

BLS International (MCAP Rs23b)

What do they do?

- Runs citizen facing services while performing non-judgemental tasks for governments (G2C) across the world. Within this broad definition of operations, BLS (The company does not differentiate between the two types of services and this classification is only from investor's perspective) operates two types of services for citizens:

- 1) Visa Application centres – Non judgemental tasks only.

-Across the world (29 clients in 58 countries with 9000 associates : payroll + outsourced, including CSC staff).

-Currently is in the top 3 outsourcers (competition includes VFS Global) in Visa Application Services.

- 2) Citizen Service centres – Non judgemental tasks only. E-governance projects in India.

-Just started with first contract being Punjab Government's Seva Kendra.

-2147 centres up and running for Punjab Government. Going up gradually from 92 services currently to 223 services over the next two years.

How big is the company?

- FY18 revenues are likely to be Rs9832m (or US\$152m), +55%/yoy. EBITDA is likely to be Rs2069m (21% of Revenues; as against 13% in FY17 and 7% in FY16). EPS will be Rs13.9.

- Application count is currently running at 20m applications per annum. In terms of revenues size, BLS is now at par with Intellect and is already bigger than Majesco, Mastek, and Sonata (IT services).

- While the company doesn't operate in the IT services space and there are no listed players from India to compete with, the reference is to demonstrate the size of the company.

Transparency and Visibility?

- BLS is an emerging company with FY18E revenues of Rs9832m. Therefore, the company is still in the process of evolving into a completely process driven company. Internal processes are little behind peer set (in the IT services sector) but at the same time, investors have more access to information than the IT companies. Here are our observations:

- Positives

- All the projects are inevitably RFP driven which also make them public and transparent. This is an advantage for investors tracking the company.
- The management is quite transparent in disclosing company information although the factsheets are still getting frozen from a time series perspective.
- For winning government contracts, audits (physical and otherwise) are also done by contract-awarding party and therefore, checks and processes always need to be in place.
- All client names are disclosed publically.
- Extremely low capex makes it FCF rich. Most of the business is done from leased premises. A reasonable 9% of PAT paid out as dividend (Rs3.5 per share before the split in shares in 1:10 ratio) in FY17.
- No new or outstanding litigation against the company.
- Moved to IndAS from 1QFY18.
- No severance payable to any of the directors.

Negatives/Risks

- Auditors changed to "SS Kothari Mehta" but they do not audit ~84% of the revenues. Mitigation: Company is likely to move to big four auditors in a span of 2 years. Four out of Seven are independent directors. BLS' Auditors globally are HLB International (UK based) Network, the network is present in 100+ countries with SS Kothari being an affiliate to the same. All affiliates are audited by HLB International UK for yearly renewal of membership to the network. Mitigation: BLS' revenues in each country are in constant scrutiny by clients (Governments) as revenue per application is remitted to government on T+2 days-basis.

To get a perspective on quality of HLB associates, here is a list of their other affiliates in India -

- Ahmedabad, Baroda, Jamnagar, Rajkot – Manubhai and Shah
- Bangalore - Guru and Jana

- Chennai - R. Subramanian and Company
- Cochin, Trivandrum - Roy Varghese and Associates
- Gandhidham, Jabalpur, Mumbai - Khimji Kunverji & Co.
- Hyderabad - M. Bhaskara Rao & Co
- Indore - Fadnis & Gupte

○ At BLS' EBITDA levels, auditors need to move in line with their peer set in terms of size.

○ The company does not pay taxes (FY17 ETR was just 6%, highest in last 5 years with previous 4 years average of just 2%). This sort of results into overstated RoE and PAT. This risk is more litigation related and we are not in a position to comment on the mitigation factors except that we have built in higher tax rates going forward (FY20 is 18%). One of the reasons for lower taxes currently is its middle east subsidiary – BLS International FZE which has zero tax rate and contributes ~82% of consolidated PBT. As other regions scale up (Europe and APAC), tax rates will keep going up sharply, in my opinion. The management believes that all indirect taxes are paid along with receipts being given out to consumers by respective subsidiaries. Consolidated tax rates appear low due to complex subsidiary structures and hence, are likely to continue.

○ Frequent management changes - CFO Mr Dheeraj Sharma, appointed on 13th Aug 2016, resigned on 16th December 2016. Mr Mukul Harmilapi was appointed as CFO in December 2016 but resigned on 27th July 2017 for health reasons. Company secretary Mr Prabhat Srivastava resigned in Feb 2017. Mr Balaji was appointed as company secretary in Feb 2017. Part of the changes was on account of company getting CS and CFOs from listed company backgrounds.

○ Mr Nikhil Gupta, ED, has attended 2/5 meetings.

○ 86% of the cash balance was held in current accounts – not earning interest. Company does not hedge at all.

○ Gratuity is not funded at all and is shown as liability in the balance sheet.

- Board and Committees

○ Audit committee consists of 2 independent directors and Mr Nikhil Gupta (MD). Best in class consists of only independent directors. Therefore, will rate BLS as average here.

○ Nomination and Remuneration committee consists of all independent directors. Best in class.

Why the industry and company are likely to grow fast?

