

## Subex Azure

### Ashish Aggarwal

+91 22 67069925

ashish.aggarwal@investsmartindia.com

### Sanket Dalvi

+91 22 67069900

sanket.dalvi@investsmartindia.com

### Shareholding (%)

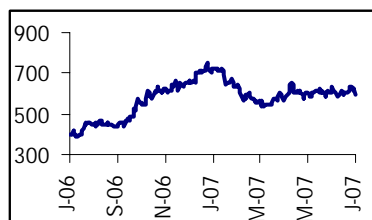
Promoters	8.7
FII's	24.2
MFs	18.0
Others	49.1

### Share price performance

52-week high/low (Rs)	790/380		
	-1m	-3m	-12m
Abs (%)	-3.7	-7.8	50.4
Rel* (%)	-6.6	-15.8	9.5

\*to Nifty

### Stock chart



### Results below expectations; maintain 'Buy'

Subex Azure Ltd's Q1FY08 revenue increased 49.3% sequentially to Rs1,317mn, much below our expectations. This was the first quarter where Syndesis revenue was consolidated with Subex. However, the company's net profit fell 21.9% sequentially to Rs216mn on account of higher cost due to Syndesis integration.

Subex has guided for a consolidated (Subex Azure + Syndesis) products revenue of US\$148mn and net profit of US\$37mn (excluding forex gains) in FY08E. Though, we believe that the revenue is achievable on the back of strong order backlog and order pipeline, the above expected redundancy cost (due to Syndesis acquisition) could have a negative impact on the bottomline. We expect the combined entity to post revenue of Rs7.31bn and net profit of Rs1.62bn in FY08E, implying an EPS of Rs46.5. Further, we expect the company to post an EPS of Rs67.8 in FY09E, implying a two-year EPS CAGR of 86.9%.

Currently, the stock is quoting at 12.8x and 8.8x FY08E and FY09E earnings. We maintain 'Buy' rating on the stock.

### Key highlights of Q1FY08 are:

- Product revenue increases 73.6% sequentially:** Subex reported product revenue of Rs1,004mn in Q1FY08, as against Rs579mn in Q4FY07, a sequential increase of 73.6%. The revenue increase was on account of Syndesis integration, revenue from which are being consolidated from Q1FY08 onwards.
- Syndesis integration impacts Revenue Maximisation Services (RMS) revenue:** Though the products revenue of Subex increased 73.6% sequentially, the management indicated that it was not able to book Rs400mn revenue in the RMS business. This was on account of the fact that most of the resources were deployed for Syndesis projects, and the company was not able to ramp-up to service RMS clients. However, the company expects these revenues to be booked in Q2FY08E.
- EBITDA margin declines:** Subex posted an EBITDA loss of Rs25mn in Q1FY08, as against a profit of Rs57mn in Q4FY07. EBITDA losses in the products business increased further from Rs104mn to Rs128mn. This was on account of integration of Subex Azure with Syndesis. The company booked US\$1.5mn redundancy cost in Q1FY08 and expects to book another US\$1.5mn in the next three quarters.

## Buy

## Rs594

July 27, 2007

### Market cap

Rs bn 21

US\$ mn 513

### Avg 3m daily volume

65,573

### Avg 3m daily value

Rs mn 40

### Shares outstanding (mn)

35

### Reuters

SUBX.BO/SUBEX.NS

### Bloomberg

SUBX IN

### Sensex

15,235

### Nifty

4,445

## Subex Azure

However, lower booking of revenue in RMS business, further led to EBITDA losses.

