

**RESULTS REVIEW**
**i-flex Solutions Limited**
**Sell**
**Share Data**

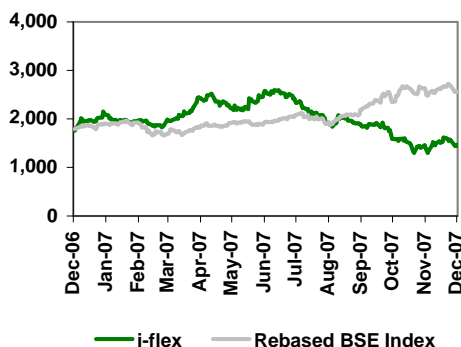
Market Cap	Rs. 123.28 bn
Price	Rs. 1,472.30
BSE Sensex	19,162.57
Reuters	IFLX.BO
Bloomberg	IFLEX IN
Avg. Volume (52 Week)	0.02 mn
52-Week High/Low	Rs. 2,630 / 1,225
Shares Outstanding	83.73 mn

**Valuation Ratios (Consolidated)**

Year to 31 March	2008E	2009E
EPS (Rs.)	45.0	58.6
+/- (%)	(1.8)%	30.2%
PER (x)	32.8x	25.1x
EV/ Sales (x)	4.4x	3.6x
EV/ EBITDA (x)	23.7x	18.2x

**Shareholding Pattern (%)**

Promoters	81
FII's	1
Institutions	2
Public & Others	17

**Relative Performance**

**'Services' segment continues to drag**

In Q2'08, i-flex considerably improved upon its performance in the first quarter. Higher 'Products' segment revenue pushed up topline by 12.2% qoq to Rs. 5.8 bn. EBITDA and EBIT margin increased by 3.1% and 2.9% qoq, to stand at 16.6% and 13.2%, respectively. PAT went up by 138.1% qoq to Rs. 874.0 mn, on account of a lower effective tax rate.

Though i-flex showed a better performance in Q2'08 with respect to Q1'08, yet the results remain lacklustre when compared with the corresponding quarter in the last fiscal year. The Company's mainstay segment 'Products' continues to grow at a fast pace. However, the 'Services' segment has witnessed a sluggish growth with deteriorating operating margins. Our outlook on the future prospects of this segment is quite bleak, considering the slowdown in the US economy. The KPO business is still incurring losses. We believe that i-flex needs to focus on enhancing its overall margins, spurring the growth rate of its 'Services' segment and deriving value from the KPO business.

We project revenue and net profit CAGR of 25.9% and 14.8%, respectively over the period FY07-09E. The stock is currently trading at a forward EV/Sales of 4.4x for FY08E and at a forward P/E of 32.8x for the same year. Considering the valuations the stock seems overpriced, hence we maintain our Sell rating.

**Key Figures (Consolidated)**

Quarterly Data	Q2'07	Q1'08	Q2'08	YoY%	QoQ%	H1'07	H1'08	YoY%
(Figures in Rs mn, except per share data)								
Net Sales	4,992	5,133	5,758	15.3%	12.2%	9,025	10,891	20.7%
EBITDA	1,098	692	954	(13.1)%	37.9%	1,618	1,646	1.7%
Net Profit	935	367	874	(6.5)%	138.1%	1,286	1,241	(3.5)%

**Margins(%)**

EBITDA	22.0%	13.5%	16.6%		17.9%	15.1%
NPM	18.7%	7.1%	15.2%		14.2%	11.4%

**Per Share Data (Rs.)**

EPS	11.9	4.4	10.4	(12.2)%	137.7%	16.3	14.8	(9.3)%
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### Result Highlights

*'Products' business fuels topline growth; FLEXCUBE continues to gain traction*

Topline, at Rs. 5.8 bn, increased 12.2% qoq and 15.3% yoy, primarily due to higher 'Products' segment revenue. Strong deal inflow resulted in higher license and implementation fees, thereby enhancing the 'Products' revenue by 18.0% qoq to Rs. 3.3 bn. The Company added eight new clients under the product business segment, with the introduction of the latest version of its product FLEXCUBE 10.0.

*Sluggish growth trend witnessed by the 'Services' segment*

Revenues from the Company's 'Services' segment stood at Rs. 2.3 bn, marginally up 5.3% qoq, primarily on account of an increase in the billing rate to the tune of 2.0-2.5%. Revenue contribution of the non-Citigroup clients to the 'Services' segment jumped from 54% in Q1'08 to 65% in Q2'08, thus enabling the improvement in pricing. However, contribution of the 'Services' segment to the total revenues has consistently declined from 49.0% in Q1'07 to 40.2% in Q2'08. Further, during the period H1'07 to H1'08 revenues from this segment grew by a meagre 4.9%. We believe that this sluggish growth is likely to continue in the near term considering the slowdown in the US economy.

