Management Discussion & Analysis

GLOBAL OUTLOOK

The Global economy was experiencing a modest slowdown through the year of 2019 in investment activity and the economic growth was majorly held up by consumption. The COVID-19 pandemic health crisis in early 2020 led the governments of majority of global economies to temporarily shut down the economy. This was to prevent a community wide transmission of the virus and thus avoid an over-whelming burden on the healthcare infrastructure and try to save as many lives as possible. This temporary measure led to a complete standstill in economic activity. The high frequency indicators such as the PMI's fell to their lowest levels since their series was recorded. Such a forced shutdown of economic activity, now being referred to as a black swan event, has led to record job losses in the months of March and April 2020. The major economies have now started planning their exit from The Great Lockdown and this will put an end to the downward spiral in economic activity, though the uncertainty of a second wave remains. Positive signs have already emerged from Asian economies like China and South Korea, where the virus has been contained and economic activity is now returning to normal. The IMF's April world economic outlook forecasts the global output to contract by 3% in the year 2020, but growth is expected to rebound in the year 2021 at 5.8% growth.

The US economy which grew by 2.9% in CY18 and 2.3% in CY19 slowed as the benefit of the tax cuts waned off. US was experiencing a modest investment led slowdown in the second half of 2019 which led the US Federal reserve to cut rates thrice. In 2019, the labor market was experiencing robust payroll growth and US unemployment fell to 3.5%, a five-decade low. With the COVID-19 pandemic cases crossing over 1 million in April 2020, over 22 million Americans have lost their jobs, putting a significant strain on the economy. The US administration has swiftly responded through multiple legislations such as the CARES Act and the Paycheck protection program which has led to a fiscal stimulus of over $3 trillion. The Federal reserve has also responded by cutting rates to zero and unlimited purchase of the US government bonds, along with support to other rated bonds. The IMF now expects US economy to contract by 6.1% in 2020 but show a recovery in 2021 through a projected growth rate of 4.5%.

The Euro zone was already in a slowdown mode with GDP growth slipping from 1.9% in 2018 to 1.2% in 2019. Germany, the major contributor to the Euro zone grew by only 0.6% in 2019. With monetary policy in negative interest rate zone for a significant period, the monetary authorities have called for a fiscal stimulus to jump start growth. There was an immediate European central Bank asset purchase program of €750 billion. COVID-19 has been a significant health crisis in Italy, France, UK and Spain with all these countries featuring in top list of maximum lives lost. Some of the European countries have already approached IMF for assistance, but the economy faces significant risks in the medium term. The IMF expects the Euro economy to de-grow by 7.5% in 2020, but expects a recovery in 2021 with a growth rate of 4.7%.

As per the IMF, growth in Asia is expected to be at zero, its worst performance in 60 years. But Asia would still stand out when compared with its western counterparts. China is set to out-perform with an expected growth of 1.2% in 2020 followed by 9.2% in 2021. The effective containment of the virus by some of the major economies such as China and South Korea, which were first to be impacted by the virus, has led to the expectation that these economies would also be the first ones to bounce back.

INDUSTRY TRENDS

The COVID-19 driven lockdowns will have a sizeable impact of automotive sales given the forced closing of economic activity. The current forecasts indicate the average decline in volumes of automotive sales can range between -15% to -40%, depending on the speed of recovery of the economy, based on availability of cure or containment of the virus.

In the short run, global light weight vehicle sales have contracted sharply. In USA, the sales rate has contracted by nearly 46% in the month of April. Western Europe where the shut-down was very strictly observed, faced sales de-growth of nearly 80% as economic activity was shut down in major economies such as Italy, Spain and France. Pre-covid, the projected sales of Global Light Vehicle were 90 million units. The risk is that global demand could drop below 70 million units if the current economic scenario worsens and the spread of the virus is not contained, which could result in the strict lockdown measures being re-imposed.

