investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
HLL	24-Nov-05	172	**215**	280
ICICI Bank	23-Dec-03	284	**964**	1,240
JP Associates	30-Dec-03	125	**620**	850
Maruti	23-Dec-03	360	**797**	1,050
Tata Elxsi	14-Dec-06	232	**309**	385

3i Infotech

Emerging Star

Stock Update

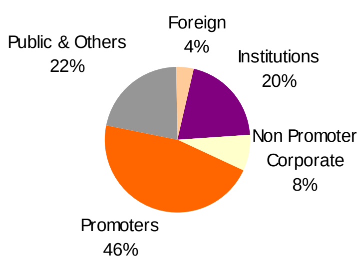
Price target revised to Rs400

Buy; CMP: Rs300

Company details

Price target:	Rs400
Market cap:	Rs1,689 cr
52 week high/low:	Rs323/123
NSE volume: (No of shares)	3.8 lakh
BSE code:	532628
NSE code:	3IINFOTECH
Sharekhan code:	ICICINFO
Free float: (No of shares)	3.1 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	17.6	-5.5	54.4	56.6
Relative to Sensex	9.7	-5.4	36.4	26.1

Result highlights

- 3i Infotech has reported a growth of 22.5% quarter on quarter (qoq) and 75.2% year on year (yoy) in its consolidated revenues to Rs210.2 crore for the fourth quarter. The service business grew by 28.3% sequentially to Rs102.6 crore whereas the product business grew by 17.4% qoq to Rs107.6 crore.
- The operating profit margin (OPM) continued to firm up. The OPM improved by 20 basis points to 25% (the highest ever reported in any quarter) on the back of a sharp improvement in the margins of the service business.
- The benefits from the lower software product development charges were nullified by the higher depreciation and lower other income. However, an increase in the tax rate resulted in a relatively lower growth rate in the earnings of 16.7% qoq and 83.7% yoy to Rs32.2 crore, in line with our expectations of Rs32.3 crore.
- On a full year basis, the consolidated revenues and earnings have grown by 56.8% and 80.6% respectively. The OPM has shown an improvement of 370 basis points to 24.2% during the year.
- In terms of operational highlights, the company continues to show a healthy growth in the pending order book that has grown by 33% qoq to Rs568.7 crore. This is more than double of Rs266 crore as in March 2006.

Result table Rs (cr)

Particulars	Q4FY07	Q4FY06	Q3FY07	% yoy	% qoq
Net sales	**210.2**	**120.0**	**171.6**	**75.2**	**22.5**
Cost of revenue	112.2	66.7	92.4	68.2	21.5
Gross profit	98.0	53.2	79.2	84.0	23.7
SG&A expenses	45.5	27.7	36.6	64.3	24.4
Total operating cost	157.7	94.4	129.0	67.0	22.3
Operating profit	52.5	25.5	42.6	105.3	23.1
Software development cost	7.3	0.0	19.1	-	-61.7
Other income	0.8	1.6	6.1	-51.8	-87.3
Interest	6.1	2.5	7.1	149.9	-14.2
Depreciation	5.8	6.5	-5.8	-10.4	-
PBT	34.0	18.2	28.3	86.7	20.1
Provision for tax	2.0	0.6	0.4	-	-
Tax	1.2	1.2	1.7	0.0	-31.9
Deferred tax	0.8	-0.6	-1.3	-	-
PAT (before minority interest)	32.0	17.6	27.9	82.1	14.8
Extraordinary items	--	0.0	12.0	-	-
Minority interest	0.2	0.1	-0.3	-	-
RPAT	**32.2**	**17.5**	**27.6**	**83.7**	**16.7**
Equity capital	56.3	53.0	56.3		
EPS (Rs)	5.7	3.3	4.9		
Margins (%)					
GPM	46.6	44.4	46.2		
OPM	25.0	21.3	24.8		
NPM	15.2	14.7	16.3		

- The growth guidance for FY2008 is also healthy. Revenues are guided in the range of Rs1,000-1,100 crore (a growth of 49-64% over the total turnover of Rs670.8 crore). The earnings per share (EPS) are guided in the range of Rs20.1-21.5 per share (on a fully diluted equity base as on March 2007).
- Along with the results, the company has rewarded the shareholders with a bonus issue of 1:1 and a dividend of 20% (or Rs2 per share).
- To factor in the healthy order backlog and robust growth guidance, we have revised our FY2008 earnings estimate by 3.9% and introduced our FY2009 estimate in the note. At the current market price the stock trades at 14.1x FY2008 and 11.2x FY2009 estimated earnings (based on fully diluted equity including the Euro 30-million foreign currency convertible bond [FCCB] issue closed in April 2007 and earnings are adjusted for dividend on the preference shares). We maintain our Buy call on the stock with a revised price target of Rs400.

