

SIS Ltd.

29th July 2024

Falling short of guidance and target

SIS Ltd. reported a revenue growth of ~5.1% and an operating profit decline of 1.2% on a YoY basis. The EBITDA margin decreased by ~30 bps from 4.7% in Q1FY24 to 4.4% in Q1FY25. The Security Services – India segment grew by 8.8% to ~Rs. 14 Bn, with a decrease of 60 bps in the EBITDA margin on a YoY basis, resulting in a margin of 5.4%. The Security Solutions – International segment showed a marginal 2.7% growth to Rs. 8 Bn, with a 14% decline in EBITDA and a 60-bps reduction in the EBITDA margin to 3.4% in Q1 FY25 on a YoY basis. The Facility Management segment's revenue grew by 2.2% to Rs. 5 Bn, with a 30-bps improvement in the EBITDA margin on a QoQ basis to 4.2%.

Security – India falling short of guidance

The segment registered a growth rate of ~9% on a YoY basis, against the guidance of 1.5x GDP growth. During the last year, the segment grew at ~12%, largely on the back of volume growth. With no major revision in wages and indications from the central government in the Budget'24, the growth from price/wage increases doesn't seem to be around the corner. However, the revisions from states can be helpful. Further, the EBITDA margin for the quarter stood at 5.4%, which is slightly below the long-term sustainable margin of ~6%. This shortfall was primarily due to a compensation review for back-office employees, leading to higher SG&A costs. This is the second quarter after achieving a pre-COVID margin of ~6% in Q3FY24, the Company has missed attaining its optimal profitability.

Security – International facing multiple challenges

During the COVID-19 pandemic, Australia closed its borders to foreign visa holders, leading to a huge drop in the migrant population creating a substantial gap in the workforce, and increasing the cost of labour. Amidst this, the security market has been undergoing fierce competition, also resulting in SIS losing business due to factors like insourcing. Subsequently, in Q1 FY25, the Company grew its business by ~3% and decreased its EBITDA margin by ~60 bps on a YoY basis. Moreover, the minimum wage in Australia has been increased by ~3.5%, magnifying the turbulence for the next 1-2 quarters.

Facility Management – India's profitability showing up

The FM segment has been actively working on cleaning up customer contracts by exiting low-profitable contracts. Subsequently, SIS registered a topline growth of ~2% and an EBITDA margin improvement of ~30 bps at ~4.2% on a QoQ basis, gradually overcoming the negative operating leverage. The management had guided in the last quarter to complete the churn out and good performance by FY25.

View & Valuation

Despite volatility going on in all three segments, we remain optimistic for the business, especially the Indian division, which includes Security – India and Facility Management, for the medium. Consequently, we revise our estimates and maintain a BUY rating on SIS with a 20x PE (derating PE by 10%) on FY26E EPS, suggesting a target price of Rs. 585 and an upside of ~39%.

BUY

CMP Rs. 420

TARGET Rs. 585 (+39%)

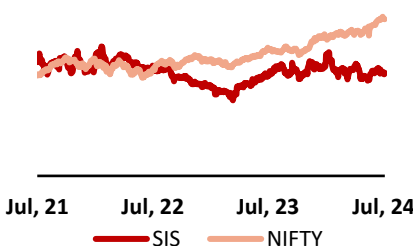
Company Data

Bloomberg Code	SECSIN
MCAP (Rs. Mn)	61,320
O/S Shares (Mn)	146
52w High/Low	560/375
Face Value (in Rs.)	5
Liquidity (3M) (Rs. Mn)	39

Shareholding Pattern %

	Jun-24	Mar-24	Dec-23
Promoters	71.69	71.7	71.58
FIIIs	16.61	16.87	16.41
DIIIs	3.04	2.91	3.17
Non-Institutional	8.67	8.52	8.83

SIS vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY24	FY25E	FY26E
Revenue	123	130	140
EBITDA	6	6	7
Net Profit	2	4	4
Total Assets	60	61	66
ROCE (%)	11%	13%	12%
ROE (%)	8%	15%	14%

Source: Company, Keynote Capitals Ltd.

