ABN·AMRO

Monday 14 May 2007

Change of recommendation

KPIT Cummins Infosystems

Over the hedge

KPIT's 4Q07 results were in line. We believe FY08 guidance builds in an optimistic operating environment, thus limiting potential outperformance. With the stock currently near its peak valuation, we see limited upside. Downgrade to Hold.

Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
Revenue (Rsm)	3182.1	4637.0	6294.4	8648.7	11176.2
EBITDA (Rsm)	459.4	715.1	954.3	1271.1▲	1546.4
Reported net profit (Rsm)	314.0	444.7	652.8	929.8▲	1186.5
Normalised net profit (Rsm)[1]	314.0	444.7	652.8	929.8	1186.5
Normalised EPS (Rs)	3.53	4.91	7.68	10.9▲	14.0
Dividend per share (Rs)	0.35	0.70	0.80▲	1.00▲	1.25
Dividend yield (%)	0.26	0.51	0.59	0.73	0.92
Normalised PE (x)	38.6	27.7	17.7	12.4▼	9.75
EV/EBITDA (x)	23.6	15.4	11.1	8.16	6.53
Price/book value (x)	8.51	6.37	4.06	3.09	2.39
ROIC (%)	38.8	28.6	27.8	32.3	31.9

1. Post-goodwill amortisation and pre-exceptional items
Accounting Standard: Local GAAP
Source: Company data, ABN AMRO forecasts

year to Mar, fully diluted

In-line 4Q07 result; hedging gains boost top line...

KPIT's consolidated revenue was up 11.3% qoq to Rs1.30bn (up 11.7% qoq in US$ terms), in line with our estimate of Rs1.30bn. Growth was volume-led; billed effort was up 13.8% qoq while blended realisation was down 1.8% qoq. KPIT books forex gains/losses in the top line; thus, the underlying operating revenue growth and margin trend is unclear. PAT grew 2.4% qoq to Rs141m (versus our estimate of Rs131m), driven by better operating margins despite interest costs rising sharply (as capitalisation ceased) and effective tax rate rising to normalised levels.

... while operating metrics improved to drive margins ahead of estimates

Gross margin rose 177bp qoq, which we believe was driven by the sharp uptick in utilisation – up 408bp onsite and 463bp offshore – and increased offshore delivery, whose share grew 118bp. However, SG&A expenses increased due to strong hiring of sales and support staff in 4QFY07. Thus, EBITDA margin rose 53bp to 15.8%, still ahead of our estimate of 14.7%. The company added two star clients (total now 17). Non-Top10 clients grew faster at 19.1%, vs 9.4% for Top10 clients.

FY08 guidance builds in an optimistic operating environment, in our view

FY08 revenue guidance of US$143m-143.7m implies 39.5-40.2% growth. PAT guidance of Rs700m-730m implies net margin expansion of 53-96bp. Management's guidance assumes a Rs43.00/US$ exchange rate and builds in: 1) a 5-6% increase in offshore and onsite realisations; 2) improved utilisation and offshore share; and 3) an effective wage hike in mid single digit vs guided average of 16% in FY08. We believe these are optimistic assumptions and thus see limited potential to outperform.

Downgrade to Hold

We adjust our forecasts to factor in 4QFY07 actuals and our latest FX forecasts. We also introduce FY10 numbers and adjust our risk-free rate assumption. We now see 34.1% CAGR in revenue (36.8% in US$ terms) and 34% CAGR in PAT over FY07-10. Our DCF-based target price is up at Rs140 (from Rs115) and values the stock at 16.4x FY08F basic EPS (post-amortisation). The stock is up 17.3% against a 0.4% rise in the BSE IT Index ytd. It currently trades at 15.9x FY08F basic EPS, the top-end of its historical band and the 12-15x band for peers. Given the inherent risks of concentrated business mix, we see limited rerating potential. Downgrade to Hold.

Priced at close of business 11 May 2007. Use of ▲▼ indicates that the line item has changed by at least 5%.

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Hold (from Buy)

Absolute performance
n/a

Short term (0-60 days)
Neutral

Market relative to region

Software
India

Price
Rs136.10

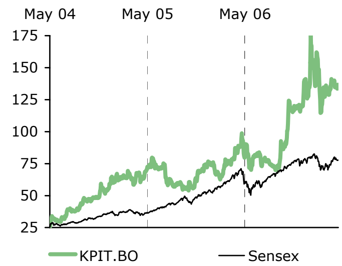
Target price
Rs140.00 (from Rs126.00)

Market capitalisation
Rs10.38bn (US$251.34m)

Avg (12mth) daily turnover
Rs24.67m (US$0.56m)

Reuters	Bloomberg
KPIT.BO	KPIT IN

Price performance	(1M)	(3M)	(12M)
Price (Rs)	135.6	141.3	94.2
Absolute %	0.4	-3.6	44.4
Rel market %	-4.1	1.5	30.2
Rel sector %	-4.4	3.8	24.8



Stock borrowing: Impossible
Volatility (30-day): 25.4%
Volatility (6-month trend): ↓
52-week range: 180.90-66.00
Sensex: 13796.16
BBG AP Software: 329.57

Source: ABN AMRO, Bloomberg

Researched by
ABN AMRO Institutional Equities Team

www.abnamrobroking.co.in

Over the hedge

KPIT's 4Q07 results were in line. We believe guidance for FY08 builds in an optimistic operating environment, thus limiting potential outperformance. With stock near peak valuations, we see limited upside. Downgrade to Hold.

