CRISIL RESEARCH

CRISIL IER Independent Equity Research

Helios and Matheson Information Technology Ltd

Detailed Report

Enhancing investment decisions

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent and integrated research house. We provide insights, opinions, and analysis on the Indian economy, industries, capital markets and companies. We are India's most credible provider of economy and industry research. Our industry research covers 70 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 4,500 primary sources, including industry experts, industry associations, and trade channels. We play a key role in India's fixed income markets. We are India's largest provider of valuations of fixed income securities, serving the mutual fund, insurance, and banking industries. We are the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today India's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macroeconomy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. We deliver our research through an innovative web-based research platform. Our talent pool comprises economists, sector experts, company analysts, and information management specialists.

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Last updated: May, 2013

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

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Helios and Matheson Information Technology Ltd

Strategy to focus on large clients has paid off

Fundamental Grade	3/5 (Good fundamentals)
Valuation Grade	5/5 (CMP has strong upside)
Industry	IT Services

CRISIL RESEARCH

April 03, 2014

Fair Value	₹125
CMP	₹98

Mid-sized IT company Helios and Matheson Information Technology Ltd's (Helios') change in strategy to focus only on large clients has paid off. Its dollar revenues grew at a CAGR of 17% over FY11-13. Growth was driven by mining the existing clients and was witnessed across all its traditional IT services. Positive outlook on IT spending driven by improving macro outlook in the US is expected to fuel Helios' growth going forward. Return ratios are below the industry average but are expected to improve with better asset turnover. However, Helios is exposed to the client concentration risk. Also, because of its past acquisition, leverage is high and is a concern. We re-initiate coverage with a fundamental grade of **3/5**.

Strong focus on large clients has yielded returns

With revenue growth of 45% y-o-y in FY13, Helios is riding the success of its strategy to focus on large clients. BFSI clients contribute the largest to its revenue mix, with 38% share as of Q1FY14. Its revenue growth is driven across various traditional IT services such as application development and maintenance (ADM), system integration, independent verification, etc. ADM has been the largest revenue contributor with over 40% share.

To benefit from the positive outlook on IT spending

With revival in the US economy and increase in global spending on IT services, CRISIL Research estimates India's IT services exports to grow by 14% to US$50 bn in FY14 and at a five-year CAGR of 15% in FY19. The IT industry is inching towards new generation offerings - social media, mobility, analytics and cloud computing (SMAC) - and Helios has started working on analytics and cloud computing. It has budgeted about ₹350 mn cost for SMAC over the next three years. Growth in SMAC is a key monitorable.

Key risks: Client concentration, vendor consolidation and high leverage

a) Helios' top five clients account for 32% of revenues. Loss of any such client / vendor consolidation could adversely impact revenues.

b) It has a leverage of 0.8x while most of its peers have zero debt.

c) Higher debtor days (including unbilled revenues) of 115 days vs its mid-sized peers' 80-90 days.

RoE below industry average; better asset turnover to improve returns

US$ revenues are estimated to grow at a two-year CAGR of 16% to US$155 mn in FY15 led by the BFSI segment. We factor in an exchange rate (₹/US$) of ~62 during FY13-15. We estimate EBITDA margin to decline marginally due to (i) higher employee cost for retention as industry prospects are positive and (ii) investment in SMAC. PAT (in rupees) is expected to grow at 20% CAGR over FY13-15. RoE is estimated to improve due to better asset turnover.

Fair value revised upwards to ₹125 per share

We have raised our earnings estimates as there has not been any pressure on billing rates compared with our assumption of pricing pressure. Hence, we raise our DCF-based fair value to ₹125 from ₹106 per share. At the current market price of ₹98, the valuation grade is **5/5**.

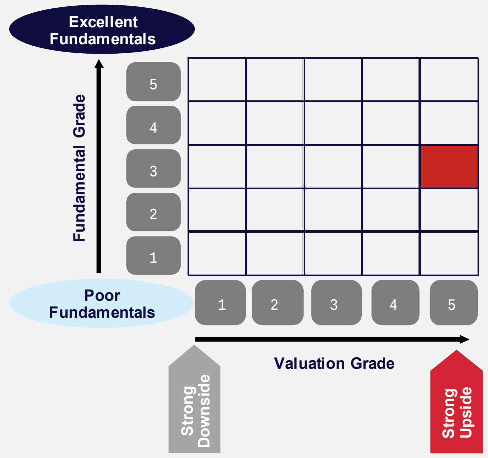
KEY FORECAST (CONSOLIDATED)

(₹ mn)	FY11	FY12	FY13	FY14E	FY15E
Operating income	3,902	4,498	6,530	8,493	9,635
EBITDA	783	1,007	1,427	1,751	1,935
Adj net income	147	278	506	644	732
Adj EPS (₹)	6.1	11.6	19.2	24.4	27.7
EPS growth (%)	(9.1)	89.2	65.1	27.2	13.7
Dividend yield (%)	1.5	2.1	5.9	6.1	6.2
RoCE (%)	7.5	10.4	15.4	17.9	18.8
RoE (%)	5.4	9.7	15.7	17.4	17.3
PE (x)	16.0	8.4	5.1	4.0	3.5
P/BV (x)	0.9	0.8	0.7	0.7	0.6
EV/EBITDA (x)	5.8	4.5	3.4	2.9	2.5

NM: Not meaningful; CMP: Current market price; September ending

Source: Company, CRISIL Research estimates

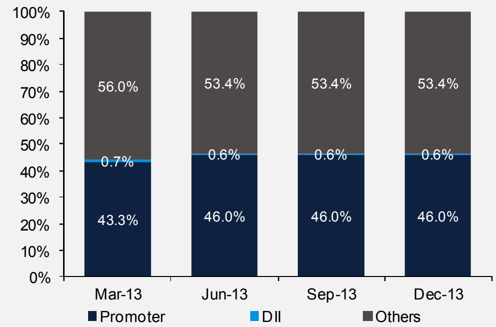
CFV MATRIX



KEY STOCK STATISTICS

NIFTY/SENSEX	6753/22551
NSE/BSE ticker	HELIOSMATH/ HELIOS
Face value (₹ per share)	10
Shares outstanding (mn)	26.4
Market cap (₹ mn)/(US$ mn)	2,588/43
Enterprise value (₹ mn)/(US$ mn)	5,536/92
52-week range (₹)/(H/L)	131/38
Beta	1.0
Free float (%)	54.0%
Avg daily volumes (30-days)	134,006
Avg daily value (30-days) (₹ mn)	14.1

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
Helios	0%	-10%	21%	124%
CNX 500	9%	8%	18%	18%

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CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

Table 1: Helios - Business environment

Product/ Segment	BFSI*	Healthcare	Technology	Other services
Revenue contribution (FY13)	37%	24%	22%	17%
Revenue contribution (FY15E)	41%	25%	20%	15%
Product/ service offering	Provides traditional IT services such as ■ Application development and maintenance ■ System integration and enterprise solutions ■ Independent verification and validation ■ Managed services (largely sub-contracting services) ■ Other services Recently forayed into social media, mobility, analytics and cloud computing (SMAC) offerings – at a very nascent stage			
Geographic presence	The US	Mostly in the US	Mostly in India	Mostly in the US
Market position	Mid-sized IT services provider to large clients			
Revenue growth (FY11-FY13 - 2-yr CAGR)	29%	4%	17%	15%
Revenue forecast (FY13-FY15E – 2-yr CAGR)	21%	18%	10%	9%
Demand drivers	Increase in the spend on IT services by companies			
Key competitors	**Direct with mid-tier IT services players:** Mindtree Ltd, KPIT Technologies Ltd, Hexaware Technologies Ltd, Infinite Computer Solutions (India) Ltd, Persistent Systems Ltd **Indirect with tier I IT services players:** Tata Consultancy Services Ltd, Cognizant, Infosys Ltd, Wipro Ltd			
Key risks	■ Client concentration risk: Top five clients constitute 32% of revenues ■ Vendor consolidation by top five clients ■ Competition from established and large IT services players			

*Banking, financial services and insurance

Source: Company, CRISIL Research

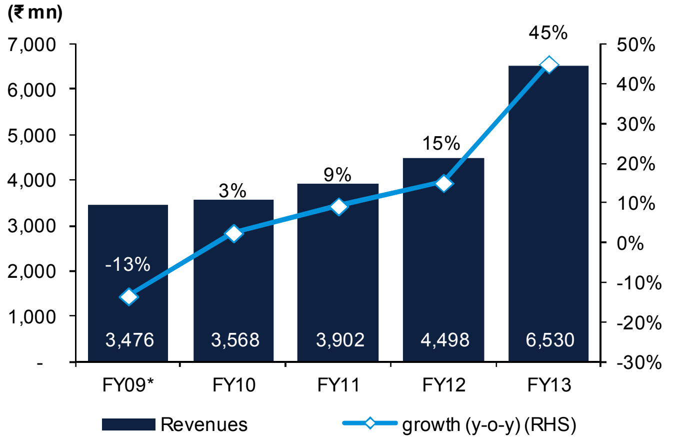
Grading Rationale

Strong focus on large clients has yielded returns

As highlighted in our previous result updates, Helios' strong focus on large clients has delivered returns. As a strategy, it focused on the larger clients to forge stronger relationships and not on the smaller clients. Due to this strategy, it registered strong revenue growth in rupees of 29% CAGR during FY11-13 compared with 9% CAGR over FY09-12. Even in dollar terms, it delivered healthy revenue growth of 17% CAGR over FY11-13. Strong revenue growth was primarily driven by mining existing clients through expansion of offerings – revenues from the top 10 clients grew at a CAGR of 29% during FY11-13, which is similar to overall revenue growth during this period.

Strategy: Focus on large clients to forge stronger relationships and not on the smaller clients

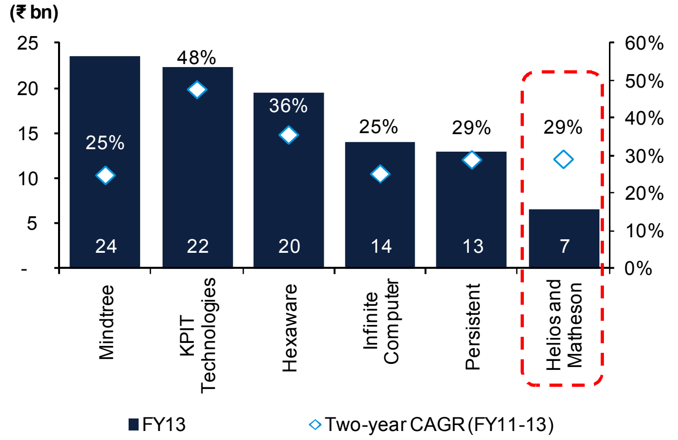
Figure 1: Helios is rebuilding revenues...



