

SECURITY AND INTELLIGENCE SERVICES (INDIA)

MIDCAPS

BUY

Target Price: Rs 1,370

Strong earnings trajectory ahead

We met with management of SIS. Our earnings growth estimate of ~38% CAGR over FY18E-20E stems from our confidence that SIS can deliver: (1) 25%+ sales growth in India security based on its current monthly run-rate, (2) Margin expansion across segments, (3) Cash and pest control businesses expected to break even and (4) Higher tax benefit under 80JJAA after recent amendment in the act.

SIS has a strong India-focused M&A pipeline ahead; it has arranged Rs 10 bn acquisition corpus at ~7.5%. Potential acquisitions will be in India security (revenue of ~Rs 2-4 bn, 7-8% EBITDA margin), facility management (revenue of ~Rs 1-2 bn, 6-7% EBITDA margin) and cash logistics. We have not built inorganic growth into our estimates, which provides a potential upside to our numbers. We believe SIS is well-positioned to tap the large opportunity landscape in business services. We reiterate **BUY** with a **TP of Rs 1,370 (30x FY20E)**.

CMP : Rs 1,096
Potential Upside : 25%

MARKET DATA

No. of Shares : 73 mn
Free Float : 25%
Market Cap : Rs 80 bn
52-week High/ Low : Rs 1,300 / Rs 708
Avg. Daily vol. (6mth) : 43,929 shares
Bloomberg Code : SECIS IB Equity
Promoters Holding : 75%
FII / DII : 6% / 4%

Key takeaways

- ◆ India security services monthly run-rate is strong at ~Rs 2 bn. The company expects growth momentum to continue into Q4 and FY19. 25%+ growth will be driven equally by increase in volumes as well as realization
- ◆ Australia security services monthly run-rate is also healthy at ~AUD 52-53 mn. SXP will be consolidated for full 12 months FY19 onwards versus 9 months in FY18. In FY18, wage hike in the region was 3.3%, higher than historical increase; consequently, it was difficult to pass on some of it to clients immediately. Going forward, SIS has plans that cost savings in Australia (~USD 1 mn) and SXP will enhance the margin profile of the business
- ◆ In FY18, SIS has added ~150 branches so far. In FY19, it plans to add only 2 more branches to network. Management expects meaningful operating leverage in next few years from recently-added branches

(continued on page 2...)

Financial summary (Consolidated)

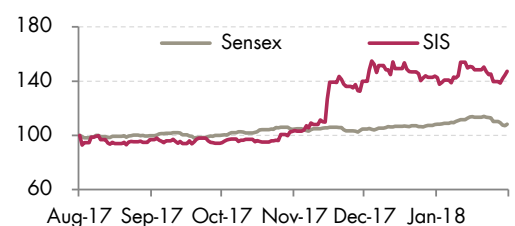
Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	43,872	58,507	69,651	81,802
Adj PAT (Rs mn)	1,106	1,608	2,547	3,349
Con. EPS* (Rs.)	-	24.4	35.6	45.7
EPS (Rs.)	15.1	22.0	34.8	45.7
Change YOY (%)	71.5	45.4	58.4	31.5
P/E (x)	72.5	49.9	31.5	23.9
RoE (%)	22.5	19.8	21.1	22.3
RoCE (%)	15.1	16.9	20.4	22.8
EV/EBITDA (x)	37.5	24.5	18.5	14.4
DPS	-	-	-	-

Source: Company, Axis Capital, CMP as on 12 Mar 2018

Key drivers

(%)	FY18E	FY19E	FY20E
Revenue growth	33	19	17
Core EBITDA	5.5	6.0	6.3

Price performance



(...continued from page 1)

- ◆ Inorganic expansion will be in India security, facility management and cash logistics space. SIS will look at acquisition valuation of ~10x 1-year forward EBITDA with a 23-25% IRR
- ◆ Dusters will be 100% owned by FY20 (there is a 3-year exit payout for promoters). There will be significant synergies in terms of cross-selling from the existing branch network and back-office re-alignment once the entity is fully consolidated
- ◆ Pest control is still losing money; expect it to break even by mid-FY19
- ◆ Alarm monitoring (V-Protect) will continue to burn money for some more years. Management remains confident of huge growth potential in the space as very few organized incumbents offer these services
- ◆ Cash logistics will be in loss in FY18, as the company chose to exit some unviable contracts. Longer term, the cash management market is expected to consolidate (globally it is a 2-3 player market); SIS is very positive on long-term prospects of the space
- ◆ In the latest budget, clause 80JJAA (an additional deduction of 30% of salaries paid to incremental employees hired, is available, provided the salary per month is less than Rs 25K per month for each such individual) has been made such that the condition of completion of 240 days by an employee will be tested in two consecutive years instead of only the first year. Thus, if the employee fulfills the condition cumulatively over the first two years of employment, the company should be allowed to claim the additional deduction from year two to four. This is an added incentive for organized players like SIS who already benefit significantly from the clause. The amendment means more employees can get under this bracket, thus extending the tax benefit for companies mentioned above

Our view: We like SIS for predictability (recurring revenue, 2%+ monthly run rate), scalability (3x GDP growth, shift to organized), and market leadership across verticals.