What drives the change in our investment view

Our original investment argument on KPIT was a) top-line growth to remain ahead of mid-tier Indian IT services players; b) improving operating metrics; and c) gradual rerating for the stock on the back of constant strong quarterly results and as fears of equity dilution from Cummins recede. We see this has played out well.

Our original investment thesis has played out well

KPIT Cummins' FY07 consolidated revenues were up 45.7% yoy to Rs4.6bn (40.6% yoy growth in US$ terms), in line with our estimates. Growth was primarily volume led; billed effort showed an 11.4% CQGR while blended realisation declined at a 2.2% CQGR as offshore share grew 928bp over FY06. PAT grew 54.5% yoy to Rs504m (versus Rs495m our estimates).

Operating metrics have improved…

Gross margins improved 258bp yoy in FY07. We believe this was driven by increased offshore delivery and onsite realisation (up 8.1% yoy) even as offshore realisation was up just 0.7% yoy due to the increasing share of lower-priced BPO services. Increased hiring has also helped; per-capita manpower costs were down 0.8% yoy despite 17.5% and 3.5% salary hikes to offshore and onsite staff, respectively, effected during the year. However, SG&A expenses also increased by 160bp due to a 65% addition to sales and support staff over FY07. Overall, EBITDA margin improved 99bp yoy to 15.4% (versus our estimated 70bp).

… and valuations now reflect the growth momentum

Improved business performance has helped drive stock performance. The stock has been a strong outperformer over the last six months – up 17.3% against a 0.4% increase in the BSE IT Index. It currently trades at 15.9x FY08F basic EPS (post-amortisation), near the top end of its historical valuation band and the 12-15x band for peers.

From here, where? We see limited upside potential

Given the stock's recent run-up, we believe the current valuation prices in most of the positives and leaves limited scope for upside.

FY08 guidance builds in an optimistic operating environment, in our view

FY08 revenue guidance of US$143m-143.7m implies 39.5-40.2% growth. PAT guidance of Rs700m-730m implies a net margin expansion of 53-96bp. Management said the guidance assumes an exchange rate of Rs43/US$ and builds in a 5-6% increase in offshore and onsite realisations; an expansion in utilisation and the share of offshore; and a wage hike of mid single digits versus the guided average of 16% in FY08. We believe these are optimistic assumptions and thus see limited potential for the shares to outperform. The company has a history of downward guidance revisions (1Q06) and missed the top end of its net income guidance by 9% in FY06 and FY07.

We are confident in top-line growth momentum…

Gross employee addition guidance of 2,400 for FY08 is ahead of our earlier estimates of 1,700. At 4Q07 attrition levels, this implies a headcount addition of over 50% to the FY07 base. We believe volume-led growth should help drive the top line marginally ahead of guidance, given the traction in existing businesses – non-Cummins revenues showed a 12% CQGR in FY07 – and a significant thrust in BPO in FY08.

… but are cautious on the margin outlook

We believe a 100bp expansion in the net margin to meet the upper end of guidance will be a challenge. Offshore delivery share, the biggest lever in FY07, at 21.4% in 4Q07, is at industry-high levels (due to the growing share of the ODC business from clients such as Cummins and Renesas) and we see limited further expansion potential. Same is the case with utilisation, given the projected 50% share of freshers among new recruits. Management said it plans to lower the "join-to-billing" cycle time for freshers to two months from the current six. However, we believe the plans are at initial stages and their effect will be delayed and spread over the medium term. Note that attrition is currently around 23% and should pick up as the share of BPO services (which typically have higher attrition) increase. We also are conservative on realisation growth potential despite management speaking of likely 5-6% yoy growth in average realisation for both onsite and offshore. We believe a concentrated client portfolio and the likely increasing share of BPO services should keep realisation growth under check. Note that management aspires to increase net margins to 16% by FY10 from 10.8% in FY07.

Stock at the higher end of valuation band – we see limited rerating potential

At the current price, KPIT trades at 15.9x basic EPS (post-amortisation) for FY08F, and at a premium to its peer group average of 13x and peer range of 12-15x. It also trades at a valuation discount of just 7% to Satyam. We see limited rerating potential, given the inherent business risks of a concentrated client portfolio.

Downgrade to Hold

We have adjusted our forecasts to factor in 4Q07 actuals our latest forex forecasts. We have also introduced FY10 numbers and have adjusted our risk-free rate assumptions. We now forecast a 34.1% CAGR in revenues (36.8% in US$ terms) and a 34% CAGR in PAT over FY07-10. We are adjusting our DCF-based target price to Rs140 (from Rs115), which values the stock at 16.4x FY08F basic EPS (post-amortisation).

Table 1 : Management speak – and our interpretation

What management said	What this could mean
▪ Planned gross additions of 2,400 in FY08, of which 20-25% will be in BPO. We expect the share of freshers in recruitment to go up to 50%.	▪ The gross addition guidance is significantly higher than our earlier estimates of net adds of 780. We have raised our net additions estimates for FY08 to 1,225, factoring in current attrition levels of around 23%. However, we have been conservative on utilisation. Our FY08 estimates factor in blended utilisation of 76.3% vs 77.7% in 4Q07, due to higher expected share of fresher recruitments.
▪ See strong upward bias in pricing – onsite and offshore pricing likely to go up by 5-6% driven by 3-5% hikes in renewals and 10%+ higher pricing in new contracts for auto/semi-conductor industry clients.	▪ We believe the net impact of higher pricing is likely to be muted for FY08, as we expect higher contribution to revenues from BPO reflected in the gross addition guidance and continued improvement in the offshoring mix. We expect a 1.9% dip in blended realisation in FY08, despite a 4.3% increase in onsite realisation and a 0.5% dip in offshore realisation.
▪ FY08 salary hikes of 16% on blended basis, but effective wage hike likely to be in mid-single digits.	▪ We see an effective hike of about 6% in offshore and 3% in onsite salaries in FY08, building in significantly higher freshers additions, and lower cost BPO headcount.
▪ Guiding for net margin improvement of to 11.4-11.8% in FY08 vs 10.8% in FY07.	▪ We believe the guidance factors in some forex gains in addition to an optimistic operating environment. Our net margin forecast is near the lower end of the guided range, as we do not build in any forex gains, given the low visibility on forex management.

