

29 May 2020

## KPIT Technologies

*Higher growth and margins in a tough quarter; Buy*

At \$76.9m, KPIT reported flat quarter (up 0.1%q/q, 8%y/y). It lost 1.5% in revenue on account of Covid-19 this quarter. The EBIT margin came at 8.5%, up 28bps q/q, down 82bps y/y. The company continued to strengthen its balance sheet, ending FY20 with high, ₹3,278m, net cash. Despite Q4 being better than expected, auto/engineering is seeing headwinds ahead, with management talking of up to a 15% drop in Q1 revenues. We cut our FY21e/FY22e revenues 15%, resulting in a lower target of ₹85 (₹100 earlier) at 13x FY22e EPS.

**Revenue to decline 10-15% in Q1.** For FY20, KPIT delivered 14% dollar revenue growth, better than peers (LTTS 9%, Tata Elxsi -1%, Cyient -5%). Besides, it secured a large, over \$50m, deal from a tier-1/existing OEM client/Europe, spread over five years, possibly its largest, and assures of its capabilities in the auto space. Growth continued to be driven by Europe (Germany) while the US was relatively soft. Its strategic-25 clients (83% of revenue) declined 1.5% q/q, up 17% y/y).

**Margins maintained in challenging environment.** The 8.5% EBIT margin came better than anticipated. Despite a reduction of 178 employees q/q and favourable currency, the gross margin was merely steady because of a revenue shortfall. SG&A leverage brought a benefit of 40bps. The company is operating at 98% (work-from-home, from 15<sup>th</sup> Apr) and is, therefore, unlikely to see any supply side challenges ahead. KPIT lags its peers, with an 8.8% EBIT margin in FY20 (LTTS 16.5%, Tata Elxsi 18.6%), which possibly can be shored up with higher offshoring.

**Maintaining a Buy, at a lower TP of ₹85 (9x FY22e).** The stock trades at 7x FY22e EPS, attractive given the anticipated H2 FY21 recovery we are building in. From a macro perspective, recovery in Germany and China are important factors for KPIT. Promoter pledges are expected to be cleared in the next 24 months. **Risk:** Dependence on one vertical.

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (₹ m)	36,656	36,553	21,562	20,774	22,861
Net profit (₹ m)	2,529	2,536	1,483	1,364	1,722
EPS (₹)	12.7	9.4	5.5	5.1	6.4
PE (x)	4.8	4.8	8.0	8.9	7.0
EV / EBITDA (x)	2.0	1.6	2.7	3.0	2.6
PBV (x)	0.7	1.3	1.2	1.1	1.0
RoE (%)	14.9	18.3	15.2	12.5	14.5
RoCE (%)	11.9	18.5	13.3	9.3	11.5
Dividend yield (%)	5.3	5.4	2.2	3.9	5.7
Net debt / equity (x)	-0.2	-0.1	-0.4	-0.4	-0.4

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: ₹85

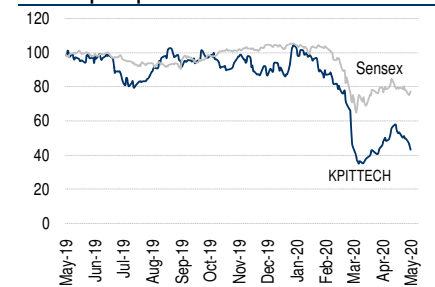
Share Price: ₹47

Key data	KPITTECH IN / KPIE.BO
52-week high / low	₹111 / 34
Sensex / Nifty	32201 / 9490
3-m average volume	\$0.2m
Market cap	₹13bn / \$169.9m
Shares outstanding	274m

Shareholding pattern (%)	Mar'20	Dec'19	Sep'19
Promoters	41.7	41.6	41.6
- of which, Pledged	17.1	18.7	18.7
Free float	58.4	58.4	58.4
- Foreign institutions	23.3	23.3	23.7
- Domestic institutions	12.6	11.8	9.9
- Public	22.4	23.3	24.9

Estimates revision (%)	FY21e	FY22e
Sales(\$)	(15.3)	(15.3)
EBITDA	(19.2)	(17.9)
PAT	(22.5)	(17.3)

