

# I-Flex Solutions

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**Shareholding (%)**

Foreign Promoters	80.6
Others	19.4

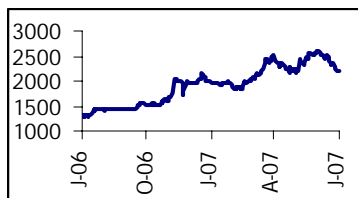
**Share price performance**

52-week high/low (Rs) 2635/1260

	-1m	-3m	-12m
Abs (%)	-14.7	-3.1	66.5
Rel* (%)	-18.6	-14.2	22.4

\*to Nifty

**Stock chart**



**Valuations stretch: Maintain Reduce**

I-Flex Solutions (I-Flex) Q1FY08 results were higher than our expectation but was lower than market. I-Flex reported a 8.2% and 46.5% sequential decline in revenues and net profit to Rs 5.3bn and Rs 415mn respectively. The tank size of the company also reduced from USD 82.5mn at the end of Q4FY07 to USD 75.3mn.

We estimate I-Flex to post an EPS of Rs 47.6 and Rs 66.6 respectively. Our FY08E EPS estimates are lower by 7% than our previous estimates on account of rupee appreciation. However our FY09E estimates are higher by 1.2% to account for higher product revenues.

Currently, the stock is quoting at FY08E and FY09E PER of 46.4x and 33.2x respectively. Though synergies with Oracle have started yielding results for the company in its products business, we believe that the current stock price factors this. Therefore, we maintain to 'Reduce' on the stock. However, an open offer from Oracle remains the key risk to our recommendation.

Key highlights of Q1FY08 results are:

- ▲ **Products business decline 9.2% sequentially:** During Q1FY08, I-Flex's product revenue declined 9.2% sequentially, on account of 13% sequential decline in license fee. The share of license fees in total products revenues was 21%, lowest in the last 17 quarters. The company attributed the decline in products revenues to seasonality than any slowdown in the business. The tank size also reduced from USD 82.5mn in Q4FY07 to USD 75.3mn in Q1FY08. We expect products revenue to grow at a two year (FY07-09E) CAGR of 41.7% to Rs22.03bn in FY09E as against Rs10.97bn in FY07.

**Reduce**  
**Rs2209**

01 August 2007

**Market cap**

Rs bn 179  
US\$ mn 4,418

**Avg 3m daily volume**

91,987

**Avg 3m daily value**

USD mn 5

**Shares outstanding (mn)**

81

**Reuters**

IFLX.BO/I-FLEX.NS

**Bloomberg**

IFLEX IN

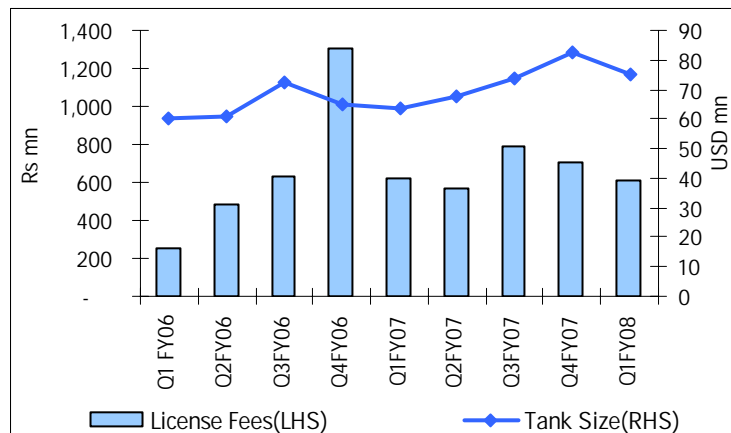
**Sensex**

15,551

**Nifty**

4,529

**Chart 1. Trend in license fee and tank size**



Source: IISL research, company

## I-Flex Solutions

- ▲ **Services revenue decline 6.9% sequentially:** I-Flex's revenue from services business declined 6.9% sequentially to Rs2.27bn. The decline was majorly on account of more than 7% rupee appreciation.
- ▲ **Consolidated EBITDA margin fell by 520bps:** The consolidated EBITDA margins of the company fell by 520bps, with products margins declining by 290bps and services by 540bps. The products margins fell on account of lower license fees booking and salary hikes. The margins in the services business were impacted by salary hikes (15-17% offshore and 3-7% onsite) and rupee appreciation. However, we expect the company's consolidated EBITDA margin to improve going forward, because of:
  - ✓ Higher license fee revenue, expanding EBITDA margin of the products business
  - ✓ Improving services margin, as the company adds more employees at the entry level and improve utilisation and realisation.
  - ✓ Benefits from economies of scale
- ▲ **Forecasts:** We are reducing our FY08E EPS estimates by 7% to Rs 47.6 to take into account rupee appreciation. We are however increasing our FY09E EPS estimates by 1.2% to Rs 66.6 to take into account higher products revenues.
- ▲ **Valuation:** I-Flex's increasing synergies with Oracle has enabled it to report higher traction in its products business, resulting in a revenue growth of 44.8% in the products business in FY07, highest in the last four years. However, we believe that at the current FY08E and FY09E PER of 46.4x and 33.2x, the stock is valued fairly and factors these synergies. We therefore maintain 'Reduce' rating on the stock. However, another open offer from Oracle at a price higher than the current market price is a key risk to our recommendation.

## I-Flex Solutions

**Table 1. Quarterly result table**

Rs mn	Q1FY08	Q4FY07	QoQ (%)	Q1FY07	YoY (%)
Revenues	5,321	5,794	-8.2%	4,075	30.6%
Products	2,912	3,206	-9.2%	2,000	45.6%
Services	2,277	2,445	-6.9%	1,984	14.8%
KPO	131	143	-8.2%	92	43.0%
Cost of Revenues	3,287	3,208	2.5%	2,605	26.2%
Gross Profit	2,034	2,586	-21.4%	1,470	38.3%
GPM	38.2%	44.6%		36.1%	
Selling and Mktg	559	747	-25.1%	519	7.8%
General and Admn	745	747	-0.2%	493	51.1%
EBITDA	729	1,093	-33.3%	458	59.1%
EBITDA Margin	13.7%	18.9%		11.2%	
Depreciation	242	247	-2.0%	160	51.2%
Other than temp. diminition in value of securities available for sale	-	-		-	
Share of associate company gain/loss	(3)	2	-225.0%	2	-255.7%
Interest and Other inocme	(10)	26		200	-105.1%
PBT	474	874	-45.8%	500	-5.3%
Provision for tax	58	97	-40.0%	85	-31.6%
Tax Rate	12.3%	11.1%		17.1%	
PAT	415	777	-46.5%	415	0.2%
NPM	7.8%	13.4%		10.2%	

Source: IISL research, company

**Table 2. Estimates**

Rs mn	FY06	FY07	FY08E	FY09E
Net Sales	14,835	20,381	26,557	34,715
% change	30.1	37.4	30.3	30.7
Net Income	2,190	2,768	3,856	5,390
% change	8.0	26.4	39.8	39.3
EPS (Rs.)	28.7	34.2	47.6	66.6
% change	8.0	19.0	39.3	39.8
P/E (x)	87.9	73.8	46.4	33.2
ROE (%)	17.6	15.7	16.4	19.4
ROCE (%)	19.7	15.6	17.7	20.8

Source: IISL research, company

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

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