

KPIT Cummins

Rs159

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs13bn; US\$275m

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Result: Q3FY11

Comment: Blockbuster results from our key small-mid cap IT pick

Last Report: 10 January 2011 (Price Rs143; Recommendation: Outperformer)

Key valuation metrics

Year to March (Rs m)	Sales	chg yoy (%)	Net Profit	EPS (Rs)	chg yoy (%)	PER (x)
2009	7,932	32.1	659	8.4	28.4	18.9
2010	7,316	(7.8)	857	10.8	28.8	14.7
2011E	9,944	35.9	967	11.7	7.7	13.6
2012E	12,141	22.1	1,331	14.7	26.4	10.8
2013E	14,144	16.5	1,573	17.4	18.2	9.1

Source: Company, IDFC Securities Research

Key result highlights

- **Blockbuster revenues** – Reported revenues of US\$60m (+19% qoq; +53% yoy) – significantly ahead of IDFC exp of US\$56m. Organic revenue (ex of CPG Solutions & In2Soft GmbH) growth was ~10% qoq – largely volume led. In INR terms revenues were Rs2.7bn (+16.5% qoq; +48.2% yoy). EBIT margin declined by ~100bp to 11.0% (IDFC exp of 12.8%). Net profits grew by 6% qoq to Rs251m (below IDFC Exp: Rs234m).
- **Margin continues to decline** – EBITDA margin declined by 140bp qoq to 14.1% – lowest in last 11 quarters. Management attributed acquisition related costs (for In2soft and CPG), lower forex realizations, low utilization level and high attrition (>30%) as the key reasons for margin decline. Lower margins at acquired companies also led to decline in overall company margins. Margin is a key monitorable at KPIT Cummins in coming quarters.
- **Fresher-led hiring reflects confidence in deal pipeline** – Company hired net ~270 technical employees (~5% of quarter ago base) majority of whom were freshers. Management plans to make ~1,200 campus offers in Q4 – an indication of its confidence on business pipeline. Significant fresher hiring will also help in improving the margins and act as a buffer for the current high attrition.
- **Positive management commentary** – Driven by strength seen from US/ Auto vertical/ Cummins, management further raised its FY11 yoy USD revenue growth guidance to 38% - 40% (from 30% earlier) and yoy PAT growth guidance to 8% - 10% (from 5% earlier). The company expects Cummins to drive further growth even in FY12.
- **Other key highlights** – Revenues from US/Europe grew ~23% qoq. All SBU's grew qoq: IES 35%, Auto 18% and SAP 8%. Manufacturing vertical grew ~10%. Added 2 clients organically; Cummins/Star customers grew ~24% qoq; FY12 effective tax rate to be 23-25%.

Valuations and View: Revenues were ahead of expectation by miles while margins were lower than expectation. We have raised FY11E and FY12E net profits by ~3% and ~23% and EPS by ~1% and ~10%, respectively, as we account for strong quarter and capital raising (~10% of fully diluted base). We also introduce FY13 estimates. We have not built any upside from REVOLLO business in our estimates. We raise our 12-month target price to Rs220/ share (based on 15x FY12E EPS) and reiterate Outperformer on the stock. Trading at ~14x FY11E and ~11x FY12E EPS, KPIT Cummins is a key pick in small-mid cap IT services space.

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Q3FY11 results

Rs m	Q3FY10	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
Revenue (US\$ m)	39.5	50.7	60.4	19.0	52.9
Revenue	1,848	2,349	2,737	16.5	48.2
Software development expenses	1,027	1,510	1,795	18.9	74.7
Gross profit	820	840	943	12.3	14.9
<i>Gross margin (%)</i>	<i>44.4</i>	<i>35.7</i>	<i>34.4</i>	<i>(130bp)</i>	<i>(997bp)</i>
Selling and marketing expenses	181	193	191	(1.3)	5.2
General and administration expenses	246	282	366	29.8	49.3
EBITDA	394	364	385	5.8	(2.1)
<i>EBITDA margin (%)</i>	<i>21.3</i>	<i>15.5</i>	<i>14.1</i>	<i>(142bp)</i>	<i>(722bp)</i>
Depreciation	81	84	85	1.7	4.4
EBIT	312	281	300	7.1	(3.8)
<i>EBIT margin (%)</i>	<i>16.9</i>	<i>11.9</i>	<i>11.0</i>	<i>(97bp)</i>	<i>(592bp)</i>
Profit before tax	253	272	302	11.3	19.3
Provision for taxation	40	34	49	44.5	24.1
Profit after tax	214	238	253	6.5	18.4
Minority interest	0	0	2	n.a.	n.a.
Profit after minority interest	214	238	251	5.8	17.6
Reported EPS (Rs)					
- basic	2.74	3.01	3.17	5.3	15.7
- diluted	2.71	2.91	3.05	4.8	12.5