### Relative price performance



Source: Bloomberg

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹m)**

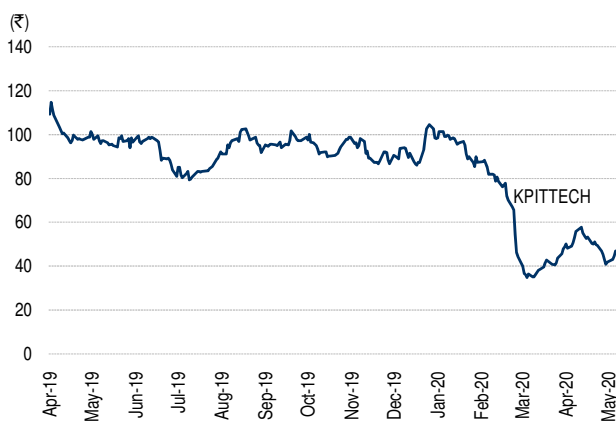
Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
<b>Revenues (\$ m)</b>	567.6	523.1	303.8	283.1	311.6
Growth (%)	15	-8	-42	-7	10
Net revenues	36,656	36,553	21,562	20,774	22,861
Employee & direct costs	27,665	26,353	16,353	15,977	17,371
Gross profit	8,991	10,200	5,209	4,798	5,490
Gross margins %	24.5	27.9	24.2	23.1	24.0
SG&A	5,037	5,186	2,238	2,147	2,324
<b>EBITDA</b>	3,954	5,014	2,971	2,650	3,165
EBITDA margins (%)	10.8	13.7	13.8	12.8	13.8
- Depreciation	843	1,113	1,080	1,176	1,176
Other income	307	-237	131	338	299
Interest expenses	104	210	198	112	111
PBT	3,314	3,455	1,823	1,701	2,178
Effective tax rate (%)	21	23	19	20	21
+ Associates / (Minorities)	-87	-132	-2	-	-
<b>Net income</b>	2,529	2,536	1,483	1,364	1,722
WANS	200	270	270	270	270
<b>FDEPS (₹ / sh)</b>	12.7	9.4	5.5	5.1	6.4

**Fig 3 – Cash-flow statement (₹m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT	3,314	3,455	1,823	1,701	2,178
+ Non-cash items	1,474	313	1,590	1,176	1,176
Oper. prof. before WC	4,788	3,768	3,413	2,877	3,354
- Incr./decr. in WC	128	-1,332	-1,300	349	501
Others incl. taxes	-586	-510	-825	-443	-511
<b>Operating cash-flow</b>	<b>4,074</b>	<b>4,590</b>	<b>3,887</b>	<b>2,085</b>	<b>2,341</b>
- Capex (tang. + intang.)	1,159	1,622	686	692	739
<b>Free cash-flow</b>	<b>2,915</b>	<b>2,968</b>	<b>3,201</b>	<b>1,393</b>	<b>1,602</b>
Acquisitions	-48	-	-233	-443	-409
- Div.(incl. buyback & taxes)	503	761	569	477	689
+ Equity raised	5	-	-0	-	-
+ Debt raised	-796	-1,482	-822	-196	-
- Fin investments	382	-1,185	511	-	-
- Misc. (CFI + CFF)	44	4,753	317	-226	-189
Net cash-flow	1,147	-2,843	750	503	693

