14 December 2020

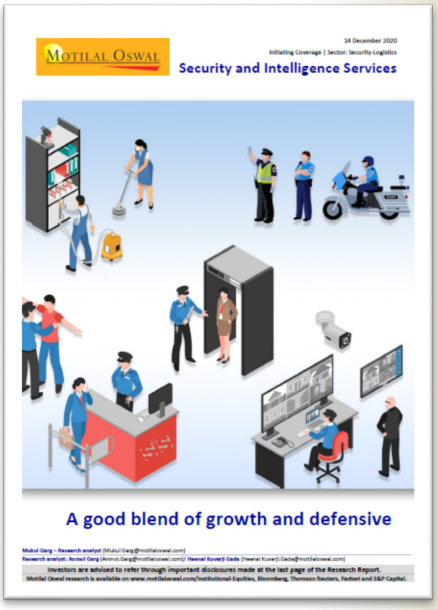
Initiating Coverage | Sector: Security-Logistics

Security and Intelligence Services

A good blend of growth and defensive

Mukul Garg – Research analyst (Mukul Garg@motilaloswal.com)

Research analyst: Anmol Garg (Anmol.Garg@motilaloswal.com)/ **Heenal Kuvarji Gada** (Heenal.Gada@motilaloswal.com)



Security and Intelligence Services

A good blend of growth and defensive

Security and Intelligence Services

CMP: INR440 TP: INR600 (+36%) Buy

A good blend of growth and defensive

India growth fueled by stability in Australia

- **Security and Intelligence Services (SECIS) is among the largest business services providers in India, with leadership across Security Services, Facilities Management, and Cash Logistics. It is also a leading security vendor in the stable markets of Australia, New Zealand and Singapore, which complement its fast-growing India business.**
- **SECIS' core businesses offer both high growth – due to low formalization and high fragmentation – and resilience to macro cycles on account of their essential nature. This makes SECIS a unique combination with dual characteristics of defensive and growth businesses, which we see as its key differentiator.**
- **Additionally, we see limited risk from competition owing to its unmatched pan-India presence, strong infrastructure, and diversified business mix.**
- **SECIS' 25% revenue CAGR over FY17–20 has been a function of (i) 30% growth in the India Security business, (ii) 16% growth in the International business, and (iii) 48% growth in FMS.**
- **We expect a 14%/18%/28% CAGR in revenue/EBITDA/PAT over FY21–23, driven by a) an increase in formalization, b) the further opening up of the economy, c) market consolidation, and d) SECIS' strong execution.**
- **Given the multi-dimensional opportunity, we initiate coverage on SECIS with a Buy rating, valuing it at INR600 per share (36% upside), derived by assigning the International business an 8x forward EV/EBITDA multiple (in line with global peers) and DCF on the India business.**

Tallest on leadership board

- In the India Security business, SECIS is the largest and fastest growing security services provider. The company also enjoys leadership in Australia with 21% market share. It is among the top two players in India in both Facilities Management and Cash Logistics.
- An aggressive buildout in these markets, partnerships with leading global players, and the acquisition of quality targets have enabled the company to achieve a dominant position.

Aided by acquisitions and partnerships

- The company started off in Security Services more than 30 years ago. However, it gained scale only a decade ago post the acquisition of Chubb (Australia), which was >6x the size of SECIS. Simultaneously, it established its Facilities Management and Cash Logistics businesses.
- It has struck several partnerships to strengthen its positioning and offerings in the market: (i) Prosegur – alarm monitoring and cash management, (ii) ServiceMaster – commercial and residential cleaning services, and (iii) Terminix – pest control. All of these partners are global leaders in the segments in which they operate.

BSE Sensex	S&P CNX
46,099	13,514

Security and Intelligence Services (India) Limited

A Market Leader in Security

Stock Info

Bloomberg	SECIS IN
Equity Shares (m)	147
M.Cap.(INRb)/(USDb)	64.6 / 0.9
52-Week Range (INR)	624 / 314
1, 6, 12 Rel. Per (%)	12/-18/-17
12M Avg Val (INR M)	43
Free float (%)	26.3

Financial Snapshot (INR b)

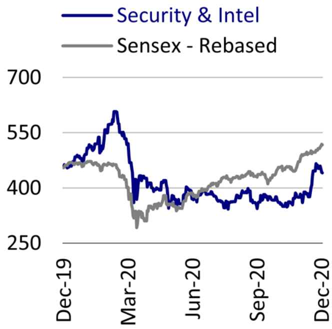
Y/E MARCH	FY21E	FY22E	FY23E
Sales	88.5	100.4	114.9
EBITDA	5.2	6.2	7.3
NP	2.3	3.0	3.9
EPS (Rs)	15.5	20.2	25.7
EPS . (%)	-4.3	30.5	27.4
BV/Sh (INR)	237.3	281.5	337.9
Valuations			
P/E (x)	28.9	22.1	17.4
P/BV (x)	1.9	1.6	1.3
RoE (%)	15.5	17.1	18.2
RoCE (%)	12.1	13.2	14.1

Shareholding pattern (%)

As On	Sep-20	Jun-20	Sep-19
Promoter	73.7	74.3	74.3
DII	6.7	6.9	6.5
FII	12.5	11.6	10.8
Others	7.1	7.1	8.3

FII Includes depository receipts

Stock Performance (1-year)



A tale of two markets

- Australia business (~40% of overall revenues) has historically grown at 1.5x GDP on account of increasing market share. Leadership in a developed and steady-state geography in a recession-proof business should continue yielding a mid-single-digit growth rate and steady cash for the foreseeable future.
- India business is a play on under-penetration and formalization. We expect this market to sustain >15% growth over medium to long term, with established and well capitalized players like SECIS growing at faster pace.

Strong moats to maintain the momentum

- SECIS' scale of operations should help it maintain its advantage over smaller peers. A pan-India presence, strong training network, and compliant practices provide it significant competitive advantage.
- It could potentially utilize its well established pan-India presence for sourcing/ fulfillment of new contracts across service verticals.

Robust growth expectations

- Assuming the impact of the pandemic eases, the confluence of the International and India businesses should result in 14% organic growth over FY21–23.
- Margin expansion for SECIS would be driven by operating leverage in the business. Based on this, we expect a cumulative 50bp expansion over FY21–23, leading to an EBITDA CAGR of 18%.
- Like other business services companies, SECIS is a large employer – with more than 150k people on its payroll in India at an average salary of INR19k per month – making it the beneficiary of Section 80JJAA of the Income Tax Act. This would further boost profit growth – we expect a 28% PAT CAGR.

DSOs increasing, along with OCF growth

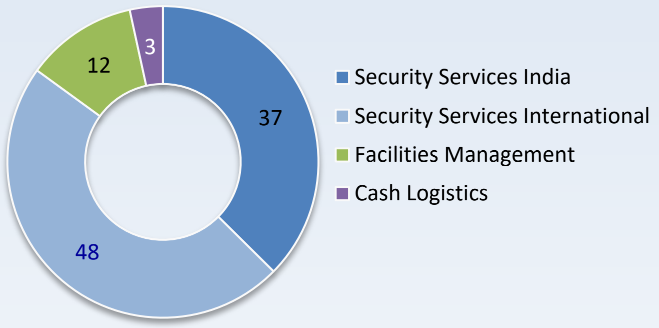
- SECIS' cash conversion days have continuously risen (54 days in FY20) due to faster growth in the India business, which has higher receivable days.
- Despite this, SECIS has been able to grow its OCF at a 29% CAGR over FY17–20. While conversion ratios (OCF/EBITDA at 39% for FY20) are still low, we remain confident on the company's ability to deliver high growth in OCF.
- We expect ROE/ROCE to improve from FY21 as the company reduces debt and improves its operating performance.

Valuation and view – stability from international, growth from India

- We value SECIS at INR600 per share using Sum of The Parts, with EV of INR625 using 1) DCF for India Security business (INR329), 2) EV/EBITDA multiple of 8x (INR166) on the International Security business (in line with global peers), and 3) DCF for Facilities Management business (INR130). Adjusting for net debt per share of INR25 gives us our Target Price of INR600/share.
- Our target value of INR600 per share implies a target P/E multiple of 30x/23x for FY22/FY23. We view this as reasonable given its strong growth profile and unique resilience to macroeconomic shocks.
- **Key risks:** These include a) integration of current/future acquired entities going wrong, b) an increase in employee attrition and difficulty in talent management, and c) AUD's depreciation against the INR.