Note: *18 months period; we have adjusted it to 12 months

Source: Company, CRISIL Research

Figure: 2... Revenue CAGR in line with other players



Source: Companies, CRISIL Research

Helios has built long-standing relationships with large multinational corporations. It has 25 clients, each contributing more than US$1 mn per annum to revenues. Its top 20 clients are Fortune 500 companies. Focus on few large clients has helped it to solidify client relationships and gain increased business from the existing clients. It derives over 90% of revenues through repeat business (similar to other IT players).

Most of the clients have been added thanks to acquisitions

Table 2: Snapshot of clientele

Revenue concentration (%)	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14
Top client	7.6%	7.7%	7.7%	7.5%	7.3%	7.4%	7.9%	7.9%	7.8%
Top 5 clients	33.9%	34.2%	34.5%	34.3%	33.8%	33.9%	32.4%	32.6%	32.4%
Top 10 clients	50.1%	50.2%	50.6%	49.4%	49.1%	49.3%	48.8%	48.9%	48.6%

Client revenues (₹ mn)	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14
Top client	77	83	89	96	101	113	133	151	156
q-o-q growth	3.0%	6.9%	7.4%	7.6%	6.0%	11.9%	17.4%	13.2%	3.5%
Top 5 clients	345	367	398	437	469	519	546	622	647
q-o-q growth	1.6%	6.5%	8.4%	9.9%	7.3%	10.7%	5.1%	13.9%	4.1%
Top 10 clients	510	539	584	630	681	755	822	932	971
q-o-q growth	1.4%	5.7%	8.3%	7.9%	8.2%	10.8%	8.9%	13.4%	4.1%

No. of million dollar clients	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14
US$ 1 mn to $ 2 mn	9	9	9	9	9	9	9	9	10
US$ 2 mn to $ 5 mn	8	8	9	9	9	10	10	10	9
> US$ 5 mn	4	4	4	4	4	4	5	5	5
> US$ 10 mn	0	0	0	0	0	0	0	0	1

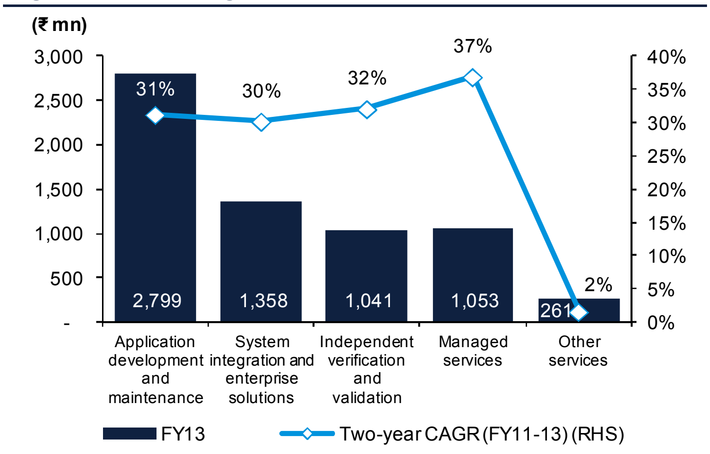
	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14
No. of active clients	65	67	67	69	71	73	73	74	75
clients added	*0*	*2*	*0*	*2*	*2*	*2*	*2*	*1*	*1*

Source: Company

Revenue growth across all services, BFSI being the key vertical

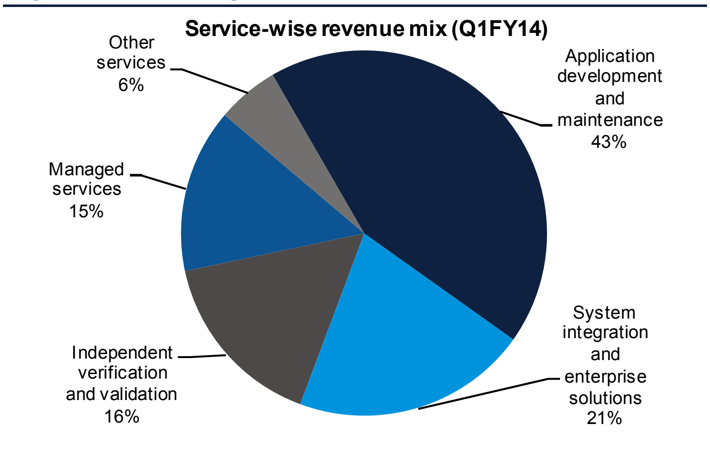
Traditional IT services – ADM, system integration, independent verification – have been driving Helios' revenue growth. ADM is the largest revenue contributor with over 40% share. BFSI is its key vertical, contributing 38% to revenues. In the BFSI vertical, Helios has seven of the top 20 global banks as its clients. Other clients in this vertical include investment banks, capital market specialists, insurance companies, etc. Under the healthcare vertical, Helios caters to healthcare providers, healthcare payers and life science companies. The company also executes managed services (sub-contracting work) for technology companies in India.

Figure 3: Revenue growth across various services



Source: Company, CRISIL Research

Figure 4: ADM – largest revenue contributor to Helios

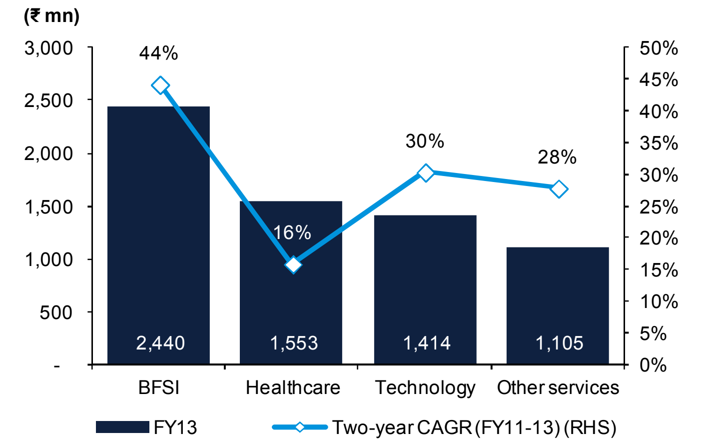


Source: Company, CRISIL Research

BFSI to remain key vertical

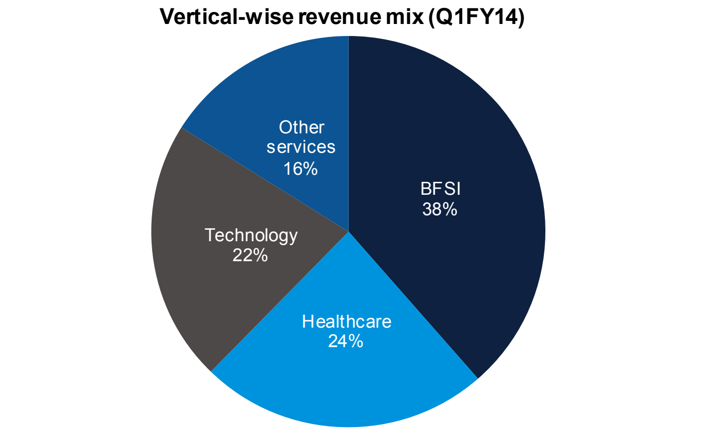
BFSI forms the key client vertical for Indian IT vendors, with almost 75% revenue share. For Helios, BFSI accounts for 38% of revenue share as already mentioned. Pressures from increasing regulatory requirements and discretionary spending for regulatory compliance are expected to be the main growth drivers for the BFSI segment in the medium term. Though BFSI is expected to remain the dominant vertical for Helios, we expect other verticals including healthcare, retail, energy and utilities to increase offshoring as increasing competition in these verticals demands better efficiency. Also, the Affordable Care Act provides opportunity in the healthcare segment. One of the requirements under the Affordable Care Act is that all health insurance providers need to ensure that the selling, general and administrative costs are within a specified limit, which means they need to look out for opportunities to reduce costs. Given that Helios is present in the healthcare vertical, it is well-placed to capitalise on the Affordable Care Act.

Figure 5: BFSI vertical has been the key revenue driver...



Source: Company, CRISIL Research

Figure 6: ...with 38% share

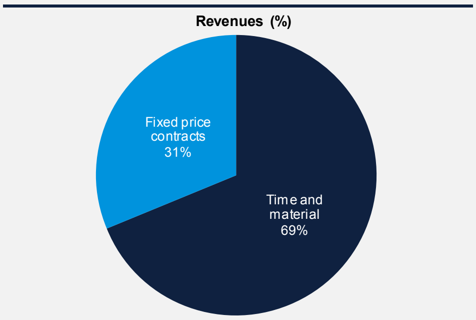


Source: Company, CRISIL Research

Engagement model is largely T&M

Helios derives 69% of revenues from time and material (T&M) contracts compared with the industry average of ~54%. The Indian IT industry has been slowly moving towards a business model based on fixed prices and milestones based on T&M (up from 43% in FY11 to 46% as of date) as clients have trimmed costs. Hence, Indian IT companies have begun to design productivity-linked contracts to provide greater value to clients, and are making higher investments in improving clients' processes.

Helios' engagement model



Source: Company

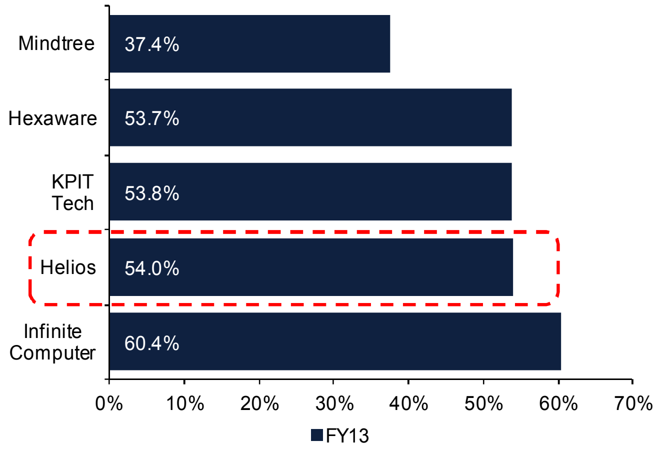
How do small companies such as Helios compete?

