

# Happiest Minds Technologies



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**Issue Opens On**
**Monday, 7<sup>th</sup> September 2020**
**Issue Closes On**
**Wednesday, 9<sup>th</sup> September 2020**
**Price Band (INR)**
**165 – 166**
**Issue Size (INR Bn.)**
**6.98 – 7.02**
**Rating**
**SUBSCRIBE**

**Happiest Minds Technologies Limited (“HMT”)** is a digital IT and product engineering service provider that positions itself as “Born Digital. Born Agile”. The company focuses on delivering a seamless and end-to-end digital experience to customers. Its key service offerings include digital business, product engineering services, infrastructure management services and security. HMT offers solutions across the spectrum of digital technologies including Robotic Process Automation (RPA), Software-Defined Networking/Network Function Virtualisation (SDN/NFV), Big Data and Analytics, Internet of Things (IoT), Cloud, Business Process Management (BPM) and security. In FY20, 96.9% of company’s revenues came from digital services, which is by far the highest among Indian IT services companies. Corresponding figure for 1QFY21 was 96.3%. 87.9% of its projects were delivered through the agile model in FY20, with the figure for 1QFY21 at 90.1%, reflecting a true digital-focused enterprise. HMT recorded revenue of ₹ 6.89 bn, EBIT of ₹ 769 mn and PAT of ₹ 717mn in FY20, with corresponding figures for 1QFY21 at ₹ 1.77 bn, ₹ 327 mn and ₹ 502 mn, respectively. HMT has reported robust revenue CAGR of 22.8% over FY18-FY20, and has steadily improved profitability as well, from -8.5% EBIT margin in FY18 to 11% in FY20 and further to 18.2% in 1QFY21. The company’s IPO includes an offer for sale of ₹ 5.88 bn to ₹ 5.92 bn, and a fresh issue of ₹ 1.1 bn, with a post-issue market capitalisation of ₹ 24.2 bn to ₹ 24.4 bn.

## OFFER STRUCTURE

Particulars	IPO Details
No. of Units	42.29 Mn
Price band (INR)	165 – 166
Face Value (INR)	2/share

Source: IPO Prospectus, KRChoksey Research

Indicative Timetable	
Bid/Offer Opens Date	7 <sup>th</sup> September 2020
Bid/Offer Closes Date	9 <sup>th</sup> September 2020
Finalisation of Basis of Allotment with Stock Exchange	14 <sup>th</sup> September 2020
Initiation of Refunds	15 <sup>th</sup> September 2020
Credit of Equity Shares to Demat accounts	15 <sup>th</sup> September 2020
Commencement of trading of the Equity Shares on the stock Exchanges	17 <sup>th</sup> September 2020

Source: IPO Prospectus, KRChoksey Research

Issue break-up	INR bn.
Fresh Issue:	INR 1.1bn
Offer for sale:	INR 5.92bn
<b>Total Issue Size:</b>	<b>INR 7.02bn</b>

Source: IPO Prospectus, KRChoksey Research

Objects of the issue bn
<ul style="list-style-type: none"> <li>To meet long term Working capital requirement (Amount of INR 1.01 bn will be financed from Net proceeds in fiscal year 2021);</li> </ul>
<ul style="list-style-type: none"> <li>General Corporate purposes (the amount shall not exceed 25% of the Gross Proceeds).</li> </ul>

Source: IPO Prospectus, KRChoksey Research

# Happiest Minds Technologies

## INVESTMENT RATIONALE

### Differentiated business, with focus on end-to-end digital technologies and high-growth verticals

HMT positions itself as a 'Born Digital, Born Agile' company, and focuses mainly on its customers' end-to-end digital IT spend, including product engineering, infrastructure management services and security. 96.9% of its FY20 revenue came from digital services, and 87.9% of its projects were delivered through the agile model (96.3% and 90.1%, respectively for 1QFY21). HMT also offers solutions across the spectrum of digital technologies including RPA, SDN, Big Data & Analytics, IoT, Cloud, BPM and Security. Industry analyst firm Frost & Sullivan expects the global digital IT services market to clock >20% CAGR over CY19-CY25 to cross US\$2,000bn (US\$691bn in CY19), providing a very large addressable market to HMT. In fact, HMT believes a comparison with global digital companies like EPAM and Globant is more suitable rather than comparing it to Indian IT service firms like Mindtree.