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Q1 FY25 Result Update

Result Highlights (Rs. Mn)

Particulars	Q1 FY25	Q1 FY24	Change % (Y-o-Y)	Q4 FY24	Change % (Q-o-Q)	FY24
Revenue	31,299	29,767	5%	31,376	0%	1,22,614
Employee benefit expense*	26,499	24,610	8%	25,884	2%	1,01,944
Gross Profit	4,800	5,157	-7%	5,493	-13%	20,671
Gross Profit %	15%	17%	-199 bps	18%	-217 bps	17%
Operating expenses	3,425	3,762	-9%	3,997	-14%	14,825
EBITDA	1,375	1,395	-1%	1,495	-8%	5,846
EBITDA %	4%	5%	-29 bps	5%	-37 bps	5%
Depreciation	427	357	20%	485	-12%	1,663
EBIT	948	1,038	-9%	1,010	-6%	4,182
Finance Cost	421	327	29%	402	5%	1,481
Other Income	118	82	45%	160	-26%	427
PBT	645	793	-19%	768	-16%	3,128
Share of Associates	69	52	33%	62	12%	248
Tax	70	-49	-243%	290	-76%	819
PAT	645	894	-28%	540	19%	1,901
EPS	4.4	6.1	-28%	-0.8	-646%	13.0

* Includes COGS, which was 1% of the revenue in Q1 FY25.

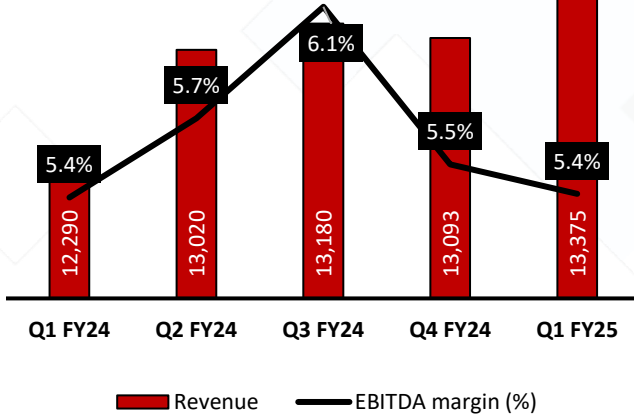
Segment Highlights (Rs. Mn)

Particulars	Q1 FY25	Q1 FY24	Change % (Y-o-Y)	Q4 FY24	Change % (Q-o-Q)	FY24
Revenue						
Security Solutions - India	13,375	12,290	9%	13,093	2%	51,585
Security Solutions - International	12,760	12,430	3%	13,219	-3%	50,690
Facility Management	5,303	5,190	2%	5,201	2%	20,921
Operating Profit						
Security Solutions - India	720	660	9%	719	0%	2,918
Security Solutions - International	432	500	-14%	572	-25%	2,062
Facility Management	222	230	-3%	204	9%	865
Operating Profit Margin %						
Security Solutions - India	5.4%	5.4%	1 bps	5.5%	-11 bps	5.7%
Security Solutions - International	3.4%	4.0%	-64 bps	4.3%	-94 bps	4.1%
Facility Management	4.2%	4.4%	-25 bps	3.9%	26 bps	4.1%

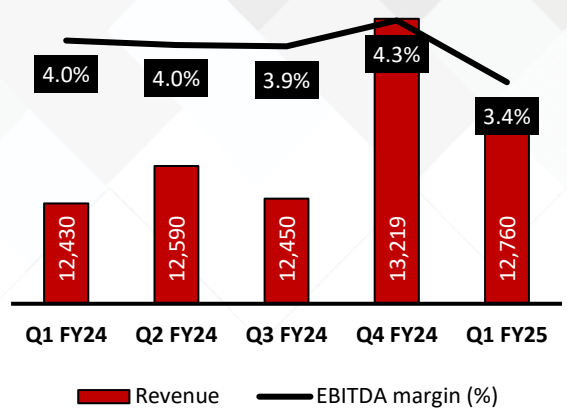
Source: Company, Keynote Capitals Ltd.

Quarterly Business Progression

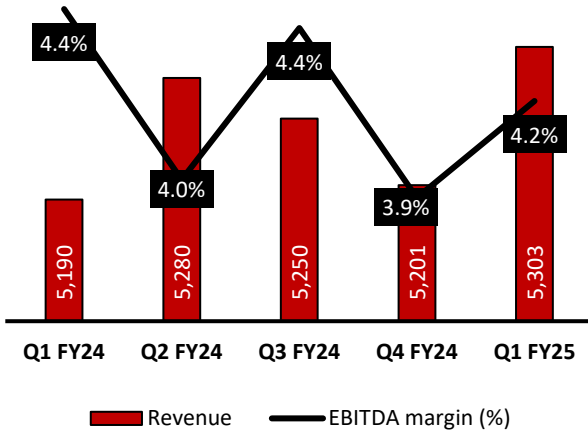
Security Solutions - India Revenue (in Rs. Mn) and Margin (%)