Source: Company data, ABN AMRO

4Q07 results review

Table 2 : Key financials

(Rs m)	1Q06	2Q06	3Q06	4Q06	FY06	1Q07	2Q07	3Q07	4Q07	FY07
Cons revenue (US$m)	16	18	18	21	73	23	25	26	29	103
Change (yoy/qoq)	***4.3%***	***9.7%***	***3.2%***	***13.3%***	***28.9%***	***9.1%***	***10.9%***	***4.0%***	***11.7%***	***40.6%***
Cons revenue	**700**	**777**	**804**	**902**	**3,182**	**1,023**	**1,140**	**1,171**	**1,303**	**4,637**
Change (yoy/qoq)	*4.0%*	*11.0%*	*3.5%*	*12.1%*	*26.0%*	*13.4%*	*11.5%*	*2.7%*	*11.3%*	*45.7%*
Cost of revenue	462	508	520	571	2,061	641	715	734	794	2,884
Gross profit	**238**	**269**	**284**	**330**	**1,121**	**382**	**425**	**437**	**509**	**1,753**
Gross margin	***34.0%***	***34.6%***	***35.3%***	***36.6%***	***35.2%***	***37.3%***	***37.3%***	***37.3%***	***39.1%***	***37.8%***
Total operating exp.	150	163	168	180	662	229	247	258	304	1,038
EBITDA	**87**	**106**	**116**	**150**	**459**	**152**	**179**	**178**	**206**	**715**
EBITDA margin	***12.5%***	***13.6%***	***14.5%***	***16.7%***	***14.4%***	***14.9%***	***15.7%***	***15.2%***	***15.8%***	***15.4%***
Depreciation & amort.	17	20	22	23	82	25	30	30	35	121
EBIT	**70**	**86**	**94**	**127**	**378**	**127**	**148**	**148**	**170**	**594**
EBIT margin	***10.0%***	***11.1%***	***11.7%***	***14.1%***	***11.9%***	***12.4%***	***13.0%***	***12.6%***	***13.1%***	***12.8%***
Interest/fin exp, net	2	3	5	9	19	11	7	9	17	45
Other income	0	0	0	0	0	1	0	1	4	6
Profit before tax	69	83	89	119	359	117	141	140	157	555
Income tax expense	5	7	6	16	33	13	18	4	17	52
Net inc from ops	**64**	**76**	**83**	**103**	**326**	**104**	**124**	**135**	**141**	**503**
Change (qoq/yoy)	***-14.1%***	***19.2%***	***8.6%***	***24.2%***	***16.3%***	***0.9%***	***19.3%***	***9.3%***	***3.9%***	***54.5%***
Minority interest	0	0	0	0	0	0	0	-2	0	-2
PAT (exl extraord)	**64**	**76**	**83**	**103**	**326**	**103**	**123**	**137**	**141**	**505**
Adj Basic EPS (Rs)	**0.9**	**1.1**	**1.1**	**1.4**	**4.5**	**1.4**	**1.7**	**1.8**	**1.9**	**6.8**
Change (yoy/qoq)	***-22.7%***	***16.7%***	***8.3%***	***23.0%***	***2.4%***	***-0.7%***	***18.4%***	***11.0%***	***2.6%***	***50.0%***

Source: Company data

FY07 revenues marginally ahead of upper range of guidance of US$102m

177bp increase in gross margins due to a 400bp+ improvement in utilisation

Share of SG&A expenses was up 124bp qoq

D&A as a proportion of revenues was up 12bp

Spike in interest expenses due to expensing out of interest on debt taken for campus that is now operational

Tax rates back to normalised levels of 10.5% after deferred tax credits were used in 3Q07

FY07 PAT just above the lower end of guided range of Rs501m-534m

Table 3 : How the margin drivers moved

	4Q06	3Q07	4Q07	Change QoQ	Change YoY
Exchange rate (Rs/US$)	**43.68**	**45.07**	**44.40**	**-1.5%**	**1.6%**
Consolidated revenues (Rs m)	**902**	**1,171**	**1,303**	**11.3%**	**44.5%**
A. EXECUTION DRIVERS					
Utilisation - onsite	93.0%	89.0%	93.1%	408bp	8bp
Utilisation - offshore	71.0%	69.8%	74.4%	463bp	338bp
Billed effort (person-month) (E)					
Onsite	1,233	1,295	1,396	7.8%	13.2%
Offshore	3,008	4,447	5,137	15.5%	70.8%
Total	**4,241**	**5,742**	**6,533**	**13.8%**	**54.1%**
Average realisation (US$/person-month) (E)					
Onsite	9,467	10,111	10,380	2.7%	9.6%
Offshore	2,981	2,899	2,831	-2.4%	-5.1%
Blended	**4,867**	**4,526**	**4,444**	**-1.8%**	**-8.7%**
B. COST DRIVERS					
Cost of revenues	571	734	794	8.1%	38.9%
Gross profit	**330**	**437**	**509**	**16.6%**	**54.3%**
Gross margin	***36.6%***	***37.3%***	***39.1%***	***177bp***	***247bp***
SG&A expenses	180	258	304	17.5%	68.8%
As % of revenues	*20.0%*	*22.1%*	*23.3%*	*124bp*	*335bp*
Operating profit (EBITDA)	**150**	**178**	**206**	**15.2%**	**36.8%**
Operating margin	***16.7%***	***15.2%***	***15.8%***	***53bp***	***-89bp***