Given the company's focus on digital technologies and minimal legacy revenue/add-on revenue, HMT has a clear differentiator with reference to the verticals it services, with the biggest including Edutech (27% contribution in 1QFY21) and Hitech (20.5%) owing to its strong product engineering pedigree. The company also serves BFSI, Travel, Media & Entertainment, Retail, Industrial and Manufacturing verticals, with its work with ISV and technology clients giving it exposure to those companies' clients and trends in those businesses, enabling it to develop expertise in those verticals as well.

### Healthy financial performance, 1QFY21 sees robust profitability, scope for SG&A leverage

HMT has clocked a robust 22.8% revenue CAGR over FY18-FY20. On the other hand, profitability has seen a sharp improvement, aided by revenue growth, SG&A leverage and higher utilisation levels. EBIT margin was -8.5% in FY18, which rose to 5.1% in FY19, 11% in FY20 and further to 18.5% in 1QFY21. This has been a result of revenue growth leverage, favourable currency and improved employee utilisation, apart from cost control, given that SG&A cost is considerably higher than most other Indian IT service firms. SG&A cost was nearly 27% of revenue in FY18, which came down steadily to 25.5% in FY19, 22.9% in FY20 and further to 17.5% in 1QFY21. This is still at a higher level compared with Indian IT firms, and could be a key lever to holding margins within a range at 1QFY21 levels. Apart from this, return ratios are also healthy for HMT, with the digital services firm likely to achieve RoE in excess of 35% in FY21, assuming a 25% tax rate conservatively for the remaining 3 quarters of FY21, same PBT in each of the remaining 3 quarters as was achieved in 1QFY21 and adding the fresh issue to equity.

### Focused efforts at raising revenue/client, cutting long tail to aid better resource utilisation and drive predictable revenue growth

Over the past few years, HMT's client count has steadily declined from 173 in FY18 to 148 in 1QFY21. The digital services firm has consciously cut down on low yield clients as a strategy, which will free up resources to work more efficiently on higher yield clients, and enable the company to focus on effective client mining. There is significant scope and runway for growth, as has been witnessed over the past few years, with revenue/client rising from US\$471,472 in FY18 to US\$614,675 in FY20 (14.2% CAGR). With robust growth expected in client digital spending, this is likely to further rise in coming years, driving predictable revenue growth.

### Strong promoter pedigree

The promoter of HMT, Mr Ashok Soota has a very strong pedigree in the IT industry, having been the Vice Chairman of Wipro and the Chairman and CEO of Mindtree, thus having experience in running a top-tier IT services firm as well as having founded and run a mid-sized IT services firm from scratch, having achieved success in both roles. This is likely to stand the company in good stead going forward, given Mr Soota's deep domain expertise and good connect with client boardrooms.

### Strong R&D capabilities with strength in disruptive technologies

HMT has substantial experience in next-generation technologies, with its expertise including technological capabilities developed to support mobile connectivity with other devices, social media, big data analytics and cloud delivery, among others. Technologies that power digital evolution are rapidly evolving with new technological breakthroughs, and the company has shown an ability to rapidly evolve its offerings into newer areas such as AR/VR.

### Issue priced at 16.5x-17.3x FY22E EPS, reasonable for a high growth digital services firm

At the price band of Rs165-166, the HMT issue comes priced at a PE of 16.5x-17.3x FY22E EPS, assuming a 15-20% PBT growth in FY22 and factoring in 25% tax rate for the year, as mentioned by management. Based on these calculations and assuming 2 scenarios of 15% and 20% growth, HMT can achieve diluted EPS of Rs.9.6-10.0 in FY22, on the basis of which the PE multiple works out to 16.5x-17.3x FY22E EPS. We believe there is a high probability of HMT achieving this growth, which is likely to be led by revenue growth aided by continuing robust traction in digital services, rising investments by clients in these services to transform their businesses, differentiated business model and vertical focus, along with growth recovery from 2QFY21 after flat YoY revenue in 1QFY21.

