Result Update – Q4FY08

Kavveri Telecom Products Ltd. (CMP: Rs. 96.90) July 09, 2008

We had initiated coverage on Kavveri Telecom Products Ltd. (KTPL) in October 2007 at a price of Rs. 189.65 with a 12-month target of Rs. 248. The stock surpassed the target within a short span of time and went on to make a high of Rs. 304.70 on 02/01/08. Due to a subdued fourth quarter, the stock has now plunged to Rs. 96.65. We present a quarterly update on the stock after the fourth quarter (Q4 FY08) results following a discussion with the management.

Company Background

KTPL is into a very niche segment of telecom products namely Antennas and Radio Frequency products for wireless (telecom) sector, defence & space applications. KTPL generates revenues from RF products, Antennas & to some extent, from solar products. KTPL offers a bouquet of world-class products and solutions to meet all antennas/RF product requirements of telecom manufacturers, telecom service providers and telecom users. KTPL has 3 units in Bangalore, 1 in Pondicherry and 2 in Canada and a total strength of about 310 people. KTPL has a capacity of 200000 antennas and 15,000 RF products (such as filters, combiners, splitters, feeder cables and repeaters) in India over a 40,000 sq. ft. area for design, development and production of these products.

Q4 FY08 Results - Standalone

- KTPL recorded revenues of Rs. 38.67 crs in Q4 FY08 as compared to Rs. 23.38 crs, a growth of 65.40%. However, sequentially, the revenues fell by 10%. The fall in revenues in this quarter was due to postponement on an order worth about Rs. 12 crs from China, which has been carried forward to the next quarter. The delay in execution of this order was due to unexpected snowfall in China.

- The other income recorded a substantial rise of 525% y-o-y and this was due to some regrouping insisted by the auditors. The discounts on raw materials and foreign exchange fluctuations also added to the other income tally. In the earlier quarters, these were set off against the raw material purchases.

- There has been a fall in the raw material consumption in this quarter as compared to previous quarter by 12%. The other expenditure increased quite significantly by 95% y-o-y and by 189% sequentially and the staff cost increased by 27% y-o-y and 10% q-o-q. The rise in other expenditure and staff cost is due to payment of gratuity, bonuses, managerial commission, etc., and payment towards acquisition expenses (Rs. 0.80 crs acquisition expenses w/off), which eventually increased the total operating expenditure by 70% y-o-y.

- The Operating Profit improved by 70% y-o-y, but on a q-o-q basis, the operating profit dipped by 23% due to rise in the operating expenses (other expenses). This led to a fall in the margins from 17.70% in Q3 FY08 to 15.23% in Q4 FY08. However, y-o-y the margins improved.

- The interest cost rose unusually by 493% y-o-y and by 93% q-o-q. This was mainly due to additional Rs. 20 crs borrowed by KTPL for funding its acquisitions of Spotwave, deal for which was signed in Q3 FY08. Earlier, it had funded the acquisition ($7 mn) from the available working capital limits. This led to interest accounting for roughly 7% of sales. However, KTPL has been talking to local banks in Canada and USA, where the interest cost is low. By substituting the borrowing at local rates, interest cost could come down in future.

- The Net profits improved by 62% y-o-y from Rs. 1.92 crs in Q4 FY07to Rs. 3.11 crs in Q4 FY08, but sequentially, the net profits dropped significantly by 49%. A subdued Q4 led to fall in the net margins from 8.21% in Q4 FY07 and 14.28% in Q3 FY08 to 8.04% in Q4 FY08. However going forward, the management claims of improving its net margins by having a better product mix and better technology.

FY08 Results

- On a full year basis, KTPL posted consolidated revenues of Rs. 157.92 crs in FY08 as compared to Rs. 53.57 crs in FY07, a sharp growth of 195%. On a standalone basis, the revenues increased by 180%. The Radio Frequency segment accounted for Rs. 88 crs of the revenues, Solar systems contributed Rs. 13 crs and In-building solutions accounted for rest of the balance of Rs. 39.7 crs. This significant growth in revenues was led by a god order book in FY08. KTPL has an outstanding order book of Rs. 200 crs, which is executable in FY09.

- The subsidiaries of KTPL (DCI, Tiltek and Sigma) recorded gross revenues of $ 6.5 mn, but after inter-company set off, the revenues come to around Rs. 19 crs. They posted a combined profit of about Rs. 1 cr for FY08. A brief performance of KTPL's subsidiaries in FY08 is mentioned below:

Particulars (in Rs Crs)	Tiltek (12 months)	DCI Inc (11 months)	Spotwave (80 days)
Income	17.21	4.51	4.17
Net Profit	0.28	-0.1	0.81

(Source: Company)

- The raw material consumption increased significantly by 217%, staff cost also increased by 112% and the other expenditure increased by 92% on a consolidated basis. The rise in staff cost was due to addition of some people at the senior management level and payment of gratuity and bonuses to the employees. KTPL faces pressure on input cost as almost half of the raw material is imported, due to which it gets affected by Rupee depreciation against the dollar. The Rupee depreciated by 1.8% v/s the US Dollar in the March quarter and has further depreciated by 7.2% in June quarter. This hit the EBIDTA by about 2%, but still KTPL was able to set this off by renegotiating on its prices. Any appreciation in the dollar could be a threat to the profitability of KTPL.

- The operating profits rose significantly by 188% on a consolidated basis and by 165% on a standalone basis. However, the operating margins fell on a consolidated basis from 15.57% in FY07 to 15.19% in FY08. The standalone margins were better as compared to consolidated, as the overseas-acquired entities recorded lower margins as compared to the Indian entity. KTPL enjoys better margins in in-building solutions and filters in RF products as compared to other products.

