Company Focus

26 October 2007 | 9 pages

NIIT (NIIT.BO)

Target price change ☑
Estimate change ☑

Sell: Negatives Outweigh Positives; Cutting Estimates

- **2Q FY08 results** — NIIT reported revenue of Rs2.7bn (+33% yoy). EBITDA of Rs359m (+50% yoy) was broadly in line with expectations. Higher taxes and depreciation, and lower equity income from NIIT Tech led to a net profit of Rs212 m (vs. estimate of Rs246m)
- **Individual business revenue lower than expectations, margins in-line** — Individual business revenue grew 31% yoy (CIR est. 41%), while EBITDA margin of 23.8% was broadly in line. NIIT said that the price hike for career segment courses in non-metros was from Aug, vs. Jun for metros.
- **INR weighing on organic corporate business** — Organic corporate business had slower revenue growth, while ElementK growth was in-line. Combined profitability was lower than expected primarily because of INR appreciation.
- **Positive surprises from institutional and IFBI/Imperia** — Institutional growth returned on a higher share of private schools. Profitability also improved marginally on a QoQ basis. IBFI/Imperia revenue grew 73% qoq. The company introduced new courses for the insurance and financial planning segments; these businesses also saw EBITDA breakeven during the quarter.
- **Maintain Sell/Medium Risk; lowering estimates and target price** — We are lowering our estimates 3-10% to factor in the net profit miss in 2Q, weaker growth for the individual business and the stronger INR, which is affecting the corporate business. We have raised our estimates for the institutional business and IFBI/Imperia. Our new SOTP-based target price is Rs144, down from Rs153.33.

Sell/Medium Risk	3M
Price (26 Oct 07)	Rs138.95
Target price	Rs144.00
from Rs153.33	
Expected share price return	3.6%
Expected dividend yield	0.7%
Expected total return	**4.4%**
Market Cap	Rs22,872M
	US$581M

Price Performance (RIC: NIIT.BO, BB: NIIT IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	414	2.81	20.1	49.5	7.5	16.5	0.6
2007A	566	3.63	29.5	38.2	6.4	19.5	0.6
2008E	943	5.67	56.2	24.5	5.3	25.4	5.4
2009E	1,385	8.33	46.8	16.7	4.2	28.5	5.8
2010E	2,092	12.58	51.0	11.0	3.3	33.5	5.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	49.5	38.2	24.5	16.7	11.0
EV/EBITDA adjusted (x)	32.3	28.8	21.4	14.0	9.6
P/BV (x)	7.5	6.4	5.3	4.2	3.3
Dividend yield (%)	0.6	0.6	5.4	5.8	5.8
Per Share Data (Rs)					
EPS adjusted	2.81	3.63	5.67	8.33	12.58
EPS reported	2.81	3.63	5.67	8.33	12.58
BVPS	18.41	21.61	25.98	33.16	42.73
DPS	0.80	0.87	7.50	8.00	8.00
Profit & Loss (RsM)					
Net sales	4,507	7,951	10,325	12,173	14,701
Operating expenses	-4,278	-7,649	-9,704	-10,976	-12,894
EBIT	**229**	**302**	**621**	**1,196**	**1,807**
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	36	-56	-125	-140	-120
Pre-tax profit	**266**	**246**	**496**	**1,056**	**1,687**
Tax	-29	-4	24	-180	-180
Extraord./Min.Int./Pref.div.	177	324	424	508	584
Reported net income	**414**	**566**	**943**	**1,385**	**2,092**
Adjusted earnings	414	566	943	1,385	2,092
Adjusted EBITDA	705	817	1,121	1,676	2,327
Growth Rates (%)					
Sales	13.1	76.4	29.9	17.9	20.8
EBIT adjusted	59.2	31.8	105.4	92.7	51.0
EBITDA adjusted	12.8	15.8	37.2	49.6	38.8
EPS adjusted	20.1	29.5	56.2	46.8	51.0
Cash Flow (RsM)					
Operating cash flow	**94**	**1,532**	**469**	**1,466**	**2,388**
Depreciation/amortization	476	514	500	480	520
Net working capital	-562	787	-676	-30	241
Investing cash flow	**-584**	**-3,240**	**-1,221**	**-1,421**	**-1,518**
Capital expenditure	-522	-2,933	-749	-850	-900
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**585**	**1,458**	**-248**	**-605**	**-916**
Borrowings	678	1,608	-438	-400	-400
Dividends paid	-131	-144	-186	-205	-223
Change in cash	**95**	**-249**	**-1,000**	**-559**	**-46**
Balance Sheet (RsM)					
Total assets	**5,105**	**9,050**	**8,976**	**10,384**	**12,428**
Cash & cash equivalent	701	741	186	185	754
Accounts receivable	1,895	2,204	2,546	3,001	3,423
Net fixed assets	795	1,041	1,308	1,659	2,009
Total liabilities	**2,379**	**5,901**	**4,694**	**4,923**	**5,390**
Accounts payable	1,132	2,823	2,271	2,678	3,234
Total Debt	1,090	2,698	2,260	1,860	1,460
Shareholders' funds	**2,725**	**3,149**	**4,282**	**5,462**	**7,037**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	15.7	10.3	10.9	13.8	15.8
ROE adjusted	16.5	19.5	25.4	28.5	33.5
ROIC adjusted	8.4	8.3	13.2	18.5	28.4
Net debt to equity	14.3	62.1	48.4	30.7	10.0
Total debt to capital	28.6	46.1	34.6	25.4	17.2