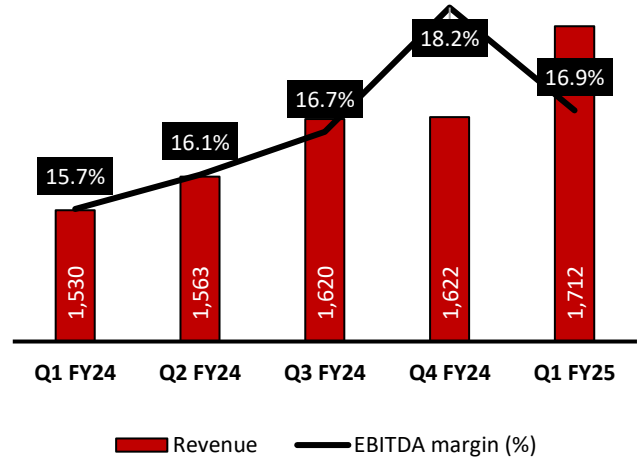
Security Solutions - International Revenue (in Rs. Mn) and Margin (%)



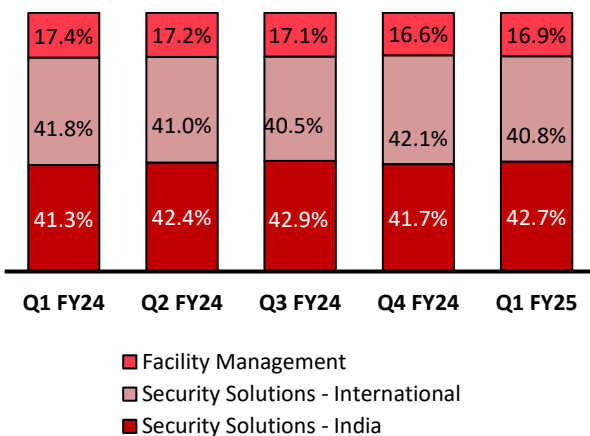
Facility Management - India Revenue (in Rs. Mn) and Margin (%)



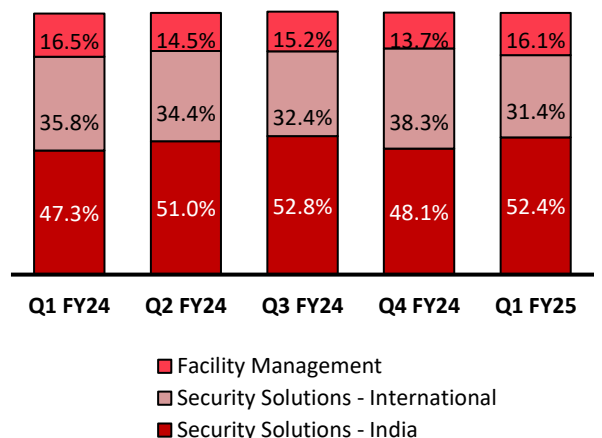
Cash Logistics - India Revenue (in Rs. Mn) and Margin (%)



Revenue Mix (%)



EBITDA Mix (%)



Q1 FY25 Conference Call Takeaways

Security Services – India

- The EBITDA margin for the quarter was 5.4%, ~60 bps below the long-term sustainable margin of ~6%, primarily due to a compensation review for back-office employees, leading to higher SG&A costs.
- Central government wage revisions typically occur annually. However, the last revision was minimal, with an increase of only Rs. 100-150, making it inconsequential. Unlike the central government, state governments revise minimum wages more frequently, often every month. Each state has its schedule and criteria for wage revisions.
- The most recent central minimum wage revision took place around the time of the elections, with the latest Dearness Allowance (DA) revision announced on April 6th, 2024. States such as Odisha have recently revised their minimum wages.
- In India, from the date the minimum wage hike becomes effective, even if it is applied retrospectively, the increased costs are immediately passed through to clients.
- The management has expressed scepticism about wage hikes by the central government as the budget for FY25 highlighted a focus on creating more jobs compared to better-paid jobs.
- The Finance Minister announced three new employment-linked schemes aimed at boosting job creation. Scheme B is focused solely on the manufacturing sector and does not apply to SIS Limited. However, Schemes A and C are relevant as they provide incentives for both employees and employers. Scheme A aims to incentivize first-time employees entering the workforce across all formal sectors by providing a one-month wage of up to Rs. 15,000, paid in three instalments. Scheme C supports employers in creating additional employment by reimbursing them up to Rs. 3,000 per month for two years towards the EPFO contribution for each additional employee.