Source: Company, AnandRathi Research

**Fig 5 – Price movement**



Source: Bloomberg

**Fig 2 – Balance sheet (₹ m)**

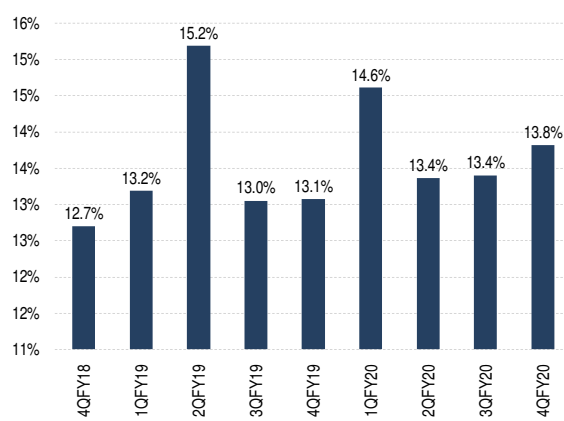
Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	379	2,685	2,689	2,689	2,689
Net worth	18,169	9,596	10,470	11,356	12,389
<b>Debt</b>	<b>2,771</b>	<b>1,289</b>	<b>196</b>	<b>-</b>	<b>-</b>
Minority interest	36	39	36	36	36
DTL/(Assets)	-944	1	-387	-387	-387
<b>Capital employed</b>	<b>20,032</b>	<b>10,924</b>	<b>10,314</b>	<b>11,004</b>	<b>12,037</b>
Net tangible assets	3,096	3,261	4,277	3,793	3,356
Net intangible assets	1,171				
Goodwill	4,275	942	988	1,431	1,840
CWIP (tang. & intang.)	68	-	52	52	52
Investments (strategic)					
Investments (financial)	1,185	-	93	93	93
Current assets (ex cash)	11,541	10,332	6,744	6,836	7,319
<b>Cash</b>	<b>5,049</b>	<b>2,207</b>	<b>3,810</b>	<b>4,313</b>	<b>5,006</b>
Current liabilities	6,353	5,818	5,650	5,513	5,629
Working capital	5,188	4,515	1,095	1,323	1,690
<b>Capital deployed</b>	<b>20,032</b>	<b>10,924</b>	<b>10,314</b>	<b>11,004</b>	<b>12,037</b>
Contingent liabilities	311	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	4.8	4.8	8.0	8.9	7.0
EV / EBITDA (x)	2.0	1.6	2.7	3.0	2.6
EV / Sales (x)	0.2	0.3	0.4	0.4	0.3
P/B (x)	0.7	1.3	1.2	1.1	1.0
<b>RoE (%)</b>	<b>14.9</b>	<b>18.3</b>	<b>15.2</b>	<b>12.5</b>	<b>14.5</b>
RoCE (%) - after tax	11.9	18.5	13.3	9.3	11.5
<b>RoIC (%) - after tax</b>	<b>16.2</b>	<b>24.9</b>	<b>18.0</b>	<b>13.8</b>	<b>17.6</b>
DPS (₹ / sh)	2.4	2.4	1.0	1.8	2.6
Dividend yield (%)	5.3	5.4	2.2	3.9	5.7
Dividend payout (%) - incl. DDT	22.1	30.0	21.2	40.8	46.6
Net debt / equity (x)	-0.2	-0.1	-0.4	-0.4	-0.4
<b>Receivables (days)</b>	<b>92</b>	<b>128</b>	<b>86</b>	<b>93</b>	<b>92</b>
Inventory (days)					
Payables (days)	18	25	17	15	13
CFO : PAT %	155.7	172.1	261.8	152.9	136.0

Source: Company, AnandRathi Research

**Fig 6 – EBITDA margins**



Source: Company

Note - Q1/Q2/Q3FY19 figures are KPIT Engineering financials(before the split); Q4FY19's are KPIT Tech's financials after the hiving off from Birlasoft IT

# Result Highlights

## Q4FY20 Results at a Glance

**Fig 7 – Segment-wise results**

	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q/Q growth, %	Y/Y growth, %
Revenues (\$ m)	71	73	77	77	77	0.1	8.3
Growth Y/Y %	-53	16	15	9	8	-110 bps	6099 bps
Revenues (₹m)	5,013	5,058	5,441	5,501	5,562	1.1	11.0
Eff. exchange rate	70.6	69.5	70.5	71.6	72.3	1.0	2.5
Employees (EoP)	6,614	6,891	7,295	7,303	7,125	-2.4	7.7
Revenue productivity (\$ '000 / employee)	5.2	11.0	11.2	10.5	10.5	0.0	101.4
Gross utilisation (IT services)	73.4	72.9	73.0	73.0	73.0	0 bps	-44 bps
CoR (excl. D&A)	(3,755)	(3,805)	(4,140)	(4,180)	(4,228)	1.1	12.6
As % of revenues	-75	-75	-76	-76	-76	-2 bps	-110 bps
SG&A	(602)	(514)	(574)	(584)	(566)	-3.1	-6.0
As % of revenues	-12	-10	-11	-11	-10	44 bps	184 bps
EBITDA	655	739	727	737	768	4.3	17.2
EBITDA margins %	13.1	14.6	13.4	13.4	13.8	42 bps	74 bps
EBIT	468	500	462	454	474	4.6	1.3
EBIT margins %	9.3	9.9	8.5	8.2	8.5	28 bps	-82 bps
Other income	(27)	(57)	51	76	60	-21.2	-320.1
Forex gain / loss	(40)	(69)	29	58	2	-96.9	-104.4
Interest expense	(48)	(46)	(59)	(48)	(45)	-6.6	-6.4
PBT	393	398	454	482	489	1.6	24.5
PBT margins %	7.8	7.9	8.3	8.8	8.8	0.5	12.2
Taxes	(83)	(88)	(86)	(72)	(92)	26.4	9.9
ETR %	-21	-22	-19	-15	-19	-367 bps	248 bps
Net income	301	376	330	429	388	-9.4	28.8
NP margins %	6.0	7.4	6.1	7.8	7.0	-81 bps	97 bps

