realizations. This, coupled with sequential reduction in ad-spends (owing to lower TV advertising) drove a healthy 360 bps sequential improvement in Naukri's EBITDA margins. Deferred revenue growth of 16% yoy was broadly in line with reported revenue growth, indicating that 1QFY19 revenue growth trajectory is sustainable. Management mentioned that both IT and non-IT sectors such as autos, BFSI, industrials accounted for the growth.

99acres: early signs of revival

99acres has reported strong revenue growth of 30%+ for the past three years, indicating that the online real estate advertising market may have bottomed. INFOE continues to retain strong 50% traffic share among online real estate portals. Management indicated that while the resale segment continues to see more interest, there is some revival in enquiries from builders, indicating a potential pick-up in ad-spends. This is also reflected in healthy deferred revenue growth of 43% yoy.

Downgrade rating a notch to ADD post sharp run-up in stock price

We like INFOE's mix of businesses comprising the steady cash flow generating nature of Naukri and high growth potential of 99acres and investee companies such as Zomato. We raise revenue growth estimates for Naukri and 99acres by 1-4%, resulting in EPS increase of 1-3%. This leads to an increase in our SoTP based target price to ₹1,425 (₹1,390 earlier). The sharp run-up in stock price drives a downgrade in our rating to ADD.

Kawaljeet Saluja

Garima Mishra

Exhibit 1: Standalone quarterly financials of Info Edge, March fiscal year-ends, (Rs mn)

	1QFY19	1QFY19E	1QFY18	4QFY18	Change (%)			FY2019	FY2018
					KIE	yoy	qoq		
Total operating income	2,595	2,580	2,225	2,407	0.6	16.7	7.8	10,738	9,155
Employee expenses	(1,106)		(991)	(1,048)		11.6	5.6	(4,396)	(3,931)
Network, Internet and other direct charges	(43)		(34)	(41)		26.1	3.9	(152)	(143)
Administration and other expenses	(228)		(242)	(246)		(6.0)	(7.5)	(1,086)	(944)
Advertising and promotion cost	(376)		(254)	(478)		48.1	(21.3)	(1,365)	(1,164)
Operating expenses	(1,753)	(1,778)	(1,521)	(1,813)	(1.4)	15.2	(3.3)	(6,999)	(6,182)
EBITDA	843	802	703	593	5.1	19.8	42.0	3,739	2,973
Depreciation	(53)	(60)	(54)	(56)	(11.9)	(2.4)	(4.4)	(262)	(215)
EBIT	790	741	649	538	6.5	21.7	46.8	3,477	2,758
Other income	236	237	264	225	(0.3)	(10.5)	5	1,215	971
Financial charges	(0)	—	(0)	(0)	—	5.9	—	—	(1)
Pre-tax profit	1,026	978	913	763	4.8	12.4	34.4	4,692	3,728
Taxation	(236)	(294)	(270)	(197)	(19.6)	(12.7)	19.7	(1,548)	(991)
PAT (recurring)	790	685	642	566	15.3	22.9	39.6	3,144	2,737
Exceptional items	(160)	—	—	(703)	NA	NA	NA	—	—
Reported PAT	630	685	642	(138)	(8.0)	(1.9)	(557.9)	3,144	2,737
Key ratios (%)									
Direct cost of sales	44.3	0.0	46.1	45.2				42.4	44.5
Fixed cost of sales	23.3	0.0	22.3	30.1				22.8	23.0
EBITDA margin	32.5	31.1	31.6	24.7				34.8	32.5
PAT margin	30.4	26.5	28.9	23.5				29.3	29.9
Tax rate	23.0	30.0	29.6	25.8				33.0	26.6
Segmental break-up									
Revenues									
Recruitment Solutions	1,841	1,821	1,598	1,752	1.1	15.2	5.1	7,630	6,688
99acres	419	408	314	373	2.8	33.6	12.4	1,806	1,354
Other Verticals	335	351	313	282	(4.5)	7.0	18.9	1,301	1,113
Total	2,595	2,580	2,225	2,407	0.6	16.7	7.8	10,738	9,155
PBT									
Recruitment Solutions	1,020		853	908		19.7	12.4		
99acres	(129)		(112)	(149)		15.1	(13.7)		
Others	(34)		(30)	(120)		16.0	(71.4)		
Total	858		712	640		20.5	34.1		
Less unallocable expenses	(68)		(63)	(102)		8.6	(33.1)		
Add unallocable income	236		264	225		(10.5)	4.9		
Exceptional items	(160)		-	(703)					
Profit before tax	866		913	60		(5.1)	1,352.8		

Source: Company, Kotak Institutional Equities

Exhibit 2: Segmental revenue and EBITDA snapshot of INFOE, March fiscal year-ends

	1QFY18	1QFY19	Yoy growth (%)
Revenues			
Recruitment Solutions	1,598	1,841	15
99acres	314	419	34
Jeevansathi	137	140	2
Shiksha	176	195	11
Total	2,225	2,595	17
Operating EBITDA			
Recruitment Solutions	879	1,045	19
99acres	(87)	(115)	
Jeevansathi	(41)	(56)	
Shiksha	20	31	55
Unallocated expenses	(67)	(62)	
Total	703	843	20

Source: Company, Kotak Institutional Equities

Exhibit 3: Naukri and 99acres drive deferred revenue growth of 19% in 1QFY19

Segmental deferred revenue, billing and recognized revenue trends (Ind-AS), March fiscal year-ends (Rs mn)

	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	Yoy growth (%)
Deferred revenue														
Recruitment Solutions	2,068	1,910	1,888	2,210	2,425	2,150	2,168	2,556	2,762	2,618	2,537	2,939	3,203	16.0
99acres	273	289	279	359	358	398	384	501	485	485	518	705	693	42.9
Other Verticals	193	187	205	244	211	199	238	310	290	245	276	313	302	4.1
Total	2,534	2,386	2,372	2,813	2,994	2,747	2,790	3,367	3,537	3,348	3,331	3,957	4,198	18.7
Billing														
Recruitment Solutions	1,337	1,156	1,284	1,757	1,622	1,284	1,442	1,982	1,821	1,464	1,632	2,163	2,101	15.4
99acres	251	284	254	361	277	349	246	392	298	333	378	562	409	37.2
Other Verticals	208	175	199	267	225	225	235	328	297	228	274	318	324	9.1
Total	1,796	1,615	1,737	2,385	2,124	1,858	1,923	2,702	2,416	2,025	2,284	3,043	2,834	17.3
Revenue														
Recruitment Solutions	1,263	1,289	1,314	1,423	1,440	1,555	1,404	1,555	1,598	1,648	1,690	1,752	1,841	15.2
99acres	271	268	264	280	279	308	261	275	314	326	341	373	419	33.4
Other Verticals	213	183	180	228	258	237	196	254	313	278	240	282	335	7.0
Total	1,747	1,740	1,758	1,931	1,977	2,100	1,861	2,084	2,225	2,252	2,271	2,407	2,595	16.6

