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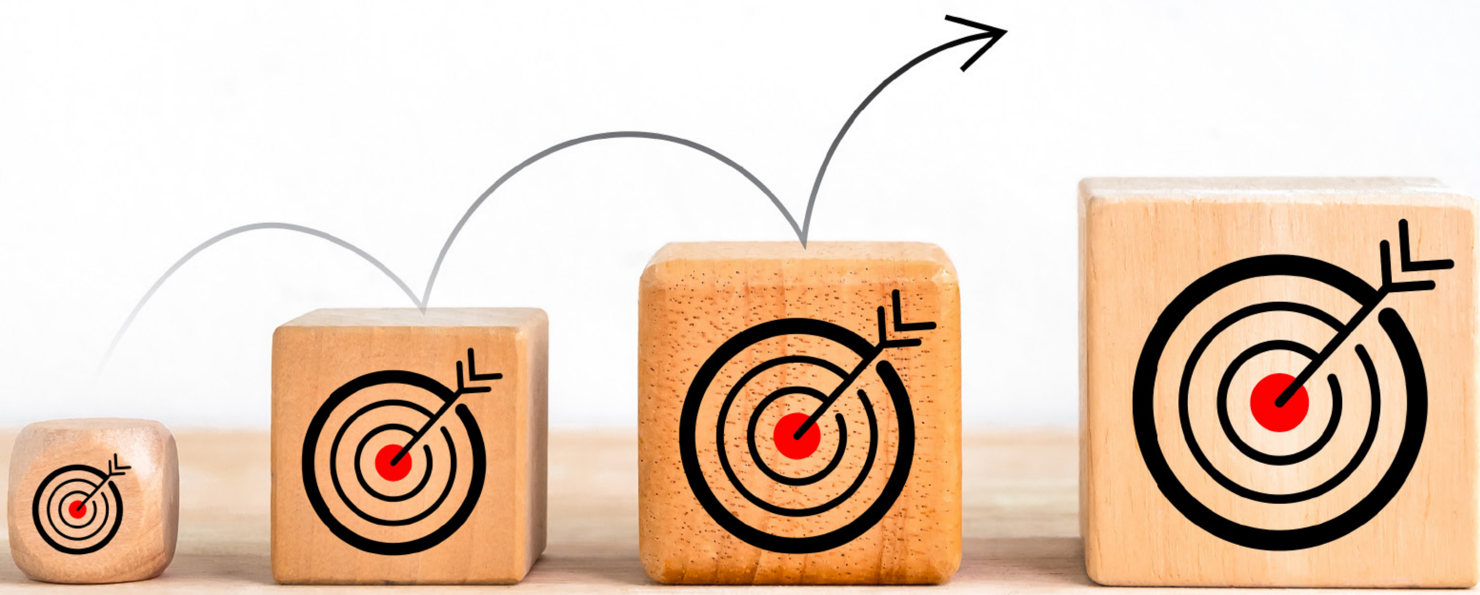
THINK 'MICRO', WIN BIG:
DISSECTING THE RISE OF SMID IT

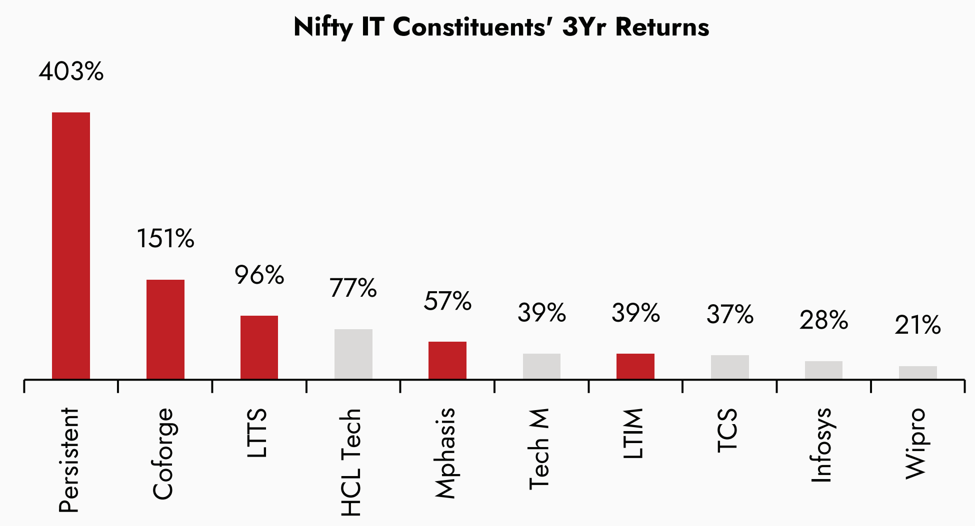


MONTHLY NEWSLETTER • MARCH '24

Dear Patron,

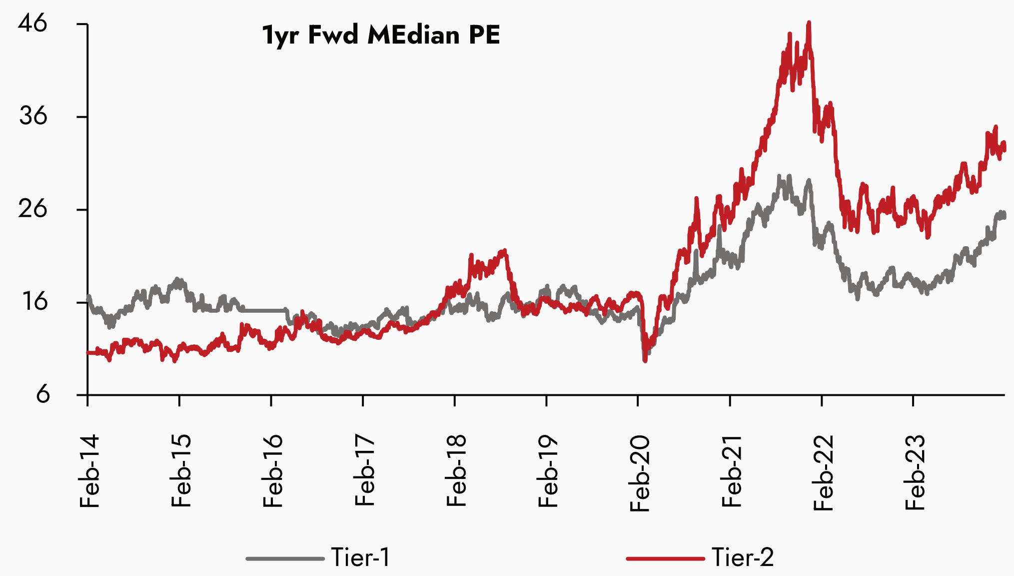
Our **January 2024 newsletter** covered the fundamental changes that led to a significant rally in the small-caps and why we believe this rally is here to stay despite premium valuations relative to historical averages. This month, we go more micro and deep dive into IT industry which has witnessed a similar divergence. Among the IT services industry, Tier–2 companies (LTIMindtree, Coforge, Persistent, Mphasis) have outperformed the larger, Tier–1 companies (TCS, Infosys, HCL Tech, Wipro, and TechM) in returns across the last 3 years.

Exhibit 1: Over the last 3 years, 4 of the Top-5 performers in CNX IT are Tier–2 companies ...



Source: Ambit Asset Management, investing.com, Prices as of 29th February 2024

Exhibit 2: ...and their PE multiple is now at a premium to Tier- 1 companies



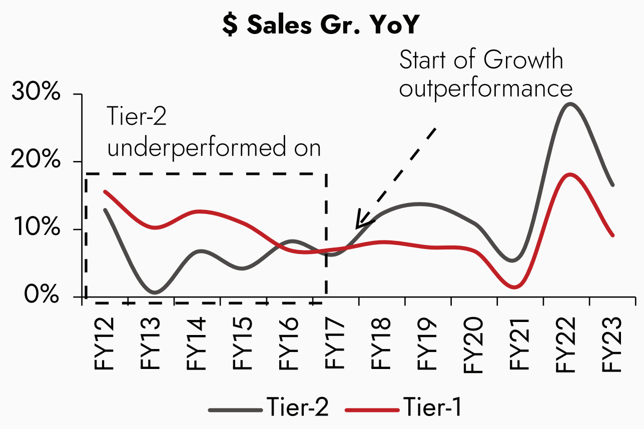
Source: Ambit Asset Management, Bloomberg
Note: Tier-2 is median of LTIM, Coforge, Persistent and Mphasis. Tier-1 is median of TCS, Infosys, HCLT, Wipro and TechM.

Conventional wisdom would allude this outperformance to the overall rally in the SMID space as the valuations of Tier–2 have also jumped up sharply as compared to their Tier–1 peers. We beg to differ here; valuation re-rating is an outcome not the cause of the outperformance.

TIER-2 COMPANIES HAVE BEEN GROWING MUCH FASTER THAN TIER-1!

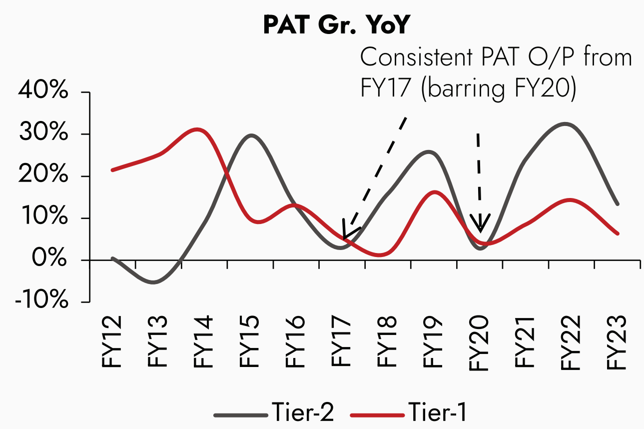
Tier–2 companies have consistently O/P Tier–1 on sales as well as PAT growth – not just post-COVID but pre-COVID as well.

Exhibit 3: T2's revenue O/p over T1 started from 2017...



Source: Ambit Asset Management, Company
Note: Tier-2: LTIM, Coforge, Persistent, Mphasis.
Tier-1: TCS, Infosys, HCLT, Wipro and TechM.

Exhibit 4: ...and this has translated into PAT as well



Source: Ambit Asset Management, Company
Note: Tier-2: LTIM, Coforge, Persistent, Mphasis.
Tier-1: TCS, Infosys, HCLT, Wipro and TechM.

But the question to ask is why is this happening? What are the factors behind it and more importantly, is this sustainable, as conventional wisdom would imply that Tier–1 or larger companies would be much better off during a slowdown (FY23, FY24) as they are bigger beneficiaries of vendor consolidation and cost take-out deals.

WHY TIER-2 COMPANIES ARE GROWING FASTER?

As is the case with many industries, the new entrants/smaller players often capitalize on the inefficiencies or shortfalls of the incumbents. They target specific gaps to get a foot in the door with clients and expand from there onwards. This trend is evident in the IT services sector as well where Tier–2 companies have expanded on their capability or niche and capitalized on client's fatigue with Tier–1 providers that operated largely on (prioritized) scale. The Tier–2 companies that **(1)** Operated in a niche and mastered that, and **(2)** Hired the right 'Captain' to lead the 'Ship' have seen outsized gains. Let's delve further into these –

1. Carving and capitalizing on their niche –

A key differentiator between T1 & T2 companies lies in their respective emphasis on scale and capability. T2 companies have deliberately selected and operated within specific niches, maintaining a sharp focus and cultivating deep expertise in these areas. These niches often include areas that T1 companies didn't heavily invest in given the lower Addressable Market (TAM), as that would not have created a significant delta on the T1's large base.

