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HAPPIEST MINDS

Key player in fast growing digital transformation market

INITIATING COVERAGE

March 22, 2023

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INITIATING COVERAGE | Sector: Information Technology

Happiest Minds

Play on the fast growing digital IT services market

Reco	:	**BUY**
CMP	:	Rs 803
Target Price	:	Rs 1,018
Potential Return	:	+ 27%

6 REASONS TO BUY THE STOCK

1 IT company with 20% plus revenue growth outlook led by predominant presence in digital business that includes focus on Cloud, SaaS, Security Solutions, AI, IoT, etc. Digital revenue accounting for 97% of revenue drives faster revenue growth. While the industry faces near term challenges due to macroeconomic issues, the long term demand environment remains robust on account of accelerated adoption of digital technologies.

2 20%+ EBIT margin for IT company, that is significantly smaller than other Tier 2 IT companies, led by high offshore effort mix (96%) and better revenue mix with dominant presence in Digital business. While, other expenses have increased over last few quarters, we expect falling employee attrition, positive operating leverage, and improving employee pyramid to support operating margin in near term.

3 In terms of business units, it operates through 1) Product Engineering Services (PES-47.7% of revenue), 2) Digital Business Services (DBS-30.7% of revenue) 3) Infrastructure Management and Security Services (IMSS-21.6% of revenue). PES is the largest segment for the company and provides access to clients. On the other hand, DBS and IMSS segments provide scalability and annuity revenue stream. The presence in these three segments provide cross sell opportunities for the company.

4 Diversified revenue base across industry verticals and geography. As of Q3FY23, in terms of revenue mix, the revenue base is diversified across EduTech (23.2%); Hi-Tech (~15.7%); Travel, Media & Entertainment (13.1%); BFSI (~10.3%); Retail (10.4%); Manufacturing (10.0%); and Other (8.2%). In terms of geographical breakup of revenue, it derives 67.5% of revenue from the US, 15.4% from India, 9.4% from Europe and 7.7% from the Rest of World.

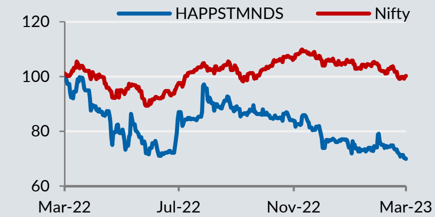
5 Strong promoter (Promoter holding 53%) track record as the management team is led by its founder and industry veteran Mr. Ashok Soota, with several decades of experience in the IT services industry. He was also the founder of MindTree and prior to founding MindTree, he was vice chairman at Wipro. Capital allocation remains prudent as seen in Return on Equity around 30%. DSO at 60 days remains reasonable, with robust FCF conversion.

6 Strong revenue growth outlook along with superior margin profile makes it credible play in the IT services space. Trades at PER of 31.7x on FY25E. Revenue / EBITDA /PAT are expected to grow at CAGR of 26.7%/27.1%/27.1% over FY22-FY25E. We initiate coverage with BUY rating with target price of Rs 1,018, valuing it through DCF method, with terminal growth rate of 5% and discount rate of 11.5%.

Stock data (as on Mar 22, 2023)

Nifty	17,152
52 Week h/l (Rs)	1179 / 786
Market cap (Rs/USD mn)	115317 / 1397
Outstanding Shares (mn)	143
6m Avg t/o (Rs mn):	324
Div yield (%):	0.4
Bloomberg code:	HAPPSTMN IN
NSE code:	HAPPSTMNDS

Stock performance



	1M	3M	1Y
Absolute return	-8.4%	-9.6%	-29.4%

Shareholding pattern (As of Dec'22 end)

Promoter	53.3%
FII+DII	5.4%
Others	38.8%

Financial Summary

(Rs mn)	FY23E	FY24E	FY25E
Net Revenue	14,393	17,861	22,244
YoY Growth	31.6%	24.1%	24.5%
EBIDTA	3,575	4,179	5,294
YoY Growth	38.8%	16.9%	26.7%
PAT	2,439	2,936	3,720
YoY Growth	30.2%	20.4%	26.7%
ROE	33.0%	32.5%	33.5%
EPS	17	20	25
P/E	48.3	40.1	31.7
BV	55	68	83
P/BV	14.5	11.8	9.6

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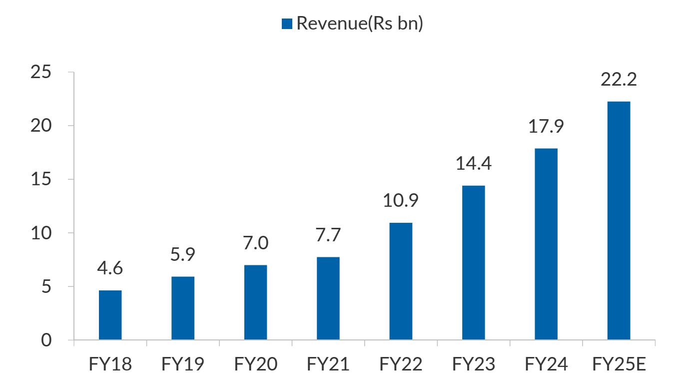
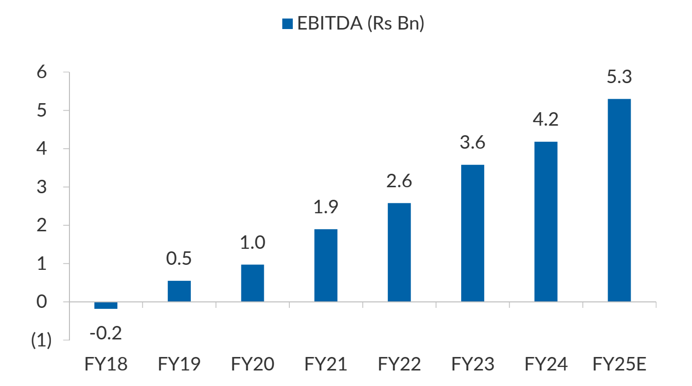
STORY IN CHARTS

