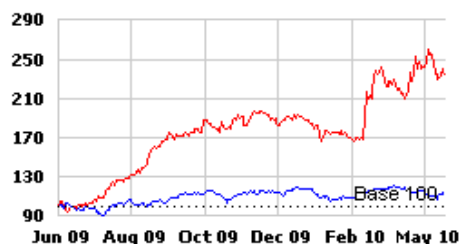


June 02, 2010

C.M.P:
Rs.441.00

Target Price:
Rs.507.00

1 Year Comparative Graph



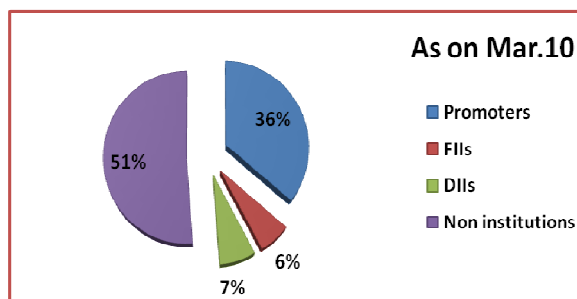
ZYLOG SYSTEMS LTD

BSE SENSEX

Stock Data

Sector	IT
Face Value (Rs)	Rs.10.00
52 wk. High/Low (Rs.)	Rs.500.10/176.95
Volume (2 wk. Avg.)	104000
BSE Code	532883
Market Cap (Rs.mn.)	7252.69

Share Holding Pattern



V.S.R. Sastry
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Chief Research Officer
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SYNOPSIS

- Zylog Systems is an ISO 9001 certified provider of Onshore, Offshore & Near shore technology solutions and services to enterprises & technology companies across the globe.
- Company provide complete Product Lifecycle Management services, ranging from new product development and product advancement to product migration, re-engineering, sustenance and support.
- During the quarter Zylog acquires Brainhunter, a Consulting and Engineering Services Company in Canada.
- A subsidiary of Zylog Systems USA, Zylog Systems India (ZSL) plans to invest Rs 200 crore to expand its 'Wi5' wireless broadband services in five metropolitan cities in the coming two years.
- Zylog Systems launches Enterprise 2.0 SocNet CiC, a next generation collaboration and knowledge management solution.
- During the quarter company launches Wi5 wireless broadband services in Chennai.
- Net sales and PAT of the company are expected to grow at a CAGR of 8% and 8% over 2009 to 2012E respectively.

Financials

(Rs.mn.)	FY10A	FY11E	FY12E
Net Sales	7835.22	8305.33	9135.97
EBIDTA	1582.57	1715.99	1887.59
PAT	921.46	988.52	1063.57
EPS (Rs)	56.03	60.11	64.67
P/E (x)	7.87	7.34	6.82

Peer Group Comparison

Name of the company	CMP(Rs.)	Market Cap.(Rs.Mn.)	EPS(Rs.)	P/E(x)	P/BV(x)	Dividend (%)
Zylog Systems Ltd	441.00	7252.69	56.03	7.87	1.28	60
MindTree	544.75	21525.8	52.66	10.34	2.91	10
KPIT Cummins	108.15	8492.3	9.99	10.83	3.39	30
OnMobile Global	291.10	17034.2	9.04	32.20	2.37	-

Investment Highlights

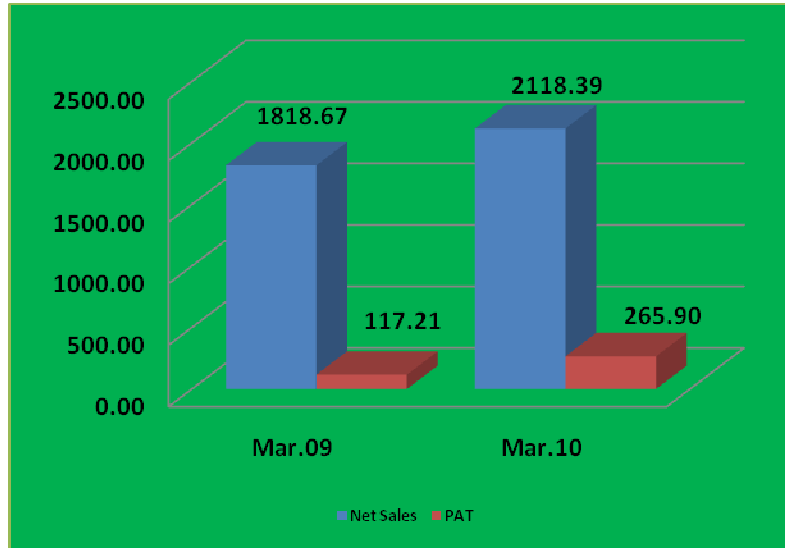
- Result Update (Q4 FY10)**

Zylog Systems Ltd reported a rise in standalone net profit for the quarter ended March 2010. During the quarter, the profit of the company rose 126.086% to Rs 265.90 million from Rs 117.21 million in the same quarter previous year. Net sales for the quarter increased 16.48% to Rs 2118.39 million from Rs 1818.67 million in the same quarter previous year. While total income for the quarter marginally increased 1.39% to Rs 2131.09 million, when compared with the prior year period. Company posted earnings of Rs 16.16 a share during the quarter, registering 126.80% growth over prior year period.

