

# Max Software Services: Relative Valuation

“Hey Pradeep, very busy?” said Kunal to his teammate who was preoccupied with his work. “Oh! Hi Kunal, as you know, we have to deliver the valuation report based on multiples analysis to Manish by Thursday so that he can prepare the final report by Saturday,” replied Pradeep. He further continued, “By the way, what about your data collection? Any data regarding Max Software Services (Max Soft) (Annexure I)?” “Yes, I have almost finished. Hopefully, I would provide sufficient data by Tuesday. What’s the progress on multiples analysis? Have you decided on the multiples for this purpose?” said Kunal. “Yes, I am planning to work out all the major multiples of the top four IT players (TCS, Infosys, Wipro, and HCL Tech) in India,” replied Pradeep (Annexure II).

Pradeep and Kunal are CFA charterholders and Information Technology (IT) industry experts at Golden Step Service Plc. (Golden Step), a private equity firm focused on service industry. James Dowdell (James), founder chairman and CEO of Golden Step, has been nourishing the company since 1998. Under his leadership, the \$20 million small firm developed into a \$3,600 million public listed company with delivery centres in New York, Sydney, Mumbai and Hong Kong.

## Market Atmosphere

Over the past decade, the Indian economy experienced rapid growth with the ingress of multinational companies and became the hub of outsourcing services. Especially, the development of software industry has significantly contributed to the boom in the Indian economy. By the end of Financial Year (FY) 2008, the sector contributed 5.5% to the GDP and generated 2 million employment opportunities. Indian companies have major outsourcing deals with the US and during recent times, its exports (outsourcing services) increased substantially.

However, the 2008 global financial crisis, which has effected international financial markets and advancing economies alike, had its impact on India as well. Various sectors of the economy like automobile, banking, real estate and software industries were affected by the global recession.

Especially, the slowdown in the US economy has hit hard the Indian software industry as nearly 60% of the country’s outsourcing deals are linked up with the US economy. Indian companies with big-ticket deals in the US are experiencing shrinkage in their bottom lines as they are downsizing and adopting cost-cutting tools.

The global slowdown has also severely hit the Indian stock market. India’s most active indices i.e., National Stock Exchange (NSE) plunged by 39% from 4,739.6 as on April 1<sup>st</sup> 2008 to 3,020.95 as on March 31<sup>st</sup> 2009. Cheap valuation aggravated the chances of takeover. In the same period, Indian rupee became 30% weaker than US dollar with movement from INR 40.1/\$ as on April 1<sup>st</sup> 2008 to INR 52.2/\$ as on March 31<sup>st</sup>, 2009.

Nevertheless, despite the slowdown, the Indian software and services industry is expected to grow 16% in fiscal year 2009 and log revenues of \$60 billion, stated the Nasscom. It also asserted that the BPO sector is expected to reach \$71.7 billion with a growth of 17%.<sup>1</sup> “The current financial year has been challenging for economies across the globe. But the Indian IT-BPO industry has exhibited a balanced growth,” said Ganesh Natarajan, chairman of NASSCOM and global chief executive of Zensar Technologies.<sup>2</sup>

## Investment in Information Technology (IT) Sector

Keeping the current scenario in mind, last week, Golden Step received an investment proposal from one of its top rated high net worth individuals to invest at least \$500 million in Max Soft, a privately held Indian IT company, which earned more than INR 22 billion in FY’09 (Annexure III). James employed an eight- member team in India on this job. Pradeep and Kunal being members of this team are working to find out the true value of Max Soft using market-based valuation approach.

## **Annexure I**

### **Max Software Services**

#### **Introduction**

Max Software Services (Max Soft) is an India-based global IT player with presence in 10 countries at 25 locations all over the world. It provides a wide range of IT-related products and services to small- and mid-size enterprises all over the world with the help of more than 12,000 employees.

Max Soft is a part of Max Group, a prominent name in real estate and textile sector since 1980. The company earns around 70% of its income from group companies established in these sectors. However, the rest of the revenue comes from its relatively newly established venture in IT sector – ‘Max Soft’ established in 1999. The company did a noticeable job in a short span of time by focusing on quality of service and gaining expertise in IT Infrastructure Management services and Business Process Outsourcing (BPO) services.