Exhibit 1: Revenue Growth momentum remains intact



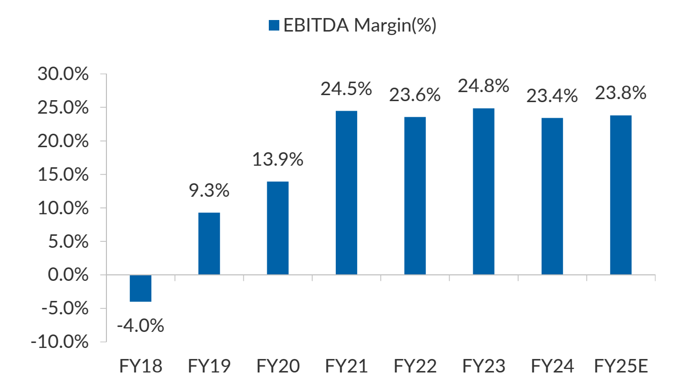
Source: Company, YES Sec

Exhibit 2: Sustains robust growth in EBITDA



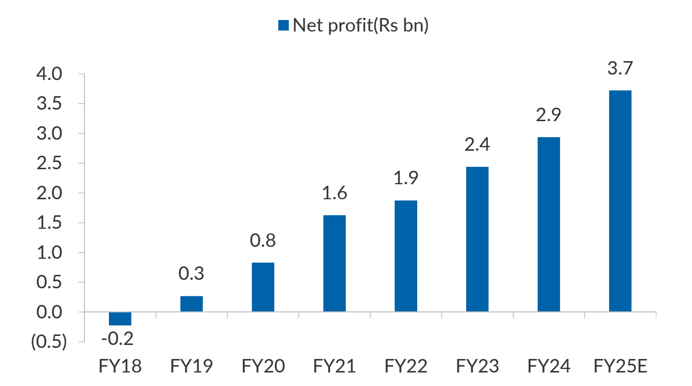
Source: Company, YES Sec,

Exhibit 3: EBITDA Margins remains above 20%+



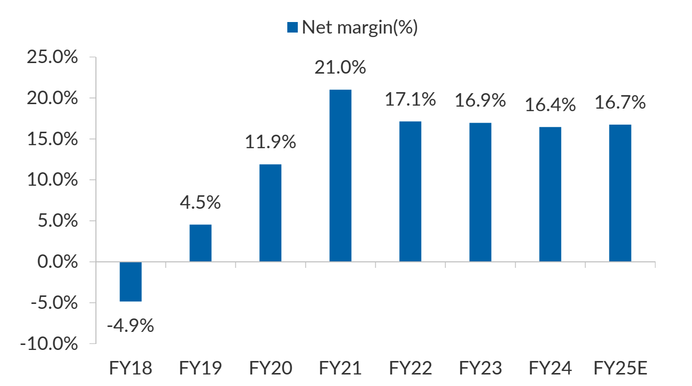
Source: Company, YES Sec

Exhibit 4: Maintains growth momentum in PAT



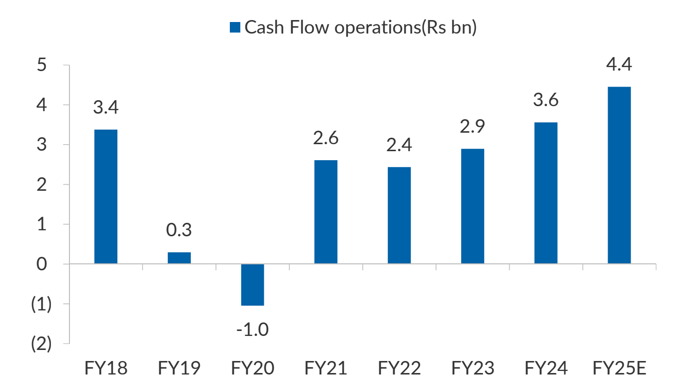
Source: Company, YES Sec

Exhibit 5: Net Profit Margin remains above 15%



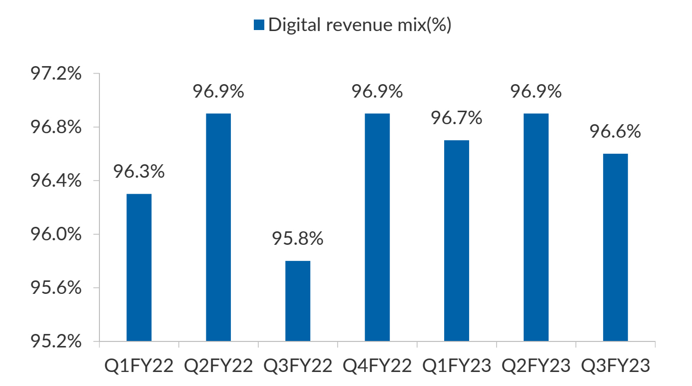
Source: Company, YES Sec

Exhibit 6: Robust operating cashflow generation



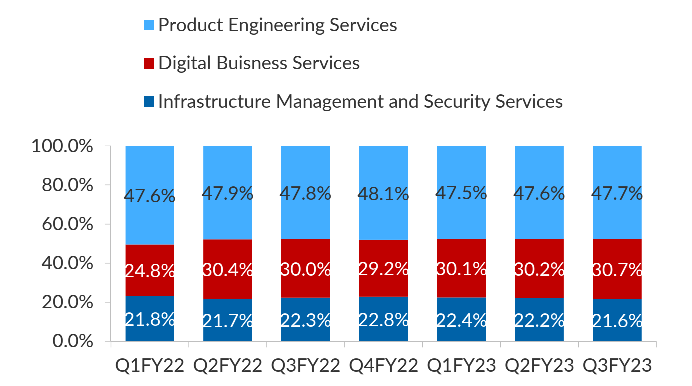
Source: Company, YES Sec

Exhibit 7: Digital Revenue Mix share remains attractive



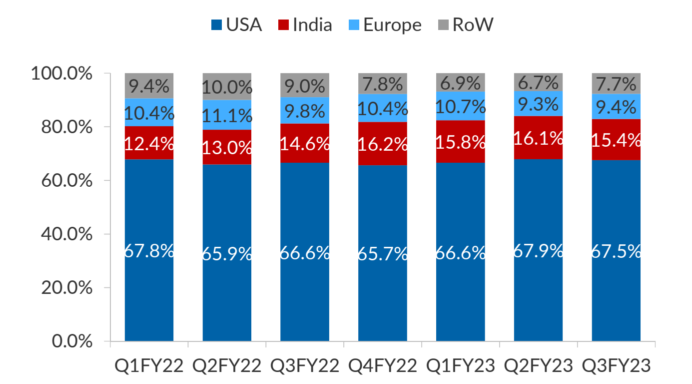
Source: Company, YES Sec

Exhibit 8: Revenue remains well diversified across business units



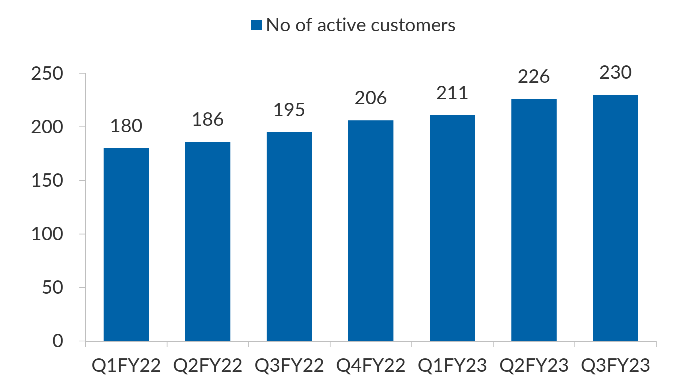
Source: Company, YES Sec

Exhibit 9: USA remains the key market in terms of revenue contribution



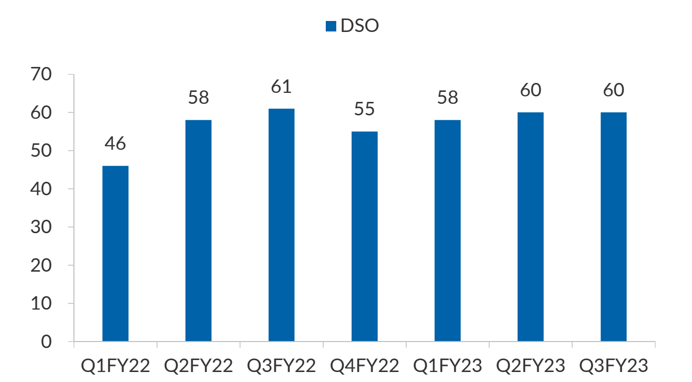
Source: Company, YES Sec

Exhibit 10: Active customers base continues to grow



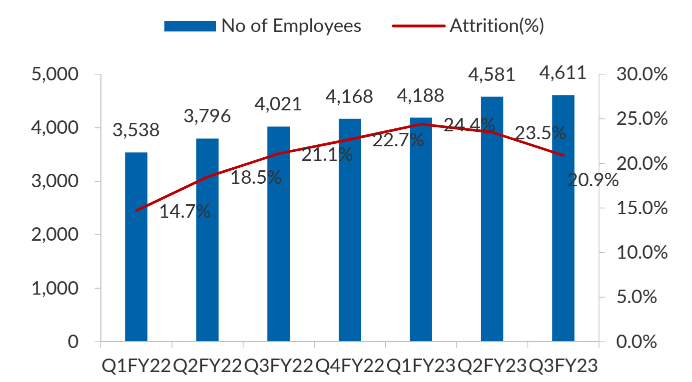
Source: Company, YES Sec

Exhibit 11: DSO remains in reasonable range



Source: Company, YES Sec

Exhibit 12: Employee attrition likely to moderate going ahead



Source: Company, YES Sec

MEDIUM/LONG TERM IT INDUSTRY OUTLOOK REMAINS STRONG

Globally, the Information technology industry continues to be on strong footing led by accelerated adoption of Cloud technologies, Artificial Intelligence and Machine Learning across industries. We are still in the early phase of this digital transformation, signifying the quantum of business opportunities lying ahead in this multiyear technology upcycle.

We continue to be positive on the IT services sector despite near term challenges due to macroeconomic concerns in the US and Europe (key markets of IT companies). This has led to more time in decision making on the part of clients and it can lead to near term moderation in deal booking/revenue growth. The clients have become cautious especially in sectors like Retail, Hitech and Mortgages etc. regarding evolving macroeconomic situation and many of them are trying to optimize their cost structure and consequently, we expect an increase in work volume related to cost optimization projects for Indian IT companies. However, the current valuation of IT companies(down 30-40% from peak valuation) captures most of near term headwinds. The medium to long term demand environment remains strong led by accelerated adoption of technologies such as cloud computing, artificial Intelligence, machine learning, etc. by enterprises. We expect employee hiring to moderate for most IT companies in near term as they focus on training/utilization of recently hired employees. We expect EBIT margin to improve in near term, led by improving employee pyramid(amid increased fresher hiring), lower subcon cost and positive operating leverage. The costs related to travel and admin have started coming back to an extent but IT companies should be able to manage these margin headwinds through operational efficiency measures. We prefer Tier 1 IT stocks over Tier 2 IT stocks given that they are better placed to manage near term macroeconomic headwinds.

Near term challenges are evident but already factored in by the market

Deal booking momentum has slightly slowed down over last few months due to concerns in the US and Europe as clients have become watchful regarding new deals. It has led to increase in deal conversion cycle. The expected near term weakness in deal booking would adversely impact revenue growth for FY24, which is expected to be lower than that of FY23. We may witness more divergence in the performance of IT companies(especially for tier 2) in FY24 versus last two years that saw broad-based growth across the sector. Also, IT companies have reduced the headcount addition in recent months to manage the near term uncertainty. The focus currently is on improving utilization and overall productivity.

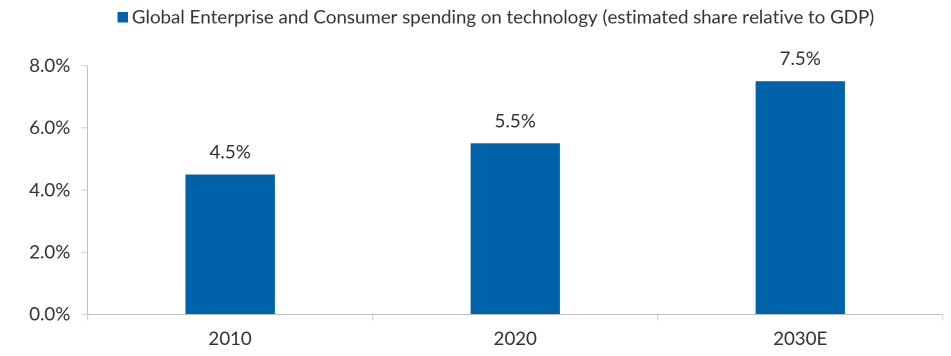
Operating Margin expected to improve led by multiple levers

Employee attrition has started moderating for most IT companies as seen in Q3FY23 result, with most IT companies reporting reduction in LTM employee attrition by 100-200bps QoQ and will support operating margin. Subcontracting cost is expected to come down as supply side constraints ease. It is expected that wage hikes/retention bonus would normalize going ahead. Also, as freshers become billable after their training, the employee pyramid will improve resulting in better operational efficiency. Most IT companies have been able to get some price increase especially for niche skills. Other expenses have started rising, but they are not expected to reach precovid level as percentage of revenue.

Rising tech intensity

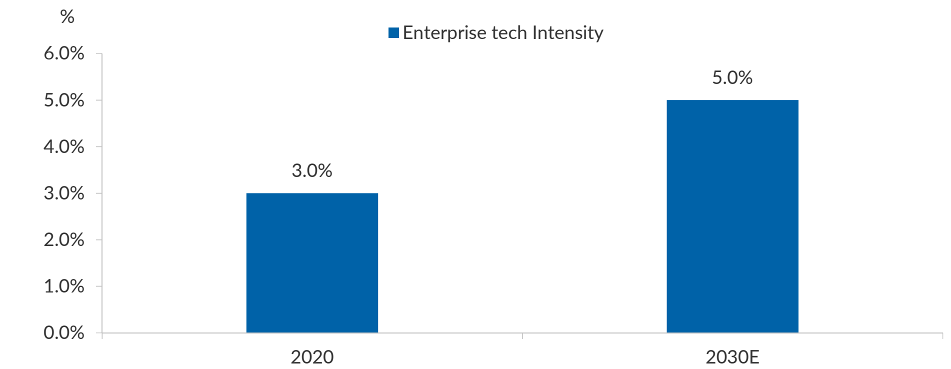
The intensity of tech spending is expected to increase going ahead. As per McKinsey, global spending on technology as a percentage of enterprise revenue is expected to go from 3% in 2020 to up to 5% by 2030.

Exhibit 13: Technology related spending is set to increase going ahead



Source: Company, Bloomberg, YSEC Research

Exhibit 14: Global enterprise tech intensity is expected to touch 5% by 2030



Source: Company, Bloomberg, YSEC Research

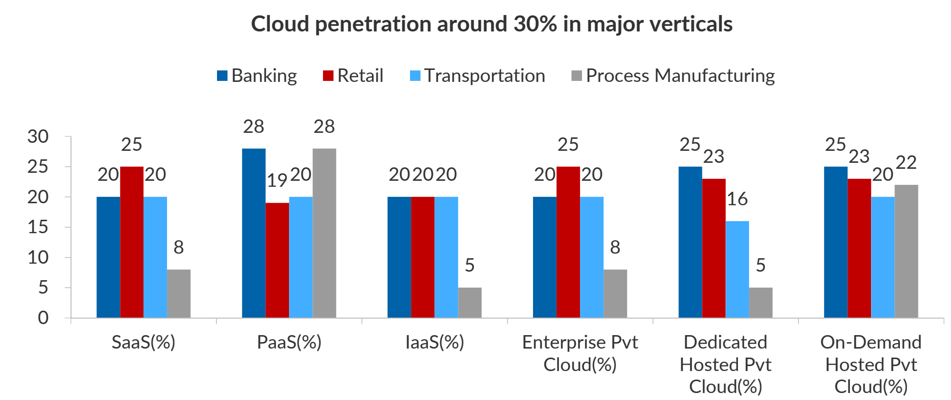
Long term drivers remain strong

It is estimated that only 30% IT workload has been transitioned to cloud, thus signifying the potential demand. Also, Artificial Intelligence/Machine Learning based tools would find adoption across industries as world has recently seen the emergence of several advance AI applications such as ChatGPT, DALL-E by Open AI etc.

Cloud adoption holds significant potential

Globally, enterprises are still in the early stages of cloud adoption and we expect the cloud adoption cycle to last another 4-5 years; as till now, only 30% of IT related workload has got migrated to cloud.