Quarterly Results - Standalone (Rs in mn)			
As at	Mar - 10	Mar - 09	%Change
Net Sales	2118.39	1818.67	16.48
Net Profit	265.90	117.21	126.86
Basic EPS	16.16	7.13	126.80

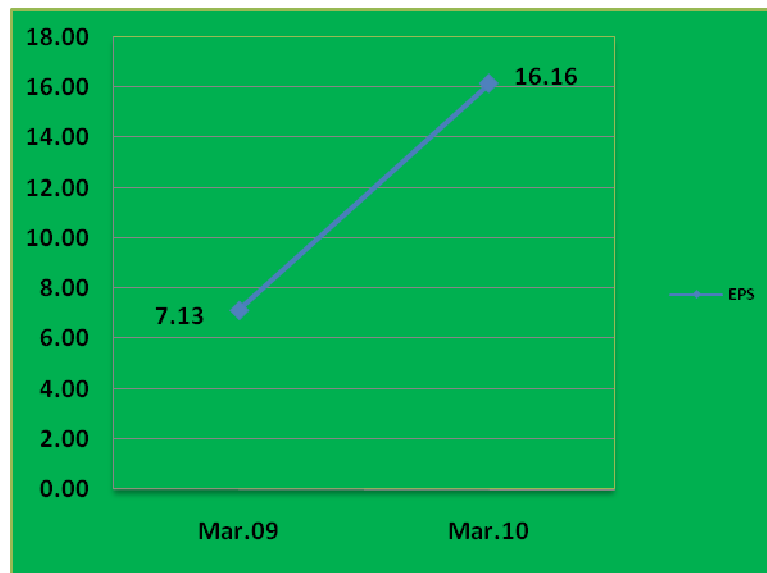
Net Sales & PAT Growth

During the quarter, Net sales increased by 16.48% to Rs.2118.39 million from Rs.1818.67 million in the same quarter last year and the Total Profit for the quarter ended March 2010 was Rs.265.90 million grew by 126.86% from Rs.117.21 million compared to same quarter last year.



EPS Growth

The basic EPS of the company stood at Rs.16.16 for the quarter ended Mar 2010 from Rs.7.13 for the quarter ended Mar 2009.



- **Zylog Systems To Invest 200 cr**

A subsidiary of Zylog Systems USA, Zylog Systems India (ZSL) plans to invest Rs 200 crore to expand its 'Wi5' wireless broadband services in five metropolitan cities Delhi, Mumbai, Bangalore, Hyderabad and Kolkata in coming two years. With a launch of Wi5 services, the company expects a business of Rs 500 crore in the next five years.

Zylog Systems also plans to expand its presence in e-governance segment by acquiring two overseas companies by the end of the current year. For this the ZSL is in talks with various companies in e-governance segment with revenue of less than Rs 50 crore (\$10 million).

- **Enters ISP business**

Zylog Systems (India) has recently launched 'Wi5' services in Chennai. The service will enable customers to access high-speed wireless broadband connectivity through their laptops, desktops or mobile devices by subscribing to 'Wi5' service on the move. With this launch, the company has entered ISP business in the country and has obtained a category A internet service provider license to operate in all of India's DoT circles.

Company Profile

Zylog Systems, established in 1996, is an ISO 9001 certified provider of Onshore, Offshore & Near shore technology solutions and services to enterprises & technology companies across the globe. The company works with some of the world's leading innovative ISVs and software-enabled businesses, ranging from start-ups to establish industry leaders. Zylog Systems is a Public Limited Company, listed in the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) in India. It provides complete Product Lifecycle Management services, ranging from new product development and product advancement to product migration, re-engineering, sustenance and support. By leveraging their experience in product engineering, they bring products to market faster, with high quality and reduced costs.

Zylog leverages specialized knowledge in

- Custom Enterprise Application Development
- Enterprise 2.0 Computing Services
- Enterprise Reporting
- Enterprise Data Management & Administration
- Enterprise Application Integration
- Mobile/Wireless/Web Application Development
- Research & Development
- IT Infrastructure Management
- Replacement Technology Services

- QA & Testing
- BPO Services

The company's customer base includes large corporate organizations as well as medium size businesses across a broad range of verticals, as well as respected leaders in Finance & Banking, Insurance, Life Sciences, Telecommunications, Retail, and Manufacturing.

