

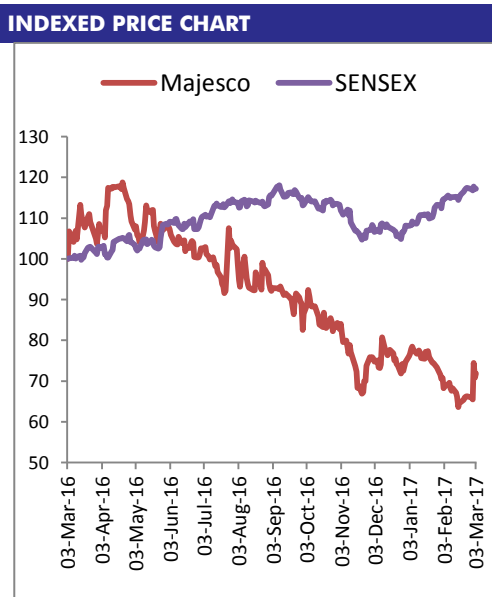


Majesco Ltd. Initiating Coverage

MARKET DATA - Majesco	
Networth (₹Cr)	287
P/BV Ratio (FY16) (x)	2.9x
EPS (FY16) (₹)	3.0
Market Price (₹)	353
P/E Ratio (FY16) (x)	118x
52 Week High (21/04/2016)	649
52 Week Low (15/02/2017)	331
Market Capitalisation (₹Cr)	826

1 MONTH AVERAGE DAILY VOLUME ('000)	
BSE	20
NSE	91

SHARE HOLDING PATTERN (DEC-16) (%)		
Promoters	FII, DII	Others
48.43	13.49	38.08



Return	3M	6M	12M
Majesco	-15%	-27%	-31%
Sensex	5%	4%	17%

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Majesco was spun off from Mastek one of India's mid-tier IT companies in FY15. With increased management focus the Company has been able to build on its niche focus on the insurance sector. The Company offers a wide portfolio of IT products and services catering to the Property & Casualty (P&C) and Life, Annuities & Pensions (L&A) verticals of the insurance industry. The Company's core product offerings help clients across three critical functions of Policy, Claims and Billing.

What we like about the business:-

- Huge target addressable market of ~\$175 bn in Industry IT spends of which only ~15% is serviced by third party vendors as of today
- Extremely sticky business which huge switching costs for the customer
- Long term revenue visibility (5+ years) for the recurring stream of revenues (~26% of current revenues)
- Non-linear margin profile allowing for significant EBITDA margin expansion
- Early mover advantage in Cloud with product quality being ratified by IBM Watson which could generate the optionality of big ticket contracts

Key concerns:-

- Fast consolidating industry with a large competitor being owned & managed by a Private Equity firm
 - Would reduce the potential to carry out value accretive acquisitions
 - Might create adverse competitive pressure with aggressive pricing on future contracts which could derail growth trajectory
- Industry leader might out-innovate with R&D spends being ~600% higher
- Dual listing structure with the Indian listed business being a holding company having a ~70% stake in Majesco USA which hosts the businesses
- Revenue growth in the immediate future might slow down as cloud revenues which are growing faster have back-ended revenue streams
- Consolidation in the US Insurance Industry could cause companies to rationalize IT vendors which could cause to company to lose key clients

Valuations:-

We value the business using a SOTP method. We value the recurring revenues (~26%) and contractual revenues (76%) separately given their significantly different EBITDA trajectories, visibility and stickiness.

- We value the recurring stream of revenues at ~4.5x LTM EV/Sales capturing a ~50% discount to industry leader Guide-wire (NYSE:GWRE)
 - Implies a valuation of ~₹307 per share after adjusting for Minority Interest
- We value the contractual revenues in line with other mid-tier IT companies at ~1.0x EV/Sales
 - Implies a valuation of ~₹194 per share after adjusting for Minority Interest
- We also apply a holding company discount of 20% to account for the complex cross border holding structure with separate listed entities
- Cash on balance sheet is valued without discounts at ~₹50 per share

We thus value Majesco Ltd. at ₹451 per share as of today implying a 28% upside from CMP.