Source: Company data

Management said current hedge position covers 60-70% of net cash inflows for FY08

Offshore utilisation now at highest level in last 9 quarters

Share of offshore effort is up 928bp in FY07, now at historically high levels of 78.6% in 4Q07

Onsite and offshore realisation are up 8.1% and 0.7% respectively in FY07

Gross margin was up 258bp in FY07

We estimated a 50bp contraction in EBITDA margin in 4Q07

Table 4 : Key manpower and execution metrics

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07
Employee base								
Delivery manpower	1,464	1,630	1,764	1,906	2,306	2,529	2,787	2,900
Net addition	166	166	134	142	400	223	258	113
Sales and Support	203	214	219	216	238	269	332	356
Total	**1,667**	**1,844**	**1,983**	**2,122**	**2,544**	**2,809**	**3,119**	**3,256**
Net addition	186	177	139	139	422	265	310	137
As % of opening base	*12.6%*	*10.6%*	*7.5%*	*7.0%*	*19.9%*	*10.4%*	*11.0%*	*4.4%*
Utilisation								
Onsite	92.5%	95.0%	92.0%	93.0%	92.0%	93.0%	89.0%	93.1%
Offshore	69.5%	72.0%	70.0%	71.0%	71.0%	72.0%	69.8%	74.4%

Source: Company data

53% net adds over opening base in FY07

Management guiding for 2,400 gross adds in FY08

Attrition currently at 23% for overall company

Table 5 : Key client metrics

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07
Client base								
Active clients	na	32	35	39	77	82	86	90
Net client addition	-	-	3	4	38	5	4	4
Rev/active client (US$m/qtr)	-	0.55	0.52	0.53	0.29	0.30	0.30	0.32
Client concentration								
Top Client – Cummins	43.9%	47.9%	49.6%	45.3%	44.3%	42.0%	40.0%	37.5%
Star Customers - Non Cummins	41.0%	36.6%	34.3%	36.1%	31.3%	35.7%	41.8%	43.0%
Top 10 Client Billing	89.8%	88.7%	86.9%	83.8%	79.5%	76.3%	75.8%	74.2%
NonTop10	10.2%	11.3%	13.1%	16.3%	20.5%	23.7%	24.3%	25.9%
Revenue growth								
Top Client – Cummins	27.3%	21.1%	7.4%	2.3%	11.0%	5.8%	-2.2%	4.4%
Star Customers - Non Cummins	-4.7%	-0.9%	-3.1%	18.1%	-1.5%	27.1%	20.2%	14.6%
Top 10 Client Billing	4.5%	9.7%	1.4%	8.1%	7.7%	7.0%	2.0%	8.9%
Non Top 10	-0.5%	22.9%	20.1%	39.2%	43.1%	29.0%	5.0%	18.6%

Source: Company data

17 star clients with 2 being added during the quarter

Revenue per active client largely static over the last 4 quarters

Revenues from Cummins grew only 3.9% CQGR vs 8.9% for overall company in the last four quarters

Management said slowdown of growth in Cummins is due to completion of certain projects and will pick up once new projects ramp up

Table 6 : 4Q08 Guidance analysis

	FY08 Guidance		Implied Growth	
	Lower	Upper	Lower	Upper
Rev ($ m)	143.0	143.7	39.5%	40.2%
Net profit ($ m)	16.3	17.0	44.5%	50.7%
Rev (Rs m)	**6,150.0**	**6,180.0**	**32.6%**	**33.3%**
Net profit (Rs m)	**700.0**	**730.0**	**38.7%**	**44.6%**
Net margin	**11.4%**	**11.8%**	**53bp**	**96bp**

Source: Company data

We believe top-line guidance is achievable, given the strong headcount guidance; however, wage pressures and already high levels of offshoring mix and utilisation pose a challenge in achieving net margin expansion

Downgrade to Hold

We are downgrading KPIT from Buy to Hold, on a revised DCF-based target price of Rs140 (Rs115 previously). Our new target implies only 3% potential upside from the current level.

Forecasts revisions

We have revised our forecasts, factoring in the higher-than-expected management guidance for headcount addition and realisation growth in FY08 and higher than expected utilisation in 4Q07. We have changed our currency assumptions also to reflect the latest view of our regional economists. We project an FY07-10 revenue CAGR of 34.1% (36.8% in US$ terms) and a net income CAGR of 34%. We have also changed our risk-free rate assumption in our DCF model from 7.75% to 8.25%, in line with our economists' view, and have adjusted other assumptions to maintain fair value and a six- to 12-month target price of Rs140. At our target, the stock is valued at 15.9x FY08F basic EPS (post-goodwill amortisation) and represents 3% potential upside from current levels.

The key downside risks to our target price for KPIT are: 1) rupee appreciation exceeding the level we assume; 2) a slowdown in the US economy that could affect corporate IT spending; 3) a major breach of data security by an Indian firm resulting in strong regulatory action against outsourcing. Upside risk could come from 1) a rupee depreciation; and 2) acquisitions/large deal wins not built into our model.

