

Company Flash

17 October 2007 | 7 pages

KPIT Cummins Infosystems (KPIT.BO)

Buy: Good Results; Good Deal Wins

- Decent results** — The company reported revenue US\$35.6m (vs. exp. of US\$34.6m) – up 13% qoq and 44% yoy. EBITDA margin at 15.7% was lower than expectation of 16.2%. However, better revenue and lower interest costs led to net profit of Rs.141m - broadly in-line with our expectation of Rs.143m.
- FY07 annual guidance unchanged** — The company has not revised its FY08 guidance. Revenue guidance of US\$145-148m looks reasonable while net profit guidance of Rs630-680m would be a challenging task, in our view. Our net profit estimate is already at Rs573m for FY08.
- Deal wins and pipeline** — The company had a few good deal wins this quarter – a) ~US\$20m deal from Asian tier1 supplier in auto-electronics space, b) ~US\$10mn deal for enterprise software support, and c) multi-million US\$ deal in BI space. Management commented that it is prospecting three other US\$10mn+ deals; also recent deal wins are at 12-15% better price points.
- Preferential equity issuance** — The company will be issuing up to 1.6m equity shares to Cummins, raising its stake by 1.8% to 14.9%. With SEBI formula, company would get ~US\$5.4m of cash and would lead to ~2% equity dilution.
- Reasonable valuations; challenging macro** — The stock trades at reasonable valuations of 11x FY09E earnings. Key investor concerns continue to be (1) INR appreciation and (2) clarity over 2008 IT budgets.

Buy/Medium Risk	1M
Price (17 Oct 07)	Rs112.70
Target price	Rs154.00
Expected share price return	36.6%
Expected dividend yield	0.4%
Expected total return	37.1%
Market Cap	Rs8,596M
	US\$219M

Price Performance (RIC: KPIT.BO, BB: NKPIT IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	326	3.66	7.0	30.8	5.7	26.3	0.3
2007A	505	5.47	49.5	20.6	4.2	29.6	0.3
2008E	573	7.27	33.0	15.5	3.4	25.4	0.4
2009E	807	10.25	41.0	11.0	2.6	27.9	0.7
2010E	921	11.69	14.1	9.6	2.1	25.0	0.7

Source: Powered by dataCentral

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Figure 1. Key Financial, Rs m

	2Q07	1Q08	2Q08	QoQ	YoY
Revenue	1,140	1,353	1,492	10.3%	30.9%
Cost of revenue	715	842	940	11.6%	31.4%
Gross profit	425	511	553	8.2%	29.9%
Gross margin	37.3%	37.8%	37.0%	-73bp	-27bp
Operating expenses	247	297	318	7.3%	28.9%
EBITDA	179	215	235	9.4%	31.4%
EBITDA margin	15.7%	15.9%	15.7%	-13bp	6bp
Depreciation and amortization	30	54	57	6.6%	88.0%
EBIT	148	161	178	10.4%	19.7%
EBIT margin	13.0%	11.9%	11.9%	1bp	-111bp
Interest expenses	7	20	19	-5.6%	156.4%
Other income	0	0	0	n.a.	n.a.
Profit before tax	141	141	159	12.6%	12.7%
Income tax expense	18	15	18	22.6%	4.6%
Income from operations	124	126	141	11.4%	13.9%
Minority interest	0	0	0	n.a.	n.a.
Profit after minority interest	123	127	141	11.0%	14.0%
EO income/(expense)	0	0	0	n.a.	n.a.
Reported profit	123	127	141	11.0%	14.0%
EPS - basic	1.66	1.66	1.84	10.8%	10.8%
EPS - fully diluted	1.35	1.61	1.79	11.2%	33.0%

Source: Company Reports

Figure 2. Key HR metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
Total staff	2,544	2,809	3,119	3,256	3,601	3,939
- net add	422	265	310	137	345	338
Delivery staff	2,306	2,529	2,787	2,900	3,256	3,561
- net add	400	223	258	113	356	305
Support	208	249	298	318	306	334
Sales	30	31	34	38	39	44
Utilization rate						
- onsite	92.0%	93.0%	89.0%	87.0%	89.0%	93.7%
- offshore	71.0%	72.0%	69.8%	68.0%	67.0%	70.5%

Source: Company Reports

Figure 3. Revenue mix

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
Geography wise						
USA	64.8%	62.4%	62.3%	58.8%	57.7%	56.6%
Europe	28.9%	28.7%	29.5%	29.7%	30.6%	32.5%
Rest of world	6.4%	8.9%	8.3%	11.6%	11.8%	10.9%
Vertical wise						
Manufacturing	77.3%	76.3%	77.5%	78.0%	78.4%	82.5%
BFSI	8.7%	10.8%	10.6%	10.4%	9.7%	8.4%
Others	14.0%	12.9%	11.9%	11.5%	12.0%	9.2%
Contract type						
Time and material	90%	90%	91%	91%	90%	88%
Fixed price	10%	10%	9%	9%	10%	12%