Helios works with large clients who also have tier I IT players as their vendors. While bigger contracts are awarded to the tier I players, smaller players such as Helios offer customisation in these contracts at an operational level. Also, majority of the projects that are awarded to Helios are < US$5 mn, which are not targeted by tier I players.

Helios' onsite billing rates lower than that of other players

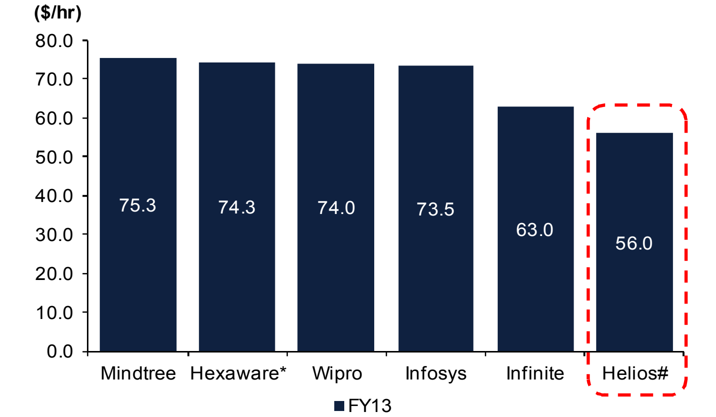
Helios onsite billing rate is US$56 per hour and offshore is US$15-18 per hour. Its onsite billing rates have been lower than other players.

Figure 7: Revenue contribution from onsite is in line with others



Source: Companies, CRISIL Research

Figure 8: Helios' onsite billing rates are lower compared with other players



*December ending; #September ending

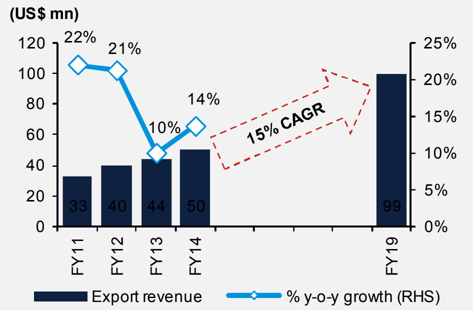
Source: Companies, CRISIL Research

To benefit from positive outlook on IT spending

With the signs of revival in the US economy and increase in worldwide spending on IT services, CRISIL Research estimates India's IT services exports to grow by 14% to US$50 bn in FY14 and at a five-year CAGR of 15% to ₹99 bn in FY19. This reflects significant improvement from 10% growth in FY13, which was due to a weak global macroeconomic environment. Key growth drivers include a mature global offshore delivery model, higher ability of Indian vendors to execute bigger projects, increased focus on new markets, better capabilities in non-traditional service lines, process innovation and cost optimisation by clients. Also, focus on service offerings through new technologies such as cloud, analytics and related applications should drive growth.

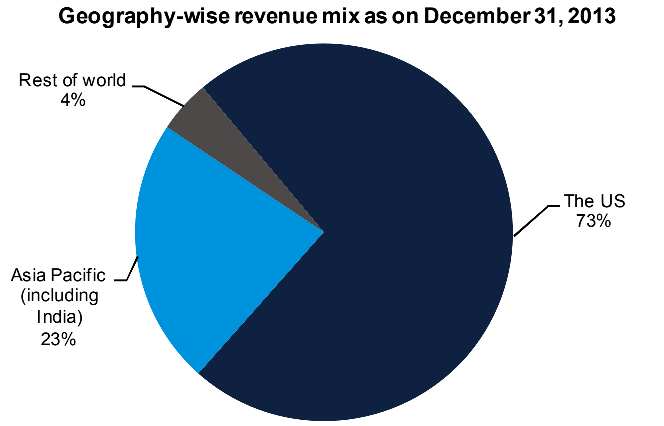
Given that Helios derives 73% of its revenues from the US, CRISIL Research believes that the improving growth prospects of the US economy are favourable for the company.

Indian IT services exports to grow at 15% CAGR over next four years



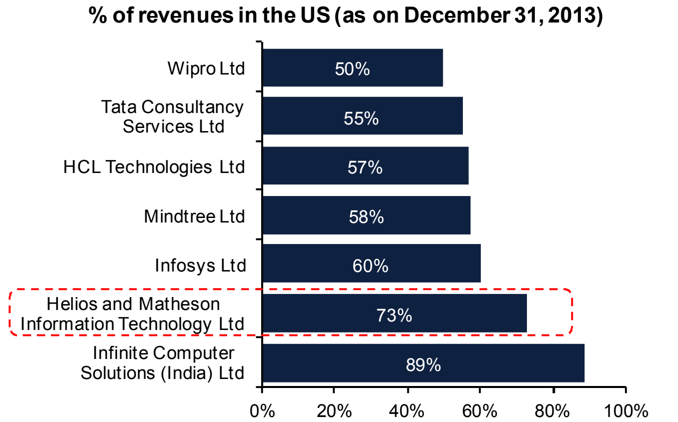
Source: CRISIL Research

Figure 9: Helios to benefit as it derives bulk of revenues from the US



Source: Company

Figure 10: Peer comparison - proportion of revenues from the US



Source: Companies, CRISIL Research

Indian IT vendors exploring new geographies

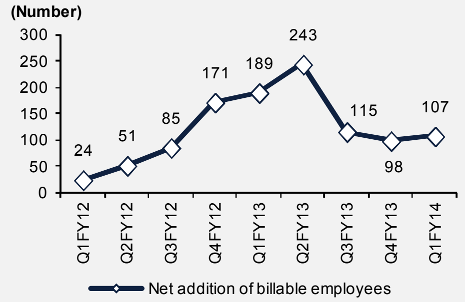
Traditionally, the US has accounted for the maximum share of revenues earned by Indian IT service vendors. However, over the past couple of years, revenues from Europe and emerging markets in the Middle East and Asia-Pacific have also increased. Over the long term, CRISIL Research believes that geographic concentration of Indian IT services exports to the US could narrow, with Indian IT companies exploring new markets in Europe (France and Germany) and the Asia-Pacific regions.

European countries have been slow in adopting the outsourcing model. But these markets have begun to accept Indian IT service companies. Adoption of new technologies such as SMAC is expected to further aid growth. Indian IT companies are also expected to channelise efforts towards improving efficiencies and alter their business models, focusing on non-linear streams, i.e. de-linking employee growth from revenue growth.

Expected headcount addition indicates healthy deal flow

Helios has planned gross addition of 1,000 employees in the next four quarters which indicates a healthy deal pipeline. On an average, it expects to add ~250 employees every quarter.

Quarterly addition of billable employees



Source: Company, CRISIL Research

Focusing on analytics and cloud to remain competitive

At nascent stage for SMAC offerings

Helios is in the nascent stage of offering analytics and cloud services as the IT services industry is inching towards new generation offerings – SMAC. In addition to traditional IT services such as ADM, system integration and enterprise solutions, emerging technologies such as cloud and analytics (as mentioned) are expected to drive industry growth. According to NASSCOM, revenues from SMAC services are likely to grow at 17-19% CAGR over the next three years.

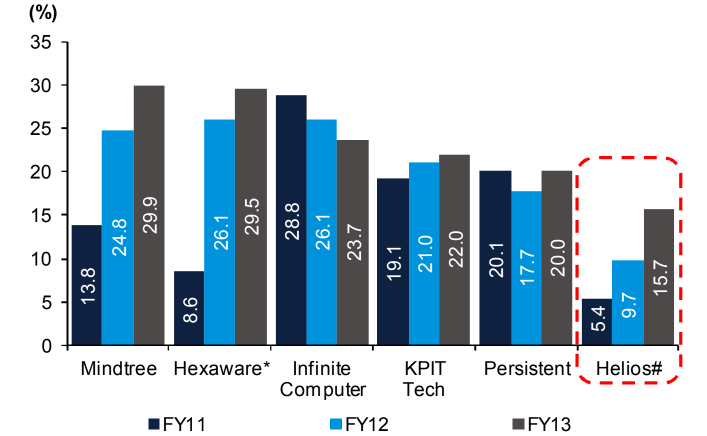
Helios launched 'predictive analytics' for one of its top clients in Q3FY13. This service helps clients to analyse their large database to identify key trends. It also conducted test runs in cloud computing in Q1FY14. Cloud is enabling clients to use IT resources efficiently. Tier I companies such as Tata Consultancy Services Ltd, Infosys Ltd, Wipro Ltd and HCL Technologies Ltd, along with some mid-tier companies, are already offering cloud computing services. Helios could venture into cloud computing as it has received a lead from its IT training business segment.

As the IT services industry is expected to gradually increase SMAC offerings, Helios too plans to make substantial investments in this area. In Q1FY14, the company invested ₹20 mn on SMAC offerings. It has a team of 40 people working for the analytics division in the US; few of them have earlier worked at the in-house analytic division of global banks. The company has budgeted ₹350 mn costs for SMAC offerings over the next three years. Majority of this spend would be towards building technological framework and the rest for sales, marketing and R&D expenses. Our capex assumptions of ₹400 mn p.a. in FY14 and FY15 factor in maintenance capex and spend on SMAC offerings; we have assumed ~₹150 mn for SMAC sales, marketing and R&D expenses over the next three years. These offerings are at a nascent stage currently and will take time to make a meaningful contribution to the company's revenues. Though the addressable market for SMAC offerings is huge and Helios is spending on building technology and capabilities, its ability to launch a product and/or service that proves to be commercially successful is a key monitorable.

RoE below industry average; better asset turnover to improve returns

Helios' three-year average RoE of 10.3% is much lower than its peers' ~20%. The company made large investments during FY09-12 on new office space, hardware and software products in anticipation of higher demand for its services. Lower-than-expected deal flow during FY09-12 resulted in lower utilisation of investments leading to lower asset turnover compared with its peers. Following strong revenue growth, utilisation of capacity improved to 65% in FY13 from 56% in FY12. The likelihood of better deal flows (supported by positive outlook on IT spending) is expected to result in further utilisation of investments leading to improvement in asset turnover. Out of 2,100 workstations, currently ~20% of the capacity is unutilised. As 20% of the capacity is still unutilised, no significant capex for infrastructure is needed for FY14 and FY15, though we have assumed maintenance capex of around ₹400 mn p.a. which also factors in investments in SMAC offerings. Hence, we expect RoE to improve to 17.3% in FY15 from 15.7% in FY13.