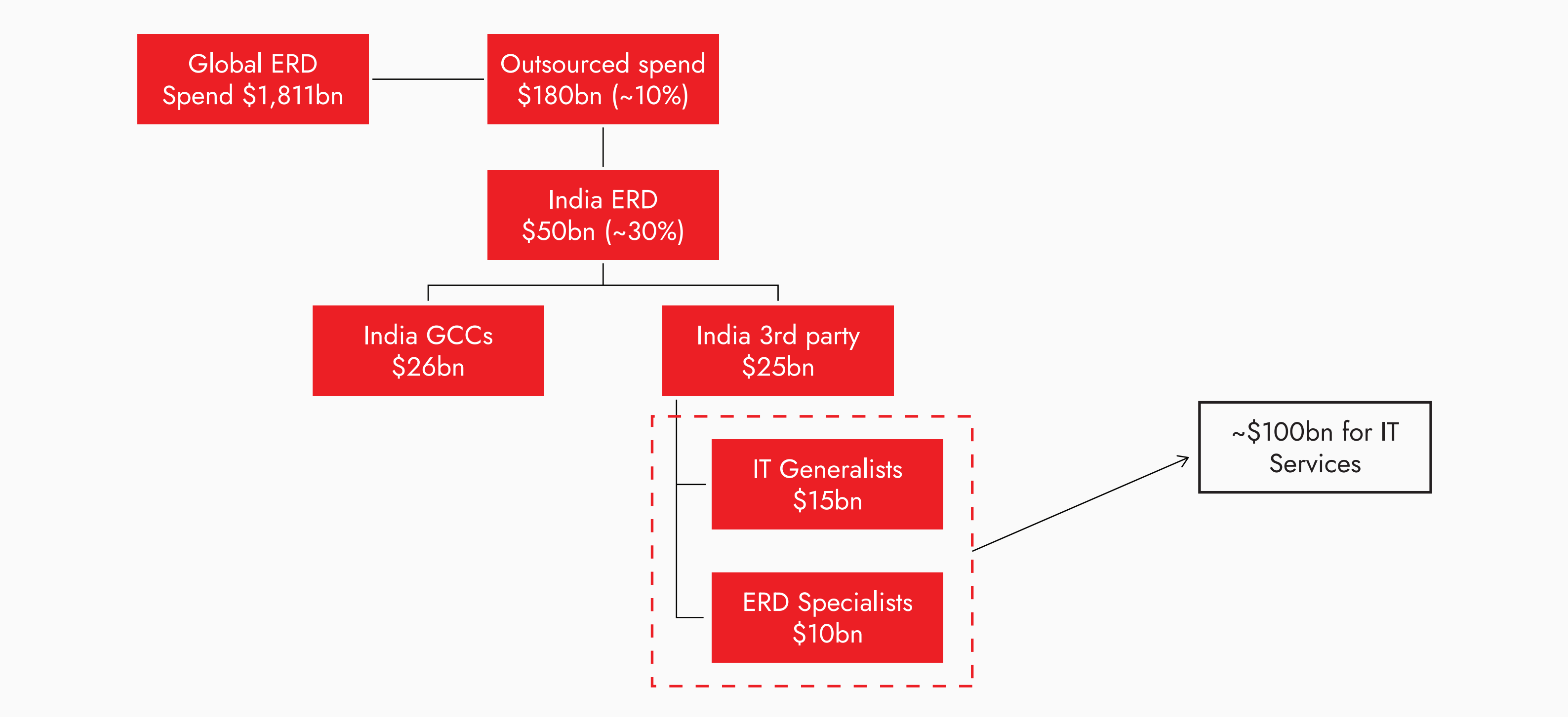
a. **Domain-specific ER&D capability** – While the overall Indian ERD industry is ~$50bn, the highly technical nature of various sub-verticals within, vis-à-vis IT services, implies a much more fragmented TAM **(Refer Exhibit: 6)**. Furthermore, innate intricacies such as deep domain knowledge, limited outsourcing, volatile R&D spends and onsite-centric workflow **(Refer Table)** imply lumpy ERD revenue. Large Indian System Integrators (SIs) also offer ERD services, but their approach is typically broader compared to pure-play ERD companies such as Cyient or KPIT Tech, which possess deep domain-specific expertise in their respective verticals of Aerospace/Defence and Auto. This niche focus and domain expertise foster sticky client relationships and impede new entrants. While their growth has been uneven, reflecting the underlying industry macros, these investments have positioned them well to capitalize on industry upcycles as seen in the case of KPIT, which is benefiting from rising R&D spending in Autonomous Driving and EVs **(Refer Exhibit: 14, 15)**.

Exhibit 5: ER&D market size is much more complex than IT Services

IT Services		ER&D
$125bn	**Industry Size (India)**	$40bn
Low	**Customer Stickiness**	High
3x of ERD proportion	**Outsourcing**	7-9%
Less Cyclical and volatile as compared to ERD	**Cyclicality**	Vertical concentration implies higher cyclicality
Lower number. Majorly seen as competitors	**GCC (Global Captive Centres)**	Higher number. Can be collaborators with service provider
Less Onsite presence as compared to ERD	**Offshoring**	Higher Onsite presence; Diversified across Japan, S.Korea, China, implying language barriers
Largely RFP/RFQs and larger in size ($25M+)	**Deal Structure**	Smaller deal sizes ($5M+) and duration
Global delivery model, competitive rates, resource capabilities	**Win Factors**	Knowledge Assets (IP/Solutions), R&D Infrastructure, Innovative Engagement Models

Source: Ambit Asset Management

Exhibit 6: The Indian ERD market is not large enough vis-à-vis IT Services for Tier-1 to focus on



Source: Ambit Asset Management, Industry Data, Tata Technology RHP

Exhibit 7: KPIT and Cyient work with top clients in ERD

Source: Ambit Asset Management, Company

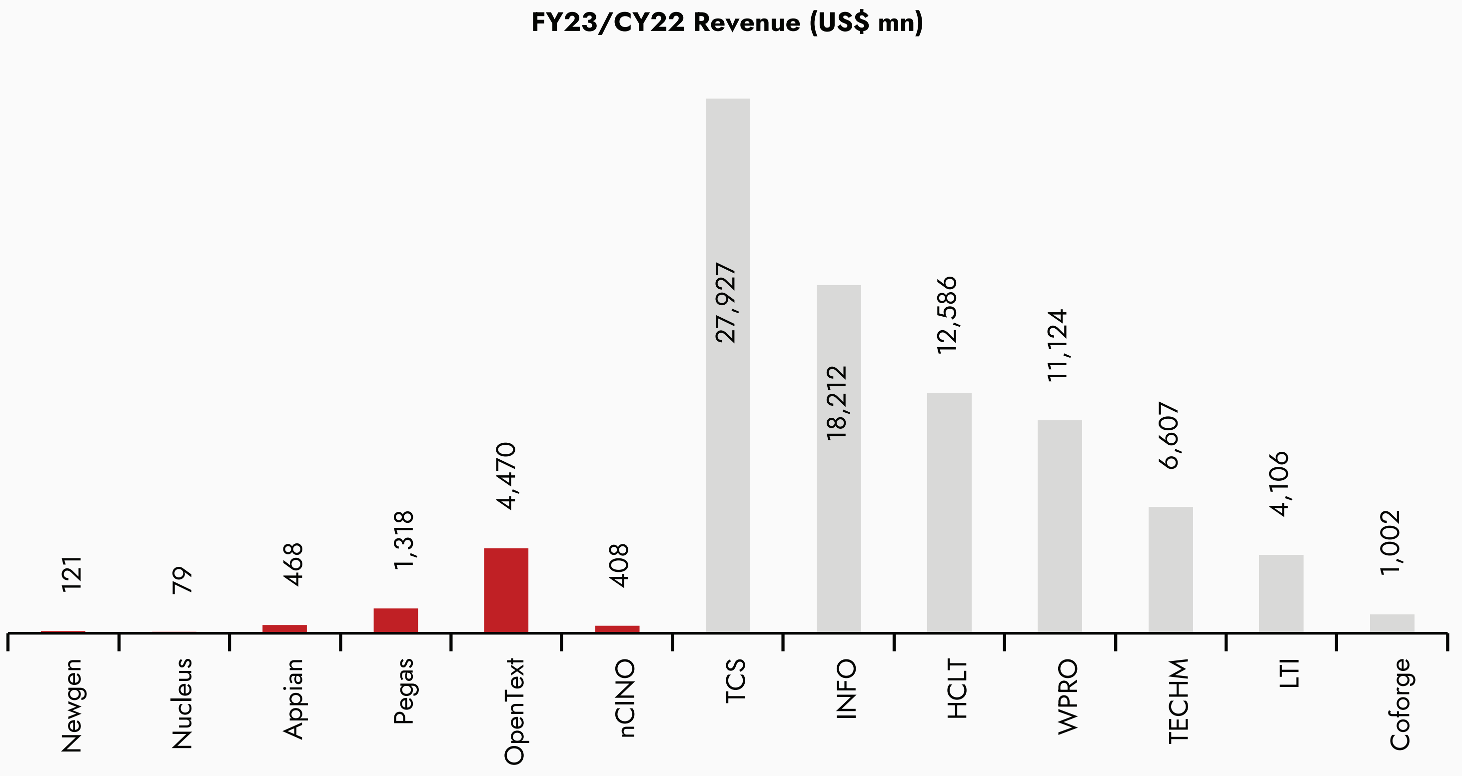
b. **Presumably 'Edge' product companies** – Founded in 1992 and listed in 2018, Newgen Software helps organizations digitize complex content-driven workflows through its products and platforms. These solutions facilitate, for example, digitalizing account opening forms or loan origination for clients like ICICI Bank. While this offering may not be considered core or mission-critical like Core Banking Software, Newgen has achieved remarkable success through disciplined execution and Go-To-Market (GTM) strategies. Newgen has implemented multiple GTM strategies to target clients, particularly in mature markets. One such strategy involves partnering with large Global System Integrators (GSIs) **(Refer Exhibit: 8)** to gain access to large clients in mature markets, which would have been challenging organically given Newgen's modest revenue base **(Refer Exhibit: 9)**. This partnership benefits both GSIs and Newgen, saving GSIs from investing in a smaller segment, while providing trust and helping Newgen penetrate large enterprises.

Exhibit 8: Newgen has partnered with leading GSIs which has helped the company make inroads with large clients...