Our new currency assumptions reflect the latest view of our regional economists

We factor in guidance for 2,400 gross adds as well as US$ revenue guidance for FY08 into our assumptions

We increase share of offshore delivery to factor in the 928bp improvement in FY07

While we factor in management's strong outlook on pricing for onsite, we believe higher share of BPO services will drag offshore realisation

EPS estimates for FY08 are down despite higher EBITDA margin as a result –higher interest expense and equity dilution impact of 2.9% and 3.0% respectively

Table 7 : What has changed in our key assumptions and forecasts

	FY08F	FY09F	FY10F		FY08F	FY09F	FY10F
Exchange rate (Rs/US$)							
OLD	45.08	44.80	-				
NEW	43.09	42.60	42.60				
Change	-4.4%	-4.9%	-				
A. OPERATIONAL ASSUMPTIONS							
Total employees - delivery				**Utilisation – offshore**			
OLD	3,709	4,569	-	OLD	76.5%	77.0%	-
NEW	4,210	5,570	6,970	NEW	76.3%	76.7%	77.2%
Change	13.5%	21.9%	-	Change	-18bp	-32bp	-
Billed effort (person-months)				**Billed effort share – onsite**			
OLD	30,772	38,551	-	OLD	23.5%	23.0%	-
NEW	32,701	45,153	58,201	NEW	20.7%	20.2%	20.0%
Change	6.3%	17.1%	-	Change	-277bp	-277bp	-
Billing rate (US$/p-m) - Onsite				**Billing rate (US$/p-m) – Offshore**			
OLD	10,315	10,470	-	OLD	2,884	2,913	-
NEW	10,585	10,764	10,872	NEW	2,868	2,906	2,917
Change	2.6%	2.8%	-	Change	-0.6%	-0.2%	-
B. FINANCIAL FORECASTS							
Revenue (US$m)				**Revenue (Rs m)**			
OLD	142	179	-	OLD	6,424	8,033	-
NEW	146	203	262	NEW	6,294	8,649	11,176
Change	2.5%	13.2%	-	Change	-2.0%	7.7%	-
EBITDA margin				**EPS – basic (pre-goodwill amortisation)**			
OLD	14.9%	13.9%	-	OLD	9.65	11.03	-
NEW	15.2%	14.7%	13.8%	NEW	9.34	12.97	15.93
Change	25bp	77bp	-	Change	-3.2%	17.5%	-

Source: Company data, ABN AMRO forecasts

Chart 1 : KPIT - PE valuation band movement (Rs)

Source: Bloomberg, Company data, ABN AMRO

We see limited upside in valuation, with the stock trading at the higher end of 12-month forward PE valuation range

The spikes in valuation in January and February were due to speculation of a large order win, which management subsequently denied in a communication to investors in March

Chart 2 : KPIT - valuation discount to Satyam

Source: Bloomberg, Company data, ABN AMRO

Valuation discount to Satyam is low by historical standards

We believe this is unjustifiably low, given the inherent business risks for KPIT due to a concentrated client portfolio

Key assumptions and forecasts

Table 8 : Key assumptions and forecasts

(Rsm)	FY05A	FY06A	FY07F	1Q08F	2Q08F	3Q08F	4Q08F	FY08F	FY09F	FY10F
Exchange rate (Rs/US$)	**44.63**	**43.63**	**45.23**	**43.20**	**43.50**	**43.15**	**42.60**	**43.09**	**42.60**	**42.60**
OPERATIONAL ASSUMPTIONS										
Total employees	1,481	2,122	3,256	3,606	3,987	4,377	4,696	4,696	6,155	7,677
Billed person-months	10,728	14,618	22,524	7,074	7,854	8,438	9,335	32,701	45,153	58,201
Change (yoy/qoq)	-	*36.3%*	*54.1%*	*8.3%*	*11.0%*	*7.4%*	*10.6%*	*45.2%*	*38.1%*	*28.9%*
Average realisation										
Onsite (US$/person-month)	8,976	9,381	10,145	10,458	10,537	10,616	10,695	10,585	10,764	10,872
Change (yoy/qoq)	*15.6%*	*4.5%*	*8.1%*	*0.8%*	*0.8%*	*0.8%*	*0.8%*	*4.3%*	*1.7%*	*1.0%*
Offshore (US$/person-month)	2,808	2,862	2,882	2,845	2,859	2,873	2,888	2,868	2,906	2,917
Change (yoy/qoq)	*-3.8%*	*1.9%*	*0.7%*	*0.5%*	*0.5%*	*0.5%*	*0.5%*	*-0.5%*	*1.3%*	*0.4%*
KEY FINANCIAL FORECASTS										
Revenue	2,525	3,182	4,637	1,358	1,528	1,624	1,785	6,294	8,649	11,176
Change (yoy/qoq)	*98.8%*	*26.0%*	*45.7%*	*4.2%*	*12.5%*	*6.3%*	*9.9%*	*35.7%*	*37.4%*	*29.2%*
Gross margin (%)	**34.1%**	**35.2%**	**37.8%**	**35.4%**	**36.6%**	**35.6%**	**36.7%**	**36.1%**	**34.2%**	**31.6%**
Operating margin (%)	**13.2%**	**14.4%**	**15.4%**	**13.4%**	**15.3%**	**14.8%**	**16.7%**	**15.2%**	**14.7%**	**13.8%**
PAT (pre goodwill amortisation)	**283**	**326**	**505**	**127**	**174**	**180**	**232**	**712**	**989**	**1,215**
Change (yoy/qoq)	*91.5%*	*15.0%*	*54.5%*	*-9.8%*	*36.9%*	*3.8%*	*28.5%*	*41.6%*	*38.8%*	*22.8%*
PAT (Adj. for goodwill amortisation)	**274**	**314**	**445**	**112**	**159**	**165**	**217**	**653**	**930**	**1,186**
EPS - Basic (Rs) (pre-goodwill amort)	**4.42**	**4.53**	**6.79**	**1.68**	**2.28**	**2.36**	**3.04**	**9.36**	**12.97**	**15.93**
EPS - Basic (Rs) (post-goodwill amort)	**4.27**	**4.37**	**5.98**	**1.48**	**2.08**	**2.17**	**2.84**	**8.58**	**12.19**	**15.56**
EPS - Fully diluted (Rs) **(pre-goodwill amort)**	3.42	3.66	5.48	1.42	2.04	2.12	2.72	8.31	11.63	14.29
EPS - Fully diluted (Rs) (post-goodwill amort)	**3.30**	**3.53**	**4.91**	**1.26**	**1.87**	**1.95**	**2.55**	**7.68**	**10.94**	**13.96**
Shares outstanding – basic (m)	70.45	72.05	74.78	76.25	76.25	76.25	76.25	76.25	76.25	76.25
Shares outstanding – fully diluted (m)	85.45	88.65	93.09	85.02	85.02	85.02	85.02	85.02	85.02	85.02

