

## Strong business momentum

3 May 2007

## BUY

Price **Rs 1,035** Target Price **Rs 1,150**

Sensex - 14,209

## Price Performance

(%)	1M	3M	6M	12M
Absolute	13	14	118	161
Rel. to Sensex	1	14	103	128

Source: Bloomberg

## Stock Details

Sector	IT Services
Reuters	NESL.BO
Bloomberg	NCS@IN
Equity Capital (Rs mn)	161
Mkt. Cap (Rs bn)	16.7
Face Value (Rs)	10
52 Week H/L	Rs 1,199/245
Daily Avg Volume (No of shares)	66955
Daily Avg Turnover (US\$ mn)	1.6

## Shareholding Pattern (%)

Promoters	59.8
FII's /NRI's	6.6
Institutions	8.1
Private Corp	6.7
Public	18.9

Source: BSE,31.Mar.2007

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## Q4 below expectations

Nucleus Software posted revenue growth of 7.1% qoq to Rs 602 mn on the back of strong growth in products (12.3% qoq). Products revenues now contribute ~60% of total revenues during Q4FY07, up from 38% in FY06. EBITDA margins improved by 60 bps qoq to 28.5% due to lower software development expenses, despite one-time expenses to the tune of Rs 18 mn on account of penalty for delay in execution of the project. EBITDA jumped by 9.5% to Rs 172 mn. However, due to lower other income and higher depreciation and taxes, PAT was flat at Rs 139 mn, below our expectations of Rs 155 mn.

## Key Highlights for FY07

- Order book position stood at Rs 3.3 bn, Rs 2.86 bn pertaining to products and balance services. Rs 1.56 bn products order book to be executed in a year time.
- Orders spread includes from India, Sri Lanka, UAE, Nigeria, Japan & Singapore.
- 21 new clients added, taking total active clients to 141.
- 22 new product orders won for implementing 74 modules of FinnOne suite and other products.
- FinnOne suite ranked as the No 1 best selling retail lending software by IBS Publishing, London.
- FinnOne lending now covers almost 75% of the Retail Business in India.
- Multi country roll outs for FinnOne and Cash@Will suite.
- Won a multi million dollar (~ US\$ 35 mn) deal from ACOM Corporation, Japan.
- Leading banks in Japan / Middle East/ Africa /Sri Lanka and India chose Nucleus Software FinnOne.
- Bagged multi country deals from leading banks in SAARC & SEA region for Cash@Will suite.
- Commissioned the second facility block at the existing campus in Noida with the proposed investment of Rs 200 mn, which will seat 800+ additional personnel.
- Added 464 employees in the year, taking total head count to 1532.
- 'Cash and Bank Balances' and 'Current Investments' were at Rs 819 mn as on March 31, 2007.

## Key Financials (Rsmn)

Mar	Rev	EBITDA	EBITDA	PAT	EPS	RoE	EV/	P/BV	Div Yld	P/E
			(%)		(Rs)	(%)	EBITDA	(x)	(%)	(x)
FY06	1481	451	30.4	371	23.0	32.1	37.0	14.5	0.3	45.0
FY07	2212	632	28.6	552	33.9	33.2	26.5	10.5	0.3	30.6
FY08E	3319	992	29.9	857	51.0	35.1	16.9	7.2	0.4	20.3
FY09E	4705	1383	29.4	1205	71.7	33.8	12.1	4.9	0.4	14.4

Source: Company, Emkay research

### Strong FY07 results

Nucleus Software posted revenue growth of 49% yoy to Rs 2,212 mn on the back of strong growth in products revenues (111% yoy). Products revenues now contribute 54% of total revenues during FY07, up from 38% in FY06. EBITDA margins declined by 180 bps to 28.6% mainly due to higher employee costs. However, due to higher other income and lower taxes (effective tax rate reduced from 14.6% to 11.1%), PAT grew by 49% yoy to Rs 552 mn. FDEPS stood at Rs 33.85. The company declared bonus in the ratio of 1:1.

### Continuance investments in new product development and upgrades

The company is continuously investing in new product development and upgrading the existing products suite. The company continues with their focus on 'SME Loan Origination and Servicing' business domain. FinnOne Collections product, which concentrates on debt collections and delinquency management business, was upgraded in Q3FY07 functionally to cater to the new requirements for retail lending and credit card business. The new version would focus more on improving management reporting in order to ensure tight control on delinquency. New product module, FinnForecaster, a Java-based interactive suite that transforms organizational data to business solution is expected to be launched in the current financial year. Cash@will would be upgraded with Electronic Bill Presentation, RTGS and other two modules. This product made significant inroads in India, Malaysia and Singapore during FY07. We believe the company is continuously investing in new product development and upgrades, which augurs well for the sustainable future growth of the company.

### Risks and concerns

We believe attracting and retaining the right talent is the biggest challenge for the company. The company had announced wage hike twice a year during FY07. The company expects wage hike of 15-18% for FY08E. Attrition at 19% can have huge adverse impact on a mid-size company like Nucleus Software. We believe the company's retention initiatives could impact margins of the company.

### Future Outlook and Valuations

We believe Nucleus Software would continue to maintain its leadership in Retail Lending segments globally. Nucleus Software has successfully maintained the highest level of global worldwide partnerships with technology giants like HP, IBM, Intel & Oracle. We have revised our estimates for FY08E to take into consideration recent rupee appreciation and introduced FY09E. We now expect Nucleus Software to post 46% CAGR in revenues and 48% CAGR in profits for FY07-09E. We expect fully diluted EPS of Rs 51.0 for FY08E and Rs 71.7 for FY09E based on 16.8 mn equity shares. At CMP of Rs 1,035, it trades at a P/E of 20.3x and 14.4x and EV/EBITDA of 16.9x and 12.1x based on FY08E and FY09E respectively. With EBITDA margin of 30%, PAT margin of 25-26%, ROE of 35%, PEG of 0.4 for FY08E and strong visibility of future growth, we believe Nucleus Software is an attractive investment proposition. We maintain BUY with a revised one year price target of Rs 1,150 (16x FY09E).

