

Happiest Minds Technologies



A quality small-sized digital franchise
with a long runway for growth

Happiest Minds Technologies Ltd. Quality digital firm, well-placed to benefit from client digital investments

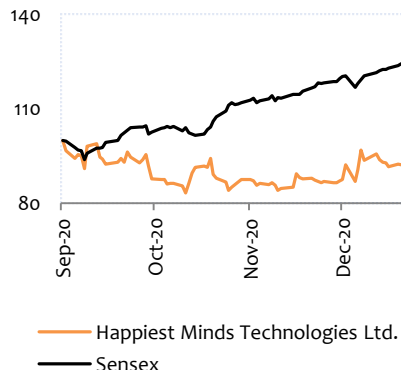
CMP INR 336	Target INR 385	Potential Upside 14.7%	Market Cap (INR Mn) 49,302	Recommendation ACCUMULATE	Sector Information Technology
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Happiest Minds Technologies (HMT) is a digital IT firm that positions itself as “Born Digital. Born Agile”. HMT’s services include Product Engineering Services (PES), Digital Business Services (DBS) and Infrastructure Management & Security Services (IMSS). Its solutions span the digital technology spectrum including Robotic Process Automation (RPA), Software-Defined Networking/Network Function Virtualisation (SDN/NFV), Big Data and Analytics, Internet of Things (IoT), Cloud, Business Process Management (BPM) and security. In FY20, 96.9% of HMT’s revenue came from digital services (97.1% in 2QFY21). Agile development accounted for 87.9% of revenue in FY20 (92.8% in 2QFY21). HMT has clocked INR revenue CAGR of 22.8% over FY18-FY20 (17% in USD terms as per our calculations), with steady EBIT margin improvement (-8.5% in FY18 to 11% in FY20 and 21.4% in 2QFY21). HMT is promoted by Ashok Soota, who has excellent pedigree in the Indian IT services industry, having been Vice Chairman of Wipro and Chairman & CEO of Mindtree in earlier roles.

MARKET DATA

Shares outs (Mn)	146
Equity Cap (INR Mn)	293.73
Mkt Cap (INR Mn)	49,302
52 Wk H/L (INR)	395.00/285.55
Volume Avg (3m K)	1,656.73
Face Value (INR)	2
Bloomberg Code	HAPSTMTN IN

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	48,093.32
NIFTY	14,137.35

SHARE HOLDING PATTERN (%)

Particulars	Sep 20	15-Sep 20
Promoters	53.25	53.25
FIIIs	7.21	7.21
DIIIs	6.47	6.47
Others	33.06	33.06
Total	100.00	100.00

Investment Rationale

A quality small sized digital IT services firm with good management pedigree

HMT is a quality small-sized digital IT services firm with a healthy financial profile, good management pedigree and strong scope for growth over the next several years. The company supports its digital initiatives through three Centres of Excellence (CoE) for IoT, Analytics & AI, and DPA. We believe investments made by HMT in these CoEs are critical to build industry-specific skill sets and widen its scope of service offerings. HMT’s breadth of digital service offerings and go-to-market approach with CEOs appointed for each of its 3 business segments address the entire gamut of customer digital IT spends. We expect the company to record >15% USD revenue CAGR over FY21-FY23E, led by rising customer digital IT spend, deeper engagements with existing customers, new customer wins, and investments in critical initiatives like CoEs, strategic acquisitions and alliances.

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

Long runway for growth, enough scope for all in a global B2B industry, US\$ 1.3 trln digital services market, growing at >16%

The addressable market for HMT is significantly large at ~US\$ 1.3 trillion in CY19 (Source: Frost & Sullivan), which includes its focus segments of PES DBS and IMSS. This is expected to grow at a robust CAGR of 16.4% till CY25 to touch US\$ 3.2 trillion. We believe in a global B2B business like digital IT services, there is ample runway for growth for all IT firms including HMT, with the critical driver being firm-level differentiation in terms of verticals served and breadth of service offerings. Core engineering pedigree is a critical driving factor to grow the PES segment, and HMT is favourably placed on that count, with PES accounting for the lion’s share of revenue (>50%) and likely to be a critical growth driver going forward.

Strong profitability indicators in-line with or better than peers and global digital comps

HMT, despite being one of the smallest listed IT firms in terms of revenue, enjoys healthy financial and operating indicators, with key ratios such as profitability, RoE and cash flow all in-line with or in some cases better than peers.

15.0%

Revenue CAGR between
FY21 and FY23E

8.1%

PAT CAGR between FY21
and FY23E

Happiest Minds Technologies Ltd.

Valuation

Going forward, the global digital IT services market is likely to clock a robust double digit CAGR of 16.4% over CY19-CY25 to touch US\$ 3.2 trillion vs US\$ 1.3 trillion in CY19 (Source: Frost & Sullivan), which includes HMT's focus segments of PES, DBS and IMSS. Through its primary go-to-market services, HMT addresses the entire gamut of enterprise digital IT spends, with its service offerings and domain knowledge built through CoE investments driving ever-increasing customer engagements and new customer wins.

HMT's promoter and Executive Chairman, Ashok Soota has strong pedigree in the IT industry, having been Vice Chairman of Wipro and Chairman and CEO of Mindtree. This is likely to stand the company in good stead going forward, given his deep domain expertise and connect with client boardrooms. Apart from Ashok Soota, HMT is led by a capable executive management team, with each of its segments headed by a CEO, who report to the company's Executive Board.

Despite being one of the smallest listed IT firms in terms of revenue, HMT enjoys healthy operating and financial indicators, with key ratios such as profitability, RoE and cash flow all in-line with or in some cases better than peers.

Going forward, we expect HMT to clock 15.3% USD revenue CAGR and 13.2% EBIT CAGR over FY21-FY23E, with EBIT margin likely to decline slightly to 20.3% in FY23E vs 20.9% in FY21 owing to wage hike impact and return of some travel and administrative costs. On the other hand, EPS CAGR is expected to be subdued at 8.1% owing to marginal EPS growth in FY22 on account of lower EBIT margin and higher tax rate. For FY23, we expect ~15% EPS growth. We expect revenue growth to be led by continuing digital transformation investments by client organisations across industry verticals. We expect growth to come from a combination of volume and pricing, and pricing can improve on the back of strong client demand for digital services, along with greater employee digital skill sets.

At the CMP, HMT's stock trades at a PE of 30.0x/26.2x FY22E/FY23E EPS, respectively. We note that global digital services firms including EPAM Systems and Globant command substantially higher valuation owing to their superior growth profile and pure-play digital service portfolios. EPAM trades at a PE of 35.8x CY22E EPS, while Globant trades at 52.7x CY22E EPS.

Given the substantial growth runway ahead, we believe HMT will be able to sustain 15-20% revenue growth in the medium-term, along with 20% EBIT margin. We believe a PE multiple of 30x forward earnings is justified given the long growth runway, quality of management, pure digital focus, healthy financial and operating metrics and strong cash flow generation, which can potentially lead to greater M&A activity and dividend pay outs in future. **We Initiate Coverage on HMT with an ACCUMULATE rating and target price of INR 385, implying a PE of 30x FY23E EPS. The stock has performed well post-IPO, notching up gains of >100%, and we would turn buyers at slightly lower levels (10%) from here, even as we would be comfortable buying in staggered quantities from a long-term investment perspective. Key risks include street perception of Ashok Soota as the key driver for the company, and any development on him not continuing his relationship with HMT, be it in the form of retirement or any other manner, would impact the stock adversely.**

Key Financials (INR Mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenue (USD Mn)	84.3	98.3	100.3	116.1	133.3
Revenue	5,904	6,982	7,461	8,593	9,866
EBIT	301	769	1,563	1,727	2,002
FDEPS (INR)	1.0	4.9	11.0	11.2	12.8
EBIT margin (%)	5.1	11.0	20.9	20.1	20.3
PE ratio (x)	345.4	68.4	30.6	30.0	26.2
EV/EBIT (x)	83.1	43.9	28.3	24.8	20.6

Source: Company, KRChoksey Research; Note: USD revenue for FY19 and FY20 has been derived as per our internal calculations.

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1. Company Overview

Happiest Minds Technologies (HMT) is a digital IT firm that positions itself as “Born Digital. Born Agile”

In FY20, 96.9% of HMT’s revenue came from digital services (97.1% in 2QFY21). Agile development accounted for 87.9% of revenue in FY20 (92.8% in 2QFY21)

HMT has clocked INR revenue CAGR of 22.8% over FY18-FY20 (17% in USD terms as per our calculations), with steady EBIT margin improvement (-8.5% in FY18 to 11% in FY20 and 21.4% in 2QFY21)

HMT’s services include Product Engineering Services (PES, 50.5% of FY20 revenue), Digital Business Services (DBS, 27.5% of FY20 revenue) and Infrastructure Management & Security Services (IMSS, 22% of FY20 revenue)

Happiest Minds Technologies (HMT) is a digital IT firm that positions itself as “Born Digital. Born Agile”. HMT’s services include Product Engineering Services (PES), Digital Business Services (DBS) and Infrastructure Management & Security Services (IMSS). Its solutions span the digital technology spectrum including Robotic Process Automation (RPA), Software-Defined Networking/Network Function Virtualisation (SDN/NFV), Big Data and Analytics, Internet of Things (IoT), Cloud, Business Process Management (BPM) and security. In FY20, 96.9% of HMT’s revenue came from digital services (97.1% in 2QFY21). Agile development accounted for 87.9% of revenue in FY20 (92.8% in 2QFY21). HMT has clocked INR revenue CAGR of 22.8% over FY18-FY20 (17% in USD terms as per our calculations), with steady EBIT margin improvement (-8.5% in FY18 to 11% in FY20 and 21.4% in 2QFY21). HMT is promoted by Ashok Soota, who has excellent pedigree in the Indian IT services industry, having been Vice Chairman of Wipro and Chairman & CEO of Mindtree in earlier roles.