Significant upside risks to our target price:-

Revenue growth is sporadic where the addition of a few large clients either organically or via the IBM Watson tie-up could significantly increase revenues and thus target valuations.

The shift to cloud contracts would increase the proportion of recurring revenues within the company's revenue mix. The management aims to garner significantly higher revenues from recurring streams over the next 3 years. This shift would create a significant upside in profitability and valuations.



About The Business

Brief background:-

Mastek Ltd. is a mid-tier IT company which had a large product vertical catering to the Insurance business. Given the significantly different growth, margin and investment profile of the vertical, it was demerged as Majesco Ltd. in FY15. The Company has thereafter grown well in a niche vertical to become one of the top-three companies in Insurance technology.

How the business has scaled over the years

Majesco currently services ~164 clients across tier-1, mid-tier and new insurance companies. The same is an impressive ramp-up from ~3 clients in 2005.

The company currently services 7 of the top 25 P&C Insurance companies, making its client list an extremely attractive asset. The company however still has room to grow both by selling additional products to existing clients as well as tapping new clients as the US market is home to over ~2000 insurance companies as a result of complex state and anti-monopoly laws.

Company Timeline:-

Milestone	2005	2007	2008	2013	2015	2016
Client Count	3 Customers	10 Customers	35 Customers	80 Customers	140 Customers	165 Customers
Key Developments	Development of Distribution Management Solution	Acquired Vector Insurance, to expand presence in the L&A Industry	Acquired STG international, to expand presence in the P&C Industry	Refreshed Core L&A, P&C Solutions. Built Cloud Capabilities	Acquired Agile Technologies Demerged into separate listed entity "Majesco" Merged with Cover-All Technologies	Signed a Non-Exclusive 5 year partnership with IBM Watson to offer Majesco's Platform to IBM on the cloud

Source:- Company Filings

The company has significantly scaled using a judicious mix of organic and in-organic growth and appears to have reached a critical scale of operations.

IBM Watson Alliance:-

IBM announced a 5 year Non-Exclusive tie-up, to jointly offer a new cognitive, cloud-based platform to help insurance carriers worldwide create new services on IBM Cloud. This is the first such tie-up in the insurance vertical for a platform. This would provide IBM with a core platform to sell their analytics and cognitive abilities. IBM choosing Majesco's platform over those of larger competitors does help ratify product quality and could trigger higher acceptance in the industry.



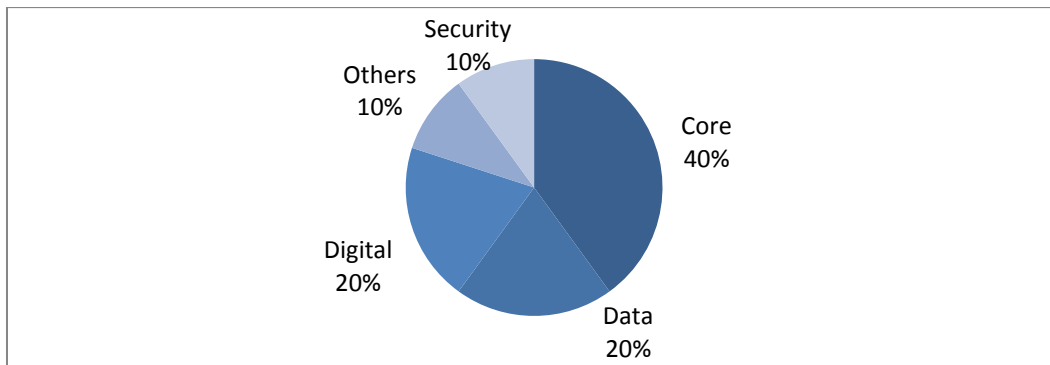
Insurance Tech Industry and Target Addressable Market

Insurance Technology Industry Overview:-

The US insurance industry currently spends ~3-4% of their gross under-written premiums on annual IT spends. In 2016 the US Insurance industry under-wrote ~\$4,800 Bn of premiums and spent ~\$175 Bn on technology.