- There has been a huge rise in the interest cost by 282% due to loans borrowed for fulfilling the funding of acquisitions and capacity expansion. KTPL has debt worth Rs. 55 crs out of which term loan accounts for Rs. 28 crs and the balance being towards working capital requirement. However, the interest cost could reduce going forward, if KTPL could get access to funds at lower rates from the local banks in Canada for its Canadian subsidiaries.

- KTPL was liable to pay tax under MAT, but due to deferred tax of Rs. 2.14 crs, the tax payable increased for the full year on a standalone basis to 25.61% from 15.45% in FY07. KTPL's tax rate could increase, as it would not fall under MAT in FY09.

- The net profits improved from Rs. 5.91 crs in FY07 to Rs. 11.65 crs in FY08, a growth of 97% on a standalone basis. However, the net profit margins declined from 11.77% in FY07 to 8.28% in FY08. On a consolidated basis, the net profits increased by 168%, but here again the NPM declined from 8.62% in FY07 to 7.83% in FY08.

Key Developments

1. The project of setting up the new facility at Jigani has been delayed by about 3-4 months and facility would be operational by Sep 08. The area of this facility has been increased from 1,22,000 sq ft to 1,50,000 sq ft, which has led to the delay in operation of the facility. KTPL has incurred an additional expenditure of Rs. 3 crs and the R&D expenditure has also been increased to Rs. 14-15 crs for FY09 as compared to Rs. 11.5 crs in FY08. The full effect of this expansion would be visible in FY10.

2. KTPL has been increasing its foothold on in-building solutions as it gives higher margins as compared to other businesses. KTPL believes that in-building solutions has a big market in China and after the introduction of Wi-max and 3G services, virtually every building could need in-building solution, and this could be a big opportunity for KTPL. Presently, KTPL has contracts worth Rs. 55 crs in in-building solutions, which is executable over the next financial year.

Recommendation:

Postponement of an order from China led to a subdued quarter in terms of revenue. Recruitment of personnel at the senior management level, other expenditure and huge interest cost burden for repaying the funds raised for acquisition also increased the cost. All this led to KTPL recording a subdued quarter.

We are not revising our estimates for FY09 till we study the unconsolidated annual report for FY08 and the Q1FY09 results. KTPL promises to have a good business model and seems to be strongly placed to reap the benefits of increased used of technology in Telecom business. Moreover, expansion of its facility could help in improving the turnover. The acquisition of Spotwave and Sigma gives KTPL a strong foothold in in-building solutions business and more competitiveness on the technology front. In-building solutions could be the next major catalyst for future revenues and profitability growth. However, KTPL faces the risk of execution of the orders without any delays, as any delay in order execution could affect our revenues and earnings estimates for FY09. Moreover, Rupee depreciation seems to be a major concern to growth in profits as raw material cost could be under pressure if the Rupee continues to depreciate against US Dollar. The Rupee's 7.2% depreciation against the US Dollar could impact Q1 FY09 results adversely.

KTPL reported sharply lower numbers for Q4 FY08 out of the blue without giving any inkling about them. Sentiments towards small/midcap stocks are anyway down and such sequential dip, without any forewarning makes it difficult for KTPL to get better valuations.

Financials:

P& L Account	Q4 FY08	Q4 FY07	Chg %	Q3 FY08	Chg %	FY07	FY08 (A)	% Chg	FY08 (E)	Chg %	FY09 (E)	% Chg	FY07 *	FY08* (A)	% Chg
Net Sales	38.67	23.38	65.40	43.00	-10.07	50.2	140.73	180.34	150.04	198.88	165.50	4.80	53.57	157.92	194.79
Other Income	1.5	0.24	525.00	0.04	3650.00	0.32	2.99	834.38	0.40	25.00	2.80	-33.17	1.59	4.19	163.52
Total Income	40.17	23.62	70.07	43.04	-6.67	50.52	143.72	184.48	150.44	197.78	168.30	3.82	55.16	162.11	193.89
Total Expd	34.28	20.16	70.04	35.43	-3.25	42.35	122.1	188.31	124.61	194.24	140.30	1.58	46.82	138.12	195.00
PBIDT	5.89	3.46	70.23	7.61	-22.60	8.17	21.62	164.63	25.83	216.16	28.00	16.72	8.34	23.99	187.65
Interest	2.61	0.44	493.18	1.35	93.33	0.87	5.45	526.44	4.15	377.01	2.80	-57.58	1.73	6.60	281.50
Depreciation	0.16	0.09	77.78	0.12	33.33	0.31	0.51	64.52	0.47	51.61	1.80	74.76	0.90	1.03	14.44
PBT	3.12	2.93	6.48	6.14	-49.19	6.99	15.66	124.03	21.21	203.43	23.40	43.03	5.71	16.36	186.51
Total Tax	0.01	1.01	0.00	0	0.00	1.08	4.01	271.30	2.44	125.85	5.26	31.50	1.09	4	266.97
Reported PAT	3.11	1.92	61.98	6.14	-49.35	5.91	11.65	97.12	18.77	217.61	18.14	46.76	4.62	12.36	167.53
EPS	3.09	1.91	61.98	6.10	-49.35	5.87	11.58	97.12	18.66	217.61	18.03	46.76	4.59	12.29	167.53
Equity	10.06	10.06	0	10.06	0	10.06	10.06	0.00	10.06	0	10.06		10.06	10.06	
Face Value	10	10		10		10	10		10		10		10	10	
OPM (%)	15.23	14.80		17.70		16.27	15.36		17.22		16.92		15.57	15.19	
NPM (%)	8.04	8.21		14.28		11.77	8.28		12.51		10.96		8.62	7.83	

* - Consolidated Financials (Source: Capitalline, HDFC Sec estimates)

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