Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Expleo Solutions Limited

Combining the firepower

IT & ITeS	Sharekhan code: EXPLEOSOL	New Idea

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View
View: **Positive**
CMP: **Rs. 1,144**
Upside potential: **28%**

↑ Upgrade ↔ Maintain ↓ Downgrade

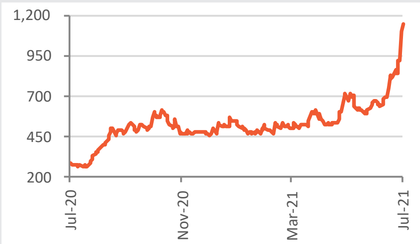
Company details

Market cap:	Rs. 1,173 cr
52-week high/low:	Rs. 1,183 / 262
NSE volume: (No of shares)	0.6 lakh
BSE code:	533121
NSE code:	EXPLEOSOL
Free float: (No of shares)	0.4 cr

Shareholding (%)

Promoters	56
FII	9
DII	3
Others	33

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	71.4	94.3	107.8	296.6
Relative to Sensex	70.9	85.6	100.7	252.8

Sharekhan Research, Bloomberg

Summary

- We initiate viewpoint coverage on Expleo Solutions with a Positive view and expect a 28% upside in the next 12 months given strong earnings growth potential, favorable synergies from recent merger announcement and reasonable valuation.
- Stock is attractively valued at 15x/13x of FY2023E/FY2024E earnings of combined entity; is debt-free with improving cash conversion; net cash of the combined entity accounts for 24% of current market capitalisation.
- Expleo Solutions is a leader in next-gen software testing services and is well-placed to benefit as this market that is expected to clock a 13% CAGR over FY2020-FY2026E.
- Amalgamation of all the Indian entities of Expleo Group under ESL with a favourable swap ratio would enhance the company's capabilities in engineering services, diversify industry portfolio beyond financial services, expand markets and provide cross-selling opportunities.

Expleo Solutions Limited (ESL) has successfully transformed itself from a quality assurance (QA) consulting and onsite delivery testing company to a specialised testing services player by building capabilities in digital quality assurance and offshore delivery testing business model. With the announcement of amalgamation of all Indian Expleo Group entities under ESL, the company would diversify its service capabilities (engineering services), industry portfolio (aerospace, automobiles, defence, industrial and media & entertainment) and markets. Expleo Solutions is recognised as a leader in next-generation software testing services such as mobile testing, AI-based automation and other cognitive & testing capabilities in financial services domain. The pandemic has accelerated digital transformation initiatives among financial institutions given the changes in regulatory frameworks, reduced costs and rising adoption of digital channels. Increasing demand for customised software development and applications is expected to drive growth of the quality assurance (QA) services market going ahead. Software testing forms ~6% of the total budget for software development and has a lot of room to grow considering the rise of agile and DevOps application development methodologies. The specialised testing services (STS) market is expected to outpace the traditional testing services (TTS) market, led by higher demand for next-generation testing, which is expected to clock a 13% CAGR over FY2020-FY2026. The company continues to invest in quality engineering and quality assurance (QA), around embedded software, Internet of Things (IoT) and product life cycle management (PLM) technologies to expand its presence in non-BFSI industries such as automobiles, transportation and manufacturing by leveraging its parent's network. The merger of the Expleo Group's Indian entities would help the company attract talent and skills in niche areas, access global clientele, expand markets and leverage cross-selling opportunities. The management eyes revenue growth of 15-20% (significantly higher as compared to 2.6% CAGR clocked during FY2016-FY2021) for FY2022E, led by a large deal pipeline, deal wins, traction for new-generation testing and presence in high-growth BFSI space. Further, the newly-appointed Group CEO, Rajesh Krishnamurthy, expects to double the India business (both in capability and scale) in the next years by investing on digital capabilities and to restart its US business (that accounted for 3.2% of total revenues in Q4FY2021) through an inorganic route and hiring staffs in the US. We expect ESL (without consolidation of the Group's India business) to register a revenue and earnings CAGR of 18% and 16% over FY2021-FY2024E.

Our Call

Valuation – Reasonable valuation, expect a 28% upside: The merger of Indian Group entities with ESL would diversify its service portfolio from a pure-play quality engineering and testing company to engineering services and industry portfolio beyond the banking, insurance and automotive verticals. We believe that the swap ratio is favourable for shareholders because of diversified product and industry portfolio, cross-selling opportunities, accessing global clientele, new capabilities, market expansion and scalability. Based on our quick estimates, at CMP, the stock trades at 15x/13x of FY2023E/FY2024E earnings of combined entity, which is reasonable given strong earnings growth potential. Further, cash on balance sheet of combined entity stood at Rs. 277 crore (24% of current market capitalisation). With an improvement in free cash flow generation and increase in promoter's stake in the combined entity, we expect the company could resume its dividend payouts. Hence, we initiate viewpoint coverage on Expleo Solutions with a Positive view and expect a 28% upside in the next 12 months.

Key Risks

(1) Limited presence in US despite its huge potential; (2) currency risks; (3) higher client concentration and 4) challenges in talents availability.

Valuation (without consolidation of Group's India business) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	300.9	362.2	431.4	501.0
OPM (%)	23.2	18.2	19.6	20.8
Adjusted PAT	50.4	52.1	65.3	79.4
% YoY growth	*26.4*	*3.3*	*25.4*	*21.6*
Adjusted EPS (Rs.)	49.2	50.9	63.8	77.5
P/E (x)	23.3	22.5	17.9	14.8
P/B (x)	5.8	5.1	4.3	3.6
EV/EBITDA (x)	14.9	15.7	12.0	9.4
RoNW (%)	28.5	24.2	26.2	26.7
RoCE (%)	34.6	26.6	30.0	31.6