STORY IN CHARTS

Exhibit 1: Business services company, majorly generating revenue from Security Services (%)

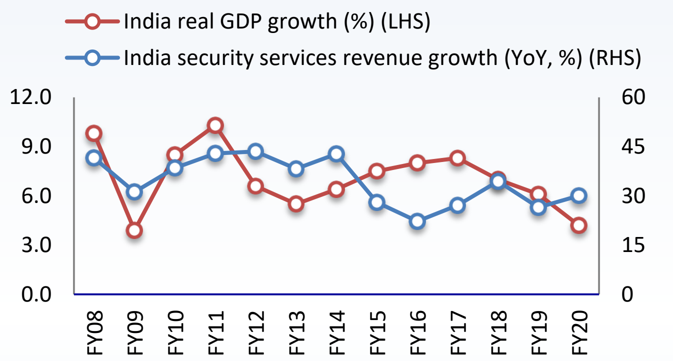


Source: MOFSL, Company

Exhibit 2: Leading market position in most of the business segments

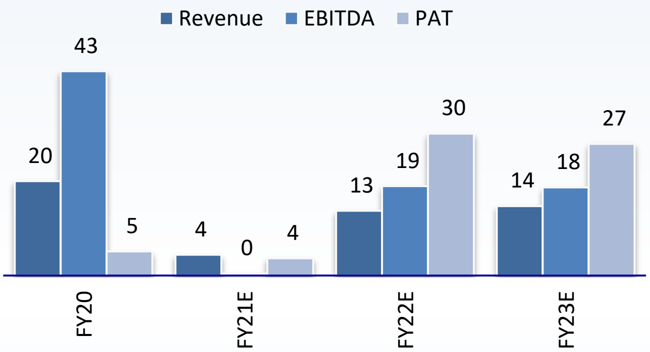
Source: Company

Exhibit 3: High growth, independent of economic cycles



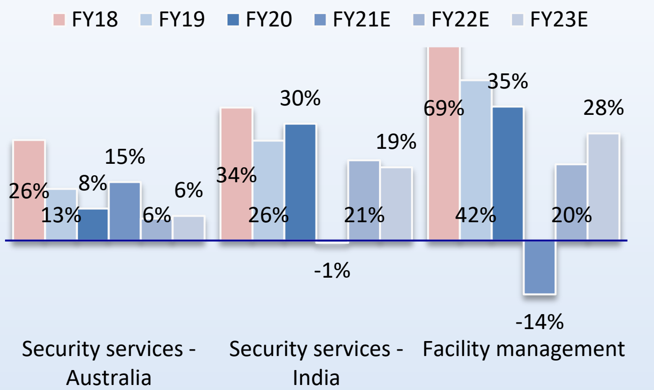
Source: Company

Exhibit 4: Margin expansion and tax benefit to aid growth in PAT



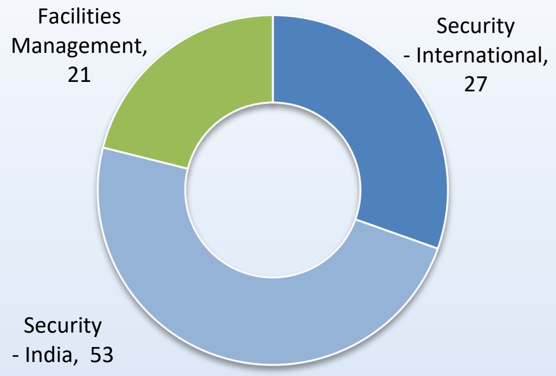
Source: Company

Exhibit 5: India business to dominate growth



Source: Company

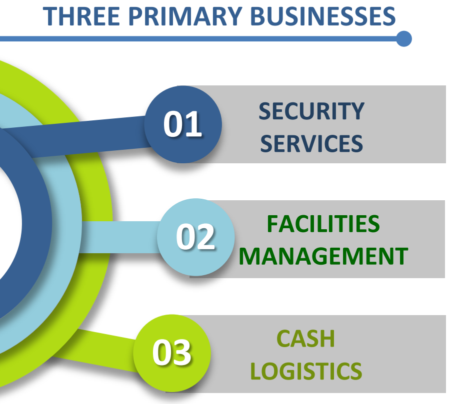
Exhibit 6: Valuing the company by SOTP; TP – INR600



Source: MOFSL, Company

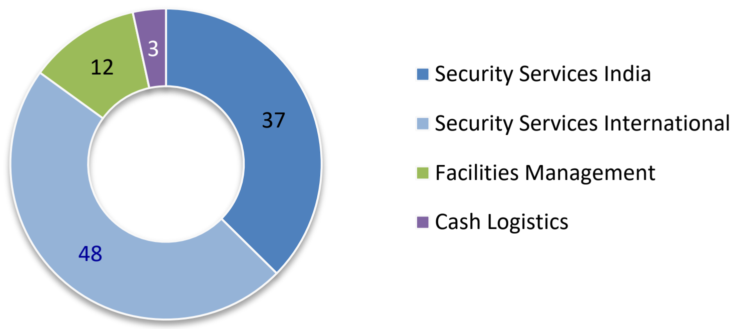
Security and Intelligence Services

Basics at a glance



The SIS Group has three primary businesses – Security Services, Facilities Management, and Cash Logistics. It is among the leading and fastest growing players in all of the markets in which it has a presence – making it a multi-dimensional, high-growth opportunity.

Exhibit 7: Business mix for SECIS (% of total revenue as of 2QFY21)



Source: Company

With recent acquisitions, SECIS has also entered the Singapore and New Zealand markets, where it is now the third largest security company

Security Services

The SIS Group is a leading provider of security services in both India and Australia, with diverse solutions across the security spectrum. Its portfolio of services includes security design and solutions, fire safety, event security, VIP protection, aviation security, emergency response, investigation work, and integrated technology solutions (man-tech solutions).

Facilities Management

SECIS' facilities management services are designed and delivered according to the customer's need. They are spread across the housekeeping services, janitorial support, HVAC repairs, and pest control domains. It has shown significant growth over the past few years to emerge as the second largest player in this space, with a nationwide presence. Clients are diverse, ranging from households, businesses, to industrial establishments.

Cash Logistics

In the Cash Logistics business, the company has capabilities spanning cash-in-transit, doorstep banking, ATM-related services, and bullion and cash vaulting services. It is the second largest and fastest growing cash logistics company in India.

Exhibit 8: Leading player in all markets in which it has a presence (rank by size)

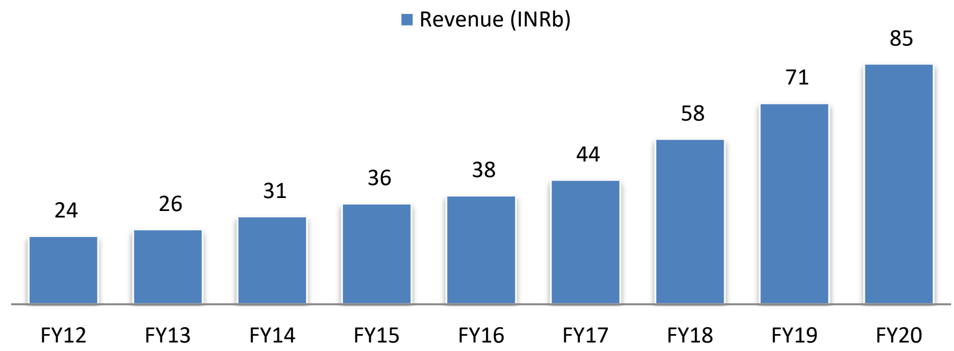
Source: Company

SECIS started off as a security services provider in 1985 and had expanded to over a 1,000 employees by 1991. Furthermore, it achieved two other key milestones – generated INR250m revenue in 2002 and achieved employee strength of 10,000 in 2005 – in the business.

The next stage of expansion was its foray into the Cash Logistics business in 2006, followed by its acquisition of Australia's largest security company in 2008. With these acquisitions, it surpassed INR10b revenue in 2009 and entered the Facilities Management space in the same year.

Thereafter, it was involved in various acquisitions, joint ventures, and partnerships, which further fueled growth. The notable ones include – 1) JV with Prosegur, Spain for the Cash Services business, 2) JV with TERMINIX for the Pest Control biz, and 3) Master Franchise Agreement with ServiceMaster, and 4) the acquisitions of DTSS, Uniq, SCP, SLV Securities, Rare Hospitality, Henderson Security Services, and P4 Group.

Exhibit 9: Revenue CAGR of 17% clocked over FY12-20



Source: Company, MOFSL

Security Services – a tale of two markets

Services are crucial, sticky, and recession-proof

We are encouraged by certain defining characteristics of the Security market that are uniform across geographies, more associated with the model rather than with specific markets.

1. Higher up the value chain

Security services are in the nature of managed services, wherein the outcome (safety and security) is highly critical. Although the market is sensitive to price, this would not be the only determinant in the choice of vendor. Quality of service is becoming increasingly important for many customers.

2. Sticky and predictable

SECIS has demonstrated revenue retention of more than 90% consistently over the last decade

The Security business is one where providers are not changed often, unless there is an operational issue or a breach. Given that this is a business associated with a sense of value and responsibility, such events are a rare occurrence. The business, hence, creates long-term relationships.

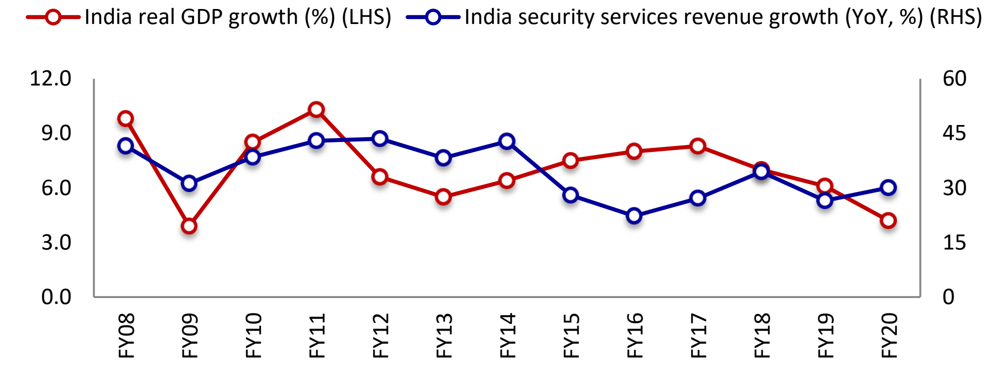
Moreover, revenue from security services is predictable and has a high degree of visibility. Unlike flexi-staffing services, where demand is based on several macro and micro factors that may result in year-to-year deviations, security headcount, once placed, can be assumed to generate annuity revenue.

3. What recession?

Even in 1HFY21, growth in the India Security business remained positive (1% YoY), while GDP declined ~15.5%

Despite variation in customers' operating performance, security would be one of the last places one would think of cutting costs. Viewed more as a necessity than an option, the business is recession-proof and has come out unharmed through various economic cycles. A good demonstration of this is the sustenance of high revenue growth by SECIS through the periods of FY09 and FY12–14.

Exhibit 10: 20–40% growth maintained, independent of economic cycles



Source: Company, MOFSL

Security Services in India

India growth at 2.5–3x GDP, a potential multiplier

The SIS Group is a leading provider of security services in both India and Australia. The two markets, however, are starkly different – India is developing, while Australia is developed. India, being largely under-penetrated and unorganized, presents huge growth opportunity for many more years to come, while Australia helps in stabilizing revenues.

The difference in the maturity of the two markets is quite glaring, as visible from the following:

- **Citizen-to-police ratio:** 726 in India v/s 450 globally
- **Share of organized market:** 5% market share of the industry leader in India v/s 15–20% market share in Australia
- **Per capita security spend:** INR597 in India v/s >INR3,000 for other developing nations

Historically, the Security Services market in India has grown at 2.5–3x GDP growth. Revenue for the Security business is a function of **volume and realization**.
The factors that would continue to fuel higher volume comprise:

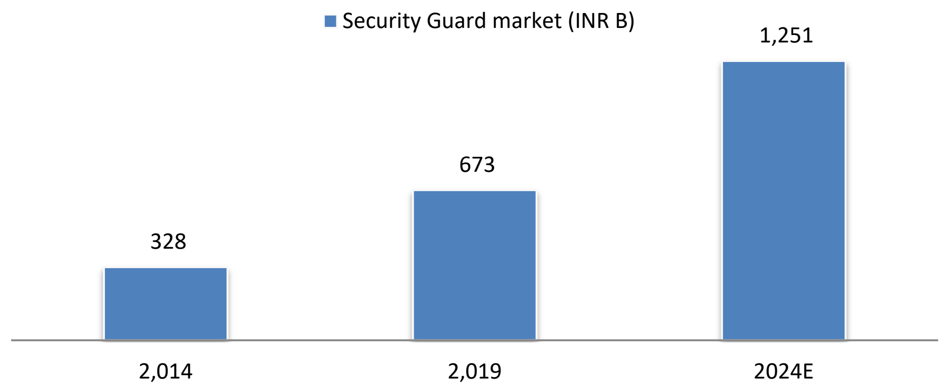
1. Low citizen-to-police ratio
2. Lower per capita security spend
3. Formalization of the sector

Factors that would continue to fuel higher realization constitute:

1. Wage inflation
2. Increase in price realization, driven by value

Together, these drivers of both volume and realization would ensure >13% growth in the industry for some years. Moreover, a shift from the unorganized market to organized counterparts would fuel further growth for organized players.

Exhibit 11: 13% CAGR expected in India Security services industry over FY19-24E



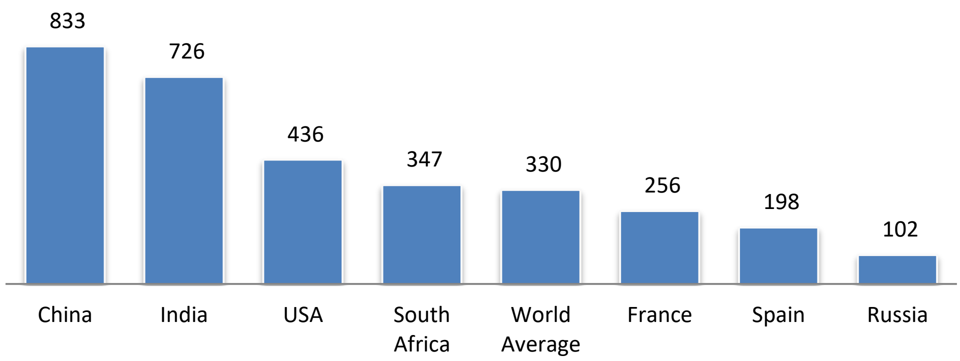
Source: Frost & Sullivan

Volume drivers

1. Low citizen-to-police ratio

India has one of the lowest police-to-population ratios; the growing concern over security has created an opportunity for private security services to supplement the efforts of government forces. India has a ratio of 1 policeman for every 726 people. The ratio is far lower than the government-sanctioned ratio of 1 officer for every 547 Indians as well as the United Nations' recommended ratio of 1 police officer for every 450 people.

Exhibit 12: India has one of the worst citizen-to-policeman ratios globally (726 citizens per policeman)



Source: Company

2. Formalization of the sector

While the formalization of security services is well-entrenched in commercial establishments, there is potential for this to increase in the Retail and Residential sectors.

In the Commercial sector, the verticals of IT and ITES, industrial, offices, healthcare, and BFSI together constitute ~80% of the total business of organized companies. These have adopted global best practices in terms of security services, with high quality control for deployed guards. Organized industry participants cater to these segments chiefly on account of their clear emphasis on compliance.

However, both organized companies and unorganized companies participate in the Retail and Residential sectors. The unorganized sector tends to gain a competitive advantage owing to the cost-sensitiveness of the customer, location, and nature of services demanded.

Several factors work in favor of organized players:

- Compliance assurance
- Quality assurance
- National network
- Financial strength

However, reports suggest 80% of agencies hired by apartments and gated communities are not organized

The government has made it mandatory for any private security service provider to obtain a PSARA (Private Security Agency Regulation Act, 2005) license.

We see two key triggers for the formalization of the sector:

- **PSARA:** PSARA has brought all private security agencies under government control. The central government has drafted the law, and state governments are responsible for its implementation and enforcement. PSARA is a key driver favoring organized participants as agencies are mandated to undergo certain training to bring about a sense of professionalism in the market.
- **GST:** India has around 15,000 unorganized players that provide security services. In the service tax era, they charged clients on a per employee per month basis, but did not remit the service tax to the government. On the other hand, the organized players charged a service tax to the clients and remitted the amount to the government. This created a non-level playing field, with unorganized players benefiting over organized players.

Realization drivers

1. Wage inflation

SECIS' revenue consists of the salary payable to guards (pass-through) and the commission earned by it. This makes revenue growth a function of volume and realization. We believe wage inflation would provide a natural tailwind for revenue growth of 6–8%.

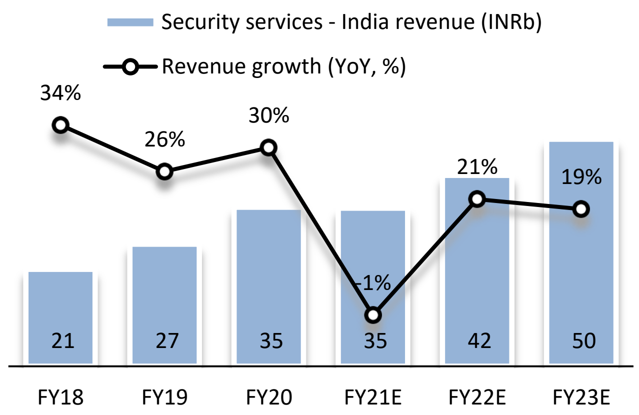
2. Value addition

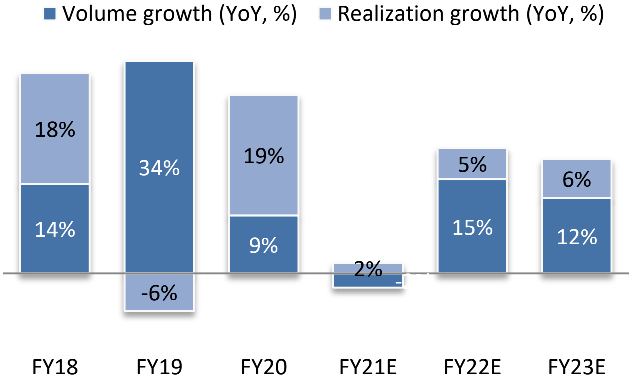
A change in the business mix toward the higher end and increased contribution from electronic security would lead to a further increase in realization. This would reflect in revenue and should also yield better profitability.

Expect 20% revenue CAGR in India Security business over FY21–23

Over FY21–23, we expect a revenue CAGR of 20% – a function of 14% volume CAGR and 6% realization CAGR.

Exhibit 13: Expect 20% revenue CAGR in India Security business

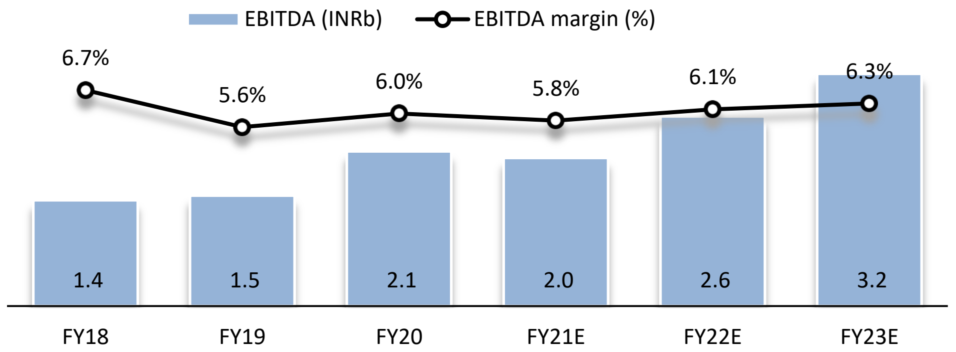




Source: Company

While staff salaries are a pass-through, margin expansion for SECIS would be driven by scale. Like other business service models, this industry too is characterized by a high degree of operating leverage. We expect it to drive cumulative margin expansion of 50bp over FY21–23.

Exhibit 14: Operating leverage would be a key driver of higher margins

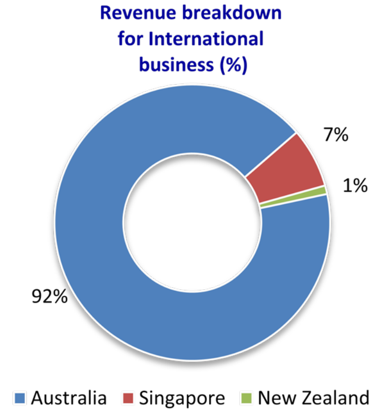


Source: Company

Security Services International

Market leadership in Australia, with >20% share

92% revenue within International business contributed by Australia



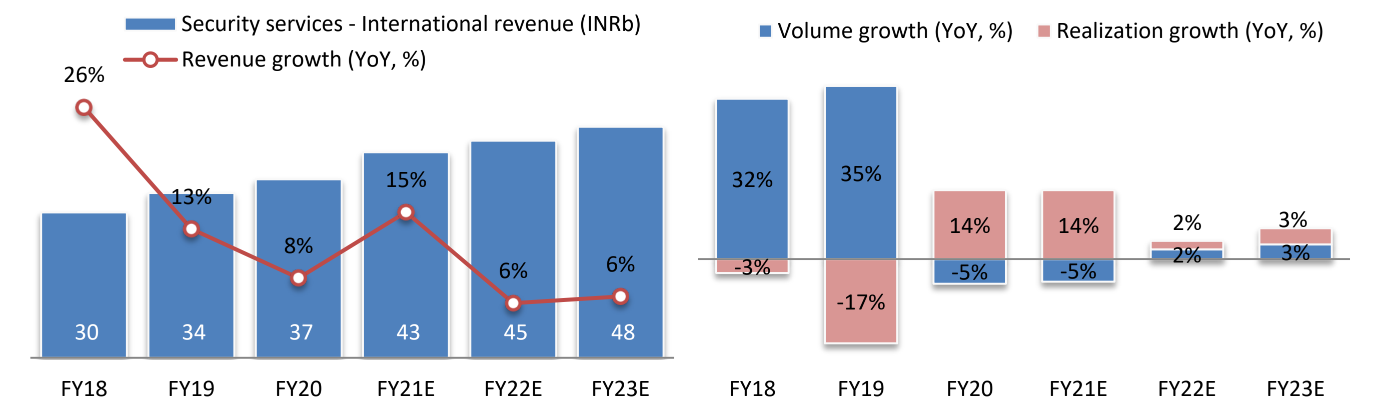
Source: MOFSL, Company

- While high growth is at the crux of the Security Services business in India, the Australian market is mature and developed. Hence, one cannot expect growth materially higher than that exhibited by the country's GDP.
- SECIS entered the Australian market through the acquisition of the country's largest security services company – MSS/Chubb – in 2008. It has since been operating under the MSS brand in Australia. In the past two years, the company has ventured into two new geographies (Singapore and New Zealand) by acquiring Triton Security Services (New Zealand) and 60% majority stake in Henderson Security Services (Singapore).
- Together, MSS and SXP have ~20% market share in Australia. SECIS leads the market in Australia and is among the top three security manpower companies in Singapore and New Zealand.

Expect 6% revenue CAGR in Australia Security business over FY21–23

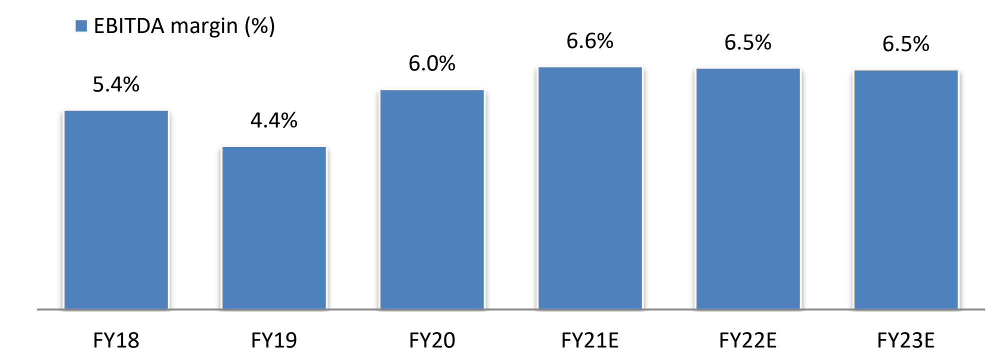
SECIS is the largest security services player in Australia, with share of 21%. It has more than 9,000 trained guards spanning ~280 clients across the country. Over FY21–23, we expect the business to see INR revenue CAGR of 6%.

Exhibit 15: Expect 6% INR revenue CAGR for SECIS International revenue



Source: Company

Exhibit 16: Expect moderate decrease in margins on expected reduction in temporary high-margin government business



Source: Company

Market leadership bodes well

Operational excellence aiding further growth

The SIS Group has a comprehensive range of services – from general guarding to specialized security roles. It has also forayed into electronic security, alarm monitoring, and response services for homes. In Australia, it offers services such as paramedic and allied health, mobile patrol, and fire rescue.

The Security Services businesses of SECIS have c150k employees in India and ~9k in the international markets

The India business was established in 1985 and grew organically initially. It entered the Australian market through the acquisition of Chubb Security in August 2008. It further beefed up its presence in Australia by increasing its stake in Southern Cross Protection (SXP) to 51% in July 2017. SECIS' Electronic Security business was commenced in 2010–11. It entered into a JV with affiliates of Prosegur Spain, a global player in alarm monitoring.

Exhibit 17: Security business at a glance

Segment	Brands	Year of commencement	Method of growth
Security Services – India	❖ SiS, SLV, Uniq, Tech SIS, V Protect	1985	❖ Organic and acquisitive
Security Services – International	❖ MSS, SXP, Henderson, P4 Group	2008	❖ Organic and acquisitive

Source: Company

SECIS is poised to grow in the Security business in both the markets on the back of its strong compliance, recruitment and training infrastructure, continued investments in systems and processes, and comprehensive business support services platform.

1. Strong compliance

The industry has been historically marked by low entry barriers with minimal regulatory oversight. However, there is now increased emphasis on compliance through specific acts such as PSARA and generic regulations such as provident fund / ESI / gratuity / bonus, among others. Greater enforcement of these regulations has empowered large players to penetrate deeper and carve growth away from unorganized, localized, or non-compliant players.

2. Recruitment and training infrastructure

SECIS has established its reputation on the back of its vast recruitment and training infrastructure. It currently operates 20 pan-India academies that train employees in the Security Services, Cash Logistics, and Facilities Management businesses. A unique strength of SECIS is its graduate trainee officer (GTO) program that provides instant access to a pipeline of qualified operational managers. Many of the branch heads of SECIS began their journey with GTO.

3. Quick sourcing and deployment capabilities

SECIS has the largest trained manpower supply chain in India, with integrated capabilities in sourcing, training, and deploying a large manpower base. Its training institutes in India make it possible to train more than 25,000 guards a year, securing its personnel pipeline and ensuring prompt deployment. This infrastructure also ensures the timely and quality sourcing of managers.

SECIS also looks to expand the Security business in a non-linear manner, thereby reducing dependency on manpower and deploying customized solutions

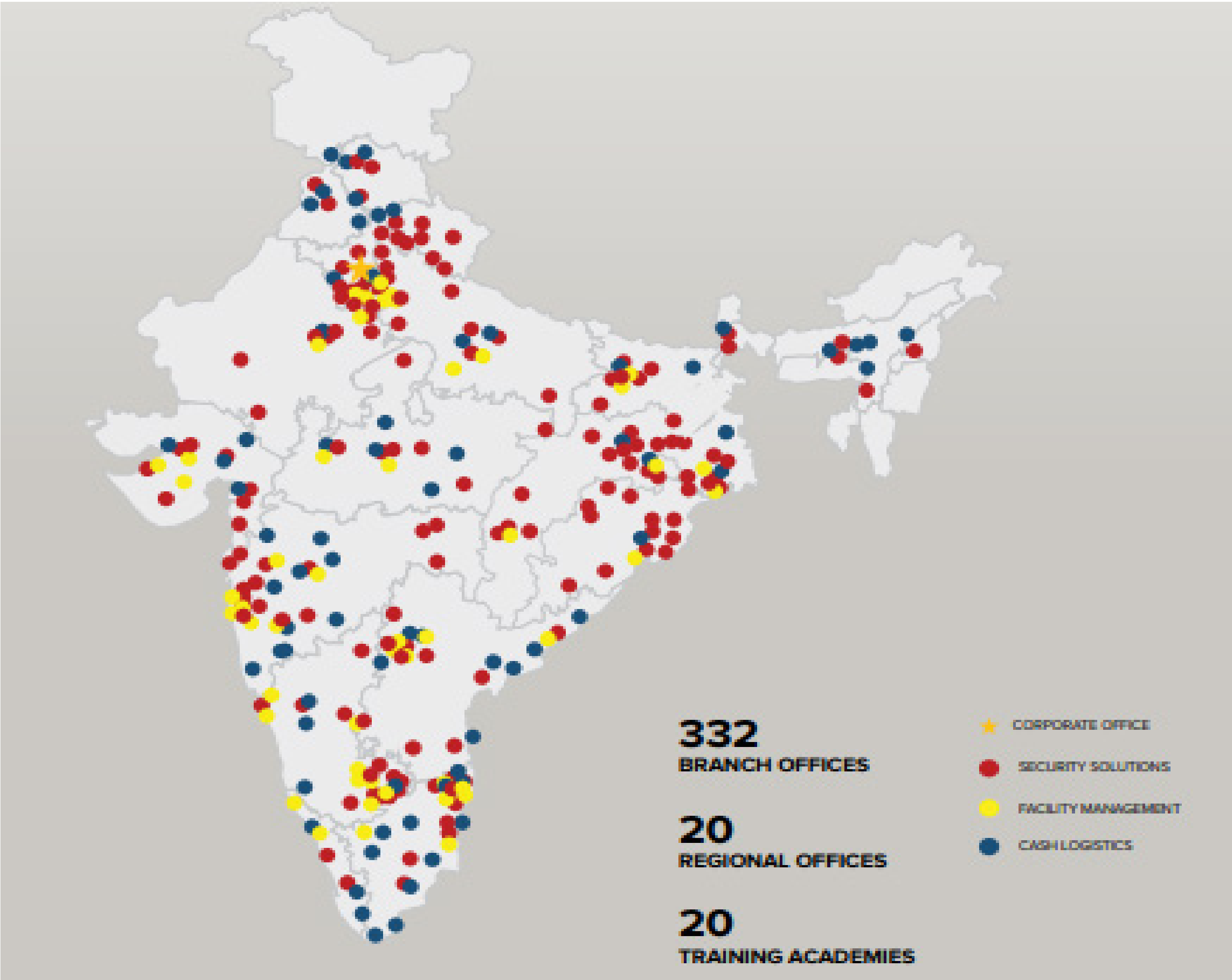
4. Continuous investments in systems and processes

SECIS has been at the forefront of using technology and processes in an industry that has historically been behind with regard to leveraging IT support. It built its technology platform long ago around an ERP, which it has progressively strengthened. It has further continued investments and improvements in internal systems to improve operational productivity.

5. Extensive network and reach

SECIS has an extensive network in both India and Australia, which enables the company to fulfil customer requirements faster, without hampering quality. In India, it services >5,900 customers across 18,500 locations, while in Australia, it services ~280 clients.

Exhibit 18: 332 branch offices, 20 regional offices, 20 training academies in India; 8 state offices, 6 local offices, 4 training centers in Australia



Source: Company

SECIS has been increasing its penetration through two strategies:

- **Branch creation strategy:** For small/regional customers, it is adopting the approach of placing its branches close to customer locations, leading to better sales and services. For larger customers, SECIS needs and has the capability to serve across the country with consistent systems, processes, and SLAs.
- **Branch expansion strategy:** Existing branches that grow beyond a certain revenue/manpower threshold are split into two so that all branches are able to maintain the same performance metrics and parameters.

Through this method, SECIS is able to a) sell more per branch per month, b) serve customers across the country, and c) achieve economies of scale, all without hampering the ability to service customers or compromising on quality.

Additional options for growth

Inorganic foray has paved the way for multiple opportunities

SECIS has had a successful inorganic strategy that has enabled it to create multiple dimensions for growth. Thus far, its track record toward the integration of 11 acquisitions and four JVs/partnerships has been impeccable. The company's acquisition strategy revolves around:

- Consolidating market share in key growth territories
- Augmenting service portfolio gaps
- Building market share and credentials in promising customer segments

SECIS' structure for all its deals is focused on aligning the interests of SECIS and the sellers. To ensure promoters' interest after selling majority stake to SECIS, the company always sources deals with an earn-out structure. In all its acquisitions, the company has aimed to achieve IRR of at least 20%. For future acquisitions, the company would seek to further consolidate the market in Security Services and Facilities Management.

Exhibit 19: M&A over the years

Acquisitions	Date	Geography	Segment	Stake	Payment
MSS Security	Aug-08	Australia	Security services	100%	AUD45m
Cash Services of ISS	Dec-14	India	Cash logistics	100%	nm
Dusters Total Solutions Services	Aug-16	India	Facilities management	78%	INR1169m
Southern Cross Protection	Jul-17	Australia	Security services	51%	AUD18m
SLV Security	Sep-18	India	Security services	51%	INR505m
Rare Hospitality	Nov-18	India	Facilities management	80%	INR320m
Henderson Security Services	Feb-19	Singapore	Security services	60%	SGD43m
Platform 4 Group	Feb-19	New Zealand	Security services	51%	NZD1m
Uniq Detective & Security Service	Feb-19	India	Security services	51%	INR515m
Triton Security Services	Jun-19	New Zealand	Alarm monitoring	100%	NZD6m
Adis Enterprise	Dec-19	India	Facilities management	51%	INR9m

Source: Company

...as have partnerships

SECIS has entered into four partnerships in the past, which have enabled it to augment offerings and enter new potential growth areas.

Exhibit 20: Partnerships

Partnerships	Geography	Segment	Comments
Prosegur Spain	India	Security Services	❖ Alarm monitoring
ServiceMaster	India	Facilities Management	❖ Commercial and residential cleaning services (exclusive license agreement)
Terminix US	India	Facilities Management	❖ Termite and pest control services
Prosegur Spain	Australia	Cash Logistics	❖ Cash management

Source: Company

Leadership in Cash Logistics and FM segments

Facilities Management

In Facilities Management (FM), SECIS' offerings include:

- Cleaning, janitorial services, disaster restoration, and damage clean-up
- The deployment of receptionists, lift operators, electricians, plumbers, etc.
- Pest and termite control services

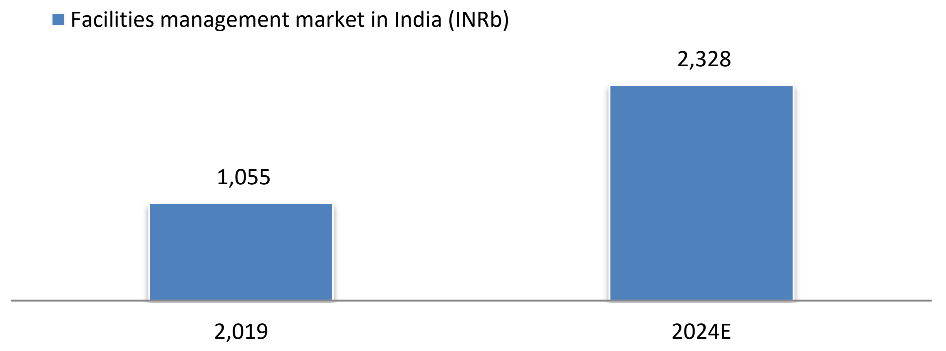
It is the second largest facilities management company in India and has pan-India coverage, with 92 branches and a team of over 50k people. SECIS FM still does not have a presence in Landscaping and Catering Services.
The company's key customer segments include IT/ITES companies, retail chains, hospitals, educational institutes, commercial offices, etc.
The Facilities Management business comprises DTSS, SMC, RARE Hospitality, and TerminixSIS.

The market is currently at INR1,055b and is expected to grow at a 17% CAGR by FY24E. This would largely be led by:

- A growing awareness of outsourcing of non-core activities
- Increased penetration in emerging sectors
- B2G and B2C opportunities
- A shift toward organized players offering higher quality offerings

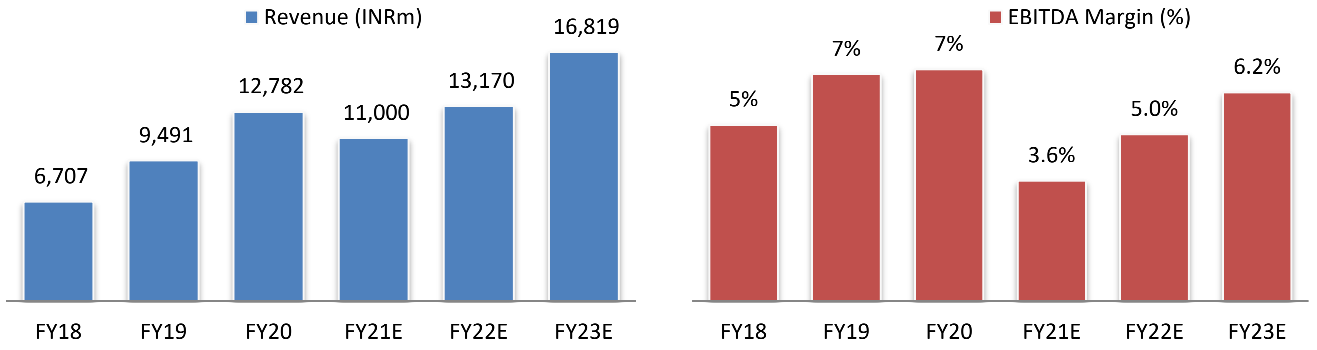
Led by strong execution, the SECIS FM business posted a three-year CAGR of 48% (over FY17–20). At the same time, operating margins expanded to 6.9% in FY20 from 2.7% in FY17.

Exhibit 21: Facilities Management market to grow at a 17% CAGR



Source: Company

Exhibit 22: Expect a 24% revenue CAGR over FY21–23 and 260bp margin expansion

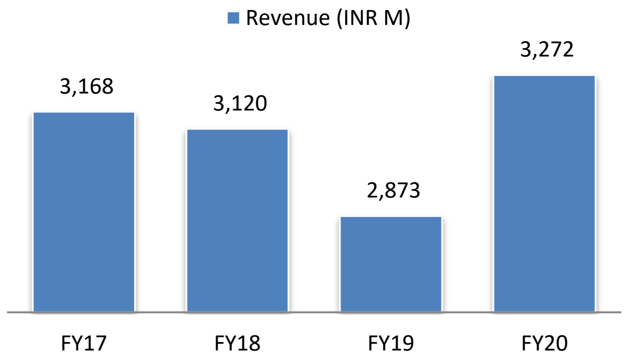


Source: Company

Cash Logistics

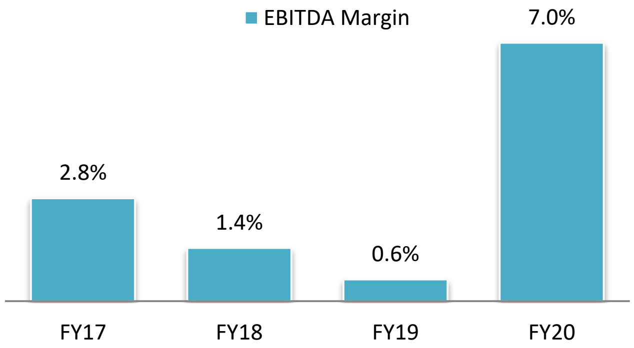
- In Cash Logistics, SECIS' offerings include cash-in-transit, doorstep banking, and ATM-related services.
- The business started off with SECIS entering into a JV with affiliates of Prosegur Spain in May 2011. To further mark its presence in this space, it acquired the Cash and Valuables Services division of ISS SDB in India in December 2014. Furthermore, it acquired specified business contracts, vendor contracts, licensed properties, employees, and related assets from Scientific Security.
- Currently, SECIS' Cash Logistics business has 54 vaults or strong rooms, 2,300 cash vans, and operates in 300 cities across India. It is the second largest player in India in the Cash Logistics space.
- The Cash business was largely dominated by ATM servicing (~60% of revenue). However, higher competition and fewer ATM additions have led to sluggishness in the Cash Logistics business. With revenue diversification, SECIS has significantly reduced its dependency on the ATM business, which now contributes just 27% to the total revenue. After two years of decline, SECIS' Cash Logistics revenue/EBITDA grew at 14%/14x YoY.

Exhibit 23: Revenue growth is led by industry consolidation



Source: MOFSL, Company

Exhibit 24: And now generates good margin profile



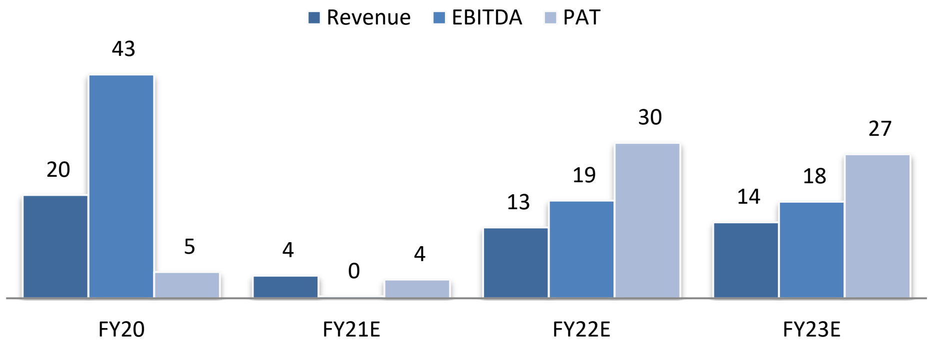
Source: MOFSL, Company

Putting it all together

Financial expectations going forward

SECIS' growth and margin trajectory would be a function of how its three different segments perform. Over FY21–23, we expect a revenue/EBITDA/PAT CAGR of 14%/18%/28%.

Exhibit 25: Margin expansion and tax benefits to aid higher PAT growth for SECIS



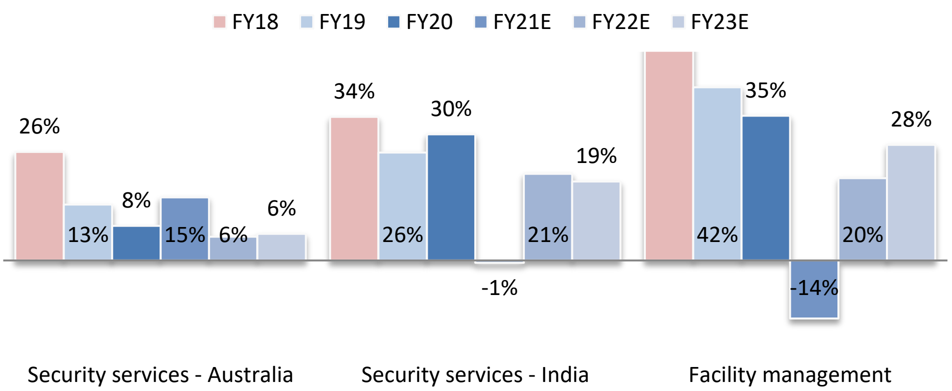
Source: Company

Revenue growth expectations in the low teens

We expect a 14% revenue CAGR for SECIS over FY21–23, factor in the following:

- India's Security Services business is likely to witness a revenue CAGR of 20% over FY21–23. We expect FY21 to be relatively weaker amid the COVID-19 disruption, and expect growth to start picking up from 2HFY21. Our growth assumptions are based on 1) higher formalization, 2) market consolidation as some of the smaller players would have taken a step back, and 3) robust execution by the company based on higher compliance, an extensive network, the continued training of guards, and the higher use of technology.
- The Security Services business in Australia is likely to grow at a CAGR of 6% over FY21–23. Growth should partially taper off in FY22/FY23 due to loss of revenue from the closure of temporary high-margin contracts by the Australian government. However, we expect some of the contracts in Aviation to normalize as the situation eases.
- We expect a 24% revenue CAGR in the FM business over FY21–23. Our high-growth expectations account for pent-up demand as offices/buildings start to open up by the end of FY21.

Exhibit 26: India-based businesses to contribute the most to incremental growth

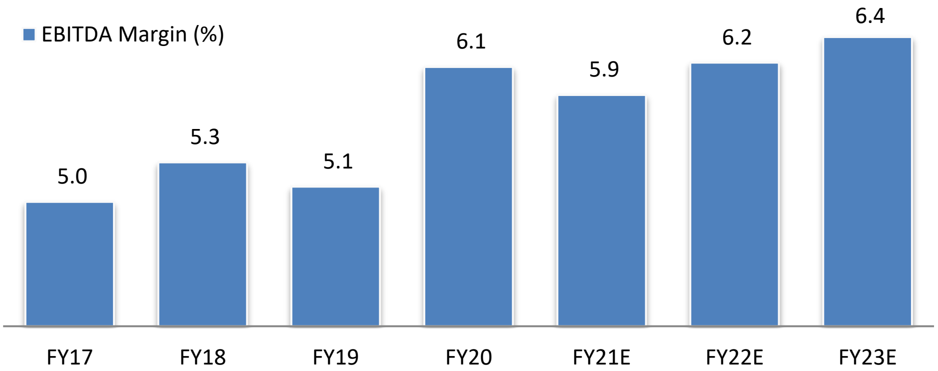


Source: Company

Cumulative margin improvement of 50bp over FY21–23

The largest driver of improvement in profitability in Business Services has been scale. We expect operating margins to increase over FY21–23 by 50bp, majorly led by operating leverage in the business. This would be partially offset by some normalization in margins in the Australian business on account of expected loss in temporary high-margin government contracts.

Exhibit 27: Expect 50bp increase in margin over FY21-23



Source: Company

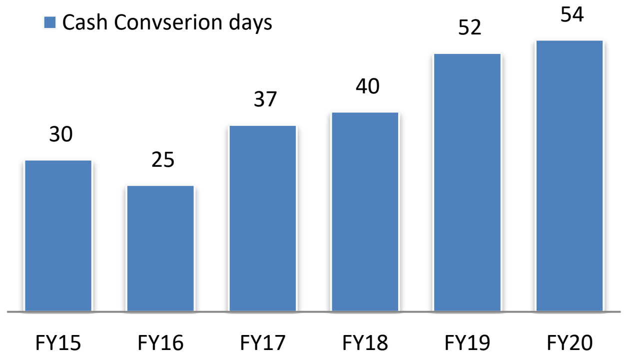
PAT boosted by 80JJAA benefits

- Our PAT growth expectations of a 28% CAGR over FY21–23 are mostly driven by strong revenue growth and margin expansion. However, they would be further boosted by 80JAA benefits, due to which the effective tax rate for SECIS is expected to reduce to 20% from ~22% in FY20.
- Of the total employee base of SECIS, only ~9k operates in the International business. However, the contribution of the International business to revenue is ~48% on account of high realization rates. In India, ~150k employees have an average realization of INR19k per person per month, making them all eligible for benefits from Section 80JJAA of the Income Tax Act.
- From FY20, the company has decided to move to a new tax regime, leading to the write-down of MAT credit. However, SECIS would continue to enjoy benefits from 80JJA on account of the expanding India business share, which should lower the ETR. We expect an ETR of 20% for the next two years.

Working capital for India biz high, as is growth in OCF

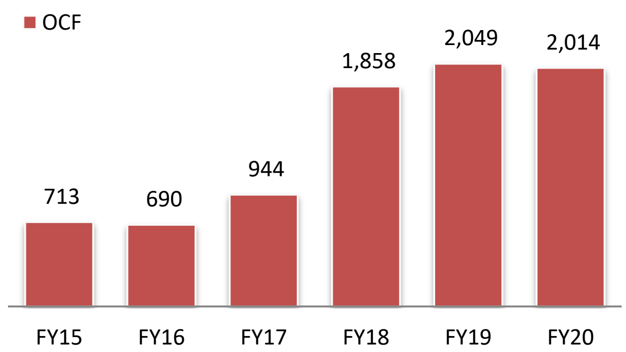
- SECIS' cash conversion days have continuously risen – they reached 54 days by FY20. This has been led by faster growth in the India business, which has higher receivable days. Within the India business, the fastest growing entity FMS also has the highest DSOs (~70 days), which is thus further inching up the DSOs of the company. We estimate the average DSOs of the business to continue to increase gradually as the India business gains higher share in revenues.
- Nevertheless, despite higher working capital days, the company has been able to grow its OCF at a 29% CAGR over FY17–20. While we are concerned about lower conversion ratios (OCF/EBITDA at 39% for FY20), we remain confident on the company's ability to deliver high growth in OCF.
- The company has adopted the strategy of deploying its fast-growing OCF to fuel growth through acquisitions. We note the total consideration for the business acquisition was INR10.2b over FY19–20; of this, a significant part has been allocated as goodwill (INR8.9b; 87% of aggregate purchase consideration). This has led to an increase in consolidated goodwill to 12.3b, 89% of NW (FY18: INR4.7b, 46%). This primarily constitutes the Security Services – International business for INR9.1b and Security Services – India business for INR2.1b.
- On an aggregate basis, the performances of the acquired businesses improved over FY19–20, with revenue/PAT increasing to INR17.2b/INR0.9b in FY20 (FY19: INR8.8b/INR0.6b); this gives us confidence regarding the company's acquisition strategy.