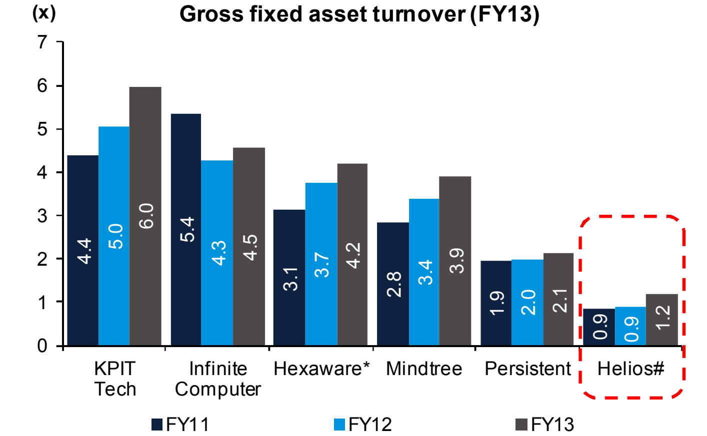
Figure 11: RoE below industry average...



*December ending; #September ending

Source: Companies, CRISIL Research

Figure 12: ... as fixed asset turnover lower than that of peers



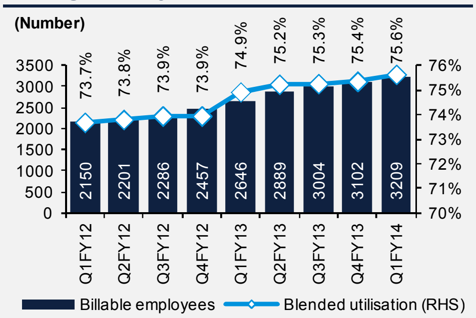
*December ending; #September ending

Source: Companies, CRISIL Research

Rising employee utilisation, scope to improve further

Employee blended utilisation has been rising, up from 74.9% in Q1FY13 to 75.6% in Q1FY14. There is room for further improvement as the industry's average employee utilisation is over 80%.

Rising employee utilisation



Source: Company, CRISIL Research

Leverage continues to be a concern

Helios is leveraged at 0.8x debt-equity (excluding the preference share capital of ₹630 mn), while most of its peers have zero debt, due to its debt-funded acquisition of The A Consulting

Team (TACT). To fund the acquisition of the US-based TACT, Helios raised foreign currency convertible bonds (FCCBs) worth US$ 25 mn (₹1.15 bn) in 2006. The redemption of these FCCBs in 2011 was done through internal accrual and term loan. Due to prior investments in setting up delivery centres, no major additional capex is required in the short term. We expect leverage to improve to 0.6x in FY15E.

Leverage higher than peers

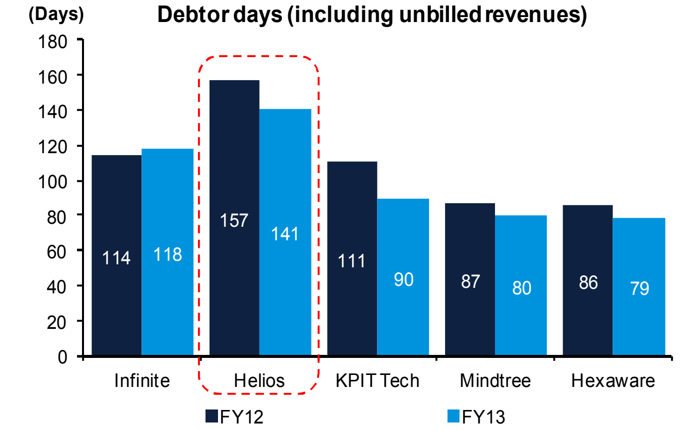
	FY11	FY12	FY13
Helios	**1.0**	**0.9**	**0.8**
KPIT Tech	0.2	0.6	0.6
Infinite	0.1	0.1	0.1
Mindtree	0.0	0.1	0.0
Hexaware	0.0	0.0	0.0
Persistent	0.0	0.0	0.0

Source: Companies, CRISIL Research

Higher debtor days than peers

Helios' debtors (including unbilled revenues) at 115 days as of FY13 are relatively higher than that of peers. Marquee customers and high client concentration have prompted Helios to offer more payment flexibility to its clients. The company will have to demonstrate strong recovery capability on a consistent basis amidst strong revenue growth to reduce debtor days.

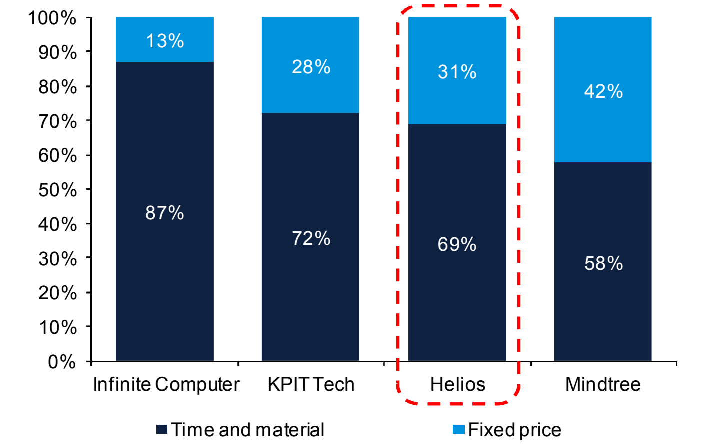
Figure 13: Helios' debtors (including unbilled revenues) much higher than most of its peers...



*December ending; #September ending

Source: Companies, CRISIL Research

Figure 14: ... also driven by higher contribution from fixed price contracts



As of FY13

Source: Companies, CRISIL Research

Successful foray into high-margin training business can provide upside

Training business has EBITDA margin of 35%

Helios' organic IT training business accounts for less than 5% of total revenues. EBITDA margin in the IT training business is ~35%, much higher than the company's overall EBITDA margin of ~22%. Its team of about 300 empanelled trainers caters to niche technology training services across India. Helios has also delivered corporate training to large companies in India and abroad. Going ahead, the company plans to focus on government training services, e-learning initiatives and also on expanding its operations overseas. Successful foray into the higher-margin segment will provide an upside and is a monitorable.

Status quo on litigation against promoter with reference to Vmoksha deal

The lawsuit filed by Vmoksha's promoter, Rajeev Sahwney, against Helios' promoters (regarding the acquisition of Vmoksha) is pending in the magistrate court.

Vmoksha acquisition in arbitration; no impact on Helios' business

In 2005, Helios was to buy Vmoksha entities (Vmoksha Technologies – US, Vmoksha Technologies – Singapore and Vmoksha Technologies – India through the holding company Vmoksha Mauritius) for ₹650 mn, translating into 1.5x price/sales. The transaction was structured in such a way that the amount was to be reinvested through issuance of preference shares redeemable after 18 months.

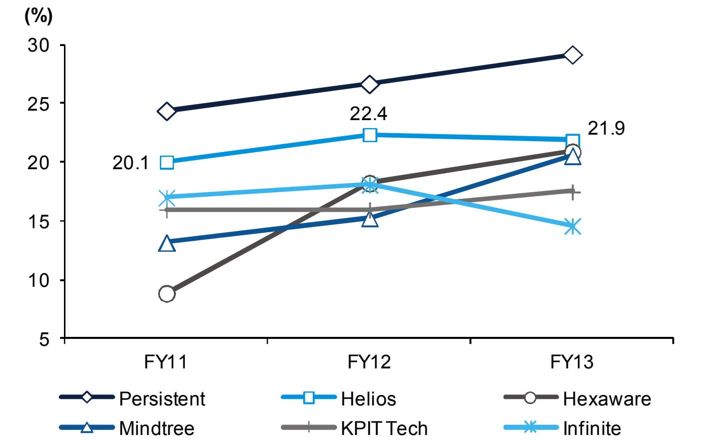
Vmoksha deal unlikely to have an adverse impact

Due to differences between the promoters of Vmoksha, the deal is currently stuck in arbitration. In the books, Helios reports 'advance' of ₹650 mn for acquisition of Vmoksha on the asset side. A contrary entry of ₹630 mn is mentioned in the liabilities as advance received towards subscription of redeemable preference shares. The difference of ₹20 mn is a result of advisory and transaction-related fees to PricewaterhouseCoopers (PwC).

Based on the legal opinion obtained by the company, we do not expect any impact of the arbitration on Helios' business and financials. We have factored in a loss of ₹20 mn in the reserves with regards to the transaction fees to PwC.

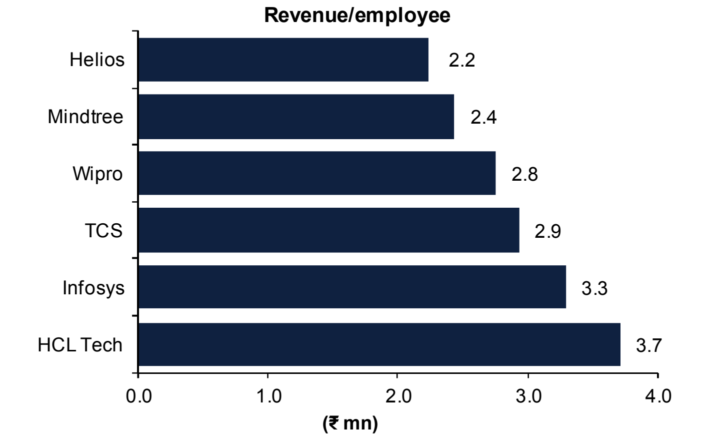
Peer comparison

Figure 15: Helios' EBITDA margin largely comparable to that of most mid-tier IT players



Source: Companies, CRISIL Research

Figure 16: Helios' revenue / employee lowest than peers



*December ending; #September ending

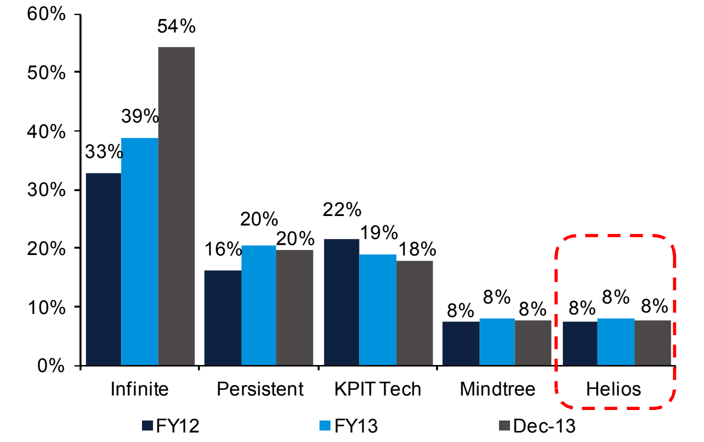
Source: Companies, CRISIL Research

Key Risks / Monitorables

Client concentration risk; vendor consolidation by clients

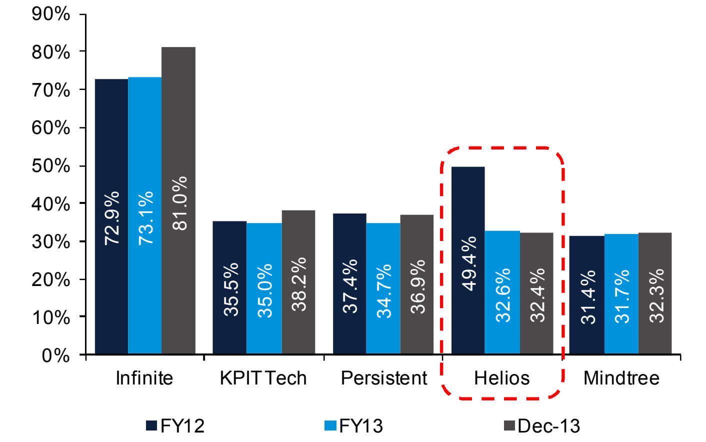
Helios' top five clients continue to account for 32% of its revenues. The company could lose a significant proportion of revenues even if a single client from the top five moves away. Also, vendor consolidation by the top five clients is a monitorable.