Partner Type	Partners
Global System Integrators	Coforge, Cognizant, HCLT, Infosys, LTI, NCS, TCS, TechM, Wipro
Consulting Partners	Accenture, BCG, Capgemini, Deloitte, KPMG, McKinsey & Company, PWC
Technology Partners	Amazon, IBM, Microsoft, Redhat, Oracle, SAP
Vertical Domain partners	Sopra and Mambu
ISVs	Digital Imaging and Scanning International

Source: Ambit Asset Management, Company

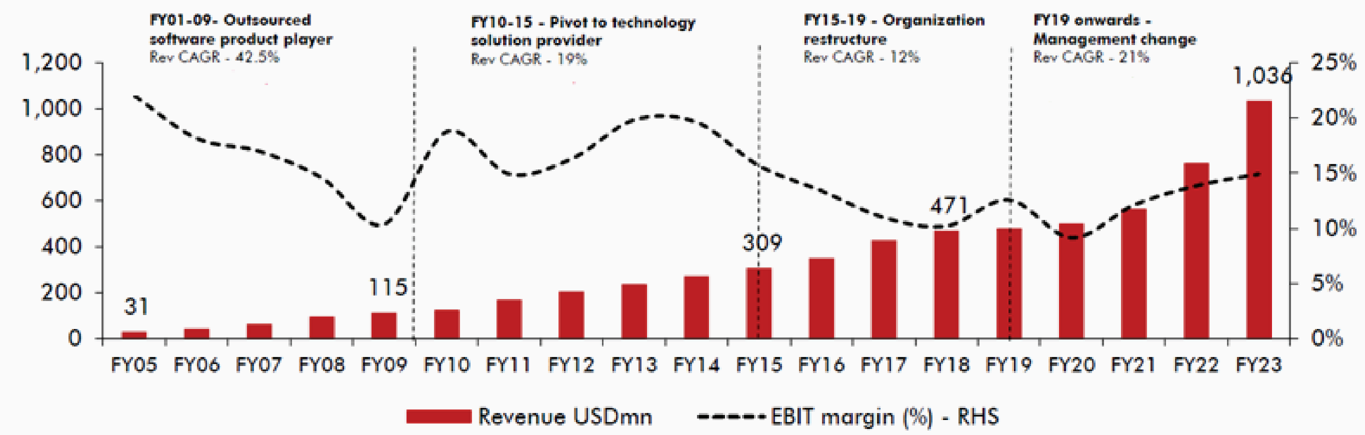
Exhibit 9: ...which would have been difficult organically given the small revenue base



Source: Ambit Asset Management, Compay, Note: Red color are peers, Grey color are SI partners

c. **From niche Software Product Engineering to Digital IT Services** – Persistent's (PSYS) origins as an Outsourced Product Development (OPD) company working with Independent Software Vendors (ISVs) such as IBM and Microsoft, helped develop new technology capabilities over the years. PSYS was one of the first Indian IT companies to focus on Digital / SMAC (Social, Mobility, Analytics and Cloud) based technologies as early as 2008 – much before Gartner (2012) and biggies like TCS and Cognizant. PSYS leveraged its relationship with ISVs to implement those software products at the client's end, thus gaining a foot-in-the-door with enterprise clients and pivoting to a Technology Solutions Provider. Thus, PSYS was able to extend its product engineering prowess and tech-led approach to provide solutions to enterprise clients. While this process has not been without hiccups, it has been much smoother since Sandeep Kalra took over as the CEO. PSYS is amongst the few mid-Tier companies rated as a challenger in the public cloud and Salesforce services.

Exhibit 10: PSYS has undergone multiple pivots since inception; transitioned from a pure OPD player to digital services player with smoother sailing since the current CEO joined in 2019



Source: Ambit Capital research, Company

Exhibit 11: Persistent has mastered its niche – it is ranked as a leader in software product engineering. Even with low-code platform providers, PSYS has the highest certifications among all Indian SIs in OutSystems, a leader in low-code platforms

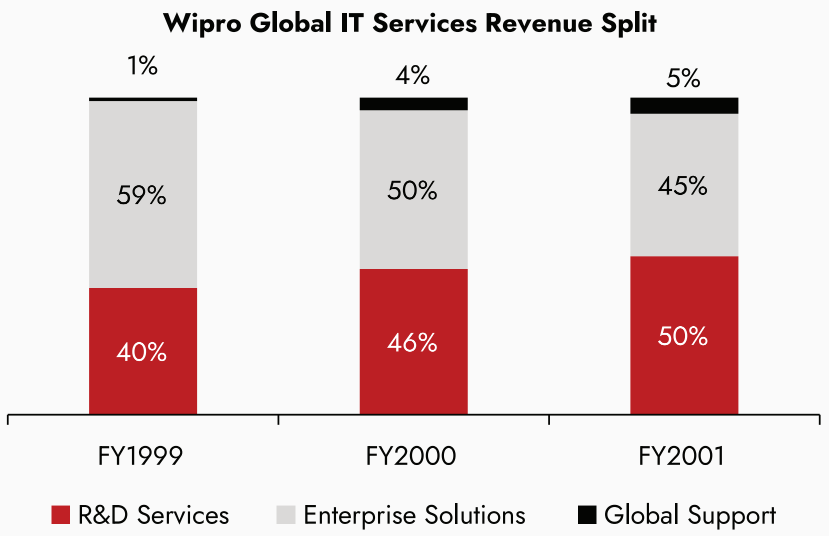
Services	PSYS	MPHL	LTIM	Globallogic	Globant	EPAM
Software engg services, BFSI	Leader	Challenger	Challenger	Challenger	Challenger	Challenger
Software product engg. services	Leader	Challenger	Challenger	Leader	Challenger	Leader
Software engg. services, Healthcare	Leader	Challenger	Challenger	Leader	Challenger	Challenger
Software platform engg.	Leader	Challenger	Not Participated	Not Participated	Not Participated	Not Participated
Consumer software engg.	Leader	Leader	Not Participated	Not Participated	Not Participated	Not Participated
Enterprise software engg.	Leader	Challenger	Not Participated	Leader	Not Participated	Not Participated

Legend: Leader, Challenger, Not Participated

Source: Ambit Asset Management, Everest Group, Zinnov

Additionally, there are several other smaller IT service providers (beyond T-2) specializing in niche areas that have exhibited decent execution **(Refer Exhibit: 13)**. Even within T-2, companies like Coforge and LTIM standout for their alliance with Guidewire and Snowflake, respectively which is one of the strongest in the industry. Success for these companies doesn't hinge on groundbreaking technology which T1s can't execute or replicate. The key differentiators lie in agile and focused execution, combined with the ability to scale those capabilities to a size that significantly impacts their bottom line. Wipro, for eg, was an early mover in the ERD space **(Refer Exhibit: 12)**. In FY05-06, it made three ERD services acquisitions around semi-conductors and PLM services, which was followed by a lull for 13 years. Another example is HCL Tech, whose ERD vertical is ~4x of KPIT Tech. However, it constitutes merely ~16% of HCL Tech's overall revenue.

Exhibit 12: Wipro was talking about R&D services as early as the 2000s which formed ~50% of its Global IT services



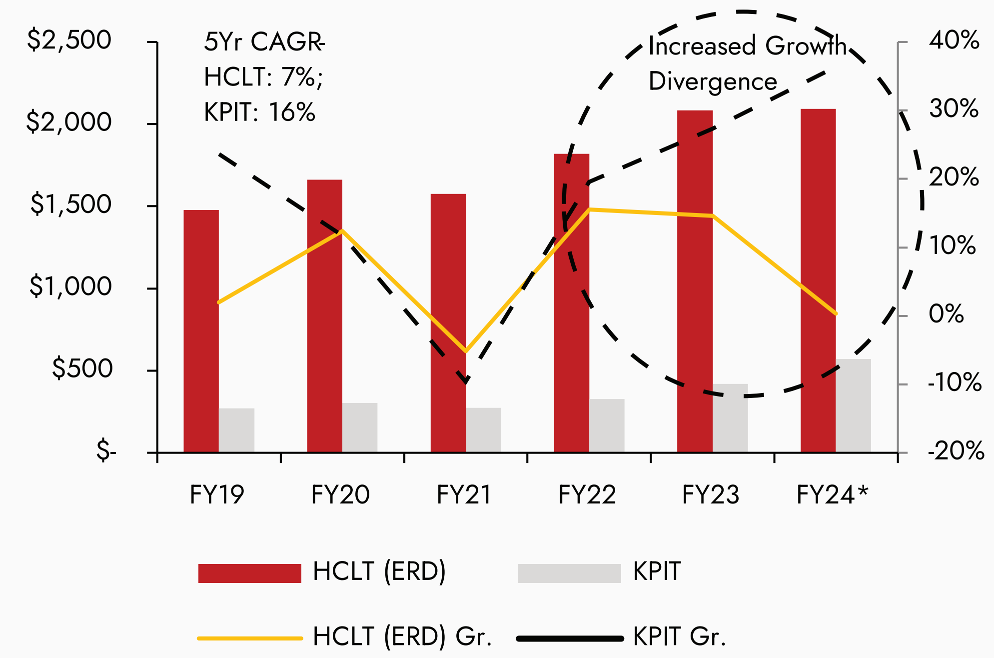
Source: Ambit Asset Management, Wipro Annual Report

Exhibit 13: Some of the smaller companies operating in a niche segment / offering

Company	Key Offering / Strength	Company	Key Offering / Strength
Mastek	UK Public Service / Oracle	Tata Tech	Auto ERD (Mechanical)
Cigniti	Software Testing Services	Netweb Technologies	High-end Computing Solutions (HCS) Provider
Rategain Travel	Travel / Hospitality solution	Accelya Solutions	Airline / Transport Industry
Firstsource / eClerx	BPO / KPO	Nucleus Software / OFSS / Intellect Design	Banking Product
Newgen Software	Product (Content / Workflow automation)	KPIT Tech	Auto ERD
Sonata Software	Microsoft Technologies (Dynamics)	Latent View	Data / Analytics

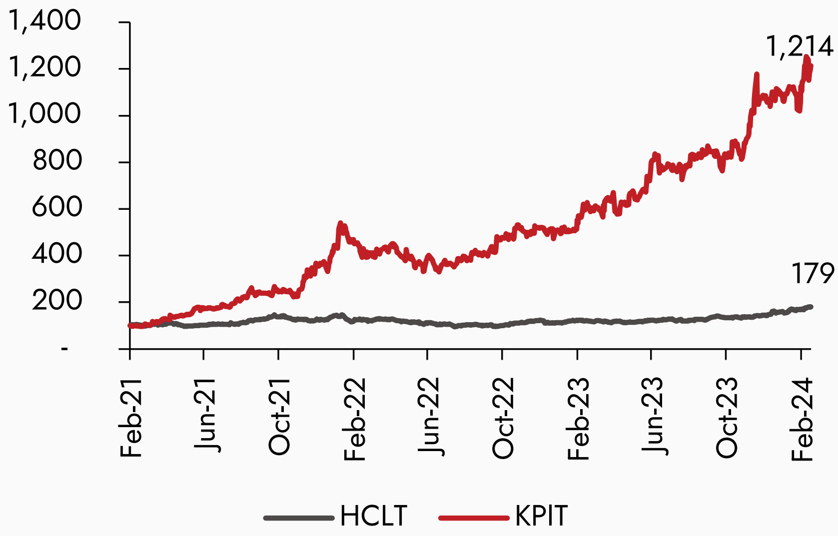
Source: Ambit Asset Management, Company

Exhibit 14: KPIT's focus on fast-growing Auto ERD vs HCL's lack of focus (lower growth) ...