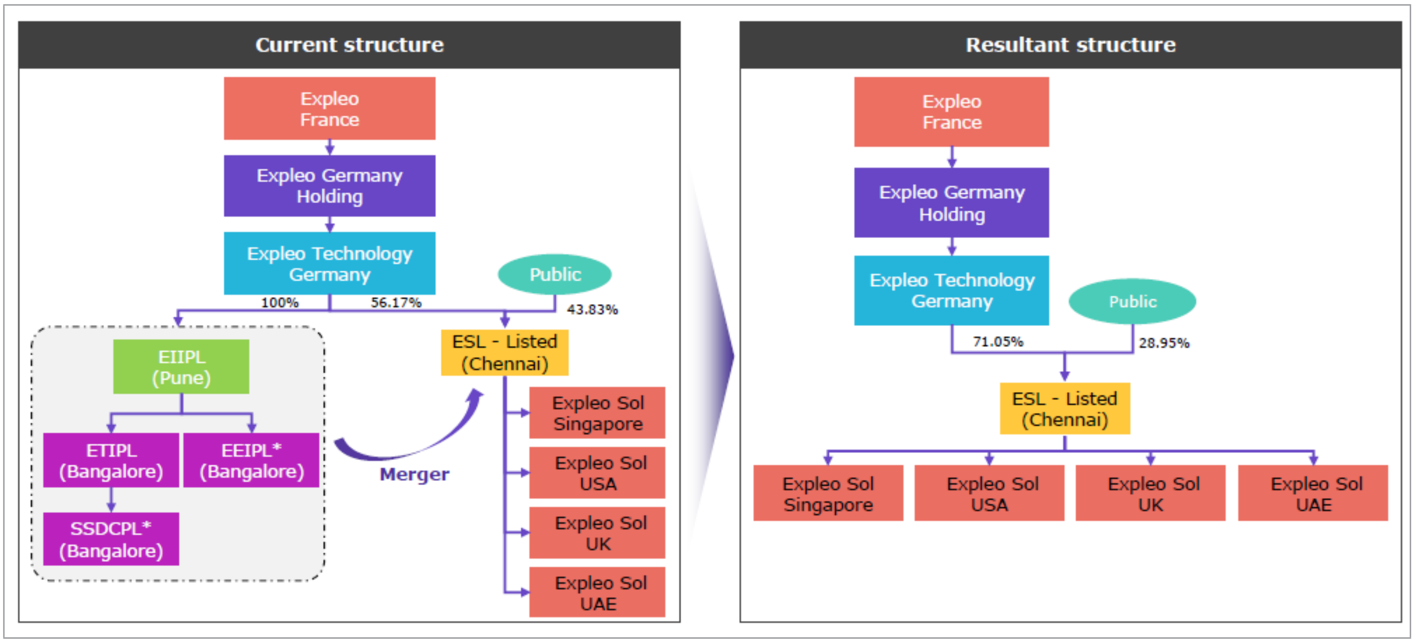
Source: Company; Sharekhan Research

**We have not incorporated the financials of merged entities (Group's India business). Numbers are estimated for ESL.*

Event: Consolidation of Group's India business

The Expleo Group plans to consolidate its entire India business under Expleo Solutions Limited (ESL). The Board of ESL and Expleo India Infosystems Private Limited (EIIPL) announced a Scheme of Amalgamation involving the merger of EIIPL (including its subsidiaries and stepdown subsidiary) into ESL. EIIPL, registered under an SEZ scheme, is engaged in end-to-end, integrated quality services and management consulting for the automotive, manufacturing, gaming & gambling, energy & utilities and commodity trading industries. EIIPL holds 100% of shares in Expleo Technologies India Private Limited (ETIPL) which provides software development, validation, verification, certification and engineering design services in the field of aerospace, automotive, defence and rail transportation domains. Pursuant to the above restructuring, ESL shall issue 459 fully paid-up equity shares of Rs. 10 each of ESL for every 10 equity shares of Rs. 10 each held in EIIPL. As a results, total number of equity shares of ESL will be diluted by 51% to 1.55 crore outstanding shares post scheme of amalgamation. The management expects the merger process to take 10-11 months.

Sustained tech spends by large banks



Source: Company

Consolidation will enhance product offering and improve synergies

The management highlighted that the amalgamation of all the Indian Group entities under ESL would enhance the company's new capabilities (engineering services), industry portfolio (aerospace, automobiles, defence, industrial and media & entertainment), market expansion, cross-selling and sales enhancement. This transaction will enhance ESL's end-to-end engineering, consultancy and quality assurance capabilities beyond financial services. This consolidation will help ESL to leverage its global capabilities and build scale in India. Further, the scalability of the enterprise would enable the company to attract talents and skills in niche areas. In the next 3-5 years, the management indicated that it would further diversify into newer industries such as healthcare, medical devices, construction and manufacturing industries. Though the Bangalore entity focuses on the automotive and aerospace sectors, its Pune entity focuses on automotive and other industries such as media and entertainment, industrial, manufacturing and among others. The management indicated that the direct business contribution from the group would reduce to around 55% over next 2-3 years from 66% currently. The management expects the improving synergies would help the company to drive double-digit revenue growth in next few years, supported by addition of new capabilities, penetration to new markets and higher offshoring opportunities from group entity.

Favorable synergies to drive growth going ahead

New Capabilities	Insurance Best Shoring	Engineering Capabilities	Market Expansion	Cross-Selling	Sales Enhancement
• ERP, Supply chain, Manufacturing & Entertainment Industry • Top tier product co. as a client and partnership with a leading ERP • Mobile Device and IOT lab in Pune (300+ devices) – Reduced external dependencies	• Adding Insurance business and a Top European and UK Insurer as client • Capability enhancement in Automation, Functional QA and other Insurance platforms	• Engg (Mechanical and Software) capabilities in Avionics & Automotive • Top European clients with $20mn+ revenue • Enhanced tech. competency attracting Engineers and Developers	• Expansion in Direct Markets (India, Asia, ME) for Non-BFSI engagements • Engineering capability in the Direct Markets.	• Financial Treasury functions for the Engineering and Non BFSI clients • ERP Implementation for BFSI clients • Leverage the ERP and technical partnerships	• Additional Direct Sales and Pre-Sales capability for Engineering, Digital, Software competencies

Source: Company

Favourable swap ratio likely to benefit shareholders

ESL shall issue 459 fully paid-up equity shares for every 10 equity shares held in EIIPL, which looks favorable for shareholders as the combined entities net profit would grow by 75% with a 51% equity dilution. ESL's FY2021 revenue stood at Rs. 300.9 crore, while Bangalore and Pune unit's revenue stood at around Rs. 100 crore and Rs. 159 crore, respectively. Effectively, the combined entity's revenue would be Rs. 559.8 crore. Similarly, the net profit of Bangalore and Pune unit stood at Rs. 12 crore and Rs. 26 crore, respectively. As a result, the consolidated net profit of combined entity would be at Rs. 88.3 crore. We believe the swap ratio is favourable for shareholders because of diversified product and industry portfolio, cross-selling opportunities, accessing global clientele, new capabilities, market expansion and scalability.

Financials of ESL and unlisted entities

INR Mn

FY 2020-21	Listed	Unlisted
Revenue	3,009	2,589
Growth %	*12%*	*13%*
Revenue share from Group	21%	44%
EBITDA	698	490
EBITDA Margin	*23%*	*19%*
Profit After Tax [PAT]	504	379
PAT Margin	*17%*	*15%*

Source: Company

Key con-call highlights

- Consolidation of all India businesses of the Group with ESL would enhance business focus, improve synergies and help to attract talent and skills.
- Enhance product offerings in engineering services which is currently not part of ESL product portfolio.
- The transaction would help the company to diversify its business from BFSI to other industries such aerospace, Defense, E&U, Industrial, media & entertainment sectors. Also diversify services from quality and consulting capability to engineering such as software development, manufacturing engineering, design, in-service support and among others.
- The unlisted companies' revenue increased 13% to Rs. 258.9 crore. EBITDA margin remained at 19%, lower than ESL's EBITDA margin of 23%. The unlisted companies generated revenue from 44% of their total revenues from the Group.
- The consolidated entity's revenue dependence on the Group would be more than 60%. ESL generates 21% revenue from the Group.
- The management highlighted that the Bangalore unit had a net profit of ~Rs. 25 crore in FY2021, while the Pune entity had a net profit of Rs. 12 crore.
- The balance sheet size of the combined entity would be worth Rs. 562 crore. Networth of the unlisted company was around Rs. 257 crore. The cash balance remained at Rs. 277 crore as of March 31, 2021 (~24% of current market capitalisation).
- The net profit of the combined entity was Rs. 88.3 crore in FY2021, translates the EPS of Rs. 60 versus standalone EPS of Rs. 49.2.
- The management expects to increase its employees to 5000 by 2023 from current base of 3200.
- At the group level, of 14,000 employees, 3000 employees are based in India. The management believes offshoring from India would increase to 25-30% in next 3 years from single-digit currently.
- Outlook: Management expects revenue to grow at double digit in FY2022. Margin could get diluted because of lower margin profile in unlisted companies. The company would diversify its industry exposure in next 3-5 years. The merger would help to access global clientele, enhance new capabilities and market expansion. The management indicated that India business will go up as sourcing from India will increase going ahead.