The company has technology partnership with the following companies:

- Microsoft
- HP
- Dell
- Sun
- IBM
- GUPTA
- Brooktrou
- TOrange Partner
- Ubuntu
- ECS

Subsidiaries

- Vishwa Vikas Services Limited
- Zylog Systems (Europe) Limited
- Zylog Systems (India) Limited
- Zylog Systems Asia Pacific Pte Limited
- Zylog BV Limited

Alliances



Services

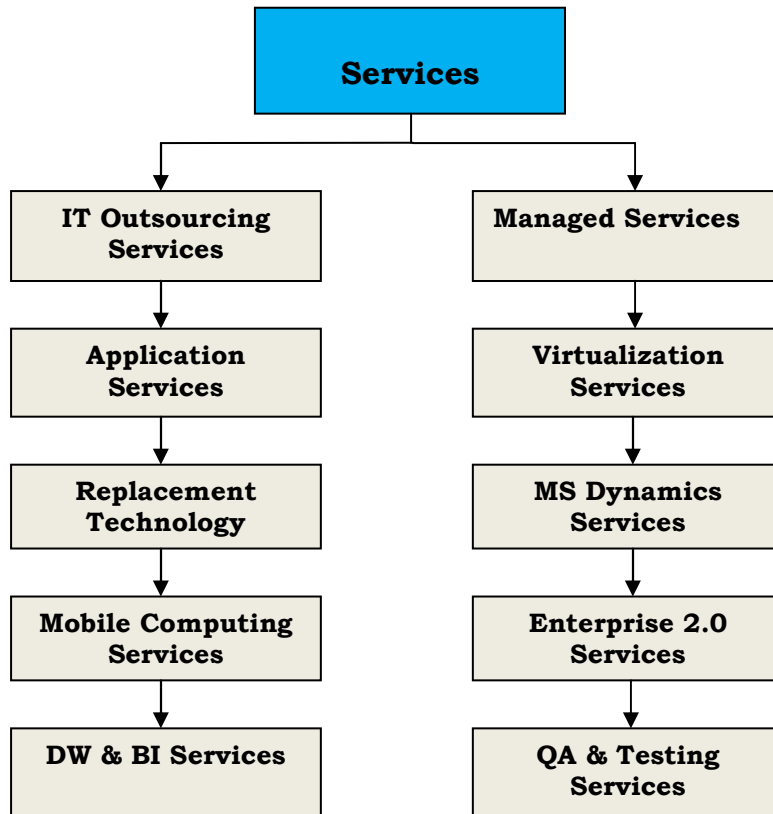
- IT Outsourcing Services
- Application Services
- Replacement Technology
- Mobile Computing Services
- DW & BI Services



Firstcall Research

(KPO Division Of Firstobject Technologies Ltd.)

- Managed Services
- Virtualization Services
- MS Dynamics Services
- Enterprise 2.0 Services
- QA & Testing Services
- BPO Services



Products

- Mobile banking system
- RTGS pay manager
- AML-Detector
- Cheque truncation system
- Claims Management system
- iPage-Forms Processing
- D P online
- Zymobile server
- Z*connect
- MS Dynamics
- iVARS TM
- zPrism

Financial Results

12 Months Ended Profit & Loss Account (Standalone)

Value(Rs. in million)	FY09A	FY10A	FY11E	FY12E
Description	12m	12m	12m	12m
Net Sales	7,349.35	7,835.22	8305.33	9135.87
Other Income	489.48	43.94	54.93	60.42
Total Income	7,838.83	7,879.16	8360.26	9196.28
Expenditure	-6,623.29	-6,296.59	-6644.27	-7308.69
Operating Profit	1,215.54	1,582.57	1715.99	1887.59
Interest	-55.75	-116.80	-137.82	-165.39
Gross Profit	1,159.79	1,465.77	1578.17	1722.20
Depreciation	-193.71	-284.24	-326.88	-375.91
Profit before Tax	966.08	1,181.53	1251.29	1346.29
Tax	-114.39	-260.07	-262.77	-282.72
Profit after Tax	851.69	921.46	988.52	1063.57
Equity Capital	164.46	164.46	164.46	164.46
Reserves	4,700.18	5,506.20	6,494.72	7,558.29
Face Value	10.00	10.00	10.00	10.00
Total No. of Shares	16.45	16.45	16.45	16.45
EPS	51.79	56.03	60.11	64.67