Exhibit 15: Cloud penetration: Lot of room for cloud adoption to grow



Source: Company, Bloomberg, YSEC Research

More than half of Enterprise IT spending will shift to Cloud by CY25

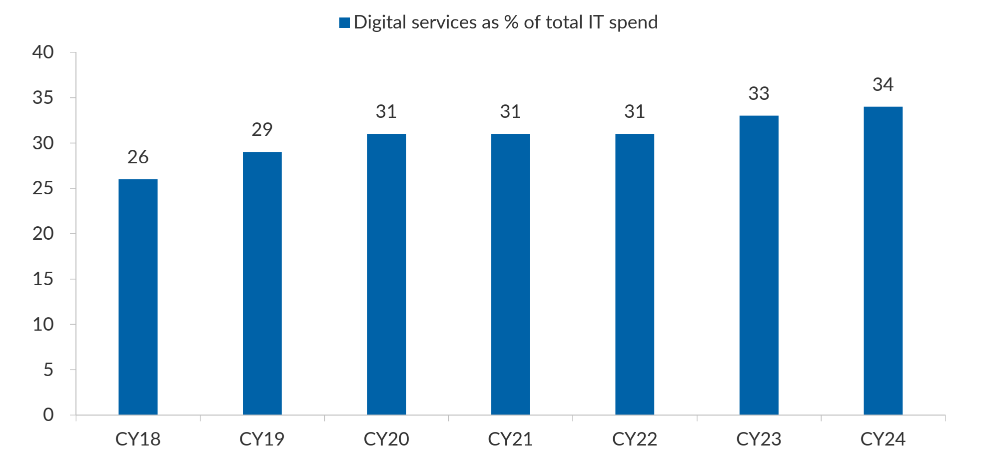
It is estimated that around 51% of IT spending is expected to shift from traditional solutions to the public cloud by CY25 as compared to 41% in CY22, driven by significant improvement in operational efficiency of enterprises due to adoption of cloud based business models.

Amazon Web Services (AWS), Azure and Google Cloud (GCP) – hold more than 60% market share among public cloud providers. Indian IT services companies have strengthened their relationship with global public cloud providers. There has been some slowdown recently in cloud related deals for Hyperscalers due to current macroeconomic concerns in developed economies. But, overall, the demand for cloud related deals remain strong compared to precovid level as seen in recent deal bookings.

Digitalisation across sectors driving IT services demand

Rapid technology adoption over the last decade and especially the uptick in tech adoption during the covid19 years has increased the role of technology in the life of a common man and hence companies across industries have increased their technology spending to augment their online channels to improve customer service and we expect this trend to continue. According to Gartner, digital spending is projected to grow at a CAGR of 11% over CY20-24. The share of digital revenue to total IT services revenue is expected to grow from 31% in CY22 to 34% by CY24.

Exhibit 16: Digital Services contribution to total IT spending



Source: Company, Bloomberg, YSEC Research

Cloud and digital adoption to remain strong

According to Gartner, during CY21-CY26E, it is projected that Global IT services would grow at a CAGR of 8.7% , implying strong demand environment. Globally, CY22 IT spending has been impacted in value terms due to cross currency headwinds as USD appreciated against other currencies, but volume growth has been broadly as per trend.

Historically, global IT services spending grew at an average of 5% pa over the last 2 decades and it is projected that IT spending is expected to grow at higher rate than the historical trend over next 4-5 years.

Industry experts remain confident of medium/long term potential

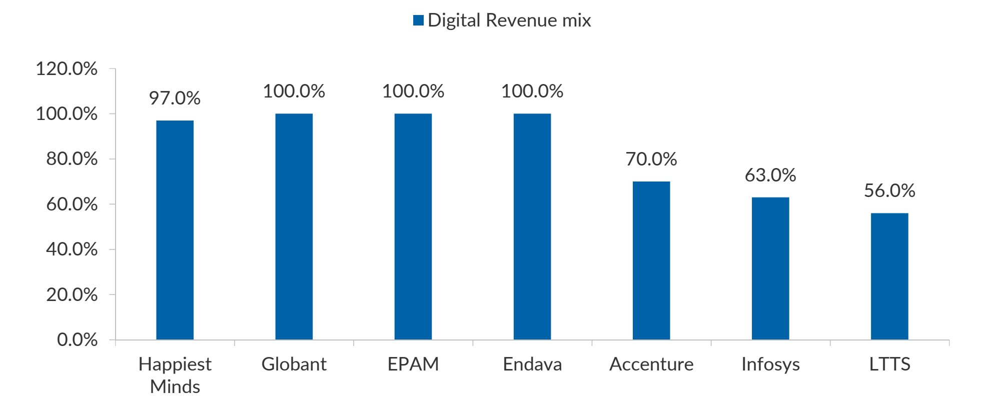
Industry experts have alluded to recent moderation in deal booking but remain bullish about medium to long term demand potential driving the sector. According to joint study by NASSCOM and McKinsey, Indian IT industry is projected to grow at CAGR of 15% to reach US$ 350 bn in FY26 against US$ 224 bn in FY22.

BUSINESS DRIVERS OF HAPPIEST MINDS REMAIN STRONG

Significantly higher share digital revenue

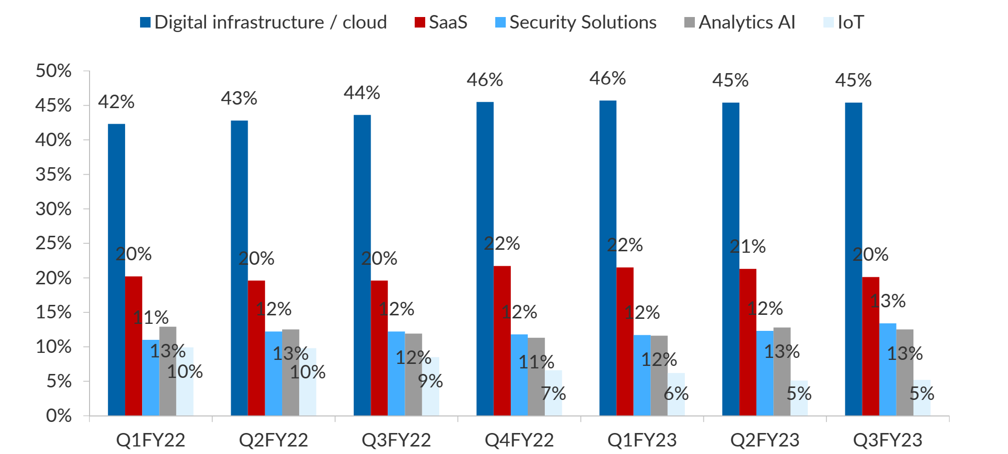
Digital technologies account for bulk(97%) of Happiest Minds' revenue. It includes digital infrastructure/cloud (45.4% of revenues), SaaS (~20.1% of revenue), security solutions (~13.4% of revenue), and analytics, AI(12.5% of revenue) & IoT (~5.4% of revenues). Comparatively, the proportion of revenue from Digital technologies for Happiest Minds is similar to global peers such as EPAM, Globant and Endava (they derive ~100% of their revenues from new technologies). Most Indian IT services companies generate ~50-60% of revenue from digital technologies; while Accenture gets ~65-70% of revenue from digital services. The high proportion of digital revenue enables Happiest Minds to grow faster than most Indian peers at more than 20% CAGR. The market for digital technologies is growing at 15-20% CAGR and is expected to reach $900bn by FY25E from $490bn in FY21, as per Gartner.

Exhibit 17: Digital Revenue Mix Comparison with Peers



Source: Company, Bloomberg, YSEC Research

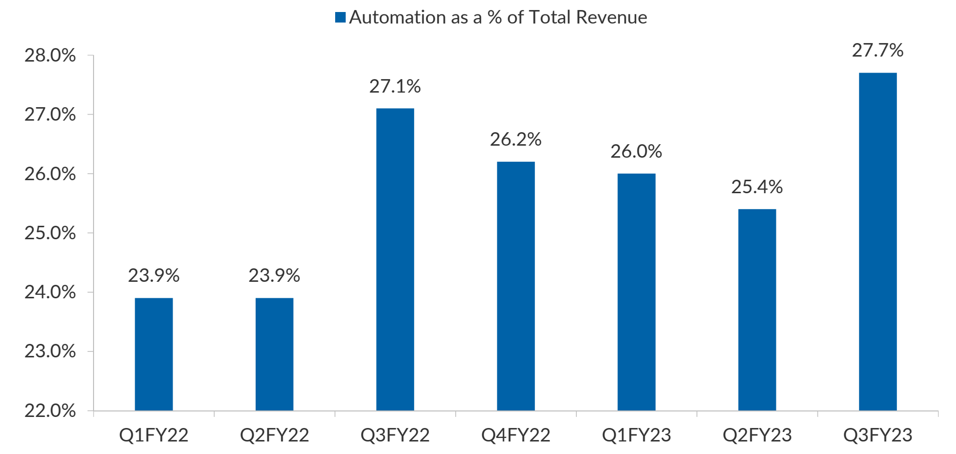
Exhibit 18: Digital Offerings as a % of Revenue for Happiest Minds



Source: Company, Bloomberg, YSEC Research

It has developed automation solutions that include infrastructure automation, test automation, industrial automation, 'development and operations' (DevOps) automation and 'robotic process automation' (RPA). Its RPA solution leverages AI including optical character recognition (OCR) to digitally process documents in the workflow and API-based approach to integrate disparate systems to achieve automation across IT security management, cyber security and finance.

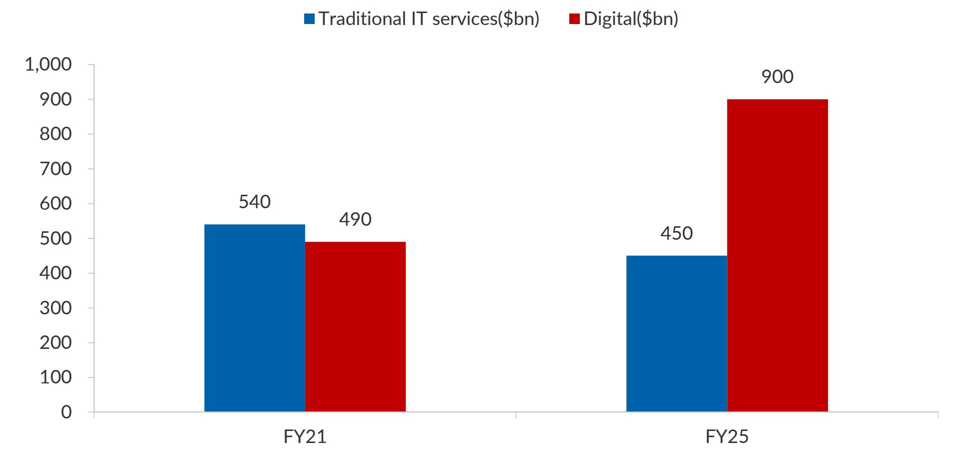
Exhibit 19: Contribution of Automation to Total Revenue