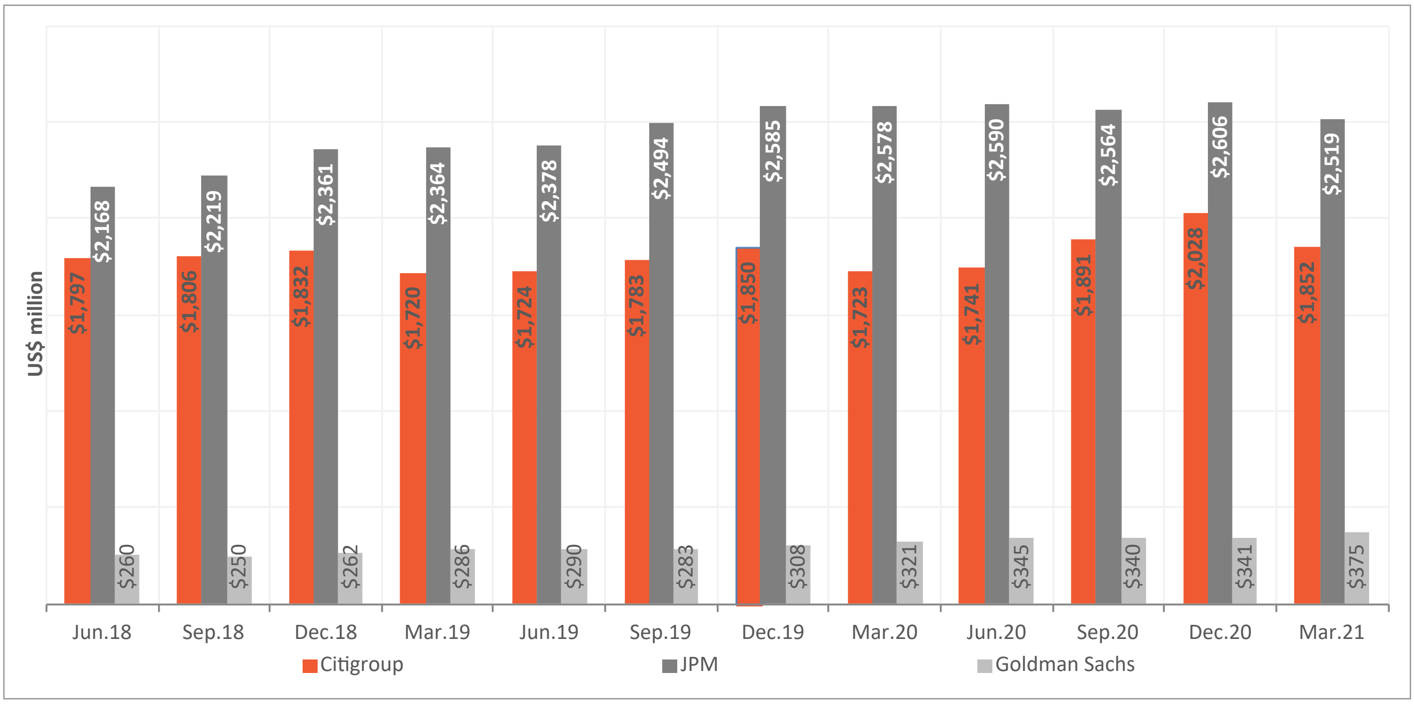
Financial services companies continue to embrace disruptions

The financial services industry has seen significant changes on the technology front over the past few years. Further, the pandemic crisis has accelerated digital transformation initiatives among financial institutions, given the changes in regulatory frameworks and adoption of higher digital channels. The higher online activity has been driving technology spends among large financial institutions in areas such as Cloud and Cloud-related technologies, workplace transformation and collaboration tools, modernization of legacy systems, enhanced customer experiences and cybersecurity. As technology is seen as a source of competitive differentiation, we believe technology spends are expected to remain elevated in the next 3-5 years even after the situation normalises.

Banks are the highest spenders on technology. Technology spends by major US and UK banking clients have been remained strong over last few quarters. Adoption of online channels by end-users accelerated investments in digitalisation by BFS firms across developed markets. Banks are leveraging technology both to reduce costs and improve customer experience. The Indian IT sector is well positioned to capture opportunities in this space because of its strong relationship with large global BFSI firms, strong digital capabilities, superior execution and a customer-centric approach. We expect healthy growth in the BFSI vertical for Indian IT companies in CY2021, led by ramp-up of large transformational deals, market share gains and higher outsourcing.

Financial services clients have been scaling up the digital transformation initiative to stay relevant to customers. We expect acceleration of IT spends would continue going ahead to exploit benefits such as scalability, resiliency, flexibility, efficiency and security offered by digital and cloud technologies. Digital leaders are stepping up investments to extend the lead, while the laggards allocate higher investments on new-age technologies to catch up.

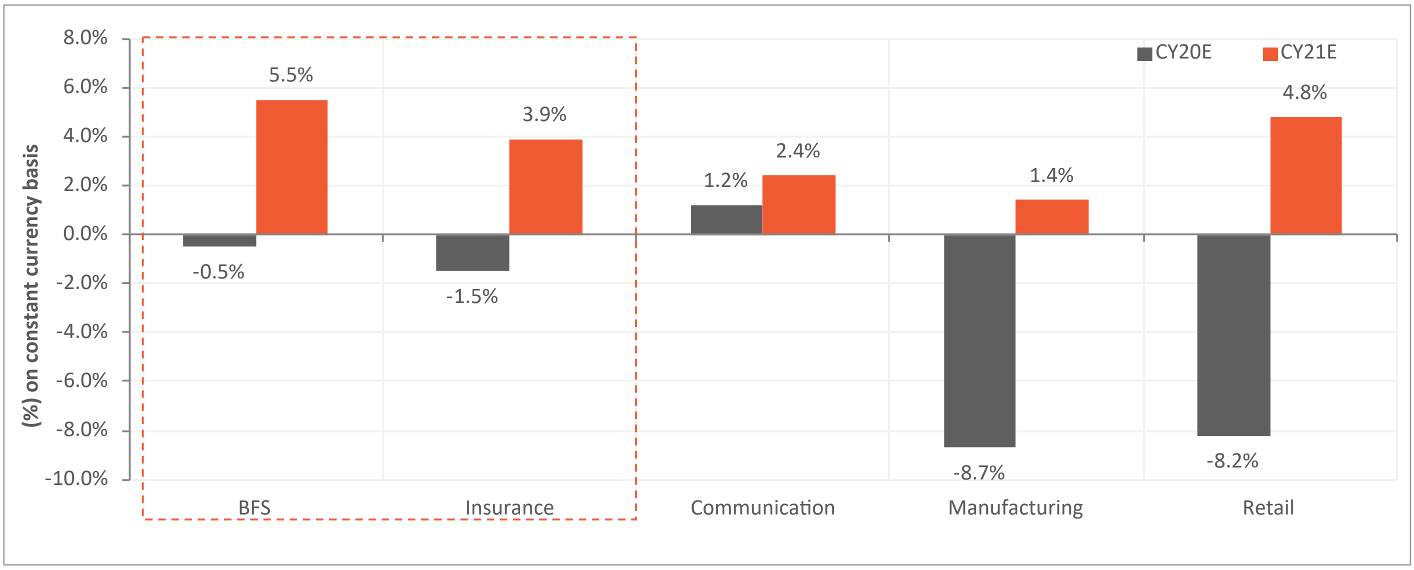
Sustained tech spends by large banks



Source: Companies, Sharekhan Research

Worldwide IT spending in the banking and securities sector is forecast to decline by just under 1% in 2020, while IT investments by financial institutions are expected to recover in 2021. Large banks have indicated that they will increase technology spends by 1-2% in 2021, despite a sharp decline in their revenues and operating incomes in 2020.