Service business boosted by Rhyme Systems

The robust sequential growth of 28.3% in the service revenues was driven by the incremental contribution of around Rs15 crore from the consolidation of Rhyme Systems' performance for the full quarter. The UK-based Rhyme Systems was acquired in the latter part of Q3FY2007 and contributed around Rs27.3 crore in Q4 (up from Rs12 crore in Q3).

Segmental revenues

(Rs cr)	Q4FY07	Q4FY06	Q3FY07	% yoy	% qoq
Products	107.6	58.0	91.7	85.4	17.4
Services	102.6	62.0	80.0	65.6	28.3
Total	210.2	120.0	171.6	75.2	22.5

Margins continue to firm up

For the eighth consecutive quarter, the company has reported a sequential improvement in its OPM, which inched up by 20 basis points to 25%. The continuous improvement has been driven by the increasing contribution by the relatively higher-margin product business. Moreover, the gross margin in both product and service businesses itself has improved gradually. In case of the service business, the reducing dependence on the ICICI group business and higher billing rates from the existing and new clients have boosted the margins by 190 basis points in FY2007. On the other hand, the enhanced range of product portfolio and the foray into developed markets have pushed up the profitability of the product business (up 190 basis pints to 54.3%).

Segmental margins

(Rs cr)	Q4FY07	Q4FY06	Q3FY07	% yoy	% qoq
Gross profit					
Products	58.0	30.6	50.9	89.7	14.0
Services	40.0	22.7	28.4	76.2	40.9
GPM (%)					
Products	53.9	52.7	55.5		
Services	39.0	36.6	35.5		

Given the consolidation of Rhyme Systems, the management expects the contribution from the relatively low-margin service business to increase gradually to 58-60% (up from 49.4% in FY2007). This is likely to put pressure on the overall margins going ahead. However, the company has enough leverage in the selling, general and administration cost (at 22.1% of the sales in FY2007) to cushion against the negative impact of the expected shift in the revenue mix.

Order backlog jumps to Rs568.7 crore

The order backlog has increased by 33.3% sequentially to Rs568.7 crore, largely on the back of a 68.8% jump in the order backlog in the service business. The management has indicated that it has bagged some large e-governance orders from some of the state governments (like Karnataka) and also the consolidation of Rhyme Systems has bloated the order backlog in the service business. The robust order book position provides strong growth visibility for FY2008.

(Rs cr)	Q4FY07	Q4FY06	Q3FY07	% yoy	% qoq
Products	277.8	132.0	254.4	110.0	9.2
Services	290.9	134.0	172.3	116.9	68.8
Total	568.7	266.4	426.7	113.5	33.3

Robust guidance

The growth guidance for FY2008 is also healthy. Revenues are guided in the range of Rs1,000-1,100 crore (a growth of 49-64% over the total turnover of Rs670.8 crore). The EPS is guided in the range of Rs20.1-21.5 (on a fully diluted equity base as on March 2007).

Valuation

At the current market price the stock trades at 14.1x FY2008 and 11.2x FY2009 estimated earnings (adjusted for the dividend on preference shares). To funds its inorganic growth strategy, the company has raised Euro-30-million in April 2007 through its third FCCB issue. Consequently, the total diluted equity now stands at Rs73 crore and the same has been factored in our estimates for EPS. We maintain our Buy call on the stock with a revised price target of Rs400.

Valuation table

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net sales (Rs cr)	417.8	655.3	1089.5	1398.8
Adj net profit (Rs cr)	50.2	96.5	155.7	195.5
Share in issue (cr)	5.3	6.7	7.3	7.3
EPS (Rs)	9.5	14.3	21.3	26.8
% y-o-y growth	*37.4*	*51.0*	*49.0*	*26.1*
PER (x)	31.7	21.0	14.1	11.2
Book value (Rs)	69.4	113.2	153.7	173.1
P/BV (x)	4.3	2.7	2.0	1.7
EV/EBIDTA (x)	20.6	11.5	7.5	5.7
Dividend yield (%)	1.1	1.5	1.5	1.5
ROCE (%)	9.4	15.1	15.0	16.3
RONW (%)	9.8	13.7	14.5	16.0

Infrastructure Development and Finance Company

Viewpoint

Plans to raise equity capital

CMP: Rs98

Infrastructure Development and Finance Company (IDFC) was established in 1997 sponsored by the Government of India, Reserve Bank of India (RBI) and Infrastructure Development Bank of India as a private sector enterprise with the sole objective of promoting infrastructure financing. The company's future plans are based on the four-by-four strategy. It would pursue four objectives (profitability, balance sheet expansion, innovation and thought leadership) focus on four sectors (transport, energy, telecom and industrial/commercial infrastructure), its portfolio would comprise four products (treasury/structured products, equity/asset management, project finance and advisory) and it would also like to explore four frontiers (urban services, rural infrastructure, health and education).