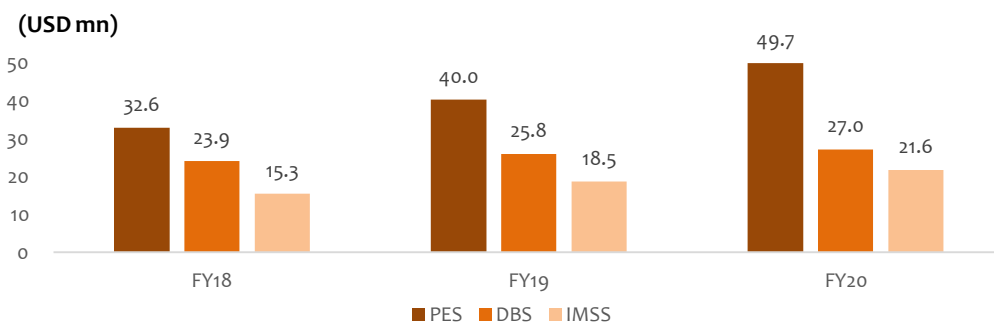
Key go-to-market service offerings:

Product Engineering Services (PES): HMT’s PES BU aims to help customers capitalise on the transformative potential of ‘digital’ by building products and platforms that are smart, secure and connected. The company provides its customers a blend of hardware and embedded software knowledge which combines with its software platform engineering skills to help create high quality, scalable and secure solutions. HMT’s offerings extend across the development lifecycle from strategy to final roll out. The company works on a cloud and a mobile approach along with an agile model. In FY20, HMT earned INR 3.53 billion (~US\$ 50 million) in PES revenue, accounting for 50.5% of total revenue; over FY18-FY20, this segment has clocked a robust 29.6% revenue CAGR in INR terms (23.5% in USD terms as per our calculations)

Digital Business Services (DBS): HMT’s DBS offerings are aimed at driving digital modernisation and transformation for customers through digital application development and application modernisation for an improved business outcomes, implementation of solutions, development and implementation of solution, capabilities for improving data quality of customer’s platform, assistance in designing and testing of operations and management of platform and modernisation of digital practices, and consulting and domain-led offerings such as digital roadmap, design thinking, and migration of on-premise applications to cloud. HMT earned INR 1.92 billion (~US\$ 27 million) in DBS revenue in FY20, accounting for 27.5% of total revenue; over FY18-FY20, this segment has clocked 11.6% revenue CAGR in INR terms (6.3% in USD terms as per our calculations).

Infrastructure Management & Security Services (IMSS): HMT’s IMSS offerings provide end-to-end monitoring and management capability with secure ring fencing of customer applications and infrastructure. The company provides support and managed security services for mid-sized enterprises and technology companies. Specialised in automation of business and IT operations with DevSecOps model and with NOC/SOC, HMT ensures safety and security of data center, cloud infrastructure and applications. Its security offerings include cyber and infrastructure security, governance, risk & compliance, data privacy and security, identity and access management and threat and vulnerability management. Infrastructure offerings include DC and hybrid cloud services, workspace services, service automation (RPA, ITSM & ITOM), database and middleware services and software-defined infrastructure services. HMT earned INR 1.54 billion (~US\$ 21.6 million) in IMSS revenue in FY20, accounting for 22% of total revenue; over FY18-FY20, this segment has clocked a healthy 24.8% revenue CAGR in INR terms (18.9% in USD terms as per our calculations).

Exhibit 1: Segment-wise revenue break-up



Source: Company, KRChoksey Research; Note: USD revenue has been derived as per our internal calculations.

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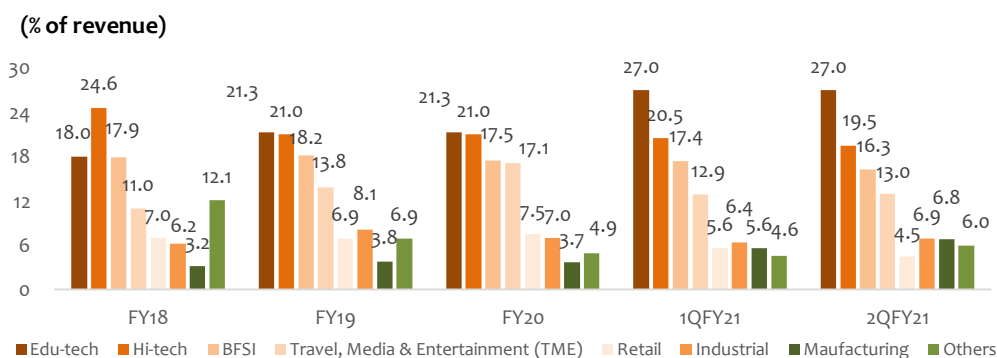
From a vertical standpoint, HMT serves several verticals including its 2 biggest ones - Edutech (its largest vertical, accounting for 21.3% of FY20 revenue and 27% in 2QFY21) and Hi-tech (21%/19.5%, respectively) other verticals include BFSI (17.5%/16.3%), Travel, Media & Entertainment (17.1%/13%), Retail (7.5%/4.5%), Industrial (7%/6.9%) and Manufacturing (3.7%/6.8%), among others

From a geographic standpoint, HMT earned the lion's share of its revenue from USA (77.5% in FY20, 77.3% in 2QFY21), followed by India (11.9%/10.9%), UK (7.2%/9.2%) and Others (3.4%/2.6%)

From a delivery standpoint, HMT s a substantial share of revenue offshore (77.5% in FY20/78.1% in 2QFY21

From a vertical standpoint, HMT can be classified as a diversified digital services firm, and the company serves several verticals including its 2 biggest ones - Edutech (its largest vertical, accounting for 21.3% of FY20 revenue and 27% in 2QFY21) and Hi-tech (21%/19.5%, respectively). Other verticals include BFSI (17.5%/16.3%), Travel, Media & Entertainment (17.1%/13%), Retail (7.5%/4.5%), Industrial (7%/6.9%) and Manufacturing (3.7%/6.8%), among others.

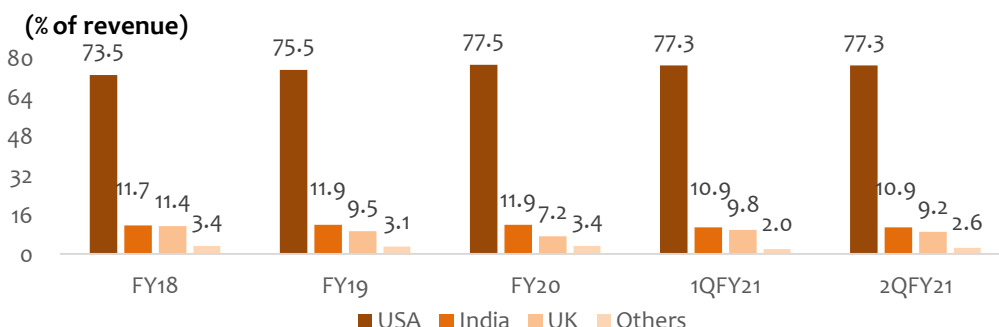
Exhibit 2: Vertical-wise revenue break-up



Source: Company, KRChoksey Research

From a geographic standpoint, HMT earned the lion's share of its revenue from USA (77.5% in FY20, 77.3% in 2QFY21), followed by India (11.9%/10.9%), UK (7.2%/9.2%) and Others (3.4%/2.6%).

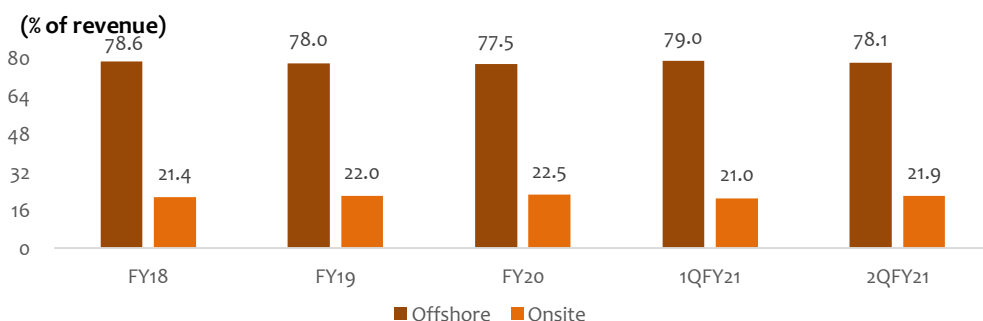
Exhibit 3: Geographic revenue break-up



Source: Company, KRChoksey Research

From a delivery standpoint, HMT s a substantial share of revenue offshore (77.5% in FY20/78.1% in 2QFY21). This trend is likely to get exacerbated with the COVID-19 pandemic, making offshore project execution critical given limited ability to work at client sites, even as this is likely to pick up to some extent as the economy slowly gets back to work and global travel restrictions get eventually lifted over a period of time. Nonetheless, it is clear that a substantially high offshore revenue share is here to stay.

Exhibit 4: Delivery-wise revenue break-up – High offshore here to stay



Source: Company, KRChoksey Research

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2. Investment Rationale

a) A quality small sized digital IT services firm with good management pedigree

HMT is a quality small-sized digital IT services firm with a healthy financial profile, good management pedigree and strong scope for growth over the next several years. The company positions itself as ‘Born Digital, Born Agile’, with a focus on clients’ digital IT spends, and offers solutions across the spectrum of digital technologies including RPA, SDN, Big Data & Analytics, IoT, Cloud, BPM and Security. HMT has clocked INR revenue CAGR of 22.8% over FY18-FY20 (17% in USD terms as per our calculations), along with steady EBIT margin improvement led by improved scale of operations and higher utilisation, with decline in travel cost further boosting profitability in 1HFY21 (-8.5% EBIT margin in FY18, rising to 11% in FY20 and 21.4% in 2QFY21).

Given its focus entirely on digital IT services, HMT has minimal “legacy revenue”, with the marginal 2.9% non-digital revenue in 2QFY21 more a result of specific services performed for clients as add-on revenue along with core digital services. Within digital services, HMT earned the maximum revenue from Digital Infrastructure/Cloud (41.1% of total revenue in 2QFY21) followed by SaaS (24.6%). This is not surprising given the substantial traction being witnessed in this space, with global enterprises shifting workloads to public/hybrid cloud, and the need to integrate applications on cloud infrastructure. HMT’s strategic alliances with partners including Amazon Web Services (AWS), Microsoft Dynamics and IBM are key drivers.

HMT supports its digital initiatives through three Centres of Excellence (CoE) for IoT, Analytics & AI, and DPA. Within IoT, the company’s focus is on device/platform engineering, SI on industry standard IoT platforms, IoT security, IoT-enabled managed services, analytics from connected assets and connecting manufacturing, supply chain, products and services. In FY19, FY20, 1QFY21 and 2QFY21, HMT earned 8.4%, 9.8%, 9.3% and 10.5% of its revenue, respectively from IoT.