Figure 17: Helios' top client concentration relatively lower than that of most mid-tier IT players



Source: Companies, CRISIL Research

Figure 18: Top five client concentration in line with that of most mid-tier IT players

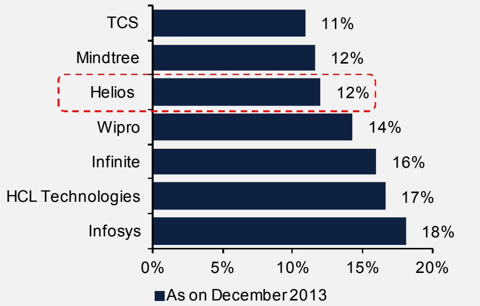


Source: Companies, CRISIL Research

Talent acquisition and retention

Attrition at Helios is 12%, below the average industry-wide level. The company employs computer science graduates in its technical workforce. With strong growth outlook expected for the IT services industry in the next couple of years, many tier 1 vendors (such as TCS and Infosys) have already announced extensive hiring plans for the next year. Therefore, retaining quality resources, especially with Helios' policy on lateral hiring (campus recruitments being negligible compared with peers'), could be a challenge. Helios' ability to improve profitability while managing attrition and wage inflation is a monitorable.

Helios' attrition below industry average



Source: Companies, CRISIL Research

Exposed to currency fluctuations, but impact is less due to higher onsite contribution

Since ~75% of Helios' revenues are denominated in foreign currency, it remains vulnerable to currency fluctuations. However, the currency impact is less as Helios has higher onsite presence (54% of its revenues are from onsite), which provides a natural hedge. The company has a natural hedge to the extent of ~40% of its forex exposure as most of its operational expenses in foreign subsidiaries are denominated in the currency of the respected country. It does not cover the unhedged portion of its forex exposure. Hence, its earnings are exposed to currency fluctuations.

Does not cover unhedged portion of forex exposure

The US immigration bill

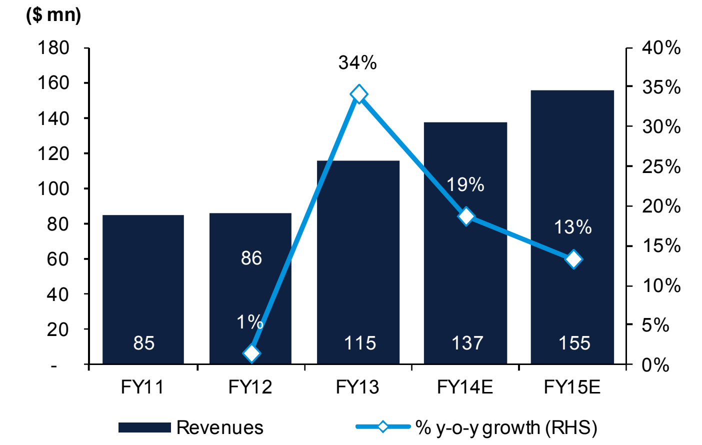
The proposed immigration bill in the US is expected to become a law in the next 10-12 months if it gets passed by both the houses and is signed by the US president. The bill is expected to limit the proportion of H-1B and L-1 visa workers at the client's site. The proposed bill is expected to impact Helios as it has a higher proportion of onsite revenues.

Financial Outlook

US$ revenues to increase at a two-year CAGR of 16%

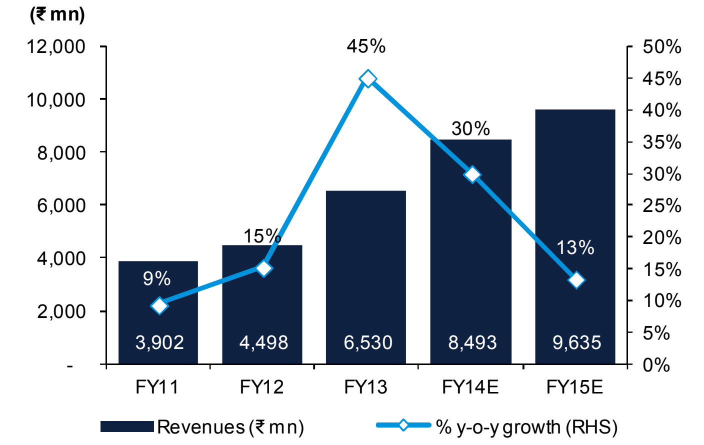
US$ revenues are expected to grow at a two-year CAGR of 16% to US$155 mn in FY15. Revenue growth is expected to be driven by the BFSI and the healthcare verticals. We have factored in average exchange rate (₹/US$) of ~62 for FY14 and FY15.

Figure 19: Revenue growth in dollar terms



Source: Company, CRISIL Research

Figure 20: Revenue growth in rupee terms

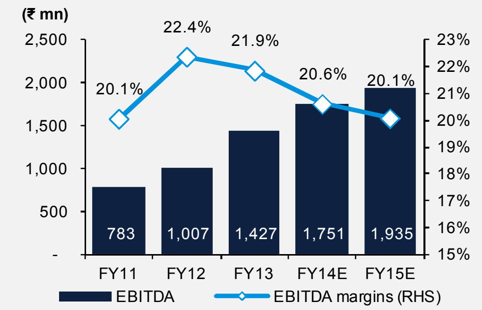


Source: Company, CRISIL Research

EBITDA margin expected to be under pressure hereon

We estimate EBITDA margin to decline marginally due to (i) higher employee cost for retention as industry prospects are positive and (ii) investment in SMAC. Accordingly, we estimate EBITDA margin to decline by ~178 bps to 20.1% in FY15 from 21.9% in FY13.

EBITDA margin to be under pressure

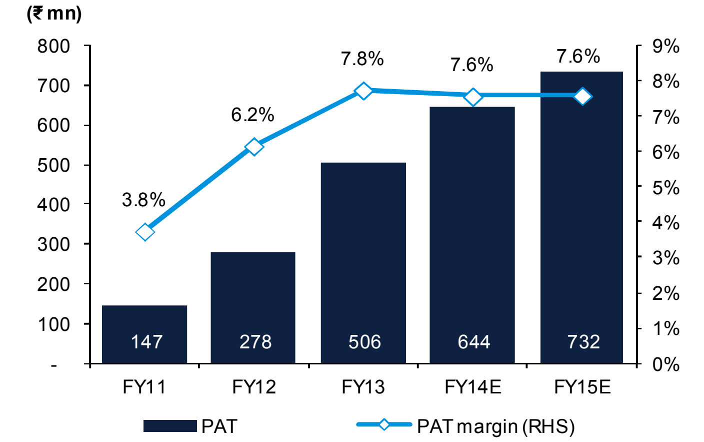


Source: Company, CRISIL Research

PAT to increase at a CAGR of 20% during FY13-15

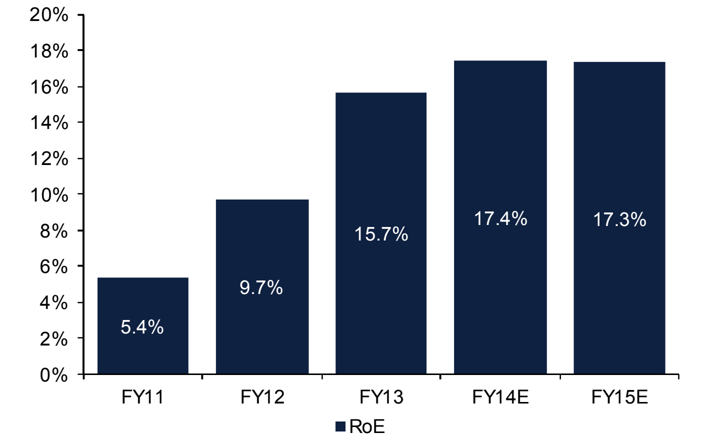
We expect PAT to increase at a two-year CAGR of 20% to ₹732 mn in FY15. We do not expect the company to incur substantial capex over the next two years. We have factored in capex of ~₹400 per annum for FY14 and FY15, which reflects maintenance capex and investment in SMAC offerings. EPS is expected to increase to ₹27.7 in FY15 from ₹19.2 mn in FY13. RoE is expected to improve to 17.3% in FY15 from 15.7% in FY13 following better asset turnover.

Figure 21: Trend in PAT margin



Source: Company, CRISIL Research

Figure 22: RoE to improve due to better asset utilisation



Source: Company, CRISIL Research

Earnings estimates revised upwards

		FY14E			FY15E		
	Unit	Old	New	% change	Old	New	% change
Revenues	₹ mn	8,493	8,493	0.0%	9,629	9,635	0.1%
EBITDA	₹ mn	1,719	1,751	1.8%	1,909	1,935	1.4%
EBITDA margin	%	20.2%	20.6%	37bps	19.8%	20.1%	26bps
PAT	₹ mn	626	644	2.8%	706	732	3.7%
PAT margin	%	7.4%	7.6%	21bps	7.3%	7.6%	27bps
EPS	₹	23.7	24.4	2.8%	26.7	27.7	3.7%

Reasons for change in estimates

Particulars	FY14E and FY15E
Revenues	Unchanged
EBITDA	Revised upwards as the company has not witnessed any pricing pressure compared with our earlier assumption that billing rates would reduce owing to pricing pressure from BFSI clients and competition faced from players who passed on some of the benefits of rupee depreciation to clients. There is hardly any pricing pressure, also because the company has higher onsite presence (onsite is 54% of total revenues)
PAT	Raised following revision in EBITDA

Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance.