Note: Q1/Q2/Q3FY19 figures are KPIT Engineering financials(before the split); Q4FY19's are KPIT Tech's financials after the hiving off.Thus q/q and y/y comparisons are not possible

1)CoR includes G&A employee costs as well

Source: Company, Anand Rathi Research

**Fig 8 – Quarterly results(₹ m)**

Year-end: Mar	Q4FY20	% Q/Q	% Y/Y	FY20	FY21	% Y/Y
Sales (\$ m)	77	0.1	8.3	304	283	(6.8)
Sales	5,562	1.1	11.0	21,562	20,774	(3.7)
EBITDA	768	4.3	17.2	2,971	2,650	(10.8)
EBITDA margins (%)	13.8	42 bps	74 bps	13.8	12.8	-102 bps
EBIT	474	4.6	1.3	1,890	1,475	(22.0)
EBIT margins (%)	8.5	28 bps	-82 bps	8.8	7.1	-167 bps
PBT	489	1.6	24.5	1,823	1,701	(6.7)
Tax	(92)	26.4	9.9	(338)	(337)	(0.3)
Tax rate (%)	(18.7)	-367 bps	248 bps	(18.6)	(19.8)	-127 bps
PAT (₹m)	388	(9.4)	25.3	1,523	1,364	(10.5)

Source: Company

## Conference-call takeaways

### The industry

- The auto industry will be faced with delays in and deferment of new projects because of Covid-19. But major OEMs are still spending in the autonomous, EV and connected-vehicle spaces. This will drive growth and new deals.

### The company

- The company wishes to expand beyond its T-25 strategic customers, incl. new-generation companies (Microsoft and Amazon) as it expects some shocks from a few of these strategic customers given the stress in the auto value-chain.
- The large deal of five years, of \$50m, that was in the pipeline has been signed. The benefit will start flowing in in H2FY21. This requires minimal additional capex and will be serviced through a dedicated software centre in Munich and Pune.
- To contain costs, the company decided to expand the percentage of variable pay by 10-15%, and has consolidated three facilities in India and two in Germany. The variable pay will be payable at the year-end depending on the company's performance.
- It is not feeling pressure on pricing but has extended credit periods for some clients.
- Till now, it has not seen any delays in collections.
- FY21 capex to be 1–1.25% of revenue.

### Business outlook

- Consequent on volumes declining, Q1 revenue will decline 10-15% q/q, but H2 will be better than H1.

### Notes from the Q3 FY20 concall

- The demand environment is positive, with opportunities across regions and verticals.
- The company added four strategic customers in the target T-25 customer base.
- It has large deals (five-year, of double-digit million dollars) in the pipeline, giving it confidence of growth ahead, driven by passenger cars.
- The margins were lower on account of higher increments given this year to retain talent.
- Germany has 800 people, of which 25% are based at the client site.
- The tax rate was lower because of the cumulative impact of consolidation of income of the Germany entities. The tax rate will continue to be low (below 20%).
- The company maintains its FY20 revenue growth guidance of 16-18% and expects margins to trend up by another 200-300bps in coming years based on levers such as offshoring and utilisation.

**Notes from the Q2 FY20 concall**

- Promoter pledges are at peak levels and expected to come down gradually to zero in the next two years. The proceeds of the pledges have been used entirely to increase the promoters' stake in the company.
- Due to OEMs' focus on electric vehicles, traditional power-train is also growing as OEMs offload past works to vendors. On connected vehicles, one large programme was completed last year; hence, figures appear negative.
- Due to the high wage hikes, attrition has come down by ~10 percentage points, y/y.
- Management expects utilisation to pick up gradually. At present, net hiring is on the fresher side as KPIT attempts to reduce its dependence on lateral hires. This trend may continue for two quarters; the results will then show up in margins.
- Capex to hold at 2% of revenues.
- The company maintains its FY20 revenue growth guidance of 16-18% and EBITDA margin guidance and demand for its services at 14-15%.