Within Analytics & AI, offerings include advanced analytics using AI, machine learning and statistical models, engineering big data platforms, modernisation of data infrastructure and process automation through AI. In FY19, FY20, 1QFY21 and 2QFY21, revenues from Analytics/AI constituted 9.1%, 11.6%, 12.1% and 13.5% of revenue, respectively.

Within DPA, offerings include digital transformation through process automation of core business applications, products and infrastructure landscape of clients, leveraging intelligent process automation tools and technologies including RPA, intelligent BPMS and cognitive automation. In FY20 and 1QFY21, revenue from DPA constituted 20.7% and 24.1% of revenue, respectively.

We believe investments made by HMT in these CoEs are critical to build industry-specific skill sets and widen its scope of service offerings. Even as digital services are horizontal in nature and can be applied across industry verticals, each industry has unique characteristics and customised requirements for which it is necessary to build skill sets. The CoE model is thus an important part of HMT’s business strategy to expand industry knowledge and service capabilities.

HMT offers solutions across the spectrum of digital technologies including RPA, SDN, Big Data & Analytics, IoT, Cloud, BPM and Security

HMT has clocked INR revenue CAGR of 22.8% over FY18-FY20 (17% in USD terms as per our calculations)

Within digital services, HMT earned the maximum revenue from Digital Infrastructure/Cloud (41.1% of revenue in 2QFY21) followed by SaaS (24.6%); HMT’s alliances with partners like AWS, Microsoft Dynamics and IBM are key drivers

HMT supports its digital initiatives through three Centres of Excellence (CoE) for IoT, Analytics & AI, and DPA

Exhibit 5: USD revenue, growth

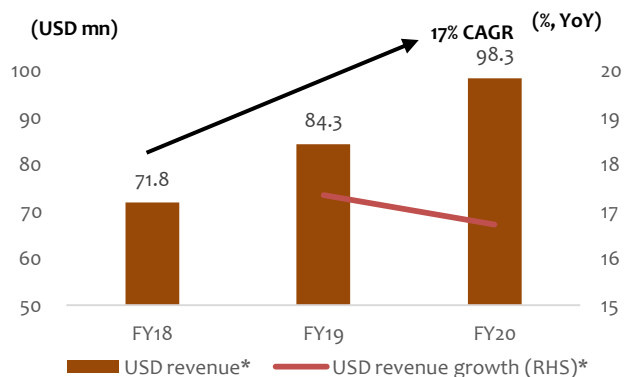
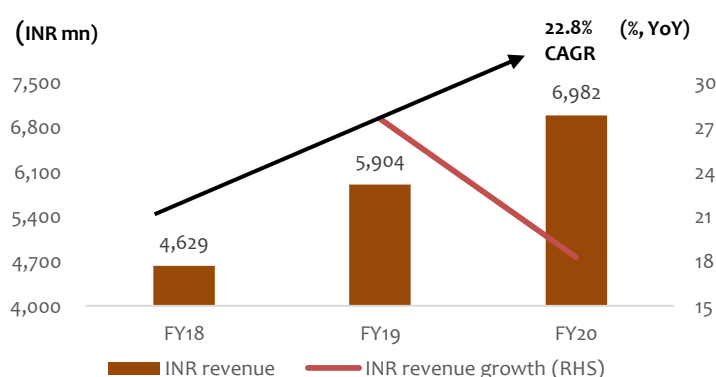
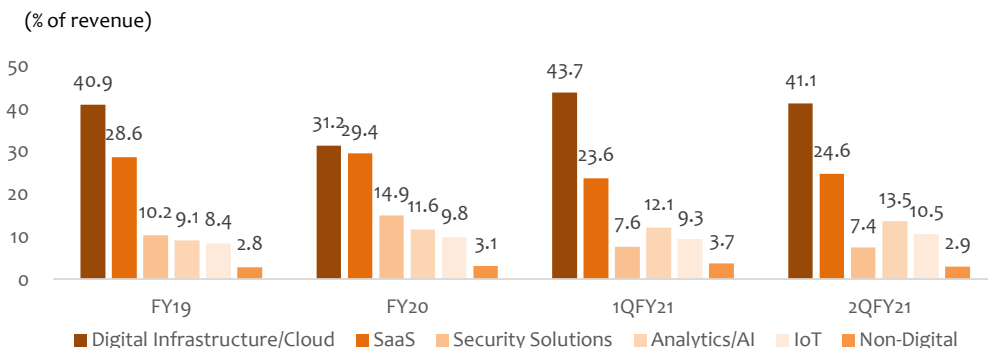


Exhibit 6: INR revenue, growth



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Exhibit 7: Digital revenue break-up – Cloud, SaaS dominate



Source: Company reports, KRChoksey Research

Strong Product Engineering pedigree, which along with Digital and IMSS targets customer digital IT spends

HMT has strong product engineering pedigree, a result of promoter Ashok Soota's Wipro and Mindtree heritage, with both firms having built well established product engineering practices, particularly on the hardware side. Unsurprisingly, from a segment-wise perspective, Product Engineering Services (PES) accounts for the largest pie at 50.5% in FY20 (52.6% in 2QFY21).

In FY20, HMT earned INR 3.53 billion (~US\$ 50 million) in PES revenue, and over FY18-FY20, this segment has clocked a robust 29.6% revenue CAGR in INR terms (23.5% in USD terms as per our calculations). This reflects healthy growth on the back of deepening client relationships, increasing digital capabilities and growth-related investments, such as in Centres of Excellence for IoT, Analytics and AI, and Digital Process Automation.

In the PES segment, HMT helps clients to design and develop enterprise products and platforms aided by use of disruptive technologies and digital transformation tools to enable them to go to market faster. The company's strong engineering DNA, use of agile, DevOps and CloudOps, along with key disruptive technologies like Mobility, Security, SDN, AI, Analytics and IoT helps it drive faster time to market for customers along with aiding their digital transformation journeys. The key target client executives and divisions for PES include CTO and R&D units.

In the DBS segment, HMT earned INR 1.92 billion (~US\$ 27 million) in FY20 revenue (27.5% of total revenue), and over FY18-FY20, this segment has clocked 11.6% revenue CAGR in INR terms (6.3% in USD terms as per our calculations). In this segment, HMT provides digital modernisation services through agile development, solution implementation, systems integration, platform services and cloud migration services to clients. Key target client executives include CIO, CMO and Chief Digital Officers.

In the IMSS segment, HMT earned INR 1.54 billion (~US\$ 21.6 million) in FY20 revenue (22% of total revenue), and over FY18-FY20, this segment has clocked a healthy 24.8% revenue CAGR in INR terms (18.9% in USD terms as per our calculations). In this segment, HMT provides end-to-end infrastructure management and support services, managed security services, workspace services, automation through DevOps (including Robotic Process Automation and IT Service Management), Network/Security Operations Centre, hybrid cloud services and software-defined infrastructure services. Key target client executives include CIO and Chief Security Officers.

Through these primary go-to-market services, HMT addresses the entire gamut of enterprise digital IT spends, with its service offerings and domain knowledge built through CoE investments driving ever-increasing customer engagements and new customer wins. The company is focusing more on clients with high potential for digital IT investments and clear digital vision, and has been cutting down on the long tail over the past few years. HMT counted a total of 152 active clients at 2QFY21-end, down from 173 in FY18, with average revenue/client up to US\$ 0.61 mn in FY20 (US\$0.47 mn in FY18) and further to US\$ 0.66 mn on an annualised basis in 2QFY21.

We believe there is tremendous scope for HMT to grow business over the next several years in light of a multi-year investment phase by client organisations in digital IT, be it transitioning to cloud infrastructure, applications (SaaS), platforms and other enterprise IT products.

In FY20, HMT earned INR 3.53 billion (~US\$ 50 million) in PES revenue, accounting for 50.5% of total revenue; over FY18-FY20, this segment has clocked a robust 29.6% revenue CAGR in INR terms (23.5% in USD terms as per our calculations)

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Exhibit 8: PES USD revenue, growth

