



2016

CIGNITI TECHNOLOGIES



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INDEX

1.	Thesis
2.	What is software Testing ?
3.	Why is software testing important?
4.	Growth Prospects
5.	Risks
6.	Peer Comparison
7.	About Cigniti
8.	Conclusion

Thesis – Cigniti is world's third largest Independent software testing company. We live in a world where we transact billions in Capital market, banking system just with a click. From ordering food to buying grocery to booking a cab everything is done online. There has been a blowout of the number of applications made in past 3 years with the entry of smart phones.

A lot of these companies are generating billions of revenue as you & me use these apps. An app like Uber has Thousands of Cab Drivers around the world generating their living with that. Market Place apps like flipkart and Amazing have lakhs of sellers on the website whose living is dependent on that. Banks have data of transactions and account statements are extremely crucial.

After a developer(example Infosys) makes an application, that application is tested by an Independent tester like Cigniti. Every time software is updated it has to be tested again by a third party independent Tester likes Cigniti. The Process of testing can be done in-house by the application buyer since these applications have tremendous importance these are given to experts like Cigniti.

This software is then rated and necessary changes are made. In the ratings business the company which gets the most business (market share) automatically develops a moat. For Example –A credit rating given by Crisil (S&P) is more considered more reliable in the market compared to any other new company.

Cigniti is third largest Independent software testing company in the world having a global market share of 3%.We believe that this company can grow at 30%+ over the next 2-3years and is trading at fair valuations of 25 times. We believe that testing is too small a Game for large players like TCS & Infosys to enter with full strength. With Internet of things pretty much a reality we believe there are strong sector tailwinds to the company to grow. We have put a buy with 5% weight but will increase the weight once the QIP is done with or if the company crosses the level of 500.

What is software testing?

Software testing is a process of executing a program or application with the intent of finding the software bugs. It can also be stated as the process of validating and verifying that a software program or application or product:

- Meets the business and technical requirements that guided its design and development
- Works as expected
- Can be implemented with the same characteristic.

Why is software testing important?

Software Testing is necessary because we all make mistakes. Some of those mistakes are unimportant, but some of them are expensive or dangerous. We need to check everything and anything we produce because things can always go wrong –humans make mistakes all the time.

Since we assume that our work may have mistakes, hence we all need to check our own work. However some mistakes come from bad assumptions and blind spots, so we might make the same mistakes when we check our own work as we made when we did it. So we may not notice the flaws in what we have done.

This is when Cigniti technologies comes into picture. Cigniti is an expert in software testing with the latest technology and trained workforce to get the job done.

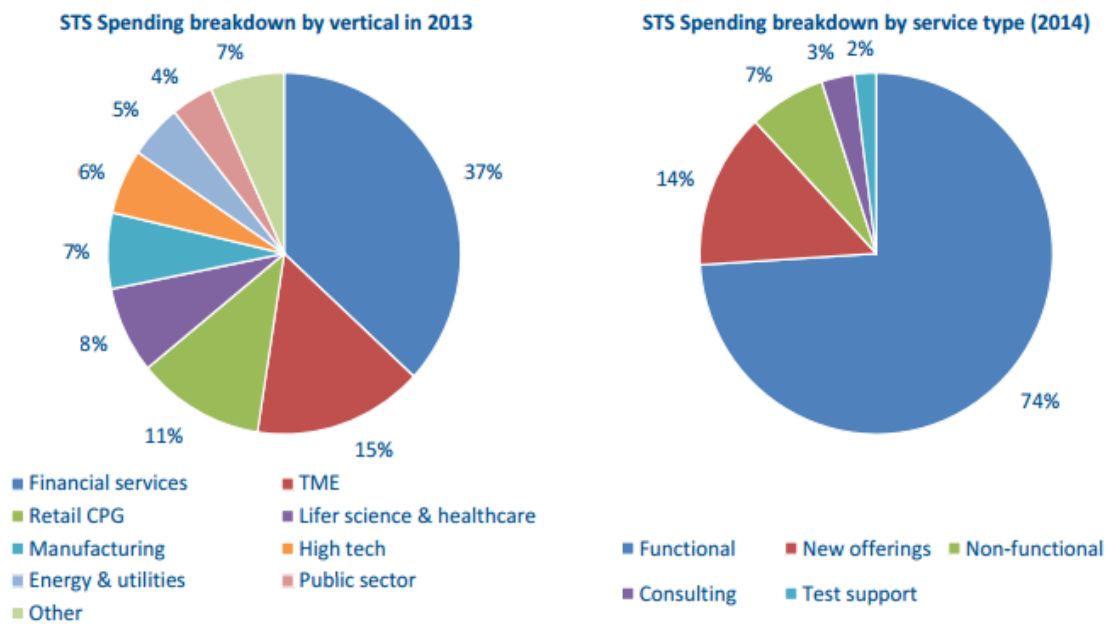
Testing is also important to stay ahead in the business. In this ever changing world, the only way to have an edge over others is to stay a step ahead in technology. For example if a company makes a mobile app for itself, it obviously does a lot of marketing of the same. If the app is not tested properly by the third party and if there are any errors which goes undetected, then company will not only bear a loss financially but will also lose its prospective customers.