Of the above technology spend ~\$75 Bn was spent by P&C companies (~44%), while ~\$100bn was spent by L&A companies. Only ~15% (\$26 Bn) of the above spend is serviced by third party software providers as ~75% of insurance companies continue to maintain large internal teams and operate on legacy software.

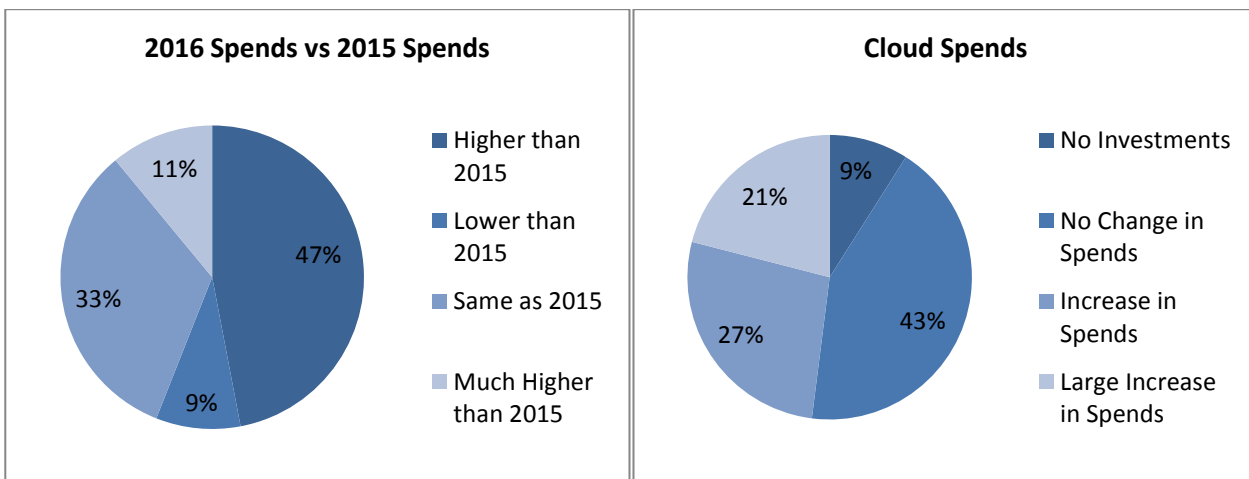
Industry IT spends by Offering



Source:- Company, DSPL Research.

As of today Majesco largely operates in the Core Offerings category namely Claims, Billing and Policy Admin. This category of offerings account for ~40% of industry third party IT spends or \$10.4 Bn. Majesco has recently diversified into data offerings which is a fast growing stream of IT spends by insurance companies and is expected to account for 40% of the growth in IT spends going forward. These new data offerings grow the Company’s target addressable market for products by ~50% to ~\$ 17 Bn. The Target addressable market for services stands at ~50% of the products business taking the total Target addressable market to ~\$25bn.

Insurer IT Budget Changes:-



Source:- Investor Presentation, DSPL Research.

The above was the result of a CTO survey conducted by a global tech research agency. Over 58% CTO’s suggested a growth in IT spends while just 9% CTO’s suggested a de-growth in IT spends. The numbers were even more stark for Cloud Spends with ~21% CTO’s suggesting large increases in Cloud spends as compared to just ~11% CTO’s suggesting large increases in overall tech spends

**Comparison with Industry Leader:-**

Guide-wire (NYSE:- GWRE), is a leader in the Insurance technology industry and is viewed as the gold-standard of the industry. Below is a brief comparison between Majesco USA, and Guidewire on key metrics:-

Metric	Guidewire	Majesco USA
Market Cap (\$ Mn)	4,370	190
TTM Revenues (\$ Mn)	450	126
Y-o-Y Revenue Growth %	18.4%	9.4%
TTM Gross Profit (\$ Mn)	285	59
Gross Profit Margin (%)	63.3%	46.8%
TTM SG&A Expenses (\$ Mn)	155	42
SG&A as a % of Sales	34.4%	33.3%
TTM R&D Expenses (\$ Mn)	122	18
R&D as a % of Sales	27.1%	14.3%
Valuation M Cap/ Sales	9.7x	1.5x

Source:- Quarterly Filings, DSPL Research.