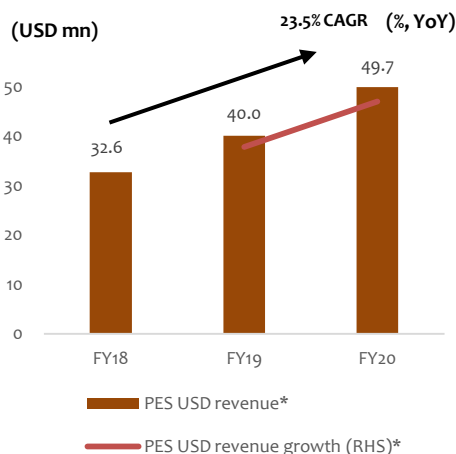


Exhibit 9: PES INR revenue, growth

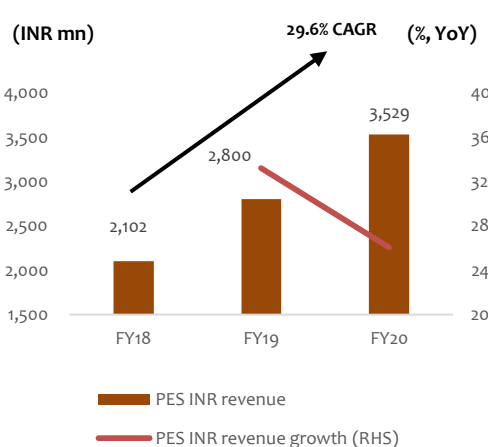


Exhibit 10: DBS USD revenue, growth

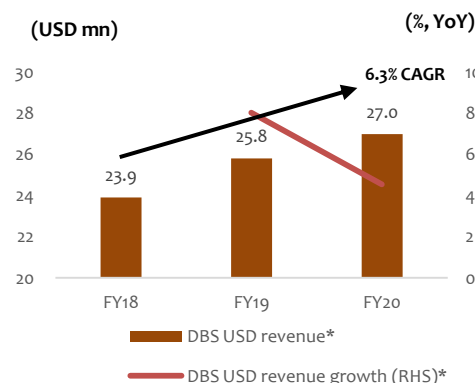


Exhibit 11: DBS INR revenue, growth

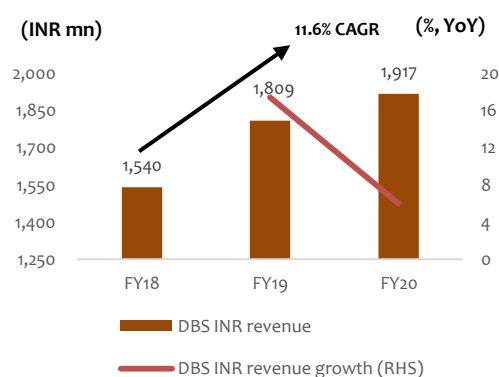


Exhibit 12: IMSS USD revenue, growth

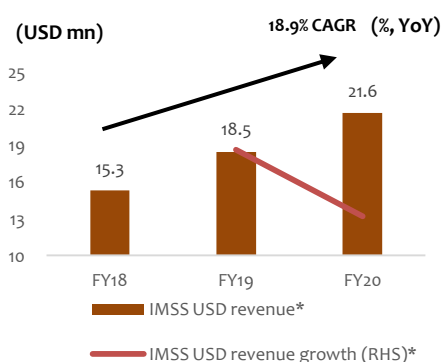
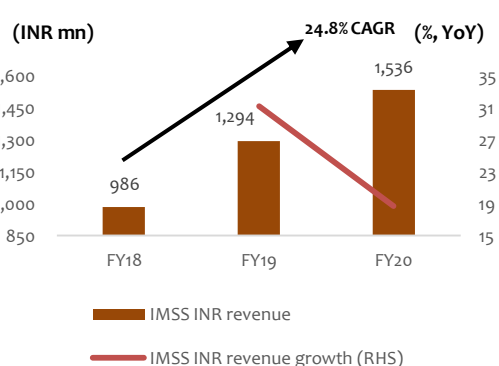


Exhibit 13: IMSS INR revenue, growth



Source: Company, KRChoksey Research;

* USD revenue derived as per KRChoksey internal estimates.

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Mr Soota has experience in running a top-tier IT services firm and has also founded and run a mid-sized IT services firm from scratch, which is likely to stand the company in good stead going forward, given his deep domain expertise and connect with client boardrooms

HMT's key business segments are headed by capable CEOs with work experience in firms such as Mindtree and Wipro, who along with the CFO form the Executive Board, which functions as the CEO, reporting to the Chairman

From a Board perspective, HMT has 6 directors, with 3 being Executive Directors and 3 being Non-Executive Independent Directors, all of whom were appointed in June 2020; independent Directors are from varied fields including management consulting, finance and education

We believe with the current composition of the Board of Directors, HMT will operate transparently from a corporate governance point of view

From an Executive Management perspective, HMT's key go-to-market segments are run by capable CEOs with vast experience, which gives us confidence in the firm's ability to leverage the digital IT services growth opportunity over the next several years

Strong promoter pedigree, comfort around corporate governance; experienced executive management team capable of leveraging digital IT growth opportunity

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

Apart from Ashok Soota, HMT is led by a capable executive management team, with each of its segments headed by a CEO, who report to the company's Executive Chairman. The PES segment is headed by Joseph Anantharaju, who is a co-founder of the company and apart from being CEO – PES, is also Executive Vice Chairman and Member of the Executive Board. He holds a bachelor's degree in engineering from BITS, Pilani and master's degree in management from IIM, Ahmedabad. Mr Anantharaju has 20 years of experience in the IT industry and joined the company in August 2011. He has worked with firms like Aztecsoft, which was subsequently acquired by Mindtree, and he worked with Mindtree till July 2011, with his last role being VP and Head of the Microsoft Business Unit.

The DBS segment CEO is Rajiv Shah, who has prior work experience with firms like Wipro, where his last role was Chief Executive of the Financial Services and Healthcare business units, IBS Software Services Pvt Ltd, where he was CEO and Member of the Board, and Mu Sigma Limited, where he was a member of the Global Leadership Team and Advisor. He joined HMT in June 2019 and is a Member of the Executive Board. He holds an MSc in Mechanical Engineering (Robotics) from the University of Missouri.

The IMSS segment CEO is Chaluviya Ramamohan, who has previously worked with firms like Wipro Infotech, Vinciti Networks Pvt Ltd (EVP - Operations) and Mindtree (EVP). He joined HMT in December 2017 and is a Member of the Executive Board. Mr Ramamohan has a bachelor's degree in engineering from Bangalore University.

The finance function is headed by Venkatraman Narayanan, who is Managing Director and CFO, and has prior work experience with firms such as Perot Systems TSI India (CFO and Director), Teamlease Services (CFO) and Sonata Software (CFO), with the latter 2 firms both being listed entities. Mr Narayanan joined HMT on April 2015 and holds a bachelor's degree in commerce from Mahatma Gandhi University, a bachelor's degree in law from Karnataka State Law University and is an FCA of ICAI, New Delhi.

Thus, apart from Ashok Soota as Executive Chairman, HMT's key business segments are headed by capable CEOs with significant work experience in firms such as Mindtree and Wipro, with the finance function also being run by a CFO with prior experience in a couple of listed IT firms. The Executive Board plays a supervisory role, with the segment CEOs all reporting to it.

From a Board perspective, HMT has 6 directors, with 3 being Executive Directors (Ashok Soota, Joseph Anantharaju and Venkatraman Narayanan) and 3 being Non-Executive Independent Directors, all of whom were appointed in June 2020. Independent Directors are from varied fields including management consulting, finance and education.

We believe with the current composition of the Board of Directors, HMT will operate transparently from a corporate governance point of view, as is the case with many Indian IT firms, with the sector having been a leader in adoption of good corporate governance practices, and companies like Infosys being the torch bearers.

From an Executive Management perspective, as mentioned above, HMT's key go-to-market segments are run by capable CEOs with vast work experience, and they function under Executive Board supervision, which gives us confidence in the firm's ability to effectively leverage the substantial digital IT services growth opportunity over the next several years, given the long runway for growth ahead of it. The addressable market for HMT is significantly large at ~US\$ 1.3 trillion in CY19 (Source: Frost & Sullivan), which includes its focus segments of PES, DBS and IMSS. This is expected to grow at a robust CAGR of 16.4% till CY25 to touch US\$ 3.2 trillion.

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The addressable market for HMT is significantly large at ~US\$ 1.3 trillion in CY19, which includes its focus segments of DBS, PES and IMSS, which is expected to grow by >16% CAGR to touch US\$ 3.2 trillion by CY25

We believe in a global B2B business like digital IT services, there is ample runway for growth for all IT firms including HMT, with the critical driver being firm-level differentiation in terms of verticals served and breadth of service offerings

Greater investments in technologies like data & analytics, AI & ML, AR/VR and other new-age technologies will drive enterprise digital IT spend (DBS), which stood at US\$ 691 billion in CY19 and is expected to clock >20% CAGR till CY25 to cross US\$ 2 trillion

PES spend stood at US\$ 459 billion in CY19, which is expected to hit US\$ 869 billion by CY25, clocking 11.2% CAGR; within PES, the Software sub-segment is expected to grow at the fastest pace of 17.7% CAGR, followed by Embedded (8.3% CAGR) and Mechanical (7% CAGR)

The IMSS segment is expected to grow at 10.5% CAGR over CY19-CY25 to touch ~US\$ 248 billion, with the RPA sub-segment likely to witness the strongest growth (~25% CAGR, albeit on a low base), followed by IT Security (10.8% CAGR) and Managed Infrastructure Services (9.6% CAGR)

b) Substantial and fast-growing digital services market, long growth runway for HMT

The addressable market for HMT is significantly large at ~US\$ 1.3 trillion in CY19 (Source: Frost & Sullivan), which includes its focus segments of PES, DBS and IMSS. This is expected to grow at a robust CAGR of 16.4% till CY25 to touch US\$ 3.2 trillion, with the DBS segment likely to see the fastest growth of >20% CAGR over the period, followed by PES (11.2% CAGR) and IMSS (10.5% CAGR).

We believe in a global B2B business like digital IT services, there is ample runway for growth for all IT firms including HMT, with the critical driver being firm-level differentiation in terms of verticals served and breadth of service offerings. Even factoring in a certain proportion of offshoring, which reduces effective addressable market size owing to lower realisations, the market size is significant, in the region of hundreds of billions of USD, leaving substantial scope for growth.

Client organisations are putting digital transformation investments on priority given the need to reap the benefits and identify business-specific solutions that will drive growth Consumer-facing industries such as BFSI and Retail require to prioritise digitisation even more, given rapid consumer adoption of digital technologies. Thus, greater investments in data & analytics, AI & ML, AR/VR and other new-age disruptive technologies will drive enterprise digital IT spend (DBS), which stood at US\$ 691 billion in CY19 and is expected to clock >20% CAGR till CY25 to cross the US\$ 2 trillion-mark.

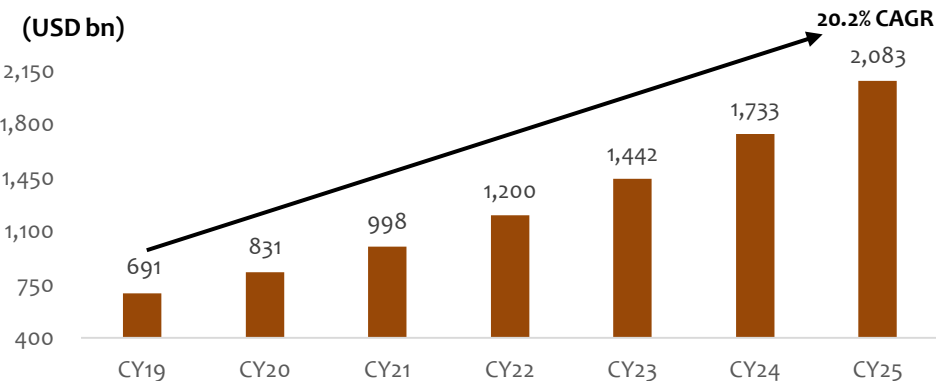
The PES segment size stood at US\$ 459 billion in CY19, which is expected to hit US\$ 869 billion by CY25, clocking 11.2% CAGR over the period. Offshore development and delivery of software products and platforms is seeing rapid growth, with factors such as minimising time to market, driving operational efficiency and innovation likely to boost client investments. Within PES, it is the Software sub-segment that is expected to grow at the fastest pace of 17.7% CAGR from CY19-CY25 to cross US\$ 360 billion (US\$ 137.6 billion in CY19), and will account for the largest share of PES spend by CY25. Embedded sub-segment is likely to clock 8.3% CAGR to cross US\$ 300 billion, while the Mechanical sub-segment will clock the slowest growth of 7% CAGR to touch US 200 billion.