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Growth Prospects

Larger Opportunity Size

STS	2013	2014	2015	2016	2017	2018
Spending (\$bn)	14.0	15.7	17.7	20.0	22.6	25.6
Growth (%)	7	12	13	13	13	13



A shift from TTS(In-house Testing) to STS(Testing by an expert) because...

A pure play testing providers offers clients independence and is able to deliver the full life cycle of testing services

- Pure play providers can work with clients on deals ranging from a few to several hundred projects
- Good fit for specialist skills, smaller projects, or country-or industry-specific skills and for their often flexible and nimble approach.
- By 2016,40% of enterprises will make proof of independent security testing a precondition for using any type of cloud service.

Going forward larger and longer contracts in third party testing is going to be a trend.

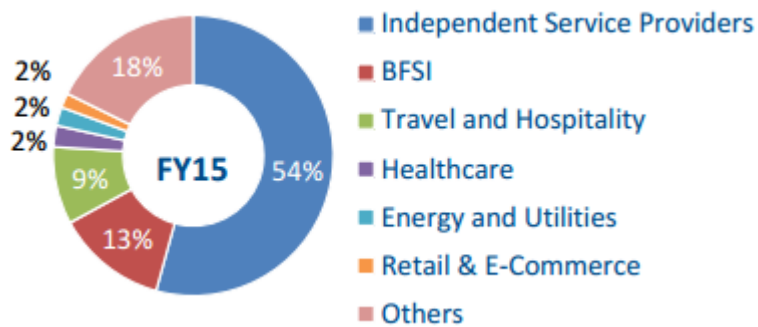
Fast Grower Company

In 2013, the company acquired Gallop Industries with revenues of around \$9 million. After this acquisition they have not looked back. These takeovers help them to bid bigger orders worth \$1 million or more from Fortune 500 and global 2000 companies. The company already has about 170 clients in 13 countries, including close to 40 from Fortune 500 and global 2000 clients.

The strategy now is to get to serve 100 global 2000 clients that have budgets of \$2-3 million each for software testing so that we get to \$300 million by 2017/18 -Management

[Click Here](#)

Cigniti works broadly in following verticals:



Geographical Revenue break-up

Geography	% of FY15 revenue	Key Clients
North America	91%	Heartland Inc, Payment South West Insurance, Freeman Airlines, Expositions Co., Alfa Synovus Financial Corp
Europe	2%	Optos Plc, WorldRemit, Anatwine Ltd., GSK Maxinutrition, Kingfisher IT Services (UK) Ltd.
India	2%	Broadcom, HP, NCR, Sapient, Magma
Rest of the world	5%	Napier Healthcare, ICE Information Tech., The Talent Exchange (Pty) Ltd, Quickflix, N3V Games

Does it have a competitive advantage?

Cigniti is the third largest global player in software testing .

STS Pure-Plays: SQS, QualiTest and Cigniti Lead			
Rank	Vendor	Est. 2013 STS Revenues (\$m)	Market Share (%)
	SQS PF (incl. Thinksoft)	330	2
1	SQS (actuals)	310	2
2	QualiTest	80	2
3	Cigniti	37	1
4	Planit	35	0
5	MTP	30	0
=	Insparit	30	0
=	Thinksoft Global	30	0
8	MavericSystems	20	0
=	Imbus	20	0
=	RTTS	20	0
=	QA Infotech	20	0
Total top 10		632	5

Cigniti has a competitive advantage as it has niche products with strong customer base. Cigniti being the leader, it shall not be affected by peer competition.