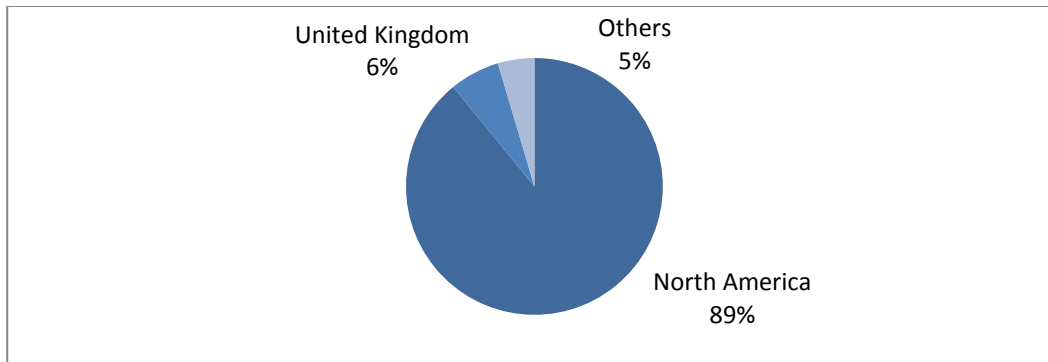
Key Observations:-

- Guidewire revenues are only comparable to the ~26% recurring revenues of Majesco as the company delegates system integration to third party companies unlike Majesco which prefers to do the same in-house and books the same as contractual revenues.
 - This significantly lowers gross margins which are otherwise comparable on the recurring revenue stream
- Product:- Product quality tends to be highly subjective, though Guide-wire does enjoy a top of mind recall due to a stronger client list and execution track-record.
- Pricing:- Pricing of product licences and maintenance is similar for both companies and contracts are not won on price.
 - Implementation however is ~10-20% cheaper for Majesco products as a significant chunk of the same is offshored to India
- SG&A:- Majesco is heavily investing in its sales teams and have hired client partners who each manage 3-5 clients and become in-house consultants for clients.
 - Client partners however help in maintaining client relationships and driving cross-selling opportunities
 - SG&A should moderate as the business scales, however the exact extent of contraction as a % of sales is dynamic and cannot be extrapolated
- R&D:- Majesco enjoys significant wage cost arbitrage in its R&D activities.
 - The company employs ~400 people in product development of which over ~90% are based out of India



The Company in Graphs (as of Q3 FY17):-

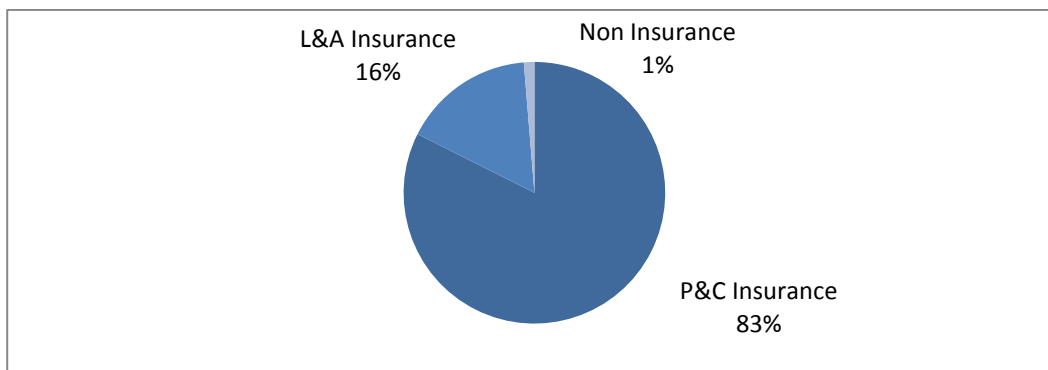
Revenue Mix by Geography-



Source:- Quarterly Filings, DSPL Research.

