

## INVESTMENT RATIONALE

- Companies spend, on average, 3-4% of their payroll expenditure on training. **In the developed world, this amounts to around \$1000-1300 per employee per year on training**, which corresponds to 1-1.5% of the company's revenues. Companies in the mining and utility sectors spend 0.5%, while professional services firms allocate twice the amount on average ~\$2400 per employee per annum to training. This represents the cost of training that companies incur, **including both internal and external training, adding up to a total of \$370 billion.**
- The \$370 billion training industry can be further divided into the following categories:**
  - Generic courses:** Approximately **\$78.5 billion** is spent on standardized courses (such as Technology, Sales, Leadership, Health & Safety, etc.).
  - Formal education programs:** Roughly **\$44.4 billion** is allocated to tuition reimbursement.
  - Learning Technology:** About **\$5 billion** is spent on purchasing Learning Management System (LMS) platforms.
  - Learning and Development contributes around \$240 billion, of which only \$10 billion (i.e. ~4% of L&D) is presently outsourced (Learning Services).**
- The Learning and Development Services is the area of focus for NIIT Learning Systems (NLSL), which can be further broken down into the following segments:**
  - Content Development (30% of L&D):** Creating engaging and relevant learning materials that align with organizational goals.
  - Training Delivery (31% of L&D):** Delivering high-quality training sessions through various formats, including workshops, seminars, and e-learning modules.
  - Training Administration (15% of L&D):** Efficiently managing the logistics and administration of training programs.
  - Learning Tech Management (10% of L&D):** Overseeing the implementation and management of learning technology solutions.
  - Others (14% of L&D):** Providing customized solutions to address specific organizational training needs.

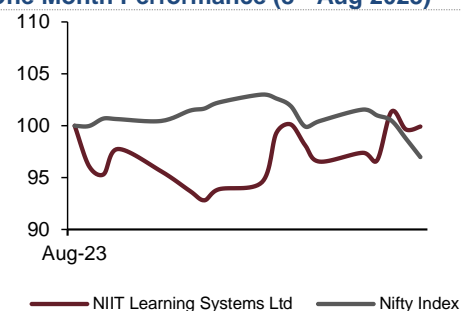
Rating	TP (Rs)	Up/Dn (%)
<b>BUY</b>	<b>512</b>	<b>35</b>

### Market data

Current price	Rs	380
Market Cap (Rs.Bn)	(Rs Bn)	52
Market Cap (US\$ Mn)	(US\$ Mn)	622
Face Value	Rs	2
52 Weeks High/Low	Rs	399 / 348.45
Average Daily Volume	('000)	209
BSE Code		543952
Bloomberg		NIITMTS.IN

