April 06, 2023

KPIT Technologies Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount	Current Rated Amount	Rating Action
Fund based/Non-Fund Based-Working Capital Facilities	Rs. 265.0 crore	Rs. 265.0 crore	[ICRA]AA (Stable) /[ICRA]A1+; reaffirmed
Long-term Unallocated	US$7.5 million	US$7.5 million	[ICRA]AA (Stable); reaffirmed
Total	**Rs. 265.0 crore and US$7.5 million**	**Rs. 265.0 crore and US$7.5 million**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation for KPIT Technologies Limited (KPIT) factors in its established business profile with its niche offerings and strong position in the automobile engineering & technology solutions space, supported by its established relationships with top global automotive players. KPIT's financial profile remains strong, evident from its steady revenue growth and internal accrual generation, a comfortable capital structure and strong liquidity position (unencumbered cash/deposits/liquid investments of ~Rs. 723.5 crore as on December 31, 2022). The company remains net-debt free, which, coupled with healthy internal accrual generation, has continued to result in strong debt protection metrics.

KPIT posted revenue growth of 31.8% YoY in INR terms in 9M FY2023, supported by healthy revenue growth in passenger car vertical under all the three segments (Feature Development & Integration, Architecture & Middleware Consulting and Cloud-Based Connected Services) and partly by consolidation of the recently acquired entity - Technica Engineering[1] (Technica) in October 2022. The upfront purchase consideration for this acquisition is €80 million, of which €60 million was paid in Q3 FY2023, and the balance will be paid by April 2023. Moreover, an earnout between €0 to €30 million will be paid over the medium term, subject to achievement of predetermined financial targets. The acquisition was completely funded by available surplus and internal accruals. Revenue growth apart, this acquisition is expected to strengthen KPIT's offering as an end-to-end player for Software Defined Vehicle (SDV) and provide operational synergies, given the Technica's technological capabilities and common client base. Strong demand for electric vehicles (EVs) across geographies owing to country-wise regulation, has resulted in increased IT spending on EVs, along with emerging technologies such as autonomous driving, and connected and shared mobility. KPIT is also working with top OEMs[2] (Honda, Renault, etc.) on multi-year engagements for SDV, which provides revenue visibility for the long term. These factors, coupled with healthy order book position, are expected to drive KPIT's revenue growth over the near to medium term.

The ratings are, however, tempered by KPIT's revenue concentration from a few clients and a single vertical (automobiles). The company generates ~82-85% of its revenue from its top-25 clients, exposing it to the client concentration risk to an extent, as the revenue loss from its top clients may impact its revenue and profitability. However, ICRA notes that KPIT's offerings are niche and focused on entrenched relationships with top global automobile players. Additionally, industry participants, including KPIT, continue to face challenges in the form of wage inflations, foreign exchange (forex) fluctuations, talent acquisition and retention. ICRA also notes the company's plans to grow inorganically through acquisitions in the short to medium term, funded by its sizeable cash and liquid investments. Any sizeable debt-funded acquisition can materially impact KPIT's financial risk profile and will be evaluated on a case to-case basis.

[1] Technica Engineering is specialized in production-ready system prototyping (combination of network system architecture, hardware prototyping, integration), automotive ethernet products, and tools for validation.

[2] OEMs – Original Equipment Manufacturers

The Stable outlook on the rating reflects ICRA's opinion that KPIT will maintain its strong credit profile and liquidity position, supported by healthy internal accrual generation and continued net debt free status.

Key rating drivers and their description

Credit strengths

Healthy operational profile driven by niche offerings and strong relationships with top global automotive OEMs and tier-I suppliers - KPIT's business is focused entirely on the mobility industry with its niche offerings in power trains, autonomous and connectivity categories. The company offers software IP, software integration, feature development, and verification and validation services to global OEMs and Tier-I suppliers across its key practices. KPIT has deep-domain technical capabilities across its key practices. Further, the company has an established client base, which includes majority of the top-20 global OEMs, to whom it offers multiple services. KPIT's niche offerings and strong relationships have driven healthy revenue growth over the years.

Strong financial profile with stable earnings, net-debt free and strong cash reserves - KPIT's financial profile remains strong, aided by steady revenue growth, improved profitability, a comfortable capital structure and sizeable net worth of Rs. 1,547.7 crore as on December 31, 2022, and net debt-free status. In 9M FY2023, KPIT's revenue grew by 31.8% YoY, supported by growth across geographies and segments and consolidation of the Technica Group from October 2022. KPIT's operating margin improved to 18.8% in 9M FY2023 from 18.5% in FY2021, supported by operating leverage, improvement in net realisation; although partially offset by healthy wage increments in the fiscal, integration cost of the acquisitions and cross-currency headwinds. KPIT's debt protection metrics are expected to remain comfortable, going forward, aided by strong accrual generation and no major debt-funded capital expenditure (capex).

Increased R&D expense by global auto companies provides growth opportunities - The global EV demand is increasing owing to the high carbon emission by conventional vehicles, with Governments across countries offering incentives in electrical mobility. This has led to an increase in R&D expenses from OEMs and Tier-I suppliers on emerging technologies such as autonomous vehicles and EVs, and addition of new features in vehicles to stay competitive in the industry. ICRA believes these factors provide healthy revenue visibility for KPIT over the near to medium term.

Credit challenges

Client and segment concentration risks - KPIT derives its entire revenue from the auto sector with its top-21 clients contributing ~82-85% of its revenues, exposing it to concentration risks. Any slowdown in the auto segment or decrease in technology spend by its top clients can have an adverse impact on the company's performance. However, the risk is mitigated to an extent with KPIT's established relationships with its top global auto OEM clients and its niche offerings/technological capabilities in mobility solutions. The company's strategy to focus on its top automobile clients (OEMs and Tier-I suppliers), is in line with the concentrated nature of the industry to drive revenues by offering multiple services.

