Company In-Depth

9 April 2007 | 11 pages

NIIT (NIIT.BO)

Buy: Pricing Power Returns; Raising Target Price

Rating change ☐
Target price change ☑
Estimate change ☑

- Retail training upswing intact — The upswing is being driven by the underlying trends in the IT industry: Indian IT companies are recruiting non-engineering resources for new service lines like testing, IMS and maintenance services; and non-IT engineers from tier 2 & 3 colleges are looking at short-term courses to improve their job prospects, driving career segment enrollment for NIIT.

- Pricing power returns — With campus wages on an upswing, we think there is a case for another fee hike after a 20-25% rise in June 2006. *Our channel checks indicate that NIIT has already implemented an 8-15% hike in CATS (short term re-skilling) courses.* We expect a similar hike in GNIIT and AAE in May-Jun 07.

- Case for re-rating — We have again raised our estimates for the domestic retail training business. We now expect an EBITDA CAGR of 45%+ over FY06-09 (one of the highest in our IT coverage universe); we believe a re-rating is imminent. We use 12x (up from 10x) as our target EV/EBITDA for the organic training business.

- Near-term correction cannot be ruled out — While we remain positive on the medium-to-long term prospects for the business, the stock is exposed to the risk of some correction near-term because it has run up 125% in the past 6 months.

- Raising estimates and target price — We are raising our estimates slightly for the retail training business while largely maintaining our other forecasts. Also, we incorporate new prices for NIIT Tech stake and value the organic learning business at 12x average FY08E-09E EBITDA. Our new sum-of-the-parts values NIIT at Rs870.

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

Buy/Medium Risk	**1M**
Price (09 Apr 07)	Rs706.25
Target price	Rs870.00
from Rs690.00	
Expected share price return	23.2%
Expected dividend yield	1.0%
Expected total return	**24.2%**
Market Cap	Rs13,952M
	US$327M

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 (%)
2005A	348	17.52	na	40.3	5.8	na	0.8
2006A	414	19.29	10.1	36.6	5.1	16.5	0.8
2007E	526	24.22	25.5	29.2	4.5	18.4	1.0
2008E	958	43.75	80.6	16.1	3.6	27.9	1.1
2009E	1,483	67.45	54.2	10.5	2.7	33.2	1.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	40.3	36.6	29.2	16.1	10.5
EV/EBITDA adjusted (x)	na	19.7	17.7	11.5	7.8
P/BV (x)	5.8	5.1	4.5	3.6	2.7
Dividend yield (%)	0.8	0.8	1.0	1.1	1.1
Per Share Data (Rs)					
EPS adjusted	17.52	19.29	24.22	43.75	67.45
EPS reported	17.52	19.29	24.22	43.75	67.45
BVPS	121.58	138.09	156.45	196.00	261.87
DPS	5.50	6.00	7.00	7.50	8.00
Profit & Loss (RsM)					
Net sales	3,984	4,507	7,567	9,814	11,404
Operating expenses	-3,840	-4,280	-7,268	-9,013	-10,054
EBIT	**144**	**227**	**299**	**801**	**1,350**
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	73	38	-81	-140	-91
Pre-tax profit	**217**	**266**	**218**	**661**	**1,259**
Tax	-10	-29	3	-99	-252
Extraord./Min.Int./Pref.div.	141	177	305	397	476
Reported net income	**348**	**414**	**526**	**958**	**1,483**
Adjusted earnings	348	414	526	958	1,483
Adjusted EBITDA	626	703	827	1,301	1,770
Growth Rates (%)					
Sales	na	13.1	67.9	29.7	16.2
EBIT adjusted	na	57.8	31.7	167.8	68.5
EBITDA adjusted	na	12.4	17.6	57.3	36.0
EPS adjusted	na	10.1	25.5	80.6	54.2
Cash Flow (RsM)					
Operating cash flow	**-253**	**92**	**1,062**	**1,264**	**1,689**
Depreciation/amortization	482	476	528	500	420
Net working capital	-876	-562	232	62	171
Investing cash flow	**-234**	**-582**	**-2,690**	**-1,009**	**-1,030**
Capital expenditure	-198	-522	-2,372	-550	-550
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**32**	**585**	**1,311**	**-376**	**-598**
Borrowings	153	678	1,522	-200	-400
Dividends paid	-121	-131	-154	-176	-198
Change in cash	**-455**	**95**	**-317**	**-122**	**61**
Balance Sheet (RsM)					
Total assets	**3,817**	**5,105**	**7,469**	**8,669**	**10,078**
Cash & cash equivalent	545	701	631	896	1,492
Accounts receivable	1,258	1,895	2,073	2,420	2,656
Net fixed assets	441	795	1,192	1,446	1,709
Total liabilities	**1,411**	**2,379**	**4,429**	**4,847**	**4,971**
Accounts payable	831	1,132	1,665	2,159	2,509
Total Debt	412	1,090	2,612	2,412	2,012
Shareholders' funds	**2,405**	**2,725**	**3,041**	**3,823**	**5,107**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	15.7	15.6	10.9	13.3	15.5
ROE adjusted	na	16.5	18.4	27.9	33.2
ROIC adjusted	na	8.3	8.4	15.9	25.2
Net debt to equity	-5.5	14.3	65.1	39.7	10.2
Total debt to capital	14.6	28.6	46.2	38.7	28.3