**Notes from the Q1 FY20 concall**

- KPIT had the highest deal wins in the quarter as demand for its services is strong.
- Attrition was higher in the past, at 18%, but is now shrinking every quarter. This is also on account of the sharper focus and growth.
- Dividend payout will increase gradually but not in a huge way as the company needs cash and has retained earnings to support growth.
- Management talked of 16-18% CC revenue growth for FY20.
- The EBITDA margin would be 14-15%, according to the old accounting, and 15-16% per reported figures.

**Notes from the Q4 FY19 concall**

- The major chunk of the company's work lies in power-train (conventional and electrical), connectivity, autonomous (vision and control systems) and diagnostics. Diagnostics was soft in the quarter, especially in Europe. The company saw great traction in this space and, hence, is confident of growth returning.
- Growth in Europe was hit by the delayed execution of large deals. These revenues are expected to come in Q1 FY20. This region currently has 700 employees.
- The company is looking at \$500m revenue in the next 4-5 years. Management guided to 16-18% CC revenue growth for FY20.
- FY20 margin of 14-15%, backed by operational efficiencies.
- ETR likely at ~22-23%

## Factsheet

**Fig 9 – Revenue-split, by industry**

(%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Passenger cars	74	73	76	76	76
Commercial vehicles	23	24	22	23	22
New mobility	1	1	1	1	1
Others	2	2	1	1	1

Source: Company

**Fig 10 – Revenue-split, by services**

(%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Power-train	31	35	37	33	33
AD-ADAS	19	21	20	25	26
Connected vehicles	15	15	13	13	10
Others	34	29	30	30	31

Source: Company

**Fig 11 – Revenue-split, by region**

(%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
North America	40	42	44	40	40
Europe	34	37	36	41	42
APAC/RoW	27	21	20	19	19

Source: Company

**Fig 12 – Client profiles (LTM)**

%	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Top-25	76.4	81.2	84.4	84.0	82.6
Growth, Q/Q		8.8	10.3	-1.0	-1.5
Growth, Y/Y		24	13	15	17
Active clients	60	60	55	55	58
Revenue per active client (\$m / quarter)	1.2	1.2	1.4	1.4	1.3

Source: Company

**Fig 13 – Employee movement**

(%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
<b>Employee movement</b>					
Employees (EoP)	6,614	6,891	7,295	7,303	7,125
Gross additions (est.)	-6,503	589	688	300	111
Attrition (est.)	467	312	284	292	289
Net increase	-6,970	277	404	8	-178

Source: Company

\* Note: Q4FY19- On the hiving off of KPIT Technologies from Birlasoft, some KPIT Technologies' parameters for Q4FY19 are not comparable

**Fig 14 – Revenue-split, by delivery type and billing**

(%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
<b>Delivery type</b>					
On-site	NA	NA	NA	NA	NA
Offshore	NA	NA	NA	NA	NA
<b>Billing type</b>					
T&M	52	49	54	46	49
FP	44	51	46	54	51

Source: Company

**Fig 15 – Key verticals and horizontals growth**

(%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
<b>Verticals growth</b>					
Passenger cars		15	13	9	11
Commercial vehicles		22	33	26	3
New mobility		(33)	90	44	(11)
Others		17	(60)	(79)	(15)
<b>Horizontals growth</b>					
Power-train		23	58	40	12
AD-ADAS		91	8	19	45
Connectedvehicles		(23)	(26)	(28)	(24)
Others		7	9	2	(2)

Source: Company

\* Note: Q4FY19- On the biving off of KPIT Technologies from Birlasoft, some KPIT Technologies' parameters for Q4FY19 are not comparable

## Valuations

The stock quotes at 7x FY22e EPS of ₹6.4, which we find attractive given that the company is growing faster than the industry (14.3% overall revenue growth in FY20), expected to clock a 1.3% CAGR over FY20-22.

Its focus on its top-25 strategic clients (of its 58 active ones) and the expansion of its business to newer new-gen companies and regions such as China make us optimistic about its performance as China (the largest auto market in the world and an important one for European auto) is resuming economic activity. Also, the company is confident of enjoying greater profitability (16-18%) in the next few years by higher offshoring although this target was delayed by a year due to FY21 being damaged by Covid-19. On the higher utilisation (76-77%), we expect the margin to recover to FY20 levels by FY22 (13.8%) after declining to 12.8% in FY21.