Source: Ambit Asset Management, Company

Exhibit 15: ...led to significant shareholder returns in KPIT (>600% outperformance over 3 yrs)



Source: Ambit Asset Management, ACE Equity

The importance of these niche offerings was exacerbated by decentralized decision-making by clients. In the early days of the IT industry, tech spending decisions by clients were concentrated in a few roles, such as a CEO or a CTO. However, as the nature of services evolved and technology became more critical to organizations, with new use cases emerging across departments, decision-making became increasingly decentralized. Subsequently, the tech budgets got bifurcated into multiple smaller buckets. It was no longer just the CEO or CTO allocating the entire tech budget of the firm, but also the CMO, CIO, and various department heads. Rising empowerment at the clients' end lead to increasing budgetary allocation towards specific domains which required domain expertise; these are the areas where Tier-2 companies thrive.

While it is true that size begets size, but larger size brings in its innate challenges and complacencies which are not unique to IT Services, and make it difficult to adapt to change. These Tier–2 companies may also face these challenges, but they have a long way to go as some of these are still ~$1bn in revenue, implying ~4% of the largest Indian company TCS (~$28bn revenue).

2. Right 'Captain' to steer the 'Ship' –

The influence of leadership in transforming the fortunes of a company, across industries, is undeniable. The magnitude and speed of the same however may vary. In certain industries, even a mediocre leader may not significantly affect business moats (e.g., exchanges like NSE), while in others, even exceptional management can struggle to overcome deep-rooted challenges (e.g., airlines). Within the people-centric realm of IT services, the impact of leadership is notably profound and swift.

Over the last few years, there has been a major rejig in Tier-2 leadership. Current CEOs of many Tier–2 and smaller IT companies have previously held senior leadership roles with T1 companies **(Refer Exhibit: 17)**, where they had P&L responsibilities. These T2 CEOs have strong relationships with their previous clients across CXO levels, thus leveraging the above two industry shifts. They were able to capitalize on the increasingly decentralized nature of tech-spends by clients. Clients typically won't drop their engagement with an incumbent solely because a senior executive has switched firms. However, these T2 CEOs can often secure an opportunity to showcase their capabilities (providing proactive solutions), poach key account managers from their former organizations, and gain a foothold with these clients; potentially expanding their market share. We highlight some key steps taken by these leadership changes that altered the fortunes of their respective Tier-2 companies –

Exhibit 16: Most senior management exits of Infosys during the 2014-15 CEO transition ended up joining Tier- 2 companies

Name	Designation at Infosys	Date	Tenure	Joined after Infosys	Current Organization / Role
Ashok Vemuri	Head of Americas	Aug-13	14 yrs	iGate	Multiple Consulting roles
V Balakrishnan	Head of BPO, Finacle & India BU at Infosys	Dec-13	22 yrs	Tejas	Multiple roles
Basab Pradhan	Head of Global Sales & Marketing	Jul-13	10+2 yrs	Hexaware	Non-exec Chariman, Coforge
Chandrashekar Kakal	Sr. VP & Head - Global Delivery	Apr-14	15yrs	LTI, Ramco group	Consultant
Prasad Thrikutam	Head of Energy, Utilities, Comm. & Services	Jun-14	19 yrs	Dell, Birlasoft	Various sr. leadership roles
Subrahmanyam Goparaju	Sr. VP and head of Infosys Labs	Dec-13	26yrs		
Stephen R Pratt	Managing Partner - Worldwide Consulting & SI	Nov-13	10 yrs	TPG, IBM	Multiple roles
BG Srinivas	Head of Delivery Excellence	Jun-14	15yrs	PCCW group	Advisor, PDS Ltd
Gautam Thakkar	MD - Infosys BPO	Nov-14	14 yrs		
Sanjay Jalona	Global Head of Engg and Mfg	Jul-15	15yrs	LTI	Multiple roles

Source: Ambit Asset Management, Company, LinkedIN

Exhibit 17: Almost all of the current CEOs of Tier–2 IT companies have had leading roles at Tier–1s some point in time

Company	CEO Name	Joining	Previous Firm	Role at previous firm
Coforge	Sudhir Singh	May-17	Infosys, 9 years Genpact, 7 yrs	Global Head - BFSI Payments and Cards Practice (Infosys) COO - IT services and Capital Market (Genpact)
Birlasoft	Angan Guha	Dec-22	Wipro, 29yrs	CEO - Americas
Zensar	Manish Tandon	Dec-22	Infosys, 20yrs	Exec VP - Healthcare, LS, Insurance and HiTech
LTIMindtree	Debashis Chatterjee	Nov-22*	Cognizat, 15yrs# TCS, 7yrs	EVP and President, Global Delivery and Digital Systems and Tech
Mphasis	Nitin Rakesh	Jan-17	Syntel, 6+4 yrs	President and CEO
Sonata Software	Samir Dhir	Apr-22	Virtusa, 12Yrs Wipro, 7yrs	CEO - Global Markets & Industries (Virtusa) VP and Practice Head, SAP
eClerx	Kapil Jain	May-23	Infosys, 23yrs	Exec VP, Global Head of Sales & Enterprise Capability, Infosys BPM
Mastek	Hiral Chandrana	Jul-21	Wipro, 13yrs	Sr. VP & Global Head - Business Applications & Digital Services
Firstsource	Ritesh Idnani	Sep-23	TechM, 5yrs Infosys, 13yrs	President (TechM) Sr. VP and COO (Infosys)
Persistent Systems	Sandeep Kalra	Oct-20	Harman, 4yrs HCL Tech, 14 yrs	SVP, GM (Harman) VP, Healthcare and EM (HCL)

Source: Ambit Asset Management, Company, LinkedIN

(i) **Strengthen the senior management hires** – Tier–2 CEOs, upon their appointment, strategically enhanced their leadership teams. For instance, by the 4th year of Sudhir Singh's reign (2021), 11 of the 12 direct reportees at Coforge were recruited from Tier-1 companies, thus underscoring a focus on scalable management expertise. Even at a level below the direct reportees, ~60% were new people with strong Tier–1 backgrounds. Additionally, a key factor contributing to COFORGE's success was relocating leadership to markets (such as the US and EMEA) closer to customers.

Exhibit 18: Under Sandeep Kalra, PSYS too has followed the strategy of strengthening below CEO management

Name	Designation	Joining	Role at previous firm
Debashis Singh	CIO	Oct-22	Mphasis - SVP & CIO
Gurvinder Sahni	CMO	Apr-23	Wipro – VP (Marketing & Analyst Relations)
Ayon Banerjee	Chief Strategy and Growth Officer	Oct-23	MD & Partner - BCG
Rajiv Sodhi	SVP - Hyperscaler Business & Strategic Alliances	Dec-23	Microsoft - Global GTM strategy
Barath Narayanan	Head - Global BFSI and Europe	Jan-24	Wipro - Global Head(Digital & Cloud)
Dhanashree Bhat	COO	Nov-23	Techm - Chief Delivery Officer (Telecom, Media, Tech)
Merlyn Mathew	Head, Delivery Excellence & Talent Management	Jan-22	COO – UBS Technologies India
Rajesh Gharpure	Chief Delivery Officer – Service Lines	Jan-23	LTIMindtree - EVP & Global Delivery Leader
Nitish Shrivastava	Head – Products Business	Jul-22	Harman -Sr Director of Engg
Ganesh Nathella	SVP – Global Lead HLS	Oct-22	Mindtree - Head of Health BU
Rahul Shrivastava	SVP- Hitech & ISV	Dec-20	Harman - VP Sales

Source: Ambit Asset Management, Company, LinkedIN

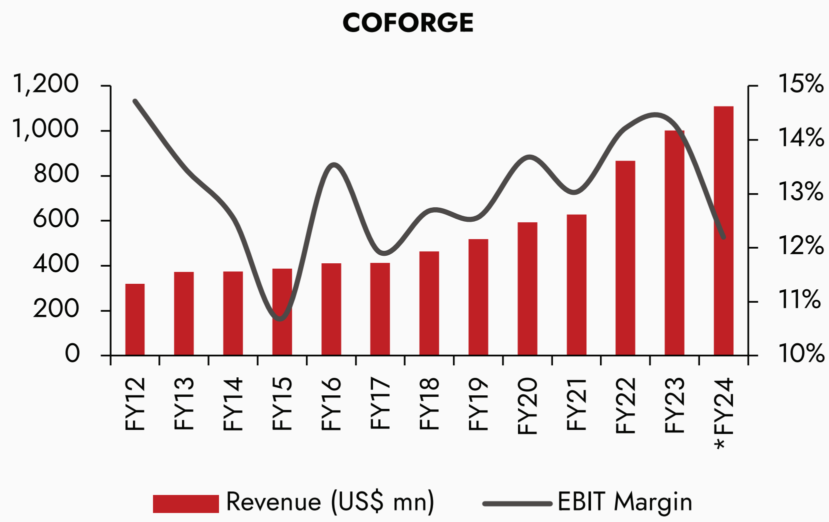
Exhibit 19: Samir Dhir (CEO) is also doing a similar thing at Sonata Software

Name	Designation	Joined From	Joined
Sathish Nuggu	SVP - Client Services Delivery Portfolio	Kfintech, Virtusa	Nov-22
Manu Swami	Head of Technology	Virtusa for 14 years, TCS 9 yrs	Feb-23
Santos Jha	Head of Sales, BFSI, US	Dell	Dec-22
Raghav Dave	Head of Sales, HLS, US	Virtusa 13yrs, TCS 3yrs	Apr-23
Suresh HP	Chief Delivery Officer	Mindtree 15yrs	Apr-23
Sharmila Sherikar	Sr. VP, Head - Corporate Development	Virtusa, 20yrs	Aug-23
Rajashekhara Tavarakere	Delivery Head, UK, Ireland & Europe	Coforge, Infosys, Mindtree	Jan-23
Anand Nair	Head of Sales, APAC	Regional Sales Manager for HCL	Sep-22
Murthy Mulugu	Head of IP Engineering		Jun-22

Source: Ambit Asset Management, Company, LinkedIN

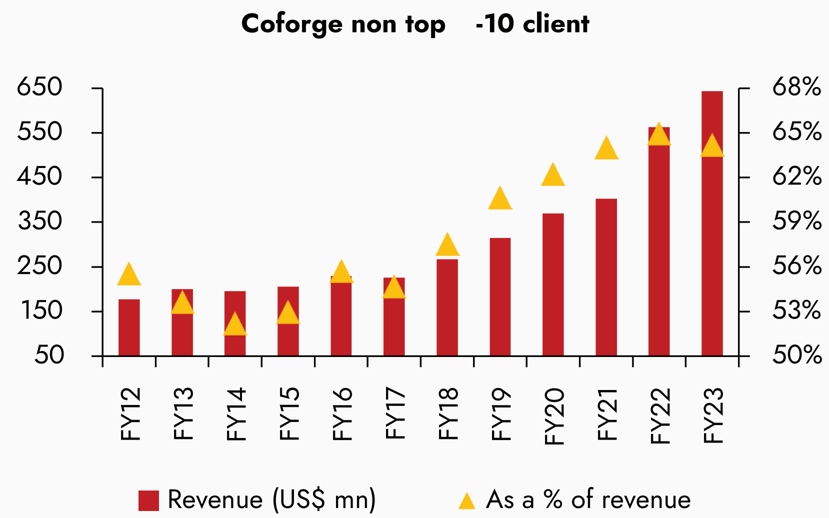
(ii) Aligning incentives – Whether it is Sudhir Singh (Coforge), Nitin Rakesh (Mphasis), or Sandeep Kalra (Persistent), each of the new leaders in Tier–2 companies focused on enhancing the Sales practice and aligning incentives accordingly **(Refer Exhibit: 24,25)**. These efforts were reflected in large deal wins and faster non-top-10 client growth **(Refer Exhibit: 21)**. Additionally, these companies were not afraid to invest in the business aggressively and grow, albeit at the cost of margin (improvement) in the near term **(Refer Exhibit: 20)**.

