

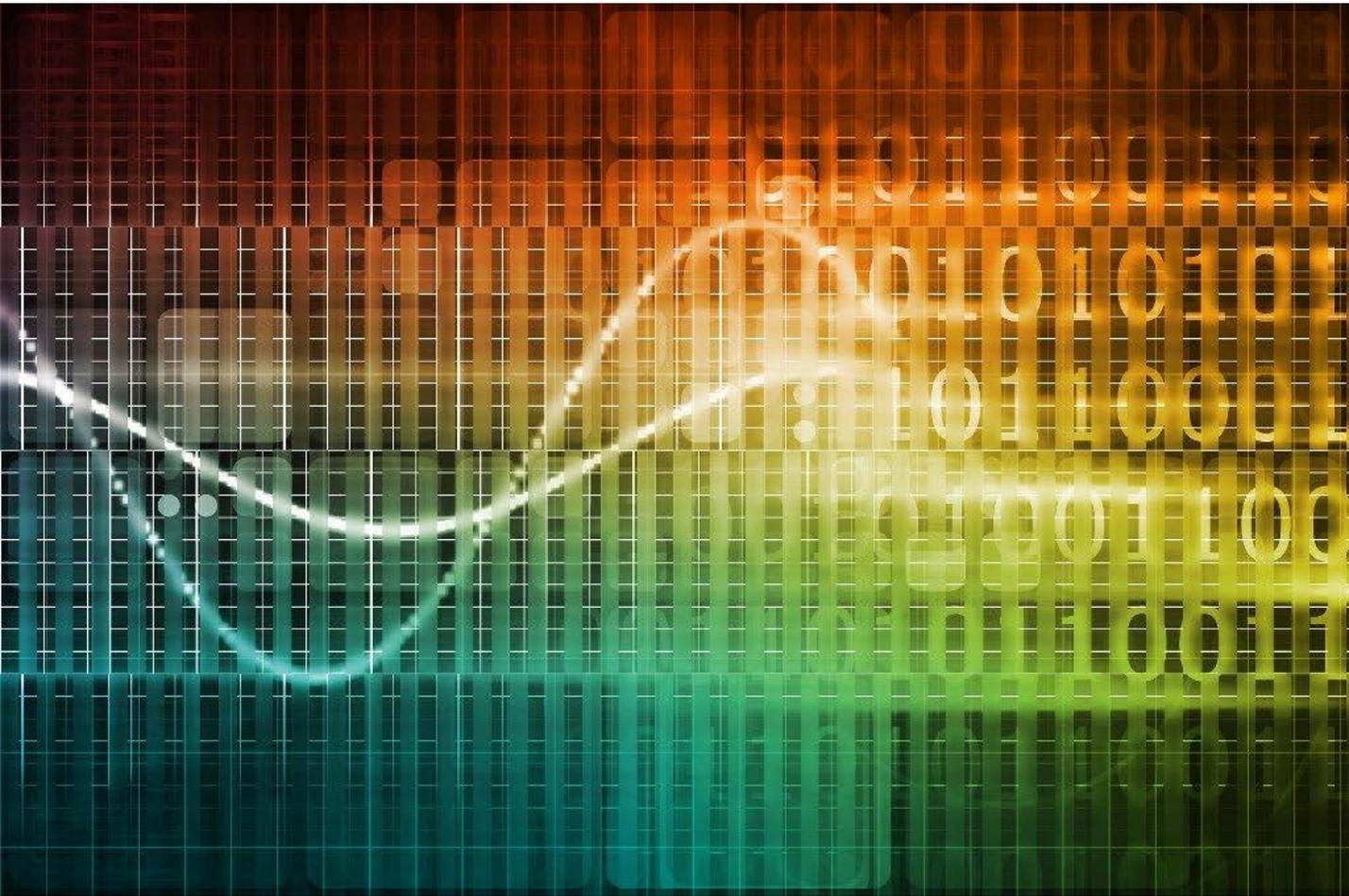
IMAP

Industry Report

Indian IT Industry M&A Landscape 2017

Research Conducted by

IMAP | India



Information Technology in India M&A Landscape 2017

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India is the world's largest sourcing destination for the global information technology ("IT") industry with overall annual revenue of USD 130 billion (2016). India is the dominant destination for the global IT outsourcing market with a market share of 55%.