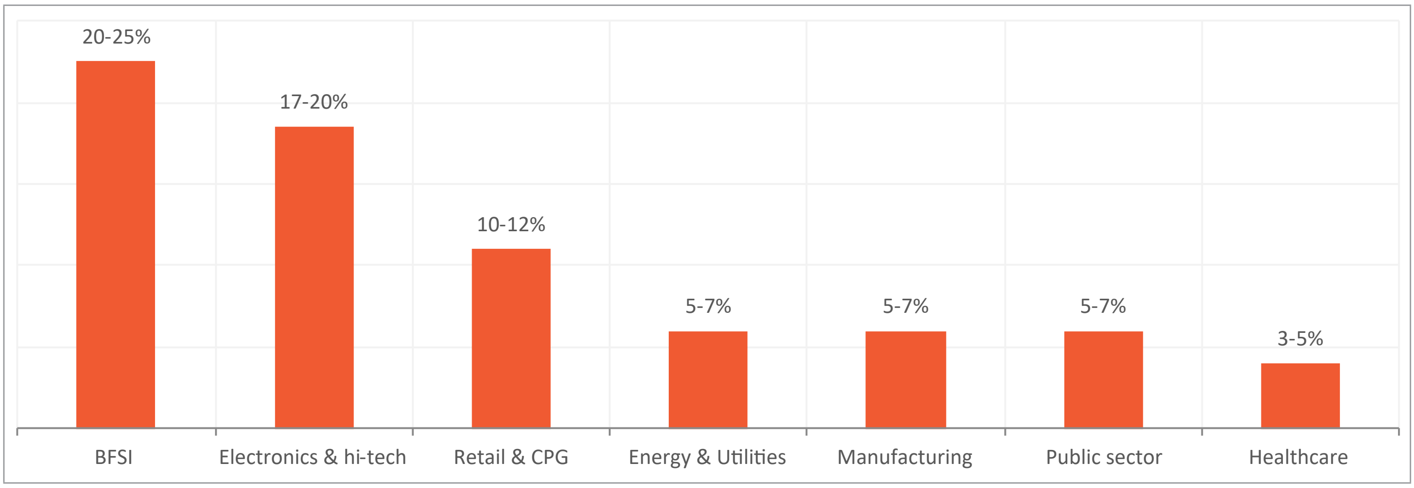
IT service spend growth by BFS & insurance vertical



Source: Gartner, Sharekhan Research

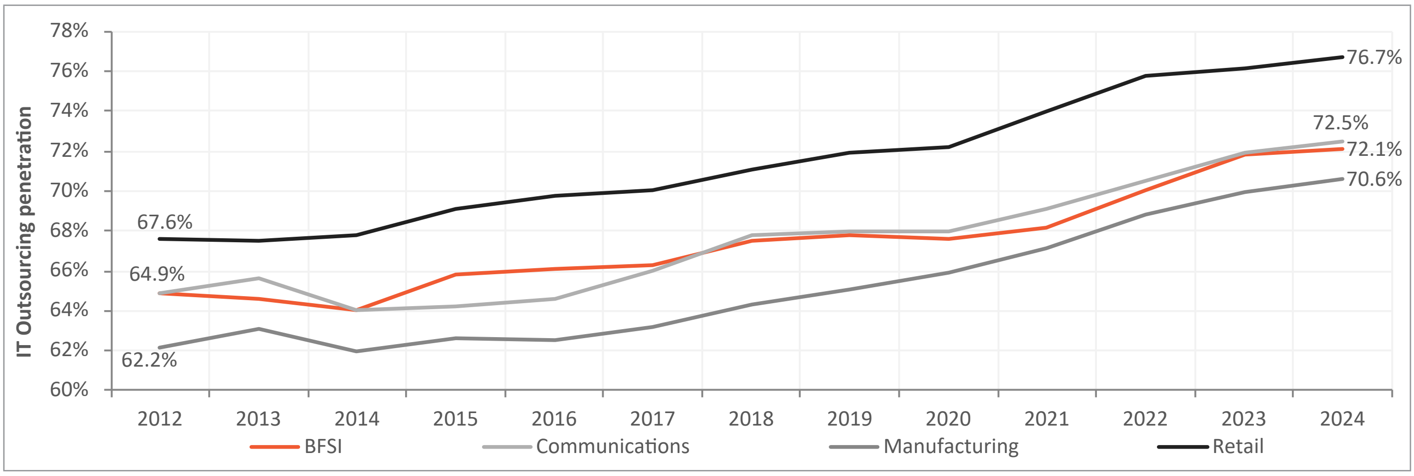
In terms of digital services adoption, a recent survey (of 295 global firms) by the Everest Group highlighted that consumer-facing sectors (including BFSI) and technology companies were leading digital services adoption as of 2019.

BFSI leads in terms of adoption digital technologies



Source: Everest Group #% of respondents (n=295) as in 2019

BFSI – IT outsourcing penetration to accelerate



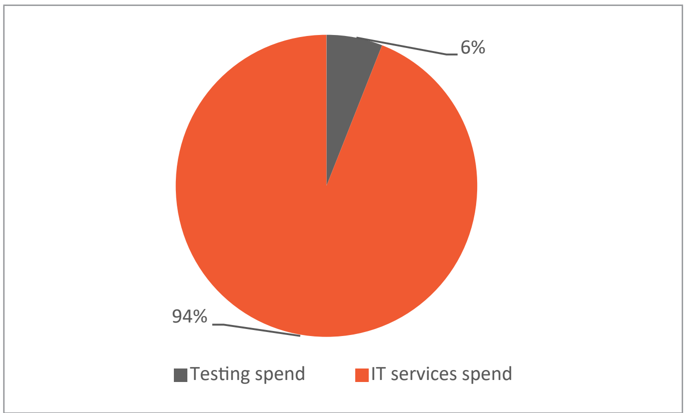
Source: Gartner, Sharekhan Research

Specialized testing services (STS) to drive growth; next-gen testing growing at 13%

The unprecedented COVID-19 pandemic has pushed organizations to adopt and adapt to newer processes and digital technologies in order to remain relevant to the customers. With increasing adoption of digital transformation across industries, next-generation technologies such as hyper-automation, 5G, edge computing, artificial intelligence (AI), RPA, and Cloud started gaining importance. However, implementing these customised technologies require new levels of frameworks, processes, compliance, infrastructure, security, services and support. Increasing demand for software development and applications is expected to drive growth of the overall quality assurance (QA) services market going ahead.

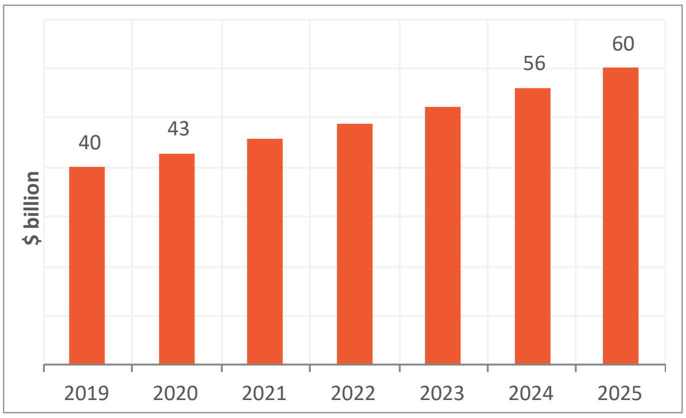
Software testing forms ~6% of the total budget of software development and has lot of room to grow considering the rise of agile and DevOps application development methodologies. As per industry estimates, the software testing market size stayed at $43 billion in 2020 and is expected to grow at a CAGR of 7% over 2020-2026. Higher customisation of software and increasing demand for automated application testing services are the major drivers for strong growth in specialised testing services (STS). STS accounted for around 60% of testing services spending globally in 2020, mostly fuelled by continued transfer from TTS to STS. We believe that STS is expected to outgrow the traditional testing services (TTS) market, led by higher demand for next-generation testing (mobile, security, UI/UX, testing of RPA, RPA in testing and AI in testing), non-functional, and other specialized testing services. New-gen testing is expected to grow at a CAGR of 13% over FY2020-2026.

