

3i Infotech Ltd

₹ 46

KRChoksey
wealth enhancement solutions


Debt overhang continues!!

HOLD

We recently met with the Amar Chintopanth (CFO and joint MD) of 3i Infotech Ltd. The key takeaways from the meet are as follows: -

Revenue is expected to trail behind Indian IT industry overall growth rate in FY12E:

3i's revenue is expected to increase by around 9%-10% in FY12E, whereas Indian IT industry export is expected to grow by 16%-18% in FY12E. The primary reason for the slower growth expectation in FY12E by the management is flat growth in Regulus (contributes around 25% of the total revenue) and low single digit growth in application development and maintenance business (share in total revenue is around 18%). Whereas, other segments such as E-commerce, Managed IT services, software products and India based BPO business is expected to grow in the range of 10%-15% in FY12E on YoY basis.

EBITDA margin is expected to remain stable on YoY basis in FY12E:

The management expects EBITDA margin to remain unchanged (on YoY basis) in FY12E; despite the slower revenue growth expectation and wage hike pressure. The primary reason for the same is change in revenue mix favorably i.e. share of IT Solutions in total revenue increases whereas share of Transaction Services come down in FY12E. The margins of IT Solutions and Transaction Services stood at 46% and 30%, respectively, in 9M FY11. Moreover, the management expects margins to be supported by operating leverages as the company plans to undertake consolidation of the rental premises, which constitutes significant portion of other operating expenses.

Ratio of net debt to free cash flow continues to be beyond our comfort zone:

We continue to be concerned with the company's ability to generate enough cash in order to repay its debts (including FCCBs and preference shares). The ratio of net outstanding debt to net cash flow available to repay debt is around 14 times in FY12E i.e. assuming status quo the company will take around 14 years to become debt free. We believe the primary reason for the same is lack of traction in case of companies acquired through leverage buyout (such as Regulus), huge losses in state government projects and high cash conversion days i.e. around 140 days.

Particulars	FY10	FY11E	FY12E
*Cash flow from operations	342.3	221.2	399.6
Less-Capex and acquisitions/ earn-out paid	(419.2)	(181.7)	(41.8)
Adjusted free cash flow	(76.9)	39.5	357.8
Less-Interest expenses	(145.1)	(158.8)	(170.3)
Less-Dividend paid	(30.4)	(49.4)	(49.4)
Net Cash-flow available to repay debt	(252.4)	(168.7)	138.1
Net outstanding debt (including preference share and FCCBs)	2,116.4	2,072.6	1,912.5

Source: Company data, KRChoksey Research. Note:- * Loan repayable in 12 months are excluded from changes in working capital

Valuation and view

Considering, slower revenue growth than peers in FY12E and high debt position beyond our comfort zone, we maintain our "HOLD" recommendation on the stock. Taking the same into account, we assign the company multiple of 5.5x to its FY12E EBITDA and arrive at a target price of ₹51.

Key Financials

Particulars	FY09	FY10	FY11E	FY12E
Revenue	2,285.6	2,448.5	2,573.2	2,808.7
EBITDA Margin (%)	19.0%	19.7%	19.9%	19.8%
Net Profit Margin (%)	10.9%	10.6%	9.7%	9.2%
Adjusted EPS	12.6	13.1	12.7	13.1
P/E	3.6	3.5	3.6	3.5
P/BV	0.6	0.9	0.7	0.6
EV/EBITDA	6.8	6.3	5.8	5.1
RONW (%)	24.7%	26.8%	18.6%	18.1%

Source: Company data, KRChoksey Research

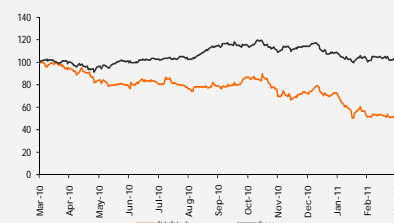
Price Outlook : ₹51

Market Data	April 5, 2011
Shares outs (Cr)	19.2
Equity Cap (₹. Cr)	192
Mkt Cap	883
52 Wk H/L (₹)	83/38
Avg Vol (1yr avg)	1,611,959
Face Value (₹)	10
Bloomberg Code	III IN

Market Info:

SENSEX	19,710
NIFTY	5,908

Price Performance



Share Holding pattern (%)

Particulars	Dec-10	Sep-10	Chg (%)
Promoters	20.3	20.3	0.0
FIIIs	11.7	8.1	3.6
DIIIs	28.7	29.3	-0.6
Others	39.3	42.3	-3.0
Total	100.0	100.0	100.0

Source: BSE

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Profit and Loss Account

(₹ crore)

