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DIGITIAN CAPITAL

Future focus

FUTURE FOCUS

Saugata Banerjee
saugatab@mydigitian.com

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Technical Analysis - Rule 40 for software company (Part 12)

DIGITIAN VIEW!

This is a series on technical analysis

(TA) of stocks - how it helps to enter into a long term position in stock. It will also cover the very important aspect of exit from the stock at the right time.

In this issue we shall discuss Rule 40 which is used for Software Company.

Rule 40 :

Hyper growth remains the primary goal of most Software companies. In recent years, the Rule of 40 has been a standard benchmark used to define a healthy Software Companies especially SaaS company. The "Rule of 40" suggests a company's combined revenue growth rate and profit margin should be 40% or higher to be considered healthy and attractive to investors. Companies that consistently outperform this rule, meaning they have a higher combined growth and profit, are often valued more highly.

The Rule of 40 helps investors and analysts assess the trade-off between a company's growth and profitability. It's a way to gauge how well a company is balancing these two key metrics. The calculation is straightforward:

Revenue Growth Rate (%) + Profit (EBIDTA) Margin (%) ≥ 40%

Venture capitalists began to popularize the Rule 40 in 2015 as a high level health check of Saas Companies. Analysts have differed on which measure of profitability to use - **most used EBIDTA but free cash flows and EBIT or net income are also used as alternatives.** For SaaS companies : **Monthly Recurring Revenue (MRR)** = Total Active Customer Accounts × Average Revenue Per Account (ARPA)
ARR = MRR × 12 months

MARKET WATCH

Equity Indices	Monthly Close	Monthly Change %	2025%	2024%
S & P	5604	-5.9%	-4.7%	24.0%
Nasdaq	17710	-5.5%	-8.3%	30.8%
FTSE 100	8496	-3.6%	4.0%	9.1%
Shanghai Compsite	3279	-1.3%	-2.2%	13.4%
NIFTY	24422	10.4%	2.8%	10.1%
Nairobi SE 20	2226	0.0%	10.7%	33.3%
Egypt SE 30	32126	4.1%	8.0%	16.8%
Tanzania All Shares	2299	3.6%	7.4%	2.3%
Nigeria SE 30	3924	-2.0%	2.9%	34.3%
Morrocco All Shares	17390	4.0%	17.7%	21.7%
Bangladesh DSE 30	1823	-4.4%	-6.0%	-7.3%

Commodity	Monthly Close	Monthly Change %	2025%	2024%
Gold	2862	0.6%	8.5%	27.4%
Crude Oil	72.81	-5.1%	1.5%	-4.8%
WTI Oil	69.76	-4.1%	-6.3%	5.9%
Copper	4.57	6.0%	13.6%	4.0%
Irone Ore	106.9	5.2%	3.2%	-24.0%
Aluminium	2608	0.5%	2.0%	10.5%

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Significance :

Companies that significantly outperform the Rule of 40 (meaning they have a higher combined growth and profit) are often seen as more attractive to investors and may be valued more highly . They may also generate higher returns compared to companies that don't meet the Rule of 40.

Limitations :

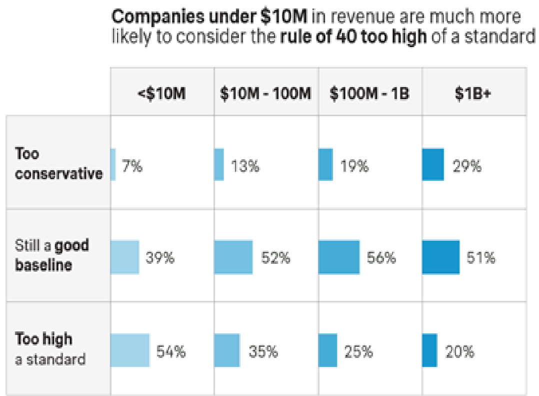
The Rule of 40 is a simplified metric and shouldn't be the only factor in evaluating a company. It's most applicable to mature SaaS companies, as younger companies are often focused on growth rather than immediate profitability.