Given HMT's growth profile and >97% digital revenue share, we believe the company can comfortably command a PE of 24x-25x, which makes the IPO valuation fairly attractive for long term investors. **We recommend a SUBSCRIBE to the issue, with the potential for healthy listing gains as well as long term stock price appreciation.**

# Happiest Minds Technologies

## Key Tables

Digital Service Offerings (% of revenue)	FY19	FY20	1QFY21
Digital Infrastructure/Cloud	40.9	31.2	43.7
SaaS	28.6	29.4	23.6
Security Solutions	10.2	14.9	7.6
Analytics/AI	9.1	11.6	12.1
IoT	8.4	9.8	9.3
Total	97.2	96.9	96.3

Billing Rates (US\$/hour)	FY18	FY19	FY20
Onsite	89.4	90.4	91.1
Offshore	24.2	25.5	25.6

Vertical Break-Up (% of revenue)	FY18	FY19	FY20	1QFY21
Edutech	18.0	21.3	21.3	27.0
Hitech	24.6	21.0	21.0	20.5
BFSI	17.9	18.2	17.5	17.4
Travel, Media & Entertainment	11.0	13.8	17.1	12.9
Retail	7.0	6.9	7.5	5.6
Industrial	6.2	8.1	7.0	6.4
Manufacturing	3.2	3.8	3.7	5.6
Others	12.1	6.9	4.9	4.6
Total	100.0	100.0	100.0	100.0

Customer Size Break-Up (Nos.)	FY18	FY19	FY20
US\$ 1-5 million	14	18	24
US\$ 5-10 million	2	2	0
>US\$ 10 million	0	1	1
Total	16	21	25

Particulars	FY18	FY19	FY20	1QFY21
Utilisation rate (%)	68.4	77.3	76.9	74.9

Geographic Break-Up (% of revenue)	FY18	FY19	FY20	1QFY21
USA	73.5	75.5	77.5	77.3
India	11.7	11.9	11.9	10.9
UK	11.4	9.5	7.2	9.8
Others	3.4	3.1	3.4	2.0
Total	100.0	100.0	100.0	100.0

Delivery-Wise Break-Up (% of revenue)	FY18	FY19	FY20	1QFY21
Onsite	21.4	22.0	22.5	21.0
Offshore	78.6	78.0	77.5	79.0
Total	100.0	100.0	100.0	100.0

Project-Wise Break-Up (% of revenue)	FY18	FY19	FY20	1QFY21
Fixed Price	18.4	16.8	19.0	18.8
Time & Material	81.6	83.2	81.0	81.2
Total	100.0	100.0	100.0	100.0

Source: IPO Prospectus, KRChoksey Research

# Happiest Minds Technologies

## Company Overview

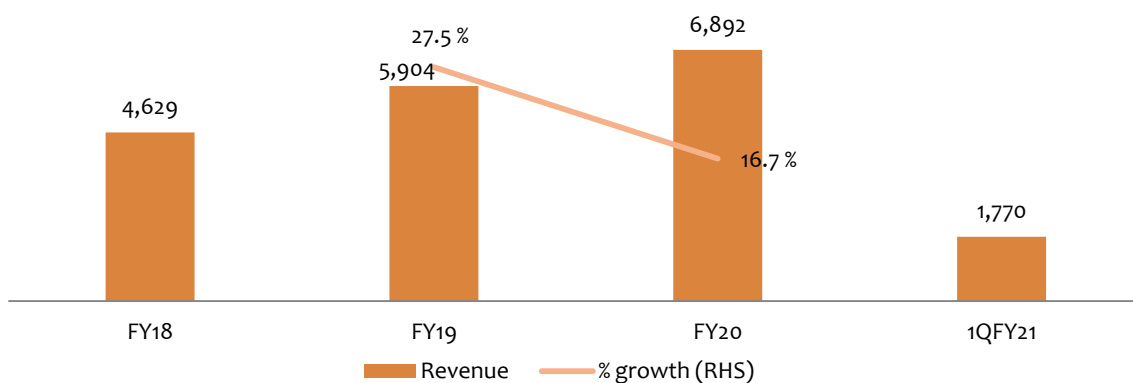
HMT is promoted by Ashok Soota and was incorporated on March 30, 2011. The company positions itself as “Born Digital. Born Agile” and focuses on delivering a seamless end-to-end digital experience to its customers. Its offerings include, among others, digital business, product engineering (PES), infrastructure management and security services (IMSS). HMT helps its customers in finding new ways to interact with their users and clients enabling them to become more engaging, responsive and efficient. It also offers solutions across the spectrum of digital technologies including Robotic Process Automation (RPA), Software-Defined Networking/ Network Function Virtualization (SDN/NFV), Big Data and advanced analytics, Internet of Things (IoT), Cloud, Business Process Management (BPM) and security.