The commercial vehicle (CV) Industry is facing a mixed impact during the current COVID-19 crisis. Truck load demand and freight rates have received a short-term boost due to massive Inventory replenishment during the initial panic buying in the US. However, since mid-march, the trucking activity has fallen significantly. Strong demand for essential items and a surge in online shopping will keep the demand warm, but a slowdown in Industrial goods manufacturing will hurt demand for loads. The average scenario now suggests that volumes will fall about 60% in heavy duty trucks in 2020 but the bounce back will be equally strong in 2021.

In the midst of such a gloomy economic scenario, the silver lining lies in the point that once the economy opens up, people will prefer to own and commute in their self-owned vehicles and would want to minimize the use of shared transport to reduce the risk of contracting the virus. This can serve as a demand boost to the sales of vehicles and result in faster than expected return to growth.

Another factor that can assist the recovery are Industry incentives, such as those implemented during the Global Financial crisis.

The mega trends in the Automotive Industry viz. Digitization (ecockpit/connected), Electrification, Autonomous and Shared will continue, albeit at a slightly lower pace in the current disruption. Post COVID-19, these trends will gather even more steam.

Within the next 10 years, almost all cars in mature markets will have some form of connectivity, largely due to availability of faster communication networks and rising consumer preferences towards connected features.

Penetration rates for autonomous cars may reach a level between 5% and 26% in 15-20 years as necessary economics, regulations and technology fall into place.

Share of Electric cars in new cars sold can reach levels of 35%-45%, led by China and Europe.

As we have been saying, cars are evolving into computers on wheels, a change like events in the computer industry about 20 years ago and the cell phone industry about 10 years ago. As a result, we anticipate that a complex ecosystem will emerge in the mobility sector and technology focused players like KPIT will have a major role to play in this change.

KPIT AT A GLANCE

We are a **Global Technology Leader in Mobility**

WITH

A sharp focus on **Autonomous, Clean, Smart and Connected**

SPECIALIZING IN

Embedded Software, Artificial Intelligence and Digital Solutions

AND

Located across all **major Automotive Hubs**

Our Vision

Reimagining Mobility with you for creation of a cleaner, smarter and safer world

FINANCIAL PERFORMANCE:

FY20 was the first complete year after demerger of KPIT. Hence the comparable numbers for FY19 are the Engineering SBU numbers reported in FY19.

REVENUE:

During this year, our $ revenue stood at $ 303.8 Million, a Y-o-Y growth of 12.2% against $ 270.8 Million in FY19. In ₹ terms, revenue for the year was reported at ₹ 21,561.69 as against ₹ 18,929.16 Million in FY19, a Y-o-Y growth of 11.0%.

The passenger cars vertical contributed around 75% of the total revenues in FY20 whereas the commercial vehicles segment contributed around 23% of the revenues. New Mobility is a new vertical of focus and contributed just around 1% of the revenues whereas the balance was from other small segments.

In terms of geography, US contributed around 41%, Europe 39% and the balance 20% came from Asia. Europe led the growth followed by US and then Asia.

Our Strategic Accounts contributed around 83% of the overall revenues and the growth in these accounts was close to 20%.

PROFITABILITY:

The EBITDA for FY20 stood at 13.7% as against 11.5% for FY19. The EBITDA for FY20 was ₹ 2,954 Million. The Net

Profit for FY20 stood at ₹ 1,467 Million. During the year we continued our investments in practice development and onsite development centers, especially in Germany which helped us win some significant deals in our strategic accounts. Going forward these investments will be leveraged, helping improve profitability.

In the medium term, we want to focus on improvement in operating profitability with emphasis on productivity improvement, increase in offshore revenues, leveraging of fixed costs and scaling up in our strategic accounts.

SHAREHOLDER'S FUNDS

The Shareholder's Funds as at March 31, 2020 stood at ₹ 10,470 Million.

LIQUIDITY

The Cash Balance as at March 31, 2020 stood at ₹ 3,820 Million as against ₹ 2,207 Million as at March 31, 2019.

The DSO were at 66 days as at March 31, 2020 as against 87 days as at March 31, 2019. We have consistently focused on faster cash conversion and as a result have been able to bring down the DSO substantially.