- ▲ **Forex gains push net income:** Though Subex reported a loss of Rs25mn at the EBITDA level in Q1FY08, the company reported a net profit of Rs216mn. This was on account of higher other income, as the company posted a forex gain of Rs349mn, which in turn was on account of restatement of liability towards FCCB of US\$180mn at the end of the quarter.
- ▲ **Syndesis integration on track:** Syndesis' integration with Subex is on track, as the company has completed integration with all departments in Q1FY08, except engineering. Though the company had indicated that the integration would be completed only at the end of Q4FY08, we believe that it could happen earlier, much like the Azure integration. The company expect redundancy cost of US\$6mn in FY08E on account of the integration, as the company shifts employees from high cost geographies to India. Out of the US\$6mn cost on integration, US\$3mn is expected to be written-off in FY08E and the rest is to be capitalised and amortised over the next three years.
- ▲ **Good visibility ahead:** Subex has entered Q2FY08E with an order backlog and AMC revenue of US\$65mn. This coupled with a sales pipeline of (orders bid for) US\$317mn at the end of Q1FY08, shows good visibility ahead. Historically, Subex has had a success rate of 35-40% in converting order pipelines into actual orders.
- ▲ **Guidance:** Subex has maintained its FY08E guidance. It expects products revenue of Rs6.15bn and a consolidated net profit of Rs1.55bn in FY08E. The company's net profit guidance is without forex gain/losses.
- ▲ **Financials:** We expect Subex to post consolidated revenue of Rs7.31bn in FY08E and Rs9.25bn in FY09E; the products division is likely to contribute Rs6.1bn and Rs7.9bn to the company's revenue respectively. We also expect Subex to post a net profit of Rs1,617mn and Rs2,361mn in FY08E and FY09E, implying an EPS of Rs46.5 and Rs67.8 respectively, a two-year CAGR of 86.9%. However, we have not taken into account conversion of FCCB's into equity shares for our FY08E and FY09E EPS estimates.
- ▲ **Valuation:** Currently, the stock is quoting at FY08E and FY09E PER of 12.8x and 8.8x respectively. With the company expected to grow at two-year CAGR of 86.9%, we remain bullish on the stock and maintain 'Buy'.

## Subex Azure

**Table 1. Quarterly result table**

Rs mn	Q1FY08	Q4FY07	QoQ (%)	Q1FY07	YoY (%)
Revenue	1,317	882	-33.0%	434	203.0%
Products	1,004	579	-42.4%	210	377.3%
Services	312	303	-3.0%	224	39.4%
Expenditure	1,342	900	-32.9%	396	238.6%
Cost of equipment & software	14	16	12.1%	17	-16.7%
Personnel cost	1,012	597	-41.0%	321	214.8%
Other expenditure	316	287	-9.2%	57	454.1%
Commission on sales	-	-		1	
EBITDA	(25)	(18)	-27.3%	38	-166.2%
EBITDA margin	-1.9%	-2.1%		8.8%	
Depreciation and amortisation	41	37	-11.3%	28	45.7%
EBIT	(66)	(55)	-17.4%	10	-770.7%
EBIT margin	-5.0%	-6.2%		2.3%	
Interest	69	39	-43.9%	9	689.7%
Other income	361	228	-36.9%	49	631.5%
PBT	226	134	-40.5%	51	346.8%
Taxes	10	(142)	-1503.7%	10	-1.4%
Tax rate	4.5%	-105.4%		20.3%	
PAT	216	276	28.0%	40	435.3%
NPM	16.4%	31.3%		9.3%	

Source: IISL research, company

**Table 2. Estimates**

Rs mn	FY06	FY07	FY08E	FY09E
Revenue	1,825	3,409	7,316	9,249
% growth	56.6%	86.7%	114.6%	26.4%
Net income	405	676	1,617	2,361
% growth	53.8%	66.9%	139.3%	46.0%
EPS	18.6	19.4	46.5	67.8
% growth	42.3%	4.4%	139.3%	46.0%
PER (x)	31.9	30.6	12.8	8.8
ROE (%)	26.6%	13.2%	17.6%	21.3%
ROCE (%)	25.0%	3.9%	11.7%	15.0%

Source: IISL research, company

IISL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report or may make sale or purchase or other deals in the securities from time to time or may deal in other securities of the companies/ organizations described in this report

### **Certification of Research Analyst**

We, Ashish Aggarwal & Sanket Dalvi, hereby certify that: the views expressed in the attached research report accurately reflect our personal views about Subex Azure and its securities, and our compensation is not directly or indirectly, related to the specific views or recommendations expressed in the research report.

### **Disclaimer Clause**

This report has been prepared by the Research Department of IL&FS Investsmart Securities Limited (IISL). E\*TRADE Financial Corporation holds an equity interest in IISL. E\*TRADE and the asterisk logo are registered trademarks of E\*TRADE Financial Corporation or its subsidiaries and are used with permission.