Business spearheaded by promoters

Helios is led by co-promoter Mr Muralikrishna G.K., CEO and managing director; he is a graduate in science with post-graduate degree in business management from the Indian Institute of Management, Ahmedabad. The other co-promoter, Mr Ramachandran, a chartered accountant, is a strategic advisor to the company but is no longer on the board of directors. The promoters are supported by executive director Diwakar Sai Yerra, who has been associated with the company since inception. He looks after infrastructure/security and personnel for the parent company; he has two decades of experience in international trade/exports. Ms Divya Ramachandran, Mr Ramachandran's daughter, is the president and CEO of the US operations. She is an alumnus of Kellogg Business School, Chicago and has over a decade of experience in the industry.

Experienced promoters supported by strong second line of management

Strong second line of management

Helios has not seen much churn at the senior management level. Most members of the second line of management have been associated with the company for a fairly long time – over 10 years on an average. Based on our interactions, we believe the second line has adequate domain expertise and a fair degree of autonomy in decision making. At the company level too, attrition was 12% as of Q1FY14, which is among the best in the industry.

Centralised management

The second line of management reports to the MD and CEO. Operationally, there are no separate heads for managing the delivery and business development region-wise or function-wise. Mr Pat Krishnan, CTO, handles the healthcare vertical. The BFSI vertical is headed by Mr Joseph Judenberg. Ms Divya Ramachandran has been nominated by the parent company to take charge of the US subsidiary.

Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Research analyses the shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Overall, corporate governance at Helios meets the regulatory requirement – it has reasonably good board practices and an independent board.

Board composition

Helios' board comprises five members, of whom three are independent directors, which meets the requirement under Clause 49 of SEBI's listing guidelines. The directors are well qualified with strong industry experience as given below.

Corporate governance practices are good

- Ms Chandra Ramesh has more than two decades of experience in the finance industry. She is a qualified chartered accountant, company secretary, cost accountant and post-graduate in management from IIM, Ahmedabad.
- Mr S K Patil has more than two decades of experience in the IT industry. He has set up large e-governance projects. His focus is to drive the benefits of information and communication technologies to governments and businesses in both emerging and established markets. He holds an engineering degree and MBA from IIM, Ahmedabad.
- Mr S R Sistla, Retired Air Vice Marshal from the Indian Air Force, has 35 years of experience in both technical and management areas.

Board processes

The board's processes are well structured. All the necessary committees – audit, remuneration and investor grievance – are in place to support corporate governance practices. The audit committee is chaired by an independent director, Mrs Chandra Ramesh. The committee meets at timely and regular intervals.

Four board meetings were held during the year; full attendance by all members expect Ms Chandra Ramesh

Scope to improve disclosures

Over the past year, the company's quality of disclosure has improved judged by the level of information and details furnished in the annual report, fact sheets and press release. However, there is scope to further improve its disclosures. For instance, it could provide information for previous quarters too on the company website.

Valuation Grade: 5/5

We have raised our earnings estimates for FY14 and FY15 as there has not been any pressure on billing rates compared with our earlier assumption that billing rates would reduce owing to pricing pressure from BFSI clients and competition faced from players who passed on some of the benefits of rupee depreciation to clients. Following a positive outlook on IT spending, we have also raised our long-term revenue growth estimate for Helios. Accordingly, we have raised our DCF-based fair value to ₹125 from ₹106 per share. The fair value implies P/E multiples of 5.1x FY14E and 4.5x FY15E EPS. At the current market price of ₹98, the valuation grade is **5/5**.

Key DCF assumptions

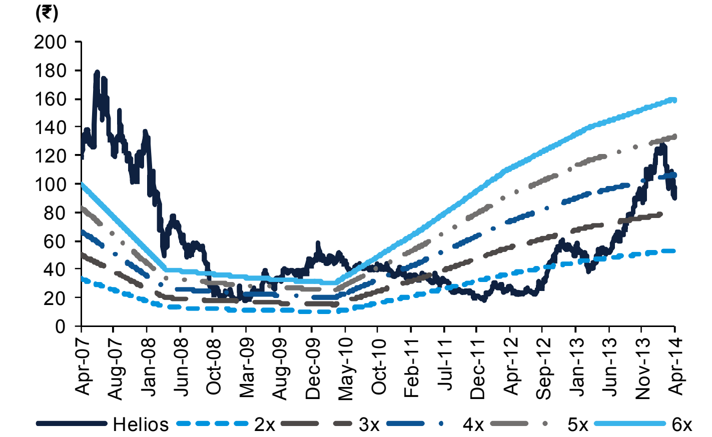
- We have considered the discounted value of the firm's estimated free cash flows from FY14 to FY20.
- We have assumed a terminal growth rate of 3% beyond the explicit forecast period until FY20.
- We have used cost of equity of 19.3%.

WACC computation

	FY14-20	Terminal value
Cost of equity	19.3%	19.3%
Cost of debt (post tax)	7.6%	7.6%
WACC	14.5%	16.9%
Terminal growth rate		3%

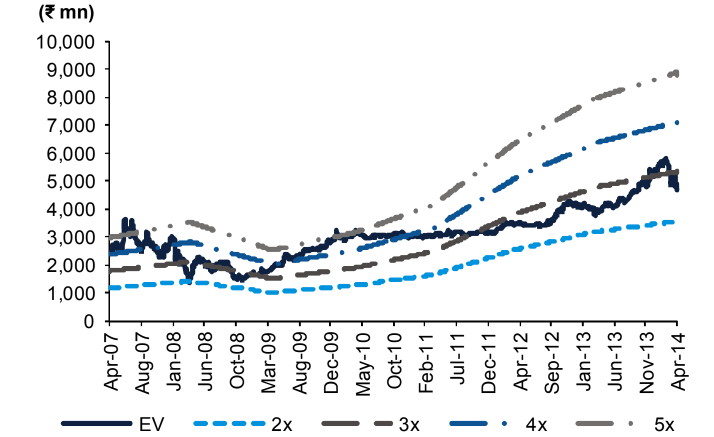
		Terminal growth rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
Terminal WACC	14.9%	130	136	142	150	159
	15.9%	123	128	133	139	146
	16.9%	117	121	**125**	130	136
	17.9%	112	115	119	123	128
	18.9%	108	110	114	117	121