% testing spend over total IT spend



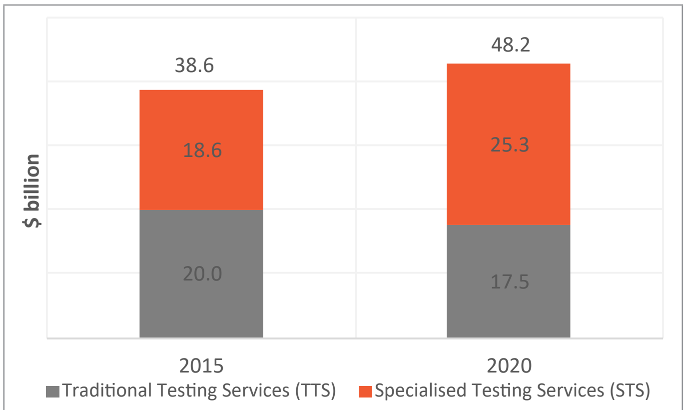
Source: Industry, Sharekhan Research

Estimated software testing market size ($ bn)



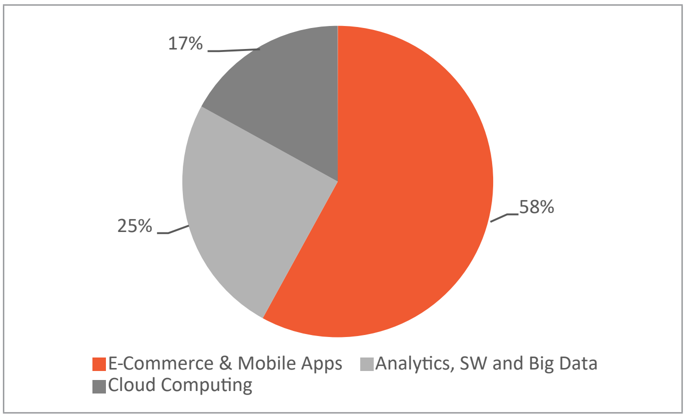
Source: Industry, Sharekhan Research

STS grew at a CAGR of 8%



Source: Industry, Sharekhan Research

Digital sevices growth to drive STS market



Source: Industry, Sharekhan Research

Expleo Solutions positioned as leader in next-gen software testing services

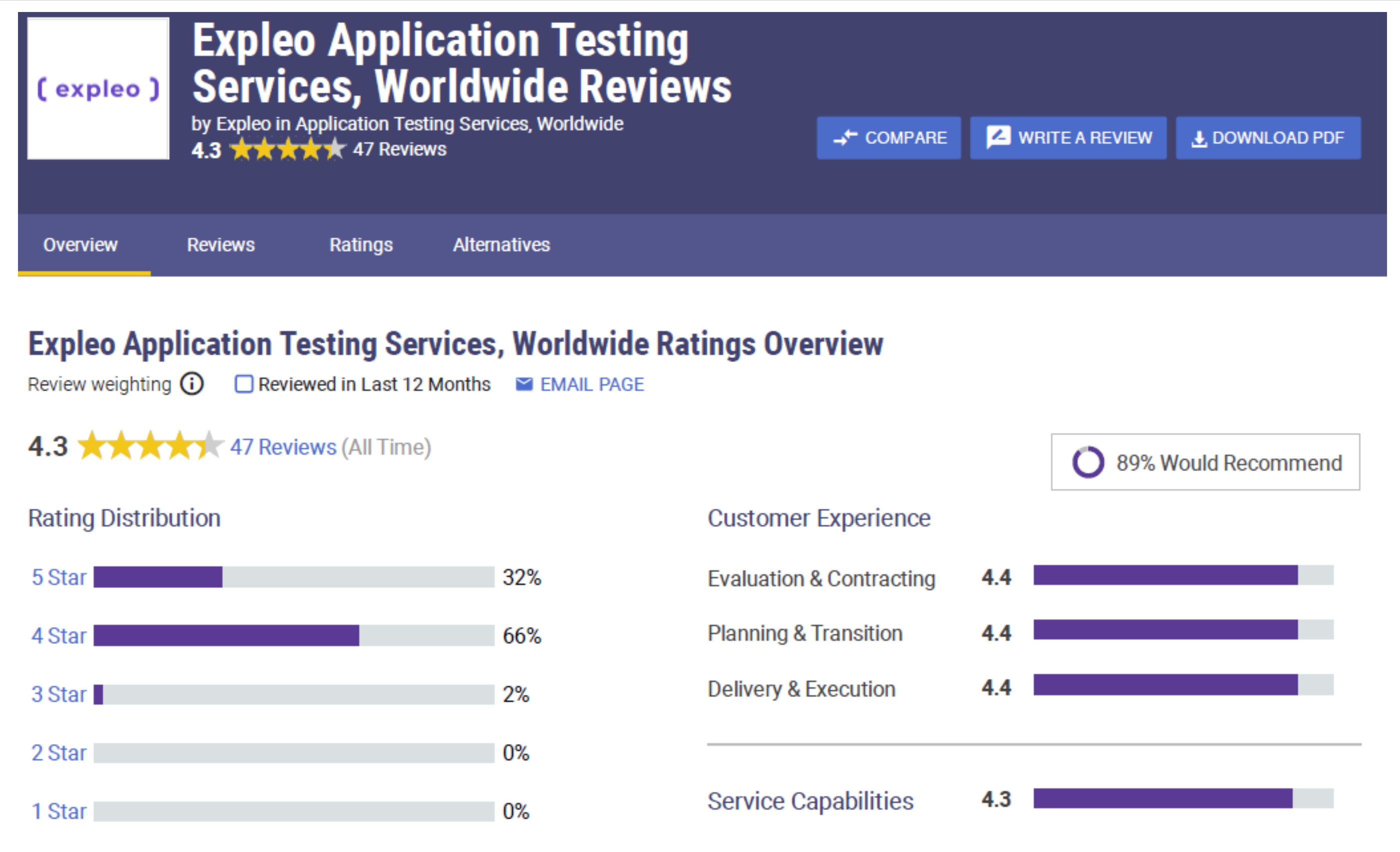
Expleo Solutions is positioned in the Challengers Quadrant of Magic Quadrant for application testing services, Globally (Gartner 2020), while the company is positioned as a leader in next generation software testing services such as mobile testing, AI-based automation and other cognitive and testing capabilities. This is a testament to the excellent execution of the company. Expleo Solution has invested to build an intelligent quality platform that covers automation of the overall agile and DevOps software delivery process, security, performance, environments and data, as well as quality management and test automation. Hence, the company remains at the forefront of the next generation of quality services, especially in mobile, AI-based and Robotics Process Automation (RPA).

Expleo Solutions provides QA and software testing services to primarily EMEA-based automotive, banking and insurance enterprises. The company has strong presence in the EMEA region as more than 50% of its resources reside here and over 80% of its total revenue is generated from this region.