The company is predominantly focussed on the North American market with the same forming ~89% of revenues. The company expects to maintain a similar geographical revenue mix going ahead

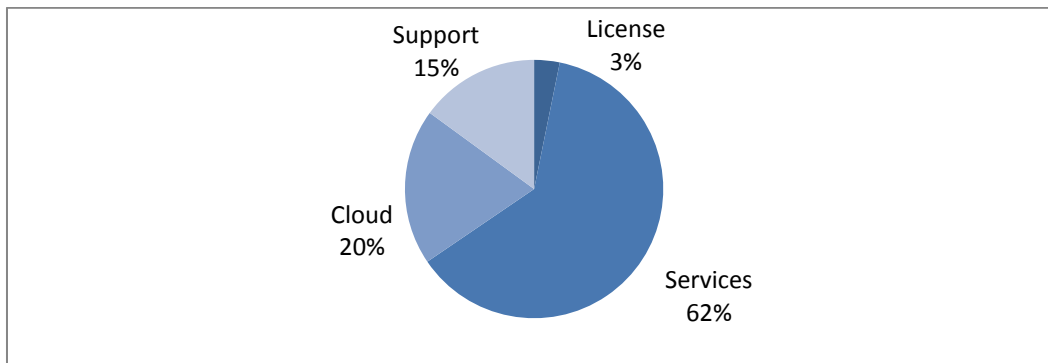
Revenue Mix by Line of Business:-



Source:- Quarterly Filings, DSPL Research.

The management would continue to focus on its core insurance businesses with increased focus on the Life & Annuity (L&A) Vertical. The L&A vertical accounts for ~56% of global gross underwritten premiums showing significant opportunities to scale.