- Two main drivers for growth in outsourced consulate services:

○ Growth in global tourism

○ Expansion in security and data storage procedures. Currently, just 31% (or 41m applications) of the overall visa processing market is outsourced.

○ For BLS in particular, penetration (3.4/40m or just 8.5%) will also play a critical role in addition to market expansion.

- Main growth driver for citizen service centres:

○ India is going through a major transformation program in terms of making government services becoming easily available to citizens.

○ Asia pacific is also seeing movement towards outsourcing of these services by government to third party vendors.

Related Party Transactions:

- Broadly under two heads:

○ Salary Paid to Promoter Family and Relatives – 1.2L+1.75L+3.2L+6.7L+13.6L = Rs26.45L – Immaterial.

○ Rent Paid for use of premises – 0.96L+1.7L+0.96L = Rs3.62 – Immaterial.

Company Financials

Key takeaways:

- Revenue growth is likely to remain very strong in FY18 and FY19 as existing contracts ramp up over the next two years. We are assuming FY20 to be little soft in terms of growth – currently assuming minimal incremental project wins due to lack of visibility and historical data. This variable can surprise positively.

- Company margins are likely to taper off from 1QFY18 as Punjab costs escalate with volumes and revenues are fixed in nature. This variable can surprise positively.
- We also build in higher taxes going forward.
- With the above three assumptions, the company can deliver Revenue CAGR of 26%, EBITDA CAGR of 42%, and a Net Profit CAGR of 49% over FY17-20E.

BLS International (Rs m) - Listing on 14-June-2016	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E		
Revenues	1,662	3,860	4,500	5,050	6,350	9,832	12,149	12,586		
Growth yoy %		132%	17%	12%	26%	55%	24%	4%		
Total Application count(mn)	0.9	2.0	1.6	1.5	4.2	16.0	22.0	25.7		
Existing Business	0.9	2.0	1.6	1.5	1.6	1.6	2.1	2.2		
Spain (118 centres, 75m tourists in 2016)			-	-	0.5	1.8	1.9	1.9		
Punjab (2147 centres, 223 services, 10K citizens per center)			-	-	2.2	13	18	22		
Revenue ex government charges			1,026	1,062	1,823	3,315	4,132	4,281		
Growth yoy %				3.5%	71.7%	81.8%	24.7%	3.6%		
Employee benefits expense		-301	-351	-329	-417	-695	-919	-921		
As % of Rev		-8%	-8%	-7%	-7%	-7%	-8%	-7%		
Number of employees (Permanent) - Employee costs				142	2,000	2,200	2,200	2,200		
Number of employees (Outsourced) - Other expenses				358	6,500	7,300	7,500	7,700		
Wages (Rs Lakh per annum)					-2.1	-3.2	-4.2	-4.2		
Opex		-3,153	-3,676	-4,132	-4,678	-6,678	-8,189	-8,489		
As % of Rev		-82%	-82%	-82%	-74%	-68%	-67%	-67%		
G&A		-159	-185	-221	-428	-728	-794	-834		
As % of Rev		-4%	-4%	-4%	-7%	-7%	-7%	-7%		
EBITDA	155	243	287	367	826	1,731	2,247	2,343		
EBITDA Margin %	9%	6%	6%	7.3%	13.0%	17.6%	18.5%	18.6%		
D&A	-11	-35	-51	-55	-260	-378	-382	-344		
As % of GFA			-28%	-28%	-32%	-27%	-22%	-17%		
EBIT	144	208	236	312	566	1,353	1,865	1,998		
EBIT Margin %	9%	5%	5%	6%	9%	14%	15%	16%		
Other Income	-	-	4	5	23	33	4	20		
As % of Cash Equivalents					5.4%	4.9%	4.9%	4.9%		
Interest expenses	-	-	-1	-3	-57	-85	-31	0		
Effective interest rate %			-3%	-5%	-13%	-13%	-13%	-13%		
PBT	144	208	239	314	532	1,301	1,838	2,019		
PBT Margin %	9%	5%	5%	6%	8%	13%	15%	16%		
Tax	-3	-3	-3	-5	-32	-131	-258	-364		
ETR %	-2%	-2%	-1%	-1%	-6%	-10%	-14%	-18%		
PAT	141	205	236	309	500	1,170	1,580	1,654		
Net Margin %	8%	5%	5%	6%	8%	12%	13%	13%		
MI			0.1	-0.1	-0.4	-0.4	-0.4	-0.4		
Net Profit	141	205	236	309	500	1,170	1,580	1,654		
EPS - Diluted	13.8	20.0	23.0	30.2	48.8	11.4	15.4	16.2		
Growth %		45%	15%	31%	62%	NA	34%	5%		
RoE %		44%	33%	31%	35%	58%	54%	42%		
WANS (m)	10.2	10.2	10.2	10.2	10.2	102.4	102.4	102.4		
Dividend					36	358	430	516		
DDT					7	72	86	103		
DPS					3.5	3.5	4.2	5.0		
Dupont Analysis										
RoE %					FY15	FY16	FY17	FY18E	FY19E	FY20E
					33%	31%	35%	58%	54%	42%
Operating efficiency (EBIT margin %)					5%	6%	9%	14%	15%	