Source: Company data, ABN AMRO forecasts

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KPIT CUMMINS INFOSYSTEMS: KEY FINANCIAL DATA

Income statement

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Revenue	3182.1	4637.0	6294.4	8648.7	11176.2
Cost of sales	-2061.1	-2883.7	-4022.6	-5689.1	-7642.7
Operating costs	-661.6	-1038.2	-1317.5	-1688.4	-1987.1
EBITDA	**459.4**	**715.1**	**954.3**	**1271.1**	**1546.4**
DDA & Impairment (ex gw)	-81.8	-121.2	-145.8	-163.4	-188.3
EBITA	**377.6**	**593.9**	**808.4**	**1107.8**	**1358.1**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**377.6**	**593.9**	**808.4**	**1107.8**	**1358.1**
Net interest	0.00	0.00	0.00	0.00	0.00
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	-19.0	-39.1	-12.7	3.21	22.1
Reported PTP	**358.6**	**554.9**	**795.7**	**1111.0**	**1380.2**
Taxation	-33.0	-51.8	-83.6	-122.2	-165.6
Minority interests	-0.03	1.66	0.00	0.00	0.00
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	-11.5	-60.1	-59.3	-59.0	-28.1
Reported net profit	**314.0**	**444.7**	**652.8**	**929.8**	**1186.5**
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	**314.0**	**444.7**	**652.8**	**929.8**	**1186.5**

Source: Company data, ABN AMRO forecasts ***year to Mar***

Balance sheet

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Cash & market secs (1)	411.3	625.3	902.9	1003.6	1172.4
Other current assets	1310.0	1446.8	1916.2	2504.3	3127.7
Tangible fixed assets	953.4	1772.1	1844.2	2230.9	2738.6
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	0.28	48.9	48.9	48.9	48.9
Total assets	**2675.0**	**3893.2**	**4712.1**	**5787.7**	**7087.6**
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	370.4	665.1	755.3	1037.8	1341.1
Long term debt (3)	875.1	1223.0	1095.4	988.9	882.4
Oth non-current liab	7.75	10.2	10.2	10.2	10.2
Total liabilities	**1253.2**	**1898.3**	**1861.0**	**2037.0**	**2233.8**
Total equity (incl min)	1421.8	1994.9	2851.1	3750.7	4853.8
Total liab & sh equity	**2675.0**	**3893.2**	**4712.1**	**5787.7**	**7087.6**
Net debt (2+3-1)	471.5	607.8	202.8	-4.45	-279.7

Source: Company data, ABN AMRO forecasts ***year ended Mar***

Cash flow statement

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
EBITDA	459.4	715.1	954.3	1271.1	1546.4
Change in working capital	-587.0	157.9	-379.1	-305.6	-320.1
Net interest (pd) / rec	-19.0	-39.1	-12.7	3.21	22.1
Taxes paid	-30.8	-49.3	-83.6	-122.2	-165.6
Other oper cash items	n/a	n/a	n/a	n/a	n/a
Cash flow from ops (1)	**-177.4**	**784.7**	**478.9**	**846.5**	**1082.7**
Capex (2)	-497.6	-939.9	-218.0	-550.1	-696.0
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-0.17	-48.6	0.00	0.00	0.00
Cash flow from invest (3)	**-497.8**	**-988.5**	**-218.0**	**-550.1**	**-696.0**
Incr / (decr) in equity	61.1	131.3	215.4	0.00	0.00
Incr / (decr) in debt	505.5	347.9	-127.5	-106.5	-106.5
Ordinary dividend paid	-26.2	-61.2	-71.4	-89.2	-111.5
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	n/a	n/a	n/a	n/a	n/a
Cash flow from fin (5)	**540.4**	**417.9**	**16.6**	**-195.7**	**-218.0**
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
Inc/(decr) cash (1+3+5+6)	**-134.8**	**214.0**	**277.5**	**100.8**	**168.8**
Equity FCF (1+2+4)	-675.0	-155.2	261.0	296.5	386.8

Lines in bold can be derived from the immediately preceding lines. ***year to Mar***
Source: Company data, ABN AMRO forecasts