Exhibit 28: Cash conversion ratio has been increasing…



Source: MOFSL, Company

Exhibit 29: ...as is OCF



Source: MOFSL, Company

Valuing the entities piece by piece

SOTP-led fair value of INR600 per share; 36% upside

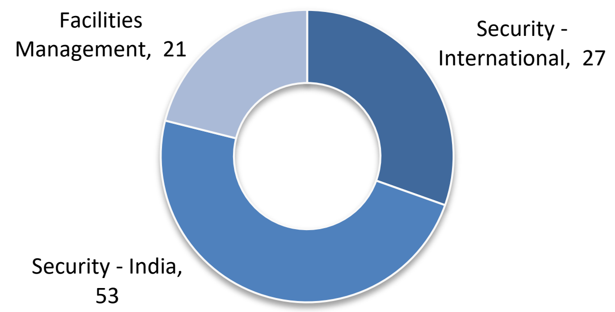
We value SECIS at INR600 per share using sum of the parts, with a EV of INR625 using 1) DCF on the India Security business (INR329), 2) a forward EV/EBITDA multiple of 8x (INR166) on the International Security business (in line with global peers), and 3) DCF on the Facilities Management business (INR130). Adjusting for net debt per share of INR25 gives us our target price of INR600/share.

The approach we follow constitutes:

- Assigning an EV/EBITDA multiple to forward earnings for the International Security Services business
- Derive value based on DCF for the India-based Security Services and Facilities Management businesses

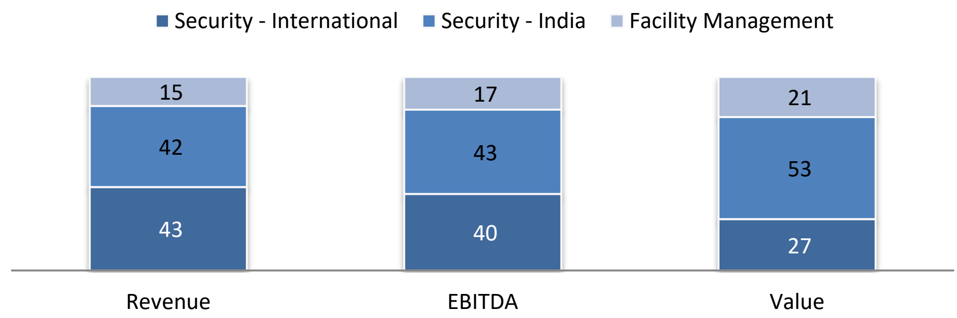
This approach brings us to a fair value of INR600 per share.

Exhibit 30: SOTP-based price target of INR600 per share



Source: Company

Exhibit 31: Contribution by segments



Source: Company

Security Services business, International

We value the International business by assigning an EV/EBITDA multiple of 8x on one-year forward EBITDA, in line with global peers. Large global security services companies such as Securitas and Prosegur trade at 5–10x for a similar financial performance. These companies have been clocking low-single-digit growth rates due to their leadership in markets wherein they have a presence. Given that these geographies are developed, the potential for excess growth over GDP is low, unless the inorganic route is taken.

The higher multiple commanded by these companies, we reckon, is purely due to business model-related benefits, namely 1) the recession-proof and cycle-agnostic nature of the Security Services business, 2) high predictability and visibility owing to near-100 customer retention, and (iii) near market leadership in geographies and services wherein they have a presence.

We believe the dynamics for MSS Security Australia are no different – it has 20% market share, making it the largest player in the Australian market. It has been exhibiting steady, 1.5x GDP growth for the past several years. It has weathered economic cycles and downturns in the past and emerged unharmed.

India business – Security Services and Facilities Management

In line with the valuation methodologies used for other business services players, we use DCF to value the India business of SECIS. We believe these companies, despite their size, are in the early stages of growth and may witness prolonged periods of high-double-digit growth – driven by the industries they are present in and due to a shift in the market toward formal players.

High revenue growth and gains in terms of scale would also lead to operational efficiencies for these businesses, resulting in a sustained increase in profitability. These models are also characterized by high FCF generation as capital expenditure needs are minimal. The pan-India network of these companies is usually based on a lease model, and operations are more people-oriented, making investments less relevant.

We use DCF to capture the longer-term, steady-state cash generation ability of these companies. Using it for the India-based businesses of SECIS, we arrive at a value of INR329 per share for the Security Services business and INR130 for the Facilities Management business. For both these businesses, we use a terminal growth rate of 5% and WACC of 12%.

Combined fair value implies a target multiple in line with peers

A fair value of INR600 per share implies target PE of 30x/23x FY22/FY23E EPS. We find this reasonable given the multi-year high-growth opportunities present for the company; security from the loss of business; and high levels of predictability, visibility, and annuity-based revenue.

Exhibit 32: Contribution by segments

WACC/g	Sensitivity analysis				
600	3.0%	4.0%	5.0%	6.0%	7.0%
10%	660	720	800	930	1,140
11%	590	630	690	770	890
12%	530	560	600	660	730
13%	490	510	540	580	630
14%	450	470	490	520	560

Source: Company

Exhibit 33: Global comparisons

	CAGR CY20–22			PE (x)			EV/EBITDA (x)			ROE (x)		
	Revenue	EBITDA	PAT	CY20	CY21	CY22	CY20	CY21	CY22	CY20	CY21	CY22
G4S Security	2	4	7	16	14	14	9	8	8	77	33	33
ISS A/S	1	NA	NA	NA	21	21	NA	10	10	(38)	9	9
Prosegur	2	8	21	19	13	13	6	5	5	9	13	13
Securitas AB	1	5	9	17	15	15	9	8	8	14	15	15

Source: MOFSL, Bloomberg

Key management personnel

Mr Rituraj Sinha, Group Managing Director

Mr Rituraj Sinha joined SECIS in 2002 after a brief stint in the Banking sector in the UK. He has built a reputation for himself in the Global Security and Business Support Services industry by forging partnerships with global market leaders and orchestrating game-changing acquisitions. He is active on various industry forums and champions the cause of the Private Security industry. He is currently Co-Chair, FICCI Private Security Sector Committee; President, Cash Logistics Association; Member of the Board of Directors at Security Ligue International, Geneva; Member, Central Advisory Board, Ministry of Labor & Employment, Government of India.

Mr Uday Singh, Group Chief Executive Officer

He has wide-ranging experience of working in Indian and multinational companies in Steel, Chemical, Power, and other Manufacturing & Process industries. Besides this, he has wide experience in Design and Consultancy Services. He joined SECIS in 2002. Prior to this, he had held senior management positions in organizations such as SAIL, MECON, Jindal Vijaynagar Steel (now JSW), and Praxair.

Mr Arvind Prasad, Director Finance

Mr Prasad has been a part of SECIS' top management since 1985. Among various initiatives, he has been instrumental in pioneering the cost plus method of pricing as well as payroll processing using in-house software, some of the firsts in the Indian Security industry. He has also designed and implemented the ERP system for SECIS India.

Mr Dhiraj Singh, CEO (Facilities Management and Emerging Businesses)

Prior to joining SECIS, Mr Singh successfully established and led several start-up businesses in the Infrastructure and Services sectors. He has also worked with companies such as Eicher, Laitram, Tata Steel, and Bechtel. He served as Head BD for Bovis Lend Lease and Country Head for Laing O'Rourke before he founded vKarma Capital (a PE fund of DLF) and assumed the role of Senior Advisor with McKinsey and Simplex Infrastructures.

Mr Mike McKinnon, CEO, MSS Security, Australia

Mr McKinnon has been in the Security industry for over 20 years. Prior to joining MSS Security, he served as General Manager, Contracted Security Services Unit, at Qantas. As a major user of security services, this role gave him an in-depth understanding of the security function from a client's perspective. Mr McKinnon also has a wealth of knowledge and experience in security electronic wholesaling, safe manufacturing and distribution, alarm monitoring, and electronic solutions.

Financials and valuations

Consolidated - Income Statement

Y/E March (INR m)	FY18	FY19	FY20	FY21E	FY22E	FY23E
Total Income from Operations	**58,334**	**70,933**	**84,852**	**88,513**	**1,00,438**	**1,14,944**
Change (%)	33.0	21.6	19.6	4.3	13.5	14.4
Total Expenditure	**55,214**	**67,281**	**79,648**	**83,288**	**94,243**	**1,07,611**
% of Sales	94.7	94.9	93.9	94.1	93.8	93.6
EBITDA	**3,120**	**3,652**	**5,204**	**5,225**	**6,196**	**7,332**
Margin (%)	5.3	5.1	6.1	5.9	6.2	6.4
Depreciation	560	660	1,283	1,167	1,329	1,523
EBIT	**2,560**	**2,992**	**3,921**	**4,058**	**4,867**	**5,810**
Int. and Finance Charges	925	938	1,517	1,372	1,472	1,572
Other Income	365	177	531	463	412	604
PBT	**2,001**	**2,231**	**2,935**	**3,148**	**3,807**	**4,842**
Total Tax	244	-52	636	801	761	968
Tax Rate (%)	12.2	-2.3	21.7	25.4	20.0	20.0
Minority Interest	-118	-135	-44	-11	-21	-21
Adjusted PAT	**1,639**	**2,147**	**2,255**	**2,336**	**3,025**	**3,853**
Change (%)	48.2	31.0	5.0	3.6	29.5	27.4
Margin (%)	2.8	3.0	2.7	2.6	3.0	3.4

Consolidated - Balance Sheet

Y/E March (INR m)	FY18	FY19	FY20	FY21E	FY22E	FY23E
Equity Share Capital	732	733	733	733	733	733
Total Reserves	9,551	11,766	13,151	15,487	18,512	22,364
Net Worth	**10,283**	**12,499**	**13,884**	**16,220**	**19,245**	**23,098**
Minority Interest	14	3	3	3	3	3
Total Loans	5,361	9,498	11,722	13,722	14,722	15,722
Deferred Tax Liabilities	-2,105	-3,397	-4,374	-4,374	-4,374	-4,374
Capital Employed	**13,553**	**18,603**	**21,235**	**25,570**	**29,595**	**34,448**
Gross Block	4,024	5,158	7,362	8,862	10,362	11,862
Less: Accum. Deprn.	2,757	3,416	4,699	5,867	7,196	8,718
Net Fixed Assets	**1,267**	**1,742**	**2,662**	**2,995**	**3,166**	**3,143**
Goodwill on Consolidation	4,691	12,284	12,323	12,323	12,323	12,323
Capital WIP	10	10	17	27	37	47
Others	1,466	1,891	1,737	1,725	1,775	1,825
Total Investments	**1,460**	**1,782**	**1,490**	**1,490**	**1,490**	**1,490**
Curr. Assets, Loans&Adv.	**16,943**	**21,137**	**23,919**	**29,471**	**34,637**	**41,779**
Inventory	142	254	339	349	359	369
Account Receivables	6,243	9,530	11,750	13,076	14,769	17,425
Cash and Bank Balance	5,428	5,429	6,137	10,354	13,817	18,293
Loans and Advances	4,238	0	0	0	0	0
Others	893	5,925	5,693	5,693	5,693	5,693
Curr. Liability & Prov.	**8,449**	**10,938**	**13,715**	**15,262**	**16,635**	**18,962**
Account Payables	806	661	538	599	653	744
Other Current Liabilities	5,457	7,864	10,599	11,795	12,856	14,654
Provisions	2,185	2,413	2,578	2,869	3,127	3,564
Net Current Assets	**8,495**	**10,199**	**10,204**	**14,209**	**18,003**	**22,818**
Other Non Current Liabilities	-3,834	-9,305	-7,198	-7,198	-7,198	-7,198
Appl. of Funds	**13,553**	**18,603**	**21,234**	**25,570**	**29,595**	**34,448**

Financials and valuations

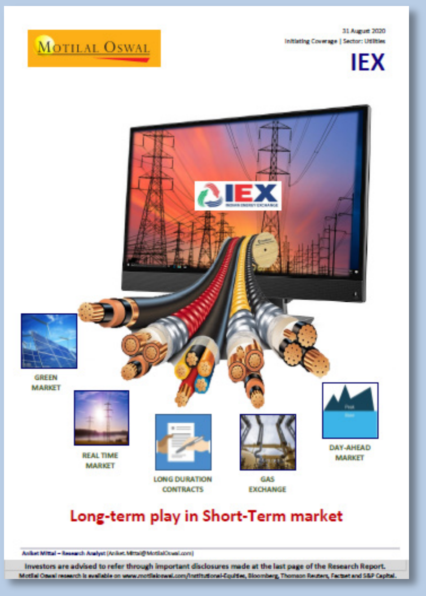
Ratios

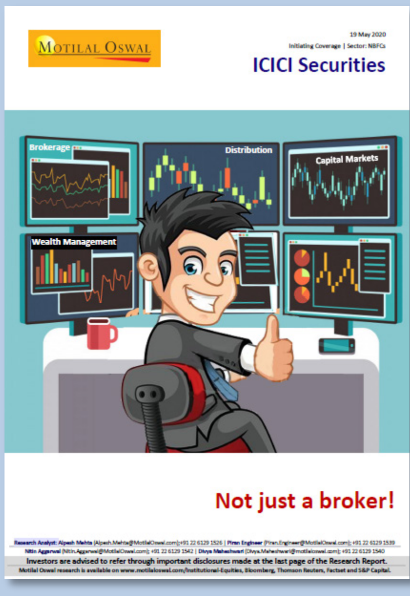
Y/E March	FY18	FY19	FY20	FY21E	FY22E	FY23E
Basic (INR)						
EPS	**20.3**	**29.3**	**16.1**	**15.5**	**20.2**	**25.7**
Cash EPS	32.2	41.1	51.8	51.2	63.7	78.6
BV/Share	150.4	182.8	203.1	237.3	281.5	337.9
DPS	1.8	0.0	0.0	0.0	0.0	0.0
Payout (%)	9.2	0.0	0.0	0.0	0.0	0.0
Valuation (x)						
P/E	22.0	15.2	27.6	28.9	22.1	17.4
Cash P/E	13.9	10.9	8.6	8.7	7.0	5.7
P/BV	3.0	2.4	2.2	1.9	1.6	1.3
EV/Sales	0.6	0.5	0.8	0.8	0.7	0.6
EV/EBITDA	11.5	10.1	13.0	13.5	10.9	8.8
FCF per share	16.6	16.7	8.9	23.7	26.2	33.7
Return Ratios (%)						
RoE	20.9	18.8	17.1	15.5	17.1	18.2
RoCE	17.9	17.2	14.7	12.1	13.2	14.1
RoIC	31.0	33.9	24.6	22.2	27.9	32.2
Working Capital Ratios						
Fixed Asset Turnover (x)	14.5	13.8	11.5	10.0	9.7	9.7
Asset Turnover (x)	4.3	3.8	4.0	3.5	3.4	3.3
Debtor (Days)	39	49	51	54	54	55
Creditor (Days)	5	3	2	2	2	2
Leverage Ratio (x)						
Interest Cover Ratio	2.8	3.2	2.6	3.0	3.3	3.7
Net Debt/Equity	-0.1	0.2	0.3	0.1	0.0	-0.2

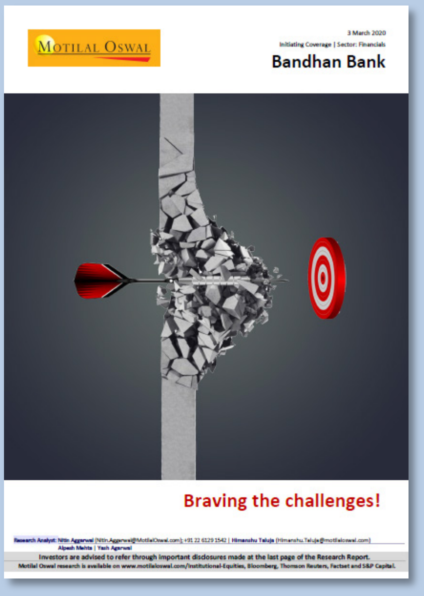
Consolidated - Cash Flow Statement (INR m)

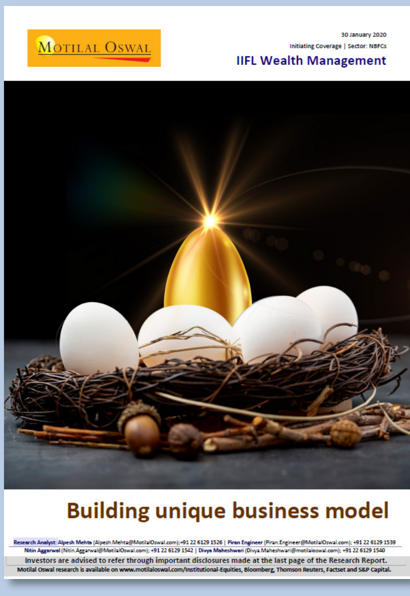
Y/E March	FY18	FY19	FY20	FY21E	FY22E	FY23E
OP/(Loss) before Tax	1,874	2,095	2,891	3,137	3,786	4,821
Depreciation	560	660	1,283	1,167	1,329	1,523
Interest & Finance Charges	654	751	791	1,372	1,472	1,572
Direct Taxes Paid	-706	-1,054	-1,276	-801	-761	-968
(Inc)/Dec in WC	-549	-742	-2,100	212	-331	-339
CF from Operations	**1,832**	**1,710**	**1,590**	**5,087**	**5,495**	**6,608**
Others	25	339	424	0	0	0
CF from Operating incl EO	**1,858**	**2,049**	**2,014**	**5,087**	**5,495**	**6,608**
(Inc)/Dec in FA	-516	-829	-775	-1,498	-1,560	-1,560
Free Cash Flow	**1,341**	**1,220**	**1,239**	**3,589**	**3,935**	**5,048**
(Pur)/Sale of Investments	-464	-4,537	-2,110	0	0	0
Others	109	142	127	0	0	0
CF from Investments	**-871**	**-5,224**	**-2,759**	**-1,498**	**-1,560**	**-1,560**
Issue of Shares	3,411	0	0	0	0	0
Inc/(Dec) in Debt	-1,360	2,098	204	2,000	1,000	1,000
Interest Paid	-880	-718	-986	-1,372	-1,472	-1,572
Dividend Paid	-174	-112	-631	0	0	0
Others	-1,062	1,908	2,866	0	0	0
CF from Fin. Activity	**-66**	**3,177**	**1,453**	**628**	**-472**	**-572**
Inc/Dec of Cash	**920**	**1**	**708**	**4,216**	**3,463**	**4,476**
Opening Balance	4,508	5,428	5,429	6,137	10,354	13,817
Closing Balance	**5,428**	**5,429**	**6,137**	**10,354**	**13,817**	**18,293**

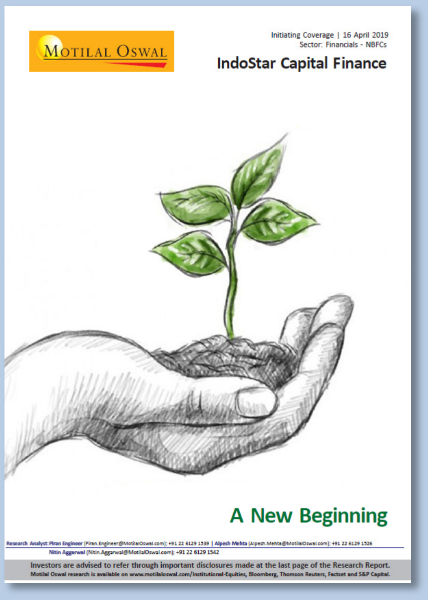
REPORT GALLERY











Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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