Core engineering pedigree is a critical driving factor to grow the PES segment, and HMT is favourably placed on that count, with PES accounting for the lion's share of revenue (>50%) and likely to be a critical growth driver going forward.

The IMSS segment is expected to grow at 10.5% CAGR over CY19-CY25 to touch ~US\$ 248 billion, with the RPA sub-segment likely to witness the strongest growth of ~25% CAGR over the period (albeit on a low base) to touch US\$ 7.2 billion. IT Security is likely to witness 10.8% CAGR to touch US\$ 119 billion, with Managed Infrastructure Services likely to clock the slowest growth of 9.6% CAGR to touch US\$ 121.9 billion.

Given HMT's breadth of digital service offerings and focused go-to-market approach with CEOs appointed for each of its 3 business segments that address the entire gamut of customer's digital IT spends, we believe the company has a fairly long runway for growth. We expect the company to record >15% USD revenue CAGR over FY21-FY23E, led by rising customer digital IT spend, deeper engagements with existing customers, new customer acquisition and investments in business-critical initiatives like CoEs and strategic alliances.

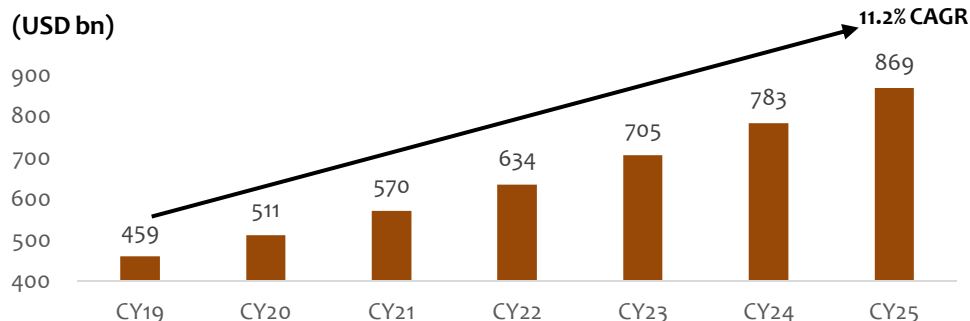
Exhibit 14: Enterprise Digital IT Spend – Robust growth likely



Source: Frost & Sullivan, KRChoksey Research

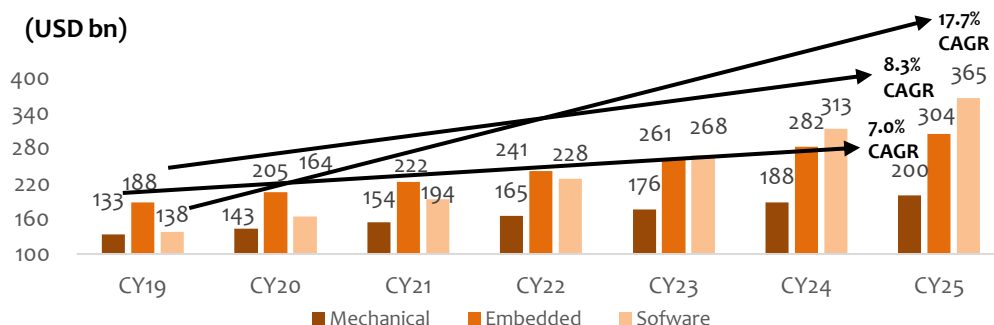
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Exhibit 15: Product Engineering Spend



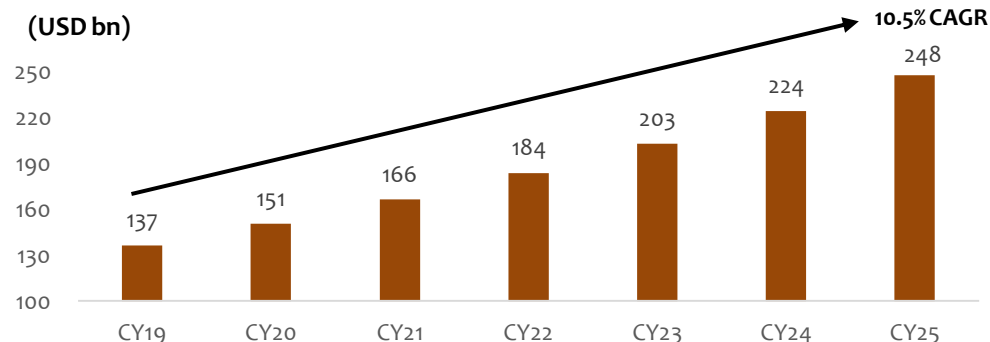
Source: Frost & Sullivan, KRChoksey Research

Exhibit 16: Product Engineering Spend break-up – Software to see robust growth



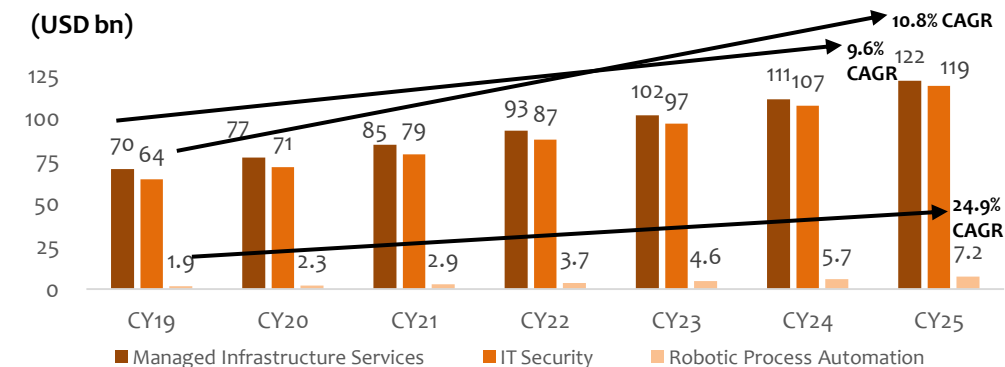
Source: Frost & Sullivan, KRChoksey Research

Exhibit 17: Infrastructure Management and Security Services Spend



Source: Frost & Sullivan, KRChoksey Research

Exhibit 18: IMSS Spend break-up – RPA to witness robust growth, albeit on a low base



Source: Frost & Sullivan, KRChoksey Research

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HMT's average revenue/client stood at US\$ 0.61 million in FY20 and US\$ 0.66 million in 2QFY21 (annualised). This has risen steadily from US\$ 0.47 million in FY18 and US\$ 0.50 million in FY19, implying 14.2% CAGR over FY18-FY20

HMT's top client accounted for US\$ 11.8 million in FY19 revenue, which rose slightly to US\$ 11.9 million in FY20 and more substantially to US\$ 14.6 million in 2QFY21 (annualised)

Average revenue/client for its top-5 clients has risen from US\$ 6.2 million in FY19 to US\$ 6.3 million in FY20, and further to US\$ 6.6 million in 2QFY21 (annualised). Corresponding data for its top-10 clients is US\$ 4.1 million/US\$ 4.8/US\$ 4.9 million, while corresponding figures for its top-20 clients are US\$ 2.6 million/US\$ 3.2 million/US\$ 3.3 million, respectively. These are well below global digital peers including EPAM and Globant, whose client productivity metrics are 5-15x those of HMT for top-5 and top-10 clients

HMT's focus has been more on ramping up revenue from key existing clients, which has led to a rise in client concentration, with the top-10 clients accounting for >48% of revenue in FY20 vs 44.9% in FY18 (49.1% in 2QFY21), with corresponding figures for the top-20 clients at 64.6% vs 59.8% in FY18 (66.7% in 2QFY21)

With rising scale of operations, new client addition and scale up of new client revenue, we believe this risk will be mitigated over a period of time

Client productivity – substantial scope for growth

HMT counted 157 active clients at end-FY20, and 152 at end-2QFY21. The digital services firm is clearly looking to increase revenue/client metrics, which stood at just US\$ 0.61 million in FY20 and US\$ 0.66 million in 2QFY21 (annualised). This has risen steadily from US\$ 0.47 million in FY18 and US\$ 0.50 million in FY19, implying 14.2% CAGR over FY18-FY20. HMT has reduced its active client base since FY18, when the figure stood at 173, to 152 at end-FY20 (156 at end-2QFY21) with a view to reducing the long tail and focusing on clients that have the capability of scaling up business with greater digital investments. This helps to save on S&M cost and drives focus on clients that can add greater value for the digital services firm.

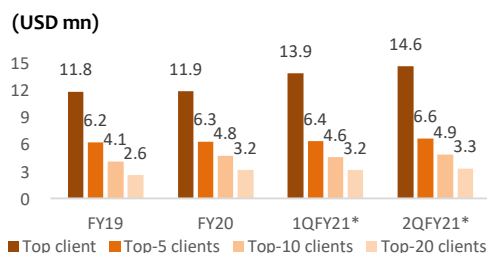
The company counted 37 Fortune 500 clients at end-FY20 (23.6% of total) and 39 at end-2QFY21 (25.7%). Its top client, top-5 and top-10 clients have seen healthy growth in average revenue/client. HMT's top client accounted for US\$ 11.8 million in FY19 revenue, which rose slightly to US\$ 11.9 million in FY20 and more substantially to US\$ 14.6 million in 2QFY21 (both annualised). Thus, the largest client (likely an Edutech major) has ramped up its digital investments, particularly in context of COVID-19 driving rise in digital education, leading to greater content management and publishing, new product and platform development, analytics, integration and mobility demand.

The average revenue/client for its top-5 clients has also risen slightly, from US\$ 6.2 million in FY19 to US\$ 6.3 million in FY20, and further to US\$ 6.6 million in 2QFY21 (latter 2 figures annualised). On the other hand, average revenue/client for its top-10 clients has risen from US\$ 4.1 million in FY19 to US\$ 4.8 million in FY20, and further to US\$ 4.9 million in 2QFY21 (annualised), while corresponding figures for its top-20 clients are US\$ 2.6 million, US\$ 3.2 million and US\$ 3.3 million. These are well below global digital services peers including EPAM and Globant, whose client productivity metrics are 5-15x those of HMT for top-5 and top-10 clients.