The highlights of the company's performance in FY2007 are mentioned below.

Consolidated income statement

- The net interest income (NII) from the infrastructure business increased by 33% to Rs392 crore.
- The NII from treasury increased by 185% from Rs13 crore to Rs37 crore.
- The non-interest income increased by 18% from Rs227 crore to Rs267 crore.
- The profit after tax increased by 29% from Rs391 crore to Rs504 crore.

Consolidated balance sheet

- Total assets increased by 50% from Rs11,949 crore to Rs17,982 crore.
- The loan book increased by 37% from Rs10,321 crore to Rs14,150 crore.
- Gross disbursements increased by 19% from Rs6,045 crore to Rs7,207 crore while gross approvals increased by 23% from Rs10,631 crore to Rs13,053 crore.
- Unrealised gains on equity book (as on March 31, 2007) stood at Rs219 crore.

Equity dilution in the near term: The board of the company has approved a plan to raise capital through the issue of equity or quasi-equity instruments of up to US$500 million and also increase the shareholding limit for foreign institutional investors (FIIs) in IDFC from 49% to 74%, subject to the approval of the shareholders at its next shareholders' meeting. The reasons behind the proposed dilution are as follows.

- The leverage of the company would soon breach the 7x mark from 5.4x at the current pace of growth and at those levels the rating companies would become uncomfortable. This can affect the AAA rating of the company and adversely affect its borrowing costs. Earlier the rating companies were uncomfortable with a 5% leverage, which has now become 7% and with time the management feels 8% can also be achieved. But in the near term, to drive the growth higher Tier-I capital is needed to maintain the leverage within the comfort levels of rating companies.
- Again, the latest RBI guidelines on exposure of non-banking finance companies to single companies and group companies has been reduced to 20% and 35% from 25% and 50% respectively which will have a bearing on IDFC's exposures to individual companies and groups.
- Lastly, IDFC plans to increase its asset management business from $700 million to $3.5 billion in three to four years and for this seed capital is needed from the parent company.

Consolidated financials

Particulars	FY2007	FY2006	yoy chng
Net interest income	428	307	39.4
Infrastructure*	392	294	33.3
Treasury	37	13	184.6
Non interest income	267	227	17.6
Fees income	134	95	41.1
Dividend	9	6	50.0
Profit on sale of equity	124	125	-0.8
Miscellaneous income	20	2	900.0
Operating income	716	536	33.6
Operating expense	82	55	49.1
Pre-provisioning profits	634	481	31.8
Provisions & losses	17	39	-56.4
PBT	616	443	39.1
Tax, minority interest	124	52	138.5
Share of associate company	12	-	-
PAT	504	391	28.9

Current funds doing well: The company currently manages two funds worth $700 million; of this Fund 1 and Fund 2 have a corpus of $220 million and $480 million respectively. The funds have done pretty well and gains on some of these investments have been booked benefits of which are expected to reflect in the numbers in the coming quarters.

Long-term fee income view: IDFC's current return on assets (RoA) stood at 3.3%. Over time it is expected to come down to 2.5% levels, mainly due to fall in the NII and also because such a high RoA is unsustainable with rapid expansion in the company's balance sheet. IDFC's operating income as a percentage of assets currently stands at 4.7% of which 2.8% is from the interest income and 1.9% is from the non-interest income. The company plans to hold its operating income as a percentage of assets at 4% levels with 2% contribution from the non-interest income of which 55-60% should be core fee income led by its asset management and debt syndication business.

IDFC has a sound management with a good business model operating in the most attractive business segments like infrastructure financing, asset management and advisory services. Its long-term growth plans remain sound. The stock is currently trading at 22x its FY2007 consolidated earnings.

The author doesn't hold any investment in any of the companies mentioned in the article.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Lever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
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Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Transport Corporation of India

Emerging Star

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Aban Offshore
Alphageo India
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Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Overseas Electronics
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
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UltraTech Cement
Union Bank of India
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