Magic Quadrant for Application Testing Services, Worldwide

Source: Gartner, Sharekhan Research

Expleo's rating on Gartner's peer insights, 89% of reviewers recommend Expleo



Source: Gartner, Sharekhan Research

NelsonHall has identified Expleo Solutions as a Leader in the Overall and AI Testing Capability market segment, as shown in the NEAT graph. This market segment reflects Expleo Solutions' overall ability to meet future client requirements as well as delivering immediate benefits to its quality engineering clients.

NEAT Evaluation: Quality Engineering Services 2020 (Overall and AI Testing Capability)

Overall

Source: NelsonHall, Sharekhan Research

AI Testing capability

Source: NelsonHall, Sharekhan Research

BFSI: Presence in high-spending industry to drive growth

Expleo Solutions Limited focuses exclusively on business assurance, quality assurance and software testing for the BFSI industry. The BFSI segment is expected to dominate the market as the implementation of software quality assurance helps to detect and remedy susceptibility providing a long-term solution to financial companies. Most large global banks have undertaken digital transformation initiatives to innovate, shorten new product development cycles and reduce costs. A strong client base in BFSI space, global delivery capability and favourable demand tailwinds in the BFSI industry would help the company to boost its revenue growth going ahead.

Focus on diversifying into non-BFSI segment by leveraging parent's network

Post the merger with Assystem Technologies, Expleo Solutions has gained a strong understanding of both IT and operational technologies in non-BFSI industries. Expleo Solutions has invested in expanding its QA capabilities towards the engineering world, around embedded software, production systems, IoT and PLM. These capabilities would amplify Expleo Solutions' attractiveness in industries like automotives, transportation and manufacturing. Expleo Solutions generates around 55-60% of the revenues from the parent, of which, 21% comes directly from the group and the remaining is indirect revenues.

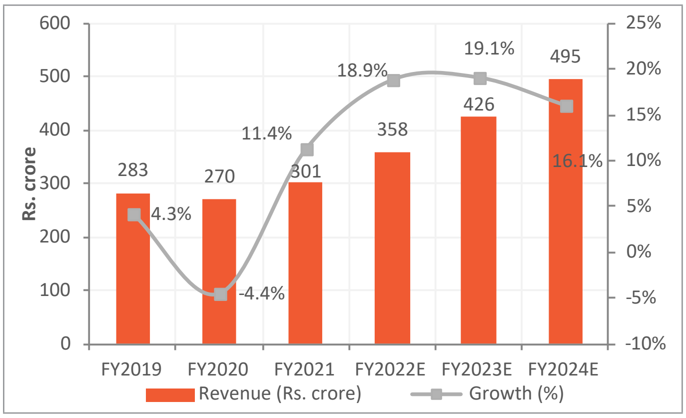
Focus on strengthening delivery model in India

In July 2020, Rajesh Krishnamurthy was appointed as Group CEO of Expleo to lead next step of services and delivery model transformation. With the change in leadership at Group level, Expleo Solutions will accelerate its strategic transformation roadmap, with a strong focus on digitalising its services and scaling its global delivery capabilities. He was mandated to harness organisational change to embrace digital transformation and drive new growth. As a result, there has been few changes at senior management levels across the organisation (including group and India operations) and changes in organisation structure in terms of integrating companies, promoting the best offshoring to offshore locations in India and building digital capabilities by integrating the engineering and the quality services segments.

Looking to accelerate revenue growth: digital revenues growing well

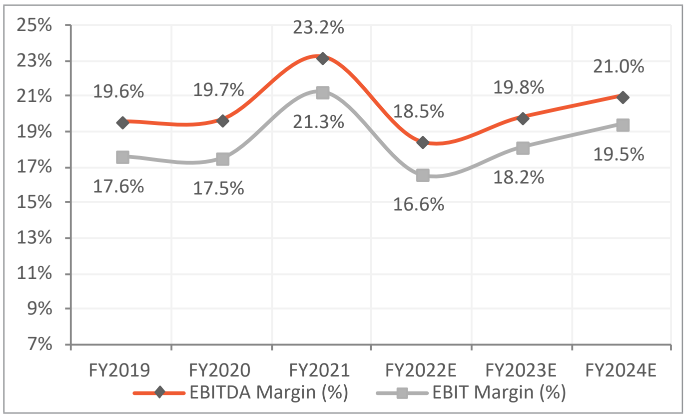
Rapid digital transformation and rising test automation for lower operational costs and enhanced quality assurance are the drivers for adoption of digital assurance. The company enters into strategic partnership, which would help the company to reach a larger set of such customers going forward. Expleo Solutions has transitioned at least 50% of its total employees into techno-functional workforce. This coupled with proven offshore delivery capabilities create a strong platform for delivering optimal and cost-effective business solutions to customers in an agile manner. The company won a large deal recently, for which it intends to hire 100-120 employees in 2021. The management guided 15-20% revenue growth for FY2022E, which is significant higher as compared to a 2.6% CAGR revenue over FY2016-FY2021, led by large deal wins, deal pipeline and traction for new-generation testing. We expect the company to register revenue and earnings growth at a CAGR of 18% and 16% over FY2021-FY2024E.

Revenue growth to pick up from FY2022E



Source: Company, Sharekhan Research

Margins likely to be impacted, owing to investments

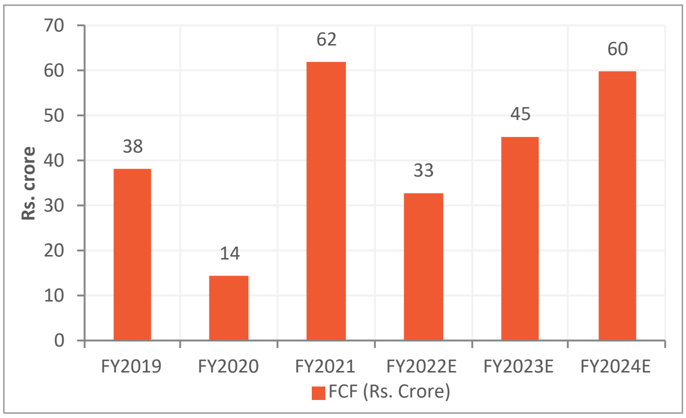


Source: Company, Sharekhan Research

Strong balance sheet; higher FCF generation; looking to resume dividend payout ahead

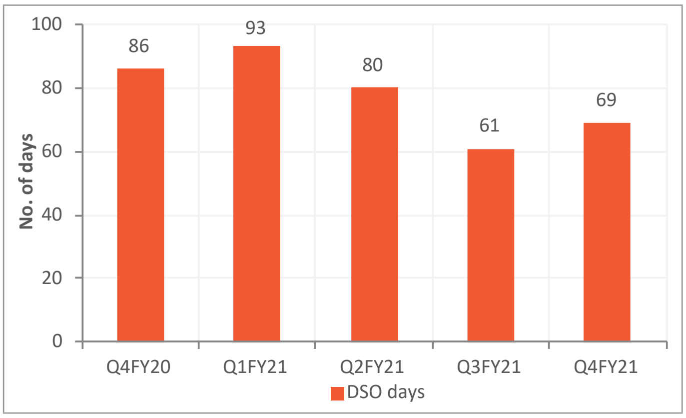
The company has strong, debt-free balance sheet, while cash & cash equivalents remained strong at Rs. 131 crore as of December 31, 2020. Further, management expects DSO days would settle at around 70 days versus 86 days in Q4FY2020, but would increase from 61 days in Q3FY2021. The company has not declared dividend for last three consecutive years. With the improvement in FCF generation, we expect the company could resume its dividend payout from FY2022E.

