

## Polaris Software Lab Limited

### VISIT NOTE

Sensex: 14,191

CMP: 208

February 13, 2007

Polaris Software Lab Limited is providing integrated global technology solutions for the Banking and Financial service industry. With over 20 years of experience and over 8400 professionals, Polaris offers specialised products, practices and solutions for corporate banks, investment banks, consumer finance institutions and insurance companies. Orbitech Solution (a citigroup company) was merged with Polaris in 2002

### Industry outlook

#### As per Nascomm Review Report 2006:

- India has the potential to capture more than 50 per cent of global offshoring market ~US \$110 billion and generate export revenues of ~\$60 billion by 2010 growing at 28 % CAGR till 2010
- IT solutions space to grow by 25 % CAGR to \$35 billion by 2010 and ITES space to grow by 37% CAGR to \$25 billion by 2010
- Nascomm Review 2007 reiterated the \$60 billion opportunity for India and outlined the areas where Indian IT industry can strengthen its operational excellence and quality.
- Banking and financial services have been the major IT spenders and account for nearly 50% of the total outsourced IT spends. Gartner has estimated the total BFSI IT spending to be around \$140 billion.
- As per the company, the expected market for legacy modernization is close to \$18.5 bn and views the current BFSI technology market close to \$85 bn.

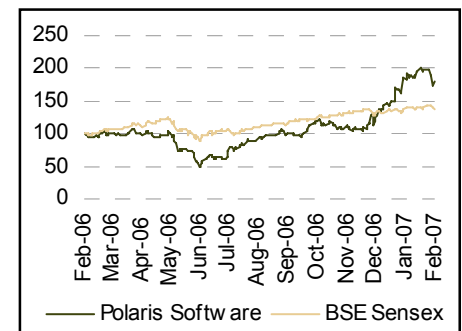
Polaris earns ~90% of its revenues from BFSI space

|                    |   |          |
|--------------------|---|----------|
| Bloomberg Code     | : | POL@IN   |
| Reuters Code       | : | POLS.BO  |
| BSE Code           | : | 532254   |
| NSE Code           | : | POLARIS  |
| 52-Week Range(H/L) | : | 237 / 52 |
| Market Cap (Rs.mn) | : | 20,506   |
| Shares O/S (mn)    | : | 98       |
| Free Float (mn)    | : | 71       |
| 3m Avg. Volume     | : | 615813   |
| Face Value         | : | 5        |

#### Price Performance: (%)

|          | 3m   | 6m   | 12m   |
|----------|------|------|-------|
| Absolute | 63.4 | 93.7 | 82.68 |
| Relative | 58.7 | 70.6 | 43.0  |

#### Relative Price Movement



| Quarter Results (Rs mn) Y/E- Mar  | 1QCY06 | 2QCY06 | 3QCY06 | 4QCY06 |
|-----------------------------------|--------|--------|--------|--------|
| Net sales                         | 1,989  | 2,320  | 2,556  | 2,740  |
| QoQ growth %                      | (2.2)  | 16.7   | 10.1   | 7.2    |
| - COGS                            | 1,657  | 1,741  | 1,833  | 1,960  |
| - Operating costs                 | 218    | 220    | 265    | 305    |
| EBITDA                            | 114    | 360    | 457    | 474    |
| Margins %                         | 5.7    | 15.5   | 17.9   | 17.3   |
| - Depreciation/Amortisation       | 124    | 117    | 118    | 124    |
| EBIT                              | (11)   | 243    | 339    | 350    |
| - Interest expense                | 2      | 2      | 2      | 2      |
| PBT                               | (13)   | 241    | 337    | 348    |
| - Tax                             | 18     | 47     | 59     | 69     |
| PAT                               | (31)   | 194    | 278    | 279    |
| QoQ growth %                      | 38.0   | 726.3  | 43.6   | 0.4    |
| + Extra-ordinary income/(expense) | 52     | 9      | (7)    | 43     |
| Net profit                        | 21     | 203    | 271    | 323    |
| # of diluted shares o/s           | 98     | 98     | 98     | 98     |
| Non-promoter holding              | 74     | 71     | 71     | 71     |
| EPS (Rs.)                         | 0      | 2      | 3      | 3      |

## Key takeaways

### Products - Intellect suite

Polaris's Intellect suite of products caters to needs of various segments in BFSI vertical. The product is an enterprise platform that meets the needs of retail, private and corporate banking. The suite is designed using J2EE technology with over 56 modular components for 10 banking business lines. The modular approach and the open standard, enables the suite for easy integration with legacy systems thereby bringing in non-disruptive and minimal-risk modernization approach. The suite is Web-enabled, multi-currency and multi-lingual, which positions the suite globally acceptable. Polaris believes with its Intellect Platforms, built using Services Oriented Architecture (SOA) technology is well positioned to address market needs.

In Q307, products contributed 18% of revenues.