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Upswing intact; pricing power returns

The upswing in the retail training industry is driven by some key underlying trends in the IT industry: (a) Indian IT companies recruiting non-engineering resources for new service lines like testing, IMS and standardized maintenance services — this is driving GNIIT enrollment; and (b) non-IT engineers from tier 2 & 3 colleges are looking at short-term courses to improve their job prospects — this is driving ANIIT enrollment.

NIIT, the market leader in the IT training industry, has been the key beneficiary of this trend. NIIT raised its course fees by 20-25% in June 2006 after a gap of a few years. Despite this hike, GNIIT enrollment increased by ~100% yoy during the June-Sept period.

Average realization to keep moving up in FY08E

We expect average realization (revenue per student) for NIIT to continue to increase in FY08 and FY09 due to a combination of three factors: a) more students coming at higher price points and students from earlier courses moving out of the system after completing their courses; b) changes in the enrollment profile — a higher share of career segment enrollment; and c) another likely fee hike in the May-June period.

Case for another fee hike? Campus wages on an upswing bodes well for NIIT

Campus salaries for fresh graduates have been on an upswing. After a 10-15% hike this year, Indian IT majors are expected to give another campus level fresher a salary hike of 10% next year. Clearly, this has reduced the pay-back period for a student enrolling for the career segment IT courses.

We see a good possibility of fee hikes in the coming few months as the training industry sees seasonal uptick with the back-to-school period around May-Sept. Our channel checks indicate that NIIT has already introduced fee hikes of 8-15% for short-term re-skilling courses (*erstwhile CATS courses*). We expect NIIT to take similar hikes for its flagship course GNIIT (3-year career program) and AAE (4 months full-time program for engineering graduates).

New innovative products – Network Labs, ANIIT should fuel growth

NIIT has launched new courses to cater to increasing demand from the industry for specialized skill-set. Over the past few months, the company has launched two key offerings — NetworkLABS and IAE (Integrated ANIIT for Engineers).

NIIT NetworkLABS is one year industry-endorsed course covering networking and infrastructure management technologies. The curriculum has been designed in partnership with global technology leaders such as 3Com, CompTIA, Intel and Microsoft, and is mapped to job profiles as per industry requirements for the IMS service line. NIIT has placement partnerships with a few major IT companies ready to absorb through relevant career openings. This program also has options of pursuing certification programmes such as A+, Network+, MCDST (Microsoft Certified Desktop Support Technician), MCSE (Microsoft Certified Systems Engineer), and CCNA (Cisco Certified Network Associate). This course has been initially launched in Chennai and Delhi, and would be gradually rolled out to other locations.