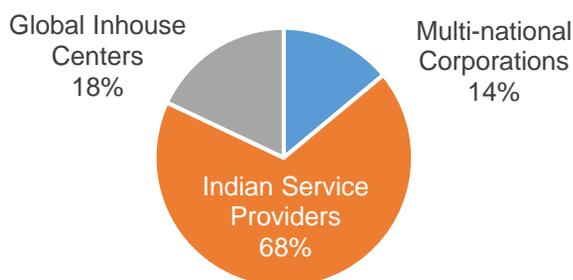
Key Facts - IT/ITes Sector - India

Number of Firms	15,000+
Revenue 2016 (USD bn)	130
Workforce Employed (in mn)	3.7
Share of India's GDP	9.5%
Market Share (% Global)	55%

Source: Nasscom, Assocham, EY

Indian IT companies mainly follow the Global Offshore Delivery model with sales and representative offices across the globe and large development offshore centres in India. This allows companies to optimize the cost structure by maintaining the flexibility to execute project components where it is most cost effective.

The IT landscape in India has a mix of Indian players (TCS, Tech Mahindra, Infosys, Wipro, HCL Technologies etc.), multinational companies (IBM, Accenture, HP, Microsoft etc.) and global inhouse centers of large corporations (EMC, Boeing, Honeywell etc.)



Source: Nasscom, IMAP India

Globally, the IT industry has evolved over the years from basic IT service providers to full business partners. The evolution can be further sub-divided into four phases:

Up To 1980: Support function providing basic IT service, maintenance & security services. Maintenance and **cost savings were the key proposition.**

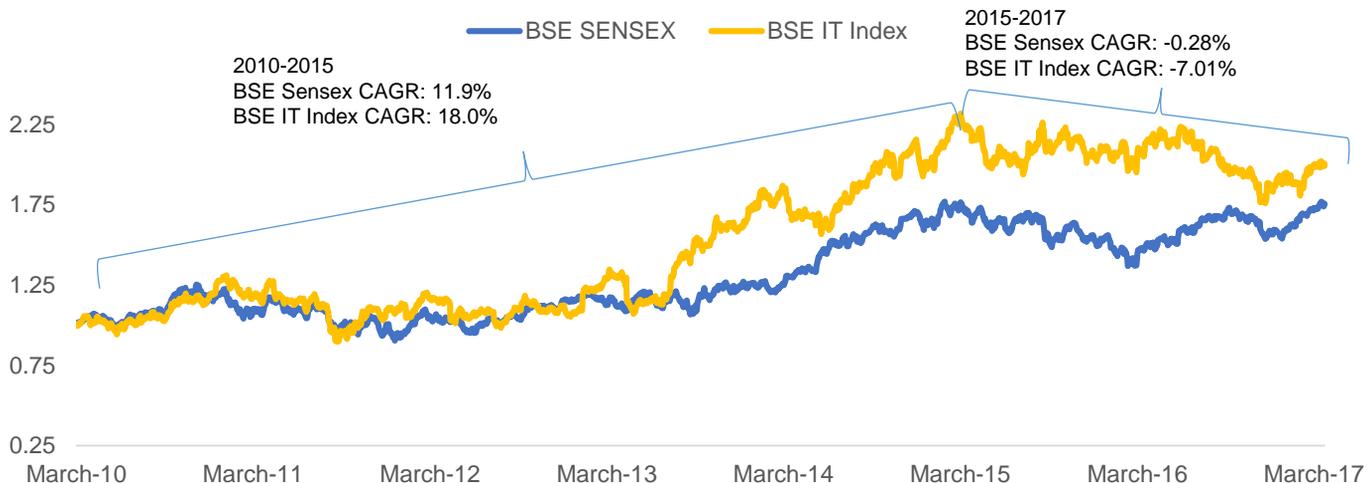
1980-1990: Functional IT, networking services to **enhance group decision making efficiency & productivity.**

1990-2010: Productivity software plus ERP where services were in the form of **collaboration, standardization & productivity improvement for the business.**

2012 onwards: Evolution of digital technologies where mobile, analytics, cloud/SaaS, big data and social are new emerging services; where **innovation through insight & rapid execution of idea, convergence of service; improvised decision making through data and user behaviour, are key value propositions offered to customers.**

The business models of IT companies have also evolved in a similar manner: they have gradually moved from being vendors for specific needs to partners with expertise in designing best practices across services, leading to significant top-line growth coupled with business and operational improvements through use of technology.

From 2004-2014, the Indian IT industry grew with an average revenue growth rate of 12%-15%. However, the growth in revenue of IT companies has been subdued and margins have been impacted due to higher costs. The returns for IT companies have been diminished due to the changing landscape of technology and lower incremental spending of business organizations towards technology improvements. Stock prices of major IT firms in India have reflected these trends as can be seen in Figure 1 below, where the BSE IT Index (benchmark index of IT firms in Bombay Stock Exchange) have underperformed viz-a-viz BSE Sensex (benchmark index of Bombay Stock Exchange) over the past two years.