Source: Company, Bloomberg, YSEC Research

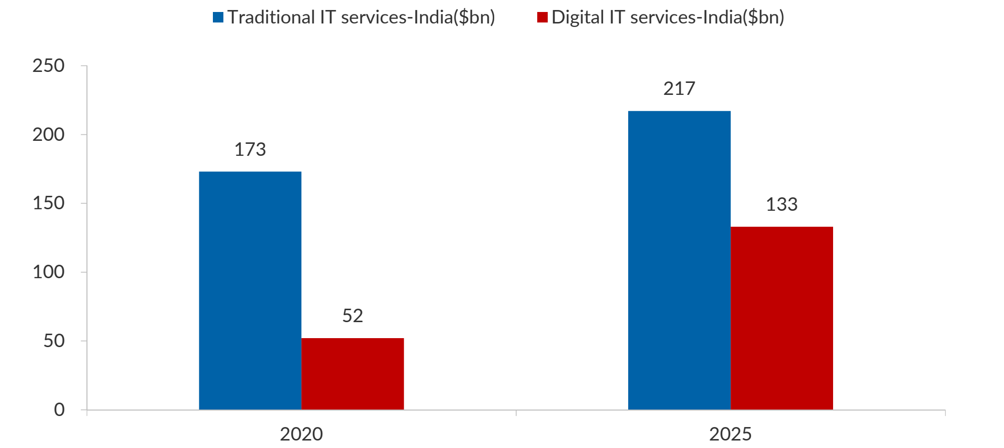
Globally, at industry level, legacy IT services is expected to decline at 5% CAGR from FY21-FY25; whereas, Digital is expected to increase at 16% CAGR from FY21-25. For Indian IT companies, Legacy services is expected to grow at 5% CAGR, while Digital IT services is expected to grow at 21% CAGR

Exhibit 20: Digital services will drive growth for global IT services industry



Source: Company, Bloomberg, YSEC Research

Exhibit 21: Increasing mix of digital services for Indian IT services industry



Source: Company, Bloomberg, YSEC Research

Diversified presence across 3 business units drive performance

Happiest Minds is present in 3 business segments. 1) Product Engineering Services(PES); 2) Digital Business Services(DBS); 3) Infrastructure Management and Security Services(IMSS). Since its launch in 2011, Product engineering platform was key focus area for Happiest Minds and gradually it expanded into other segments. PES is the biggest business segment(47% of revenue) for Happiest Minds and provides access to clients. On the other hand, DBS and IMSS segments provide scalability and annuity revenue stream. The presence in these three segments provide cross sell opportunities for the company. It has strong focus on 1)Cloud, led by its long-standing relationships with large hyperscalers like Microsoft Azure and Amazon AWS. 2) Enterprise SaaS, led by the strength in implementation/integration of large software vendors such as Salesforce alongside capabilities in certain niche software products. It has been expanding its offerings in the digital and infra service segments, which are annuity and long-term in nature. DBS and IMSS combined contributed >50% of revenue and are expected to lead growth in medium term

PES is the largest unit (47.7% of revenue as of Q3FY23) and has grown at CAGR of 21.7% over FY20-22 led by strength across verticals in the ER&D space. Happiest Minds has strong positioning in Enterprise software, Automotive, Aerospace, Telecommunication and Consumer software. It helps clients develop products/platforms on emerging technologies including cloud, IoT, analytics, etc. The offshore delivery of software products is on the rise as the global PES market is expected to grow steadily at a CAGR of 11.3% between 2019 and 2025. The typical projects are smaller and not annuity type, but it provides access and stickiness to clients. It has wide presence across verticals in ER&D space due to its focus on ISV partnerships which provides access to clients across multiple domains.

DBS is the second largest unit and contributes 30.7% to revenue(as of Q3FY23) and has grown at CAGR of 28.0% over FY20-22. Key offerings include a) app development & modernization and migration of on premise applications to cloud, b) ERP implementations including Salesforce, Appian, Mulesoft, etc. and c) customized solutions in areas of customer experience, IoT and data & analytics.

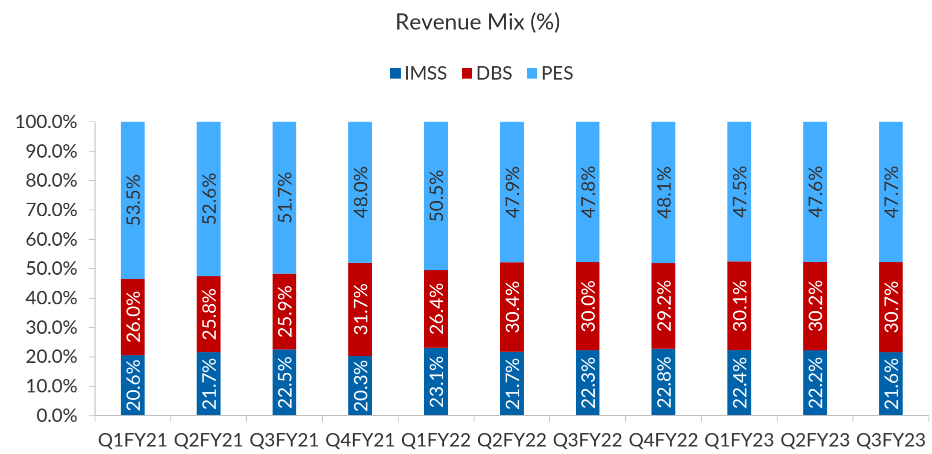
IMSS contributes 21.7% of revenues and grown at CAGR of by 25.6% over FY20- 22 led by the strength in cloud and security practice. The offerings include a) managing hybrid cloud infrastructure, b) workplace transformation and service desk automation services, c) cyber-security and governance, risk & compliance services and d) identity & access management and threat & vulnerability management services.

Its business units are supported by 4 Centers of Excellence (CoEs):

- **Internet of Things (IoT)**: Its IoT offering includes consulting led digital strategy creation, device/edge/platform engineering, end-to-end system integration on industry standard IoT platforms, IoT security, and IoT enabled managed services, implementing IoT roadmap, deriving insights from connecting assets, connecting manufacturing, supply chain, products and services to deliver IoT led business transformation and new business models aimed at enhancing its customers' operations and customer experience.
- **Analytics / Artificial Intelligence (AI)**: Its analytics/AI offering includes implementation of advanced analytics using artificial intelligence, machine learning and statistical models, engineering big data platforms to deal with large volume of data, creating actionable insights with data warehousing, modernization of data infrastructure and process automation through AI.
- **Digital Process Automation (DPA)**: Its DPA offering includes consulting led digital transformation through process automation of core business applications, products and infrastructure landscape of its customers, leveraging various intelligent process automation tools and technologies including Robotic Process Automation (RPA), intelligent Business Process Management (iBPMS) and cognitive automation using AI & machine learning based models.
- **Cyber Security**: Its offerings include security solutions that help to improve governance, compliance, vulnerability management services, etc.

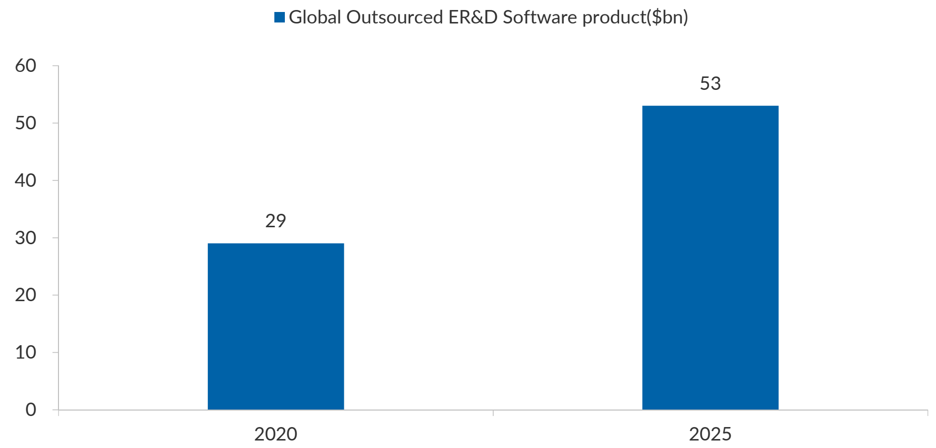
It has certain proprietary set of Platforms to manage delivery process. **A) Ellipse**: a modular platform with multiple ITSM/ ITOM tools integration, supported by powerful analytics backend with machine learning capabilities. Enables agile infrastructure operations and helps enterprises accelerate their journey toward IT-as-a-service **B). Digital content monetisation (DCM) SaaS**: it enables deriving relevant information from enterprise content and digital assets and monetize it efficiently. It ensures personalized and contextualized knowledge delivery, low TCO and time to market advantages. **C). UniVu**: a big data-based university analytics solution that enables course delivery and administrative insights along with student success analytics. It binds siloed data of universities in an integrated data platform to ensure critical, actionable, and predictive insights that are derived by using predefined or customizable KPIs. **D). Pro-RiTE**: a test automation framework to decipher and interpret industry-standard specification models and auto-generate test artifacts with optimized data feeds using model-based system engineering. Test types include UI, API and performance security testing. **E) ThingCenter**: A cloud agnostic consumer device IoT platform supporting connected device management with analytics. **F) CourseMap**: An online AI-powered degree tool for students to plan the most optimal path towards reaching their academic goals.

Exhibit 22: PES business unit is the major revenue contributor for Happiest Minds



Source: Company, Bloomberg, YSEC Research

Exhibit 23: Global Outsourced ER&D Software market is set to soar

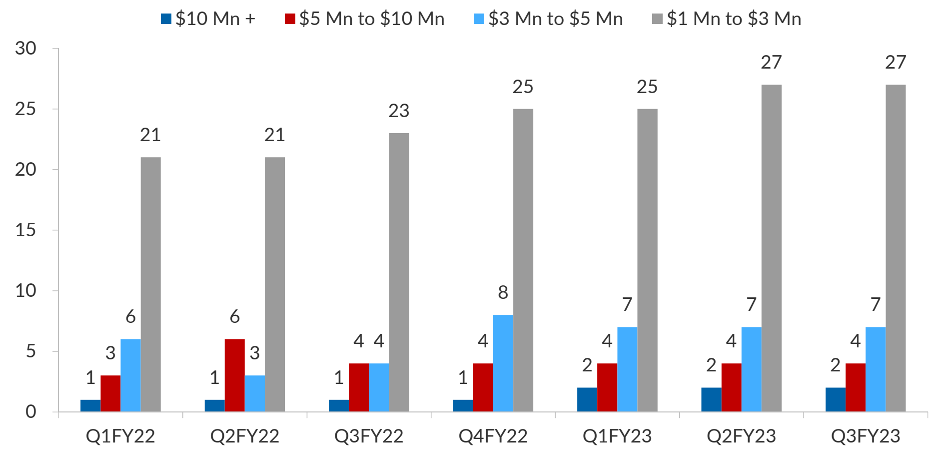


Source: Company, Bloomberg, YSEC Research

Client addition and revenue concentration remains healthy

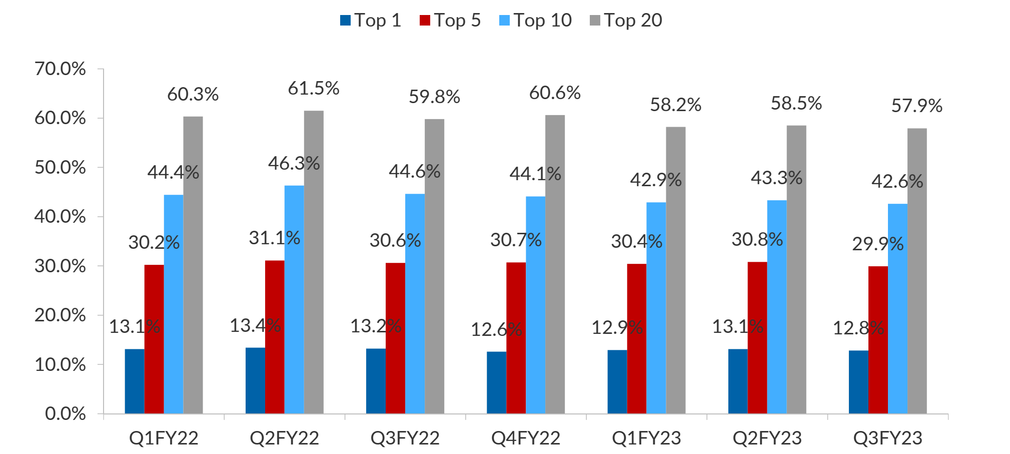
It added 57 new active customers during Q4FY21-Q3FY23. It added 11 clients in the US$1mn to $3mn bracket during this period, a healthy number considering its size. Its revenue concentration from top 20 clients has also reduced from 62.5% of revenues in Q4FY21 to 57.9% in Q3FY23. It derives 12.8%/29.9%/42.6%/57.9% from Top 1 /Top 5 /Top 10 /Top 20 clients, which looks quite similar to Indian tier 2 IT companies, despite being significantly smaller in size compared to them.