Source: Bloomberg

### One Month Performance (8<sup>th</sup> Aug 2023)



Source: Bloomberg

% Shareholding	Aug-23
Promoters	34.84
Public	65.16
<b>Total</b>	<b>100</b>

Source: BSE

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- **Outsourcing Opportunities:** As industries continue to evolve, the demand for effective training solutions has grown. NLSL identifies significant potential for the outsourcing of learning and development services. With advancements in technology and the increasing complexity of training activities, NLSL's expertise and tailored solutions position the company as a strong contender for outsourcing partnerships. **Out of the \$240 billion Learning and Development market, currently only \$10 billion is outsourced. The training industry is anticipated to experience single-digit growth, whereas the outsourcing industry has been growing at a rate of 10-15%.** The level of outsourcing for a company typically remains below 5%. However, certain companies have managed to reach up to 15% in outsourcing. **NLSL's topline and EBITDA have grown by 20.1% and 30.3% respectively from FY17 to FY23, as observed from the past financial data.**
- NLSL's impact on its clients is characterized by:
  1. **Cost Savings:** NLSL can reduce training costs for clients by approximately 20-25% initially, with the potential for greater savings over time as expertise is developed.
  2. **Enhanced Utilization:** NLSL maximizes the effectiveness of training resources by doubling the utilization rate of trainers compared to internal options. The company has strategically invested in tools and processes to automate training operations. Leveraging the Salesforce cloud platform, all training activities are seamlessly conducted. Customization plays a pivotal role, enabling NLSL to empower individuals with limited experience to adeptly manage and conduct training classes. This efficiency-driven approach extends to resource utilization across multiple clients, showcasing NLSL's adeptness in creating value through automation and resource optimization.
  3. **Global Reach:** With the ability to provide services globally or within specific regions, NLSL extends its reach to meet diverse client needs.
- The minimum duration of the Managed Training Services (MTS) contracts is 3 years, occasionally extending to 5 years. These contracts empower NLSL to become the exclusive provider of one or more Learning Services, either globally or within a specific region. **As of Q1 FY24, NLSL's current order book stands at \$360 million, executable over the next 2 years.**
- The growth is predominantly driven by new first-time outsourcing customers rather than existing ones. **NLSL's win rate in the Request for Proposal (RFP) process is approximately 1 in 2.5 deals.**
- Out of the \$1200 dollars spent on training per employee per year, 35% is spent on standardized/off the shelf courses and tuition reimbursement, an area where NLSL doesn't play a significant role beyond facilitating strategic sourcing. In such cases, they assist in the procurement of these courses, generating revenue primarily through the markup on the courses they provide. **The outsourcing penetration rate remains notably low. Even among NLSL's existing customers, the utilization rate is currently limited. NLSL currently covers only 10-15% of the customer's training costs on average. This leaves significant room for improvement.**
- The utilization rate for trainers on NLSL's payroll averages around 15-16 days per month. In cases where utilization cannot reach 12-13 days, NLSL employs trainers on a subcontracting basis, which accounts for approximately half of the training provided.
- In terms of costs 55-60% is onsite and 40-45% is offshore, traditionally this was 50-50 post the St. Charles acquisition it has shifted as they used to do everything onshore.

- **Acquisition:** NLSL recently acquired St. Charles, a company uniquely positioned in terms of its customer base. Approximately 95% of their clients are professional services firms and global management consulting companies, including renowned names like E&Y, KPMG, Deloitte, PwC, and others. Remarkably, these companies allocate nearly 2 times or more on average for training per employee per year compared to other industries. St. Charles has achieved a quarterly run rate of \$8 million, and the acquisition has proven to be margin accretive. NLSL currently maintains an active pipeline of opportunities and aims to acquire one company approximately every 12-18 months. NLSL has also made investments in clean energy space and aims to be the early movers in this industry.
- The major portion of NLSL's growth over the past year has stemmed from the acquisition of new accounts, given that existing customers have tightened their spending budgets. It is anticipated that these expenditures will return to their regular levels as the situation normalizes. In terms of sectors, notable growth has been achieved through advancements in Aviation, Energy, and Mining industries. Additionally, the Lifescience customer portfolio has expanded to encompass approximately 13-14 customers, with five of them ranking among the global top 10 in the industry. **NLSL is actively pursuing market expansion initiatives in both France and Germany.**
- **The risks of Generative AI** for NIIT Learning Systems include concerns over maintaining content quality and credibility, potential reduction in personalized human interaction, the need to adapt instructor roles, addressing ethical and bias considerations, ensuring customization to learners' needs, managing intellectual property rights, and ensuring contextual relevance of AI-generated content. NIIT Learning Systems (NLSL) has been investing in Generative AI for the past 6 months. **The benefits of Generative AI** include efficient creation of high-quality training content, reduced module creation time, the ability to generate more complex role plays and effective handling of heightened training requirements.
- **Guidance:**
  1. NLSL is anticipated to organically maintain a CAGR of 20% and sustain margins of over 20% over the next three to five years. This growth strategy positions the company to achieve significant financial progress, aiming to reach a milestone of \$500 million by FY 27 as per the management. Such projections indicate NLSL's commitment to consistent expansion while ensuring healthy profitability levels.
  2. NLSL exhibits higher expenditure compared to IT services, yet benefits from a faster working capital cycle. This efficiency is attributed to their collaboration with tier 1 customers and specific revenue streams, such as strategic sourcing, where they receive advance payments. This favorable financial structure enhances NLSL's cash flow and operational flexibility, evident from their achievement of generating a Free Cash Flow (FCF) of INR 762 million in Q1 FY24. The company's objective is to consistently generate an annual FCF of INR 2,400-2,800 million, indicating its commitment to sustained financial performance and efficient resource management.