One-year forward P/E band



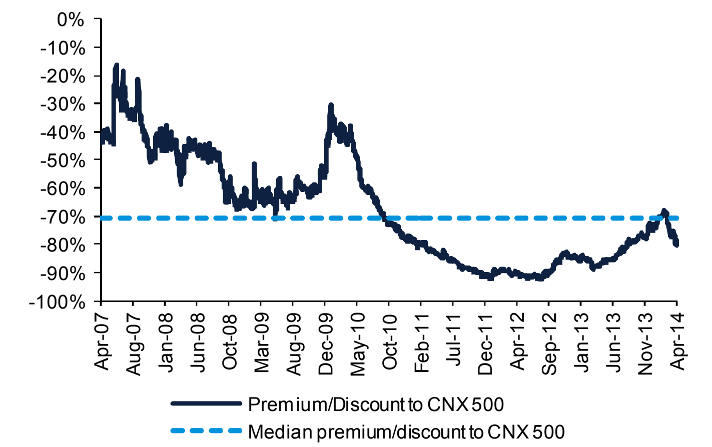
Source: NSE, CRISIL Research

One-year forward EV/EBITDA band



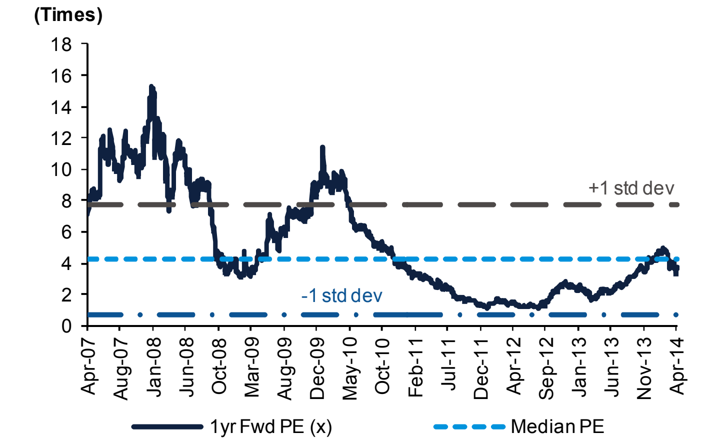
Source: NSE, CRISIL Research

P/E – premium / discount to CNX 500



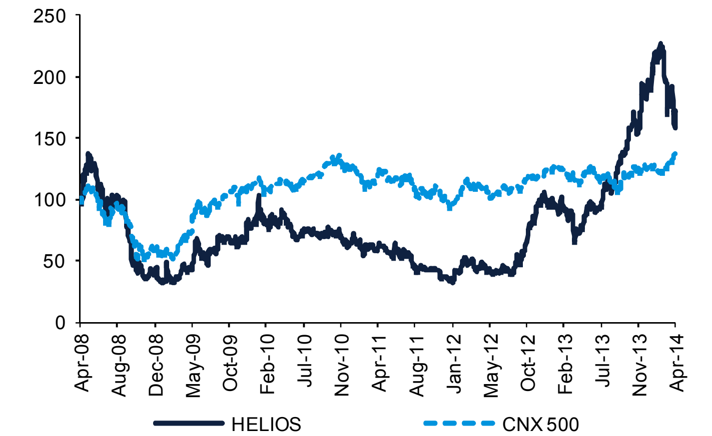
Source: NSE, CRISIL Research

P/E movement



Source: NSE, CRISIL Research

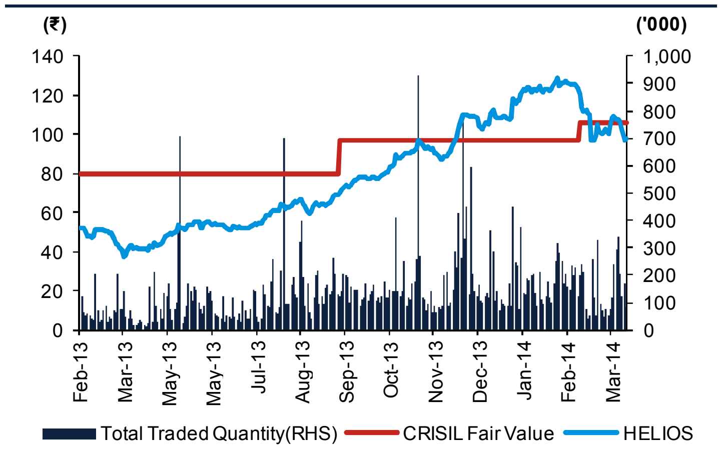
Share price movement



-Indexed to 100

Source: NSE, CRISIL Research

Fair value movement since initiation



Source: NSE, BSE, CRISIL Research

Peer valuation

Company	M.cap (₹ bn)	Price/earnings (x) FY13	FY14E	FY15E	FY16E	Price/book (x) FY13	FY14E	FY15E	FY16E	EV/EBITDA (x) FY13	FY14E	FY15E	FY16E	RoE (%) FY13	FY14E	FY15E	FY16E
Helios & Matheson Information Technology*	**3**	**5.1**	**4.0**	**3.5**	**NA**	**0.7**	**0.7**	**0.6**	**NA**	**3.4**	**2.9**	**2.5**	**NA**	**15.7**	**17.4**	**17.3**	**NA**
Helios and Matheson Analytic (in US $)	**0**	**35.9**	**NA**	**NA**	**NA**	**3.0**	**NA**	**NA**	**NA**	**33.0**	**NA**	**NA**	**NA**	**8.9**	**NA**	**NA**	**NA**
Mid-cap players																	
Infinite Computer Solutions (India) Ltd*	6	4.6	5.7	4.4	3.8	1.0	0.9	0.8	0.7	2.6	2.6	2.1	1.6	23.7	16.4	19.2	19.6
Mindtree Ltd	59	11.6	13.2	12.2	10.2	2.8	3.6	2.9	2.3	7.7	9.0	7.6	6.3	27.5	30.0	26.4	25.8
Hexaware Technologies Ltd	49	10.4	11.7	10.7	10.0	3.3	3.3	2.8	3.0	6.6	7.6	7.0	6.5	31.6	29.1	27.8	31.1
Persistent Systems Ltd	43	11.2	17.0	13.6	11.5	2.1	3.6	3.0	2.5	5.4	8.9	7.4	6.4	20.2	22.6	23.5	23.5
Polaris Financial Technology Ltd	20	5.5	9.6	7.7	6.7	0.8	1.4	1.2	1.0	3.1	4.2	3.9	3.9	15.7	14.6	16.2	16.3
KPIT Technologies Ltd	32	8.9	12.6	10.2	8.6	1.8	2.5	2.0	1.7	5.2	7.5	6.4	5.6	22.8	21.4	21.3	21.5
Median		**9.6**	**12.2**	**10.4**	**9.3**	**2.0**	**2.9**	**2.4**	**2.0**	**5.3**	**7.6**	**6.7**	**6.0**	**23.2**	**22.0**	**22.4**	**22.5**
Large-cap players																	
Tata Consultancy Services Ltd	4,221	22.2	22.3	19.0	16.4	8.0	8.0	6.2	5.0	16.7	16.4	14.1	12.3	40.9	39.8	36.3	33.6
Infosys Ltd	1,913	17.5	18.0	15.4	13.5	4.4	4.1	3.5	3.0	12.3	12.3	10.6	9.3	27.2	24.4	24.1	23.7
HCL Technologies Ltd	995	13.3	16.6	14.5	12.8	4.1	5.2	4.1	3.3	9.0	11.6	10.6	9.4	35.1	36.2	31.6	28.5
Wipro Ltd	1,381	17.5	17.9	15.4	13.7	3.8	4.1	3.4	2.9	13.2	13.1	11.2	10.0	23.3	24.5	23.9	22.9
Tech Mahindra Ltd	424	10.5	14.4	12.8	11.2	2.5	4.4	3.3	2.6	9.9	9.5	8.3	7.5	27.2	34.5	28.9	25.8
Median		**17.5**	**17.9**	**15.4**	**13.5**	**4.1**	**4.4**	**3.5**	**3.0**	**12.3**	**12.3**	**10.6**	**9.4**	**27.2**	**34.5**	**28.9**	**25.8**

Source: *CRISIL Research, Industry sources

CRISIL IER reports released on Helios and Matheson Information Technology Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
22-Feb-13	Initiating coverage	2/5	₹80	5/5	₹53
06-May-13	Q2FY13 result update	2/5	₹80	5/5	₹49
10-Sep-13	Q3FY13 result update	3/5	₹97	5/5	₹73
13-Nov-13	Q4FY13 result update	3/5	₹97	4/5	₹87
20-Feb-14	Q1FY14 result update	3/5	₹106	2/5	₹120
03-Apr-14	Detailed report	3/5	₹125	5/5	₹98

Company Overview

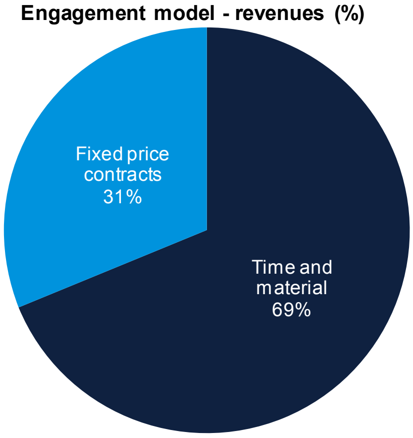
Helios was co-founded by Mr Muralikrishna and Mr Ramachandran in 1991. The company is a mid-sized global provider of IT services such as IT application and development, application validation and verification, and other related services to the BFSI, healthcare, technology and other sectors. It began as a provider of networking solutions and IT training. Beginning with the acquisition of US-based Laxmi Group Inc in 2001, the company entered into a string of acquisitions in the subsequent years.

The company has five subsidiaries in the US, Singapore and India. All subsidiaries are wholly owned except the US subsidiary where it holds 74% stake, the remaining is held by US public members. It has 3,209 billable employees to cater to 75 clients (as of Q1FY14).

Evolved from an IT training firm to a diversified IT services provider

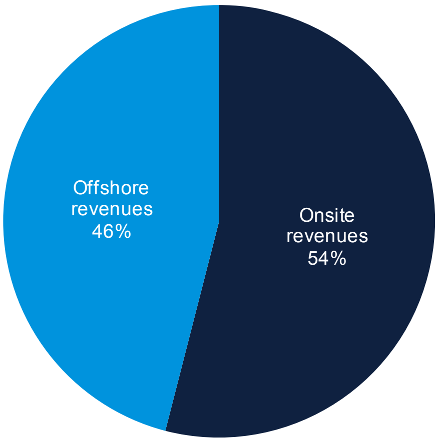
Has offices in New York, California and Singapore, and off-shore development centers in Bengaluru and Chennai

Majority of its engagement mode is on time and material



Source: Company

54% of revenues are from onsite



Source: Company

Acquisition-driven growth in the past

Helios acquired five companies over 2001-2007 to expand its service offerings in the US, which is the key market for Indian IT companies.

Acquired five companies between 2001 and 2007

Table 3: Acquisition details

Acquired entity	Year of acquisition	Based in	Consideration	Subsidiary	Valuation	Reasons to acquire
The Laxmi Group Inc.	2001	The US	Total consideration is US$1.6 mn. US$1 mn at the time of acquisition for 51% stake in the first tranche and US$ 0.6 mn in the second tranche for 49% stake	Wholly owned	4x EBITDA	To enter the US market
SystemLogic Solutions Ltd (rechristened Helios and Matheson IT (Bangalore) Ltd)	2001	Bengaluru	₹55.8 mn (additional ₹40 mn was invested through capital infusion)	Wholly owned	1x revenue	The acquired company was a market leader in technology training
Maruthi Consulting Inc., US and ODC Jayamaruthi Software Systems, Chennai	2004	The US and Chennai	US$3 mn	Wholly owned	3x EBITDA	This acquisition helped strengthen Helios' presence in the healthcare vertical in the US

Acquired entity	Year of acquisition	Based in	Consideration	Subsidiary	Valuation	Reasons to acquire
The A Consulting Team Inc (TACT), now known as Helios and Matheson Information Analytics Inc.	2006	The US	It was initially acquired for a 43% stake at US$8.75 mn. Over a period of time, the company's holding was increased to 74% for a total payout of US$14 mn	74% stake	0.8x revenue	The acquired company had strong focus in the financial services industry with a client list comprising Fortune 1000 companies

Table 4: Key financials of the US-listed subsidiary - Helios and Matheson Analytics

US$ mn	FY10	FY11	FY12	FY13
Revenues	13.3	12.2	12.4	13.3
EBITDA	-0.9	0.2	0.5	0.4
PAT	-0.9	0.2	0.6	0.4
RoE (%)	-29.9	5.4	14.5	8.9

Source: Company

Milestones

1991	Year of incorporation
1999	Public issue of ₹100 mn
2001	Acquired Laxmi Group Inc. headquartered in California
2001	Acquired System Logic Solutions headquartered in Bengaluru
2004	Acquired Maruthi Consulting Inc. US
2006	Raised US$25 mn through FCCB
2006	Acquired US-based The A Consulting Team Inc (TACT), now known as Helios and Matheson Information Analytics Inc.
2011	FCCB redemption through bank loan and internal accruals

Source: Company

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Annexure: Financials (Consolidated)

Income statement

(₹ mn)	FY11	FY12	FY13	FY14E	FY15E
Operating income	**3,902**	**4,498**	**6,530**	**8,493**	**9,635**
EBITDA	**783**	**1,007**	**1,427**	**1,751**	**1,935**
EBITDA margin	**20.1%**	**22.4%**	**21.9%**	**20.6%**	**20.1%**
Depreciation	381	423	503	565	605
EBIT	**401**	**583**	**924**	**1,186**	**1,330**
Interest	218	226	293	313	304
Operating PBT	**183**	**357**	**631**	**873**	**1,026**
Other income	39	1	55	36	25
Exceptional inc/(exp)	-	-	-	-	-
PBT	**223**	**358**	**686**	**909**	**1,050**
Tax provision	76	81	180	265	318
Minority interest	-	-	-	-	-
PAT (Reported)	**147**	**278**	**506**	**644**	**732**
Less: Exceptionals	-	-	-	-	-
Adjusted PAT	**147**	**278**	**506**	**644**	**732**