Exhibit 24: Continues to add clients at healthy pace across revenue buckets



Source: Company, Bloomberg, YSEC Research

Exhibit 25: Revenue concentration among top customers has been falling for Happiest Minds

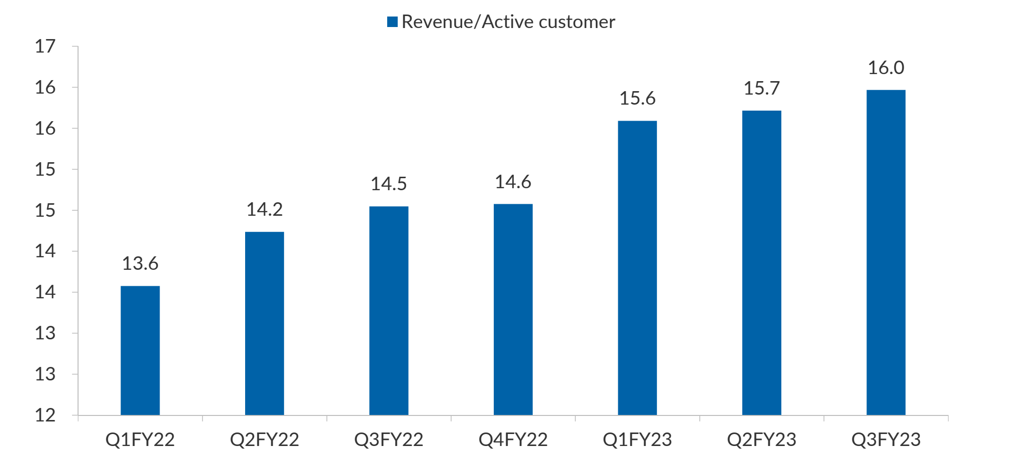


Source: Company, Bloomberg, YSEC Research

Client mining:

It places special emphasis on client mining and that is reflected in its Land and Expand strategy and this has resulted in increase in average revenue per active customer from Rs13.6mn in Q1FY22 to Rs16.0mn in Q3FY23 and there is further potential to grow this metric, as seen for other Indian peers. Since FY18, the company has placed higher emphasis on mining accounts by up-selling into other businesses of the enterprise or leveraging cross-selling opportunities by selling digital and infra services and exiting non-scalable accounts. Between FY18-20, its active client base fell from 173 in FY18 to 157 in FY20, as the focus remained on increasing wallet share among key clients; It currently derives ~90% of its revenues from repeat business, indicating robust client-mining ability.

Exhibit 26: Revenue per Active Customer maintains growth trend

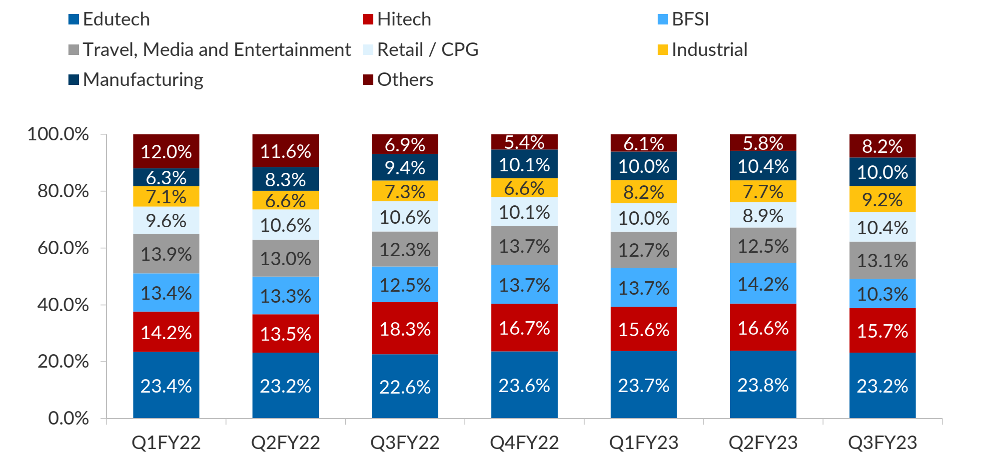


Source: Company, Bloomberg, YSEC Research

Presence in key markets with a well-diversified vertical presence,

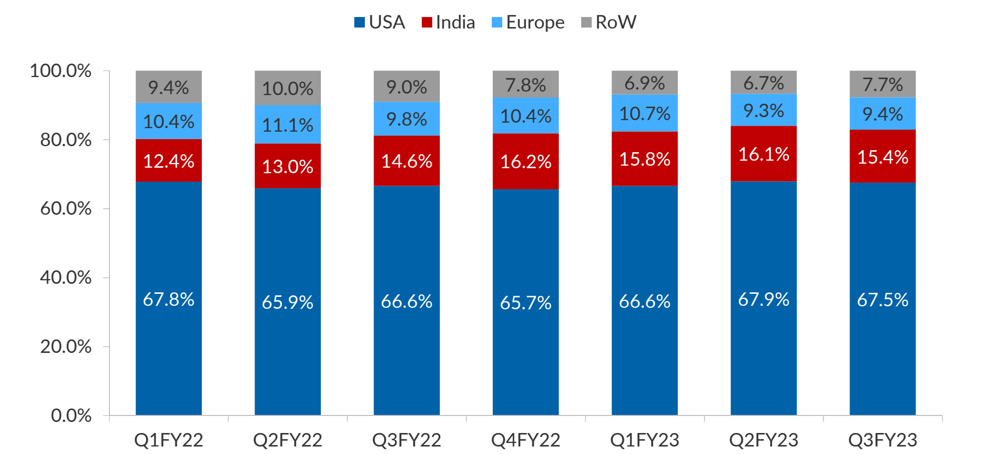
It derives ~76% of its revenues from the US and Europe; with remaining 24% coming from India and RoW. Its revenue is well diversified across industry verticals. As of Q3FY23, EduTech contributed 23.2% to revenue; Hi-Tech contributed ~15.7% of revenues; Travel, Media & Entertainment (TME) contributed 13.1% of revenue; BFSI contributed ~10.3% of revenue; Retail contributed 10.4% of revenue; Manufacturing contributed 10.0% of revenue; and Other contributed 8.2% of revenue. Revenue growth in the past two years has been largely led by Retail, Industrial and Manufacturing verticals. It needs to deepen its domain expertise in key areas to strengthen relationships with T1 clients.

Exhibit 27: Diversified base across verticals



Source: Company, Bloomberg, YSEC Research

Exhibit 28: Diversified revenue base across geographies

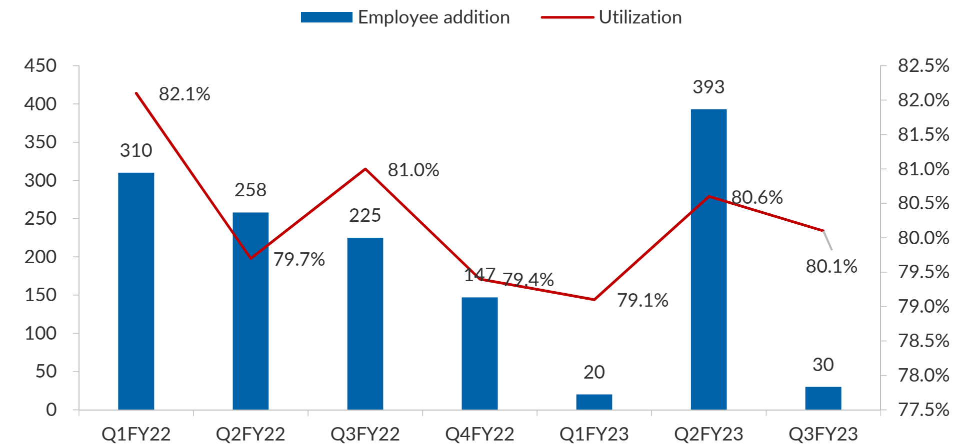


Source: Company, Bloomberg, YSEC Research

Employee addition/utilization related metrics remain healthy.

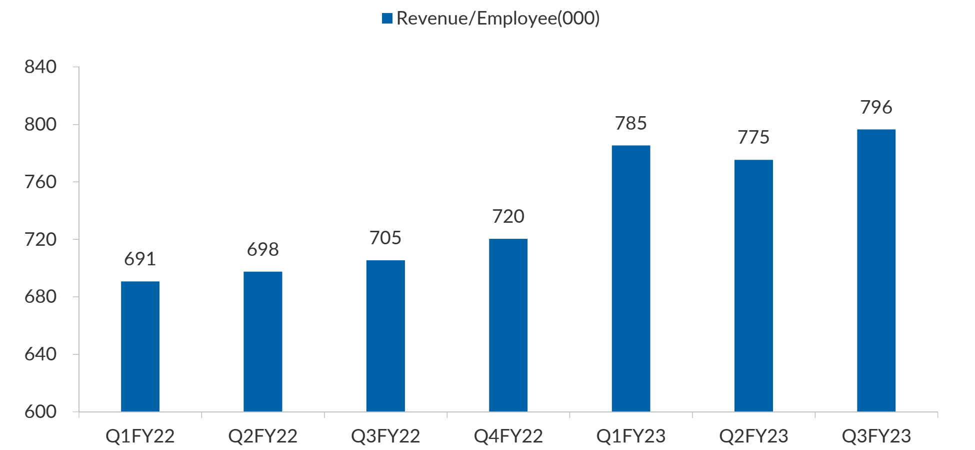
Employee base has grown by ~60% over last 2 years led by strong demand environment especially for digital related deals. Current utilization levels remain robust at ~80%. Revenue per employee has grown from Rs 691k in Q1FY22 to Rs 796k in Q3FY23. It has dominant offshore effort mix as 96% of its employees are based out of India, thus supporting its operating margin.