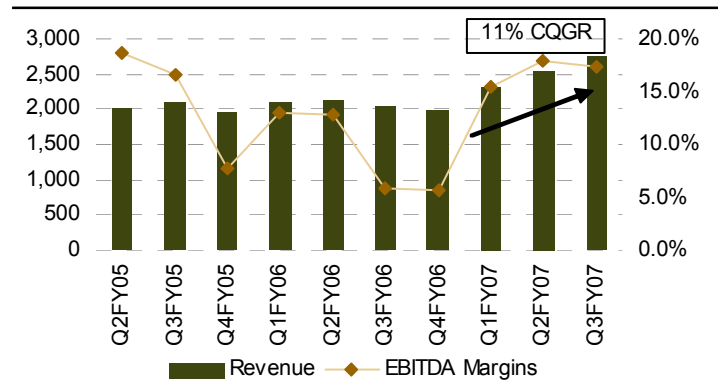
### Change at Polaris

During CY05 and FY06 the company's financial performance had deteriorated with de-growth in profits. Polaris had engaged mckinsey to confirm its product driven strategy, which was being validated and was advised to have an execution capability in place. To implement the execution machinery, Polaris inducted Mr. Arup Gupta in October, 2005. Mr. Gupta is an ex-TCSer with a rich experience of over 25 years in the field. He headed and grew North American geography for TCS. The company also took steps to integrate the company completely bringing in project management in place, where geographies and practices were defined to bring in efficiencies. The company also appointed Mr. R Srikanth as Chief Financial Officer in July, 2006. He has over 24 years of rich experience in the field of Finance and Business Management. Prior to joining he worked as the Associate Chief Operating Officer with Wipro BPO Solutions and as Group Chief Financial Officer with Future Software.

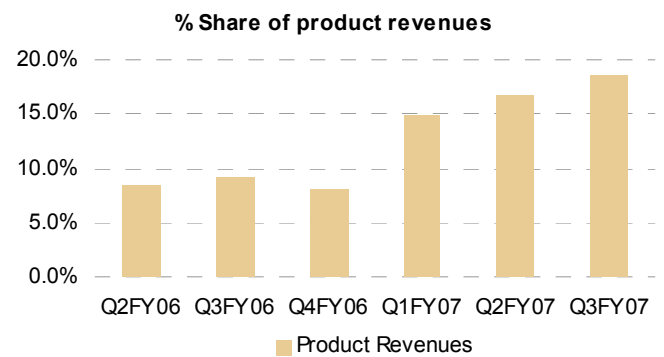
### Change is visible

With the focus that company has and the cultural change that the company has brought into place, the change is visible from the financial performance of last 3 quarters. The revenues have grown by 11% CQGR in last 3 quarters.

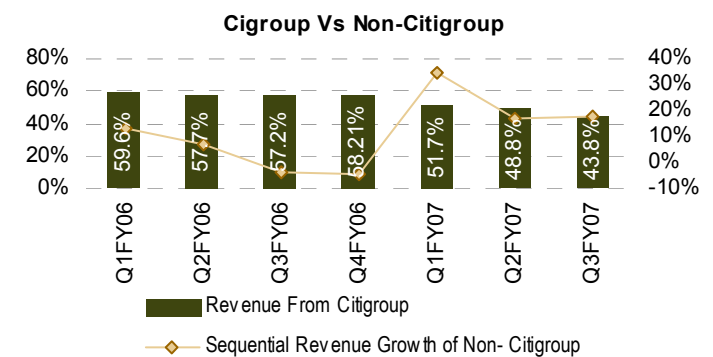
Margins has bounced back to 17% levels in Q307



Share of revenue from products has been growing since last 3 quarter.



Dependence on Citibank decreasing and non-Citi accounts growing



The company plans to mine the existing 55 global clients where it believes ample opportunities exist. In order to strengthen account mining, the company has added 30 people in Global Sales and Account Management teams during Q307.

The company plans to add 500 people in the next quarter.

## **Risks**

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### **Competition and Technology obsolescence**

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Any competition from the larger players in the field that Polaris operates can affect the company's financial performance. Also the product segment is highly technology driven where obsolescence of technology can make a product incompetent in the market. To keep up with the market, continuous investments are required in products. Higher than expected investment in products may impact the financial performance

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### **Industry risk**

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Short supply of skilled manpower, more than expected rupee appreciation against foreign currencies and loss of key managerial manpower may impact the company's financial performance.

## **Valuations**

Given the fact that company is showing improvements in their financial performance and has put in place execution machinery which has improved its operational performance, we believe the company's stock will provide a good upside to investors. With the company growing at 5% sequentially (with 6% in seasonally strong quarters) and focus on products, would help the margins to improve by 100 bps in FY08 and FY09 each. As per our estimates Polaris is trading at 12.9x FY08E and 10.2x FY09E. We recommend a BUY with a target price of Rs.300 an upside of more than 40% over a one year period horizon.