As on March 31, 2020 our total debt stood at ₹ 542 Million comprising of ₹ 376 Million of Loan Term Debt and ₹ 166 Million of Working Capital Loan. As on March 31, 2019 the total debt was at ₹ 1,307 Million comprising of ₹ 689 Million of Term Loan and ₹ 618 Million of Working Capital Loan.

Thus, the Net Cash Balance as at March 31, 2020 stood at ₹ 3,278 Million as against ₹ 900 Million as at March 31, 2019, a net increase of ₹ 2,378 Million

EMPLOYEES

The total headcount for the company stood at 7,125 as at the end of FY20. The same was 6,614 as at the end of FY19. The Development Headcount was 6,594 as against 6,303 last year. The detail update on People is covered under the Chairman's Letter.

INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY

The CEO & CFO certification provided elsewhere in this Annual Report discusses the adequacy of internal control systems and procedures in place.

RISKS AND CONCERNS

A separate report on Enterprise Risk Management is provided elsewhere in this Annual Report.

COVID-19 PANDEMIC NOTE

The rapid outbreak of the coronavirus (COVID – 19) presents an alarming health crisis that the world is grappling with. The impacts of COVID-19 pandemic are unfolding in real time. The COVID-19 outbreak is expected to have an impact on the economies of the affected countries and the international markets. Countries across the globe resorted to lockdowns, resulting in shutting down the manufacturing & services activities and bringing the global supply-chain to a grinding halt. Globally across all industries, companies are working hard to recoup revenue losses, manage costs, keep employees safe and at the same time ensure uninterrupted service to the clients. KPIT has received many testimonials from its existing clients for its seamless remote delivery model & managing this crisis effectively.

KPIT is working on bringing in appropriate changes in the business model to tackle the possible future uncertainties in economic conditions due to the global pandemic and taking appropriate measures to control its cost structure. We will continue to build on the work we have done over the past years to drive efficiency in operations and strengthen the foundations of the business.

Since beginning of March, KPIT started working on business continuity enabling its employees work remotely to ensure both employee safety and service to customers with due necessary approvals from the customers as well as regulatory authorities in various countries. We are glad to inform that by end of March 31, 2020, KPIT had over 95% of its global staff working from remote locations. While direct vehicle sales and manufacturing plants of our customers were directly impacted, KPIT revenue model did not have direct impact since its revenue model is not linked to direct vehicles sold during the year.

In view of pandemic relating to COVID-19, KPIT has considered internal and external information and has performed sensitivity analysis based on current estimates in assessing the recoverability of receivables, unbilled revenues, goodwill, intangible assets and other financial assets. However, the actual impact of COVID-19 on the financial statements may differ from that estimated and the Company will continue to closely monitor any material changes to future economic conditions.

As per our initial assessment there will be significant impact in H1 of FY 2021 and we expect recovery to commence from Q3 of FY 2021. KPIT has a strong Balance Sheet with over INR 3.8 billion net cash balance and negligible debt. Its collection cycle remains strong with DSO @ 66 days and highest level of customer engagement with its strategic customers. It has also taken proactive steps in deferring its medium-term capex plans and pulling out levers to manage profitability. It remains confident that it will be able to meet all its delivery & financial commitments in time. With the exception of a few, KPIT has not seen any material changes in production programs and it continues to engage strategically with its customers across the globe.

KPIT continues to believe that Europe, particularly Germany will bounce back fast paving way for quicker and strong bounce back, towards the end of FY 2021. At this time, KPIT will refrain from giving any guidance for FY 2021 but will keep on updating all the stakeholders on regular basis. During this unprecedented period of crisis, KPIT continues to maintain effective internal controls on its assets, resolving customer problems and processing payments in time to its employees and other partners.

Cautionary Statement

Certain statements under ‘Management Discussion & Analysis’ describing the Company’s objectives, projections, expectations may be forward looking statements within the applicable securities laws and regulations. Although, the expectations are based on reasonable assumptions, the actual results could differ materially from those expressed or implied, since the Company’s operations are influenced by external and internal factors beyond the Company’s control. The Company assumes no responsibility to publicly amend, modify or revise any forward-looking statements, basis any subsequent developments, information or events.