Source: www.bseindia.com

The various growth challenges currently faced by Indian IT companies are:

1

Emerging protectionist policies in developed countries (mainly US and Europe) are affecting Indian IT companies, with increasing pressure to have local employees rather than having a fully outsourced model, leading to higher costs and lower margins. Due to US restrictions on work visas and increasing visa costs, Indian IT companies are subcontracting work to local US employees. Additionally, uncertainty about the new immigration bill and its expected outcome of increasing minimum employee cost for visas is expected to increase cost of onsite employees and reduce growth and margins for Indian IT companies.

2

Near-End of Regulations in BFSI Segment: Banking and Financial Services (BFSI) has been the key sector for Indian IT industries with a large percentage of revenues coming from the BFSI segment. Since the 2008 financial crisis, a high amount of spending has been seen in the BFSI segment towards complying with regulation. Since 2008 several regulations have been introduced and implemented including: Volker Rule, Dodd Frank Act, FATCA, EMIR, Basel Norms, Market Abuse Directive, Money Market Fund Reform, etc. The pace of additional regulation has slowed down considerably in past few years. Going forward, earmarked funds toward IT spending are expected to be down to 10% of the overall budget of BFSI firms (existing 15%-20%; source: Gartner).

3

Stagnation in the Capex Cycle: Revival in the US economy has still not translated into a high capex cycle across sectors. Companies in the S&P 500 are close to all time highs in terms of cash levels. Dividend pay-out and buybacks ratios viz-a-viz capex have also been at all time highs (46% in 2016 viz-a-viz 35% in 2009). Companies have been conservative towards new capex and hence incremental IT spending has not been growing at the historical pace, leading to earnings pressure for Indian IT firms.

4

Disruptive Technologies and Implementation: Globally, the next level of increased IT spending is expected on account of adoption of disruptive technologies like IoT, cloud, computing, social, mobility, etc. The Global Digital Transformation Industry, which is currently a USD 150 billion market, is expected to grow at CAGR of 19.2% over the next 4 years to USD 432 billion. As per the Digital Initiatives survey conducted by Tata Consultancy Services (TCS) in 2014, the average spend on digital initiatives was significant: USD 113 million per company, although the median was very low: USD 11.3 million per company. The vast difference between average and median suggests that there is a large number of prospective clients that have much lower IT spending than the traditional 'spenders,' such as global financial banks or large telecom operators. Indian IT firms have to increase their reach to tap this segment of small and medium enterprises or clients which are moving toward digital transformation. Also, rapid changes in technology require IT companies to build their capabilities through acquisitions in this segment.

The dynamics mentioned above have led to lower earnings growth for Indian IT companies over last two years. However, Indian IT companies have high cash reserves available which is being utilized to improve returns for shareholders through:

1. Dividend and buyback of equity
2. Inorganic growth through M&A

Over the last 12 months, some large IT companies (such as TCS and Infosys) have announced a buyback program. However, a large number of companies are looking at inorganic growth to enhance or augment their technological expertise and improve portfolio offerings to ensure a strong growth in the earnings.

Cash Reserves (as of 30th Sep 16, USD mn)

TCS	5,600
Infosys Limited	5,300
Wipro Limited	4,800
HCL Technologies Ltd.	2,500
Tech Mahindra	600
Mindtree Limited	100
Persistent Systems	90
L&T Infotech	80
Zensar Technologies	70
KPIT Technologies	70

Source: IMAP India Research

Technological disruptions in the form of digitisation and related technologies (IoT, cloud, AI, social etc) and macroeconomic events like Brexit, immigration challenges and lower capex in traditional technologies, have led Indian IT companies to look for growth through M&A activities over the past 2-3 years.

M&A activity during the last two years has been at an all time high in the IT sector in India, with 162 transactions and 132 transactions closed in 2015 and 2016 respectively. (Source: E&Y)

Going forward, the trend is expected to continue as Indian IT players further strengthen their portfolio, client mix and geographical coverage through acquisitions.

In terms of valuations, transaction multiples have been in the range of 1.0x to 5.0x of revenue:

- Multiple of 3.0x to 5.0x have been paid for companies being acquired earlier in their business cycle like cloud, digital technologies, big data analytics & specialised technologies.
- More standardized technology companies and services providers like storage, CRM, and ERP have realized lower multiples in the range of 1.5x to 3.0x.
- Companies with traditional application development and engineering services offerings have been acquired at revenue multiples in the range of 1.0x to 1.5x. The rationale for these acquisitions has been mainly to increase geographical reach and client acquisition.