IAE (Integrated ANIIT for Engineers) is a newer version of AAE (Accelerate ANIIT for Engineers). It is a five-semester-long dual-qualification program to be pursued alongside engineering studies. This course has been launched in Chennai, Hyderabad, Bangalore, Pune and Delhi. IAE has widened the target market for the ANIIT curriculum, as earlier it was only available to graduate engineers after completing their graduation.

Figure 1. NIIT — Breakdown by Business

	FY06	FY07E	Change	FY08E	Change	FY09E	Change
Individual business							
Net revenue	1,670	2,465	47.6%	3,384	37.3%	4,116	21.6%
Operating profit	128	421	228.9%	776	84.3%	1,008	29.9%
Operating margin	7.7%	17.1%	941bp	22.9%	585bp	24.5%	156bp
Institutional business							
Net revenue	1,175	812	-30.9%	688	-15.4%	704	2.4%
Operating profit	214	96	-55.0%	89	-7.2%	106	18.1%
Operating margin	18.2%	11.9%	-636bp	13.0%	114bp	15.0%	200bp
Corporate business							
Net revenue	1,661	1,931	16.3%	2,307	19.5%	2,768	20.0%
Operating profit	260	290	11.5%	345	19.0%	429	24.4%
Operating margin	15.7%	15.0%	-64bp	15.0%	-6bp	15.5%	55bp
Existing NIIT businesses							
Net revenue	4,506	5,208	15.6%	6,378	22.5%	7,587	19.0%
Operating profit	602	807	34.1%	1,210	49.9%	1,543	27.5%
Operating margin	13.4%	15.5%	214bp	19.0%	348bp	20.3%	136bp
New business - IFBI and Imperia							
Net revenue		69		150	117.4%	225	50.0%
Operating profit		-104		-69	NM	0	NM
Operating margin		-150.4%		-46.0%	10436bp	0.0%	4600bp
ElementK							
Net revenue		2,289		3,286	43.6%	3,591	9.3%
Operating profit		66		150	127.8%	287	91.6%
Operating margin		2.9%		4.6%	169bp	8.0%	344bp
NIIT consolidated							
Net revenue	4,506	7,566	67.9%	9,814	29.7%	11,404	16.2%
Operating profit	602	769	27.8%	1,291	67.8%	1,830	41.7%
Operating margin	13.4%	10.2%	-319bp	13.2%	299bp	16.0%	289bp

Source: Company Reports and Citigroup Investment Research estimates

US corporate business – consolidation to drive pricing power

The US corporate business continues to consolidate. SkillSoft now expects to close NETg acquisition by May/June 2007. We expect pricing power to return to learning platform vendors after a series of consolidation in the US corporate training market. (Refer our NIIT initiation report *"Initiating at Buy: Structural Upturn, Play the Leader in IT Training"*, 29 November 2006 for a detailed discussion of industry consolidation.) We have maintained our estimates for this business.

Institutional business – Status quo

We have maintained our estimates for this business, which is reducing as a percentage of overall revenue as the retail business accelerates and ElementK gives scale to the corporate business. We expect this business to further decline in FY08 by 15% after a ~31% decline in FY07E.

IFBI, Imperia – prospects look good but still not valuing them

IFBI (Institute of Finance, Banking and Insurance), has seen decent enrollment post its launch. A very good long-term growth driver, in our view, we believe it is still in its infancy. Imperia – distance executive management education – in partnership with Indian Institute of Management (IIMs) has also had a decent response, though we would wait to see how well NIIT can scale it up. We do not ascribe any value to both IFBI and Imperia.

Case for re-rating

We have raised our estimates marginally for the retail training business, incorporating better realization — primarily on the back of enrollment profile changes and more students coming at higher price points. Our overall EPS estimates for FY08-09 rise around 3%. We also factor in modest fee hikes for career segment courses. This has already happened for the CATS, and we expect it to flow to GNIIT and AAE courses over the next 2-3 months.