## Valuation & Outlook

NIIT Learning Systems Ltd (NLSL) is strategically positioned to capitalize on the growing trend of outsourcing in the training industry. As technology continues to advance, training processes are expected to become more intricate, leading companies to seek external expertise to navigate this complexity. Additionally, in their pursuit of cost reduction, companies are likely to explore outsourcing options, creating a favorable landscape for NLSL's specialized services. NLSL is capable of initially reducing training costs for customers by around 20-25%, and this improvement continues as they gain expertise while working with the customers. **NLSL is able to enhance the effectiveness of training by reducing time, increasing productivity, and minimizing errors, ultimately leading to improved cost efficiency for its customers.** The utilization of internal trainers typically remains in single digits, whereas NLSL can double the utilization rate of trainers. **The demerger of NLSL allows the company to strategically allocate its resources towards developed markets, where the average expenditure on training per employee per year typically falls within the range of \$1000 to \$1300. This focused approach enables NLSL to optimize its efforts and tap into markets with higher training investment potential.**

At the current level of INR 380, the stock is trading at 22.7x / 17.1x FY24e / FY25e EPS, the company has communicated its expectation for FY24 to experience growth within the mid to high teens range. As macroeconomic conditions improve and budgets for existing customers begin to expand, NLSL anticipates returning to its **targeted growth trajectory of a 20% or higher Compound Annual Growth Rate (CAGR) along with maintaining margins over 20%.**

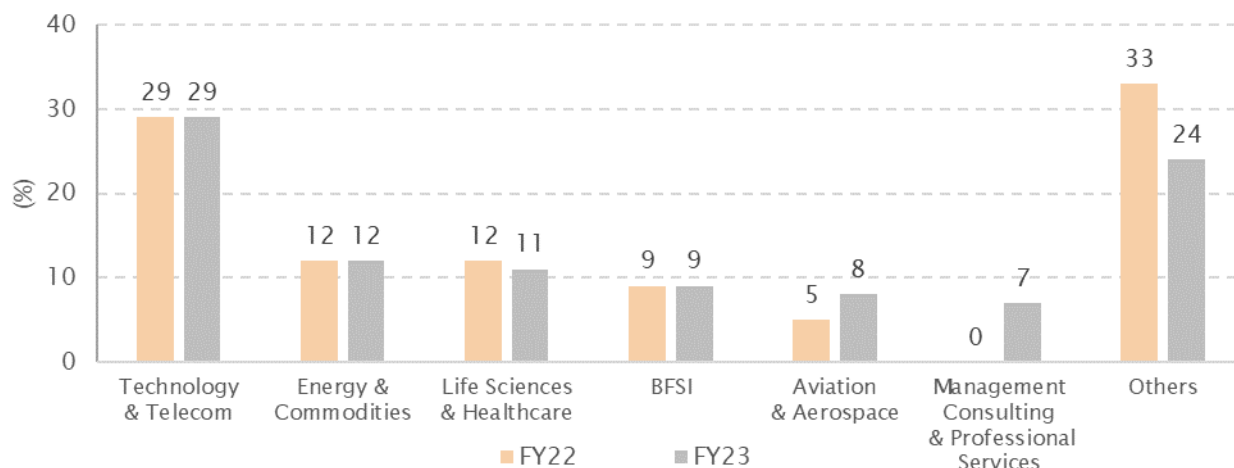
The company has exhibited strong growth, with a 20% CAGR in Topline and a 30% CAGR in EBITDA from FY17 to FY23. Looking ahead, we are projecting a more conservative growth scenario, with an expected 18% CAGR in Topline and a 19% CAGR in EBITDA up to FY25. These projections take into consideration the potential slowdown in macroeconomic conditions in the US and Europe.

We recommend a BUY rating on the stock with a target price of INR 512 valuing the company at 23x PE multiple on FY25E earnings.