Inbound/Domestic M&A Transactions

Acquirer	Target	Target Location	Brief Description Target	Deal Value (USD mn)	Date
Zensar	Keystone Logic	India	Retail technology provider	20	Mar-17
L&T Infotech	Augument IQ	India	IP Based big data and analytics solution provider	N/A	Oct-16
HCL Technologies	Geometric Ltf	India	IT service provider with specialization in the domain of engineering solutions, services and technologies	200	Apr-16
Virtuasa	Polaris	India	IT consulting and services	177	Nov-15
HCL Technologies	Concept2Silicon Systems	India	Solution provider for system designs	N/A	Oct-15
Genpact	Endeavour Software	India	Mobile digital solutions provider	N/A	Sep-15
Infogain	BlueStar Infotech	India	IT services firm with focus on digital services	27	Sep-15
Capgemini	IGate	India	IT services company	4,040	Apr-15
Cyient	Rangsons Electronics	India	Electronics system design and manufacturing services company	58	Jan-15

Outbound M&A Transactions

Acquirer	Target	Target Location	Brief Description Target	Deal Value (USD mn)	Date
Tech Mahindra	CJS Solutions Group LLC	US	IT services company in Healthcare sector and implementation of Electronic Medical Records (EMR) software	114	Mar-17
Wipro	Infoserver	Brazil	Application Development and Software development services provider in Brazil	9	Jan-17
HCL Technologies	Butler America	US	Provides engineering, design services and aftermarket engineering services to aerospace and defense customers	85	Jan-17
Zensar	Foolproof Group	UK & Singapore	User Experience Design Agency	N/A	Nov-16
Wipro	Appirio	US	Cloud Services Company	500	Oct-16
Infosys	Cloudyn Software	Israel	Monitors and Optimizes Cloud Deployment of Organizations	4	Aug-16
Wipro	Intsights Cyber Intelligence	Israel	Threat intelligence driven security platform	2	Aug-16
Tech Mahindra	The Bio Agency	UK	Digital Transformation and Innovation	57	Jun-16
Tech Mahindra	Target Group	UK	Business process outsourcing and software solutions provider in Fintech segment	164	May-16
Persistent Systems	GENWI	US	Mobile content enablement platform	N/A	Apr-16
Persistent Systems	PRM Cloud Solutions	Australia	Leading salesforce partner and cloud application development firm	N/A	Mar-16
Wipro	Health plan Holdings	US	Independent technology and Business Process as a Service (BPaaS) provider	460	Feb-16
Persistent Systems	Citrix Cloud Platform	US	Cloud computing software for creating, managing, and deploying public and private cloud infrastructure services	N/A	Feb-16
Mindtree	Magnet 360	US	Salesforce platinum consulting partner with expertise in sales and marketing cloud implementations	50	Jan-16
Mahindra Comviva	Advanced Technology Systems	Latin America	Mobile Tech Solutions firm	N/A	Jan-16

Acquirer	Target	Target Location	Brief Description Target	Deal Value (USD mn)	Date
HCL Technologies	Point 2 Point	UK	Application development in enterprise workplace transformation services	11	Jan-16
Wipro	Cellent AG	Germany	IT Solutions and service provider	78	Dec-15
Infosys	Cloudendure	Israel	Cloud based application service provider and Disaster recovery software product	4	Dec-15
Infosys	Noah Consulting	US	Provider of advanced information management consulting services for the oil and gas industry	70	Oct-15
HCL Technologies	Power Objects	US	Professional services firm completely focused on providing service, support, education and add-ons for Microsoft Dynamics CRM	46	Oct-15
Mindtree	Bluefin	UK	Business Consulting, technology strategy, implementation in SAP, analytics, digital, mobile, web, cloud and SAP HANA	66	Jul-15
Mindtree	Relational Solutions	US	IT solutions company specializing in technology services to the consumer goods industry	10	Jul-15
Infosys	Kallidus	US	Provides cloud based platform for range of service for online retailers	120	Apr-15
Infosys	Panaya Inc.	Israel	Provider of automation technology for enterprise software management	200	Feb-15
Tech Mahindra	Sofgen	Switzerland	Consulting and IT services company	40	Jan-15
Mindtree	Discoverture	US	Provider of Insurance Solutions	15	Jan-15
Tech Mahindra	Lightbridge	US	One of the world's largest independent global providers of Network engineering services to the Telecommunication Industry	240	Nov-14
Zensar	Professional Access Inc.	US	Oracle ATG and Endeca partners.	N/A	Aug-14
Wipro	ATCO -Itek	Canada and Australia	IT services arm of Canadian logistics and utilities service provider Atco	195	Jul-14
Persistent Systems	CloudSquads	US	Deploys, integrates and runs social communities on social customer platforms	N/A	Feb-14
Tech Mahindra	BASF Business Services Holdings	Germany	IT services arm of BASF	N/A	Feb-14

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