Exhibit 20: Coforge's absolute revenue has grown 2.7x since Sudhir Singh joined the company in 2017



Source: Ambit Asset Management, Company *9MFY24 annualized

Exhibit 21: Coforge's revenue from non-top-10 clients have grown 2.5x since Sudhir Singh took over



Source: Ambit Asset Management, Company

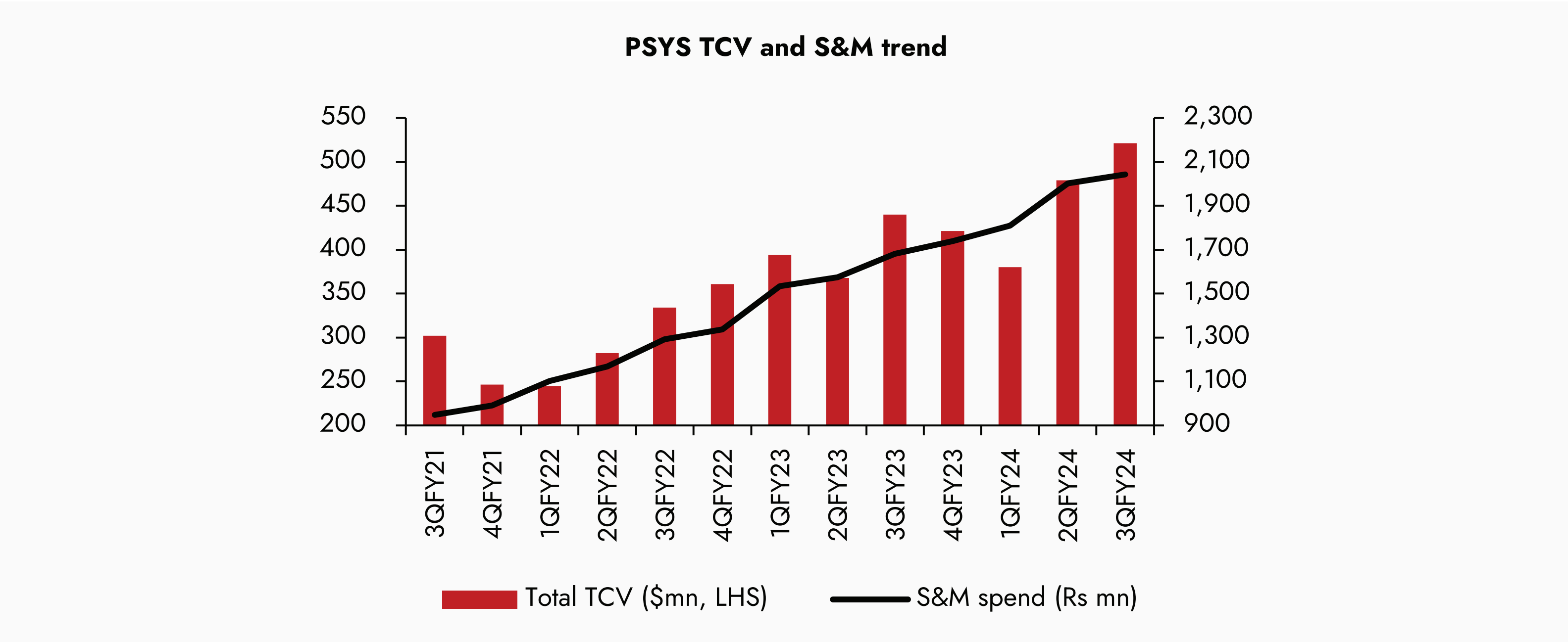
Persistent, for eg, underwent organizational restructuring to increase sales effectiveness and incentivize account mining:

- Sales and Delivery were better aligned. A new structure was rolled out to enable sales to cross-sell better and avoid turf clashes
- Sales team was incentivized on both revenue and bookings instead of just revenues in the past
- Incentives were increased for large deals
- ESOP schemes were better utilized to incentivize top leadership
- Created playbooks for large deals in the US$10-50mn TCV and above categories

Sudhir Singh at Coforge undertook the following steps:

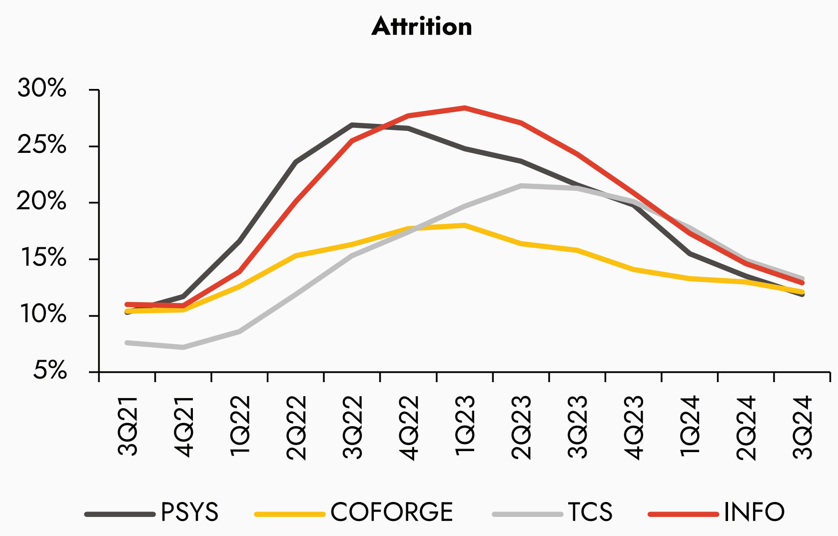
- ~4x sales commissions for getting large deals
- Equal weighted incentives across sales and margins for business unit heads
- Encouraging incentive structure to promote objectives, such as diversifying away from its top clients or growing clients to $20mn+ in relationship value; with account managers also eligible for bonuses similar to salespeople
- Early wage hikes during peak demand as well as bonus on $1bn milestone achievement helped curtail attrition not just in Sales but across organiziation.

Exhibit 22: PSYS's total TCV won over last 3 years (+73%) reflected higher sales spend (+115%)



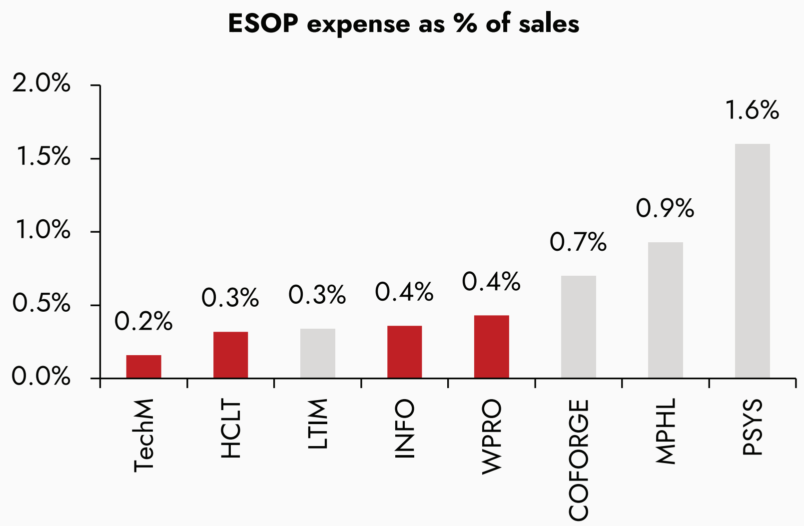
Source: Ambit Asset Management, Company

Exhibit 23: PSYS was the first to see attrition cool off in 3Q22, while Coforge has seen the least volatility



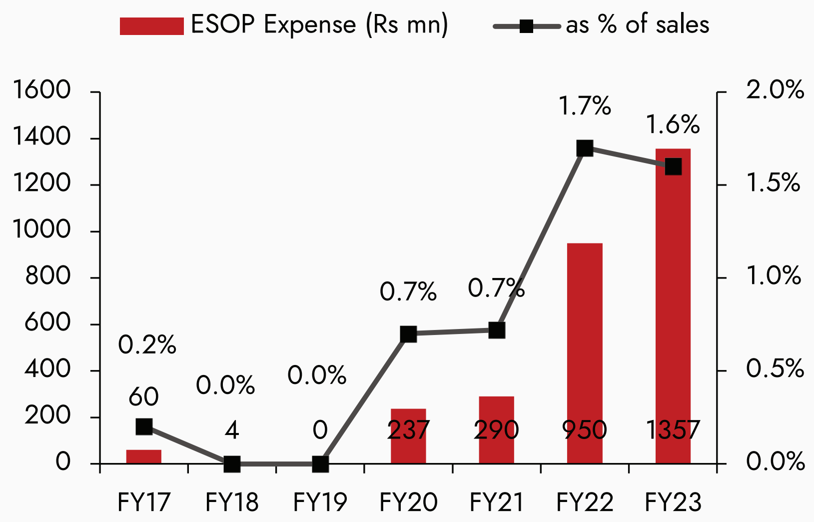
Source: Ambit Asset Management, Company

Exhibit 24: PSYS offered high ESOP based compensation..



Source: Ambit Asset Management, Company, Note: Red color T1, Grey color T2

Exhibit 25: ... covering ~80% of workforce



Source: Ambit Asset Management, Company

(iii) Plugging gaps through M&A – Tier- 2 IT companies have not shied away from plugging capability gaps (especially in technology partnerships) through M&A. Among our portfolio companies, PSYS and Mastek have used this amazingly well to plug gaps in capability. Mastek's strength over the years has been predominantly in Oracle. However, it has made acquisitions in SalesForce and Snowflake which has helped enhance those capabilities.