## About The Company

- The demerger of the corporate learning business was finalized on May 24, with the business now under NIIT Learning Systems. NIIT Limited will now concentrate on the Skills & Careers business, while NLSL will handle the Corporate Learning Business. After the demerger, each NIIT Limited shareholder received one NLSL share for every NIIT Limited share they hold as of the Record Date, which was set for June 8, 2023. NLSL debuted in the secondary markets on August 8 at INR 356 on BSE and INR 366 on NSE

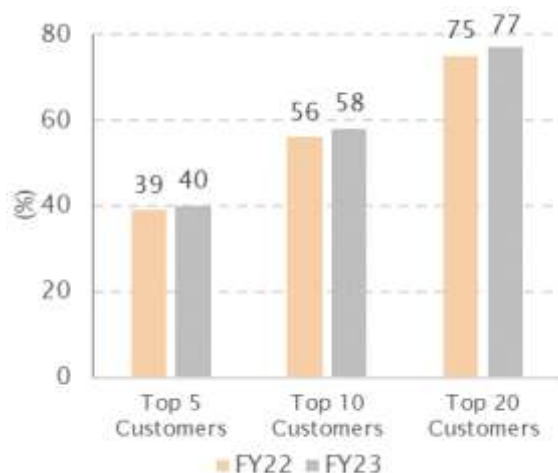
### Revenue Mix - By Industry Yearly



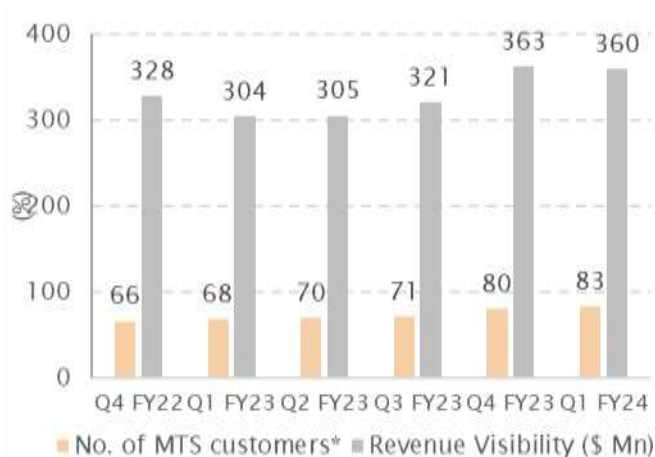
Revenue Mix - By Industry (%)	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24
Technology & Telecom	31	31	32	29	26	25
Energy & Commodities	12	13	14	12	9	10
Life Sciences & Healthcare	11	13	13	11	10	9
BFSI	9	9	10	8	8	8
Aviation & Aerospace	5	5	7	9	9	9
Management Consulting & Professional Services	0	0	0	9	17	17
Others	32	28	25	21	21	22