Given the need to scale up revenue, HMT's focus has been on ramping up revenue from existing clients, which has led to a rise in client concentration, with top-10 clients accounting for >48% of revenue in FY20 vs 44.9% in FY18 (49.1% in 2QFY21), with corresponding figures for top-20 clients at 64.6% vs 59.8% in FY18 (66.7% in 2QFY21). Repeat business accounted for 95% of FY20 revenue.

We believe client concentration risk is inherent in most mid sized IT firms, and HMT is no exception. However, with rising scale of operations, new client addition and scale up of new client revenue, we believe this risk will be mitigated over a period of time. HMT's 39 Fortune 500 clients will also serve as good reference points for new client and deal wins.

Exhibit 19: FY20 revenue/client for top client, top-5, top-10 and top-20 clients – On the up



Source: Company, KRChoksey Research; * Annualised

Exhibit 20: FY20/CY19 revenue/client peer comparison – Substantial scope for improvement

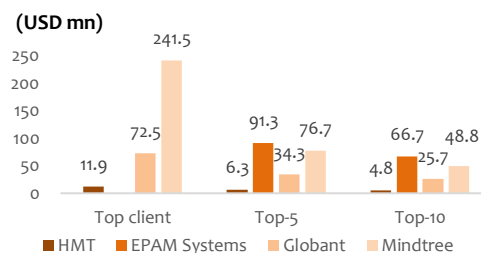
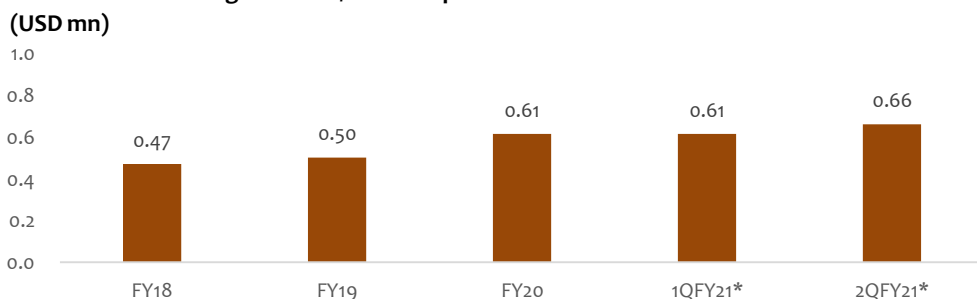


Exhibit 21: HMT Average revenue/client – Upward trend



Source: Company, KRChoksey Research; * Annualised

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HMT, despite being one of the smallest listed IT firms in terms of revenue, enjoys healthy financial and operating indicators, with key ratios such as profitability, RoE and cash flow all in-line with or in some cases better than peers. We compare HMT with Mindtree and Persistent Systems among our coverage mid-tier IT firms, and Infosys as a top-tier comparable, apart from comparison with global digital services firms like Globant and EPAM Systems

c) Strong profitability indicators and financial metrics in-line with or better than peers

HMT, despite being one of the smallest listed IT firms in terms of revenue, enjoys healthy financial and operating indicators, with key ratios such as profitability, RoE and cash flow all in-line with or in some cases better than peers. We compare HMT with Mindtree and Persistent Systems among our coverage mid-tier IT firms, and Infosys as a top-tier comparable, apart from comparison with global digital services firms like Globant and EPAM Systems.

The digital IT services firm is likely to clock >15% USD revenue CAGR over FY21-FY23E, with EBIT margin in excess of 20% in FY23E, led by revenue growth leverage and various cost control levers, with pricing also a potential lever in light of robust demand for digital services and the skill sets required to perform these mission-critical services. In comparison, we forecast 11-12% USD revenue CAGR for some of HMT's peers including Mindtree and Persistent Systems. HMT's EBIT margin is likely to be superior to both Mindtree and Persistent Systems (FY23E margins of 16.2% and 11.9%, respectively vs 20.3% for HMT), while Infosys' EBIT margin is likely to be 23.1%.

On the other hand, global digital services firms Globant and EPAM Systems are both likely to clock healthier revenue growth than HMT, with EPAM likely to grow revenue at a robust 22% CAGR over CY20-CY22E to touch US\$ 3.9 billion, with an EBIT margin of 18.9% in CY22E. Globant on the other hand is likely to clock a strong 23.6% revenue CAGR over the same period to touch US\$ 1.23 billion, with an EBIT margin of 16.1% in CY22E. Clearly, these 2 firms' first-mover advantage, vast digital service capabilities to a diversified range of verticals and greater geographical diversification is likely to drive growth going forward.

In terms of other metrics, HMT is likely to earn decent RoE of 24.2% in FY23E, which is higher than EPAM, Globant (20.3% and 15.4%, respectively in CY22E) and Persistent (19.3%), although lower than Mindtree and Infosys (26-31%). HMT earns the highest gross margin at 38.5% in FY20 compared with 28-38% for the listed comparables here. In 1HFY21, the company's gross margins have further expanded to 43.4%, aided by substantial cost reductions owing to lower travel and other administrative costs. Gross margin of the digital service majors is in the range of 35-38%. In terms of digital revenue share, HMT stood at 96.9% in FY20 (97.1% in 2QFY21) compared with 38-39% for Infosys and Mindtree, while Globant and EPAM earn 100% revenue from digital solutions.

Regards revenue productivity per employee, HMT is at the bottom of the table, with average revenue/employee at US\$ 38,357 in FY20 compared with US\$ 48,000-US\$ 54,000 for its Indian IT peers compared with here. Global digital services firms Globant and EPAM enjoy substantially higher revenue/employee at US\$ 65,000-US\$ 69,000, partly a reflection of their greater geographical diversification compared with HMT, with pricing generally higher in geographies like Eastern Europe, South America and Asia Pacific compared with India, thus boosting revenue and revenue productivity. It should be noted that for global digital services firms like Globant and EPAM, offshore revenue includes many geographies apart from India, including Belarus, Argentina, Colombia and Russia, where revenue productivity is higher than India, albeit costs are also on the higher side, leading to their lower margin profile compared with HMT.

In terms of offshore mix, HMT has the highest offshore revenue component (77.5% revenue mix in FY20) compared with peers for which data is available. Regards Time & Material contract share, HMT's revenue proportion of 81% is very similar to its global digital service peers (83-87% for Globant and EPAM). Given lower execution risks associated with T&M contracts, along with criticality of digital transformation projects for clients, proportion of these contracts tends to be on the higher side for digital service firms, which is reflected in HMT, Globant and EPAM's metrics.

Client concentration-wise, HMT compares slightly unfavourably vs the digital service majors, with 48.4% of its FY20 revenue being accounted for by its top-10 clients, compared with 39-41% for EPAM and Globant. Persistent and Mindtree's top-10 clients accounted for 45-52% of their FY20 revenue, while for Infosys, the figure is understandably much lower at 19.2%, given its greater client diversification as a top-tier IT services firm.

In terms of cash flow from operations (CFO), HMT stacks up well against peers, with the digital services firm's CFO at a healthy 122% of EBITDA in FY20, compared with 90-110% range for Mindtree, Persistent and Infosys, and 76-83% for Globant and EPAM. We expect this to trend down towards 90-95% by FY23E, as gains from lower debtor days peter down, and EBITDA grows at a faster pace.

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Exhibit 22: Comparative Data – HMT fares well on most parameters

Key Operating and Financial Metrics	HMT*	Mindtree**	Persistent Systems	Infosys	Globant#	EPAM Systems#
Revenue (US\$ mn, FY23E)	133	1,318	680	16,426	1,228	3,929
EBIT Margin (% , FY23E)	20.3	16.2	11.9	23.1	16.1	18.9
PAT Margin (% , FY23E)	19.0	12.4	11.2	19.5	13.4	14.0
USD Revenue CAGR (% , FY21-FY23E)	15.3	11.8	11.1	11.2	23.6	22.0
RoE (% , FY23E)	24.2	26.0	19.3	31.5	15.4	20.3
Gross Margin (% , FY20)	38.5	27.7	34.1	36.3	37.9	35.1
Digital Revenue Share (% , FY20)	96.9	38.2	N.A.	39.2	100.0	100.0
Employee Base (Nos, FY20)	2,666	21,991	10,632	242,371	11,855	36,739
Revenue/Employee (US\$, FY20)	38,357	51,608	48,714	54,330	65,154	68,579
Offshore Revenue Share (% , FY20)	77.5	N.A.	48.1	N.A.	N.A.	N.A.
Time & Material Revenue Share (% , FY20)	81.0	42.8	N.A.	N.A.	83.0	86.8
Top-10 Client Revenue Share (% , FY20)	48.4	44.8	51.8	19.2	40.7	39.0
Cash Flow from Ops. (% of EBITDA, FY20)	121.8	91.5	105.9	109.8	76.0	82.6
P/E (x, FY23E)	26.2	22.7	20.2	22.4	52.7	35.8
EV/EBIT (x, FY23E)	20.6	17.2	16.6	18.0	39.5	23.7

Source: Respective companies, Bloomberg, KRChoksey Research;

Note: Stock price close as on January 7, 2020.

* Revenue/employee for FY20 has been arrived at based on derived revenue as per our internal calculations.

** Mindtree Digital revenue share is based on the old service classification. From 1QFY21, the company has changed its service break-up and does not provide pure digital revenue separately.

December-ending FY; thus, FY20 corresponds to CY19 and FY23E corresponds to CY22E, with future estimates as per Bloomberg consensus data.

Valuation-wise, HMT commands a premium multiple to much larger IT service peers such as Persistent, Mindtree and even a top-tier IT firm like Infosys. The stock has seen impressive performance post-IPO and the CMP is >2x the IPO price, which was fairly attractive. A pure digital service firm, long runway for growth, positive stock performances across the sector, robust growth in client digital transformation investments over the next several years, and a small sized firm with good management, along with healthy financial and operating metrics are key factors that have led to valuation sustaining at higher levels, in our view.