Exhibit 26: Both PSYS and Mastek have spent >$200mn on M&A over the last few years. In Mastek's case, this has helped build a presence in the US where they were not present earlier

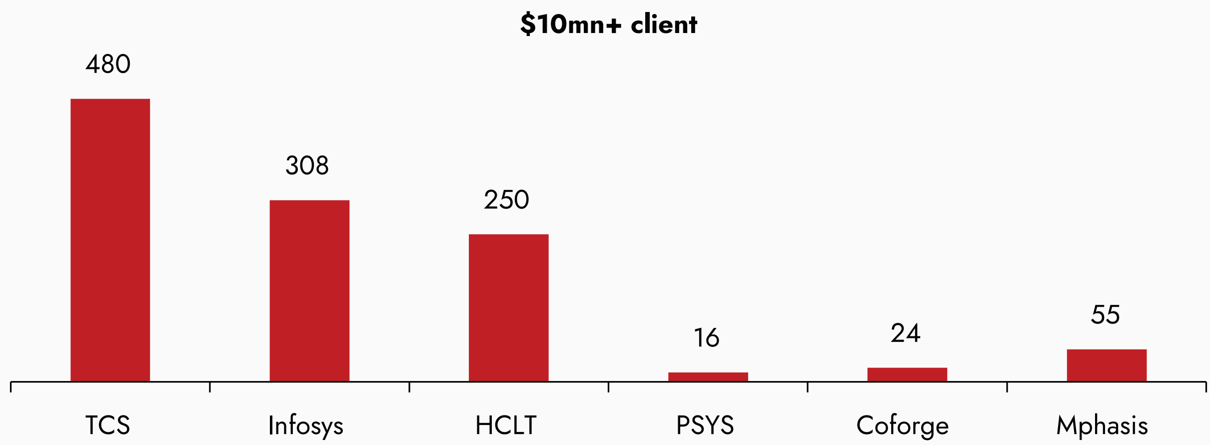
Acquiree	Co. Acquired	Consideration (USD mn)	Date	Valuation (EV/Sales)	Capability
Sonata Software	Quant Systems Inc.	95.0	Feb-23	4.3	Enterprise Data Analytics & Cloud Modernization Co
Persistent	CAPIOT	10.3	Oct-20	1.6	Expertise in MuleSoft, Red Hat and TIBCO
	Sureline Systems (few assets)	2.5	May-21	0.9	Cloud services
	SCI and Fusion360	53.0	Sep-21	3.1	Consulting and implementation services in payments
	Shree Partners	6.9	Sep-21	0.9	IT services
	Data Glove	90.5	Feb-22	1.8	Microsoft Azure cloud services, 700+ employees
	MediaAgility	71.7	Mar-22	2.8	Google cloud services, 500+ employees
Mastek	Evosys	96.0	Feb-20	1.5	Oracle Platinum partner
	MST Solutions	115.0	Jun-22	3.9	salesforce consulting partner
	BizAnalytica	32.0	Jun-23	2	Snowflake Partner (Data and Cloud capabilities)

Source: Ambit Asset Management, Company, News articles

(iv) Leveraging client connects (Focused client mining strategy) – Leveraging these initiatives, Tier-2 companies have capitalized on clients' weariness with Tier-1s. As these Tier-1s grow larger, providing CXO-level attention and personalized engagement to smaller clients becomes increasingly challenging. For example, TCS manages ~300 clients in the >$20 million, while Persistent caters to only 11 (up from 4 in FY22). Consequently, some clients might inadvertently experience less attention and slower dispute resolution with Tier-1s compared to their Tier-2 counterparts.

There also have been instances in the past of larger companies facing bad press due to execution slip-ups in relatively smaller but high-visibility deals. For eg. (1) Infosys' execution of GST Network and the new **Income Tax Portal**; (2) **Delay in delivery of MCX trading platform by TCS** (3) **Major slip-ups by some of the large Global SIs** in the UK which resulted in administrative headaches and multiple protests, calling for an overhaul.

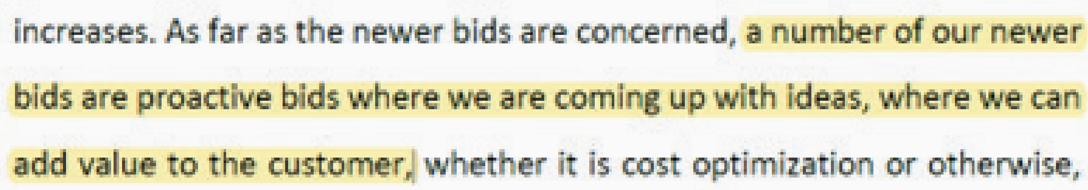
Exhibit 27: CXO level attention becomes difficult as clients become larger; T-2 companies consequently start mushrooming



Source: Ambit Asset Management, Company

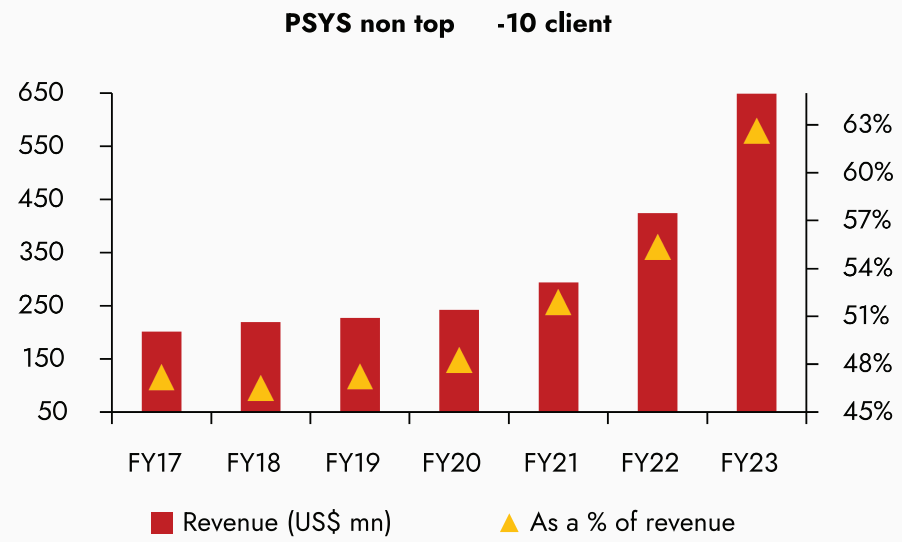
Additionally, the T-2s have not been afraid to disrupt their existing business models and cannibalize their revenues over the near term for longer-term gain **(Refer Exhibit: 30)**. The new leaders are using their expertise, connects and domain knowledge to suggest proactive solutions to clients. Their relatively smaller size implies better agility and swift decision -making. For eg, PSYS' growth, especially over the last 5-7 quarters has surprised the street positively. In a difficult macro environment, PSYS was able to maintain industry-leading revenue growth and deal wins courtesy of its client mining efforts and proactive client engagements. **(Refer Exhibit: 28)**

Exhibit 28: Secret sauce to PSY's strong outperformance – proactive client engagements


increases. As far as the newer bids are concerned, a number of our newer bids are proactive bids where we are coming up with ideas, where we can add value to the customer, whether it is cost optimization or otherwise,

Source: Ambit Asset Management, Q2FY24 Transcript

Exhibit 29: Persistent has addressed client concentration risks effectively



Source: Ambit Asset Management, Company

Exhibit 30: Nitin Rakesh and Sandeep Kalra have extensively talked about reinventing and disrupting themselves for client's benefit and longer term gain

I'll give you a small example: Why should we not apply something like predictive analytics to an offering as standard as infrastructure application management? Why should we not turn AMS or an IMF into a big data analytics problem, and why should we wait for something to fail or break, so that we can go and fix it, which is (let's face it) the traditional IT outsourcing model?

So, I think, from that perspective, it means that we end up shrinking the overall footprint of the ITO team, but that's okay with us because I think that's the right thing to do for the customer. So, I think from our perspective, we've been fairly aggressive in moving clients along this journey of applying technology to traditional services as well.

And given that our scale is normally a fraction of some of the very large players, we are able to go back in and propose something very creative, even if it means that it actually shrinks the core and has an adverse impact on us as well. I just think that's the right thing to do. So that's how we are able to challenge the status quo, and in the process, carve out a position for ourselves.

seen as disruptors. If Persistent today has 23,000 employees, I'm pretty sure our biggest US-based competitors, India-based competitors are 20-30 times our size. If we cand disrupt ourselves, the market for us is huge. So, we are not worried about disrupting ourselves, we are worried about providing the right value to our customers and bringing them the latest and greatest. If we do that, I'm pretty sure, for a small company that we are, we'll keep growing and we'll healthily out beat our nearest to the farthest competition. Hopefully that gives you enough.

Source: Ambit Asset Management, **horsesforsources**, PSYS Q2FY24 transcript

Exhibit 31: Birlasoft (BSOFT) has won some deals in the past where they have displaced a Tier–1 vendor

Company	Mention	Concall Comments
Birlasoft	2Q24	Displaced a Tier-1 vendor in a large $100mn+ deal
Birlasoft	4Q23	Displaced existing Tier-1 competitor for addition business with a US Tech client
Persistent	2Q24	A number of newer bids are proactive bids

Source: Ambit Asset Management, Company Transcripts

Exhibit 32: 6 out of the top 10 clients of MPHL's are also Top-10 clients of Tier–1 IT companies

Client	Ranking as per LCA filings					Overlap with Tier-1
	FY19	FY20	FY21	FY22	FY23	
JP Morgan	1	1	3	2	1	**CTSH**
Charles Schwab	3	3	1	1	2	**INFY/WPRO**
Fedex	2	2	2	3	3	**WPRO/HCLT**
Wellls Fargo	6	6	5	4	4	INFY
AIG	8	7	6	5	5	TCS/CTSH
HP	NA	8	9	8	6	**Wipro**
DXC	5	4	7	7	7	
QBE	9	NA	8	12	8	
United Airlines	NA	16	14	9	9	
Fiserv	NA	NA	NA	NA	10	

Source: 2023 LCA filings, Ambit Capital Research. Note: NA indicates either new client or not material client historically. **Bold** implies Top-10 client for Tier-1
Note: Ranking as per labour certification applications (LCAs) which are pre-requisites for filing work visa, where IT companies need to specify how many visas are sought for a particular client.

SO DOES THIS IMPLY THAT LARGER PLAYERS ARE AT AN INNATE DISADVANTAGE?

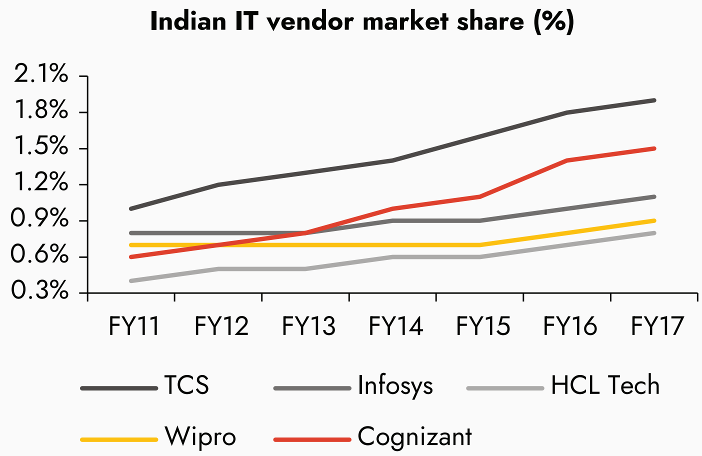
There have been examples of Tier–1s that have grown at industry-leading rates despite their large scale. Accenture and Cognizant are two companies that come to mind that adopted a differentiated approach. Accenture gained market share over the last decade owing to a focused M&A strategy. Since its demerger from Arthur-Anderson, the company has made >250 acquisitions. Not many know that Accenture's Interactive Business Unit called Accenture Song **generates $14bn in revenue annually**. Moreover, it has made >20 acquisitions in GenAI space. This strategy is in sharp contrast to TCS's strategy which is the largest India-based IT Services company. Over the last many years, TCS has made no sizeable acquisition and still managed to outpace industry growth barring the post-covid years.

Exhibit 33: Ex-acquisition, Accenture would have been roughly on par with TCS' 7 yr CAGR of 7.5%

								CAGR	
Accenture Revenue Gr.	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	Accenture (FY17-24)	TCS (FY17-24)
Reported	10.5%	8.5%	4.0%	11.0%	26.0%	8.0%	3.5%	10.0%	7.5%
Inorganic Contribution	1.6%	2.0%	2.0%	4.0%	5.0%	2.0%	2.2%		
Reported Organic	8.9%	6.5%	2.0%	7.0%	21.0%	6.0%	1.3%	7.4%	7.5%
Pure Organic	8.8%	6.3%	1.6%	6.3%	19.7%	4.7%	-0.3%	6.5%	7.5%
Acquisition spends (USD bn)	0.70	1.20	1.50	4.20	3.40	2.50	0.80		

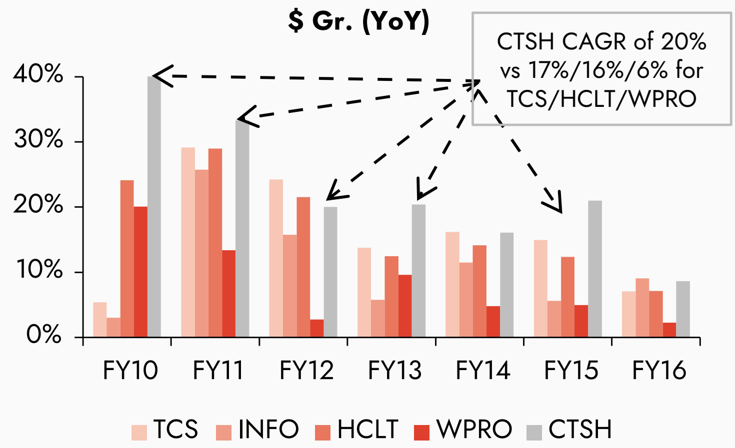
Source: Ambit Capital Research, Company. Note: Pure Organic means revenue for the core business considering no acquisitions had been made since FY17. FY24E for Accenture (ACN) is mid-point guidance and acquisition spends for 1Q24. TCS FY24 is Bloomberg estimates

Exhibit 34: ...Cognizant gained market share from FY11 to FY17...



Source: Ambit Asset Management, Company Note: market share is calculated as revenue /IT Gartner IT spend estimate. CY for Cognizant

Exhibit 35: ...owing to fastest revenue CAGR despite being the same size as INFO / WIPRO in FY11



Source: Ambit Asset Management, Company

Tier–1's are more efficient in scale-based deals compared to the capabilities-based proposition of Tier–2. This implies that in case of a sharp slowdown (akin to GFC and not 2023), Tier–1 will stand to benefit given their cost-takeout capabilities.

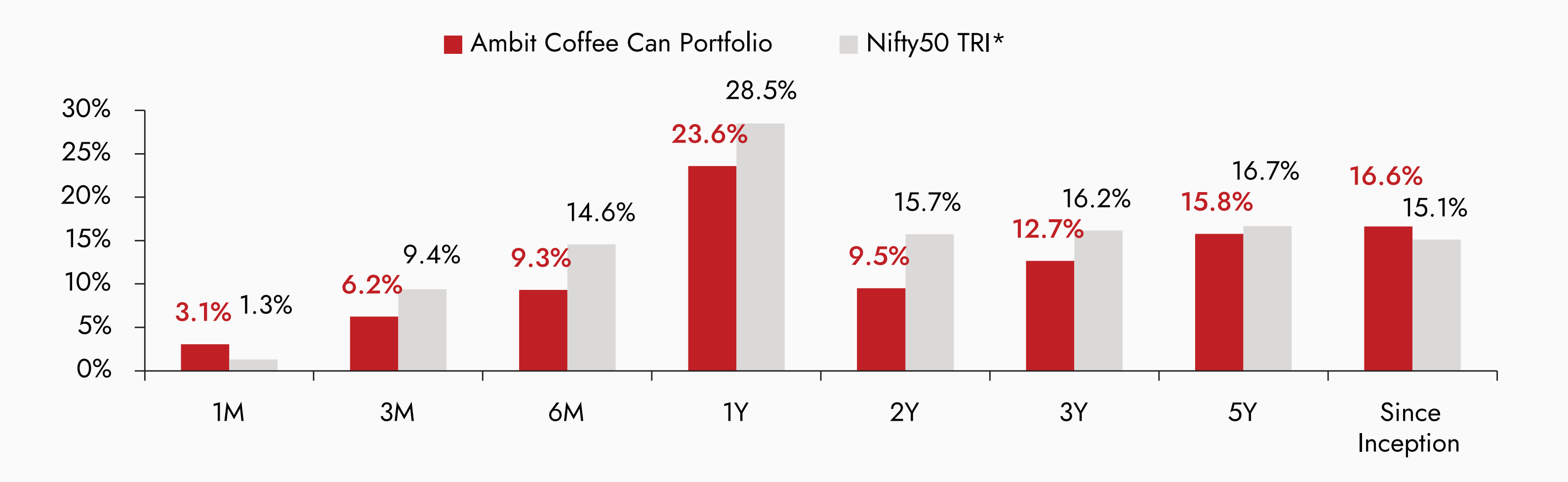
CONCLUSION

Despite a fast-changing technology landscape, Indian IT has proved its relevance time and again over the last 2-3 decades. The winners, however, have been different going by the ongoing trend. We feel that the current rally in Tier–2 IT is much more than 'liquidity-fuelled'. Tier–2 companies that have mastered a niche and run by an efficient leader who can (1) Strengthen below-CEO level management (2) Effectively align Sales and Delivery (3) Plug capability gaps through M&A (4) Work out effective client-mining strategies, will stand to benefit. With improving macro environment and ensuing tech spend recovery, we feel rich valuations are here to stay and Tier–2 are well placed to outperform their larger peers.

AMBIT COFFEE CAN PORTFOLIO

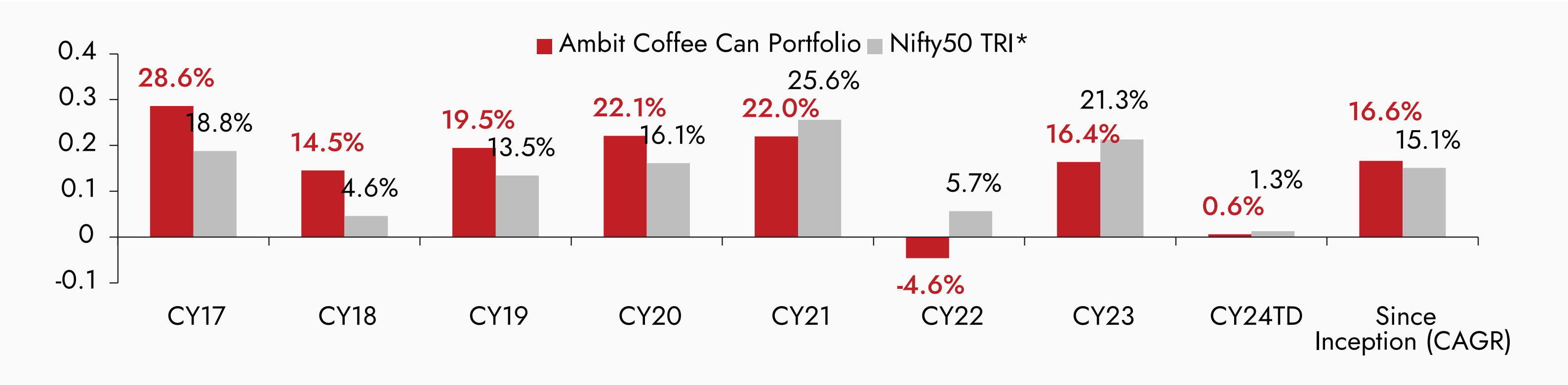
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has an unwavering commitment to companies that have consistently sustained their competitive advantages in core businesses despite being faced with disruptions at regular intervals. As the industry evolves or is faced with disruptions, these competitive advantages enable such companies to grow their market shares and deliver long-term earnings growth.

Exhibit 36: Ambit's Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of February 29th 2024; All returns are post fees and expenses; Returns above 1 year are annualized; Note: Returns prior to Apr'19 are returns of all the Pool accounts excluding non-aligned portfolio, and returns post Apr'19 is based on TWRR returns of all the pool accounts.
*Nifty 50 TRI is the selected benchmark for the Ambit Coffee Can Portfolio and the same is reported to SEBI.

Exhibit 37: Ambit's Coffee Can Portfolio calendar year performance



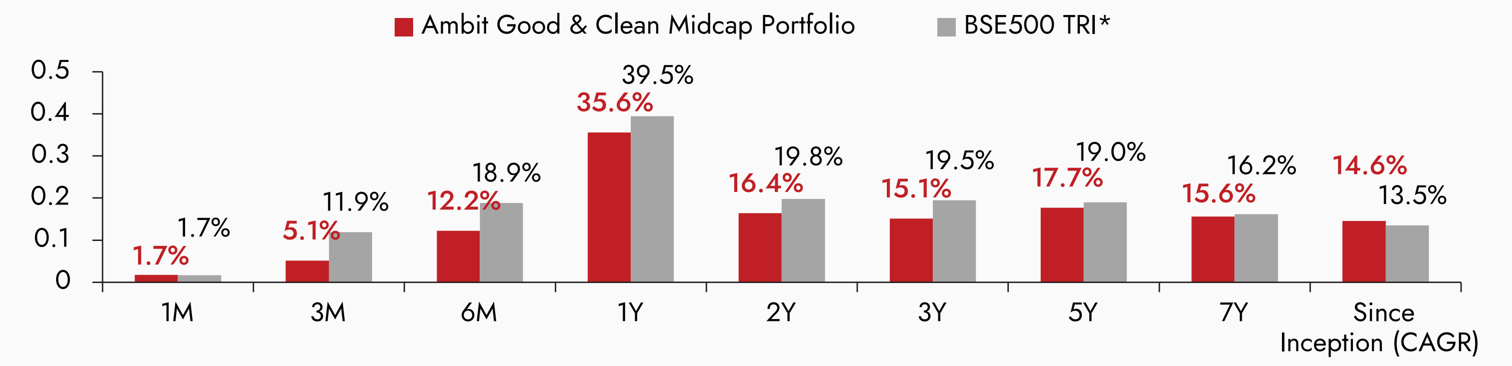
Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of February 29th 2024; All returns are post fees and expenses. Note: Returns prior to Apr'19 are returns of all the Pool accounts excluding non-aligned portfolio, and returns post Apr'19 is based on TWRR returns of all the pool accounts.
*Nifty 50 TRI is the selected benchmark for the Ambit Coffee Can Portfolio and the same is reported to SEBI.

AMBIT GOOD & CLEAN MIDCAP PORTFOLIO

Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while our proprietary 'greatness' framework helps identify efficient capital allocators with a holistic approach for consistent growth. Our focus has been to deliver superior risk-adjusted returns with as much focus on lower portfolio drawdown as on return generation. Some salient features of the Good & Clean strategy are as follows:

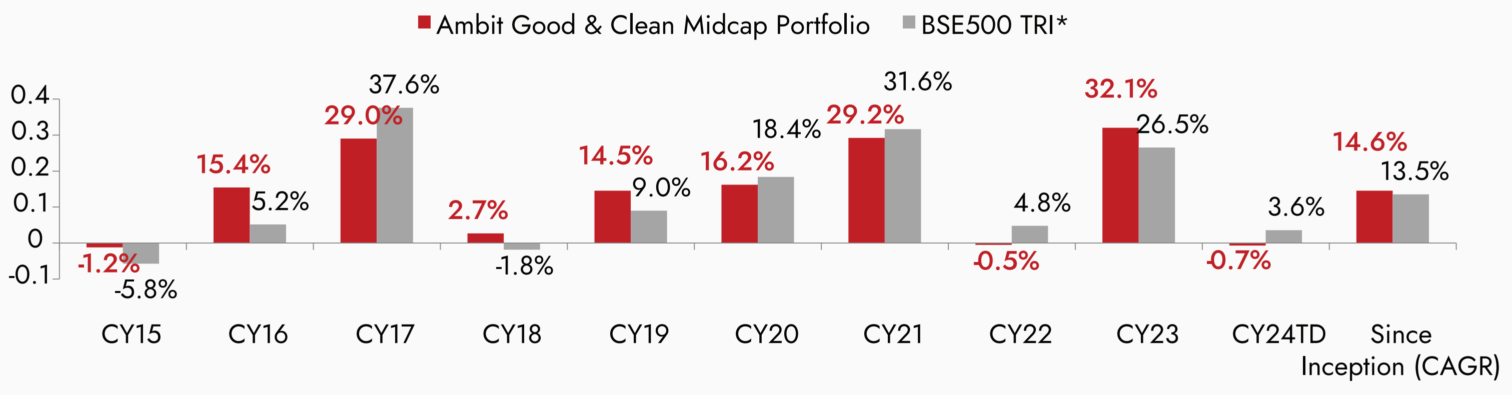
- Process-oriented approach to investing: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated on bottom-up fundamentals to create a concentrated portfolio of no more than 20 companies at any time.
- Long-term horizon and low churn: Our holding horizons for investee companies are 3-5 years and even longer with annual churn not exceeding 15-20% in a year. The long-term orientation essentially means investing in companies that have the potential to sustainably compound earnings, with these compounding earnings acting as the primary driver of investment returns over long periods.
- Low drawdowns: The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines.

Exhibit 38: Ambit's Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of February 29th 2024; All returns above 1 year are annualized. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Midcap Portfolio and the same is reported to SEBI.

Exhibit 39: Ambit's Good & Clean Midcap Portfolio calendar year performance

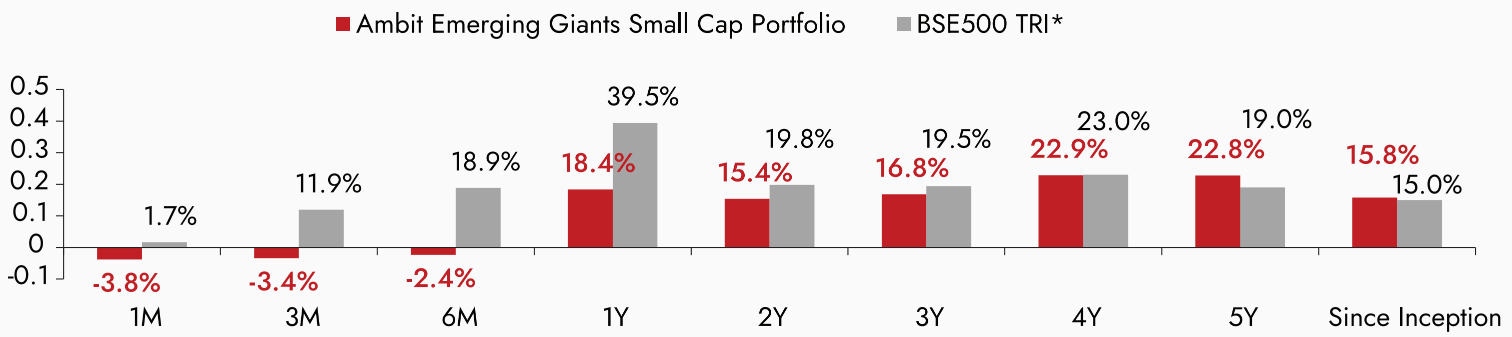


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of February 29th 2024. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Midcap Portfolio and the same is reported to SEBI.

AMBIT EMERGING GIANTS SMALL CAP PORTFOLIO

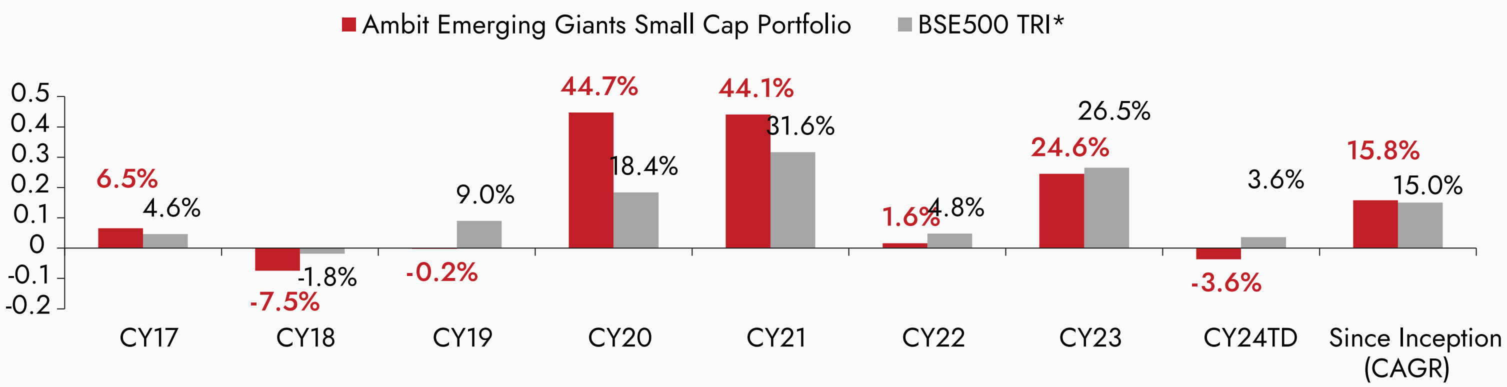
Small caps with secular growth, superior return ratios and no leverage – Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs4,000cr. These companies have excellent financial track records, superior underlying fundamentals (high RoCE, low debt), and the ability to deliver healthy earnings growth over long periods of time. However, given their smaller sizes, these companies are not well discovered, owing to lower institutional holdings and lower analyst coverage. Rigorous framework-based screening coupled with extensive bottom-up due diligence led us to a concentrated portfolio of 15-16 emerging giants.

Exhibit 40: Ambit Emerging Giants Small Cap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of February 29th 2024; All returns above 1 year are annualized. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants Small Cap Portfolio and the same is reported to SEBI.

Exhibit 41: Ambit Emerging Giants Small Cap Portfolio calendar year performance



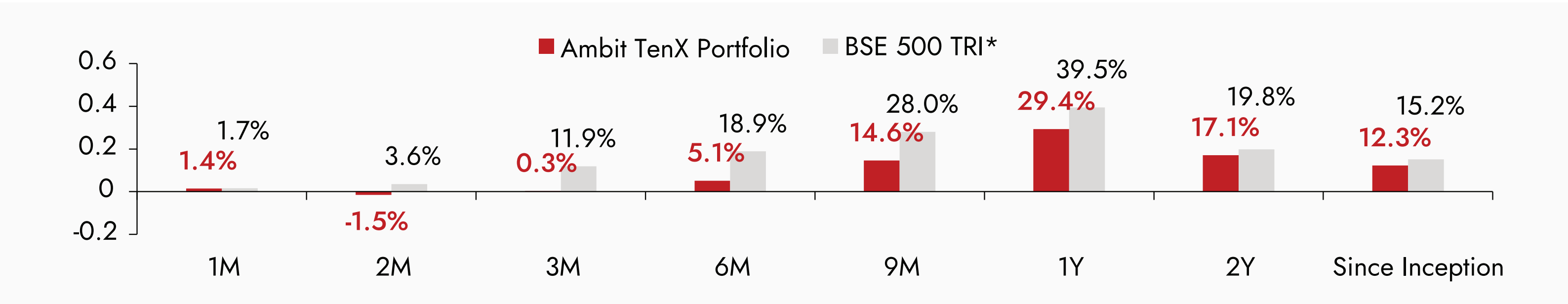
Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of February 29th 2024. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants Small Cap Portfolio and the same is reported to SEBI.

AMBIT TenX PORTFOLIO

Ambit TenX Portfolio gives investors an opportunity to participate in the India growth story as the Indian GDP heads towards a US$10tn mark over the next 12-15 years. Mid and Small corporates are expected to be the key beneficiaries of this growth. The portfolio intends to capitalize on this opportunity by identifying and investing in primarily mid & small cap companies that can grow their earnings 10x over the same period implying 18-21% CAGR. Key features of this portfolio would be as follows:

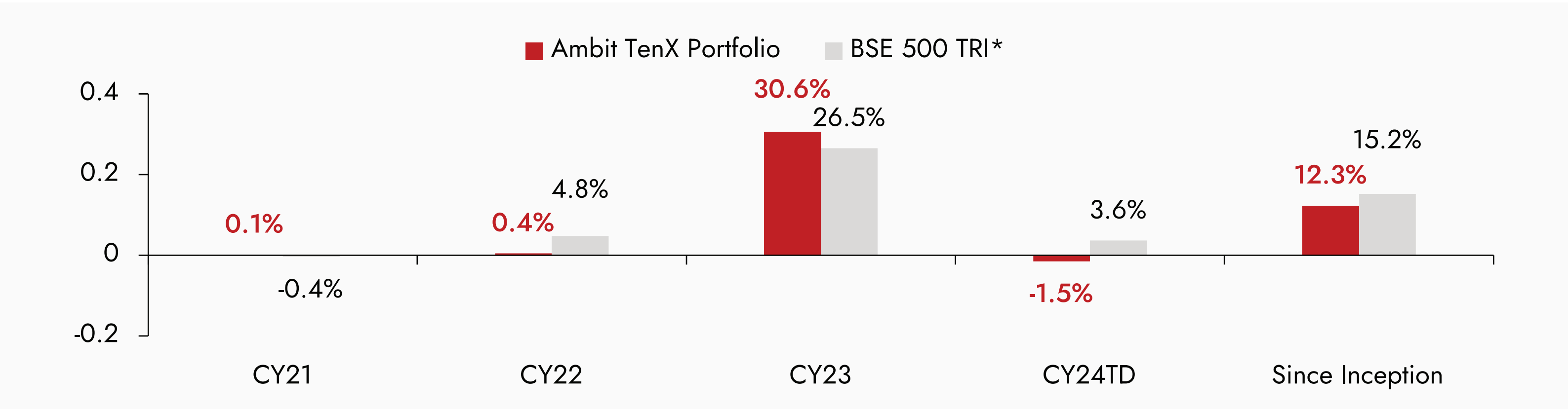
- Longer-term approach with a concentrated portfolio: Ideal investment duration of >5 years with 15-20 stocks.
- Key driving factors: Low penetration, strong leadership, light balance sheet
- Forward-looking approach: Relying less on historical performance and more on future potential while not deviating away from the Good & Clean philosophy.
- No Key-man risk: Process is the Fund Manager

Exhibit 42: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of February 29th 2024; Returns are net of all fees and expenses
*BSE 500 TRI is the selected benchmark for the Ambit TenX Portfolio and the same is reported to SEBI.

Exhibit 43: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of February 29th 2024. Returns are net of all fees and expenses
*BSE 500 TRI is the selected benchmark for the Ambit TenX Portfolio and the same is reported to SEBI.

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