The information and opinions contained herein have been compiled or arrived at based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guarantee, representation or warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This report has been produced independently of any company or companies mentioned herein, and forward looking statements, opinions and expectations contained herein are entirely those of IISL and given as part of its normal research activity and not as a Manager or Underwriter of any Offering or as an agent of the subject company (the "Company") or any other person. Accordingly if any such Company should at any time commence an Offering of securities, any decision to invest in any such Offer or invitation to subscribe for or acquire securities of any such Company must be based wholly on the information contained in the Final Prospectus issued or to be issued by any such Company in connection with any such Offer or invitation and not on the contents hereof. This document is for information purposes only and is provided on an "as is" basis. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer, or solicitation of an offer, to buy or sell any securities or other financial instruments. We are not soliciting any action based on this research report.

IISL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of the shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or would subject IISL or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently sent or has reached any individual in such country, the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purpose without prior written approval of IISL.

Foreign currency denominated securities, if any, wherever mentioned are subject to exchange rate fluctuations which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs or GDRs, the values of which are influenced by foreign currencies effectively assume currency risk. Certain transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors.

This research report is for the general information and does not take into account the particular investment objectives, financial situation or needs of any individual customer, and it does not constitute a personalized recommendation of any particular security or investment strategy. Before acting on any advice or recommendation in this research report, a customer should consider whether it is suitable given the customer's particular circumstances and, if necessary, seek professional advice. Certain transactions, including those involving futures, options, and high yield securities, give rise to substantial risk and are not suitable for all investors.

E\*TRADE Capital Markets, LLC, E\*TRADE Canada Securities Corporation, E\*TRADE Securities Limited and E\*TRADE Securities (Hong Kong) Limited (together with E\*TRADE Financial Corporation and collectively "E\*TRADE") do not represent or endorse the accuracy or reliability of any of the information or content of the research report and reliance upon it is at your own risk. E\*TRADE expressly disclaims any and all warranties, express or implied, including without limitation warranties of merchantability and fitness for a particular purpose with respect to the research report and any information in it. E\*TRADE shall not be liable for any direct, indirect, incidental, punitive or consequential damages of any kind with respect to the research report.

Distribution of this report into the United States is intended to be solely to "major U.S. institutional investors" pursuant to Rule 15a-6 under the U.S. Securities Exchange Act 1934, as amended. All U.S. persons that receive this report, by their acceptance thereof, represent and agree that they are a major U.S. institutional investor and understand the risks associated in executing transactions in securities. U.S. persons wishing to obtain further information or effect transactions in any securities mentioned in the attached report should contact E\*TRADE Capital Markets, LLC, 135 East 57th Street, 14<sup>th</sup> Floor, New York, NY 10022, Telephone Number- 646-840-8730, Fax - 646-840-8701.

Research, analysis, charting, reports, estimates, commentary, information, data, views, opinions, news and other content (collectively, the "Research") provided to you by E\*TRADE Canada Securities Corporation ("E\*TRADE Canada") is for informational purposes only. The Research provided herein by E\*TRADE Canada has been prepared by IISL, but such research has been prepared independently from E\*TRADE Canada and its employees. Accordingly, the Research may not have been, and no representation is made that such Research has been, prepared in accordance with Canadian disclosure requirements. Neither the Research nor the profiles of the third party research providers have been endorsed or approved by E\*TRADE Canada, and E\*TRADE Canada is not responsible for the content thereof or for any third party products or services. Some Research may contain financial information, but nothing in the Research constitutes a recommendation by E\*TRADE Canada to buy, sell or hold any security discussed therein, and the Research neither is, nor should it be construed as, an offer or a solicitation of an offer to buy or sell securities by E\*TRADE Canada. E\*TRADE Canada does not provide investment advice or recommendations of any kind, nor advice regarding the suitability or profitability of any investment. You are fully responsible for any investment decisions that you make and any profits or losses that may result. Any opinions, views, advice, services or other content provided by a third party are solely those of such third party, and E\*TRADE Canada neither endorses nor accepts any liability in respect thereof.

E\*TRADE Securities Limited is a company registered in Scotland No. SC103238 with its principal place of business at 42nd Floor, One Canada Square, London E14 5AA, United Kingdom. Registered Office: 24 Great King Street, Edinburgh EH3 6QN, United Kingdom. E\*TRADE Securities Limited is a member of the London Stock Exchange and is authorised and regulated by the Financial Services Authority.

E\*TRADE Securities (Hong Kong) Limited is licensed by the Hong Kong Securities & Futures Commission under Central Entity Number: ACT 764. Registered Office: Suite 2401-12 Two Pacific Place, 88 Queensway, Admiralty, Hong Kong.