The net cash balance was ₹3,278m (₹2,584m the quarter prior), a significant stepping up from the ~₹900m it reported a year earlier. Higher cash generation and limited capex should take the total to ~₹4.4bn by end-FY21. The FCF yield is now 15%.

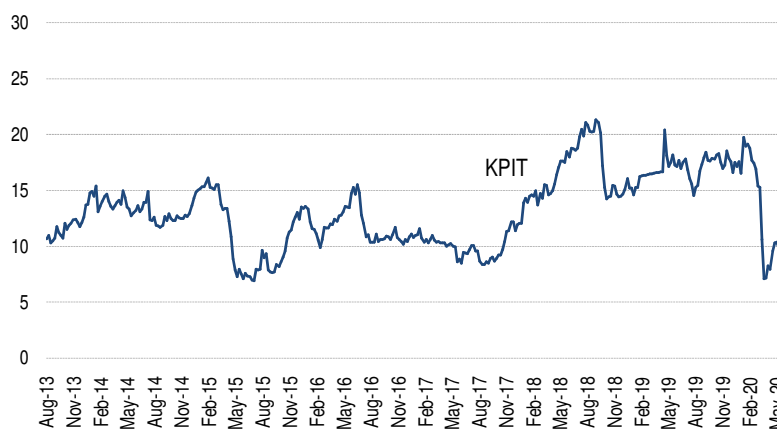
Considering these positives, we have assigned a target multiple of 13x FY22e EPS, with a target price of ₹85. We recommend a Buy.

**Fig 16 – Change in estimates (₹m)**

	FY21e			FY22e		
	New	Old	Chg.%	New	Old	Chg.%
Revenues (\$m)	283	334	(15.3)	312	368	(15.3)
Revenues	20,774	24,151	(14.0)	22,861	26,598	(14.1)
EBITDA	2,650	3,278	(19.2)	3,165	3,856	(17.9)
EBITDA margins %	12.8	13.6	-82 bps	13.8	14.5	-65 bps
EBIT	1,475	2,145	(31.3)	1,990	2,610	(23.8)
EBIT margins %	7.1	8.9	-179 bps	8.7	9.8	-111 bps
PBT	1,701	2,203	(22.8)	2,178	2,652	(17.9)
Net profit	1,364	1,759	(22.5)	1,722	2,081	(17.3)

Source: Anand Rathi Research

**Fig 17 – PE band**



Source: Bloomberg, Anand Rathi Research

## Risk

- Dependence on one vertical.



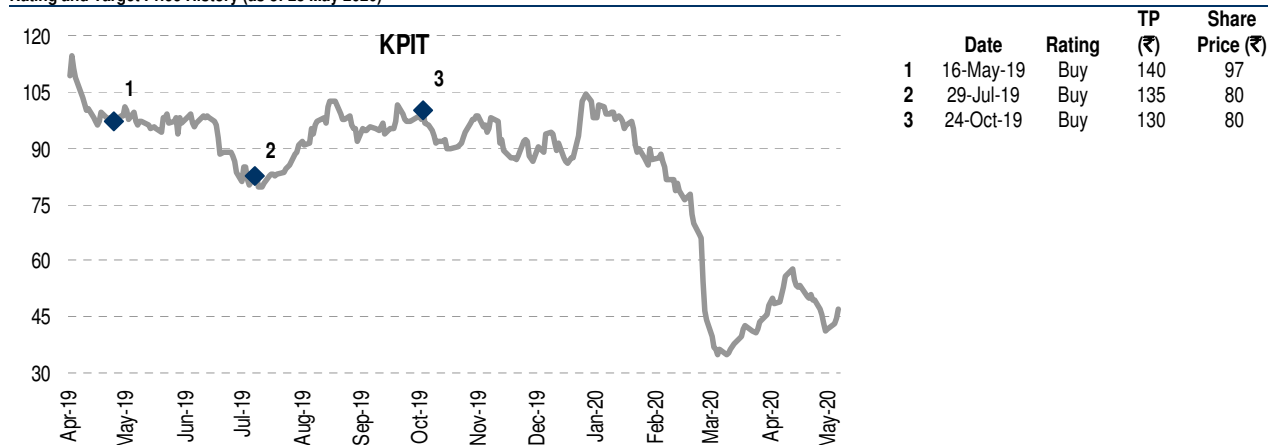
## Appendix

### Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

### Important Disclosures on subject companies

#### Rating and Target Price History (as of 28 May 2020)



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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

#### Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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