- ◆ In India, addressable market size for SIS (across operating verticals) is USD 25 bn by FY20, growing at 18-20% p.a. Steady formalization of the sector and superior operations of SIS should ensure that it grows faster than industry. India's security and facility management industry is highly fragmented; organic growth remains core to the business model driven by shift to the organized segment, steady economic growth, and increased spending on infrastructure. We estimate SIS' India security services to double its earnings between FY18 to FY20 led by strong compounding organic growth, steady increase in wages and strong operating leverage
- ◆ In Australia, SIS is the largest security services provider (21% market share). Australia is a unique asset that offers high RoCE (72% in FY17) and generates significant cash (average OCF/EBITDA ~80% in last 5 years) that is utilized in India for organic and inorganic growth needs. Recently-acquired SXP, largest mobile patrol services in Australia, has a higher margin profile and offers USD 1 mn of savings on integration which should reflect in FY19

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	43,872	58,507	69,651	81,802
Other operating income	-	-	-	-
Total operating income	43,872	58,507	69,651	81,802
Cost of goods sold	(39,435)	(51,952)	(61,628)	(72,032)
Gross profit	4,437	6,554	8,023	9,770
Gross margin (%)	10.1	11.2	11.5	11.9
Total operating expenses	(2,233)	(3,356)	(3,867)	(4,634)
EBITDA	2,204	3,199	4,157	5,135
EBITDA margin (%)	5.0	5.5	6.0	6.3
Depreciation	(356)	(456)	(560)	(692)
EBIT	1,848	2,743	3,597	4,443
Net interest	(654)	(592)	(342)	(192)
Other income	(60)	(156)	(71)	(65)
Profit before tax	1,133	1,994	3,183	4,186
Total taxation	(27)	(386)	(637)	(837)
Tax rate (%)	2.4	19.4	20.0	20.0
Profit after tax	1,106	1,608	2,547	3,349
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	1,106	1,608	2,547	3,349
Adj. PAT margin (%)	2.5	2.7	3.7	4.1
Net non-recurring items	-	-	-	-
Reported net profit	1,106	1,608	2,547	3,349

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	687	4,307	4,307	4,307
Reserves & surplus	4,744	6,502	9,049	12,398
Net worth	5,431	10,809	13,356	16,704
Borrowing	6,855	4,255	3,155	2,055
Other non-current liabilities	1,534	1,534	1,534	1,534
Total liabilities	13,965	16,598	18,044	20,293
Gross fixed assets	4,417	4,461	4,401	4,209
Less: Depreciation	-	-	-	-
Net fixed assets	4,417	4,461	4,401	4,209
Add: Capital WIP	3	3	3	3
Total fixed assets	4,420	4,464	4,404	4,212
Total Investment	195	195	195	195
Inventory	40	41	48	57
Debtors	4,617	6,158	7,331	8,609
Cash & bank	4,512	6,069	6,625	8,030
Loans & advances	2,532	3,377	4,020	4,721
Current liabilities	6,519	8,976	10,685	12,549
Net current assets	8,473	11,058	12,565	15,006
Other non-current assets	876	879	879	879
Total assets	13,965	16,597	18,044	20,293

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	1,133	1,994	3,183	4,186
Depreciation & Amortisation	356	456	560	692
Chg in working capital	(758)	(1,028)	(950)	(1,036)
Cash flow from operations	944	1,186	2,156	3,005
Capital expenditure	(647)	(500)	(500)	(500)
Cash flow from investing	(2,057)	(500)	(500)	(500)
Equity raised/ (repaid)	-	3,620	-	-
Debt raised/ (repaid)	2,968	(2,600)	(1,100)	(1,100)
Dividend paid	3	-	-	-
Cash flow from financing	2,128	875	(1,100)	(1,100)
Net chg in cash	1,015	1,561	556	1,405

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	15.1	22.0	34.8	45.7
CEPS (Rs)	20.0	28.2	42.4	55.2
DPS (Rs)	-	-	-	-
Dividend payout ratio (%)	-	-	-	-
GROWTH				
Net sales (%)	14.3	33.4	19.0	17.4
EBITDA (%)	30.1	45.2	29.9	23.5
Adj net profit (%)	71.5	45.4	58.4	31.5
FDEPS (%)	71.5	45.4	58.4	31.5
PERFORMANCE				
RoE (%)	22.5	19.8	21.1	22.3
RoCE (%)	15.1	16.9	20.4	22.8
EFFICIENCY				
Asset turnover (x)	6.8	6.9	7.4	7.9
Sales/ total assets (x)	2.5	2.5	2.6	2.7
Working capital/ sales (x)	0.1	0.1	0.1	0.1
Receivable days	38.4	38.4	38.4	38.4
Inventory days	0.3	0.3	0.3	0.3
Payable days	4.1	4.1	4.1	4.1
FINANCIAL STABILITY				
Total debt/ equity (x)	1.4	0.5	0.3	0.1
Net debt/ equity (x)	0.5	(0.2)	(0.3)	(0.4)
Current ratio (x)	2.3	2.2	2.2	2.2
Interest cover (x)	2.8	4.6	10.5	23.1
VALUATION				
PE (x)	72.5	49.9	31.5	23.9
EV/ EBITDA (x)	37.5	24.5	18.5	14.4
EV/ Net sales (x)	1.9	1.3	1.1	0.9
PB (x)	14.8	7.4	6.0	4.8
Dividend yield (%)	-	-	-	-
Free cash flow yield (%)	0.4	0.9	2.1	3.1

Source: Company, Axis Capital

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Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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