Source: Company, Dalal & Broacha Research

### Customer Contribution (Revenue) %



### No. of MTS customers



Source: Company, Dalal & Broacha Research

## Financials

Key Financials				
YE March (Rs. mn)	FY22	FY23	FY24E	FY25E
<b>Net Sales</b>	<b>11,323</b>	<b>13,618</b>	<b>15,877</b>	<b>19,077</b>
<i>Growth (Y-o-Y) (%)</i>		20.26	16.59	20.16
<b>EBIDTA</b>	<b>2,916</b>	<b>2,920</b>	<b>3,451</b>	<b>4,282</b>
<i>Growth (Y-o-Y) (%)</i>		0.14	18.16	24.11
<b>Net Profit</b>	<b>2,020</b>	<b>1,922</b>	<b>2,249</b>	<b>2,994</b>
<i>Growth (Y-o-Y) (%)</i>		-4.86	17.01	33.11
<b>Adj. Net Profit</b>	<b>2,021</b>	<b>2,108</b>	<b>2,249</b>	<b>2,994</b>
<i>Growth (Y-o-Y) (%)</i>		4.32	6.69	33.11
<b>Adj. Diluted EPS</b>	<b>15.1</b>	<b>15.7</b>	<b>16.7</b>	<b>22.2</b>
<i>Growth (Y-o-Y) (%)</i>		3.94	6.69	33.11
<b>No of Diluted shares (mn)</b>	<b>134</b>	<b>135</b>	<b>135</b>	<b>135</b>
Key Ratios				
YE March (Rs. mn)	FY22	FY23	FY24E	FY25E
<b>EBIDTA (%)</b>	<b>25.75</b>	<b>21.44</b>	<b>21.73</b>	<b>22.45</b>
<b>EBIT Margins %</b>	<b>22.02</b>	<b>17.98</b>	<b>17.89</b>	<b>19.25</b>
<b>NPM (%)</b>	<b>17.84</b>	<b>14.12</b>	<b>14.17</b>	<b>15.69</b>
<b>RoE (%)</b>	<b>37.06</b>	<b>27.37</b>	<b>26.13</b>	<b>27.19</b>
<b>RoCE (%)</b>	<b>46.54</b>	<b>22.85</b>	<b>24.14</b>	<b>25.25</b>
<b>Tax Rate %</b>	<b>22.94</b>	<b>15.87</b>	<b>19.17</b>	<b>19.23</b>
<b>Book Value Per share (Rs.)</b>	<b>40.7</b>	<b>57.2</b>	<b>70.7</b>	<b>93.0</b>
Valuation Ratios				
<b>P/E (x)</b>	<b>25.2x</b>	<b>26.6x</b>	<b>22.7x</b>	<b>17.1x</b>
<b>EV/EBITDA</b>	<b>16.3x</b>	<b>16.7x</b>	<b>12.5x</b>	<b>9.2x</b>
<b>P/BV (x)</b>	<b>9.3x</b>	<b>6.6x</b>	<b>5.4x</b>	<b>4.1x</b>
<b>Market Cap. / Sales (x)</b>	<b>4.5x</b>	<b>3.8x</b>	<b>3.2x</b>	<b>2.7x</b>

Source: Company, Dalal & Broacha Research

Profit & Loss A/c				
YE March (Rs. mn)	FY22	FY23	FY24E	FY25E
<b>Net Sales</b>	<b>11,323</b>	<b>13,618</b>	<b>15,877</b>	<b>19,077</b>
<i>Growth %</i>		20	17	20
<b>Less:</b>				
Employee benefits expense	5,734	6,942	8,002	9,589
Professional & Technical outsourcing expense	1,703	2,469	2,946	3,434
Other expenses	918	1,280	1,471	1,763
<b>Total Operating Expenditure</b>	<b>8,407</b>	<b>10,698</b>	<b>12,426</b>	<b>14,795</b>
<b>EBIDTA</b>	<b>2,916</b>	<b>2,920</b>	<b>3,451</b>	<b>4,282</b>
<i>Growth %</i>		0.14	18.16	24.11
Less: Depreciation	423	471	611	611
<b>EBIT</b>	<b>2,493</b>	<b>2,449</b>	<b>2,840</b>	<b>3,672</b>
<i>Growth %</i>		-1.78	15.96	29.29
Interest Paid	10	129	323	320
Extraordinary Expense	-0	-186	0	0
<b>Profit Before tax</b>	<b>2,622</b>	<b>2,285</b>	<b>2,783</b>	<b>3,707</b>
Tax	601	363	533	713
<b>Net Profit</b>	<b>2,020</b>	<b>1,922</b>	<b>2,249</b>	<b>2,994</b>
<b>Adjusted Profit</b>	<b>2,021</b>	<b>2,108</b>	<b>2,249</b>	<b>2,994</b>
<i>Growth %</i>		4.32	6.69	33.11
<b>Reported EPS</b>	<b>15.1</b>	<b>15.7</b>	<b>16.7</b>	<b>22.2</b>
<i>Growth %</i>		3.94	6.69	33.11
<b>Adjusted EPS</b>	<b>15.1</b>	<b>15.7</b>	<b>16.7</b>	<b>22.2</b>
<i>Growth %</i>		3.94	6.69	33.11

**Note: Post the demerger the latest Annual report for NIIT Learning Systems is yet to be published**

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