Source: Company Reports

Figure 4. Key client metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
Clients added (organically)	5	5	4	4	7	5
Total clients	77	82	86	90	97	102
Total star clients (inc. Cummins)	10	13	15	17	18	21
Client concentration						
Top Client – Cummins	44.3%	42.0%	40.0%	37.5%	39.0%	39.1%
Star Customers - Non Cummins	31.3%	35.7%	41.8%	43.0%	45.4%	41.5%
Top 10 Client Billing	79.5%	76.3%	75.8%	74.2%	74.8%	72.3%

Source: Company Reports

KPIT Cummins Infosystems

Company description

KPIT Cummins Infosystems is a mid-tier IT services provider focused on two verticals: manufacturing services and BFSI (banking, financial services and insurance). Within these two verticals, the company is focused on a few key customers. Among service lines, in addition to regular application development and maintenance services, KPIT Cummins offers VLSI and embedded software services, package implementation, business intelligence, and BPO services. The company has close to 3,600 employees working for close to 100 clients.

Investment strategy

We rate KPIT Cummins as Buy/Medium Risk (1M). With offshoring becoming mainstream, clients are increasingly using offshore for newer service areas like product engineering, embedded software, and engineering design services. KPIT Cummins has a head-start in the fast-growing embedded software and VLSI design services due to its Cummins and Renesas relationships. With client access to 7 of the top 10 auto OEMs and 13 leading tier 1 & 2 auto suppliers and five of top 10 semiconductor manufacturers, KPIT Cummins could become one of the top offshore vendors in auto electronics and semiconductor design - leading to 37% revenue and 41% earnings CAGRs over FY06-09E.

Valuation

Our 12-month target price is Rs154 based on 15x our FY09E EPS. Our target multiple is derived by applying a ~20% discount to our target multiple for peer Satyam. We apply this discount as Satyam is a large and diversified company while KPIT is a niche-focused mid-tier IT player. We believe 15x is a fair multiple given the strong growth that we expect from KPIT over the next three years. Our target multiple is also supported by an historical valuation range of 10-20x forward earnings (average 15x) for the KPIT stock over the past two years. We believe a P/E-based valuation is most appropriate given KPIT's profitable track record and widespread investor use of this metric.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, rates KPIT Cummins as Medium Risk. Risks that could impede the stock from reaching our target price include: (1) high client concentration; (2) a slowdown in the auto-electronics industry; (3) a slowdown in the US/global

economies; (4) technology obsolescence; (5) supply-side situation becoming more difficult - wage inflation being higher than that factored in our model; (6) currency appreciation more than that factored in our model; and (7) limited H1B visas.

Appendix A-1

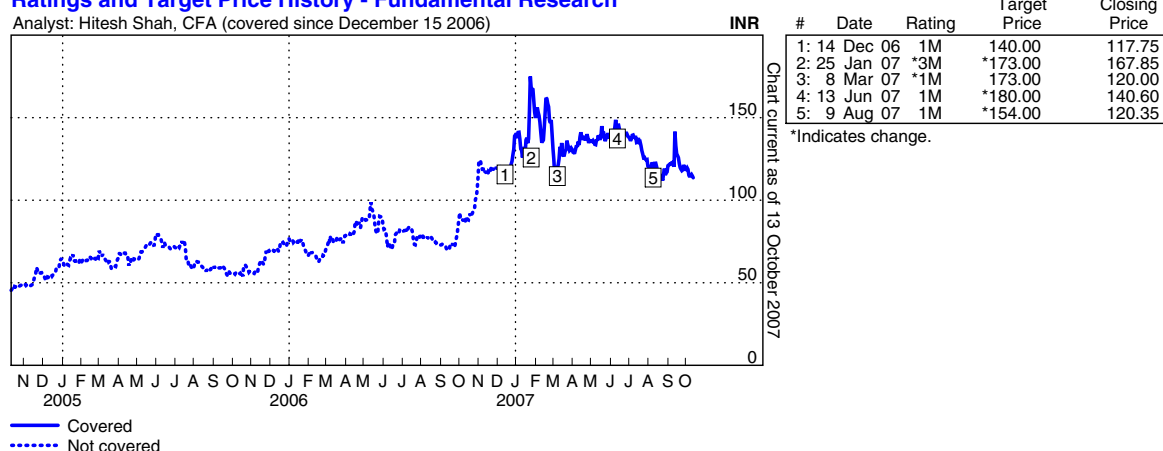
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Analyst: Hitesh Shah, CFA (covered since December 15 2006)



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