It should be noted that a comparison with global digital services firms Globant and EPAM Systems shows that substantial valuation premium commanded by these firms. EPAM trades at a PE of >35x CY22E EPS, while Globant trades at >52x CY22E EPS. Superior growth of these pure digital firms, along with much larger size vs HMT, diversified geographical presence in terms of employees and good client profile are factors that are ensuring sustained higher multiples for these firms, apart from overall robustness in performance of IT services firms led by expectations of continuing healthy growth in digital transformation investments by clients. We believe as HMT grows in revenue size, valuation multiples can sustain in the region of 30x and could even exceed this as the firm moves towards a more meaningful size somewhere close to US\$ 250 million, a point from which it will have better scale, client engagement and the potential to make more acquisitions and pay dividends to shareholders. Thus, we believe it makes sense to view HMT as a longer-term investment, and a play on a long growth runway of digital investments.

Valuation-wise, HMT commands a premium multiple to much larger IT service peers such as Persistent, Mindtree and even a top-tier IT firm like Infosys; a pure digital service firm, long runway for growth, positive stock performances across the sector, robust growth in client digital transformation investments over the next several years, and a small sized firm with good management, along with healthy financial and operating metrics are key factors that have led to valuation sustaining at higher levels, in our view

Global digital services firms Globant and EPAM Systems command substantial valuation premium owing to their superior growth profile, along with much larger size vs HMT, diversified geographical presence in terms of employees and good client profile, apart from overall robustness in performance of IT services firms led by expectations of continuing healthy growth in digital transformation investments by clients

We believe as HMT grows in revenue size, valuation multiples can sustain in the region of 30x and could even exceed this as the firm moves towards a more meaningful size somewhere close to US\$ 250 million, a point from which it will have better scale, client engagement and the potential to make more acquisitions and pay dividends to shareholders

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We expect HMT to clock a healthy 15.3% USD revenue CAGR over FY21-FY23, and expect revenue to touch US\$ 133 million in FY23E from US\$ 100 million in FY21. We have modelled for a USD-INR rate of 74 for future years, and thus expect revenue to touch INR 9.9 billion by FY23 (INR 7.5 billion in FY21), clocking 15% CAGR

We expect revenue to be led by digital investments by clients with focus on the key go-to-market segments addressed by HMT; we expect growth to come from a combination of volume and pricing, and pricing can improve on the back of strong client demand

We expect HMT to report 13.2% EBIT CAGR over FY21-FY23E, with EBIT margin likely to trend down over the period, to touch 20.3% in FY23E vs 20.9% in FY21 owing to wage hike impact and return of some travel and administrative costs

We expect EPS CAGR to be subdued at 8.1% over FY21-F23E owing to marginal EPS growth in FY22 on account of lower EBIT margin and higher tax rate

3. Financial Projections

Revenue

We expect HMT to clock a healthy 15.3% USD revenue CAGR over FY21-FY23, and expect revenue to touch US\$ 133 million in FY23E from US\$ 100 million in FY21. We have modelled for a USD-INR rate of 74 for future years, and thus expect revenue to touch INR 9.9 billion by FY23 (INR 7.5 billion in FY21), clocking 15% CAGR. We expect revenue growth to be led by continuing digital transformation investments by clients across verticals with focus on the key go-to-market segments addressed by HMT (PES, DBS, IMSS). We expect growth to come from a combination of volume and pricing, and pricing can improve on the back of strong client demand for digital services, along with greater employee digital skill sets.

Exhibit 23: USD revenue forecasts

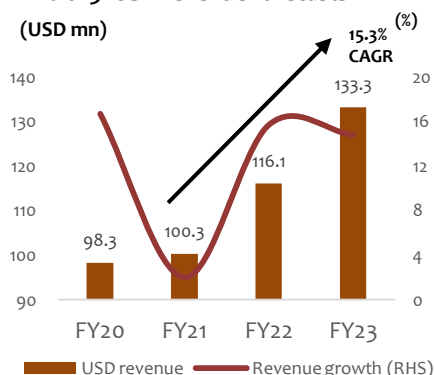
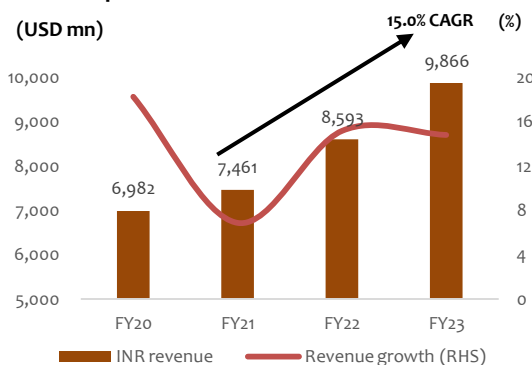


Exhibit 24: INR revenue forecasts



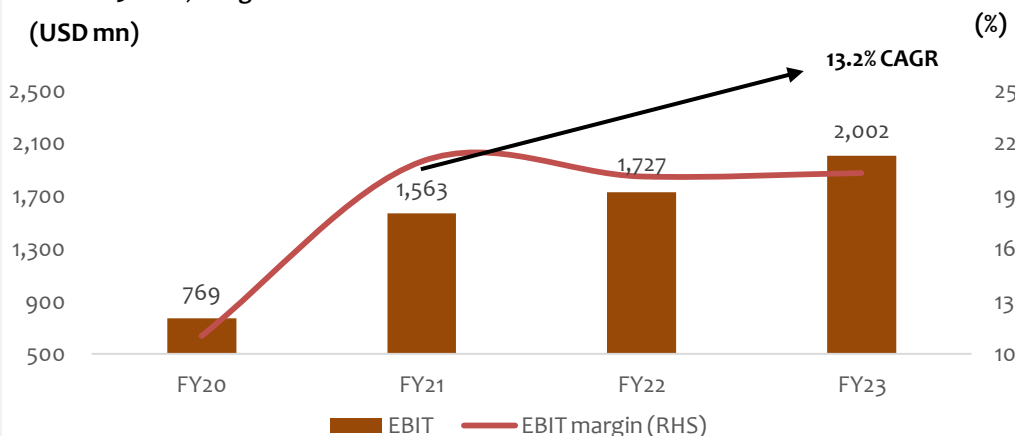
Source: Company, KRChoksey Research;

Note: USD revenue for FY20 has been calculated based on derived revenue as per our internal calculations.

EBIT, EBIT margin

We expect HMT to report 13.2% EBIT CAGR over FY21-FY23E, with EBIT in absolute terms likely to cross INR 2 billion in FY23 (INR 1.56 billion in FY21). EBIT margin is likely to trend down over the period, to touch 20.3% in FY23E vs 20.9% in FY21 owing to wage hike impact and return of some travel and administrative costs.

Exhibit 25: EBIT, margin forecasts



Source: Company, KRChoksey Research

EPS

We expect EPS CAGR to be subdued at 8.1% over FY21-F23E owing to marginal EPS growth in FY22 on account of lower EBIT margin and higher tax rate. For FY23, we expect ~15% EPS growth led by revenue growth and stable margin profile. We forecast EPS of INR 12.8 in FY23E vs INR 11.0 in FY21.

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4. Valuation

Going forward, the global digital IT services market is likely to clock a robust double digit CAGR of 16.4% over CY19-CY25 to touch US\$ 3.2 trillion vs US\$ 1.3 trillion in CY19 (Source: Frost & Sullivan), which includes HMT's focus segments of PES, DBS and IMSS. The DBS segment likely to see the fastest growth of >20% CAGR over the period, followed by PES (11.2% CAGR) and IMSS (10.5% CAGR). Through its primary go-to-market services, HMT addresses the entire gamut of enterprise digital IT spends, with its service offerings and domain knowledge built through CoE investments driving ever-increasing customer engagements and new customer wins. We believe investments made by HMT in these CoEs are critical to build industry-specific skill sets and widen its scope of service offerings across emerging and high-growth verticals such as Edutech and Hi-tech.

The promoter and Executive Chairman of HMT, Ashok Soota has strong pedigree in the IT industry, having been Vice Chairman of Wipro and Chairman and CEO of Mindtree. Mr Soota is a key driver for HMT's strong engineering pedigree. This is likely to stand the company in good stead going forward, given his deep domain expertise and connect with client boardrooms. Apart from Ashok Soota, HMT is led by a capable executive management team, with each of its segments headed by a CEO, who report to the company's Executive Board. The company's key business segment CEOs have significant work experience in firms such as Mindtree and Wipro, with the finance function also being run by a CFO with prior experience in a couple of listed IT firms. The Executive Board plays a supervisory role, with the segment CEOs all reporting to it. This gives us confidence in the firm's ability to effectively leverage the substantial digital IT services growth opportunity over the next several years.

HMT has significant scope to increase revenue/client metrics, which stood at just US\$ 0.61 million in FY20 and US\$ 0.66 million in 2QFY21 (annualised). The company counted 37 Fortune 500 clients at end-FY20 (23.6% of total) and 39 at end-2QFY21 (25.7%). Its top client, top-5 and top-10 clients have seen healthy growth in average revenue/client. Nonetheless, this is still well below global digital services peers including EPAM and Globant, whose client productivity metrics are 5-15x those of HMT for top-5 and top-10 clients.

Despite being one of the smallest listed IT firms in terms of revenue, HMT enjoys healthy operating and financial indicators, with key ratios such as profitability, RoE and cash flow all in-line with or in some cases better than peers. We compare HMT with Mindtree and Persistent Systems among our coverage mid-tier IT firms, and Infosys as a top-tier comparable, apart from comparison with global digital services firms like Globant and EPAM Systems.

Going forward, we expect HMT to clock 15.3% USD revenue CAGR and 13.2% EBIT CAGR over FY21-FY23E, with EBIT margin likely to decline slightly to 20.3% in FY23E vs 20.9% in FY21 owing to wage hike impact and return of some travel and administrative costs. On the other hand, EPS CAGR is expected to be subdued at 8.1% owing to marginal EPS growth in FY22 on account of lower EBIT margin and higher tax rate. For FY23, we expect ~15% EPS growth. We expect revenue growth to be led by continuing digital transformation investments by client organisations across industry verticals with focus on the key go-to-market segments addressed by HMT (PES, DBS, IMSS), and expect Edutech, Hi-tech, BFSI and Healthcare to be key growth drivers. We expect growth to come from a combination of volume and pricing, and pricing can improve on the back of strong client demand for digital services, along with greater employee digital skill sets.