Risks to Cigniti –

- 1) No large durable Competitive Advantage
- 2) Automation in software testing may automatically find errors for free
- 3) The company has to upgrade continuously in technology to have an edge over its competitors. Management plays an important role in development of technology.

Comparing 9M financials yoy

- Income grew to Rs. 433 crores up by 65%
- Employee cost increased considerably to 232 crore up by 42%
- Bottomline grew to 36 crores up by 47%

The company is surely adding employees to support its growing business which ensures growth in the business.

Balance sheet financials: FY13 to FY15

INR mn		FY13	FY14	FY15
Share capital	Company is diluting stake by raising more share capital	188	208	247
Reserves and surplus		370	874	2,443
Share application money		-	42	-
Shareholder's fund		559	1,124	2,691
Long Term Borrowing		10	4	48
Deferred tax liabilities (net)		7	8	3
Long term provision		3	9	14
Non-current liabilities (including short-term debt)		20	22	66
Short term borrowings		186	252	383
Trade payables		122	129	360
Other current liabilities		0	127	90
Short term provisions		101	195	251
Current liabilities		409	703	1,084
Total Liabilities		988	1,849	3,841
Fixed assets	Company's investments have increased considerably	418	786	1,262
Long-term loans and advances		46	188	160
Other non current assets		2	3	3
Non-current assets		467	976	1,425
Trade receivables		401	639	1,347
Cash and bank balances		20	57	339
Short term loans and advances		94	144	668
Other current assets		6	33	62
Current assets		521	873	2,416
Total		988	1,849	3,841

Peer Comparison:

SQS Software Quality Systems AG, the world's leading specialist in software quality, acquired a majority stake in Thinksoft Global Services Ltd, the world's fourth-largest software tester. This Acquisition happened at 1.7 times sales, 3x Book value and 15 PE multiple in 2013.

The only listed player in software testing is SQS BFSI where SQS is the global market leader. Let us compare both of them to understand the valuations of these companies.

SQS (global) has an operating margin of 4% (a lot lower than Cigniti's margin of 10%) because expensive employee cost. India holds a competitive advantage due to cheaper employee cost.

SQS BFSI India has got better margins than Cigniti. Cigniti's margins have taken a hit in FY15. The company is on expansion mode eyeing bigger clients and more contracts from the current clients hence more room for margin expansion.

	Sales	OPM	NPM	Market Cap	P/E
Cigniti Tech	379 crores	9.95%	6.62%	1039	25
SQS BFSI	214 crores	19.41%	11.53%	947	34

About Cigniti

Cigniti Technologies Limited is an India-based company engaged in software testing business. The Company operates in Testing Services segment. The Company offers a range of services, which include test the cloud, test offerings on cloud, mobile testing, big data testing, test advisory services, functional testing, automation testing, performance testing, regression testing, compatibility testing, globalization testing, security testing and game testing.

It also offers SMART tools, such as Static Requirements Analyzer, iGenerate Test Scenarios, Test Optimizer, Web Services Validator, Automation accelerator Kit, Performance Analyzer and Cigniti TestCloud. The Company serves global companies across the United States, Europe, Australia, New Zealand, Middle East, South East, Asia, India and South Africa.

Conclusion

We believe that there is massive opportunity in the testing business and Cigniti has shown that the management bandwidth required reach new scale.

Year	Mar-13	Mar-14	Mar-15
Sales(cr.)	151	249	379

The company is growing at great speed and we believe that 30%+ growth rate is sustainable to the next few years. It is difficult to value this fast growing business as no one actually knows when this growth will stop. The company did 151 crores of revenue in December 2015 quarter and is growing 5% quarter over quarter for last many quarters. We believe the company will do Rs. 600 Cr of revenue in 2016 with an EPS of about Rs. 21. The company is trading at 20 times FY 2016 which is reasonable for a fast growing business.

Vamsheedhar Chennamaneni (promoter of Kaveri Seeds has bought 2 lakh shares of Cigniti @473 per share. [Click Here](#)

Growth companies have to be reviewed every Quarter. We like this fast growing software testing company who is increasing marketshare for the next 1-2 years.

Disclosure – No Position

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