The Company's KPO business has been incurring losses ever since the acquisition of Equinox Corporation in FY05. In Q2'08 this segment recorded an operating loss of 34.6 mn in Q2'08. Management expects this business to break-even by the end of FY08.

*Overall margins low due to poor operating performance of the 'Services' segment*

EBITDA improved by 37.9% qoq to Rs. 954.0 mn, with a reduction in employee cost and G&A as a percentage of the total revenue. However, EBITDA was still lower by 13.1% when compared with the corresponding quarter last year. Though, the EBITDA margin went up by 309 bps qoq to 16.6%, it declined by 543 bps yoy. Similarly the EBIT margin, at 13.2%, registered a slump of 565 bps yoy, while it increased by 290 bps qoq. The operating margins of the 'Products' business continue to improve; however, the overall margins were down because of a tremendous decline in the 'Services' business margin from 15.1% in Q1'08 to 9.3% in Q2'08. Going

forward, we predict the margins to improve slightly. However, the outlook for the 'Services' business remains bleak.

*PAT jumps on account of lower effective tax rate*

PAT was higher by 138.1% qoq to Rs. 874.0 mn. This is attributable to the decline in the effective tax rate from 17.7% in Q1'08 to 9.7% in Q2'08 on account of MAT credit and lower effective tax rate for the Company's European subsidiary. However, PAT declined by 6.5% yoy. While the PAT margin went up by 8.0% qoq to stand at 15.2%, it dipped by 3.6% yoy.

*Employee strength crosses the 10,000 mark*

With the addition of eight new clients, the Company's client tally stood at 131. i-flex increased its employee base by 1,245 to 10,778 at the end of Q2'08. Attrition rate, though went down by 1.5% qoq, is still on the higher side in comparison to its peers and stood at 19.5%. However, days of sale outstanding (DSO) increased from 102 in the last quarter to 110 in the present quarter, which indicates a downward trend on the collection front.

### Key Events

- i-flex successfully completed the rollout of FLEXCUBE in 67 countries for the Citigroup's Markets & Banking division.
- The Company increased its stake in Canada-based Castek Software from 59.9% to 100%. Castek provides core insurance business processing systems for large and mid-sized property and casualty insurers.
- i-flex entered into a partnership with the US-based Tyfone, a producer of software and hardware platform for mobile banking. The two companies will have West Coast Bank, headquartered in the US, as their first client.
- The Company sealed an agreement with IZB Informatik-Zentrum, a Munich-based IT and telecommunication service provider, to provide a range of banking application services to German banks.

### Key Risks

Any significant slowdown in the US economy leading to lower IT financial services spending and more than anticipated appreciation of the rupee against the dollar pose a risk to our rating.

### Outlook

Though i-flex improved upon its performance in Q2'08 with respect to Q1'08, the results are lacklustre when compared with the corresponding quarter in the last fiscal year. The Company's traditional stronghold - 'Products' segment has led the growth in topline, with growing traction of its flagship product FLEXCUBE. However, the 'Services' segment has been sluggish growing by just 4.9% yoy for H1'08. Its revenue contribution has deteriorated from 49.0% in Q1'07 to 40.2% in Q2'08. Moreover, i-flex has been unable to arrest the consistent decline in the operating margin of this segment. Going forward, there seems to be low visibility on the growth prospects of this segment, considering the slowdown in the US economy. The Company's KPO division continues to incur losses. We believe that i-flex needs to focus on enhancing its overall margins, spurring the growth rate of its 'Services' segment and deriving value from the KPO business. We project topline and bottomline to grow at a CAGR of 25.9% and 14.8%, respectively over the period FY07-09E. The stock is currently trading at a P/E of 32.2x and at a forward P/E of 32.8x for FY08E. Considering the valuations the stock seems overpriced, hence we maintain our Sell rating.

#### Key Figures (Consolidated)

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY07-09E)
Net Sales	11,386	14,823	20,609	26,415	32,649	25.9%
EBITDA	3,001	3,262	4,425	4,887	6,367	20.0%
Net Profit	2,324	2,474	3,723	3,764	4,903	14.8%
<b>Margins(%)</b>						
EBITDA	26.4%	22.0%	21.5%	18.5%	19.5%	
NPM	20.4%	16.7%	18.1%	14.2%	15.0%	
<b>Per Share Data (Rs.)</b>						
EPS	30.2	31.9	45.8	45.0	58.6	13.1%
PER (x)	19.6x	41.5x	32.2x	32.8x	25.1x	

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