Source: Company, Kotak Institutional Equities

Recruitment segment – IT headwinds continue, other sectors drive growth

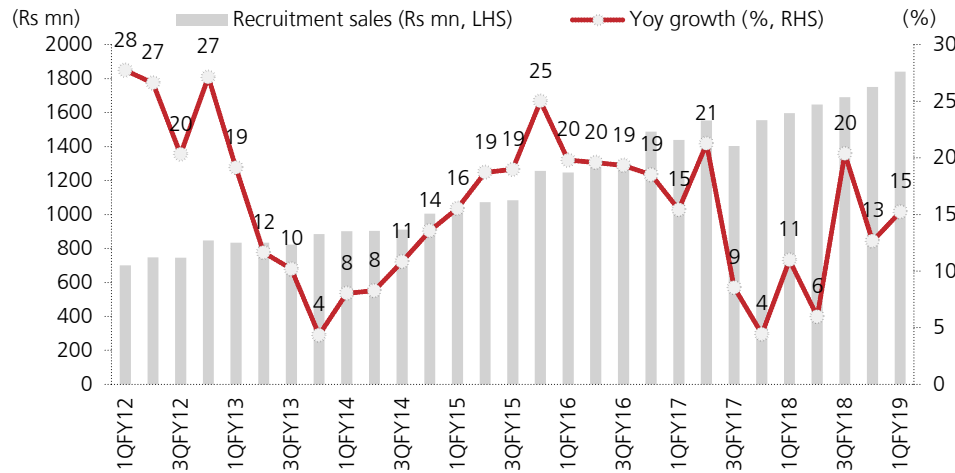
Recruitment segment growth came in at 15% yoy, an acceleration from 13% growth reported in 4QFY18. Revenue growth was driven by 12% growth in customers and 3% growth in realizations. Margins expanded meaningfully from 53% in 4QFY18 to 57% in 1QFY19.

- ▶ Billing growth of 15% yoy as well as deferred revenue growth of 16% are indicative that current revenue growth momentum can sustain.
- ▶ Management mentioned that IT hiring seems to be reviving, after remaining tepid in FY2018. Further, demand from other industries such as autos, BFSI, travel etc. seems to be picking up. The only customer base which seems under pressure are placement agencies.

- ▶ Naukri remains the traffic leader, with 70%+ market-share (excluding Indeed) and ~60% share including Indeed. Advertising spends on Naukri declined sequentially, and will be volatile depending on competitive activity. Lower ad-spends in 1QFY19 led to a sharp sequential improvement in EBITDA margins from 53% in 4QFY18 to 57% in 1QFY19. Naukri will selectively choose to advertise on various media.

Exhibit 4: Revenue growth inched up to 15% in 1QFY19

Recruitment sales trajectory for Info Edge, March fiscal year-ends



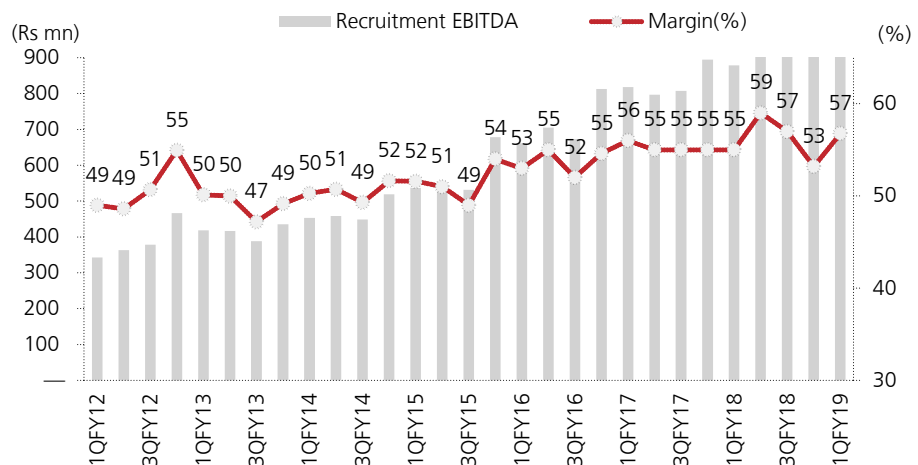
Notes:

(a) Revenues pertain to IGAAP till FY2015 and to IndAS FY2016 onwards.

Source: Company, Kotak Institutional Equities

Exhibit 5: Lower ad-spends drive a sequential increase in margins

Recruitment EBITDA trajectory for Info Edge, March fiscal year-ends

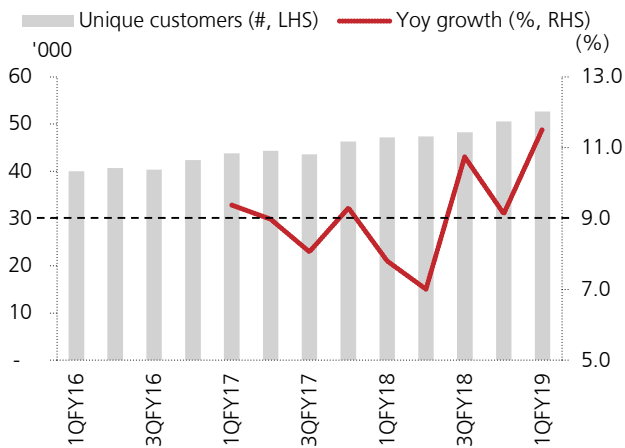


Notes:

(a) EBITDA in IGAAP till 4QFY17, in Ind-AS 1QFY18 onwards.

