AXIS DIRECT

ORACLE FINANCIAL SERVICES SOFTWARE

IT - SERVICES

17 AUG 2016 Quarterly Update

HOLD

Target Price: Rs 3,480

Higher license fees; pipeline remains healthy

OFSS deliveredlicense fees of USD 30mn in Q1FY17 (Q1FY16:USD 25 mn, and higher than our estimate: USD 26 mn).Implementation/AMC revenue in product segmentgrew6%/23% YoY.Consolidated rev/EBITDA/PAT delivered12%/11%/23% YoY growth.

Product revenue impressive; pipeline remains healthy: A Product license fee was highest since Q2FY15. Q1 is seasonally strong for license fees due to parental (Oracle) year-end. Management shared deal pipeline remains healthy and is across geographies (Europe slow vs. other regions but no Brexit effect seen as yet). We expectFY17 growth to be driven by North America (decent pick up) and MEA region.High-growth engines (next-generation banks, digital investments, analytics and risk/compliance)maintain strong momentum.

CMP	: Rs 3,713
Potential Upside	: -6%

MARKET DATA

No. of Shares	: 85 mn
Free Float	: 26%
Market Cap	: Rs 315 bn
52-week High / Low	: Rs 4,447 / Rs 3,106
Avg. Daily vol. (6mth)	: 35,105 shares
Bloomberg Code	: OFSS IB Equity
Promoters Holding	: 74%
FII / DII	: 14% / 4%

Management commentary on product business remains positive: Numbers this quarter shows OFSS is on a strong trajectory for FY17. It haswon several marquee customers for its portfolio of products and continues to focus on ensuring clients are successful in their innovation and transformation business objectives. Top 5 (32% share)/ Top 10clients (42% share) grew strongly at 14%/ 17% YoY reflecting increased momentum in large clients. Qualitatively, few global Tier-1 banks have signed OFSS for analytics, risk, custodial and private cloud core banking products.

Estimates and valuation: We expect FY17/18license fees of USD 95 mn/ USD 116 mn (no material change). Our FY17E/18E EPS remains intact at Rs 171/ Rs 205. Our TP stands at Rs 3,480 (17x FY18E earnings). Maintain **HOLD** given 6% downside from **CMP ofRs 3,713**. The stock trades at rich valuations of ~22x /18x FY17E/18E EPS.

Financial summary (Consolidated)

Y/E March	FY15	FY16	FY17E	FY18E
Sales (Rs mn)	39,049	40,928	46,622	55,990
Adj PAT (Rs mn)	11,923	12,290	14,575	17,438
Con. EPS* (Rs.)	-	-	163	187
EPS (Rs.)	141	144	171	205
Change YOY (%)	(12.6)	2.5	18.6	19.6
P/E (x)	26.4	25.7	21.7	18.1
RoE (%)	19.5	34.5	33.0	28.9
RoCE (%)	23.8	44.2	41.3	36.5
EV/EBITDA (x)	18.0	17.2	14.6	11.4

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

Revenues (Rs bn)	FY16	FY17E	FY18E
Products - license fees ($ mn)	83	95	116
Products	34.2	39.7	48.9
Services & BPO	6.6	6.9	7.0
Consolidated	40.9	46.6	56.0

Price performance

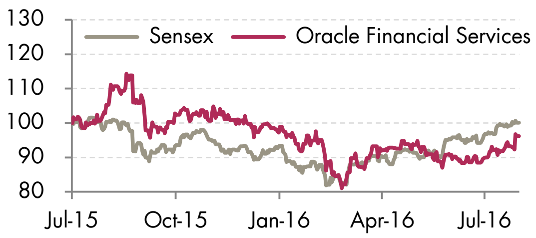


Exhibit 1: Results update

	Quarter ended					12 months ended		
(Rs mn)	Jun-16	Jun-15	% Chg	Mar-16	% Chg	FY17E	FY16	% Chg
Net Sales	**11,771**	**10,483**	**12.3**	**10,130**	**16.2**	**46,622**	**40,928**	**13.9**
EBIDTA	4,752	4,268	11.3	4,018	18.3	19,483	16,807	15.9
Other income	535	845	-	630	-	3,277	2,560	-
PBIDT	**5,287**	**5,113**	**3.4**	**4,648**	**13.7**	**22,760**	**19,367**	**17.5**
Depreciation	192	142	-	132	-	676	529	-
PBT	**5,095**	**4,971**	**2.5**	**4,516**	**12.8**	**22,084**	**18,837**	**17.2**
Tax	(1,631)	(1,729)	-	(1,476)	-	7,508	6,547	-
Adjusted PAT	**3,464**	**3,242**	**6.8**	**3,040**	**13.9**	**14,575**	**12,290**	**18.6**
No. of shares (mn)	85	85	-	85	-	85	85	-
EBIDTA margin (%)	40.4	40.7	-	39.7	-	41.8	41.1	-
PBIDT margin (%)	44.9	48.8	-	45.9	-	48.8	47.3	-
Reported EPS (Rs.)	**40.8**	**38.2**	**6.8**	**31.0**	**31.8**	**171.1**	**144.3**	**18.6**