Ratios

	FY11	FY12	FY13	FY14E	FY15E
Growth					
Operating income (%)	9.4	15.3	45.2	30.1	13.5
EBITDA (%)	18.3	28.6	41.8	22.6	10.5
Adj PAT (%)	(9.1)	89.2	82.4	27.2	13.7
Adj EPS (%)	(9.1)	89.2	65.1	27.2	13.7
Profitability					
EBITDA margin (%)	20.1	22.4	21.9	20.6	20.1
Adj PAT Margin (%)	3.8	6.2	7.8	7.6	7.6
RoE (%)	5.4	9.7	15.7	17.4	17.3
RoCE (%)	7.5	10.4	15.4	17.9	18.8
RoIC (%)	10.1	11.4	17.7	18.2	17.8
Valuations					
Price-earnings (x)	16.0	8.4	5.1	4.0	3.5
Price-book (x)	0.9	0.8	0.7	0.7	0.6
EV/EBITDA (x)	5.8	4.5	3.4	2.9	2.5
EV/Sales (x)	1.2	1.0	0.8	0.6	0.5
Dividend payout ratio (%)	24.5	18.0	30.3	24.5	22.0
Dividend yield (%)	1.5	2.1	5.9	6.1	6.2
B/S ratios					
Inventory days	-	-	-	-	-
Creditors days	25	25	17	20	18
Debtor days (including unbilled revenues)	129	129	115	117	119
Working capital days	158	166	151	154	157
Gross asset turnover (x)	0.9	0.9	1.2	1.4	1.5
Net asset turnover (x)	1.5	1.6	2.4	3.2	3.8
Sales/operating assets (x)	1.4	1.5	2.3	3.0	3.6
Current ratio (x)	8.1	9.1	7.6	6.7	7.0
Debt-equity (x)	1.0	0.9	0.8	0.8	0.6
Net debt/equity (x)	0.8	0.7	0.7	0.6	0.5
Interest coverage ratios					
EBIT/ Interest	1.8	2.6	3.2	3.8	4.4
EBITDA/ Interest	3.6	4.5	4.9	5.6	6.4

Per share

	FY11	FY12	FY13	FY14E	FY15E
Adj EPS (₹)	6.1	11.6	19.2	24.4	27.7
CEPS	22.1	29.3	38.2	45.8	50.6
Book value	112.9	125.4	130.8	149.2	170.8
Dividend (₹)	1.5	2.1	5.8	6.0	6.1
Actual o/s shares (mn)	23.9	23.9	26.4	26.4	26.4

Balance Sheet

(₹ mn)	FY11	FY12	FY13	FY14E	FY15E
Liabilities					
Equity share capital	239	239	264	264	264
Reserves	2,462	2,759	3,191	3,677	4,248
Minorities	-	-	-	-	-
Net worth	**2,701**	**2,998**	**3,455**	**3,941**	**4,512**
Preference share capital	630	630	630	630	630
Convertible debt	-		-	-	-
Other debt	2,798	2,702	2,878	2,972	2,712
Total debt	**3,429**	**3,333**	**3,508**	**3,602**	**3,342**
Deferred tax liability (net)	238	237	258	305	371
Total liabilities	**6,367**	**6,568**	**7,221**	**7,848**	**8,225**
Assets					
Net fixed assets	2,750	2,778	2,716	2,631	2,441
Capital WIP	245	139	157	117	107
Total fixed assets	**2,995**	**2,917**	**2,873**	**2,748**	**2,548**
Investments	650	655	655	655	655
Current assets					
Inventory	-	-	-	-	-
Sundry debtors	1,381	1,585	2,058	2,723	3,142
Loans and advances	620	771	1,133	1,567	1,777
Cash & bank balance	566	493	560	448	482
Marketable securities	-	-	-	-	-
Total current assets	**2,566**	**2,850**	**3,751**	**4,738**	**5,402**
Total current liabilities	**316**	**312**	**495**	**709**	**776**
Net current assets	**2,251**	**2,538**	**3,256**	**4,029**	**4,626**
Intangibles/Misc. expenditure	**472**	**457**	**436**	**416**	**396**
Total assets	**6,367**	**6,568**	**7,221**	**7,848**	**8,225**

Cash flow

(₹ mn)	FY11	FY12	FY13	FY14E	FY15E
Pre-tax profit	223	358	686	909	1,050
Total tax paid	(60)	(82)	(159)	(218)	(252)
Depreciation	381	423	503	565	605
Working capital changes	(221)	(360)	(651)	(884)	(563)
Net cash from operations	**323**	**340**	**379**	**371**	**840**
Cash from investments					
Capital expenditure	(761)	(332)	(438)	(420)	(385)
Investments and others	-	(5)	(0)	-	-
Net cash from investments	**(761)**	**(337)**	**(438)**	**(420)**	**(385)**
Cash from financing					
Equity raised/(repaid)	(292)	-	73	-	-
Debt raised/(repaid)	357	(96)	176	94	(260)
Dividend (incl. tax)	(42)	(50)	(153)	(158)	(161)
Others (incl extraordinaries)	137	70	31	-	-
Net cash from financing	**160**	**(76)**	**126**	**(64)**	**(421)**
Change in cash position	(278)	(72)	67	(112)	34
Closing cash	566	493	560	448	482

Quarterly financials

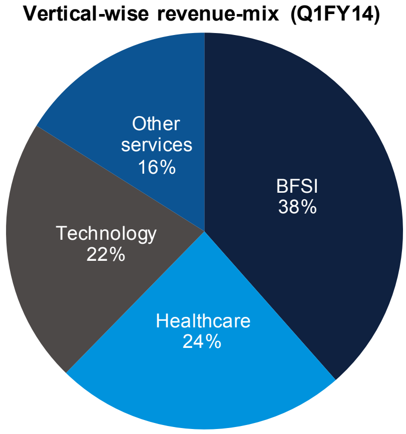
(₹ mn)	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14
Net Sales	**1,388**	**1532**	**1,685**	**1,925**	**1,998**
Change (q-o-q)	10%	10%	10%	14%	4%
EBITDA	**301**	**335**	**368**	**416**	**448**
Change (q-o-q)	9%	11%	10%	13%	8%
EBITDA margin	21.7%	21.8%	21.8%	21.6%	22.4%
PAT	105	117	130	155	159
Adj PAT	**105**	**117**	**130**	**155**	**159**
Change (q-o-q)	13%	11%	12%	19%	3%
Adj PAT margin	**7.6%**	**7.6%**	**7.7%**	**8.0%**	**8.0%**
Adj EPS	**4.4**	**4.6**	**4.9**	**5.9**	**6.0**

September ending financials

Source: Company, CRISIL Research

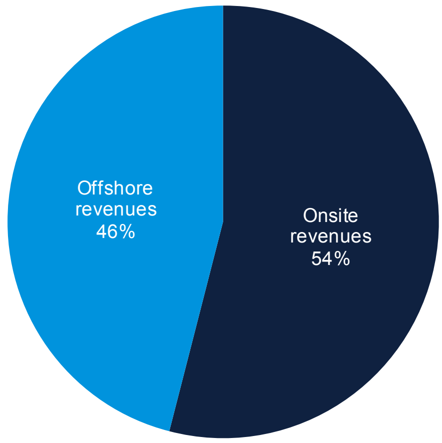
Focus Charts

BFSI vertical dominates revenues



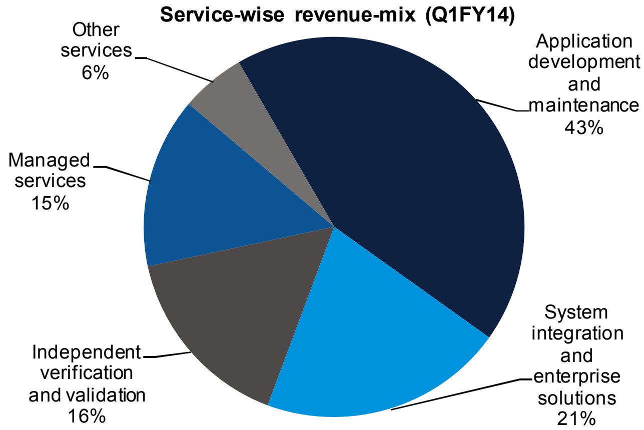
Source: Company, CRISIL Research

54% of its revenues are onsite



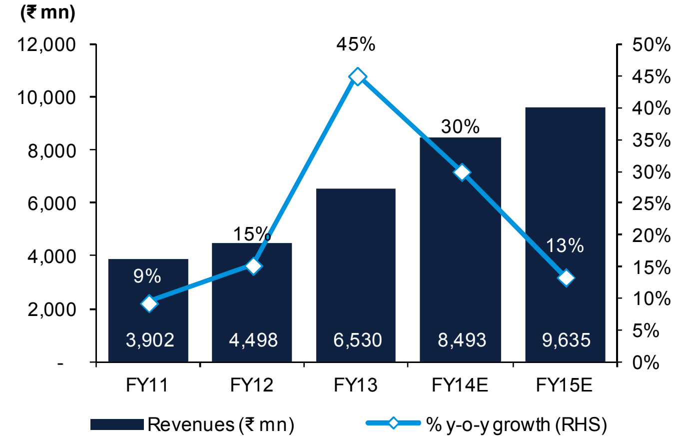
Source: Company, CRISIL Research

Service mix



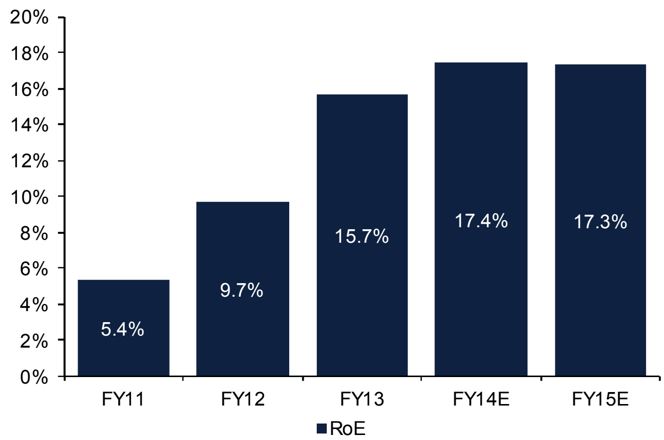
Source: Company, CRISIL Research

Revenue growth in rupee terms



Source: Company, CRISIL Research

RoE to improve due to better asset utilisation



Source: Company, CRISIL Research

Share price movement

-Indexed to 100

Source: Company, CRISIL Research

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