NIIT

Honing skills

The company is now well placed to capitalise on the rising demand for skill development

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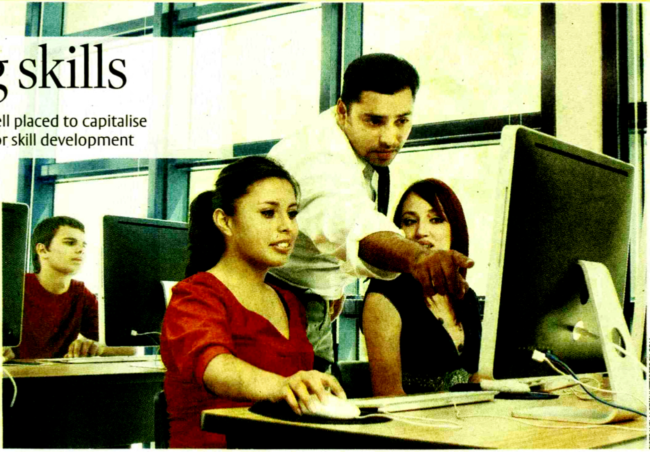
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Battling demonetisation, handling the resignation of its CEO for personal reasons, managing the shift in business from government school focus to other segments, NIIT, an education service provider, has had a challenging year, to say the least.

The company has managed to cope with these challenges. Revenues in 2016-17 increased 18 per cent and operational net profit rose 30 per cent. In the recent June quarter, the company posted operating profit as against a loss in the year-ago period.

Investors have taken note. The stock dipped up to 10 per cent in April on the news of its CEO's resignation (effective July 31), but the price recovered quickly. The stock price had touched a low of ₹70 after demonetisation, but recouped in a few months. The stock shot up 14 per cent last Friday after the announcement of the June quarter results.

The stock is reasonably valued and the current price of ₹101 discounts the company's estimated 2017-18 earnings by about 16.5 times, in line with the average forward multiple in the past few years. There are no comparable peers in the space of computer education and training to corporates, schools and individual clients.

Companies are increasingly looking for skill development in their workforce, be it freshers or existing employees. NIIT's fundamentals appear strong to capitalise on this industry requirement. Investment risk is also minimised, with high revenue visibility in the corporate learning group and diversified growth from multiple verticals.

The company's strong balance sheet — net debt at 0.2 times equity — also provides comfort. Margins are likely to improve with focus on profitable corporate learning and shift from the government school segment. Investors can buy the stock, given these positives. But exposure can be limited, given the stock's small-cap nature.

Better revenue mix

NIIT derives revenue from three main verticals — corporate learning, skill development and school segment — and it is shifting its focus to improve the mix.

Revenue share from the corporate learning vertical has been growing. The company earns intellectual property (IP) and annuity-based revenue in this segment through training contracts that provide good multi-year revenue visibility.

Its share of overall income has increased to 65 per cent in 2016-17 from 56 per cent a year ago. It is also shifting out of government schools — revenue from this segment fell 8 per cent in 2016-17, contributing only 8 per cent to the overall income (down from 11 per cent a year ago).

There were a few reasons to shift focus away from this segment. One, the receivables cycle is very long, hurting the working capital cycle.

Two, the business is capex-heavy, with low return on capital. The company plans to exit this segment by 2018-19 when contracts end and focus on asset-light, cloud-based solutions for private school clients.

The revenue shift is already helping. Depreciation expenses fell 5 per cent in 2016-17, after a 21 per cent reduction in 2015-16. The receivables cycle (days of sales outstanding) reduced to 79 days in the March 2017 quarter, from 98 days in the December quarter.

Growing revenue

NIIT's revenue growth is robust, with the key corporate learning segment growing at a strong pace. Revenue increased 35 per cent y-o-y to ₹766 crore in 2016-17, including a strategic one-time *pass-through payment (no contribution to profit)*; after excluding this, revenue growth was still good at 16 per cent y-o-y.

The company added three customers in 2016-17 and two in the June quarter (total 36); order intake increased 23 per cent y-o-y in the June quarter and revenue visibility is $191 million (1.5 times annual revenue). This provides comfort over revenue growth in the medium term. Revenue from NIIT's Skills and Career Group was impacted by demonetisation. The segment, which contributes about a third of revenue, saw a 3 per cent y-o-y dip in revenue to ₹323 crore. However, its Beyond-IT courses (retail sales, finance) are also seeing good traction and account for 40 per cent of the segment revenue.

IT courses such as DigiNxt have seen 4,000 student enrolment and deals with colleges have been signed. The company plans to launch more courses (virtual reality, robotics and cyber security) and expects to train 10,000 freshers in 2017-18.

It has launched StackRoute Online and DigiNXT NIC to help companies retrain their existing professionals in digital technology. These new courses should aid revenue growth.

In the school business segment, IP-driven private school business grew 29 per cent in 2016-17 and contributed 40 per cent to the segment revenue of ₹98 crore.

NIIT added 685 schools during the year. In the June quarter, private school business accounted for 45 per cent share of the segment's revenue and the number of contracts increased 13 per cent y-o-y to 157 schools.

In 2016-17, revenue (₹1,188 crore) was impacted by issues such as demonetisation but recovered briskly in the March quarter (up 51 per cent y-o-y). In the June quarter, overall revenue was flat y-o-y but corporate learning group income increased 7 per cent.

Management expects that the skills segment will be profitable and grow in high single digit in 2017-18. Corporate learning and school segments are expected to grow at 15 per cent this year.

Margins to improve

NIIT's operational net profit increased 30 per cent y-o-y to ₹5 crore in 2016-17, in spite of adverse forex movement. However, lower income from associates dragged consolidated profit (down 3 per cent to ₹65 crore).

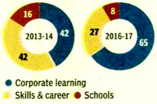
Operating margin in its corporate learning segment (after adjustment for one-time revenue) was steady at 11 per cent in 2016-17.

Margin in the skills segment inched up to 2 per cent. In the June quarter, depreciation expenses decreased 14 per cent y-o-y. Margins are likely to improve over the next few years and the management expects that school segment margins will be about 10 per cent (8 per cent currently).

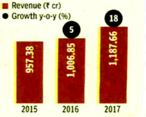
The focus on the high-margin corporate learning segment will also help, as will the turnaround in the skills segment. The company's net debt fell to ₹40 crore in June 2017, from ₹104 crore in the December quarter.

Shift to high-margin segment

Revenue contribution *(in %)*



Improving revenue



BUY

Why

- Growing revenue
- Margins to improve
- Reasonable valuation

Did you know?

NIIT added two corporate clients in the June 2017 quarter, after three additions in 2016-17