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2Q FY08 Results

Figure 1. Key Financials

Rs m	2Q FY07	1Q FY08	2Q FY08	QoQ	YoY
Revenues	**2,031**	**2,254**	**2,702**	**20%**	**33%**
Operating expenses	1,792	2,109	2,343	11%	31%
EBITDA	**239**	**145**	**359**	**148%**	**50%**
EBITDA margin	**11.8%**	**6.4%**	**13.3%**	**685bp**	**152bp**
Depreciation	113	133	142	7%	26%
Operating profit (EBIT)	**126**	**12**	**217**	**1708%**	**72%**
Operating margin	**6.2%**	**0.5%**	**8.0%**	**750bp**	**183bp**
Income from operations	95	64	128	100%	35%
Equity income	67	90	84	-7%	25%
Reported net profit	162	154	212	38%	31%
Adj. EPS - basic	**1.11**	**0.93**	**1.29**	**38%**	**16%**
Adj. EPS - fully diluted	**0.98**	**0.93**	**1.28**	**37%**	**31%**

Source: Company Reports

Figure 2. Results by Segment

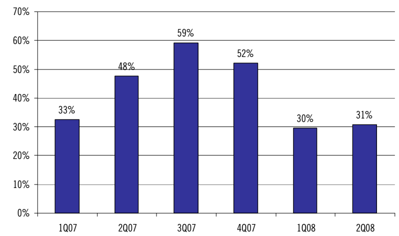
Rs m	2Q FY07	2Q FY08	YoY
Individual business			
Net revenue	746	975	30.7%
Operating expenses	614	743	21.0%
Operating profit	132	232	75.8%
Operating margin	17.7%	23.8%	610bp
Institutional business			
Net revenue	221	242	9.5%
Operating expenses	186	207	11.3%
Operating profit	35	35	0.0%
Operating margin	15.8%	14.5%	-137bp
Corporate business			
Net revenue	515	499	-3.1%
Operating expenses	434	453	4.4%
Operating profit	81	46	-43.2%
Operating margin	15.7%	9.2%	-651bp
Existing business			
Net revenue	1,482	1,716	15.8%
Operating expenses	1,234	1,403	13.7%
Operating profit	248	313	26.2%
Operating margin	16.7%	18.2%	151bp
IFBI and Imperia			
Net revenue	2	76	N.M.
Operating expenses	25	75	N.M.
Operating profit	-23	1	N.M.
Operating margin	-1150%	1%	N.M.
ElementK			
Net revenue	537	910	69.5%
Operating expenses	532	866	62.8%
Operating profit	5	44	780.0%
Operating margin	0.9%	4.8%	390bp
Consolidated NIIT			
Net revenue	2,031	2,702	33.0%
Operating expenses	1,792	2,343	30.7%
Operating profit	239	359	50.2%
Operating margin	11.8%	13.3%	152bp

Source: Company Reports

Revenue momentum slower in Individual business

Individual business momentum has slowed over the past two quarters. Management continues to guide for ~30% growth in this business for FY08. We earlier believed strong pricing power and volume growth, driven by higher capacities and capacity utilization improvement, would have led to better growth. However, after two slow quarters and the company missing our estimate for top-line growth, we are moderating our estimates. We now expect a 29% revenue CAGR for FY07-10E and an operating margin expansion to 23.3% by FY10E from 17.6% in FY07 and 21% in 1H08.

Figure 3. YoY Sales Growth: Individual Business



Source: Company Reports

Corporate business adjusting to stronger INR

The organic corporate business has seen significant erosion in profitability due to the stronger INR. With high offshore share in delivery, this business has been hit by cost escalation due to the stronger INR and wage inflation offshore. With the organic corporate business integrated with ElementK, the company now expects the combined entity to operate at 7% EBITDA margin, with 100-200bp margin improvement each year over the next few years.

Institutional business improves

The institutional business has started growing: its revenue profile has changed with a higher share of private schools. The private-school business accounted for 35% of revenue in 1H08, against 28% in FY07 and 17% in FY06. Despite a positive surprise in 2Q FY08, we are still cautious on this business as some of the older contracts are due to expire and private schools orders are typically smaller in size. Our current estimates build 2% revenue decline for FY08E and 5% decline for FY09E with improving profitability. NIIT has become aggressive in selling its IT content and school curriculum content under flagship brand NIIT@Schools. They have three key offerings in this space – “K-seven” for Primary, “Exelerate” for Secondary and “eGuru” for complete K-12 offering.

Strong traction in new businesses

NIIT reported a very strong quarter for IFBI/Imperia — revenue of Rs75m and breakeven at the EBITDA level. The company expects these businesses to make EBITDA profits for the rest of the year. Management maintained its guidance on top line at Rs350m for FY08 and Rs900m for FY09. The company expects to achieve an EBITDA margin of 25% by FY09. The company also announced that it had added four more centers, taking the total reach to 14 centers across 11 cities. The company has announced additional tie-ups — IMT Ghaziabad for Imperia and a corporate tie-up with HDFC Bank for IFBI. It has broadened its offering in IFBI to cover insurance and financial-planning courses. We have raised our estimates for IFBI/Imperia significantly.

Estimate revisions

We now expect NIIT revenue to grow at a 23% CAGR, with an EBITDA CAGR of 45% over FY07-10E. Earnings (excluding NIIT Tech equity income) is expected to grow at an 84% CAGR, while we expect consolidated earnings CAGR of 54% over FY07-10.

Figure 4. Revised Estimates by Segment (Rs m)

	FY06	FY07	Growth	FY08E	Growth	FY09E	Growth
Individual business							
Net revenue	1,670	2,471	48.0%	3,255	31.7%	4,241	30.3%
Operating profit	128	435	239.8%	681	56.6%	973	42.8%
Operating margin	7.7%	17.6%	994bp	20.9%	333bp	22.9%	201bp
Institutional business							
Net revenue	1,175	846	-28.0%	831	-1.7%	792	-4.7%
Operating profit	214	98	-54.2%	112	13.9%	119	6.4%
Operating margin	18.2%	11.6%	-663bp	13.4%	184bp	15.0%	158bp
Corporate business							
Net revenue	1,661	1,918	15.5%	2,023	5.5%	2,485	22.8%
Operating profit	260	284	9.2%	190	-33.0%	298	56.8%
Operating margin	15.7%	14.8%	-85bp	9.4%	-541bp	12.0%	260bp
Existing NIIT businesses							
Net revenue	4,506	5,235	16.2%	6,109	16.7%	7,518	23.1%
Operating profit	602	817	35.7%	983	20.3%	1,390	41.4%
Operating margin	13.4%	15.6%	225bp	16.1%	48bp	18.5%	240bp
New business - IFBI and Imperia							
Net revenue		73		345	372.6%	800	131.9%
Operating profit		-91		-23	NM	105	NM
Operating margin		-124.7%		-6.6%	11806bp	13.1%	1972bp
ElementK							
Net revenue		2,642		3,870	46.5%	3,855	-0.4%
Operating profit		50		181	262.7%	231	27.5%
Operating margin		1.9%		4.7%	279bp	6.0%	131bp
NIIT consolidated							
Net revenue	4,506	7,950	76.4%	10,324	29.9%	12,173	17.9%
Operating profit	602	776	28.9%	1,142	47.1%	1,726	51.2%
Operating margin	13.4%	9.8%	-360bp	11.1%	130bp	14.2%	312bp

Source: Company Reports and Citi Investment Research estimates

Figure 5. Earning Revisions — Consolidated Earnings

FYE 31 Mar	Net Profit (RsM)	EPS (Rs)	% chg	DPS (Rs)
2008E	943	5.67	-2.7	1.00
Prev	968	5.83		1.00
2009E	1,385	8.33	-9.9	1.07
Prev	1,535	9.25		1.10
2010E	2,092	12.58	-10.2	1.07
Prev	2,325	14.01		1.20

Source: Citi Investment Research estimates

Figure 6. SOTP-based Target Price

Core training business	
EV/EBITDA (x)	12
FY09 EBITDA (Rs mn)	1,390
EV (Rs mn)	16,679
Net debt (Rs mn)	129
Value for equity (Rs mn)	16,550
Value per share (Rs.)	100
ElementK	
Enterprise Value (US$ mn)	101
Debt (US$ mn)	35
Value for equity (US$ mn)	66
Value for equity (Rs mn)	2,625
Value per share (Rs.)	16
New Business - IFBI and Imperia	
Equity valuation	800
Value per share (Rs.)	5
NIIT Tech Stake valuation	
Average share price	363
No of shares (in mn)	14
Value at current prices	5,262
Holding company discount	25%
Stake valuation	3,947
Value per share (Rs.)	24
Consolidated valuation	
Total Equity Valuation	23,921
Fully diluted shares	166.2
Fair value of a share	144