Exhibit 29: Employee utilization remains healthy around 80%



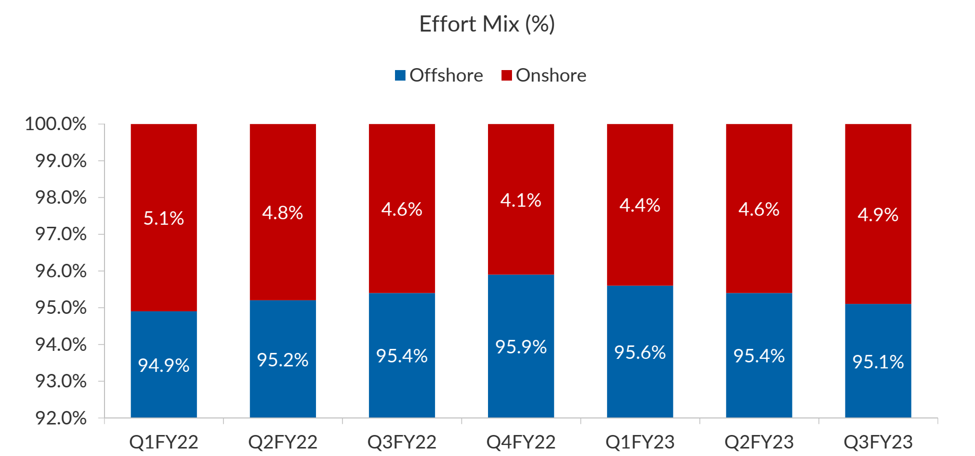
Source: Company, Bloomberg, YSEC Research

Exhibit 30: Revenue per Employee on rising trend



Source: Company, Bloomberg, YSEC Research

Exhibit 31: Offshore Effort mix among the highest in industry



Source: Company, Bloomberg, YSEC Research

Revenue growth performance-Well placed for 24% revenue CAGR over next 2 years

Its revenues grew at 26.1% CAGR in INR terms over two year period from FY20-FY22, led by broad-based growth across verticals; DBS(28.0% CAGR), IMSS(25.6% CAGR) PES(21.7% CAGR). In FY21, the first quarter was impacted badly due to covid19 and that resulted in low growth of 10.8% in FY21. But, the revenue growth bounced back strongly from the start of FY2022 as it grew at 7.5% CQGR over past seven quarters(Q1FY22-Q3FY23). The growth was led by its capabilities in the high demand areas of digital, cloud, analytics and new-gen technologies; We expect the revenue growth momentum to remain strong led by 1)its strong focus on client mining as it aims to increase wallet share among key clients. It has identified certain accounts as strategic and aims to increase market share in those accounts through investments and improving access to the CXOs of those clients. 2) Increasing participation in $10-50mn deals that will require it to fill key gaps in the product portfolio and deepen domain specialization 3) Expanding sales coverage that will help it to improve geographical footprint and gain access to new markets. and 4) M&A – It has acquired four companies till date; and we expect the M&A intensity to increase that will help it to fill gaps in its offerings. We believe the company has potential to achieve its vision to reach US$1bn in revenues by FY31.

Exhibit 32: Revenue Growth Comparison of Peers

Revenue growth(%)	FY18	FY19	FY20	FY21	FY22
Happiest Minds	7.5%	27.5%	18.3%	10.8%	41.4%
LTTS	15.4%	35.5%	10.7%	-3.0%	20.6%
LTI	29.3%	15.2%	13.7%	26.7%	23.9%
Coforge	6.9%	22.9%	13.8%	11.4%	37.9%
Mphasis	7.7%	18.1%	14.4%	9.9%	23.0%

Source: Company, Bloomberg, YSEC Research

Ability to maintain growth along with robust operating margin

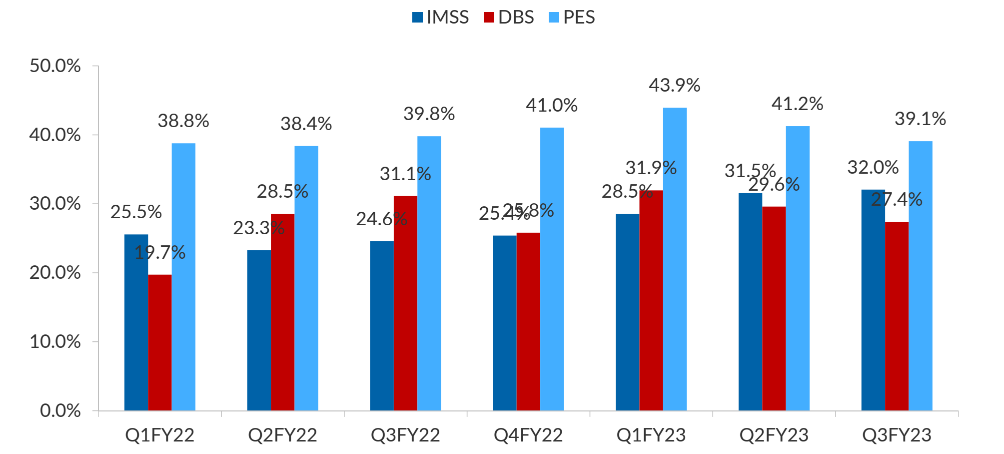
It has delivered 20%+ revenue CAGR growth over last two years while maintaining EBIT margin above 20% range. This margin profile is slightly higher than mid-cap IT services (despite being significantly smaller in size) led by higher offshore mix and greater digital revenue mix. Around 95% of its employees are in India, compared to 65%-75% offshore effort mix for Indian tier 2 IT companies. It derives close to 97% of its revenues from digital technologies compared to ~50-60% for Indian tier 2 IT services companies. EBITDA margin expanded from ~14% pre-covid level to 24.5% in FY21 led by improvement in utilisation, benefit from covid-led cost savings (lower travel, SGA costs, etc. In FY22, the margin contracted slightly by 90bps QoQ to 23.6%, but remained much above pre-covid levels despite facing supply-side pressures due to high attrition across the industry. Going forward, we believe falling attrition, improving employee pyramid and positive operating leverage will be the key margin levers. There is also scope for increase in fixed price contracts (currently at around 25% of revenue) which can further support margin. Employee utilization has improved from 76.9% in FY20 to 80.5% in FY22 and is expected to stabilize around 80%. EBITDA margin is expected to be in the range of 23-24% in near term. We expect it to sustain superior margin profile going ahead compared to Indian tier 2 IT peers.

Exhibit 33: EBIT Margin Comparison of Peers

EBIT Margin(%)	FY18	FY19	FY20	FY21	FY22
Happiest Minds	-8.5%	5.1%	11.0%	21.5%	20.6%
LTTS	13.0%	16.0%	16.5%	14.5%	18.3%
LTI	14.1%	18.4%	16.1%	19.3%	17.3%
Coforge	12.5%	14.2%	13.1%	13.0%	14.2%
Mphasis	15.1%	16.1%	16.0%	16.1%	15.3%

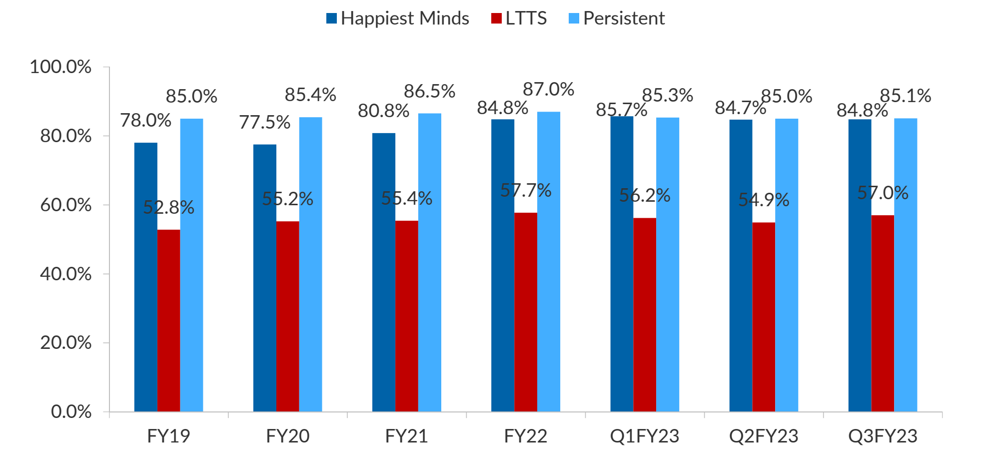
Source: Company, Bloomberg, YSEC Research

Exhibit 34: Segmental EBIT Margin (%)



Source: Company, Bloomberg, YSEC Research

Exhibit 35: Offshore Revenue Mix among the highest in the industry



Source: Company, Bloomberg, YSEC Research

Exhibit 36: Peer Comparison with P/E, EV/EBITDA, EPS Growth, Revenue Growth as of (March 17, 2023)

Particulars	P / E			EV / EBITDA			EPS Growth(22-25E)	Revenue Growth(22-25E)
	FY23	FY24	FY25	FY23	FY24	FY25	CAGR %	CAGR %
TCS	28.2	24.1	21.6	19.3	16.3	14.5	12.3%	12.5%
INFO	24.1	19.1	16.7	16.0	12.7	10.8	17.1%	15.5%
HCLT	20.3	17.4	15.5	12.6	10.5	9.2	12.9%	14.7%
TECHM	19.9	15.1	13.5	11.3	8.5	7.2	13.9%	13.6%
WPRO	17.9	15.7	13.9	10.6	9.0	7.7	6.5%	11.3%
COFORGE	29.0	21.9	17.9	16.8	12.9	10.2	24.5%	20.2%
LTTS	32.8	29.1	24.9	20.6	17.6	14.8	16.5%	17.1%
LTIM	31.2	25.8	20.9	21.4	17.1	13.4	18.8%	19.5%
MPHL	21.2	18.6	16.3	13.6	11.6	9.8	14.8%	14.2%
EMUDHRA	27.0	18.2	12.2	17.1	11.2	7.7	50.8%	37.9%

Source: Company, Bloomberg, YSEC Research

Breadth and level of partnerships

It partners with a range of global tech players to build customised platforms for its customers. It is an 'Advance Consulting Partner' to AWS worldwide and has worked on multiple system integration projects worldwide on digital platforms. It is a strategic Gold-certified, tier-1 system integrator with Microsoft. This rating is similar to mid cap IT players, despite it being much smaller in size

Key partners	Partnership rationale
Amazon AWS	Help customers (both industrial and consumer segments) to unlock the potential of the AWS platform and achieve transformational outcomes.
Cyberark	Develop simplified and robust security solutions by leveraging next-gen technologies with strong domain expertise.
Microsoft	Working closely with them in all our focus geographies. Our deep capability within Microsoft technologies has helped us achieve Gold competencies within Application Development, Azure Cloud, Collaboration, Data Analytics, and DevOps areas.
Pimcore Global Services	Pimcore is a 100% open-source and fully customizable digital experience platform spanning product information/master data/digital asset/ content management, UI/ UX and eCommerce.
Outsystems	Happiest Minds and OutSystems share the vision to transform how enterprise software is delivered to their customers.
Datarobot	Happiest Minds and DataRobot share the vision to productionize AI/ML models for Happiest Minds customers.
Mulesoft	Happiest Minds is strategically aligned with MuleSoft to offer digital services and hybrid integration solutions that accelerate digital transformation initiatives.
Netsuite	Happiest Minds accelerates NetSuite configuration, customization, integration and implementation approaches with functional and technical proficiencies
Snowflake	Happiest Minds and Snowflake have partnered to mobilize the world's data with Snowflake's Data Cloud by catering to the demand for simplified data administration through robust, cost-effective, and proven technology solutions.

M&A Strategy- a key driver in augmenting its capabilities in core and emerging technology areas.

