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## Technology

Company update  
and earnings revision

Target price Rs225

### Earnings revision

(%)	FY21E	FY22E
Sales	↓ 24.5	↓ 22.6
EBIT	↓ 27.3	↓ 30.2
EPS	↓ 27.3	↓ 30.3

### Target price revision

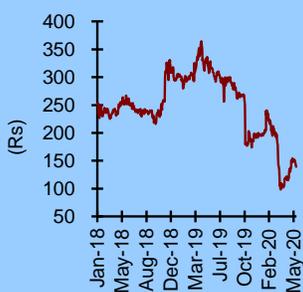
Rs225 from Rs325

### Shareholding pattern

	Sep '19	Dec '19	Mar '20
Promoters	66.0	66.0	65.7
Institutional investors	21.1	21.4	22.3
MFs/FI's	5.4	5.6	6.5
FII's	15.7	15.8	15.8
Others	12.9	12.6	12.0

Source: www.nseindia.com

### Price chart



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# Newgen Software Technologies

**BUY**

Maintained

**Rs139**

## Controlling what they can

Business model of Newgen Software lends itself to higher volatility given 1) greater reliance on license sales (and especially new logo acquisition within that) which are transactional in nature, and 2) second half heavy revenue recognition which drives a bigger hit to EBITDA if revenue falls short of expectations since cost increases and investments are set at the start of the year (less time available to calibrate cost). However, costs do get calibrated eventually in-line with lower revenue levels driving profitability back to normalised levels. We would expect a similar template to manifest in FY21 with absolute EBIT expected to increase by >30% even as we expect revenues to decline (conservatively) by 5% (which will be in-line with rest of our IT Services coverage). Q1 is the smallest quarter for Newgen, which limits the impact of Covid-19 on full year FY21 financials. Newgen is trading at 9.2x FY22E EPS (on conservative estimates) for medium-term topline growth potential of mid to high teens. Maintain high conviction BUY with a target price of Rs225.

► **Expect FY21 EBIT to increase by >30%.** Newgen is working on multiple cost optimisation efforts including rationalisation of variable and performance pay to expand margins in FY21. Lower travel costs (~9-10% of revenues in a typical year) and lower spends on marketing events are expected to be margin levers as well. The company is also variabilizing employee cost structures more in order to ensure lower impact on EBIT in case revenue execution is inferior with respect to expectations. Newgen is also better placed since the worst impacts of Covid-19 will likely manifest in Q1FY21 with Q1 being the smallest quarter for the company. If tech spends recover in H2FY21 as is expected currently once lockdown restrictions ease across geographies, we see potential for positive revenue growth as well for Newgen in the year. We conservatively model a revenue decline of 5% for now which still leads to an increase in EBIT of 33% for FY21.

► **PPP helping customer acquisition in the US; GSI effort gaining momentum; maintain BUY.** Implementations for Paycheck Protection Program has helped the company acquire 24 new logos in the US in the financial services space. Management expects to sign up more logos for the forgiveness program. Though direct monetization from such efforts will be limited, it gives the company a foot in the door in multiple accounts (which otherwise would have been difficult and required considerable investment) which they can build on over time. Newgen is also focusing aggressively on strengthening relationships with System Integrators to target developed markets and larger F-500 accounts more aggressively. The company has been able to build a reasonable pipeline of such deals through SI's with most being SaaS annuity deals. Newgen has credible products (rated well by industry advisors; acquired multiple US patents etc.) in fast growing market segments of low code BPM, ECM and CCM. FY20 growth was impacted on account of 1) spending freeze in the Government/PSU vertical, especially in India, 2) higher base in the US where the company had signed multiple large license deals in the healthcare vertical in FY19, and 3) license deferrals on account of Covid-19. We expect revenue growth to normalise to 15-20% levels from FY22. Maintain BUY.