Revenue Mix by Offerings:-

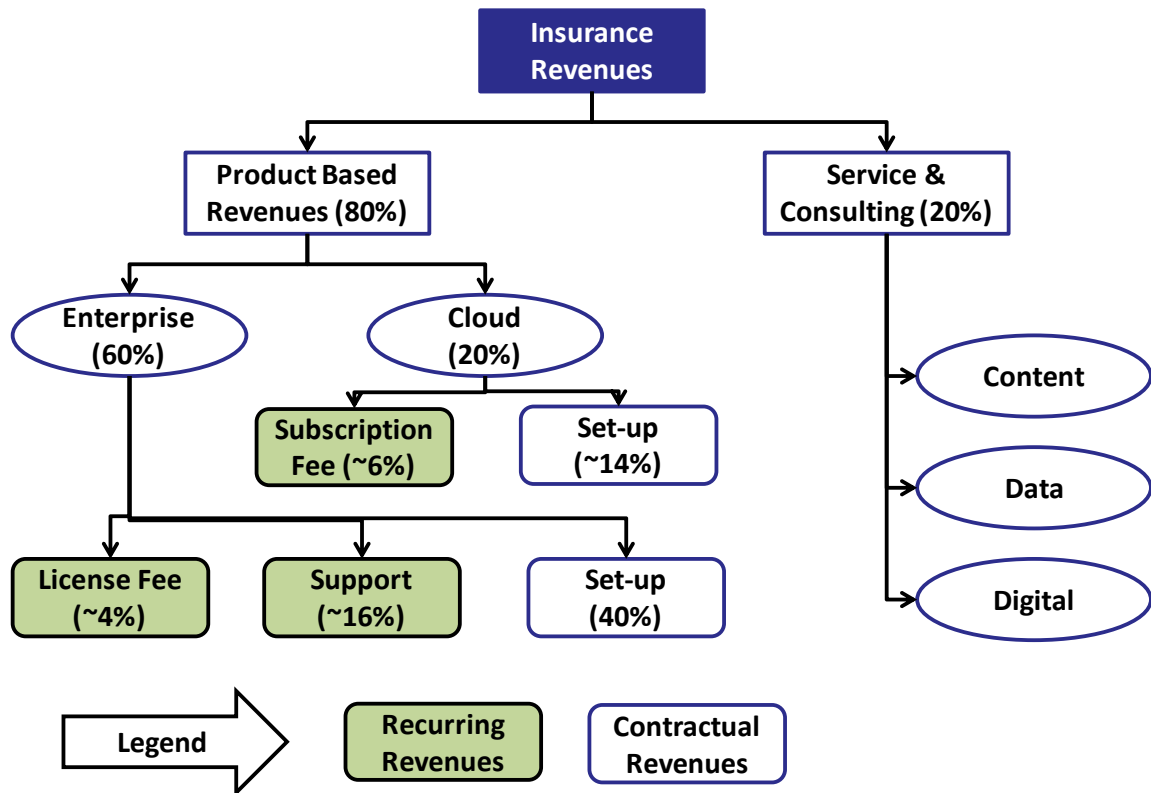


Source:- Quarterly Filings, DSPL Research.

The management is focussed on increasing revenues from recurring stream of revenues. This would imply a significant increase from cloud based revenues going ahead



Revenue Tree:



Source: - Company, DSPL Research

Recurring Revenues:-

The company currently derives ~26% of its revenues from recurring streams. These revenues are extremely sticky and have long term visibility. These revenues also carry negligible cost of human capital/ incremental investments and thus come with significantly higher gross contribution margins.

Contractual Revenues:-

The Company derives contractual revenues from both the set-up of products as well as service contracts. The set-up contracts have significantly lower revenue visibility of ~2 years for new clients and do not grow organically. Service and consulting revenues however have slightly higher visibility and are cross-sold to existing product customers.

Cloud Revenues:-

The cloud products would be a significant driver of revenue growth going ahead. While this shift in revenue mix would significantly reduce up-front set-up fees, it would greatly increase customer life time value.

The above phenomenon of cloud revenues reaching a critical mass in the overall revenue mix would generate near term revenue head-winds however would be distinctly positive for the company in the medium to long term.

3-5 Year Management Goals:-

- As the business matures, the management aims to garner a significantly higher proportion of revenues from recurring revenue streams
- The management also expects a majority of incremental growth to come from cloud based product revenues



Key Client Overview:-

The company has a robust and growing client base which creates huge opportunities to cross-sell products thereby driving organic growth. The client list is greatly valuable to any strategic acquirer of the company and is by-far the company’s most valuable asset. The company’s client list accounts for ~35% of North America’s industry premium in the P&C segment.

Client List Snapshot:-



Source: - Company Presentation

Client Profiling:-

Tier	Direct Written Premium	FY14 Client Count	Current Client Count	% Growth
1	> \$ 5 Bn	9	20	122%
2	\$ 1 Bn to \$ 5 Bn	21	27	29%
3	\$ 100 Mn to \$ 1 Bn	24	49	104%
Start-ups	< \$ 100 Mn	23	69	200%

Source: - Company Presentation

The company’s client additions have been broad-based, with the company adding clients across the Industry spectrum

Client Concentration:-

The company’s revenue streams are quite concentrated as expected in any mid-sized IT company with 2 clients each contributing over 5% of revenues each. The top 5 Clients account for ~28% of revenues with the top 10 clients accounting for ~42% of revenues.

Cloud Clients:-

The company has ~30 clients who use the cloud products. Additions to the same would be a key driver of growth going forward.

Cross Selling Potential:-

Of the company’s 94 P&C clients as of FY16 the management has identified huge cross-selling potential which if fully converted could generate annual revenues of ~\$ 300 Mn in the medium term.



Valuations:-

We value the business using a SOTP method. We value the recurring revenues (~26%) and contractual revenues (76%) separately given their significantly different EBITDA trajectories, visibility and stickiness.