In FY20, 96.9% of HMT’s revenues came from digital services, with the corresponding figure at 96.3% in 1QFY21. This is by far the highest among Indian IT companies. The company’s business is divided into 3 key business unit: Digital Business Services (DBS), Product Engineering Services (PES) and Infrastructure Management & Security Services (IMSS). Within this, DBS contributed 22.0% to total revenue in FY20, IMSS contributed 27.5% and PES contributed 50.5%; corresponding figures for 1QFY21 stood at 20.6%, 26.0% and 53.4%, respectively. These units are supported by 3 Centers of Excellence - Internet of Things (IoT), Analytics / Artificial Intelligence (AI) and Digital Process Automation (DPA). As of June 30, 2020, HMT counted 148 active customers. Its repeat business (revenue from existing customers) has steadily grown and contributed a significant portion of its total revenue, indicating a high degree of customer stickiness.

In FY20, HMT recorded revenue of INR 6.98 bn, with EBIT margin of 11% and net profit after tax of INR 717 mn; corresponding figures for 1QFY21 were INR 1.77 bn, 18.5% and INR 502 mn. The digital service provider has clocked a healthy 22.8% revenue CAGR over FY18-FY20, and even as 1QFY21 revenue was flat in YoY terms, the company is seeing a return to growth from 2QFY21 onward, particularly with its presence in high-growth verticals like Edutech and Hitech, where digital investments and investments in new technologies and products are being made at a rapid pace compared with other industries.

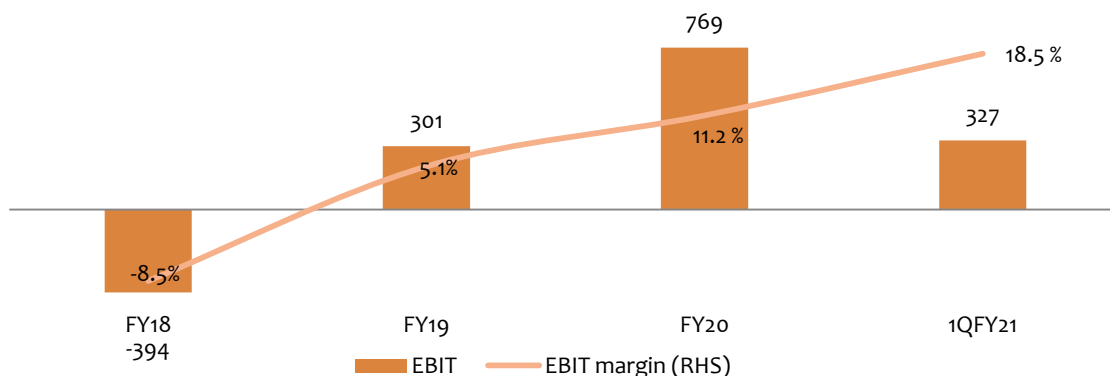
## Revenue, growth

(INR mn)



## EBIT, margins

(INR mn)



Source: IPO Prospectus, KRChoksey Research

# Happiest Minds Technologies

## KEY RISKS & CONCERNS

**Increasing competitive intensity in digital space:** While HMT has been one of the front runners in the digital race, major competitors including top-tier and mid-tier IT firms such as Accenture, TCS, Infosys, Wipro, HCL Technologies, Mindtree and Persistent Systems are rapidly expanding their digital offerings and gaining scale, which could pose a challenge for the company going forward.

**Client concentration risk:** HMT has increased its reliance on fewer clients, with active client base at 148 as of June 20, 2020 compared with 173 at FY18-end. Thus, any cut in IT or digital spend in any 1 or 2 major clients could adversely impact the company's revenue and profitability.

**Currency risk:** Given HMT's substantial dependence on the US for business, as well as some part in the UK, the company is likely to get impacted by major foreign currency swings, mainly of the USD and GBP against the INR, which could impact revenue and profitability.