Facility Management Services

- The Company categorizes its contracts into A, B, C, and D categories to manage its portfolio effectively. 'A' Category contracts are the most profitable and stable, contributing significantly to revenue with reliable payment terms and operational feasibility. 'B' Category contracts present challenges; they may be loss-making, involve clients who are bad paymasters, or be operationally unviable. 'C' Category contracts are neutral, neither significantly contributing to nor detracting from the business, with moderate revenue and manageable operational requirements. 'D' Category contracts are the least favorable, often avoided due to their high risk and low returns, characterized by very low margins, high operational difficulties, poor payment terms, and minimal strategic value. This categorization helps SIS focus on maintaining a healthy and profitable contract portfolio by prioritizing and managing contracts based on their performance and strategic importance.

Security Services – International

- The segmental revenues for Q1 FY25 were ~Rs. 13 Bn, marking a 2.7% growth over Q1 FY24, continuing the growth momentum. However, there was a 3.5% decline in revenues, on a QoQ basis, primarily due to lower casual work compared to Q4 FY24.
- The EBITDA margin for Q1 FY25 was 3.4%, down from 4.3% in Q4 FY24 and 4.0% in Q1 FY24. This decline is primarily due to continued labour shortages in Australia, which have led to high labour costs. These labour shortages are expected to persist in the medium term, further affecting the Company's financial performance. Similar trends are observed in other countries, contributing to the overall decline in EBITDA margins.
- The tight labour market has led to wage pressures, with employers having to offer higher wages to attract and retain workers. In July, Fair Work Australia announced a minimum wage hike of 3.8% in Australia effective 1st July. While it is required to implement such increases effective 1st July, many client contracts stipulate commensurate price increases on the anniversary of such contracts. The management expects the entire pass-on to take place over the next 1-2 quarters.
- The leader running SXP, a business generating under \$15 Mn, had to step down suddenly due to serious health issues. This unexpected departure created chaos as there was no immediate succession plan in place. SIS quickly inducted a new CEO and COO to stabilize the situation, but this process took three to four months. Shortly after joining, the new COO received a better offer and decided to leave, causing additional instability.
- In Australia, wage increases are incorporated into contracts with these pass-throughs to occur over the next 1-2 quarters.
- The Singapore business is now generating close to \$40 Mn in annualized revenue and continues to remain profitable through a combination of cost rationalization, shedding unprofitable contracts and new business growth.

On July 1, 2023, the minimum wage was increased by 5.75%, setting the new rates at \$23.23 per hour or \$882.80 per week. This move aimed to help low-income workers manage higher living expenses, despite concerns about potential inflationary effects. Following this, the FWC announced another increase of 3.75%, effective from July 1, 2024, raising the minimum wage to \$24.10 per hour or \$915.90 per week.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY23	FY24	FY25E	FY26E	FY27E
Net Sales	1,13,458	1,22,614	1,30,258	1,40,136	1,50,877
Growth %	13%	8%	6%	8%	8%
Raw Material Expenses	1,069	1,448	1,563	1,682	1,811
Employee Expenses	92,012	1,00,495	1,06,811	1,14,912	1,23,719
Other Expenses	15,461	15,491	15,761	16,957	18,256
EBITDA	4,915	5,179	6,122	6,586	7,091
Growth %	-1%	5%	18%	8%	8%
Margin%	4%	4%	5%	5%	5%
Depreciation	1,347	1,663	1,517	1,592	1,674
EBIT	3,568	3,516	4,606	4,994	5,417
Growth %	-7%	-1%	31%	8%	8%
Margin%	3%	3%	4%	4%	4%
Interest Paid	1,149	1,482	605	605	605
Other Income & exceptional	327	436	320	320	320
PBT	2,747	2,470	4,321	4,709	5,133
Tax	-616	819	756	824	898
PAT	3,363	1,652	3,565	3,885	4,234
Others (Minorities, Associates)	102	102	286	328	378
Net Profit	3,465	1,754	3,850	4,214	4,612
Growth %	6%	-49%	120%	9%	9%
Shares (Mn)	145.7	144.1	144.1	144.1	144.1
EPS	23.78	12.17	26.72	29.24	32.01