## Q4FY07 Results Analysis

Consolidated (Rs mn)	Dec-06	Mar-07
<b>Total Revenue</b>	<b>562</b>	<b>602</b>
Growth (%) q-o-q	2.0	7.1
Product Revenue	318	357
Growth (%) q-o-q	12.8	12.3
Project Revenue	205	234
Growth (%) q-o-q	(10.9)	14.0
Professional Services	39	11
Growth (%) q-o-q	0.1	(71.4)
Software Development Exp	317	322
Gross Profit	245	280
Selling & Marketing Exp	55	52
General & Admin Exp	33	56
<b>EBIDTA</b>	<b>157</b>	<b>172</b>
Growth (%) q-o-q	(2.0)	9.5
EBIDTA (%)	27.9	28.5
Add: Other Income	16	8
Less: Depreciation	17	21
PBT	156	159
Less: Tax	16	20
<b>PAT</b>	<b>139</b>	<b>139</b>
Growth (%) q-o-q	-	-
PAT (%)	24.8	23.2
EPS	8.7	8.7

Source: Company

Profit & Loss Statement					Balance Sheet				
Mar end (Rs mn)	FY06	FY07	FY08E	FY09E	Mar end (Rs mn)	FY06	FY07	FY08E	FY09E
Product revenues	568	1,198	2,168	3,411	Equity Capital	161	162	162	162
Growth (%)	115	111	81	57	Share Application Money	1	7	7	7
Projects revenues	782	885	1,058	1,194	Reserves	994	1,490	2,270	3,398
Growth (%)	14	13	19	13	Networth	1,156	1,659	2,438	3,567
Professional services	131	129	92	100	Deferred Tax Liability	-	3	3	3
Growth (%)	60	(1)	(28)	8	Total Capital Employed	1,156	1,662	2,442	3,570
Total Revenues	1,481	2,212	3,319	4,705	Gross Block	501	685	1,035	1,385
Growth (%)	43.5	49.4	50.0	41.8	Less Depreciation	202	266	366	503
Software Development Cost	805	1,251	1,838	2,639	Net Fixed Assets	300	420	669	883
Selling & Marketing Exp.	117	179	276	385	CWMP	38	131	100	125
General & Admin. Expenses	108	149	212	297	Investments	614	690	850	1,000
EBITDA	451	632	992	1,383	Debtors	238	553	682	967
Growth (%)	66.4	40.4	56.9	39.4	Cash and Bank	300	268	954	1,748
EBITDA margin (%)	30.4	28.6	29.9	29.4	Loans & Advances	76	95	133	188
Other Income	31	57	68	100	Other Current Assets	38	182	100	141
Depreciation	48	69	100	137	Total Curr. Assets	653	1,097	1,868	3,044
PBT	434	620	959	1,347	Current Liabilities	354	625	830	1,176
Tax	64	69	103	142	Provisions	94	51	216	306
PAT	371	552	857	1,205	Total Curr. Liabi. & Prov.	448	676	1,045	1,482
Growth (%)	78.7	48.7	55.3	40.7	Net Current Assets	205	421	822	1,562
PAT margin (%)	25.0	24.9	25.8	25.6	Total Assets	1,156	1,662	2,442	3,570

Source : Company, Emkay Research

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Cash Flow					Ratios				
Mar end (Rs mn)	FY06	FY07	FY08E	FY09E	Mar end	FY06	FY07	FY08E	FY09E
Profit Before Tax	434	620	959	1,347	EBITDA margin	30.4	28.6	29.9	29.4
Depreciation	48	69	100	137	PAT margin	25.0	24.9	25.8	25.6
Operating C F	482	689	1,060	1,484	ROCE	37.6	37.3	39.3	37.7
Change in working capital	(125)	(248)	272	55	ROE	32.1	33.2	35.1	33.8
Less:Direct Taxes	(54)	(69)	(103)	(142)	<b>Per Share Data (Rs.)</b>				
C F from Operating	303	372	1,229	1,396	EPS	23.0	33.9	51.0	71.7
C F from Investing					CEPS	26.1	38.5	57.0	79.9
(Purchase)/Sale of Fixed Asset	(96)	(277)	(319)	(375)	BVPS	71.4	98.3	144.5	211.3
(Purchase)/Sale of Investment	(127)	(76)	(160)	(150)	DPS	3.5	3.5	4.0	4.0
Others	-	14	-	-	<b>Valuation (x)</b>				
Net C F from Investing	(223)	(340)	(479)	(525)	P/E	45.0	30.6	20.3	14.4
C F from Financing	-	-	-	-	Cash PE	39.7	26.9	18.2	13.0
Dividend Paid	(46)	(64)	(64)	(77)	P/BV	14.5	10.5	7.2	4.9
Net C F from Financing	(46)	(64)	(64)	(77)	EV/EBITDA	37.0	26.5	16.9	12.1
Net Increase/(Decrease)	34	(32)	685	795	EV/Sales	11.3	7.6	5.0	3.6
Opening Balance	266	300	268	954	PEG	0.6	0.6	0.4	0.4
Closing Balance	300	268	954	1,748	Dividend Yield %	0.3	0.3	0.4	0.4

Source : Company, Emkay Research

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