

KPIT Cummins

Emerging Star Conference Note

Mkt Cap: Rs12.6bn; US\$276m

7 February 2011
BSE Sensex: 18008

IT Services

We hosted the management of KPIT Cummins at IDFC Emerging Star Conference 2011. KPIT Cummins is a mid-tier IT services provider focused on the manufacturing vertical with a presence in the automotive, industrial and defense sectors. It is now investing to expand into energy and utilities verticals. Within the above verticals, the company is focused on a few key customers. In terms of service lines, KPIT offers VLSI and embedded software services, package implementation, business intelligence, and BPO services besides regular application development and maintenance services. The company has ~5,600 employees working for 150+ clients.

□ Key takeaways from the meeting

Robust revenue growth momentum: Driven by the improving macroeconomic environment and an increase in automobile-related discretionary spending, KPIT is witnessing strong revenue growth momentum. The company's organic business is expected to grow by 30-38% and inorganic business by 7-8% in FY12 on the back of overall ~38-40% growth in FY11.

Margins to improve gradually: Operating margins have been declining recently because of acquisition-related costs, high attrition, low utilization, and lower margins at the acquired entities. The management is focused on improving these and is employing various levers like higher fresher hiring, improving utilization, and increasing revenues from offshore and fixed-price projects. These levers would play out in the long term and margins are expected to rise gradually to ~18% in the next 2-3 years.

REVOLO update: In June 2010, KPIT entered into a 50:50 JV with Bharat Forge to manufacture and market an indigenously developed hybrid technology solution for automobiles – REVOLO. This would enable both existing and new vehicles to dramatically increase fuel efficiency (by 50-80% depending upon the driving conditions) and engine performance, while significantly decreasing green house gas emissions (~30%). The solution is currently being successfully tested on a few retrofit fleet operators. REVOLO has received positive feedback from the retrofit market and, post necessary approvals from the government, is expected to be operational by Q1FY12.

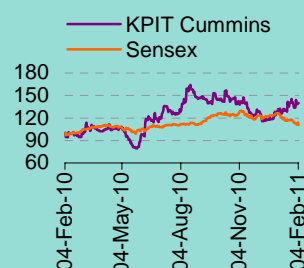
Attrition continues to be a challenge: The management conceded that high attrition is a challenge, especially in the 3-5 year experience band. It is trying to address this issue by hiring more freshers and providing existing employees more growth opportunities. The company also did not rule out the possibility of double-digit wage hikes in FY12.

M&A: KPIT acquired three companies (Sparta, In2soft and CPG) in the past six quarters and is seeking more acquisition opportunities in the Oracle and SAP space. It got board approval in January 2011 to raise Rs1.125bn by preferential share allotment, mainly for funding acquisitions.

□ Our view

We expect KPIT to continue witnessing strong demand-led revenue growth from both the organic and inorganic businesses. We currently do not build in any upside from REVOLO. Trading at ~14x FY11E and ~11x FY12E EPS, KPIT Cummins is a key pick in the small-mid cap IT services space. We have an Outperformer rating with 12-month target price of Rs220 (based on 15x FY12E EPS).

Price chart



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Key Financials

As on 31 March	FY09	FY10	FY11E	FY12E	FY13E
Net sales (Rs m)	7,932	7,316	9,944	12,141	14,144
Adj. net profit (Rs m)	659	857	967	1,331	1,573
Shares in issue (m)	78	78	80	87	87
Adj. EPS (Rs)	8.4	10.8	11.7	14.7	17.4
% change	25.1	28.8	7.7	26.4	18.2
PER (x)	18.8	14.6	13.5	10.7	9.1
Price/ Book (x)	7.6	3.2	0.8	0.8	0.8
EV/ EBITDA (x)	6.5	7.8	0.9	1.1	0.6
RoE (%)	30.8	31.1	9.7	8.0	8.7
RoCE (%)	43.5	33.0	11.0	8.3	8.8

Source: Company, IDFC Securities

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2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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