**Partial promoter holding pledged:** Pursuant to a facility agreement dated July 24, 2019, Avendus Finance Private Limited has lent ₹400 million to HMT's promoter, Ashok Soota. Pursuant to the Facility Agreement, the promoter has entered into a security trustee agreement dated July 24, 2019 with Avendus and Vistra ITCL (India) Limited (Security Trustee). The Facility Agreement was amended on May 28, 2020 whereby Ashok Soota Medical Research LLP (ASMR LLP), a member of the Promoter Group was made a party to the Facility Agreement. The promoter, ASMR LLP and the Security Trustee then entered into an amended and restated share pledge agreement on May 28, 2020 (which is an amendment to the share pledge agreement, dated July 24, 2019 entered into by the promoter), as per which, Mr Soota and Ashok Soota Medical Research LLP have pledged 24,122,331 Equity Shares and 17,948,784 Equity Shares, respectively, in favour of the Security Trustee. In the event of non-adherence of the terms under such loan and security arrangements, the pledge on HMT's promoter's shares could be invoked, which may also lead to a change in control.

# Happiest Minds Technologies

## Key Financials:

Particulars (INR mn)	FY18	FY19	FY20
Net Sales	4,629	5,904	6,982
EBITDA	-186	548	971
PAT	-225	142	717
EBITDA Margin	-4.0%	9.3%	13.9%
NPM	-4.9%	2.4%	10.3%

Source: Company Research

## Profit and Loss statement:

Particulars (INR mn)	Mar-18	Mar-19	Mar-20
Revenue from operations (Net Sales)	4,629	5,904	6,982
<b>EBITDA</b>	<b>-186</b>	<b>548</b>	<b>971</b>
Depreciation	208	248	202
<b>EBIT</b>	<b>-394</b>	<b>301</b>	<b>769</b>
Interest cost	100	159	80
Other income	262	115	160
<b>PBT &amp; Exceptional items</b>	<b>-231</b>	<b>256</b>	<b>849</b>
Exceptional gain/(loss)	0	-126	-113
PBT	-231	130	736
Tax expenses	-6	-12	19
<b>PAT</b>	<b>-225</b>	<b>142</b>	<b>717</b>
Minorities, Associates, etc.	0	0	0
<b>Adj PAT</b>	<b>-225</b>	<b>142</b>	<b>717</b>
<b>Diluted EPS</b>	<b>-3.13</b>	<b>1.16</b>	<b>5.36</b>

Source: Company Research

## Balance sheet:

Particulars (INR mn)	Mar-18	Mar-19	Mar-20
<b>EQUITY AND LIABILITIES</b>			
Equity attributable to equity holders of the parent	-1089	-661	2653
Non-controlling interest	0	0	0
<b>Shareholders' funds</b>	<b>-1089</b>	<b>-661</b>	<b>2,653</b>
Borrowings	148	85	13
Other non current liabilities	525	390	299
Total Current liabilities	4,286	4,320	2,117
<b>Total equity and liabilities</b>	<b>3,870</b>	<b>4,135</b>	<b>5,082</b>
<b>ASSETS</b>			
Property, plant and equipment	26	21	9
Capital work in progress	1	0	0
Other fixed assets	1,063	774	621
Trade Receivables	944	1293	1149
Cash and other bank balance	165	263	435
Other current assets	1,670	1,785	2,867
<b>Total assets</b>	<b>3,870</b>	<b>4,135</b>	<b>5,082</b>

Source: Company Research

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## Cash flow Statement:

Particulars (INR mn)	FY18	FY19	FY20
Net Cash Generated From Operations	103	576	1,122
Net Cash Flow from Investing Activities	-269	-3	-737
Net Cash Flow from Financing Activities	263	-588	-133
<b>Net Inc/Dec in cash equivalents</b>	<b>98</b>	<b>-15</b>	<b>251</b>
Opening Balance	67	178	184
<b>Closing Balance Cash and Cash Equivalents</b>	<b>165</b>	<b>163</b>	<b>435</b>

Source: Company Research

## Ratio Analysis:

Key Ratio	FY18	FY19	FY20
EBITDA Margin (%)	-4.0%	9.3%	13.9%
EBIT Margin (%)	-8.5%	5.1%	11.0%
Net Profit Margin (%)	-4.9%	2.4%	10.3%
RoE (%)	N.A.	N.A.	36.0%
RoCE (%)	N.A.	N.A.	45.4%
Current Ratio (x)	0.6	0.8	2.1

Source: Company Research



# Happiest Minds Technologies

## Rating Legend (Expected over a 12-month period)

Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

### ANALYST CERTIFICATION:

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