Source: Company, Axis Capital. Note: Reported PAT in Q1FY16 was Rs 2,804 mn

Q1FY17 highlights:

- **Product revenues (85% share):** License fees(20% of product revenue) at USD 30 mn was higher than our expectations of USD 26 mn. Q1 is seasonally strong for license fee bookings as it coincides with year-end of parent, Oracle. While Implementation revenue (52% of product revenue) grew single-digit (6% YoY), higher license fee bookings in Q1FY17 should see acceleration in the coming quarters. AMC revenue (28% of product revenue) grew at a healthy rate of 23% YoY. Product revenue (85% share) grew 14% YoY with margin at 45% (Q1FY16: 47%), partly due to ESOP accounting under Ind AS

- **Services (13% share)**:grew 21% QoQ/ 4% YoY after declining substantially in H2FY16.Services business remains a drag where focus on margin remains key – Q1FY17 margin was 13% (up from 11% in Q1FY16 and 5% in Q4FY16)

- **Tax rate at 32% was lower vs. our expectation/QoQ/ YoY(Q1FY16**: ~35%, Q4FY16: 36%) as OFSS received approval for six of its R&D centers for weighted deduction benefit under Indian Income Tax from the Department of Science and Industrial Research, GoI. Attrition at 22% (similar for past 6 quarters) remains high and partly reflective of demand environment for banking product companies.

Exhibit 2: Segmental break-up

(Rs mn)	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	% chg QoQ	% chg YoY
Revenues											
Products	8,953	7,561	7,546	7,755	8,758	8,262	8,604	8,606	9,982	16%	14%
Services	1,543	1,683	1,497	1,470	1,443	1,478	1,310	1,233	1,497	21%	4%
KPO	243	201	334	273	282	294	284	291	292	0%	4%
Rev net of eliminations	10,739	9,445	9,377	9,498	10,483	10,034	10,198	10,130	11,771	16%	12%
Operating Profit	4,856	3,519	3,430	3,703	4,268	4,406	4,032	4,018	4,752	18%	11%
PAT	**3,944**	**3,178**	**2,497**	**2,303**	**2,804**	**3,226**	**2,895**	**2,627**	**3,462**	**32%**	**23%**
No: of shares	85	85	85	85	85	85	85	85	85	-	-
EPS (Rs)	*46.5*	*37.4*	*29.4*	*27.1*	*33.0*	*38.0*	*34.1*	*30.9*	*40.8*	-	-
EBITDA (%)	*45.2%*	*37.3%*	*36.6%*	*39.0%*	*40.7%*	*43.9%*	*39.5%*	*39.7%*	*40.4%*	-	-
NPM (%)	*36.7%*	*33.7%*	*26.6%*	*24.3%*	*26.7%*	*32.2%*	*28.4%*	*25.9%*	*29.4%*	-	-
Receivable days	39	68	63	51	46	51	44	68	68	-	-
Employee Base (Nos)	8,854	8,948	9,032	8,928	8,795	8,876	8,754	8,733	8,733	-	-
Products	5,794	5,947	6,072	6,072	6,065	6,248	6,143	6,150	6,150	-	-
Services	2,121	2,036	1,998	1,925	1,821	1,696	1,657	1,645	1,645	-	-
KPO	269	264	257	255	242	242	236	230	230	-	-
Attrition Rates (%)	23%	24%	23%	22%	22%	22%	22%	22%	22%	-	-

