

iGate Global Solutions

Rs389
DOWNGRADE TO NEUTRAL

RESULT NOTE

Mkt Cap: Rs12.5bn; US \$292m

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Result: Q4FY07

Comment: Concern over ITOP revenues; margins on track

Last report: 04 April 2007 (Price Rs369; Recommendation: Outperformer)

Key financials

Year end 31 March (Rs m)	Net Sales	% Change yoy	Net Profits	EPS (Rs)	% Change yoy	PER(x)
2006	6,358	9.6	55	1.8	(76.2)	214.4
2007	8,051	26.6	495	15.6	760.7	24.9
2008E	9,231	14.7	792	24.6	57.4	15.8
2009E	11,480	24.4	1,056	32.2	31.1	12.1

In Q4FY07, iGATE Global Solutions's (iGS) revenues declined 0.3% qoq to Rs2.10bn (rupee appreciation shaved off 2% growth), which was in line with our estimates. Volume growth in IT services was 2.4% sequentially. Offshore billing rate increased marginally by 0.5% qoq, while 2.9%qoq increase in onsite billing rate was on account of onsite consulting assignments. Higher billing rates coupled with offshorization (47.5% offshore v/s 46.3% in last quarter) and 133bp saving in SG&A led to 265bp improvement in EBITDA margins to 15.3% - higher than our expectation of 14% margins. iGate added six clients in the quarter including four Fortune 1000 customers. The company expects sluggishness in ITOPS revenue (10% of total) from loan fulfillment processes due to US non-prime mortgage meltdown. Owing to expected decline in ITOPS revenue and sharp rupee appreciation we have downgraded earnings estimates for FY08 and FY09 by about 9%. The stock has risen 12.2% YTD out performing the NSE IT index (down 6.3%) and the Nifty index (down 2.6%). With the expected poor growth in revenues and modest upside to EBITDA margins (160bp end-FY08 compared to end-FY07), at 15.8x FY08E and 12.1x FY09E earnings, we downgrade the stock to Neutral.

KEY HIGHLIGHTS

□ Seasonally weak quarter - 0.3% decline in revenues; rupee appreciation shaved off 2%

iGate witnessed a 0.3% qoq decline in operating revenues in Q4FY07 to Rs2,101m.

Revenues from IT services (90% of total) remained broadly flat at Rs1,891m on the back of 2% qoq volume growth, – 2.7% growth offshore and –2.7% decline onsite – as rupee appreciation shaved off the growth. Offshore revenues grew 2.7% qoq, while onsite revenues declined by 1.9% qoq with share of offshore revenues increasing to 47.5% from 46.3% in Q3FY07. Billing rates too increased marginally by 0.5% qoq offshore, while onsite billing rate witnessed a strong growth of 2.9% qoq on account of higher proportion of onsite consulting assignments.

Revenues from GE declined 2.2% qoq in rupee terms (to Rs545m) contributing 28.8% of revenues. Revenue from #6-10 clients (10.9% of total) declined 21.5% qoq, while revenue from #2-5 clients (30% of total) increased marginally at 1% qoq. The decline in revenues was attributed to increase in offshorization and seasonal weakness around budgeting process at client's end. Other clients (ex top 10) increased 13.6% qoq contributing 30% to revenues.

□ EBITDA margin expansion of 265bp – driven by higher offshorization and savings in SG&A

Gross margins increased by 133bp qoq to 32.6% on account of better billing rates and offshorization offsetting adverse impact of rupee appreciation and lower offshore utilization (-100bp qoq to 67%). A 133bp qoq decline in other operating expenditure as a % of revenue led to EBITDA margin expansion of 265bp (against 133bp expansion in gross profit). Increase in EBITDA margin was higher than our expectations of ~130bp expansion. EBITDA increased by 20.6% qoq to Rs321.7m.

□ Net profit growth was higher at 42% qoq due to forex gains and tax refund

Net profit increased 42% qoq to Rs226.5m. Other income of Rs11.4m (of which Rs4m was forex gains) and prior period tax refund (Rs4.6m) helped 42% qoq growth in PAT – higher than 20.6% qoq growth in EBITDA.

□ Expects sluggishness in ITOPS revenues

Two of top 20 clients of iGate, which are in the mortgage industry have been severely impacted by the US non-prime mortgage meltdown. Consequently, revenues from loan fulfillment processes (loan application to funding) has been adversely impacted. iGate will be effecting 2% yoy salary hike onsite and 15% yoy salary hike offshore during Q1FY08. Company expects margins to increase yoy during FY08.

OTHER KEY METRICS

- Utilization declined offshore (-100bp qoq to 67%) and remained flat onsite (92%).
- Offshore efforts were 75% of the total as against 73% in the same quarter last year.
- 124 employees were added in the quarter, taking the total number of employees to 5,945. The company informed that it will add over 900 employees in FY08 against addition of 792 employees during FY07 – of the total addition iGate plans to add 800 freshers in FY08 (700 added in FY07)
- Number of USD1m+ customers remained flat at 29.
- Six new clients were added, of which 4 were Fortune 1000 customers.
- Attrition was ~19.3%.

VALUATIONS AND VIEW

iGS's Q4FY07 results were ahead of our expectations at EBITDA level – reported 265bp improvement against our expectations of 130bp expansion. We are cutting our estimates due to expected lower revenues from its ITOPs offering to the clients in the Mortgage business and the Rupee appreciation against the US dollar. We expect marginally lower volume growth in its IT services business compared to FY07 but the currency movement and lower ITOPs revenues would restrict revenue growth to 14.7% in Rupee terms in FY08. The stock has risen 12.2% YTD out performing the NSE IT index (down 6.3%) and the Nifty index (down 2.6%). With poor growth in revenues and modest upside to EBITDA margins (160bp end-FY08 compared to end-FY07), at 15.8x FY08E and 12.1x FY09E earnings, we downgrade the stock to Neutral.

Quarterly results

Year to 31 March (Rs m)	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	FY07	FY08(E)
Revenues	1,674	1,816	2,026	2,107	2,101	8,051	9,231
Direct costs	1,172	1,333	1,432	1,449	1,417	5,631	6,302
Gross Profit	502	483	594	658	684	2,420	2,928
Other Oper Expenditure	341	355	394	391	362	1,502	1,614
EBIDTA	161	129	201	267	322	918	1,314
Other Income	(3)	(1)	(3)	(1)	11	6	30
Interest	8	7	7	7	7	29	24
Depreciation	95	99	98	102	100	398	443
Profit before tax	56	21	93	156	227	497	877
Tax	9	11	6	10	8	35	105
Minority Interest	-	-	11	14	8	33	20
Extraordinary loss	-	-	(3)	-	-	-	-
Profit after Tax	47	10	101	160	227	498	792
YoY Growth(%)							
Revenues	15.0	23.1	30.1	27.6	25.5	26.6	14.7
EBIDTA	48.1	27.6	34.5	35.3	99.4	49.6	43.1
PAT	111.2	-26.6	80.2	1126.9	380.9	800.2	59.0
Revenues	1.4	8.5	11.6	4.0	(0.3)		
EBIDTA	(18.2)	(20.1)	55.6	33.0	20.6		
PBT	(38.9)	(61.8)	335.7	68.0	45.3		
PAT	262.3	(77.7)	864.8	57.5	42.0		
Operational Parameters (%)							
EBIDTA Margins	9.6	7.1	9.9	12.7	15.3	11.4	14.2
NPM	2.8	0.6	5.0	7.6	10.8	6.2	8.6

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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