Current Research :

However, most companies have historically struggled to achieve the Rule of 40. In fact, data from KeyBanc Capital Markets' (KBCM) 2021 SaaS Survey indicated that only 29% of companies exceeding $5MM ARR managed to meet this target.

According to 50% of SaaS executives participating in **Simon-Kucher's 2023 Global Software Study, Rule of 40** is not relevant. However, the study also tells us that that not all growth metrics should be weighed equally, and that the Rule of 40 should be evaluated in each situation. For example, it appears that revenue size likely plays a role when evaluatin rule.

On the other hand, larger firms (those with over $1B in revenue) are likely to view the Rule of 40 as too conservative. But any firm with $10m revenue and above considers Rule overwhelmingly valid.



Companies can beat the Rule of 40 at all stages of their life :

- **Strong growth.** Of the companies that outperform the Rule of 40 over five years, one-third achieve it with revenue growth above 30%. These companies—such as **Splunk, Wix and Workday**—are modestly profitable while investing in hypergrowth to build a large installed Platform

- **Balanced, profitable growth**. Half of the companies consistently exceeding the Rule of 40 do so with revenue growth between 10% and 30%. Such large, established companies as **VMWare, Adobe and Salesforce** have successfully **developed new products** for markets adjacent to their core, and n**avigated technology or business model transitions** (for example, to SaaS and subscription models)

- **Profitability.** Almost 18% of companies beat the Rule of 40 with **annual organic revenue growth below 10%**. Established players like **Oracle, SAP and Trend Micro** have large, profitable flagship businesses -- turn to becoming more efficient and profitable—**exacting pricing power, leveraging the scale and scope of large sales forces, cross- selling and expanding installed base customers, exploring new business models, increasing renewals, moderating R&D investment.**

For mature software business Rule of 40 puts emphasis back on strategizing : **Focus on Installed customer base for deeper share of wallet, engineering Productivity for innovation as well as maintenance, Squeezing Operating Efficiency.**

COUNTRY DATA

Countries	GDP (USD Bn)	Market Cap (USD Bn)	GDP Growth 2024p %	Inflation 2024p %
USA	29297	62204	1.8%	3.00%
China	18530	11513	4.6%	1.66%
India	3940	5140	6.5%	4.8%
Egypt	361	44	4.0%	21.19%
Kenya	1094	15.9	5.2%	5.5%
Tanzania	89.04	7	6.0%	3.1%
Morocco	151	64	3.6%	2.30%
Nigeria	390	36	4.25%	19.0%
Bangladesh	355	114	4.1%	9.90%

Forex	Monthly Close	Monthly Change %	2025%	2024%
EUR USD	1.131	8.96%	9.1%	-4.9%
GBP USD	1.332	5.97%	6.4%	-0.9%
USD INR	83.84	4.33%	-2.3%	-3.0%
USD KES	129.45	-0.58%	0.3%	17.9%
USD EG POUND	50.90	-0.59%	0.1%	-64.4%
USD TZS	2689.00	-4.46%	10.0%	2.8%
USD NAIRA	1604.00	-6.61%	4.2%	-73.7%
USD TAKA	121.87	-0.71%	2.1%	-8.6%

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Debashish

Saugata

Recommendation by	Name of the Company	Date of Purchase	Entry Price	Actual Gain Published in Dec 2023	Actual Gain Published in July 2024	Actual Gain Published in Dec 2024
Debashish	NGL Fine Chem	13-Mar-20	302	631%	730%	581%
Debashish	Tata Elxsi	27-Apr-20	790	1024%	831%	841%
Debashish	RACL Geartech	4-Aug-20	65	1817%	1805%	1298%
Debashish	Arman Financial	8-Feb-17	243	952%	840%	475%
Saugata	Shivalik Bimetal	5-Feb-21	69	770%	901%	809%
Saugata	Newgen Software	7-Apr-20	116	1279%	898%	1374%
Saugata	Indian Bank	11-Jan-21	87	422%	586%	595%
Saugata	Glenmark Pharma	31-Jan-23	371	Not in Top 4	Not in Top 4	347%

Trident sold (Saugata)

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VALUE INVESTING

Debashish Neogi

"A 100x Multi bagger will be generally in the small cap, sector agnostic, multiplies in a short time span but may be over 10 years, - a right to win is a must but you require a megatrend as tail wind"

Investment Note on HBL Engineering (Part 1)

Debashish earlier shared his selection of HBL Engineering as a multi bagger stock. He now shared his comprehensive investment note on the HBL Engineering. This is a great opportunity for our readers to follow real time a multi bagger stock.

HBL Engineering Limited (HBL) is an Indian engineering company specializing in industrial batteries and niche electronics solutions for critical sectors like telecom, railways, defense, and energy. Founded in 1977, HBL built a diversified product portfolio over four decades by filling up technology gaps. It manufactures a wide range of batteries – lead-acid (including advanced pure-lead VRLA), nickel-cadmium, silver-zinc, and lithium-ion – as well as defense and railway electronics, and even solar photovoltaic module. HBL is at present is organized into **four key segments:**

Industrial Batteries: Batteries for telecom towers, UPS systems, electricity grids, oil & gas, rail coaches, and other industrial uses. This is a major revenue engine, with HBL holding 1st or 2nd position in most industrial batteries. It occupied #1 spot in Indian telecom tower batteries.Products span 2V to 12V VRLA batteries, Ni-Cd backup batteries, and emerging lithium battery offerings.

Defense & Aviation Batteries: Specialized batteries for military and aerospace applications – including batteries for fighter aircraft, missiles, armored vehicles, submarines and torpedoes. HBL is the leading supplier to India's defense forces in these categories and one of the only exporters from India in this space.

Railway Electronics ("Kavach" Train Protection Systems): HBL co-developed Kavach, an automated train collision avoidance system (TCAS) with Indian approved vendor for its nationwide deployment. After years of R&D (2005–2012 trials) Kavach was adopted as the national ATP system in 2022. HBL supplies on board devices for locomotive, track side equipment, and railway signaling electronics. This segment has become HBL's 2nd main revenue contributor. It will further benefit from strong government investment in railway safety – the electronics revenue nearly tripled in ivision'sFY2024 due to TCAS rollout.Notably,only three companies are approved for TCAS creating a high entry barrier and ongoing maintenance revenue service life with AMCs.

E-Mobility

HBL has developed electric drive train kits to retrofit commercial diesel vehicles (like buses and heavy trucks) into electric vehicles. This effort began ~2018 to address a "technology gap" –at the time, motors and controllers for EVs were mostly imported, so HBL invested in an in-house solution. After overcoming early challenges, the company successfully demonstrated EV conversions of old trucks, This segment is nascent but positions HBL for the long-term electrification trend in transport, with focus on fleet retrofits (where payback via fuel savings and ESG benefits is attractive).

Competitive Edge / Moats: HBL's strategy is to focus **on niche, technology-intensive markets** that are "too small for big companies and too difficult for small companies," avoiding commoditiz ed products. It invests heavily in R&D to develop proprietary technologies and aims to be the #1 or #2 player in each niche it serves. This has yielded a significant competitive advantages: HBL enjoys dominant domestic market shares in industrial/VRLA batteries, specialized defense batteries, and is an original developer of India's Kavach rail safety tech. It is often the sole indigenous supplier in critical applications (e.g. the only Indian company with 100% indigenization of electronic fuzes for artillery shells, rockets and bombs, and the exclusive domestic supplier of certain communication systems for battle tanks). Such technological differentiation, along with long product qualification cycles in defense/rail, give HBL a strong right-to-win.

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Additionally, the company's broad portfolio itself is a moat – its diversification across batteries and electronics was a deliberate hedge against single-product risk This cross-sector presence (telecom, power, rail, defense) helps HBL capture opportunities while internal synergies (battery tech feeding into electric mobility, electronics know-how feeding into smart batteries, etc.) enhance its innovation pipeline.

Revenue Mix: Batteries still contribute the majority of revenue, but the share of electronics is fast rising . In FY2023-24, HBL's consolidated revenue was ₹2,209 crore (up 63% YoY from ₹1,378 crore in FY23). About 60% of FY24 revenue came from the battery business and 40% from electronics & others. By end-use sector, the largest chunks are telecom & industrial power solution (~50% of revenue), railways (~25%), defense (~12%), with the remaining ~13% from exports across sectors Notably, export markets (over 50 countries) are a growing piece – e.g. HBL exports **Ni-Cd railway batteries to global clients like Siemens, Alstom and Hitachi**.

The company operates **five main manufacturing plants** in India (Telangana & Andhra Pradesh) focused on different product lines – from VRLA batteries in Vizianagaram to lithium and submarine batteries at Nandigaon, and electronics at Hyderabad . It employs ~1,875 people and had a healthy **29% ROCE in FY24** reflecting efficient use of capital after years of investment.

Recent Trajectory (Last 5 Years): Over the past five years, HBL has transformed from a slow growing battery maker into a diversified defense and rail tech player. The company faced headwinds around 2017–2019 due to a slowdown in telecom battery demand and delays in commercializing R&D projects (many of which had long gesta-tion) underwent a turnaround starting 2020: HBL deleveraged its balance sheet (net debt is now negligible at debt/equity 0.05) and refocused on high-margin segments. A pivotal tailwind was the Indian Railways' adoption of Kavach – after initial orders in 2022-23, FY2024 saw full-scale roll-out, boosting HBL's top line significantly. Likewise, defense electronics (e.g. fuzes) that were in development for years began generating revenue as indigenous defense procurement picked up. Internally, HBL branded FY2024 as a year of **"Stabilizing to Fortify"** – consolidating gains – with an eye on major growth in FY2025-26 as execution of large orders ramps up (management has indicated FY25 will be a consolidation year and **FY26+ a high-growth phase**). Overall, the last half-decade has seen HBL emerge as a debt-free, innovation driven company with strong tailwinds in rail safety and defense localization, positioning it on a markedly improved trajectory compared to the preceding years .

2. Deep Dive into Reports (DRHP, Annual Reports, Presentations & Con-Calls)

The past 3–5 years of HBL's annual reports, investor commu-nications, and conference calls reveal the company's strategic shifts and execution on its plans. Key insights are grouped into three areas:

A. Business Updates and Growth Drivers: HBL's filings highlight a stream of new product launches, capacity expansions, and industry tailwinds supporting growth:

Railway Segment Expansion: HBL's FY 2024 Annual Report emphasized the successful transition of Kavach from R&D to commercial business. In late FY2025, it won ₹1,500+ crore of locomotive-mounted Kavach orders and an additional ₹400 crore for trackside equipment These orders (spanning ~10,000 locomotives and hundreds of route-km) secure a multi-year revenue pipeline in the electronics division. Management noted this provides visibility for a strong uptick in FY2026 when execution peaks Industry-wide, Railway capex is at record highs – the Kavach program aims to cover 34,000+ km of rail lines, a massive opportunity for HBL. Moreover, each installed system guarantees **annual service income**. The push for high-speed trains (**Mission Raftaar, new Vande Bharat trains)** is a structural tailwind ensuring sustained demand for HBL's rail safety products.

Defense Products & Order Book: Annual reports show HBL deepening its defense portfolio beyond batteries. It successfully developed electronic fuses for ammunition (for grenades, artillery shells, rockets, etc.), achieving **100% indigenous production.** This segment is expected to contribute meaningfully. Likewise, HBL's defense electronics unit secured contracts for armoured vehicle communication systems and delivered complex one-off projects (like platform management systems for Navy's Scorpene submarines). These wins, although lumpy, position HBL as a go-to local vendor for defense electronics. The consolidated order book stood at ₹1,178 crore as of Aug 2024, with repeat orders from reputable clients (Indian Railways, BSNL, Indus Towers, etc.) providing medium-term visibility. Notably, the order mix has shifted from predominantly lead batteries to a greater share of electronics and specialty products today.

The balance portion of the Investment note in the next month Newsletter.

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Level 5 Emaar Square

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