Among other operating metrics, we expect cash flow to remain healthy, with CFO as a % of EBITDA likely to remain in excess of 90% over FY21-FY23E, more than adequate to fund capex, which we expect will remain fairly light at less than 1% of revenue over the period. As a result we expect HMT's cash and bank balances, and short term investments to cross INR 7 billion by FY23 (INR 48/share, 14.2% of market capitalisation). This could be used to pay a dividend (HMT has not yet paid out any dividends owing to need to invest for growth) or make an acquisition going forward, and we would view increased M&A activity as a positive, particularly if the target firm is a good digital play in a particular segment such as IoT or cloud, is profitable and not too large in terms of size to enable easy integration. RoE is likely to be healthy at >24% in FY23E.

At the CMP, HMT's stock trades at a PE of 30.0x/26.2x FY22E/FY23E EPS, respectively. This may appear on the higher side. However, we note that global digital services firms including EPAM Systems and Globant command substantially higher valuation owing to their superior growth profile and pure-play digital service portfolios. EPAM trades at a PE of 35.8x CY22E EPS, while Globant trades at 52.7x CY22E EPS.

Going forward, we expect HMT to clock 15.3% USD revenue CAGR and 13.2% EBIT CAGR over FY21-FY23E, with EBIT margin likely to decline slightly to 20.3% in FY23E vs 20.9% in FY21 owing to wage hike impact and return of some travel and administrative costs

We expect revenue growth to be led by continuing digital transformation investments by client organisations across industry verticals with focus on the key go-to-market segments addressed by HMT, and expect Edutech, Hi-tech, BFSI and Healthcare to be key growth drivers

We expect cash flow to remain healthy, with CFO as a % of EBITDA likely to remain in excess of 90% over FY21-FY23E, which could be used to pay a dividend or make an acquisition going forward

Global digital services firms including EPAM Systems and Globant command substantially higher valuation owing to their superior growth profile and pure-play digital service portfolios

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Given the substantial growth runway ahead, we believe HMT will be able to sustain 15-20% revenue growth in the medium-term, along with 20% EBIT margin. We believe a PE multiple of 30x forward earnings is justified given the long growth runway, quality of management, pure digital focus, healthy financial and operating metrics and strong cash flow generation, which can potentially lead to greater M&A activity and dividend pay outs in future. **We Initiate Coverage on HMT with an ACCUMULATE rating and target price of INR 385, implying a PE of 30x FY23E EPS and 14.7% upside from current levels.** The stock has performed well post-IPO, notching up gains of >100%, and we would turn buyers at slightly lower levels (10%) from here, even as we would be comfortable buying in staggered quantities from a long-term investment perspective. Key risks include street perception of Ashok Soota as the key driver for the company, and any development on him not continuing his relationship with HMT, be it in the form of retirement or any other manner, would impact the stock adversely.

Key Risks and concerns

- **Street perception of HMT being excessively dependent on founder Ashok Soota:** Given Ashok Soota's impressive pedigree in the Indian IT industry, and HMT being a small firm, street perception appears to be that the company is excessively dependent on Mr Soota. Thus, any developments that would imply Mr Soota discontinuing his relationship with the firm would lead to an adverse stock reaction, in our view.
- **A major client loss:** Given that HMT is a small-sized firm with high client concentration levels (top-10 clients account for nearly 50% of revenue, and top-20 clients nearly 67%), any loss of clients, particularly in the top-20 bucket is likely to lead to a significant impact of revenue and profits of the company.
- **Major unforeseen events such as COVID-19, and geopolitical events could slow digital IT spend:** Unforeseen events such as a pandemic like COVID-19 could increase global economic uncertainty, leading to clients going slow on any major digital transformation investments till such time as a clearer picture emerges, thus impacting pure digital firms like HMT adversely. Geopolitical events such as another BREXIT-like development could also upend the global economic scenario and consequently, digital budgets of client organisations.
- **Currency risk:** Any volatile movements in the USD versus currencies like the INR, GBP and EUR could adversely impact HMT, given that the company earns revenue in these currencies.

We believe a PE multiple of 30x forward earnings is justified given the long growth runway, quality of management, pure digital focus, healthy financial and operating metrics and strong cash flow generation, which can potentially lead to greater M&A activity and dividend pay outs in future

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5. Appendix

Exhibit 26: Fund Holdings

Top Institutional holdings (as on September 2020)	% of outstanding
SBI Funds Management Pvt Ltd	2.19%
L&T Mutual Fund Trustee Ltd	0.80%
Goldman Sachs Group Inc	0.67%
Baillie Gifford & Co	0.66%
Axis Asset Management Co Ltd	0.66%
Aditya Birla Sun Life Asset Management Co Ltd	0.66%
Kotak Mahindra Asset Management Co Ltd	0.63%
Sundaram Asset Management Co Ltd	0.44%

Source: Bloomberg

Exhibit 27: Board of Directors and Key Management Personnel

Board of Directors/Management	Designation	Experience
ASHOK SOOTA	Executive Chairman	With HMT since inception as Founder Total Experience +55 years
JOSEPH ANANTHARAJU	Executive Vice Chairman, Member – Executive Board and CEO – PES	+9 years with HMT Total Experience +20 years
VENKATRAMAN NARAYANAN	Managing Director, Member – Executive Board and CFO	+5 years with HMT Total Experience +25 years
ANITA RAMACHANDRAN	Independent Director	Joined HMT in June 2020 Total Experience +35 years
RAJENDRA KUMAR SRIVASTAVA	Independent Director	Joined HMT in June 2020 Total Experience +42 years
SHUBHA RAO MAYYA	Independent Director	Joined HMT in June 2020 Total Experience +30 years
RAJIV SHAH	Member – Executive Board and President & CEO – DBS	Joined HMT in June 2019 Total Experience +35 years
CHALUVAIYA RAMAMOCHAN	Member – Executive Board and President & CEO – IMSS	+3 years with HMT Total Experience +35 years
PRAVEEN KUMAR DARSHANKAR	VP and Head of Legal, Company Secretary and Compliance Officer	+5 years with HMT Total Experience +21 years
RAJA SEKHAR	Executive Vice President & Head – Engineering and Business Excellence	Total Experience +18 years
SACHIN KHURANA	Vice President and Chief People Officer	+3 years with HMT Total Experience +14 years
SAJITH S KUMAR	Vice President and Chief Information Officer	Total Experience +23 years

Source: Company

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Exhibit 28: Financial Statements

PROFIT AND LOSS ACCOUNT (INR Mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenue (USD mn)	84.3	98.3	100.3	116.1	133.3
Revenue	5,904	6,982	7,461	8,593	9,866
Employee cost	3,851	4,412	4,540	5,244	5,981
SG&A and other expenses	1,505	1,599	1,151	1,398	1,642
EBITDA	548	971	1,769	1,950	2,243
Depreciation & Amortisation	248	202	207	224	242
EBIT	301	769	1,563	1,727	2,002
Interest Cost	159	80	72	65	58
Other Income	115	160	296	383	399
PBT	256	849	1,787	2,045	2,343
Income tax	(12)	19	183	409	469
PAT before exceptional items	268	830	1,604	1,636	1,874
Exceptional items	(126)	(113)	0	0	0
PAT after exceptional items	142	717	1,604	1,636	1,874
Diluted EPS (INR)	1.0	4.9	11.0	11.2	12.8

Source: Company, KRChoksey Research; Note: USD revenue in FY19 and FY20 is derived as per our internal calculations.

BALANCE SHEET (INR Mn)	FY19	FY20	FY21E	FY22E	FY23E
Equity share capital	60	88	292	292	292
Instruments in the nature of Equity	223	363	-	-	-
Reserves	(943)	2,202	4,892	6,528	8,402
Net worth	(661)	2,653	5,185	6,821	8,695
Borrowings	686	705	636	566	497
Operating lease liability	296	173	173	173	173
Other liabilities	94	126	126	126	126
Accounts payable	288	344	624	710	794
Other current liabilities	3,332	956	962	975	990
Provisions	100	125	125	125	125
Total current liabilities	3,719	1,425	1,710	1,809	1,908
Total Liabilities	4,135	5,082	7,829	9,495	11,399
Gross block	53	57	132	209	288
Depreciation	32	48	81	118	157
Net block	21	9	50	91	131
Capital work in progress	-	-	-	-	-
Goodwill and Intangible assets	193	68	65	75	85
Intangible assets under development	2	2	2	2	2
Non current financial assets	24	37	37	37	37
Long term loans and advances	62	77	77	77	77
Income tax assets, net	92	134	134	134	134
Right of use assets	397	301	297	283	268
Other non current assets	5	3	3	3	3
Accounts receivable	1,293	1,149	1,124	1,342	1,622
Short term loans and advances	8	10	10	10	10
Current investments	982	834	834	834	834
Cash and bank	263	435	3,173	4,585	6,173
Other current assets	795	2,024	2,024	2,024	2,024
Total current assets	3,340	4,451	7,165	8,794	10,663
Total Assets	4,135	5,082	7,829	9,495	11,399

Source: Company, KRChoksey Research

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CASH FLOW STATEMENT (INR Mn)	FY19	FY20	FY21E	FY22E	FY23E
Net cash generated from Operations	576	1,122	1,577	1,558	1,737
Net cash flow from Investing Activities	(3)	(737)	-75	-77	-79
Net cash flow from Financing Activities	(588)	(133)	1,235	-69	-69
Net inc/(dec) in cash equivalents	(15)	251	2,738	1,412	1,589
Opening balance	165	263	435	3,173	4,585
Other adjustments	112	(79)	0	0	0
Closing cash and cash equivalents	263	435	3,173	4,585	6,173

Source: Company, KRChoksey Research

RATIO ANALYSIS	FY19	FY20	FY21E	FY22E	FY23E
Tax rate (%)	(4.8)	2.2	10.2	20.0	20.0
RoE (%)	(16.2)	72.0	40.9	27.3	24.2
RoCE (%)	(36.0)	75.4	35.8	23.0	20.6
Current ratio (x)	0.9	3.1	4.2	4.9	5.6
EBITDA margin (%)	9.3	13.9	23.7	22.7	22.7
EBIT margin (%)	5.1	11.0	20.9	20.1	20.3
Net profit margin (%)	2.4	10.3	21.5	19.0	19.0
PE ratio (x)	345.4	68.4	30.6	30.0	26.2
EV/EBITDA (x)	45.5	34.7	25.0	22.0	18.4
EV/EBIT (x)	83.1	43.9	28.3	24.8	20.6

Source: Company, KRChoksey Research

Happiest Minds Technologies Ltd.

Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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