We expect acquisitions to be a key part of its strategy to achieve its goal of reaching US$1bn in revenues by 2031. It has cash equivalents of Rs 6.9bn on its balance sheet as of December 31, 2022 and that can to be utilised for M&A. It has completed four acquisitions till day. Of these, OSS Cube, Cupola Technologies, were relatively small in size and were done for strengthening specific capabilities, while PGS acquisition done in 2021, was of around 5% revenue size of Happiest Minds; Sri Mookambika Infosolutions acquisition done in Jan 2023 was ~6% of the revenue of Happiest Minds.

Its acquisition targets include companies: 1) that have high digital capabilities and ~$10mn-$20mn in revenue size, 2) which help to expand geographical presence across markets such as USA, Europe, Middle East and ANZ, 3) which help to fill gaps in new-age technologies – cloud operations, Security, AI etc. 4) that help to deepen vertical capabilities.

Acquisitions	Year	Amound paid (Rs mn)	Comments
OSS Cube	2017	194	OSSCube was founded in 2008 by Lavanya Rastogi and Vineet Agarwal, providing consulting-led digital transformation and modernization services in the fast-growing areas of cloud, big data, e-commerce, enterprise mobility and open source
Cupola	2017	70	Cupola Technology was founded in 2011 by Ajay Agrawal and Huzefa Saifee, specializing in IoT domain
Pimcore Global Services	2021	600	Pimcore Global Services, Houston based company, speacialised in digital e-commerce and data management solutions company
Sri Mookambika Infosolutions	2023	1,110	Provides product engineering services to its US customers around Enterprise Applications & Integrations, digital data platform services (Analytics, Data Strategy, AI / ML, User Experience), Mobility Services and DevSecOps.

Strong management track record

The management team is led by its founder and industry veteran Mr. Ashok Soota, with several decades of experience in the IT services industry. He was also the founder of MindTree and prior to founding MindTree, he was vice chairman at Wipro. Mr. Soota is the executive chairman of Happiest Minds and is largely focused on providing strategic direction to the company, while day-to-day operations are managed by the executive board which reports to Mr. Soota. The executive board consists of: 1) Mr Venkatraman, Managing Director and CFO; and 2) the CEO's of three business units including Joseph Anantharaju (Executive vice chairman and CEO of PES), Rajiv Shah (CEO of DBS) and Chaluvaiya Rammohan (CEO of IMSS). We think the current management is well equipped to scale business, given each of the CEOs has significant work experience in the IT services industry; and they held leadership roles at larger peers like Wipro, Mindtree, EDS and MuSigma in the past.

Recognitions

Recognized in Zinnov Zones as a Leader for Enterprise Software, Leader for ER&D (Small & Medium Service Providers), Niche-Established for AI Engineering, Niche-Established for IoT Services. Recognized as a 'Major Contender' in Everest Group's PEAK Matrix for Digital Engineering. Featured in NASSCOM Cloud Case study Compendium on Digital Content Monetization (DCM) solution. Featured in NASSCOM's report on India Cybersecurity Industry Services & Product Growth Story for a case study on major civil aviation infrastructure.

Risk factors

Key risks to our thesis include inability to mine key clients thus adversely affecting revenue growth; rising competition from larger peers, higher cost of talent going ahead impacting the margins, attrition at senior management level which might impact day to day operation.

VIEW AND VALUATION

Initiate Coverage with BUY Rating on the stock

We initiate coverage on Happiest Minds with BUY recommendation and target price of Rs 1,018/share. The business outlook remains strong led by rising demand for digital transformation across enterprises. Its digital offerings include solutions across Cloud, SaaS, Security solutions, Analytics AI and IoT. The high digital focus(97% of revenue) is expected to help it to grow at ~24% CAGR over next two years (FY24-FY25). Strong client mining focus is expected to drive higher wallet share among key clients. Revenue base remains diversified across verticals and geographies that mitigates business risk. Employee attrition has started falling and would support operating margin. Higher offshore effort mix along with major presence in fast growing digital segment would help it to post 22-24% EBITDA margin in near term.

We value Happiest Minds through DCF Method over forecasted period FY24E-FY33E period with terminal growth rate of 5% and WACC of 11.5%. We estimate its revenue to grow by CAGR of 22.5% over FY24E-FY33E period, with average EBIT margin of 21.4% during this period. The target price implies PE multiple of 40x over FY25E. Its premium valuation is due to strong positioning in digital offerings along with superior margin profile. RoE at ~30% remains strong for IT company of just Rs 10bn revenue. It is well positioned to grow at 1.5x the growth rate of tier 2 IT companies along with strong FCF generation.

Exhibit 37: DCF Valuation

(Rs mn)	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E	FY33E
EBIT	3,697	4,693	5,800	7,168	8,786	10,769	13,199	16,178	19,665	23,904
D&A	482	601	739	909	1,109	1,352	1,650	2,013	2,436	2,947
Tax Rate	0.252	0.252	0.252	0.252	0.252	0.252	0.252	0.252	0.252	0.252
Increase in working capital	226	249	284	324	369	420	479	542	612	692
Capex	536	667	821	1,010	1,232	1,503	1,833	2,237	2,706	3,275
FCFF	2,486	3,195	3,973	4,937	6,080	7,484	9,210	11,336	13,827	16,861
WACC	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%
Present value factors	0.90	0.80	0.72	0.65	0.58	0.52	0.47	0.42	0.38	0.34
PV of individual cash flows	2,229	2,570	2,866	3,194	3,528	3,895	4,299	4,745	5,191	5,677
Terminal growth rate	5.0%									
Terminal Value	272,372									
Present Value of Terminal value	91,709									
Firm Value	145,013									
Net Debt	-4,521									
Equity Value	149,534									
Share Outstanding	147									
Firm Value/share	**1018**									

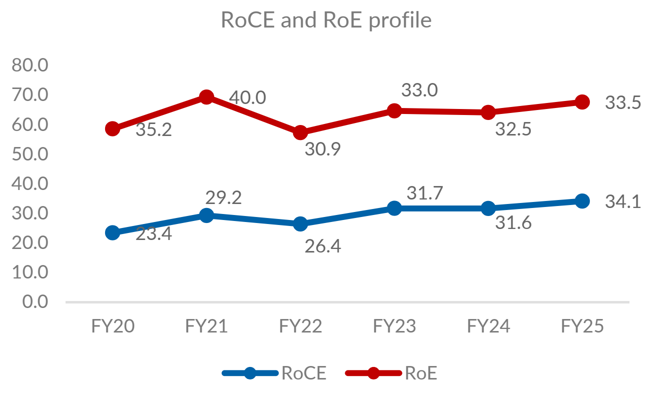
Source: Company, Bloomberg, YSEC Research

Exhibit 38: Sensitivity analysis of DCF valuation

		WACC				
		10.5%	11.0%	11.5%	12.0%	12.5%
Ter. Growth Rate	4.0%	1,097	1,007	930	862	802
	4.5%	1,157	1,056	971	896	831
	5.0%	1,228	1,114	1,018	936	864
	5.5%	1,313	1,182	1,073	981	902
	6.0%	1,416	1,264	1,138	1,034	946

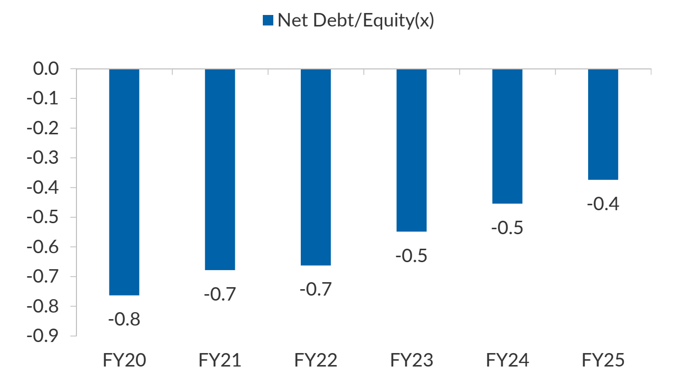
Source: Company, Bloomberg, YSEC Research

Exhibit 39: RoCE and RoE Profile



Source: Company, YES Sec

Exhibit 40: Net Debt/Equity Profile



Source: Company, YES Sec

LONG TERM POTENTIAL

Earnings		
	Past 3yr	FY22-FY25E
Revenue CAGR	24.0%	26.7%
Earnings CAGR	133.6%	27.1%

We forecast revenue/ EBITDA /EBITDA/ PAT CAGR of 26.7%/ 27.1%/ 27.1% over FY22–25E,

Multiple			
	Past 2yr	Next 3yr	Next 5yr
ROCE (%)	27.8	32.5	33.0
RoE(%)	40.0	33.0	33.5
Net Debt/ Equity (x)	-0.7x	-0.4x	-0.3x

RoE/RoCE expected to remain strong over coming years

Target Price with 3-year perspective

Long term potential			
CMP (Rs)	803		
	Base case	Bear case	Bull case
FY27 EPS	38.9	35.0	42.8
Target PE	40	35	45
Target price (Rs)	**1,557.8**	**1,226.7**	**1,927.7**
Upside	**94.2%**	**53.0%**	**140.4%**

ABOUT HAPPIEST MINDS

- Founded in 2011, Happiest Minds is an IT Service Company that helps enterprises across industries in their digital transformation journey. It has strong focus towards new age technologies such as AI, Cloud, Security Solutions, SaaS, IoT, etc.

It operates through 3 business units

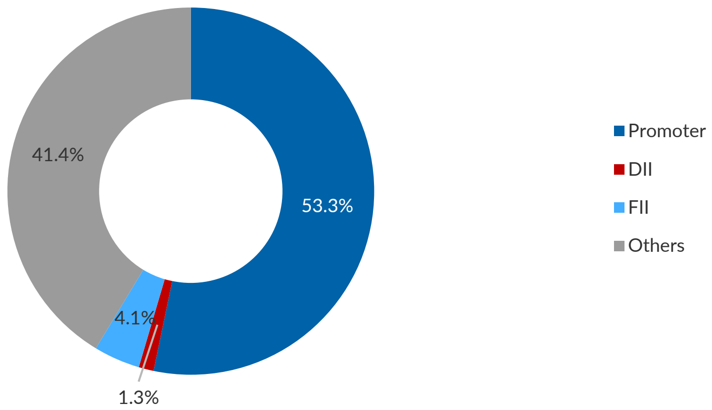
- Digital Business Services (DBS): Its offerings are aimed at (a) driving digital modernization and transformation for its customers through digital application development and application modernization for an improved customer experience, enhanced productivity and better business outcomes; (b) implementation of solutions, development and implementation of solution, capabilities for improving data quality of the customer's platform, assistance in designing and testing of operations and management of platform and modernization of digital practices; and (c) consulting and domain led offerings such as digital roadmap, mindful design thinking, and migration of on-premise applications to cloud.

- Product Engineering Services (PES): PES BU aims to help its customers capitalize on the transformative potential of 'digital' by building products and platforms that are smart, secure and connected. It provides its customers with a blend of hardware and embedded software knowledge which combines with its software platform engineering skills to help create scalable and secure solutions. Its offerings extend across the development lifecycle from strategy to final rollout. It embraces a cloud and a mobile friendly approach along with an agile model that is supported by test automation to help its clients accelerate their time to market and build a competitive advantage.