KPIT CUMMINS INFOSYSTEMS: PERFORMANCE AND VALUATION

Standard ratios

Performance	KPIT Cummins FY06A	FY07A	FY08F	FY09F	FY10F	HCL Technologies FY07F	FY08F	FY09F	Patni Computer Systems FY07F	FY08F	FY09F
Sales growth (%)	26.0	45.7	35.7	37.4	29.2	38.3	30.0	28.2	13.3	15.7	20.4
EBITDA growth (%)	37.4	55.7	33.4	33.2	21.7	39.7	30.3	25.5	14.3	7.44	15.9
EBIT growth (%)	24.9	57.3	36.1	37.0	22.6	44.3	32.0	25.3	13.2	6.00	17.0
Normalised EPS growth (%)	6.99	39.1	56.5	42.4	27.6	50.7	22.3	22.3	65.4	8.20	18.1
EBITDA margin (%)	14.4	15.4	15.2	14.7	13.8	21.0	21.1	20.6	19.7	18.3	17.6
EBIT margin (%)	11.9	12.8	12.8	12.8	12.2	16.9	17.2	16.8	16.3	15.0	14.5
Net profit margin (%)	10.2	10.9	11.3	11.4	10.9	17.9	17.2	16.4	15.0	14.0	13.8
Return on avg assets (%)	14.8	15.3	16.6	18.8	18.9	19.7	20.7	21.3	14.5	13.8	14.1
Return on avg equity (%)	26.3	29.6	29.4	30.0	28.3	24.5	26.1	27.3	17.8	16.5	17.0
ROIC (%)	38.8	28.6	27.8	32.3	31.9	43.0	45.9	45.3	39.3	32.4	32.8
ROIC - WACC (%)	24.1	13.9	13.1	17.6	17.2	28.1	31.0	30.4	23.8	17.0	17.4
					year to Mar			*year to Jun*			*year to Dec*

Valuation	KPIT Cummins FY06A	FY07A	FY08F	FY09F	FY10F	HCL Technologies FY07F	FY08F	FY09F	Patni Computer Systems FY07F	FY08F	FY09F
EV/sales (x)	3.41	2.37	1.68	1.20	0.90	3.24	2.48	1.91	1.76	1.46	1.16
EV/EBITDA (x)	23.6	15.4	11.1	8.16	6.53	15.4	11.8	9.24	8.92	7.99	6.56
EV/EBITDA @ tgt price (x)	24.3	15.8	11.4	8.39	6.72	18.2	13.9	11.0	8.84	7.92	6.49
EV/EBIT (x)	28.7	18.5	13.1	9.36	7.43	19.2	14.5	11.4	10.8	9.79	7.95
EV/invested capital (x)	5.73	4.22	3.46	2.77	2.21	7.44	5.89	4.74	4.07	3.37	2.81
Price/book value (x)	8.51	6.37	4.06	3.09	2.39	4.52	3.92	3.30	2.47	2.15	1.87
Equity FCF yield (%)	-5.57	-1.26	2.26	2.56	3.34	2.62	2.87	3.90	2.03	4.08	5.34
Normalised PE (x)	38.6	27.7	17.7	12.4	9.75	21.2	17.3	14.2	15.0	13.9	11.8
Norm PE @tgt price (x)	39.7	28.5	18.2	12.8	10.0	24.7	20.2	16.5	14.9	13.8	11.7
Dividend yield (%)	0.26	0.51	0.59	0.73	0.92	2.42	2.42	2.42	0.64	1.07	1.49
					year to Mar			*year to Jun*			*year to Dec*

Per share data	FY06A	FY07A	FY08F	FY09F	FY10F
Tot adj dil sh, ave (m)	89.0	90.6	85.0	85.0	85.0
Reported EPS (INR)	3.53	4.91	7.68	10.9	14.0
Normalised EPS (INR)	3.53	4.91	7.68	10.9	14.0
Dividend per share (INR)	0.35	0.70	0.80	1.00	1.25
Equity FCF per share (INR)	-7.58	-1.71	3.07	3.49	4.55
Book value per sh (INR)	16.0	21.4	33.5	44.1	57.0
					year to Mar

Solvency	FY06A	FY07A	FY08F	FY09F	FY10F
Net debt to equity (%)	33.2	30.5	7.11	-0.12	-5.76
Net debt to tot ass (%)	17.6	15.6	4.30	-0.08	-3.95
Net debt to EBITDA	1.03	0.85	0.21	0.00	-0.18
Current ratio (x)	4.65	3.12	3.73	3.38	3.21
Operating CF int cov (x)	-6.71	22.3	45.2	-301.1	-55.6
Dividend cover (x)	12.0	7.26	9.15	10.4	10.6
					year to Mar

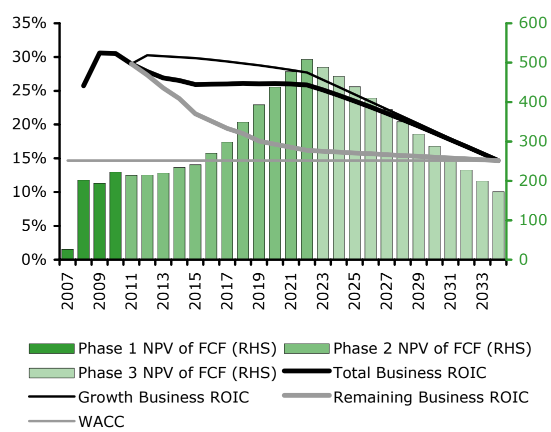
Priced as follows: KPIT.BO - Rs136.10; HCLT.BO - Rs330.50; PTNI.BO - Rs468.25
Source: Company data, ABN AMRO forecasts