Particulars	FY09	FY10	FY11E	FY12E
Revenue	2,285.6	2,448.5	2,573.2	2,808.7
Expenditure				
Cost of revenue	1,365.8	1,455.4	1,515.3	1,665.8
SGA expenses	485.4	510.2	546.7	586.3
Total Expenditure	1,851.2	1,965.6	2,062.0	2,252.1
EBITDA	434.4	482.9	511.2	556.6
Other Income & expenses	19.1	20.2	22.9	22.0
Profit before depreciation, interest & tax	453.5	503.1	534.1	578.6
Depreciation	70.1	81.4	102.9	109.0
EBIT	383.4	421.7	431.2	469.6
Interest	95.0	144.8	158.8	170.3
PBT	288.5	276.9	272.5	299.3
Taxes	22.1	11.0	15.2	33.9
Profit After Tax	266.4	266.0	257.3	265.4
Minority interest	10.4	-0.1	0.0	0.0
Net Profit before exceptional item	256.1	266.1	257.3	265.4
Exceptional income (net)	26.0	-232.6	-	-
Net Profit after exceptional item	282.0	33.5	257.3	265.4
Net Profit (after preference dividend)	248.6	258.6	249.9	258.0

Source: Company data, KRChoksey Research

Balance Sheet

(₹ crore)

Particulars	FY09	FY10	FY11E	FY12E
Share Capital				
Equity	131	169	197	197
Preference	100	100	100	0
Warrants/Application money	0	0	0	0
Reserves and Surplus	806	725	1,084	1,266
Total Shareholders Funds	1,037	993	1,381	1,463
Total Loan Funds	2,311	2,283	2,215	2,175
Minority Interest	21	8	8	8
Total Funds Employed	3,370	3,284	3,605	3,647
Goodwill arising on consolidation	1,700	1,811	1,937	1,949
Gross Block	800	660	695	745
Less: Accumulated Depreciation	233	270	373	482
Net Block	567	389	322	263
Capital work-in-progress	126	39	59	39
Investments	4	10	10	10
Deferred tax asset (net)	39	113	113	113
Net Current Assets	935	922	1,164	1,273
Total Funds utilized	3,370	3,284	3,605	3,647

Source: Company data, KRChoksey Research

Cash Flow Statement

(₹ crore)

Particulars	FY09	FY10	FY11E	FY12E
Profit before tax	288	277	272	299
Operating Profit Before Working Capital changes	478	507	511	557
Net Cash from Operations	524	342	221	400
Net Cash from investing	-1,041	-415	-159	-20
Net Cash from Financing	504	8	-50	-360
Net change in Cash Equivalents	-14	-64	12	20
Cash at the beginning of the year	258	245	181	193
Cash at the end of the year	245	181	193	213

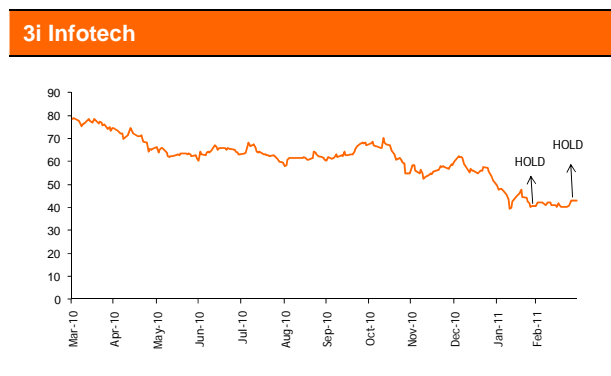
Source: Company data, KRChoksey Research

Ratios

Particulars	FY09	FY10	FY11E	FY12E
Profitability Ratios				
Operating Profit Margin (%)	19.0%	19.7	19.9	19.8
Net Profit Margin (%)	10.9%	10.6	9.7	9.2
ROCE (%)	11.4	12.8	12.0	12.9
RONW (%)	24.7	26.8	18.6	18.1
Per Share Data				
Adjusted EPS (INR)	12.6	13.1	12.7	13.1
BV Per Share (INR)	71.7	52.9	65.1	74.3
Growth Ratios				
Revenue (%)	89.6	7.1	5.1	9.2
Operating profit (%)	70.4	11.2	5.9	8.9
Adjusted Net profit (%)	45.0	3.9	-3.3	3.2
Turnover Ratios				
Debtors Turnover (x)	4.7	4.5	4.2	4.2
Fixed Asset Turnover (X)	2.9	3.7	3.7	3.8

Source: Company data, KRChoksey Research

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Rating Legend	
Our Rating	Upside
Buy	More than 15%
Hold	5% - 15%
Reduce	0 - 5%
Sell	Less than 0%

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