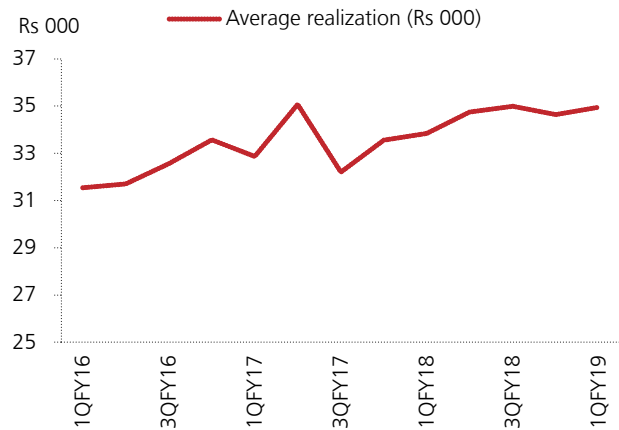
Source: Company, Kotak Institutional Equities

Exhibit 6: Unique paying customers increased 12% yoy
 Unique paying customers in recruitment business, March fiscal year-ends



Source: Company, Kotak Institutional Equities

Exhibit 7: Realization held steady in 1QFY19
 Average realization per customer, March fiscal year-ends



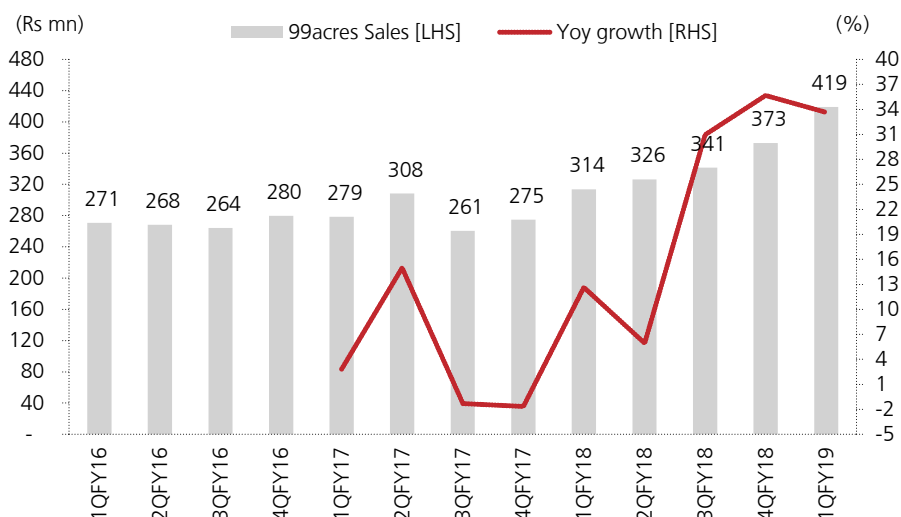
Source: Company, Kotak Institutional Equities

99acres – early signs of revival

Yoy growth of 34% in revenues and 43% in deferred revenues is indicative of possible recovery in business, albeit on a low base.

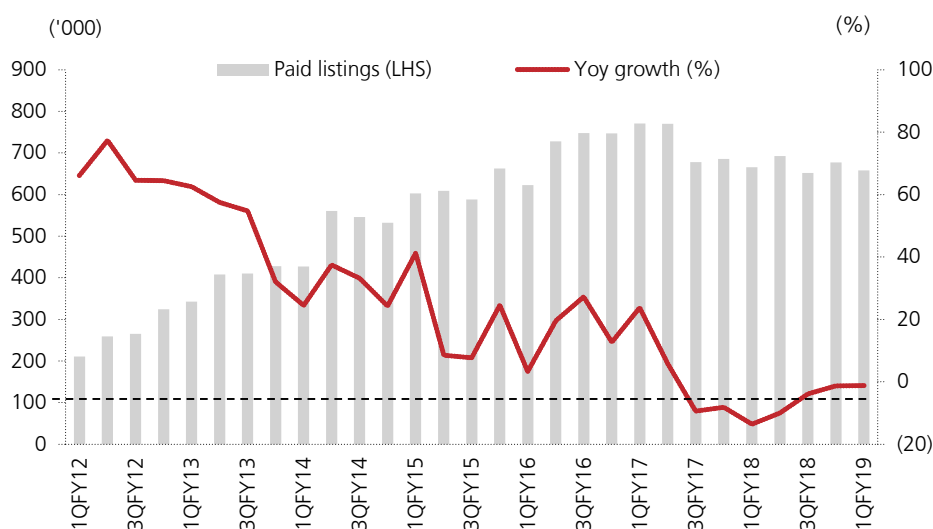
- ▶ 99acres revenue growth momentum has improved over the past three quarters owing to improved momentum in secondary sales activity. Of the overall revenue, brokers accounted for 55%, builders for 45% and property owners accounted for 5% of revenues. While the mix has not changed meaningfully over the past two quarters, 99acres is seeing an increase in enquiries from builders.
- ▶ Management mentioned that recovery is fairly broad-based, with business from key markets such as Delhi-NCR, Mumbai, Bangalore and Pune picking up. GST and RERA impact has been absorbed by the industry.
- ▶ Real estate firms have spent ₹30-40 bn on advertising at peak, and current spends are around ₹20 bn. There is thus a fair amount of advertising that can potentially come back and benefit online portals.
- ▶ Traffic share of 99acres is healthy at 50%, measured on the basis of time spent and user base, based on Similarweb data. Management indicated that 99acres would continue to advertise in order to improve market share.

Exhibit 8: 99acres revenue growth trajectory improved in 2HFY18
99acres sales growth profile, March fiscal year-ends



Source: Company, Kotak Institutional Equities

Exhibit 9: Paid listings growth momentum yet to pick-up
99acres paid listings growth trend, March fiscal year-ends



Source: Company, Kotak Institutional Equities

Zomato – focus on food delivery

Management mentioned that Zomato continues to grow fast and food delivery is a key focus area.

- ▶ Food delivery will be a key growth driver for Zomato, and it may experiment with different delivery models to grow this business faster. Zomato is looking to aggressively compete with Swiggy in this business. Zomato’s order run-rate has touched 12 mn orders a month. It is lower than Swiggy’s order run-rate though the gap is reducing.
- ▶ Zomato has clearly shifted to a cash intensive model, and will continue to invest across all its offerings such as delivery, Zomato Gold and Piggybank.

- ▶ INFOE will evaluate the opportunity to invest in any future funding rounds, though given significant investor interest, retains the option of not participating.