FCF generation to remain healthy



Source: Company, Sharekhan Research

DSO days to stabilise at 70 days going ahead



Source: Company, Sharekhan Research

Q4FY21: A mixed quarter

In Q4FY21, Expleo Solutions reported better-than-expected revenue, while margins remained below our expectations. Revenues grew by 10% q-o-q to Rs. 79.3 crore, beating our expectations. EBITDA margin improved 118 bps q-o-q to 20.8%, below our expectations, led by better cost-control measures. Net profit came in at Rs. 11 crore and was 15% below our estimates, owing to lower-than-expected operating profitability and higher tax provision.

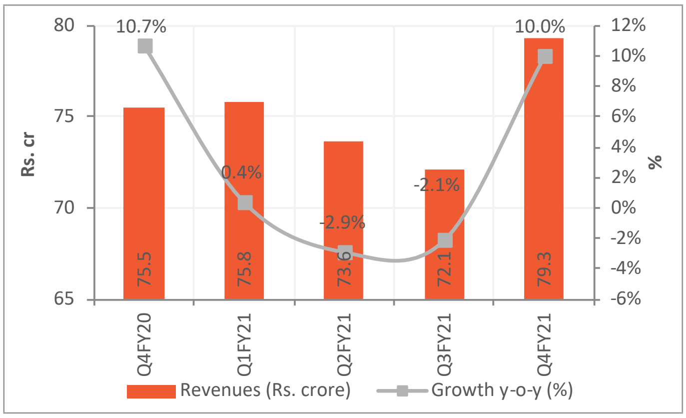
Results Rs cr

Particulars	Q4FY21	Q4FY20	Q3FY20	Y-o-Y %	Q-o-Q %
Revenue ($ mn)	**10.9**	**10.4**	**9.8**	**4.9**	**11.4**
Net sales	**79.3**	**75.5**	**72.1**	**5.1**	**10.0**
Employee benefit expenses	39.9	49.4	48.4	-19.3	-17.5
Gross Profit	**39.5**	**26.1**	**23.8**	**51.3**	**66.1**
Operating expenses	23.0	10.4	10.1	120.7	128.2
EBITDA	**16.5**	**15.7**	**13.7**	**5.3**	**20.5**
Depreciation	1.5	1.3	1.6	15.5	-5.1
EBIT	**15.0**	**14.4**	**12.1**	**4.4**	**23.8**
Other income	0.7	3.4	4.7	-79.2	-85.1
Finance cost	0.3	0.3	0.2	0.6	40.0
PBT	**15.4**	**17.4**	**16.6**	**-11.6**	**-7.1**
Tax provision	4.4	3.5	4.0	27.4	10.8
Net profit	**11.0**	**14.0**	**12.6**	**-21.3**	**-12.8**
EPS (Rs)	**10.7**	**13.5**	**12.3**	**-20.5**	**-12.8**
Margin (%)				**bps**	**bps**
EBITDA	20.8	20.8	19.0	4	181
EBIT	18.9	19.1	16.8	-13	211
NPM	13.8	18.5	17.5	-465	-363

Source: Company; Sharekhan Research

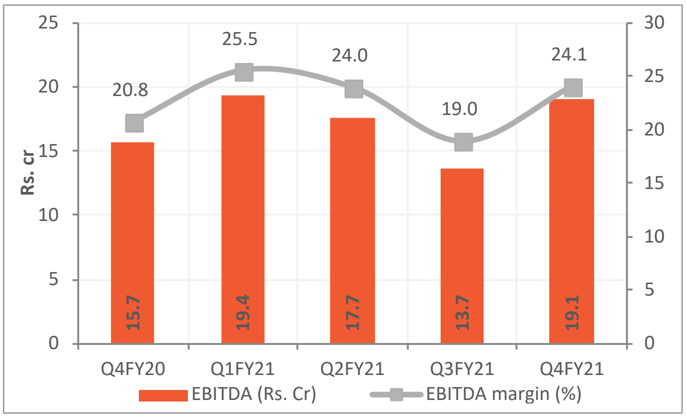
Financials in charts

Revenue (Rs. cr) and growth (%)



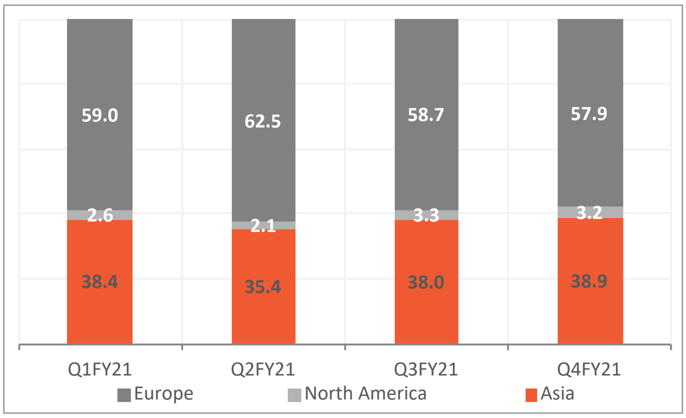
Source: Company, Sharekhan Research

EBITDA (Rs. Cr) & margin (%)



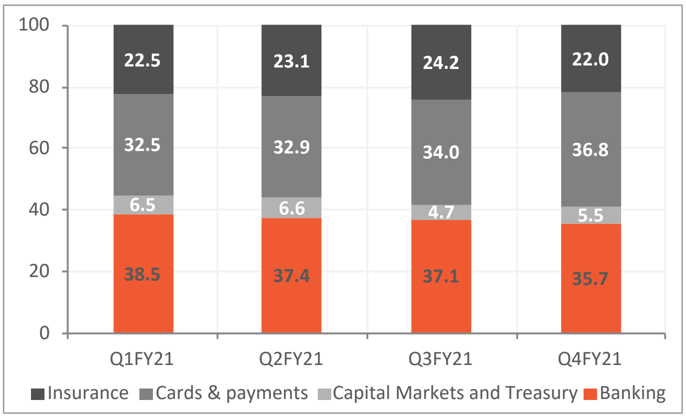
Source: Company, Sharekhan Research

Revenue mix by Geography (%)



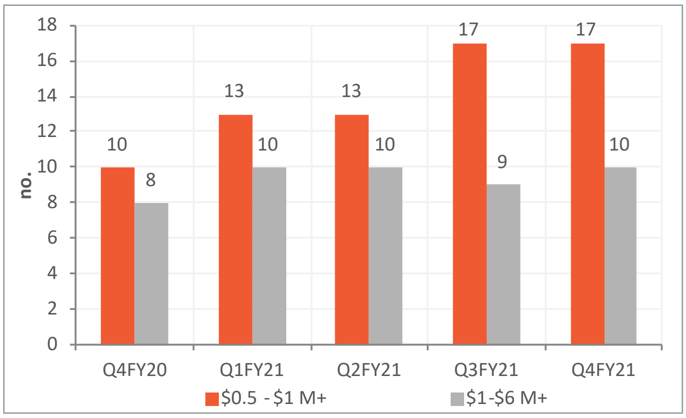
Source: Company, Sharekhan Research

Revenue mix by practice (%)