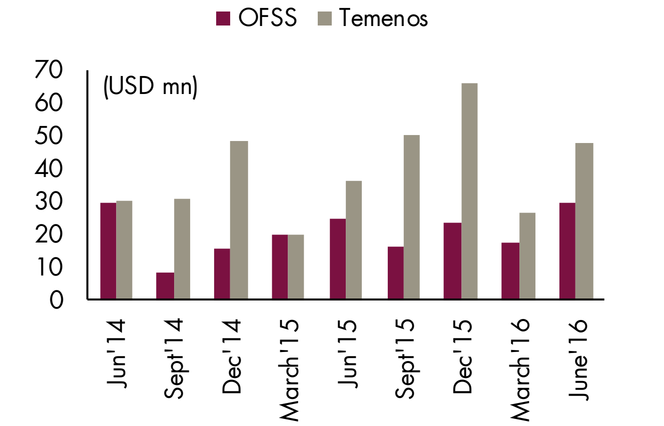
Source: Company, Axis Capital

Exhibit 3: Operating metrics - Products

Products	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	% chgQoQ	% chg YoY
Revenue Break-up (%)											
License Fees	20%	7%	13%	16%	18%	13%	18%	14%	16%	-	-
Implementation Fees/Enhancement Fees	54%	62%	57%	57%	56%	59%	54%	58%	57%	-	-
AMC	26%	31%	30%	27%	26%	28%	28%	28%	27%	-	-
Client Addition (nos)											
Client Concentration (%)											
Top Customer	13%	16%	13%	15%	12%	13%	10%	14%	11%	-	-
Top 5 Customers	33%	34%	32%	33%	32%	33%	34%	36%	32%	-	-
Top 10 Customers	43%	41%	40%	43%	41%	43%	45%	47%	42%	-	-
Remaining Customers	57%	59%	60%	57%	59%	57%	55%	53%	58%	-	-
Client Concentration (Rs mn)											
Top Customer	1,164	1,210	981	1,163	1,051	1,074	860	1,205	1,098	-9%	4%
Top 5 Customers	2,954	2,571	2,415	2,559	2,803	2,726	2,925	3,098	3,194	3%	14%
Top 10 Customers	3,850	3,100	3,018	3,335	3,591	3,553	3,872	4,045	4,192	4%	17%
Remaining Customers	5,103	4,461	4,528	4,420	5,167	4,709	4,732	4,561	5,790	27%	12%
Geography Concentration (%)											
NAMER	26%	30%	28%	26%	31%	26%	28%	32%	29%	-	-
JAPAC	37%	35%	36%	33%	33%	39%	34%	33%	35%	-	-
EMEA	37%	36%	36%	40%	36%	36%	38%	35%	36%	-	-
Geography Concentration (Rs mn)											
NAMER	2,328	2,268	2,113	2,016	2,715	2,148	2,409	2,754	2,895	5%	7%
JAPAC	3,313	2,646	2,717	2,559	2,890	3,222	2,925	2,840	3,494	23%	21%
EMEA	3,313	2,722	2,717	3,102	3,153	2,974	3,270	3,012	3,594	19%	14%

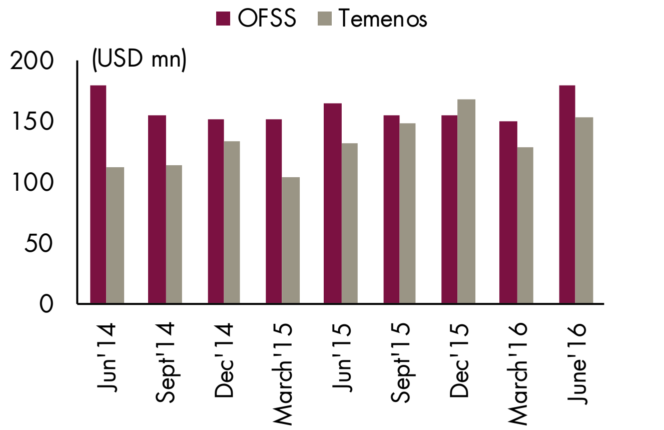
Source: Company, Axis Capital

Exhibit 4: License fees (USD mn)



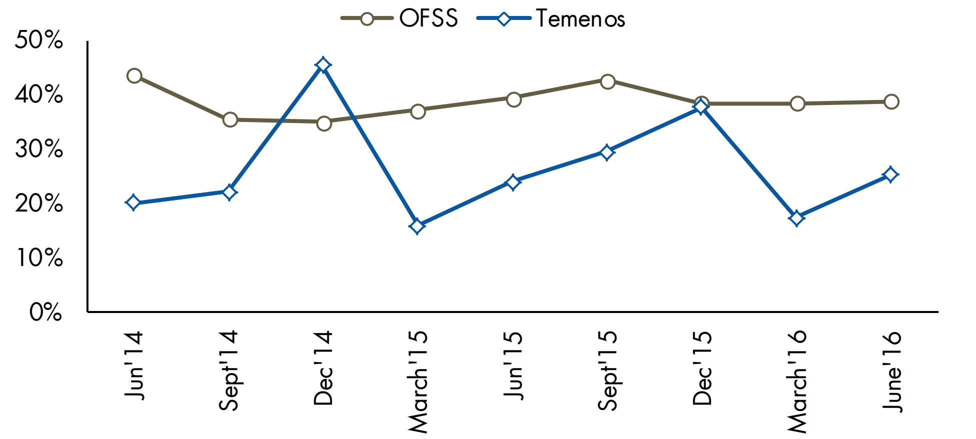
Source: Company, Axis Capital

Exhibit 5: Consolidated revenue



Source: Company, Axis Capital

Exhibit 6: EBIT



Source: Company, Axis Capital

Financial summary (Consolidated)

Profit &loss (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Net sales	39,049	40,928	46,622	55,990
Other operating income	-	-	-	-
Total operating income	**39,049**	**40,928**	**46,622**	**55,990**
Cost of goods sold	(18,479)	(19,209)	(21,816)	(26,062)
Gross profit	20,570	21,719	24,806	29,928
Gross margin (%)	*53*	*53*	*53*	*53*
Total operating expenses	(5,062)	(4,912)	(5,323)	(6,419)
EBITDA	**15,508**	**16,807**	**19,483**	**23,509**
EBITDA margin (%)	*40*	*41*	*42*	*42*
Depreciation	(681)	(529)	(676)	(1,018)
EBIT	**14,827**	**16,278**	**18,807**	**22,491**
Net interest	3,481	2,560	3,277	3,930
Profit before tax	**18,308**	**18,837**	**22,084**	**26,422**
Total taxation	**(6,385)**	**(6,547)**	**(7,508)**	**(8,983)**
Tax rate (%)	*35*	*35*	*34*	*34*
Profit after tax	*11,923*	*12,290*	*14,575*	*17,438*
Adjusted net profit	11,923	12,290	14,575	17,438
Adj. PAT margin (%)	*31*	*30*	*31*	*31*
Net non-recurring items	-	(632)	-	-
Reported net profit	11,923	11,658	14,575	17,438

Balance sheet (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Paid-up capital	423	424	424	424
Reserves & surplus	34,018	36,330	51,164	68,602
Net worth	34,441	36,754	51,588	69,027
Other non-current liabilities	1,081	1,336	1,361	1,386
Total liabilities	**62,707**	**56,770**	**63,631**	**83,205**
Gross fixed assets	**13,920**	**13,277**	**14,477**	**15,977**
Less: Depreciation	(4,809)	(4,539)	(5,215)	(6,232)
Net fixed assets	9,111	8,739	9,262	9,745
Add: Capital WIP	3	48	55	75
Total fixed assets	9,114	8,786	9,317	9,820
Debtors	6,016	8,259	8,558	10,278
Cash & bank	35,638	27,307	32,754	48,940
Loans & advances	793	4,141	4,505	5,390
Current liabilities	27,185	18,679	10,681	12,792
Net current assets	19,536	22,206	36,535	53,495
Other non-current assets	6,872	7,098	7,098	7,098
Total assets	**62,707**	**56,770**	**63,631**	**83,205**

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Profit before tax	18,308	18,837	22,084	26,422
Depreciation & Amortisation	(681)	(529)	(676)	(1,018)
Chg in working capital	*22,531*	*(11,001)*	*(8,882)*	*(775)*
Cash flow from operations	**34,996**	**1,728**	**6,370**	**17,681**
Capital expenditure	*89*	*599*	*(1,207)*	*(1,520)*
Cash flow from investing	**(609)**	**718**	**(1,182)**	**(1,495)**
Cash flow from financing	**(65,926)**	**(10,009)**	**-**	**-**
Net chg in cash	*(31,540)*	*(7,563)*	*5,188*	*16,186*

Key ratios

Y/E March	FY15	FY16	FY17E	FY18E
OPERATIONAL				
FDEPS (Rs.)	141	144	171	205
CEPS (Rs)	149	143	179	217
GROWTH				
Net sales (%)	4	5	14	20
EBITDA (%)	**11**	**8**	**16**	**21**
Adj net profit (%)	(12)	3	19	20
FDEPS (%)	(12.6)	2.5	18.6	19.6
PERFORMANCE				
RoE (%)	19.5	34.5	33.0	28.9
RoCE (%)	**23.8**	**44.2**	**41.3**	**36.5**
EFFICIENCY				
Asset turnover (x)	3.9	9.9	3.3	2.9
Receivable days	**56**	**74**	**67**	**67**
Payable days	113	98	118	118
FINANCIAL STABILITY				
Current ratio (x)	1.7	2.2	4.4	5.2
VALUATION				
PE (x)	26.4	25.7	21.7	18.1
EV/ EBITDA (x)	18.0	17.2	14.6	11.4
EV/ Net sales (x)	**7.1**	**7.1**	**6.1**	**4.8**
PB (x)	9.1	8.6	6.1	4.6

Source: Company, Axis Capital

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