Source: Citi Investment Research estimates

Valuation: New SOTP-based target price of Rs144

We value NIIT using a sum-of-the-parts analysis, as we believe the organic training business and NIIT Tech services have different industry dynamics. Our target price of Rs144 is based on the sum of: (1) the core organic training business (based on EV/EBITDA, a widely used valuation tool for the business); (2) ElementK; (3) new businesses; and (4) holding in NIIT Technologies. We forecast a 35% EBITDA CAGR for the organic training business over FY07-10. At 12x FY09E EBITDA, we value the organic training business at Rs16.7bn. We believe 12x is a fair EV/EBITDA for a 35% EBITDA CAGR expectation. It is at a small premium to the average valuation for IT mid-caps, which in our view is justified by NIIT's growth prospects. After adjusting for net debt of Rs129m from the enterprise value, we get an equity valuation of Rs16.55bn. We have valued ElementK at 1x FY09E revenue (US$101m), net of debt (US$35m). We also value new businesses at 1x FY09E revenue. For NIIT Tech we use a 25% discount to the average traded price of NIIT Tech over the last 10 trading days. This values the stake in NIIT Tech at Rs3.95bn.

NIIT

Company description

NIIT, an acknowledged leader in IT and IT-assisted training, provides learning and knowledge solutions in more than 30 countries. IDC brackets NIIT among the top 20 global IT training market leaders. NIIT's Knowledge Solutions Practice (SEI CMM Level 5 assessed) is a leading offshore vendor in knowledge management and eLearning. NIIT offers integrated learning solutions ranging from strategy and design to development, implementation and administration.

Investment strategy

We rate NIIT as Sell/Medium Risk (3M) for valuation reasons. NIIT shares have outperformed over the past year, making its risk-reward profile unfavorable. We, however, continue to like the company's business dynamics. As India's largest and most experienced IT training institute, NIIT looks well positioned to benefit from growing concerns over the supply of talent. India's retail IT training business is undergoing structural changes, which are being driven by 2 factors: (1) IT companies are looking for cheaper non-engineering talent; and (2) new non-IT engineers from less known universities are enrolling in IT training institutes to improve their job prospects.

Risks

Although our quantitative risk-rating system, which tracks 260-day historical share-price volatility, suggests Low Risk, we rate NIIT as Medium Risk in keeping with our risk ratings for other mid-sized IT companies. The key upside risks to our target price include: (1) higher-than-expected enrollment in IT courses; (2) higher price realization in the domestic retail training business; (3) lower-than-expected inflation in fixed costs; (4) faster-than-expected fresh orders in the institutional business; (5) higher-than-expected fresh orders in the corporate business; (6) faster turnaround of ElementK; and (7) faster-than-expected growth in new businesses.

Appendix A-1

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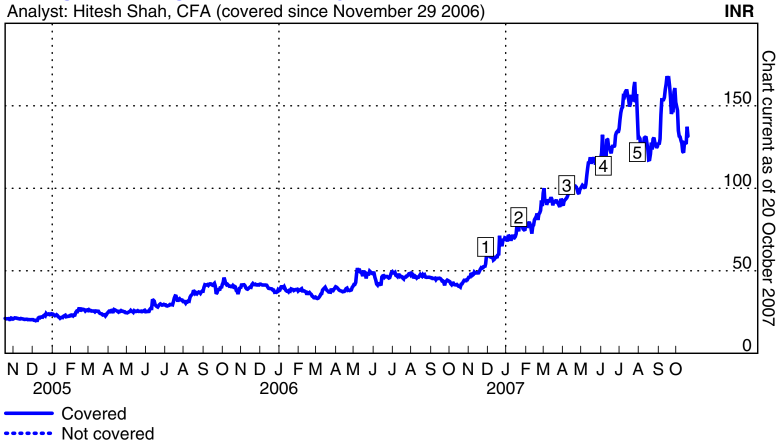
NIIT (NIIT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Hitesh Shah, CFA (covered since November 29 2006)



#	Date	Rating	Target Price	Closing Price
1:	29 Nov 06	*1M	*520.00	54.18
2:	22 Jan 07	1M	*690.00	73.89
3:	9 Apr 07	1M	*870.00	94.17
4:	6 Jun 07	1M	*1,120.00	121.53
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*Indicates change.

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