Source: Company

□ Raise 12M price target to Rs220; reiterate Outperformer

Revenues were ahead of expectation by miles while margin were lower than expectation. We have raised FY11E and FY12E net profits by ~3% and ~23% and EPS by ~1% and ~10%, respectively, as we account for strong quarter and capital raising (~10% of fully diluted base). We also introduce FY13 estimates. We have not built any upside from REVOLLO business in our estimates. We have marginally changed our INR assumption to Rs45.6/ USD for FY11E, Rs43.7/ USD for FY12E and Rs41.7/ USD for FY13.

Earnings revision table

	FY11E	FY12E	FY13E
Net profit (Rs m)			
- New	967	1,331	1,573
- Old	935	1,083	-
<i>Change (%)</i>	<i>3.5</i>	<i>22.8</i>	<i>-</i>
Fully diluted EPS (Rs.)			
- New	11.7	14.7	17.4
- Old	11.5	13.3	-
<i>Change (%)</i>	<i>1.3</i>	<i>10.5</i>	<i>-</i>

Source: IDFC Securities

We raise our 12-month target price to Rs220/ share (based on 15x FY12E EPS) and reiterate Outperformer on the stock. Trading at ~14x FY11E and ~11x FY12E EPS, KPIT Cummins is a key pick in small-mid cap IT services space.

Other key result tables

Key HR and execution metrics

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
Average FTE							
- Onsite	515	549	547	562	696	23.8	35.1
- Offshore	3,708	3,803	4,132	4,627	4,878	5.4	31.6
Quarter end FTE							
Delivery manpower	4,332	4,478	4,895	5,474	5,743	4.9	32.6
- Net add	297	146	417	579	269	(53.5)	(9.4)
Support	359	380	387	401	407	1.5	13.4
Sales	58	60	62	78	79	1.3	36.2
- Offshore	72.2	72.3	68.5	67.9	67.6	(30bp)	(460bp)
Revenues Split (%)							
- Onsite	37.1	44.3	42.8	38.3	46.3	798bp	916bp
- Offshore	62.9	55.8	57.2	61.7	53.7	(798bp)	(916bp)

Source: Company

Revenue Mix

(%)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
Geographic Mix							
USA	61.1	67.3	65.7	66.9	69.3	23.2	73.4
Europe	28.5	22.4	21.7	19.9	20.6	23.1	10.1
Rest of world	10.4	10.4	12.5	13.2	10.2	(8.4)	50.1
Vertical Mix							
Manufacturing	83.6	78.7	79.2	78.3	72.6	10.2	32.7
DFS	7.1	5.2	4.6	3.6	3.0	(1.3)	(35.3)
E&U	3.9	7.6	7.8	6.4	6.6	23.6	157.7
Others	5.3	8.5	8.4	11.7	17.8	81.5	413.7
Revenue by Contract Type							
Time and material	65.6	69.6	68.9	70.5	68.4	15.4	59.4
Fixed price	34.4	30.4	31.1	29.5	31.6	27.7	40.6
Revenue Mix - SBU wise							
Integrated Enterprise Solutions	49.3	39.7	38.2	35.0	39.6	34.8	22.8
SAP	28.6	29.6	30.8	34.6	31.5	8.2	68.5
Auto & Engineering	19.1	27.1	26.9	26.9	26.6	17.7	113.1
Semicon solution group	3.0	3.6	4.1	3.6	2.3	(22.1)	18.0

Source: Company

Client metrics

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
Client Concentration (%)							
Top Client – Cummins	30.6	24.9	24.4	23.0	24.1	24.5	20.2
Star Customers - Non Cummins	41.2	39.5	36.7	33.8	35.2	24.0	30.7
Top 10 Client Billing	58.0	48.5	54.9	55.0	51.2	10.8	34.8
NonTop10	42.0	51.5	45.1	45.1	48.8	29.0	77.9
Client relationships							
Clients added (organically)	2	2	3	3	5	2	3
Total clients	139	141	144	147	152	5	13
Total star clients (includes Cummins)	26	28	28	28	28	0	2
Number of clients > US\$1mn+	27	32	35	39	40	1	13
Revenue from repeat business	90%+	90%+	90%+	90%+	90%+	n.a.	n.a.
Debtors days	71	66	68	68	64	(4)	(7)

Source: Company

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