- Infrastructure Management & Security Services (IMSS): Its IMSS offerings provide an end-to-end monitoring and management capability, along with ring fencing of its customers' IT applications and infrastructure. It provides continuous support and managed security services for mid-sized enterprises and technology companies. It specializes in automation of IT operations using the DevSecOps model. It also runs Network & Security Operations centers to manage its client's infrastructure and data centers. Its security offerings include cyber and infrastructure security, governance, risk & compliance, data privacy & security, Identity and Access Management, threat and venerability management.

Business unit	Key offerings
Digital Business Services	Product design and development
	Connected workplace
	Virtual and augmented realty
	Cloud migration
	Insights based dashboards
	Data science as service
Infrastructure Management and Security Services	Infrastructure Consulting
	Hybrid/Multi cloud
	Digital Workplace
	Network
	ITSM & ITOM Tools and Platform
	Managed Services
Product Engineering Services	Digital Learning
	Media services and solutions
	Digital Strategy Assessment
	Product Design Optimizations
	Platform Engineering
	Solutions Engineering

Exhibit 41: Shareholding Pattern



Source: Company, YES Sec

Exhibit 42: Segmental breakup (Rs mn)

	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Revenue(Rs mn)											
IMSS	364.1	395.9	433.4	448.7	532.4	574.7	632.2	684.8	735.5	790.4	791
DBS	459.8	471	498.5	699.5	607.7	804.6	851	876.2	990.4	1071.9	1126.7
PES	946.3	961.5	996.5	1058.9	1164	1266	1356.2	1444.7	1563.3	1692.8	1751.1
Revenue share(%)											
IMSS	20.6%	21.7%	22.5%	20.3%	23.1%	21.7%	22.3%	22.8%	22.4%	22.2%	21.6%
DBS	26.0%	25.8%	25.9%	31.7%	26.4%	30.4%	30.0%	29.2%	30.1%	30.2%	30.7%
PES	53.5%	52.6%	51.7%	48.0%	50.5%	47.9%	47.8%	48.1%	47.5%	47.6%	47.7%
EBIT(Rs mn)											
IMSS	94.5	44.9	74.0	103.5	136.0	133.8	155.3	173.9	209.7	249.2	253.5
DBS	130.7	88.1	171.1	251.1	119.8	229.5	264.9	226.1	316.2	317.2	308.2
PES	405.7	171.3	233.2	432.4	451.2	485.6	539.6	592.9	686.7	698.2	684.2
EBIT Margin(%)											
IMSS	26.0%	11.3%	17.1%	23.1%	25.5%	23.3%	24.6%	25.4%	28.5%	31.5%	32.0%
DBS	28.4%	18.7%	34.3%	35.9%	19.7%	28.5%	31.1%	25.8%	31.9%	29.6%	27.4%
PES	42.9%	17.8%	23.4%	40.8%	38.8%	38.4%	39.8%	41.0%	43.9%	41.2%	39.1%

Source: Company, YES Sec

Exhibit 43: A brief Timeline of Happiest Minds since inception

Year	Events
2011	Founded by Ashok Soota (previously cofounded Mindtree)
May 2017	Strengthened its Leadership Position in IoT With Acquisition of Cupola Technology
June 2017	Acquired OSSCube, a US-based digital transformation company which modernizes legacy systems
Sep 2020	Got listed on BSE and NSE
Oct 2020	Partnered with Veridify to address security problems in IoT
Nov 2020	Partnered with AutonomIQ for autonomous testing capabilities
Jan 2021	Acquired Houston based software solutions provider Pimcore Global Services (PGS) for $8.25 million, to strengthen its presence in digital commerce
Mar 2021	Collaborated with Ilantus Technologies for IAM capabilities
Apr 2021	Partnered with BeatRoute to offer solutions for CPG industry
May 2021	Entered into partnership with Yotta to deliver Co-location and managed IT services
Oct 2022	Happiest Minds Technologies board approves raising of Rs 14bn through combination of equity and debt

KEY MANAGEMENT PERSONNEL

MR. ASHOK SOOTA, Executive Chairman

Prior to founding, he was the founding chairman and managing director of Mindtree. He was the vice chairman of Wipro and vice president of Shriram Refrigeration Industries prior to co-founding Mindtree.

MR. VENKATRAMAN NARAYANAN, Managing Director & CFO

Prior to joining Happiest Minds, he was associated with Sonata Software, TeamLease Services, SAP India, Oracle India, Arthur Anderson and Associates, Perot Systems TSI (India), Transwork Information Services and Mindtree Consulting.

MR. RAJIV SHAH, President and CEO – Digital Business Services

Prior to joining Happiest Minds, he was associated with Mu Sigma as the executive vice president, and IBS Software Services as whole-time director and chief executive officer. He is a member of R. Shah Advisory LLC.

MR. JOSEPH ANANTHARAJU, Executive Director and CEO – Product Engineering Services

Prior to joining Happiest Minds, he was associated with Mindtree in their Microsoft strategic business unit. He has spent the early part of his career in banking and manufacturing, which has allowed him to develop a broader perspective.

MR. CHALUVAIYA RAM MOHAN, President and CEO – IMSS

Prior to Happiest Minds, he was EVP and global head of IMS, enterprise integration, mainframe services business at Mindtree, and before that was EVP (operations) of e4e. and has worked with e-Serve International Limited, GE Countrywide Consumer Financial Services Limited, and Amazon Development Centre (India) Private Limited.

FINANCIALS

Exhibit 44: Balance Sheet

Y/e March 31 (Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Share capital	487	88	284	285	285	285	285
Reserves & surplus	1,581	2,565	5,176	6,373	7,845	9,666	11,972
Shareholders' funds	2,068	2,653	5,460	6,658	8,131	9,951	12,257
Minority Intersts and others	0	0	0	0	0	0	0
Non-current liablities	242	312	972	922	952	984	1,019
Long-term borrowings	116	13	366	172	169	166	162
Other non-current liabilities	127	299	606	750	783	819	856
ST borrowings, Curr maturity	601	692	1,297	1,734	1,699	1,665	1,632
Other current liabilities	**952**	**1,425**	**1,491**	**1,936**	**1,978**	**2,022**	**2,066**
Total (Equity and Liablities)	3,863	5,082	9,220	11,250	12,761	14,623	16,974
Non-current assets	1,070	630	1,774	1,976	3,274	4,900	6,992
Fixed assets (Net block)	342	319	520	790	781	776	771
Other non-current assets	728	235	1,009	927	2,219	3,834	5,913
Current assets	2,793	4,451	7,445	9,274	9,487	9,722	9,982
Cash & current investment	1,160	2,730	5,367	6,320	6,331	6,351	6,381
Other current assets	**1,633**	**1,722**	**2,079**	**2,954**	**3,155**	**3,371**	**3,602**
Total (Assets)	3,863	5,082	9,220	11,250	12,761	14,623	16,974
Total debt	717	705	1,663	1,906	1,868	1,831	1,794

Source: Company, YES Sec

Exhibit 45: Income Statement

Y/e March 31 (Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Net sales	5,904	6,982	7,734	10,937	14,393	17,861	22,244
Operating expenses	(5,355)	(6,011)	(5,842)	(8,360)	(10,818)	(13,681)	(16,950)
EBITDA	548	971	1,892	2,576	3,575	4,179	5,294
Depreciation	(248)	(202)	(227)	(329)	(394)	(482)	(601)
EBIT	301	769	1,665	2,248	3,180	3,697	4,693
Other income	115	160	265	371	206	334	362
Exceptional & extradordinary	(126)	(113)	0	(61)	(63)	0	0
Profit before tax	130	736	1,860	2,459	3,148	3,836	4,861
Tax (current + deferred)	12	(19)	(236)	(647)	(773)	(900)	(1,141)
Profit / (Loss) for the period	142	717	1,625	1,812	2,375	2,936	3,720
P/L of Associates, Min Int, Pref Div	0	0	0	0	0	0	0
Reported Profit / (Loss)	142	717	1,625	1,812	2,375	2,936	3,720
Adjusted net profit	268	830	1,625	1,873	2,439	2,936	3,720

Source: Company, YES Sec

Exhibit 46: Cash Flow Statement

Y/e March 31 (Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Profit before tax	130	736	1,860	2,459	3,148	3,836	4,861
Depreciation	248	202	227	329	394	482	601
Change in working capital	(83)	415	(251)	(434)	(157)	(171)	(185)
Total tax paid	12	(22)	(262)	(639)	(773)	(900)	(1,141)
Cash flow from operations (a)	466	1,412	1,644	1,814	2,788	3,443	4,331
Capital expenditure	(148)	(179)	(429)	(599)	(385)	(477)	(596)
Change in investments	469	(6)	(3,250)	(738)	77	74	72
Others	(529)	558	29	73	(1,307)	(1,630)	(2,093)
Cash flow from investing (b)	(208)	372	(3,650)	(1,264)	(1,615)	(2,032)	(2,618)
Free cash flow (a+b)	258	1,784	(2,006)	550	1,173	1,411	1,713
Equity raised/(repaid)	0	(399)	196	2	0	0	0
Debt raised/(repaid)	(150)	(12)	958	243	(38)	(37)	(37)
Dividend (incl. tax)	0	0	0	(683)	(903)	(1,116)	(1,414)
Others	(14)	266	408	116	(128)	(147)	(144)
Cash flow from financing (c)	(164)	(144)	1,562	(322)	(1,069)	(1,300)	(1,595)

Source: Company, YES Sec

Exhibit 47: Income Statement

Y/e March 31	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Growth (%)							
Revenue Growth	27.5	18.3	10.8	41.4	31.6	24.1	24.5
EBITDA Growth	NA	77.1	94.9	36.2	38.8	16.9	26.7
EBIT Growth	NA	155.8	116.5	35.0	41.5	16.2	26.9
Net Profit Growth	NA	404.6	126.5	11.5	31.1	23.6	26.7
Profitability Ratios (%)							
EBITDA Margin	9.3	13.9	24.5	23.6	24.8	23.4	23.8
EBIT margin	5.1	11.0	21.5	20.6	22.1	20.7	21.1
Net Profit margin	4.5	11.9	21.0	17.1	16.9	16.4	16.7
RoA	8.1	17.2	23.3	22.0	26.5	27.0	29.7
RoE	13.7	35.2	40.0	30.9	33.0	32.5	33.5
RoCE	10.4	23.4	29.2	26.4	31.7	31.6	34.1
Liquidity Ratios							
Net debt/Equity (x)	-0.2	-0.8	-0.7	-0.7	-0.5	-0.5	-0.4
Current ratio (x)	1.8	2.1	2.7	2.5	2.6	2.6	2.7
Quick ratio (x)	1.8	2.1	2.7	2.5	2.6	2.6	2.7
Valuation Ratios							
PER(x)	NA	NA	NA	62.9	48.3	40.1	31.7
PCE(x)	NA	NA	NA	53.5	41.6	34.5	27.3
Price/Book(x)	NA	NA	NA	17.7	14.5	11.8	9.6
EV/EBITDA(x)	NA	NA	NA	44.0	31.7	27.1	21.4

Source: Company, YES Sec

Exhibit 48: Dupont Analysis

Dupont Analysis	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Net margin(%)	4.5	11.9	21.0	17.1	16.9	16.4	16.7
Asset turnover (x)	1.6	1.6	1.1	1.1	1.2	1.3	1.4
Leverage factor (x)	1.9	1.9	1.8	1.7	1.6	1.5	1.4
Return on Equity(%)	**13.7**	**35.2**	**40.0**	**30.9**	**33.0**	**32.5**	**33.5**

Source: Company, YES Sec

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