Margins vulnerable to wage inflation and forex fluctuations - KPIT's profit margins are susceptible to wage inflations and forex fluctuations. Being in a highly labour-intensive business, the availability and retention of a skilled workforce are its key challenges. Due to the increased demand for digitisation, the IT industry has experienced high attrition levels in the recent quarters, which is expected to increase the overall wage costs. KPIT is also exposed to the hiring norms of its operational countries. Further, with most of its revenues generated from global clients in foreign currencies, the company is exposed to the forex risk. However, KPIT's hedging mechanism mitigate this risk to an extent.

Liquidity position: Strong

KPIT's liquidity is **strong**, with healthy estimated fund flow from operations (FF) of Rs. 460-480 crore in FY20223, aided by steady revenue growth and improving operating profitability. The liquidity is further enhanced by the significant unencumbered cash/ liquid investment of Rs. 723.5 crore and unutilised fund-based limits of Rs. 265.0 crore as on December

31, 2022. The company will continue to scout for investment/acquisition opportunities to support its inorganic growth initiatives. The impact, if any, of the same on KPIT's credit and liquidity profiles will depend on the ticket size of these investment/acquisition and their operational and financial synergies.

Rating sensitivities

Positive factors – ICRA could upgrade KPIT's ratings, if there is a sustained scale-up in revenues along with improvements in the margin, while maintaining its sizeable liquidity.

Negative factors – Pressure on KPIT's ratings could arise due to any impact on its revenue and profitability from the loss of any of its key clients or due to demand moderation in the auto industry. A specific credit metric for a downgrade is if Net debt/OPBDITA is more than 1.0 times, on a sustained basis.

Environment and Social Risk

Environmental considerations: Given the service-oriented business, KPIT's direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material.
Social considerations: Like other Indian IT service companies, KPIT faces the risk of data breaches and cyberattacks that could affect the large volumes of customer data that it manages. Any material lapses on this front could result in substantive liabilities, fines, or penalties and reputational impact. Also, KPIT remains exposed to the risk of changes in immigration laws in the key developed markets where it provides its services. While such changes would be motivated by those economies' own social and political considerations, they could have the effect of heightening the competition among IT players for skilled workforce, leading to higher attrition rates and may have an adverse impact on profitability. Managing various facets of human capital, including skills, compensation, and training, is in any case a key differentiating factor among IT companies.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Information Technology
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of KPIT. The consolidated entities are all enlisted in Annexure-2

About the company

KPIT is a technological company focused on automobile engineering and mobility solutions. The company offers technology solutions to automobile OEMs under different practices such as power trains (conventional and electrical), connectivity, autonomous (vision and control systems) and diagnostics. Each of its practice areas offer software IP, software integration, feature development, and verification and validation services.

Key financial indicators (audited)

KPIT - Consolidated	FY2021	FY2022	9M FY2023*
Operating income	2035.7	2432.4	2347.7
PAT	147.1	276.0	273.4
OPBDIT/OI	15.2%	18.5%	18.8%
PAT/OI	7.2%	11.3%	11.6%
Total outside liabilities/Tangible net worth (times)	0.6	0.7	1.0
Total debt/OPBDIT (times)	0.7	0.5	0.5
Interest coverage (times)	18.0	23.3	20.4

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore *unaudited*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021
					April 6, 2023		Mar 4, 2022	May 27, 2021	Feb 14,2020
1	Working Capital Limits	Long term and short term	Rs.265.0 Crore	-	[ICRA]AA(Stable) /[ICRA]A1+	-	[ICRA]AA (Stable) /[ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
2	Unallocated	Long term	US$ 7.5 million	-	[ICRA]AA(Stable)	-	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/Short-term – Fund based/Non-fund Based Working Capital	Simple
Long-term- Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Working capital Limits	NA	NA	NA	Rs.265.0 Crore	[ICRA]AA(Stable)/[ICRA]A1+
NA	Unallocated	NA	NA	NA	US$ 7.5 million	[ICRA]AA(Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	KPIT Ownership	Consolidation Approach
KPIT Technologies (UK) Limited	100%	Full Consolidation
KPIT (Shanghai) Software Technology Co. Limited	100%	Full Consolidation
KPIT Technologies Netherlands B.V.	100%	Full Consolidation
KPIT Technologies GmbH	100%	Full Consolidation
KPIT Technologia LTDA	99.9%	Full Consolidation
Microfuzzy Industry – Elektronic GmbH	100%	Full Consolidation
KPIT Technologies GK	100%	Full Consolidation
KPIT Technologies Inc.	100%	Full Consolidation
KPIT Technologies Holding Inc.	100%	Full Consolidation
ThaiGer Tec CO Limited	100%	Full Consolidation
Pathpartner Technology Private Limited	60%	Full Consolidation
PathPartner Technology Inc	60%	Full Consolidation
PathPartner Technology GmbH	60%	Full Consolidation
Somit Solutions (UK) Limited	65%	Full Consolidation
Somit Solutions Inc	65%	Full Consolidation
KPIT Technologies Employee Welfare Trust	100%	Full Consolidation
KPIT Technologies SAS	100%	Full Consolidation
Technica Engineering GmbH	100%	Full Consolidation
Technica Electronics Barcelona, S.L	100%	Full Consolidation
Technica Electronics Spain S.L	100%	Full Consolidation
Technica Engineering Inc	100%	Full Consolidation
FMS Future Mobility Solutions GmbH	25%	Equity

Source: KPIT

Note: ICRA has taken a consolidated view of KPIT, its subsidiaries and associates while assigning the ratings.

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About ICRA Limited:

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