Exhibit 10: Key changes to estimates for Info Edge, March fiscal year-ends (Rs mn)

	New estimates			Old estimates			% revision		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Total									
Sales	10,738	12,588	14,650	10,587	12,245	14,139	1.4	2.8	3.6
Sales growth (%)	17.3	17.2	16.4	15.6	15.7	15.5			
EBITDA	3,739	4,860	5,868	3,728	4,796	5,742	0.3	1.3	2.2
EBITDA margin (%)	34.8	38.6	40.1	35.2	39.2	40.6			
EPS (Rs)	25.9	33.0	39.8	25.6	32.3	38.7	0.9	2.2	2.9
EPS growth (%)	14.9	27.5	20.6	13.9	25.9	19.8			
Recruitment									
Sales	7,630	8,693	9,858	7,579	8,571	9,675	0.7	1.4	1.9
Growth (%)	14.1	13.9	13.4	13.3	13.1	12.9			
EBITDA	4,273	4,955	5,619	4,244	4,886	5,515	0.7	1.4	1.9
EBTDA margin (%)	56.0	57.0	57.0	56.0	57.0	57.0			
Jeevansaathi									
Sales	859	1,038	1,220	859	1,038	1,220	0.0	0.0	0.0
Growth (%)	20.8	20.8	17.6	20.8	20.8	17.6			
EBITDA	(172)	(21)	49	(172)	(21)	49	0	0.0	0.0
EBTDA margin (%)	(20.0)	(2.0)	4.0	(20.0)	(2.0)	4.0			
99 acres									
Sales	1,806	2,370	3,036	1,706	2,150	2,709	5.8	10.2	12.1
Growth (%)	33.4	31.3	28.1	26.0	26.0	26.0			
EBITDA	(397)	(119)	152	(375)	(108)	135	NA	NA	NA
EBTDA margin (%)	(22.0)	(5.0)	5.0	(22.0)	(5.0)	5.0			
Others									
Sales	442	486	535	442	486	535	0.0	0.0	0.0
Sales growth (%)	10	10	10	10	10	10			
EBITDA	35	44	48	31	39	43	14.3	12.5	12.5
EBITDA margin (%)	8.0	9.0	9.0	7.0	8.0	8.0			

Source: Kotak Institutional Equities estimates

Exhibit 11: SoTP valuation of Info Edge on a June 2020 basis

Parameter	Value (Rs mn)	Multiple (X)	Valuation basis	Valuation	Stake	Valuation of stake	Per share value	
				(Rs mn)	(%)	(Rs mn)	(Rs)	
Standalone business ex-99 acres	June 2020E earnings (ex interest income)	3,353	30.0	P/E	100,601	100	100,601	827
99acres				7X sales	17,758	100	17,758	146
Zomato				Ascribing a valuation of US\$1.1 bn	72,600	31	22,441	185
Policybazaar				Ascribing a valuation of US\$1.0 bn	66,000	14	8,248	68
Other investments	Current invested book	2,330	1.0	P/B	2,330	0	2,330	19
Cash	Cash+financial investments	21,677	1.0	1X cash	21,677	100	21,677	178
Total								1,423

Source: Kotak Institutional Equities estimates

Exhibit 12: Details of Info Edge's investments

Investment details and operating metrics of Info Edge's investee companies, March fiscal year-ends

Investee company	website	Business	Investment (Rs mn)				Shareholding (%)				Sales (Rs mn)				Operating EBITDA (Rs mn)			
			2015	2016	2017	2018	2015	2016	2017	2018	2015	2016	2017	2018	2015	2016	2017	2018
Partly owned subsidiaries																		
Zomato Media	www.zomato.com	Restaurants	3,283				50					967					(1,360)	
Applect Learning Systems	www.meritnation.com	Education	718	968	1,205	1,350	56	59	59	66		216	287	363	310		(227) (414) (240) (130)	
Canvera Digital Technologies	www.canvera.com	Lifestyle		901	1,074	150		49	57	62			560	490	420		(320) (220) (250)	
Associates																		
Zomato Media	www.zomato.com	Restaurants	4,838	4,838	1,560			46	46	31		1,839	3,323	4,810			(4,410) (1,519) na	
Etchaces Marketing and Consulting	www.policybazaar.com	Insurance	325	325	325	670		23	10	10	10							
Kinobeo Software	www.mydala.com	Deals	270	270	270	0		45	42	42	42							
Canvera Digital Technologies	www.canvera.com	Lifestyle	671									2,118	2,061	2,467	3,840		(745) (1,490) (211) na	
Happily Unmarried Marketing	www.happilyunmarried.com	Lifestyle	94	163	223	260		27	44	48	47							
Mint Bird Technologies	www.vacationlabs.com	Software		60	60	60			26	26	26							
Green Leaves Consumer Services	www.bigstylis.com	Lifestyle		64	124	0			25	39	0							
Rare Media Company	www.bluedolph.com			74	74	70			35	35	35							
VCare Technologies						40					15	15						
Unnati Online						40					29	28						
Others						24					28	30						
Total			5,361	7,663	8,297	4,490						3,301	4,747	6,643	9,380		(2,332) (6,634) (2,190) (1,880)	

Source: Company, Kotak Institutional Equities

Exhibit 13: Summary financials for Info Edge (standalone), March fiscal year-ends, 2009-21E (Rs mn)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Profit model													
Total operating income	2,452	2,322	2,936	3,771	4,373	5,059	6,116	7,176	8,021	9,155	10,738	12,588	14,650
Operating expenses	(1,782)	(1,637)	(1,938)	(2,328)	(2,875)	(3,391)	(4,293)	(5,821)	(5,746)	(6,182)	(6,999)	(7,728)	(8,782)
EBITDA	669	685	998	1,443	1,498	1,668	1,822	1,355	2,275	2,973	3,739	4,860	5,868
Other income	286	320	283	395	465	433	764	785	625	971	1,215	1,387	1,585
PBDIT	956	1,005	1,280	1,837	1,963	2,100	2,586	2,140	2,900	3,944	4,954	6,247	7,454
Financial charges	(17)	(19)	(22)	(20)	(25)	(25)	(30)	(1)	(1)	(1)	—	—	—
Depreciation	(71)	(61)	(71)	(77)	(94)	(174)	(173)	(210)	(241)	(215)	(262)	(264)	(238)
Pre-tax profit	867	925	1,188	1,740	1,843	1,902	2,383	1,930	2,659	3,728	4,692	5,983	7,215
Taxation	(270)	(317)	(400)	(511)	(528)	(591)	(736)	(564)	(575)	(991)	(1,548)	(1,974)	(2,381)
Recurring PAT	597	607	788	1,230	1,315	1,311	1,647	1,366	2,084	2,737	3,144	4,009	4,834
Recurring EPS	5.5	5.6	7.2	11.3	12.0	12.0	13.7	11.3	17.2	22.5	25.9	33.0	39.8
Balance sheet													
Equity share capital	273	273	546	546	1,092	1,092	1,202	1,207	1,211	1,216	1,216	1,216	1,216
Reserves & surplus	2,995	3,547	4,084	5,198	5,563	6,530	15,422	16,742	18,620	19,859	25,336	28,138	31,517
Shareholders funds	3,267	3,820	4,630	5,744	6,654	7,622	16,624	17,950	19,831	21,074	26,551	29,353	32,733
Total source of funds	3,270	3,826	4,636	5,747	6,659	7,626	16,627	17,953	19,835	21,077	26,551	29,353	32,733
Net fixed assets	384	357	693	626	1,006	952	935	1,020	602	529	467	403	365
Investments	195	1,276	2,969	3,814	4,247	6,152	14,383	16,246	18,120	22,809	26,439	27,439	28,439
Cash balances	3,218	2,777	2,037	2,662	2,801	2,311	3,007	1,493	2,908	1,458	4,006	6,685	10,009
Net current assets excluding cash	(546)	(618)	(1,103)	(1,396)	(1,440)	(1,852)	(1,762)	(1,298)	(2,091)	(4,078)	(4,719)	(5,532)	(6,438)
Total application of funds	3,270	3,826	4,636	5,747	6,659	7,626	16,627	17,953	19,835	21,077	26,551	29,353	32,733
Cash flow statement													
Operating profit before working capital changes	685	688	881	1,327	1,434	1,509	1,850	1,478	2,271	2,953	3,406	4,273	5,072
Change in working capital/ other adjustments	(299)	72	485	293	43	412	(90)	401	630	1,986	641	813	906
Cash flow from operating activities	387	759	1,366	1,620	1,477	1,922	1,760	1,879	2,901	4,940	4,047	5,086	5,979
Fixed assets	(74)	(34)	(407)	(9)	(475)	(119)	(157)	(293)	(84)	(142)	(200)	(200)	(200)
Investments	(20)	(162)	(164)	(979)	(1,307)	(878)	(1,878)	(1,578)	(347)	(854)	(3,630)	(1,000)	(1,000)
Cash (used)/ realised in investing activities	(94)	(196)	(571)	(988)	(1,782)	(997)	(2,035)	(1,871)	(431)	(997)	(3,830)	(1,200)	(1,200)
Free cash flow	292	564	794	631	(305)	925	(275)	8	2,470	3,943	217	3,886	4,779
Dividend paid	(24)	(24)	(48)	(127)	(127)	(319)	(435)	(725)	(437)	(805)	(1,207)	(1,207)	(1,455)
Interest charges	(17)	(19)	(22)	(20)	(25)	(25)	(30)	(1)	(1)	(1)	—	—	—
Cash (used)/realised in financing activities	(30)	(33)	(51)	(136)	(135)	(343)	7,032	(662)	(419)	(582)	(1,210)	(1,207)	(1,455)
Cash generated/ utilised	255	478	789	491	(735)	537	7,049	(654)	2,051	2,384	2,548	2,679	3,324
Cash at beginning of year	3,118	3,373	3,851	4,639	5,130	4,394	4,932	12,222	11,568	13,620	15,619	18,166	20,846
Cash at end of year	3,373	3,851	4,639	5,130	4,395	4,931	11,981	11,568	13,620	16,004	18,166	20,846	24,169

Source: Company, Kotak Institutional Equities estimates

Exhibit 14: Summary financials for Info Edge (consolidated), March fiscal year-ends, 2009-21E (Rs mn)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Profit model													
Total operating income	2,458	2,371	3,224	3,920	4,723	5,672	7,332	7,475	8,876	9,882	11,538	13,468	15,618
Operating expenses	(1,796)	(1,745)	(2,390)	(2,736)	(3,513)	(4,706)	(7,116)	(6,553)	(7,104)	(7,300)	(8,173)	(8,997)	(10,152)
EBITDA	662	626	834	1,183	1,210	966	216	922	1,772	2,582	3,365	4,471	5,466
Other income	279	307	274	395	475	502	942	4,407	828	888	1,124	1,287	1,475
PBDIT	941	932	1,108	1,578	1,685	1,468	1,158	5,328	2,600	3,470	4,488	5,758	6,941
Financial charges	(17)	(20)	(23)	(22)	(28)	(30)	(38)	(1)	(2)	(3)	(3)	(3)	(3)
Depreciation	(71)	(65)	(80)	(83)	(118)	(212)	(469)	(238)	(328)	(296)	(272)	(275)	(251)
Pre-tax profit	853	848	1,005	1,473	1,540	1,227	651	5,089	2,270	3,170	4,214	5,480	6,688
Taxation	(270)	(318)	(400)	(529)	(528)	(591)	(740)	(573)	(478)	(845)	(1,423)	(1,843)	(2,243)
Recurring PAT	570	559	581	1,043	1,153	923	296	1,501	(103)	1,883	2,632	3,581	4,386
Recurring EPS	5.2	5.1	5.3	9.5	10.6	8.4	2.5	12.4	(0.9)	15.5	21.6	29.5	36.1
Balance sheet													
Equity share capital	273	273	546	546	1,092	1,092	1,202	1,207	1,211	1,216	1,216	1,216	1,216
Reserves & surplus	2,980	3,474	3,805	4,726	4,993	5,628	12,949	14,278	14,714	19,234	24,358	26,789	29,778
Minority interest	—	—	16	(25)	105	1,392	4,188	(236)	(154)	(152)	(152)	(152)	(152)
Shareholders funds	3,252	3,746	4,367	5,247	6,189	8,112	18,339	15,249	15,771	20,298	25,422	27,852	30,842
Total source of funds	3,256	3,753	4,374	5,250	6,194	8,116	18,342	15,253	15,850	20,301	25,422	27,852	30,842
Net fixed assets	385	363	741	643	1,620	1,588	5,878	824	1,291	592	855	879	929
Investments	183	1,141	2,628	3,152	2,614	5,380	11,745	15,825	14,886	18,786	22,415	23,415	24,415
Cash balances	3,221	2,791	2,076	2,855	3,466	3,072	3,582	1,541	3,032	1,599	6,975	9,266	12,192
Net current assets excluding cash	(552)	(577)	(1,130)	(1,441)	(1,551)	(1,987)	(2,927)	(3,450)	(3,703)	(1,154)	(5,182)	(6,068)	(7,054)
Total application of funds	3,256	3,753	4,374	5,250	6,194	8,116	18,342	15,253	15,850	20,301	25,422	27,852	30,842
Cash flow statement													
Operating profit before working capital changes	671	615	708	1,049	1,157	877	418	4,755	2,122	2,625	3,065	3,915	4,698
Change in working capital/ other adjustments	(295)	24	553	311	110	436	940	523	253	(2,549)	4,028	885	986
Cash flow from operating activities	375	639	1,261	1,361	1,267	1,313	1,358	5,278	2,375	76	7,093	4,801	5,684
Fixed assets	(75)	(43)	(457)	14	(1,095)	(180)	(4,759)	4,816	(794)	402	(534)	(300)	(300)
Investments	2,471	(959)	(1,486)	(525)	538	(2,766)	(6,365)	(4,080)	939	(3,900)	(3,630)	(1,000)	(1,000)
Cash (used)/ realised in investing activities	2,396	(1,001)	(1,944)	(510)	(557)	(2,946)	(11,124)	736	145	(3,498)	(4,164)	(1,300)	(1,300)
Free cash flow	2,771	(362)	(683)	850	710	(1,633)	(9,767)	6,015	2,520	(3,421)	2,929	3,501	4,384
Dividend paid	(24)	(24)	(48)	(127)	(127)	(319)	(435)	(725)	(437)	(805)	(1,207)	(1,207)	(1,455)
Interest charges	(17)	(20)	(23)	(22)	(28)	(30)	(38)	(1)	(2)	(3)	(3)	(3)	(3)
Cash (used)/realised in financing activities	(17)	(44)	(34)	(180)	—	996	9,947	(4,269)	946	(487)	(1,213)	(1,210)	(1,458)
Cash generated/ utilised	2,735	(430)	(714)	779	611	(395)	510	(2,041)	1,491	(1,433)	5,376	2,291	2,926
Cash at beginning of year	486	3,221	2,791	2,076	2,855	3,466	3,072	3,582	1,541	3,032	1,599	6,975	9,266
Cash at end of year	3,221	2,791	2,076	2,855	3,467	3,072	3,582	1,541	3,032	1,599	6,975	9,266	12,192

Source: Company, Kotak Institutional Equities estimates

June 2018: Results calendar

Mon	Tue	Wed	Thu	Fri	Sat	Sun
23-Jul	24-Jul	25-Jul	26-Jul	27-Jul	28-Jul	29-Jul
		Ambuja Cements	Bharat Financial Inclusion	Bank of Baroda	J K Cement	
		Bharti Infratel	Bharti Airtel	Coromandel International	NTPC	
		BHEL	Biocon	Equitas Holdings		
		Canara Bank	CESC	HCL Technologies		
		Crompton Greaves Consumer	Cholamandalam	ICICI Bank		
		GRUH Finance	City Union Bank	JSW Energy		
		Hero Motocorp	Colgate-Palmolive (India)	Jubilant Life Science		
		IRB Infrastructure	Container Corporation	Mahindra & Mahindra Financial		
		JSW Steel	Dr Reddy's Laboratories	Prestige Estates Projects		
		Jubilant Foodworks	ITC	Reliance Industries		
		Jyothy Laboratories	J&K Bank			
		Karur Vysya Bank	Maruti Suzuki			
		L&T	Petronet LNG			
		PVR	SBI Life Insurance			
		Reliance Nippon Life Asset Management	Schaeffler India			
		Rural Electrification Corp.	Shriram Transport			
		Shriram City Union Finance	Tata Power			
		SIS	WABCO India			
		SKF	Yes Bank			
30-Jul	31-Jul	1-Aug	2-Aug	3-Aug	4-Aug	5-Aug
Avenue Supermarts	Ajanta Pharma	Aditya Birla Fashion	Godrej Properties	Berger Paints	Divi's Laboratories	PI Industries
Axis Bank	Astral Poly Technik	Apollo Tyres	Indiabulls Housing	Carborundum Universal		
Central Bank of India	Bank of India	Emami	JK Lakshmi Cement	CG Power and Industrial		
Century Textile	Bharat Electronics	Exide Industries	Mahindra Logistics	SAIL		
Escorts	Castrol India	Gateway Distriparks	Marico	Titan Company		
Godrej Consumer Products	Dabur India	Orient Cement	ONGC			
GSPL	IIFL Holdings	Pdillite Industries	The Ramco Cement			
HDFC	Jagran Prakashan	Reliance Infrastructure	Torrent Pharmaceuticals			
Idea	Mahanagar Gas	Tata Global Beverages				
IDFC Bank	Power Grid	Torrent Power				
Interglobe Aviation	Supreme Industries					
New India Assurance	Tata Motors					
NHPC	UPL					
Oberoi Realty	Vedanta					
Piramal Enterprises						
Shree Cement						
Tech Mahindra						
6-Aug	7-Aug	8-Aug	9-Aug	10-Aug	11-Aug	12-Aug
Adani Port and SEZ	AU Small Finance	Cipla	Coffee Day Enterprises	Apollo Hospitals	Amara Raja Batteries	
Britannia Industries	GlaxoSmithkline Consumer	HPCL	Gujarat Pipavav Port	Dr Lal Pathlabs	NBCC	
Ujivan Financial Services	Kalpataru Power Transmission	Lupin	HCG	Endurance Technologies		
	Mahindra & Mahindra	PNB Housing Finance	S H Kelkar and Company	Hindalco Industries		
	Motherson Sumi Systems	Thermax		Timken		
	Mphasis			Voltas		
	SRF					
	TVS Motor					
13-Aug	14-Aug	15-Aug	16-Aug	17-Aug	18-Aug	19-Aug
Cadila Healthcare	Grasim Industries					
Dewan Housing Finance						
Godrej Industries						

Source: NSE, Kotak Institutional Equities

Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)	Target price	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EVEBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo
		24-Jul-18	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	(US\$ mn)
Technology																													
HCL Technologies	REDUCE	992	1,010	1.9	1,381	20.0	1,409	62	68	71	5.3	9.0	5.0	15.9	14.6	13.9	11.2	9.4	8.7	3.8	3.2	2.9	24.8	23.8	21.9	0.8	2.9	3.1	35.1
Hexaware Technologies	SELL	496	435	(12.3)	147	2.1	302	17	20	23	20.2	18.4	18.0	30.0	25.3	21.5	21.6	19.0	15.0	7.5	6.5	5.5	26.6	27.4	27.8	0.8	1.6	1.6	14.5
Infosys	ADD	1,377	1,400	1.7	3,008	43.6	2,175	65	71	78	3.0	9.7	10.4	21.3	19.4	17.6	14.8	13.3	11.9	4.6	4.3	4.0	21.8	23.0	23.5	2.0	3.2	2.8	80.4
L&T Infotech	ADD	1,803	2,000	10.9	312	4.5	175	64	83	94	13.9	30.5	13.0	28.4	21.7	19.2	25.0	16.7	14.0	8.2	6.6	5.4	31.8	33.5	30.7	0.9	1.3	1.4	4.7
Mindtree	ADD	970	1,115	14.9	159	2.3	165	35	43	53	37.8	24.9	23.6	28.1	22.5	18.2	20.4	14.1	11.3	5.8	5.0	4.3	21.4	23.9	25.2	1.1	1.3	1.6	31.2
Mphasis	SELL	1,171	760	(35.1)	226	3.3	193	44	52	56	14.4	18.3	8.2	26.7	22.6	20.9	19.4	15.7	14.0	4.1	3.8	3.4	14.6	17.4	17.1	1.7	1.7	1.7	11.4
TCS	REDUCE	1,999	1,790	(10.5)	7,653	111.0	3,829	67	82	89	1.1	21.2	8.8	29.6	24.4	22.5	22.1	17.9	16.5	8.8	7.7	7.5	29.4	33.4	33.8	1.2	2.0	3.6	114.8
Tech Mahindra	ADD	642	775	20.8	566	8.2	891	43	45	53	33.1	6.6	15.8	15.0	14.1	12.2	11.0	8.5	6.9	3.0	2.6	2.2	21.5	19.9	19.7	2.2	1.4	1.6	35.7
Wipro	REDUCE	273	295	8.1	1,235	17.9	4,507	17	19	22	(3.1)	11.8	14.6	16.1	14.4	12.6	10.2	9.0	7.8	2.5	2.2	2.0	16.0	16.4	16.8	0.4	0.5	3.7	13.5
Technology	Cautious				14,688	213					1.6	12.7	9.7	22.9	20.4	18.6	16.7	14.0	12.6	5.4	4.8	4.5	23.7	23.7	24.1	1.3	2.2	3.2	341.2
Telecom																													
Bharti Airtel	ADD	357	470	31.7	1,426	20.7	3,997	5	(4)	0	(42.9)	(187.4)	104.6	75.4	(86.2)	1,888.4	8.0	9.1	7.3	2.1	2.1	2.2	2.8	(2.4)	0.1	1.5	0.3	0.0	33.4
Bharti Infratel	REDUCE	286	285	(0.3)	529	7.7	1,850	14	13	11	(7.4)	(8.7)	(9.0)	20.8	22.8	25.0	7.5	8.2	8.7	3.1	3.3	3.3	15.7	14.0	13.1	5.0	3.5	3.2	13.5
IDEA	REDUCE	56	75	33.0	246	3.6	4,359	(10)	(15)	(14)	(656.8)	(54.9)	6.4	(5.9)	(3.8)	(4.1)	12.4	22.8	16.9	0.9	1.2	1.7	(16.0)	(26.9)	(34.0)	—	—	—	15.8
Tata Communications	ADD	588	725	23.4	167	2.4	285	2	4	8	(84.3)	121.9	117.7	357	160.9	73.9	10.7	9.6	8.4	33.5	27.1	19.6	4.5	18.6	30.7	1.1	1.1	1.3	4.7
Telecom	Cautious				2,368	34					(94.7)	(1,906.6)	36.2	753.0	(41.7)	(65.3)	8.7	10.2	8.5	2.1	2.3	2.4	0.3	(5.5)	(3.7)	2.0	1.0	0.7	67.4
Utilities																													
CESC	ADD	922	1,180	27.9	122	1.8	133	87	102	118	67.1	16.8	15.5	10.6	9.1	7.8	7.7	5.6	4.9	0.8	0.8	0.7	7.9	8.8	9.4	1.3	1.1	1.1	5.8
JSW Energy	REDUCE	65	80	23.6	106	1.5	1,640	3.1	5.9	8.2	(19.2)	92.2	38.7	21.1	11.0	7.9	6.8	5.4	4.4	1.0	0.9	0.8	4.7	8.5	11.0	3.1	3.1	3.1	1.7
NHPC	ADD	24	30	24.2	248	3.6	10,260	2.4	3.1	3.2	(17.3)	26.9	1.8	9.9	7.8	7.7	9.2	7.2	7.0	0.8	0.8	0.8	8.5	10.4	10.2	5.8	7.2	7.3	2.1
NTPC	BUY	157	190	20.7	1,298	18.8	8,245	11	15	16	(7.6)	30.9	4.4	13.8	10.6	10.1	11.1	8.6	8.0	1.3	1.2	1.1	9.5	11.6	11.3	3.6	2.8	3.0	13.3
Power Grid	BUY	178	250	40.6	930	13.5	5,232	16	19	21	9.6	19.3	13.6	11.3	9.5	8.3	8.3	7.0	6.5	1.7	1.5	1.4	15.8	17.1	17.5	3.0	3.5	4.0	29.8
Reliance Power	SELL	32	43	34.4	90	1.3	2,805	3.5	5.1	5.2	(16.4)	45.6	2.7	9.2	6.3	6.1	7.8	6.7	6.5	0.4	0.4	0.4	4.5	6.1	5.9	—	—	—	4.1
Tata Power	ADD	68	97	43.1	183	2.7	2,705	5.3	7.8	8.7	(9.6)	46.1	11.2	12.7	8.7	7.8	10.1	9.3	8.4	1.2	1.1	0.9	10.7	12.9	12.7	—	—	—	5.3
Utilities	Attractive				2,978	43					(2.4)	28.6	9.0	12.3	9.6	8.8	9.3	7.6	7.0	1.2	1.1	1.0	9.7	11.5	11.6	3.1	3.1	3.3	62.0

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities: Valuation summary of KIE Universe stocks

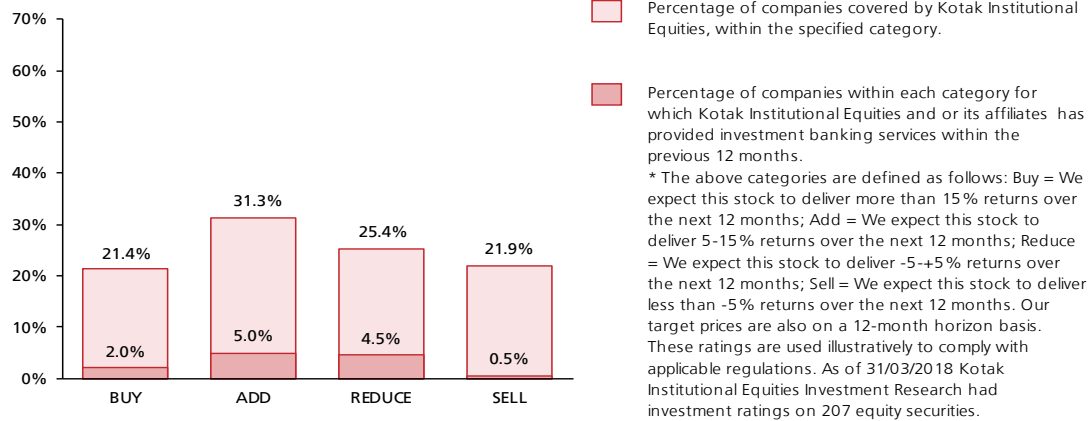
Company	Rating	Price (Rs)	Target price	Upside	Mkt cap.	O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EVEBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT	
		24-Jul-18	(Rs)	(%)	(Rs bn)	(US\$ bn)	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	2018	2019E	2020E	(US\$ mn)	
Others																													
Astral Poly Technik	SELL	1,094	625	(42.9)	131	1.9	120	15	19	23	20.8	28.0	23.0	74.6	58.3	47.4	41.9	32.5	26.4	12.9	10.6	8.8	18.8	20.0	20.3	0.1	0.1	0.1	1.0
Avenue Supermarts	SELL	1,572	860	(45.3)	981	14.2	624	13	16	20	47.9	28.6	26.4	125.0	97.2	76.9	73.3	56.1	44.0	21.1	17.4	14.2	18.5	19.6	20.3	—	—	—	—
Bayer Cropscience	REDUCE	4,442	4,000	(10.0)	175	2.5	34	86	105	124	4.4	22.7	17.5	51.7	42.2	35.9	41.8	32.7	26.2	8.6	7.4	6.4	15.4	18.8	19.2	0.4	0.5	0.6	0.5
Dhanuka Agritech	ADD	528	690	30.7	26	0.4	49	26	28	32	7.7	8.9	15.4	20.5	18.9	16.3	15.0	12.9	10.8	4.1	3.5	3.0	21.9	20.1	20.0	1.0	1.1	1.3	0.1
Godrej Agrovet	ADD	638	650	1.8	123	1.8	189	12	16	20	6.9	39.8	24.6	55.4	39.7	31.8	28.5	22.0	17.8	7.2	6.2	5.3	14.7	16.9	17.9	0.3	0.4	0.5	1.6
Godrej Industries	RS	612	—	—	206	3.0	336	15	16	20	6.8	8.9	24.2	42.0	38.6	31.1	37.3	31.6	34.4	5.7	5.0	4.4	14.4	13.9	15.1	0.3	0.3	0.3	4.4
InterGlobe Aviation	BUY	1,042	1,430	37.3	400	5.8	383	59	71	98	27.2	21.8	37.5	17.8	14.6	10.6	9.9	8.1	5.5	5.6	4.2	3.1	41.3	33.0	33.8	0.6	0.7	1.0	24.6
Kaveri Seed	SELL	598	470	(21.4)	40	0.6	66	32	31	33	18.4	(3.7)	6.1	18.7	19.4	18.3	15.9	16.5	14.9	5.1	4.3	3.8	23.6	24.0	21.9	1.0	1.3	1.7	4.9
PI Industries	BUY	767	900	17.4	106	1.5	138	27	33	41	(20.0)	25.0	23.2	28.8	23.1	18.7	21.3	16.7	13.3	5.5	4.6	3.8	20.7	21.7	22.1	0.4	0.5	0.6	1.5
Rallis India	ADD	191	220	15.3	37	0.5	195	9	10	12	(1.5)	17.2	19.4	22.1	18.9	15.8	13.7	12.4	10.5	3.1	2.9	2.6	14.6	15.8	17.1	1.7	1.9	2.1	0.8
SIS	REDUCE	1,122	1,250	11.4	82	1.2	73	23	36	43	44.0	58.5	20.6	49.7	31.4	26.0	26.7	20.2	16.7	7.9	6.7	5.5	20.2	23.4	23.3	0.3	0.5	0.6	0.8
SRF	BUY	1,640	2,110	28.6	94	1.4	57	80	92	123	(10.4)	14.4	33.6	20.4	17.8	13.4	12.6	9.9	8.1	2.6	2.4	2.0	13.7	14.0	16.4	0.7	0.8	0.9	10.8
Tata Chemicals	ADD	671	760	13.3	171	2.5	255	51	46	52	6.5	(11.2)	13.6	13.0	14.7	12.9	7.2	6.1	5.1	1.5	1.4	1.3	13.8	10.0	10.5	3.3	2.2	2.5	8.6
TeamLease Services	SELL	2,784	1,785	(35.9)	48	0.7	17	43	58	75	28.0	34.2	29.0	64.6	48.1	37.3	67.2	48.8	37.2	10.8	8.8	7.1	18.2	20.1	21.1	—	—	—	1.9
UPL	ADD	630	640	1.6	321	4.7	510	43	47	53	20.9	9.0	13.5	14.7	13.5	11.9	10.2	8.9	7.5	3.5	2.9	2.4	26.4	23.6	22.4	1.3	1.5	1.7	19.8
Vardhman Textiles	ADD	1,205	1,400	16.2	69	1.0	56	103	130	140	(8.0)	26.4	7.4	11.7	9.3	8.6	9.8	7.3	6.6	1.4	1.2	1.1	12.7	14.3	13.8	1.2	1.7	2.5	1.0
Whirlpool	SELL	1,688	1,240	(26.6)	214	3.1	127	28	37	45	13.0	33.9	22.5	61.1	45.6	37.2	36.3	28.0	22.6	11.9	9.9	8.2	21.4	23.7	24.1	0.2	0.4	0.5	1.0
Others					3,224		47				15.0	15.7	22.8	31.6	27.3	22.2	20.3	16.8	13.7	5.7	4.9	4.1	18.1	17.8	18.5	0.5	0.6	0.7	83.2
KIE universe					110,157	1,597				(6.2)	30.4	25.1	27.3	20.9	16.7	12.6	10.7	9.4	3.0	2.7	2.5	11.0	13.0	14.7	1.3	1.4	1.8		
KIE universe (ex-energy)					96,734	1,403				(8.5)	38.9	29.7	32.2	23.2	17.9	14.1	11.7	10.3	3.3	3.0	2.7	10.4	13.0	15.2	1.1	1.3	1.7		

Notes:

- (a) We have used adjusted book values for banking companies.
 (b) 2018 means calendar year 2017, similarly for 2019 and 2020 for these particular companies.
 (c) Exchange rate (Rs/US\$)= 68.95

Source: Company, Bloomberg, Kotak Institutional Equities estimates

Kotak Institutional Equities Research coverage universe
Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of June 30, 2018

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5-+5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our target prices are also on a 12-month horizon basis.

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Level 2: If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.

Level 3: If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Name: Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91-(022) 4285 8484.

Level 4: If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91-(022) 4285 8301.

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