Recurring Revenue Stream:-

- We value the recurring stream of revenues at ~4.5x LTM EV/Sales capturing a ~50% discount to industry leader Guide-wire (NYSE:GWRE)
 - Implies a valuation of ~₹307 per share after adjusting for Minority Interest

Contractual Revenue Stream:-

- We value the contractual revenues in line with other mid-tier IT companies at ~1.0x EV/Sales
 - Implies a valuation of ~₹194 per share after adjusting for Minority Interest

Holding Company Discount:-

- We apply a holding company discount of 20% to account for the complex cross border holding structure with separate listed entities

Cash and Cash Equivalents:-

- Cash on balance sheet is valued without discounts at ~₹50 per share

We thus value Majesco Ltd. at ₹451 per share as of today implying a 23% upside from CMP.

Future big ticket client additions/ shift in revenue mix toward recurring revenues:-

- Though the above optionalities of large client additions and an increasing share of recurring/cloud revenues would add significant value to the company going ahead, the same is extremely difficult to predict and thus not valued in our model thus forming a key up-side risk to our target price.

Key Risks:-

- Fast consolidating industry with a large competitor being owned & managed by a Private Equity firm
 - Would reduce the potential to carry out value accretive acquisitions (reduce growth premium)
 - Might create adverse competitive pressure with aggressive pricing on future contracts which could derail growth and margin trajectory
- Industry leader might out-innovate with R&D spends being ~600% higher, creating a risk of obsolescence
- Revenue growth in the immediate future might slow down as cloud revenues which are growing faster have back-ended revenue streams
 - Market might punish valuations viewing the same as a sign of a slowdown in business momentum
- High client concentration with top 10 clients forming ~42% of revenues. Any loss of large clients would significantly derail revenue growth and margin trajectory
- Consolidation in the US Insurance Industry could cause companies to rationalize IT vendors which could cause to company to lose key clients



Key Financials

Profit & Loss

(₹Cr.)	FY16	9M FY17
Net sales	757.2	636.7
Total expenses		
Traveling and conveyance	57.0	34.9
Employee costs	505.6	432.7
Other Manufacturing Cost	184.7	137.2
EBITDA	9.9	31.8
EBIDTA (%)	1.3%	5.0%
Depreciation	17.9	19.1
EBIT	-7.9	12.8
Interest	4.3	4.7
Other income	9.1	7.1
Exceptional Items	-4.6	0.0
PBT	-7.7	15.2
Less: Taxation	-15.0	-0.6
Effective tax rate (%)	194.6%	-3.7%
PAT	7.3	15.8
PAT (%)	1.0%	2.5%
PAT after Minority	6.9	11.7

Key Ratios

Particulars	FY16	9M FY17
Reported EPS (₹)	3.0	4.8
Book value (₹)	119.1	124.1
Debt Equity Ratio	0.3	0.2
Payable Days	5	10
Debtor Days	73	64
Inventory Days	0	0
ROCE (%)	(1.9)	NA
Recurring ROE (%)	5.3	5.6
ROA (%)	2.3	2.3
Valuation Ratios		
Market cap/sales (x)	1.7	1.4
EV/sales (x)	1.7	1.2

Balance Sheet

(₹Cr.)	FY16	H1 FY17
Equity capital	12	12
Reserves	264	272
Net worth	276	283
Total borrowings	46	67
Minority Interest	72	74
Non-Current Liabilities	52	55
Current Liabilities	228	209
Total liabilities	674	688
Net block	67	65
Goodwill	192	194
Others	13	54
Current assets		
Debtors	152	112
Cash	115	158
Other Current assets	134	105
Total assets	674	688

Cash Flow

(₹Cr.)	FY16
Net profit	(3)
Depreciation	18
Others	(4)
Change in working cap	(25)
Op. Cash flow	(14)
Capex (Net)	(41)
Investments	(76)
Inv. Cash flow	(118)
Dividend	0
Fresh Equity	3
Debt	62
Others	(7)
Fin. Cash flow	58
Net change in cash	(74.9)
Opening cash	0.0
Closing cash	37.8



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