Market Cap	Rs9.7bn/US\$129mn
Bloomberg	NEWGEN IN
Shares Outstanding (mn)	70.0
52-week Range (Rs)	328/98
Free Float (%)	34.3
FII (%)	15.8
Daily Volume (US\$'000)	112
Absolute Return 3m (%)	(24.7)
Absolute Return 12m (%)	(51.5)
Sensex Return 3m (%)	(15.3)
Sensex Return 12m (%)	(18.4)

Year to March	FY19	FY20P	FY21E	FY22E
Revenue (Rs mn)	6,206	6,608	6,277	7,533
Net Income (Rs mn)	1,022	727	884	1,088
EPS (Rs)	14.7	10.5	12.5	15.1
% Chg YoY	32.2	(28.7)	19.2	20.6
P/E (x)	9.4	13.2	11.1	9.2
CEPS (Rs)	15.6	13.4	15.4	18.1
EV/E (x)	6.2	7.6	6.0	5.0
Capital Return (%)	2.2	1.4	1.7	2.0
RoCE (%)	21.0	11.8	14.4	17.2
RoE (%)	22.7	13.9	15.2	16.5

Please refer to important disclosures at the end of this report

- **Higher annuity and timely implementations to help revenue growth even as new logo acquisition slows.** Annuity based revenues were 55.8% of overall revenues in FY20 vs just 43.1% in FY18 – though some AMC and support renewals can also get deferred in today’s environment, higher annuity does provide a solid base to build on. What helps additionally is two things: 1) Newgen is still able to secure new business with existing clients – it is new business with new logos which is more challenging to procure, and 2) implementations are happening remotely and on time – there is no fulfilment challenge if backlog is available for execution. Revenue from existing clients was Rs5.45bn in FY20 and increased by 14.2% (24.8%/21% growth in FY18/FY19). Our revenue estimate for FY21 of Rs6.28bn is only around Rs850mn higher than that with the Rs850mn to be derived as new business from existing accounts as well as new logos. New logos have contributed revenue in the range of Rs1.1-1.4bn in the past 3 years. In essence, even if new logo acquisition is meaningfully impacted in FY21 relative to prior years, our estimates will still be met as far as there is modest growth with existing clients.

## Valuation methodology and key risks

We maintain **BUY** rating on Newgen with a revised DCF-based target price of Rs225/share (earlier Rs325/share).

The key risks to our call are: i) structural weakness in balance sheet metrics, ii) inability to expand presence in developed markets, and iii) faster transition to cloud/SaaS from on-prem in emerging markets.

## Financial summary

Table 1: Profit and loss statement

(Rs mn, year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Operating Revenues (Sales)</b>	<b>6,206</b>	<b>6,608</b>	<b>6,277</b>	<b>7,533</b>
Operating Expenses	4,929	5,562	4,953	5,943
<b>EBITDA</b>	<b>1,277</b>	<b>1,046</b>	<b>1,324</b>	<b>1,589</b>
% margins	20.6	15.8	21.1	21.1
Depreciation & Amortisation	60	199	201	218
<b>EBIT</b>	<b>1,217</b>	<b>847</b>	<b>1,124</b>	<b>1,371</b>
% margins	19.6	12.8	17.9	18.2
Other Income	204	210	180	200
Interest & Finance Chgs	85	109	140	140
<b>Profit / (Loss) before Taxation</b>	<b>1,336</b>	<b>947</b>	<b>1,164</b>	<b>1,431</b>
Less: Taxes	314	220	279	343
<b>Net Profit/(Loss)</b>	<b>1,022</b>	<b>727</b>	<b>884</b>	<b>1,088</b>

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Assets</b>				
Total Current Assets	5,543	6,027	6,227	7,221
Total Current Liabilities & Provisions	2,162	2,756	2,375	2,571
<b>Net Current Assets</b>	<b>3,381</b>	<b>3,271</b>	<b>3,852</b>	<b>4,650</b>
<b>Net Fixed Assets</b>	<b>1,522</b>	<b>2,211</b>	<b>2,229</b>	<b>2,237</b>
Long-term loans and advances	69	80	113	126
Other Long Term Assets	114	167	189	248
Deferred tax assets (net)	178	227	227	227
<b>Total Assets</b>	<b>5,264</b>	<b>5,955</b>	<b>6,609</b>	<b>7,488</b>
<b>Liabilities</b>				
Long term provisions	193	233	206	248
Other Long Term Liabilities	104	231	231	231
Equity Share Capital	685	691	691	691
Reserves & Surplus	4,282	4,800	5,481	6,318
<b>Net Worth</b>	<b>4,967</b>	<b>5,491</b>	<b>6,172</b>	<b>7,009</b>
<b>Total Liabilities</b>	<b>5,264</b>	<b>5,955</b>	<b>6,609</b>	<b>7,488</b>

Source: Company data, I-Sec Research

Table 3: Quarterly trend

(Rsmn, year ending March 31)

	Jun-19	Sep-19	Dec-19	Mar-20
Net sales	1,310	1,540	1,850	1,908
% growth (YoY)	23	3	15	(6)
Recurring EBITDA	77	91	358	519
Margin (%)	6	6	19	27
Other income	29	48	40	92
Recurring Net Income	31	42	240	415

Source: Company data, I-Sec research

Table 4: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Operating Cash flow before W Cap changes</b>	<b>1,274</b>	<b>990</b>	<b>1,045</b>	<b>1,246</b>
Working Capital Inflow / (Outflow)	(252)	(89)	(130)	(282)
Capex	(717)	(438)	(220)	(226)
<b>Free Cash flow</b>	<b>305</b>	<b>463</b>	<b>695</b>	<b>738</b>
Cash Flow from other Invst Act (Ex Capex)	(136)	(602)	180	200
Proceeds from Issue of Share Capital	36	38	-	-
Inc/(Dec) in Borrowings / Deferred Liabilities	158	(195)	-	-
Interest & Dividend paid	(246)	(315)	(343)	(390)
<b>Increase/(Decrease) in Cash</b>	<b>117</b>	<b>(611)</b>	<b>532</b>	<b>548</b>

Source: Company data, I-Sec research

Table 5: Key ratios

(Year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Per Share Data (Rs)</b>				
Earnings per share (Diluted)	14.7	10.5	12.5	15.1
Earnings per share (Basic)	15.0	10.6	12.6	15.2
Cash earnings per share	15.6	13.4	15.4	18.1
Dividend per share	3.0	2.0	2.3	2.8
Book Value per share	71.6	79.3	87.4	97.3
<b>Growth Ratios (%)</b>				
Operating Income (Sales)	21.1	6.5	(5.0)	20.0
EBITDA	30.9	(18.1)	26.6	20.0
Recurring Net Income	40.2	(28.8)	21.6	23.0
Diluted Recurring EPS	32.2	(28.7)	19.2	20.6
Diluted Recurring CEPS	29.6	(14.2)	14.8	18.0
<b>Valuation Ratios (x)</b>				
P/E	9.4	13.2	11.1	9.2
P/CEPS	8.9	10.4	9.0	7.6
P/BV	1.9	1.7	1.6	1.4
EV / EBITDA	6.2	7.6	6.0	5.0
EV / Sales	1.3	1.2	1.3	1.1
EV / FCF	26.0	17.1	11.4	10.7
<b>Operating Ratio</b>				
Software Development Exp./Sales (%)	46.4	51.8	51.0	49.5
SG&A/Sales (%)	33.0	32.4	27.9	29.4
Other Income / PBT (%)	15.3	22.1	15.5	14.0
Effective Tax Rate (%)	23.5	23.2	24.0	24.0
Fixed Asset Turnover (x) on avg.	5.2	4.3	3.9	4.7
Receivables (days)	148.6	148.8	145.0	137.0
Payables (days)	12.7	15.2	13.0	13.0
D/E Ratio (x)	0.2	0.1	0.2	0.1
<b>Return/Profitability Ratio (%)</b>				
Recurring Net Income Margins	16.5	11.0	14.1	14.4
RoCEex Cash (Based on Avg)	21.0	11.8	14.4	17.2
RoNW (Based on Avg)	22.7	13.9	15.2	16.5
Dividend Payout Ratio	24.0	18.9	23.0	23.0
Dividend Yield	2.2	1.4	1.7	2.0
EBITDA Margin	20.6	15.8	21.1	21.1

Source: Company data, I-Sec research

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