We now estimate a 35% revenue CAGR and a 99% EBITDA CAGR for the retail training business (individual business). We maintain our forecasts for other businesses. Overall, we estimate a 36% revenue CAGR, a 45% EBITDA CAGR and a 52% diluted EPS CAGR over the FY06-09 period.

On strong enrollment growth, pricing power returning, higher visibility, and operating leverage, we now use 12x to value the organic training business of NIIT (up from 10x earlier). We believe 12x is a fair EV/EBITDA multiple for a 45% EBITDA CAGR. It is at a small premium to the IT mid-cap valuation average, justified in our view by NIIT's growth prospects.

Figure 2. NIIT Sum-of-Parts Valuation — Highlighting Changes

	Previous	New	Comments
Core training business			**EBITDA upgrade + Target multiple**
EV/EBITDA (x)	10	12	Target multiple raised
EBITDA (FY08/FY08-09 avg) (Rs mn)	1,278	1,342	EBITDA upgraded by ~5%
EV (Rs mn)	12,783	16,103	
Net debt (Rs mn)	269	269	
Value for equity (Rs mn)	12,514	15,834	
ElementK			**No change**
Enterprise Value (US$ mn)	40	40	ElementK valued at acquisition cost
Debt (US$ mn)	35	35	
Value for equity (US$ mn)	5	5	
Value for equity (Rs mn)	225	225	
New Business - IFBI and Imperia			**No change**
Equity valuation	0	0	We do not ascribe any value to this due to its nascent stage
NIIT Tech Stake valuation			**Update NIIT Tech price**
Average share price (Rs.)	353	440	Average price for last three weeks
No of shares (in mn)	9.66	9.66	
Value at current prices (Rs mn)	3,411	4,249	
Holding company discount	25%	25%	Holding company discount of 25%
Stake valuation (Rs mn)	2,558	3,187	
Consolidated valuation			
Total Equity Valuation (Rs mn)	15,297	19,246	
Fully diluted shares	22.14	22.14	
Fair value of a share (Rs.)	690	870	

Source: Citigroup Investment Research estimates

Figure 3. Indian IT Coverage Universe — Valuation Comparison Table

Company	RIC Code	Rating	Mkt cap (US$m)	Price# (Rs.)	TP (Rs.)	P/E (x) FY07E	P/E (x) FY08E	EV/EBITDA (x) FY07E	EV/EBITDA (x) FY08E	Div. Yield (%) FY07E	Div. Yield (%) FY08E
Infosys	INFY.BO	1L	26,722	2,044	2,660	31.2	24.1	24.9	19.0	0.6%	0.7%
TCS	TCS.BO	1L	27,902	1,217	1,560	28.7	22.5	23.3	18.1	0.8%	1.0%
Wipro	WIPR.BO	1L	19,204	562	730	28.8	22.4	22.8	17.6	1.4%	1.8%
Satyam	SATY.BO	1M	7,218	462	582	22.6	18.3	17.9	14.0	1.3%	1.7%
HCL Tech	HCLT.BO	1M	4,567	294	385	19.2	16.1	13.9	11.2	2.7%	2.7%
Patni*	PTNI.BO	1M	1,347	410	463	21.5	13.9	9.3	8.1	0.7%	0.9%
I-Flex	IFLX.BO	3M	4,145	2,127	1,850	53.4	40.4	41.1	28.8	0.1%	0.1%
Hexaware*	HEXT.BO	1M	529	170	214	18.9	15.1	16.2	10.1	0.9%	1.2%
NIIT	NIIT.BO	1M	327	706	870	29.2	16.1	17.3	12.2	1.0%	1.1%
Sasken	SKCT.BO	1M	341	510	653	29.5	16.3	16.3	11.3	0.6%	1.0%
KPIT	KPIT.BO	1M	232	133	173	24.6	14.9	13.8	10.5	0.4%	0.4%

Source: Citigroup Investment Research estimates; #As of 9 April 2007; *Using CY06E and CY07E for these companies (31-Dec year-ending).