KPIT CUMMINS INFOSYSTEMS: VALUATION METHODOLOGY

Economic Profit Valuation	INR m	%
Adjusted Opening Invested Capital	2857.2	25
NPV of Economic Profit During Explicit Period	1071.1	9
NPV of Econ Profit of Remaining Business (1, 2)	1538.1	14
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	5833.0	52
Enterprise Value	11299.4	100
Plus: Other Assets	0.0	0
Less: Minorities	4.4	0
Less: Net Debt (as at 12 May 2007)	597.6	5
Equity Value	10697.4	95
No. Shares (millions)	76.2	
Per Share Equity Value	**140.00**	
Current Share Price	136.10	2.9%

Discounted Cash Flow Valuation	INR m	%
Value of Phase 1: Explicit (2007 to 2010)	645.4	6
Value of Phase 2: Value Driver (2011 to 2022)	3860.3	34
Value of Phase 3: Fade (2023 to 2034)	3998.9	35
Terminal Value	2794.0	25
Enterprise Value	11298.6	100
FCF Grth Rate at end of Phs 1 implied by DCF Valuation		12.3
FCF Grth Rate at end of Phs 1 implied by Current Price		12.1

Returns, WACC and NPV of Free Cash Flow



Sensitivity Table

		No of Years in Fade Period				
		15	18	20	23	25
WACC	12.7%	199.60	212.95	221.79	234.95	243.65
	13.7%	171.52	181.48	187.99	197.56	203.81
	14.7%	148.00	155.41	160.20	167.14	171.62
	15.7%	128.21	133.71	137.21	142.25	145.46
	16.7%	111.50	115.56	118.12	121.75	124.04

Performance Summary	2007	2008	2009	Phase 2 Avg (2011 - 2022)
Invested Capital Growth (%)	37.9	17.5	22.8	17.7
Operating Margin (%)	11.4	11.8	12.0	10.1
Capital Turnover (x)	2.5	2.4	2.9	2.9

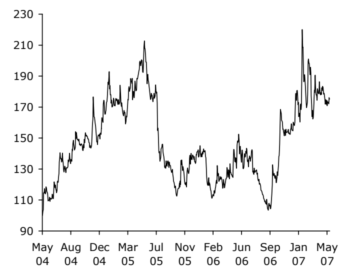
Source: ABN AMRO
1. In periods following the Explicit Period i.e. Phase 2 and Phase 3
2. Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
3. Net Investment is defined as capex over and above depreciation after Phase 1

KPIT Cummins Infosystems

Company description — Hold

KPIT Cummins Infosystem Ltd is a mid-size IT services provider focused on manufacturing and BFSI verticals. Within these two verticals, the company said it focuses on a few key customers. Among service lines, in addition to regular application development and maintenance services, KPIT Cummins offers VLSI and embedded software services, package implementation, business intelligence and BPO services. The company has more than to 3,200 employees working for 90 clients.

Price relative to country



Strategic analysis — Average SWOT company score: 3

Strengths — 2
Established client base in manufacturing and financial services verticals and an early mover advantage in the European market.

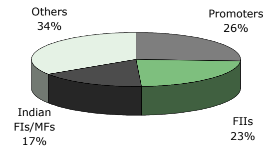
Weaknesses — 3
The lack of credible global brand/presence as well as full service capabilities, due to limited skillsets.

Opportunities — 4
Growing market opportunity for Indian offshore IT and IT-enabled services and offshore becoming mainstream.

Threats — 3
Global vendors setting up capacities in India, a depreciating US dollar, new entrants raising wages and other costs are reducing cost arbitrage in the offshore sector.

Scoring range is 1-5 (high score is good)

Shareholding, 31 Mar 2007



Source: Company data

Market data

Headquarters
Plot No 35/36,Rajiv Gandhi Infotech Park, Phase 1, MIDC, Hinjawadi, Pune - 411057

Website
www.kpitcummins.com

Shares in issue
76.2m

Freefloat
70%

Majority shareholders
Promoters (26%), Cummins group (13%), LB Group (8%)

India

Country view — Neutral

The market looks expensive, but we believe it will remain supportive when regional funds seek a domestically-driven home with continuing robust earnings growth. The ABN AMRO Indian PMI suggests the economy is still powering ahead despite the global headwinds, thanks to its domestically-oriented economic structure. At the sector level, we still like autos, software and construction-related stocks.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific

Competitive position — Average competitive score: 2-

Supplier power — 2-
Bargaining power shifting to employees, due to rising job options in the Indian IT landscape, including MNC product vendors, MNC IT services capacities, client insourcing, etc.

Barriers to entry — 2-
Low entry barriers in the offshore IT services business. However, in the embedded software space, barriers to entry are relatively higher due to the specialised skills required in this area.

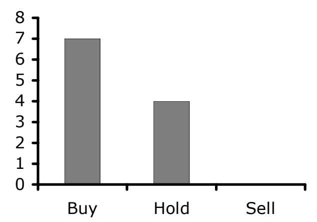
Customer power — 2-
Increasing customer bargaining power, with offshoring becoming mainstream and key service offerings becoming commoditised. New intermediaries are helping to improve price discovery.

Substitute products — 4+
Other offshore locations, such as Eastern Europe, the Philippines and China. However, this will impact only in the medium to long term, in our view.

Rivalry — 2-
Intense rivalry due to similar commoditised offerings and same low-cost, little differentiation and positioning.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg