Small & Micro Cap Stock Idea - Saksoft Ltd

Date: 20th March 2019

Wtg% in portfolio = Max 6% [Initial 3% between 280-290 & final 3% between 230-240]

Price target = Around INR 1500 by 2023 (Assuming 35% CAGR for next 5 years which is achievable)

Market Cap: 296.65 Cr	**Current Price: 283.20**	52 weeks H/L: 342.80 / 202.00
Book Value: 153.58	Stock P/E: 8.86	Dividend Yield: 1.24 %
ROCE: 20.96 %	ROE: 15.79 %	Sales Growth (3Yrs): 7.30 %
Face Value: 10.00	Promoter Holding: 69.21	Dividend Payout: 17.06%
Sales Growth (10Y): 9.06%	Profit Growth (10Y): 25.52%	ROE (10 Years): 15.43%

* Company has got descent financial ratios, growth track record, dividend payouts, reasonable valuations.

Back in 2015-16, there was lots of hype around companies operating in SMAC segment (**Social Media** like Faceboo/Twitter/Instagram/WhatsApp etc, **Mobility** like mobile banking/ticketing etc, **Big Data Analytic** includes making better decision by analyzing large volume of structured & unstructured data & **Cloud Computing** provides shared pool of resources over the internet & is scalable). Someone has even referred them as **"the fourth industrial revolution after the steam engine and the internet"**. SMAC is just a buzz word. Truly no small cap IT company in India is currently working in all four. However some of them are investing to take advantage of the euphoria. Most of the companies are involved in **"Digital transformation of enterprise using SMAC"**. Digital transformation means many things for many people. Right now we call it ISMAC that was originally called SMAC and then later IoT was added.

Before we get into our stock idea, let us see the following companies which are engaged directly or in-directly in SMAC activities & how their stock price has performed in last 3 years (Mar 2016 - Hype to Mar 2019 - Cool-Off)

Large-Cap -	Infosys (Down 8% from ATH in last 3 years), TCS (Down 10%), Wipro (Down 13%)
Mid-Cap -	Tech Mahindra (Down 6%), Mindtree (Down 18%), LT Infotech (Down 20%), LT Technology (Down 20%), Sonata Software (Down 20%), Persistent Systems (Down 28%), Tata Elxsi (Down 34%), Zensar Technologies (Down 34%)
Small-Cap -	Saksoft Ltd (Down 9%), Mold Tek Technologies (Down 40%), , Aurionpro Solutions (Down 40%), TechNVision Ventures (Down 46%), Kellton Tech (Down 67%), Cambridge Technology Enterprises (Down 68%), Ramco System (Down 67%), AXISCADES Engineering (Down 77%), 8K Miles Software (Down 90%)

Note: *High risk companies are highlighted in RED & Safe companies are highlighted in GREEN. Probability of finding a multibagger is high is small & micro cap but at the same time casualty/manipulation is also high in this space. Once upon a time 8K Miles & Kellton Tech was darling of market, people use to quote their examples but they turned out to be worthless companies not suitable for a smart portfolio. It's only when the tide goes out that you learn who has been swimming naked.*

Why we selected this little known company?

Key criterion we look for while selecting a stock from small & micro-cap segment : Quality of management with skin in the game, Company must be listed for more than 10 years with no history of price manipulation, Focus must be on profitability not on topline & Company must have some proven strategy for sustainable growth, Conservative approach of the management is preferred & if the company is not in the radar of most of the investor it's better. **This little known company - Saksoft Ltd satisfies all the criterion mentioned above.**

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Saksoft Limited is a global leader in providing digital transformation solutions and helping businesses stay relevant in a highly connected, rapidly evolving world. Saksoft offers a gamut of services including strategic consulting, information management, application development, digital testing, cloud, mobility and Internet of Things (IoT). The Company is headquartered in Chennai (India) with 14 offices across India, the US, the UK and Singapore.

Key growth drivers:-

#1) Strategy : To identify the pearls (acquitions) & then string it together - Over the years, Saksoft has grown both organically and inorganically by acquiring various companies in complementary line of business expanding its product offerings. The company now offers associated services like application development, testing & quality control and solutions based on cloud, mobility and Internet of Things (IoT) along with Information Management (IM) and Business Intelligence (BI) solutions. As on Mar'19, Saksoft had 5 subsidiaries, 4 wholly-owned subsidiaries **Acuma Solution** (acquired in 2006 - Business Intelligence & Data Analytic), **EDP** (acquired in 2013 - Electronic Data Professionals), **360 Logica** (acquired in 2014 - Digital Testing), **DreamOrbit Softech** (acquired 60% in 2016 - Cloud, IoT, Mobility for logistics & transportation), **Faichi Solutions** (acquired in 2018 - Healthcare Domain) and 6 step-down subsidiaries across geographies like US, UK, and Singapore.

The shift in strategy of the company to **move into higher margin services** in the Information Management space and **ability to cross sell services with recent acquisitions**, the company is expected to report higher operating profit. The reliance on debt is low and the capital structure is expected to remain comfortable.

#2) Focusing on digital transformation & 'agile' methodology - The company's focus is around digital services and certain verticals such as fintech, healthcare, transport and logistics, e-commerce retail, telecom and B2B space. Incumbent IT companies are mostly involved in helping the clients to run their businesses but off-late clients don't want to spend more money behind running the existing businesses but **they want to spend money in transforming their businesses** in order to suite the fast changing global environments & to stay relevant in the world of disruption. This is where niche & small IT players like Saksoft fits in with capabilities & domain expertise. During 2016, company has changed its logo & tagline to be "your digital transformation partner", it seems story has just begun. **There is a greater customer willingness to work with specialists than**

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generalists. There is a wider recognition that customers, who once played safe in their selection of IT vendors and worked only with the large and branded, are now willing to trust mission-critical assignments to the smaller and specialized. Projects are becoming shorter due to fast-changing technologies and **acceptability of the 'agile' methods of execution**, warranting focused teams and disciplined project turnaround. The buzzword within the IT sector is 'agile'; there is a premium on the need for an agile team, for an agile turnaround and for agile solutions development.

#3) Let go low margin businesses + Invest in capabilities + Add more feet on the street - Earlier software development was done on "Waterfall Model" which was rigid, time consuming, non reversible process but now one can't wait for longer period of time to deliver a product else it will be obsolete, usually a beta version is released followed by further enhancements, this process is called Agile methodology which is known for its flexibility. One of the major differences between Agile and Waterfall development methodology is their individual approach towards quality and testing. Saksoft is skipping low margin traditional development work & focusing more on specialized skill based work with higher margin. Acquitions are done to enhance capabilities at the same time large number of business development executives are hired for marketing & sales purposes.

#4) Stable revenue growth & healthy profitability - During FY18, the company reported a total operating income Rs.285 Cr Vs Rs 259 Cr in 2017, Operating profit grew from 32.91 Cr to 39.59 Cr, OPM expanded from 12.68% to 13.85% & the net profit grew from 17.10 Cr to 21.83 Cr. For FY18 company has shown EPS of around 22 while in **FY19 (E) EPS is likely to be around 34-35, hence PE of ~ 8.** The company derives about 91% of its revenue from USA (58%) and UK (32%) resulting in moderate geographic concentration of revenue. On the client concentration front, top 5 clients contributed 42% of the total revenue in FY18 as against 38.34% in FY17, mainly due to increased revenue from the top 2 clients. During FY18, about 90% of the total revenues came from existing clients and new clients/orders made up to the balance portion.

#5) Experienced promoters & long track record of operations - Saksoft, founded by Mr Aditya Krishna (Chairman and Managing Director) in 1999, offers Information Management (IM) and Business Intelligence (BI) solutions and associated services like application development, testing & quality control and solutions based on cloud, mobility and Internet of Things (IoT). They came up with IPO in 2005 and since last 13 years they are listed at BSE/NSE. Company has **long operational track record, vast industrial experience of promoters with a well-qualified management team,** strong client relationships and strong financial risk profile.

#6) Strong promoter holding & low liquidity makes it more attractive - During Sept'17 promoter holding was 72.5% which includes the 5% holding of Employee Welfare Trust. Due to SEBI's new regulation, this 5% Employee Welfare Trust was re-classified as non public, non promoter holding. On Dec'17 promoter holding was 68.31% which was further increased to 69.21%. The company has paid **dividend consistently since last 12 years** and more. Feedback from employees says that, company has best working environment & they are lead by examples.

#7) Steady compounder of 30-35% for next 5 years - Saksoft came with IPO in 2005 @ 30rs, since last 13 years stock has delivered 18.84% CAGR. From 2014-15, they started following 2 strategies - **#1. "String of pearls" strategy** to secure growth in uncharted categories & **#2. "Inch wide mile deep" strategy** of building capabilities with deep domain knowledge. And the success of these strategies are reflected in their stock price from **low of 40rs in 2014 to 284 in 2019 which is 48% CAGR in last 5 years.** According to the management, for the next 5 years, growth is going to be aggressive and better than what they have done in the last five years. Moreover, today's price of Rs 284 was last seen in Dec 2015, so we are in fact getting a 3 years old price today which is a good deal indeed.

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We believe that the building blocks for the next phase of their growth are in place. Company stands at the cusp of an inflection point that should translate into enhanced value for all stakeholders.

Regards

Binoy

Statutory Disclosure:

SEBI Research Analyst Registration No. : INH200006451

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