Balance Sheet

Y/E Mar, Rs. Mn	FY23	FY24	FY25E	FY26E	FY27E
Cash, Cash equivalents & Bank	7,509	7,404	10,356	12,980	15,801
Current Investments	103	56	56	56	56
Debtors	16,777	18,858	19,539	21,020	22,632
Inventory	314	309	391	420	453
Short Term Loans & Advances	7,284	8,211	8,211	8,211	8,211
Other Current Assets	873	1,000	1,000	1,000	1,000
Total Current Assets	32,860	35,838	39,552	43,687	48,151
Net Block & CWIP	16,465	16,073	15,859	15,668	15,503
Long Term Investments	880	1,108	1,394	1,722	2,100
Other Non-current Assets	4,446	4,691	4,691	4,691	4,691
Total Assets	54,652	57,710	61,495	65,768	70,444
Creditors	639	847	782	841	905
Provision	4,278	4,290	4,290	4,290	4,290
Short Term Borrowings	6,654	7,037	7,037	7,037	7,037
Other Current Liabilities	11,354	17,886	17,886	17,886	17,886
Total Current Liabilities	22,925	30,060	29,995	30,054	30,118
Long Term Debt	8,032	2,301	2,301	2,301	2,301
Deferred Tax Liabilities	-3,476	-2,918	-2,918	-2,918	-2,918
Other Long Term Liabilities	3,839	4,132	4,132	4,132	4,132
Total Non Current Liabilities	8,394	3,515	3,515	3,515	3,515
Paid-up Capital	729	721	721	721	721
Reserves & Surplus	22,604	23,415	27,265	31,479	36,091
Shareholders' Equity	23,333	24,135	27,986	32,199	36,811
Non Controlling Interest	0	0	0	0	0
Total Equity & Liabilities	54,652	57,710	61,495	65,768	70,444

Cash Flow

Y/E Mar, Rs. Mn	FY23	FY24	FY25E	FY26E	FY27E
Pre-tax profit	2,747	2,470	4,321	4,709	5,133
Adjustments	2,406	3,411	1,801	1,877	1,959
Change in Working Capital	-2,608	-1,749	-827	-1,452	-1,579
Total Tax Paid	-938	-437	-756	-824	-898
Cash flow from operating Activities	1,607	3,695	4,539	4,310	4,614
Net Capital Expenditure	-1,187	-1,559	-1,303	-1,401	-1,509
Change in investments	-577	161	0	0	0
Other investing activities	285	354	320	320	320
Cash flow from investing activities	-1,480	-1,044	-983	-1,081	-1,189
Equity raised / (repaid)	-996.53	-1120.87	0	0	0
Debt raised / (repaid)	191	-381	0	0	0
Dividend (incl. tax)	0	0	0	0	0
Other financing activities	-1,480	-1,900	-605	-605	-605
Cash flow from financing activities	-2,285	-3,402	-605	-605	-605
Net Change in cash	-2,158	-751	2,951	2,624	2,821

Valuation Ratios

	FY23	FY24	FY25E	FY26E	FY27E
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Per Share Data

EPS	24	12	27	29	32
Growth %	7%	-49%	120%	9%	9%
Book Value Per Share	160	167	194	223	255

Return Ratios

Return on Assets (%)	7%	3%	6%	7%	7%
Return on Equity (%)	16%	7%	15%	14%	13%
Return on Capital Employed (%)	8%	10%	13%	12%	12%

Turnover Ratios

Asset Turnover (x)	2.2	2.2	2.2	2.2	2.2
Sales / Gross Block (x)	4.7	4.8	4.8	4.9	5.0
Working Capital / Sales (x)	7%	6%	6%	8%	10%
Receivable Days	49	53	54	53	53
Inventory Days	112	79	82	88	88
Payable Days	2	2	2	2	2
Working Capital Days	159	129	133	139	139

Liquidity Ratios

Current Ratio (x)	1.4	1.2	1.3	1.5	1.6
Interest Coverage Ratio (x)	3.4	2.7	8.1	8.8	9.5
Total Debt to Equity	0.6	0.4	0.3	0.3	0.3
Net Debt to Equity	0.3	0.1	0.0	-0.1	-0.2

Valuation

PE (x)	13.5	36.0	15.7	14.4	13.1
Earnings Yield (%)	7%	3%	6%	7%	8%
Price to Sales (x)	0.4	0.5	0.5	0.4	0.4
Price to Book (x)	2.0	2.6	2.2	1.9	1.6
EV/EBITDA (x)	11.1	10.8	10.8	10.1	9.4
EV/Sales (x)	0.5	0.5	0.5	0.5	0.4

KEYNOTE Rating History

Date	Rating	Market Price at Recommendation	Upside/Downside
21 st September 2023	BUY	432	+94%
1 st November 2023	BUY	432	+84%
1 st February 2024	BUY	489	+52%
6 th May 2024	BUY	441	+52%
29 th July 2024	BUY	420	+39%

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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SEBI Regn. Nos.: BSE / NSE (CASH / F&O / CD): INZ000241530; DP: CDSL- IN-DP-238-2016; Research Analyst: INH000007997

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