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 thesis

We rate NIIT as Buy/Medium Risk (1M) with a target price of Rs870. As India's largest and most experienced IT training institute, NIIT looks well positioned to benefit from growing concerns over the supply of talent. In this context, we expect strong business momentum in the retail training business in India. 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. NIIT's corporate business is on a steady growth path with healthy new orders. The acquisition of ElementK should help NIIT build up its position in the US.

Valuation

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 Rs870 is the sum of: (1) the core organic training business (based on EV/EBITDA, a widely used valuation tool for the business); (2) ElementK; and (3) holding in NIIT Technologies. We do not ascribe any value to the two new business initiatives as they are still in their infancy. We forecast EBITDA for the organic training business will post a 45% CAGR over FY06-09. At 12x average FY08-09E EBITDA, we value the organic training business at Rs16.1bn. We believe 12x is a fair EV/EBITDA multiple for a 45% 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 deducting net debt of Rs269m from the enterprise value, we get an equity valuation of Rs15.83bn. We have conservatively valued ElementK at the acquisition cost of US$40m, net of debt (US$35m). We are therefore factoring in only acquisition cost as enterprise value for ElementK. We estimate an equity contribution to NIIT of Rs225m. For NIIT Tech; we use a 25% discount to the average traded price of NIIT Tech for the last three trading weeks. The average traded price of NIIT Tech over the past three weeks has been Rs440, giving a value of Rs4.25bn. Using a 25% holding-company discount, we value NIIT's equity stake in NIIT Tech at Rs3.2bn for NIIT.

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 downside risks to our target price include: (1) lower-than-expected enrollment in IT courses; (2) lower price realization in the domestic retail training business; (3) higher-than-expected inflation in fixed costs; (4) slower-than-expected fresh orders in the institutional business; (5) weaker-than-expected fresh orders in the corporate business; (6) integration risks from the acquisition of ElementK; and (7) receivables turning bad.

Appendix A-1

Analyst Certification

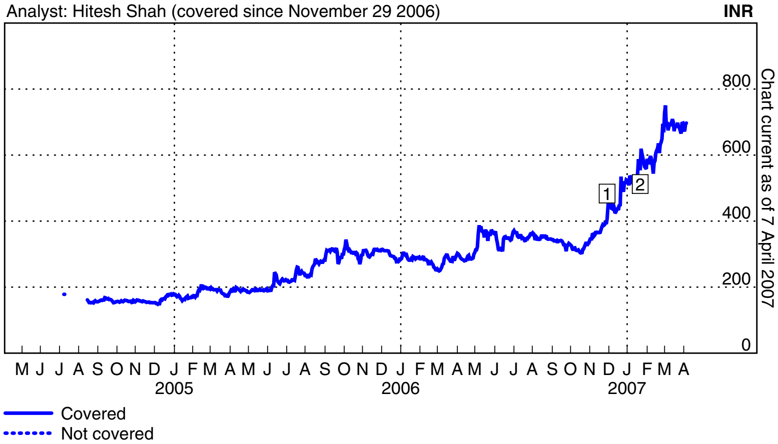
We, Hitesh Shah and Surendra Goyal, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

NIIT (NIIT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Hitesh Shah (covered since November 29 2006)



#	Date	Rating	Target Price	Closing Price
1:	29 Nov 06	*1M	*520.00	406.35
2:	22 Jan 07	1M	*690.00	554.15

*Indicates change.

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Citigroup Investment Research Global Fundamental Coverage (3215)	45%	40%	15%
% of companies in each rating category that are investment banking clients	45%	42%	32%

India -- Asia Pacific (130)	58%	14%	28%
% of companies in each rating category that are investment banking clients	42%	50%	42%

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Low to Medium Risk -- High Single A through High Triple B
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