#### **Financial Performance**

The revenue of the company grew from INR 19,737.40 million in FY‘08 to INR 22,105.89 million in FY‘09, a growth of 12.00% on Year-Over-Year (YOY) basis. It is the lowest growth in the last 3 years, thanks to the recent slowdown especially in the US and European countries, which contributed 81.00% and 12.00% respectively towards the company’s revenues. The bottom line has not seen the same pace as was found in revenue and settled down with 7.41% growth on YOY basis in FY‘09. The main reasons are soaring personnel cost due to increase in the number of employees and increase in selling and administration expenses by more than 20% on YOY basis.

The company is able to maintain its operating margin around and above 15%. However, it fell from 24.50% in FY‘08 to 15.70% in FY‘09 primarily due to rising cost of employees, sales and administration.

#### **Tuning with Changing Environment**

Recent downturn in the economy hit Max Group severely and the group suffered huge reduction in its growth rates of revenue, which plunged from 23.50% to 13.36% per annum. All its real estate projects got stuck in between. Textile export was also hit badly before seeing some improvement since the start of FY‘09. The group is facing severe cash crunch. “I have never seen such kind of slowdown in my life,” said Paul Max (Paul), group chairman, in the recent annual general meeting with shareholders. He further added, “It is the time to stick to our old gems – real estate and textile.” In the next board meeting, Paul employed Arun Jain as Chief Financial Officer (CFO) to find a Suitable investor to sell part-or full stake in its closely held venture Max Soft.

**Annexure II**  
**Selected Data for Top Four Indian IT Industry Players as on March 31<sup>st</sup> 2009**

(All amounts in INR million except share data and unless otherwise stated)

|                                | <b>TCS</b>  | <b>Infosys</b> | <b>Wipro</b>  | <b>HCLTech</b> |
|--------------------------------|-------------|----------------|---------------|----------------|
| NSE Symbol                     | TCS         | INFOSYSTCH     | WIPRO         | HCLTECH        |
| Sale or Revenue                | 278,128.80  | 216,930.00     | 256,995.00    | 98,687.00      |
| Other Income                   | (4,269.90)  | 4,730.00       | 2,621.00      | 2,095.00       |
| EBITDA                         | 67,428.10   | 71,950.00      | 55,730.00     | 21,883.00      |
| EBIT                           | 61,787.30   | 64,340.00      | 47,596.00     | 17,736.00      |
| Net Income                     | 52,564.20   | 59,880.00      | 38,999.00     | 10,886.00      |
| Non-Cash Charges               | 5,640.80    | 7,610.00       | 8,631.00      | 4,146.00       |
| Cash                           | 26,981.40   | 96,950.00      | 49,117.00     | 19,298.00      |
| Total Assets Net to Intangible | 158,580.10  | 214,370.00     | 220,775.00    | 79,035.00      |
| Current Liabilities            | 42,535.80   | 20,040.00      | 67,989.00     | 30,221.75      |
| Non-current Liabilities        | 5,632.10    | -              | 56,892.00     | 24,092.50      |
| Share Price per Share          | 538.55      | 1,323.90       | 245.90        | 102.05         |
| Par Value per Share            | 1.00        | 5.00           | 2.00          | 2.00           |
| Number of Shares               | 978,610,498 | 572,490,211    | 1,454,662,502 | 667,935,809    |

**Annexure III**  
**Selected Financial Data of Max Soft as on March 31<sup>st</sup> 2009**

(Amounts in INR million except share data)

|                                |             |
|--------------------------------|-------------|
| Sale or Revenue                | 22,105.89   |
| Other income                   | 59.81       |
| EBITDA                         | 3,376.19    |
| EBIT                           | 2,418.19    |
| Net Income                     | 1,636.98    |
| Non-cash charges               | 958.00      |
| Cash                           | 3,923.35    |
| Total Assets Net to Intangible | 18,950.00   |
| Current Liabilities            | 8,862.80    |
| Non-current Liabilities        | 5,150.00    |
| Par Value per Share            | 1.00        |
| Number of Shares               | 208,989,160 |