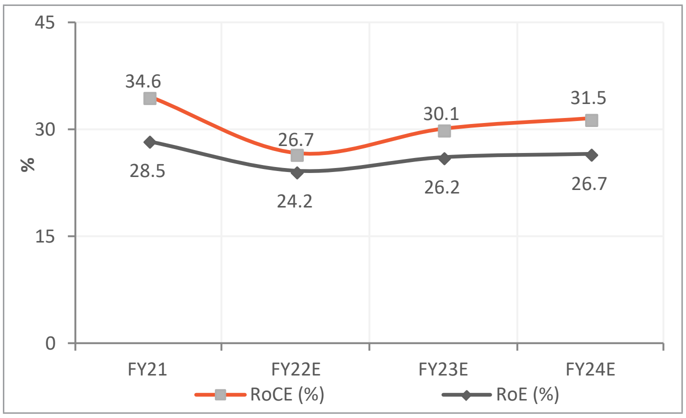
Source: Company, Sharekhan Research

Customer Profile (12m rolling)



Source: Company, Sharekhan Research

RoE (%) and RoCE (%) trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Specialised testing service market to outpace traditional testing services market

Software testing forms ~6% of the total budget of software development and has lot of room to grow considering the rise of agile and DevOps application development methodologies. As per industry estimates, software testing market size stayed at $43 billion in 2020 and is expected to record a CAGR of 7% over 2020-2026. Higher customisation of software and increasing demand for automated application testing services are the major drivers for strong growth in specialised testing services (STS). We believe STS is expected to outgrow the traditional testing services (TTS) market, led by higher demand for next-generation testing (mobile, security, UI/UX, testing of RPA, RPA in testing and AI in testing) services. New-gen testing is expected to clock a CAGR of 13% over FY2020-2026.

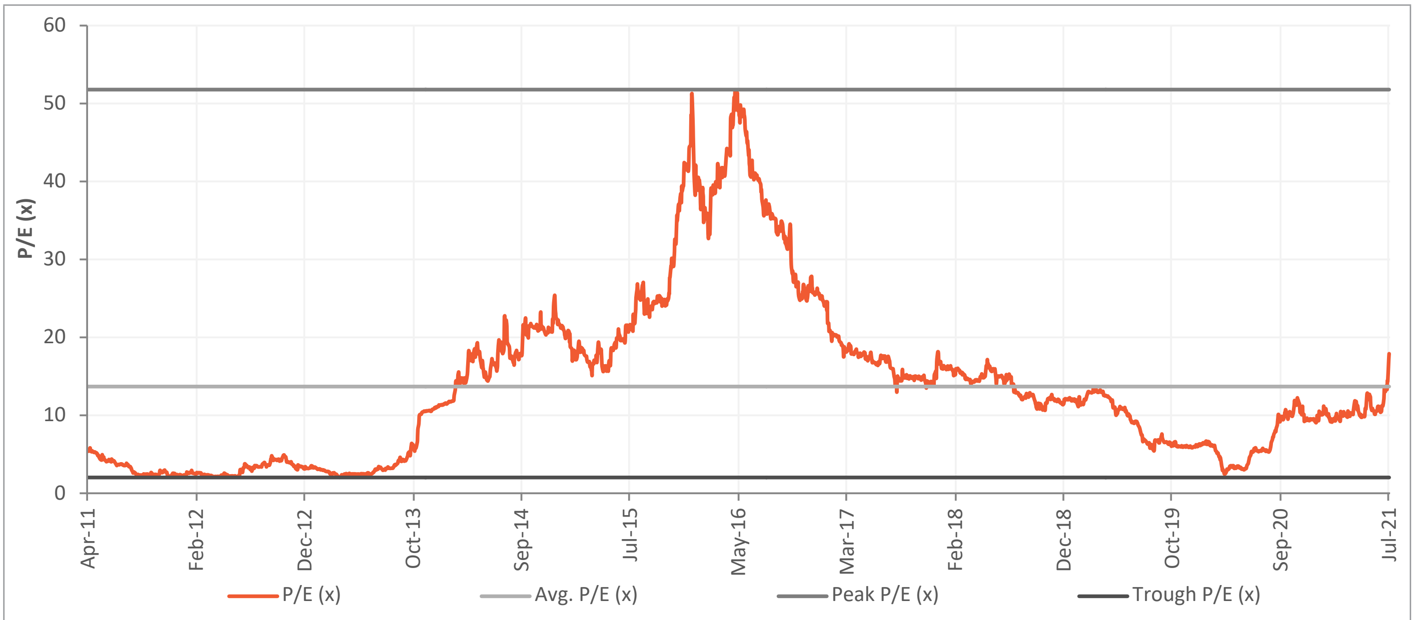
■ Company outlook – Improving outlook

A strong client base in the BFSI space, global delivery capability and favourable demand tailwinds in BFSI industry would help the company to boost its revenue growth going ahead. Further, Expleo Solutions has invested on building an intelligent quality platform that covers automation of the overall agile and DevOps software delivery process, security, performance, environments and data, as well as quality management and test automation. These investments would help it increase its presence in non-BFSI domains such as automotives, aerospace and manufacturing. Management highlighted that the amalgamation of all the Indian Expleo Group entities under ESL would enhance the company's new capabilities (engineering services), industry portfolio (aerospace, automobiles, defence, industrial and media & entertainment), market expansion, cross-selling and sales enhancement.

■ Valuation – Attractive valuation

The merger of Indian Group entities with ESL would diversify its service portfolio from a pure-play quality engineering and testing company to engineering services and industry portfolio beyond banking, insurance and automotive verticals. We believe the swap ratio is favorable for shareholders because of diversified product and industry portfolio, cross-selling opportunities, accessing global clientele, new capabilities, market expansion and scalability. Based on our quick estimates, at CMP, the stock trades at 15x/13x of FY2023E/FY2024E earnings of combined entity, which is reasonable given strong earnings growth potential. Further, net cash on balance sheet of combined entity stood at Rs. 277 crore (24% of current market capitalisation). With the improvement in free cash flow generation and increase in promoter's stake in the combined entity, we expect the company could resume its dividend payout. Hence, we initiate viewpoint coverage on Expleo Solutions with a Positive view and expect a 28% upside in the next 12 months.

One-year forward P/E (x) band



Source: Company; Sharekhan Research

About company

Expleo Solutions Limited (Expleo Solutions), which was formed after the acquisition of Software Quality Systems AG (SQS) by Assystem Technologies (ATG), is engaged in business assurance, quality assurance (QA) and software testing for the Banking, Insurance and Financial services industries. Earlier, Expleo Solutions was known as SQS India BFSI Limited. Expleo Solutions work with its customers across APAC, USA, Europe and the Middle East. Expleo Solutions provides end-to-end quality services and management consultancy and work with clients to support their quality needs including quality engineering, quality management, software testing, DevOps and test automation.

Investment theme

Expleo Solutions Limited (Expleo Solutions) has successfully transformed itself from a quality assurance (QA) consulting and onsite delivery testing company to specialized testing services player by building capabilities in digital quality assurance and offshore delivery testing business model. In addition, the company remains at the forefront of the next generation of quality services, especially in mobile, AI-based and Robotics Process Automation (RPA). Expleo Solutions has transitioned more than 50% of its total employees into techno-functional workforce. This, coupled with proven offshore delivery capabilities create a strong platform for delivering optimal and cost-effective business solutions to customers in an agile manner.

Key Risks

(1) Limited presence in US despite its huge potential; (2) currency risks; and (3) higher client concentration and 4) challenges in resource availability

Additional Data

Key management personnel

Rajesh Krishnamurthy	Group CEO
Balaji Viswanathan	Managing Director cum Chief Executive Officer
Desikan Narayanan	Chief Financial Officer
S. Sampath Kumar	Company Secretary & Compliance Officer

Source: Bloomberg

Top shareholders

Sr. No.	Holder Name	Holding (%)
1	Expleo Technology	56.17
2	Rajasthan Global Securities	4.78
3	Jain Aparna	1.11
4	Investor Education & protection	0.04

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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