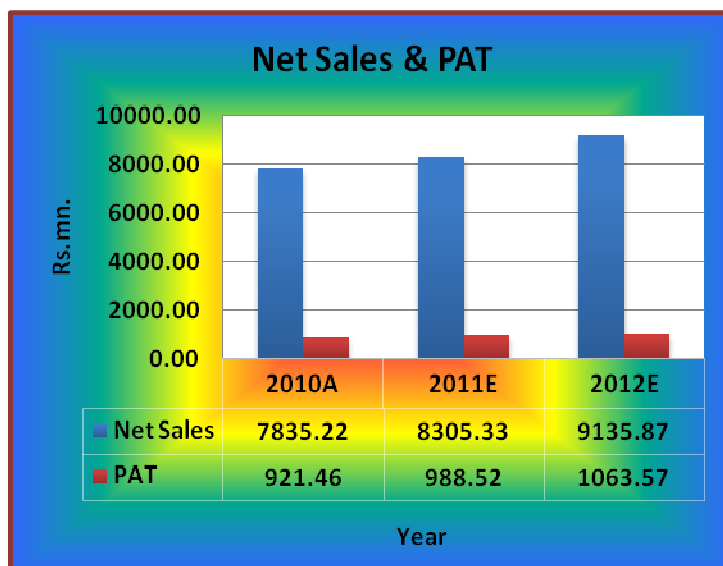
Quarterly Ended Profit & Loss Account (Standalone)

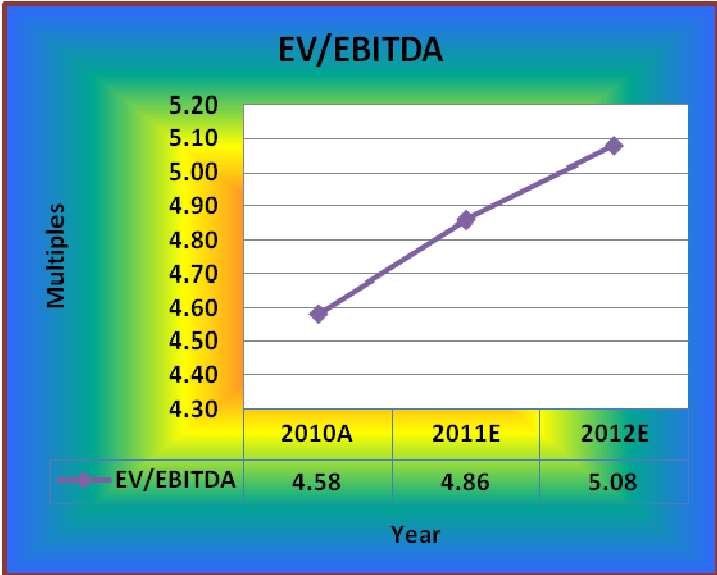
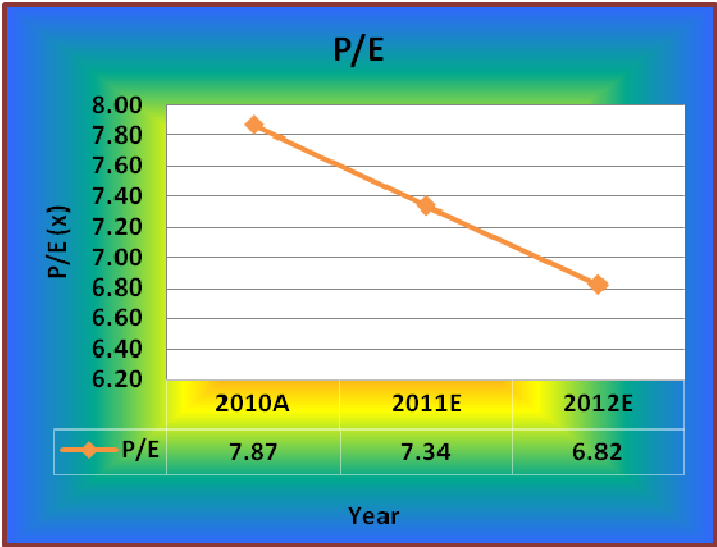
Value(Rs. in million)	30-Sep-09	31-Dec-09	31-Mar-10	30-Jun-10E
Description	3m	3m	3m	3m
Net Sales	1909.58	2016.50	2118.39	2160.76
Other Income	-1.39	26.00	12.70	13.72
Total Income	1908.19	2042.50	2131.09	2174.47
Expenditure	-1560.10	-1579.50	-1693.26	-1728.61
Operating Profit	348.09	463.00	437.83	445.87
Interest	-22.02	-36.40	-36.99	-38.84
Gross Profit	326.07	426.60	400.84	407.03
Depreciation	-67.08	-76.70	-82.45	-86.57
Profit before Tax	258.99	349.90	318.39	320.46
Tax	-49.85	-102.00	-52.49	-64.09
Profit after Tax	209.14	247.90	265.90	256.36
Equity Capital	164.46	164.46	164.50	164.50
Face Value	10.00	10.00	10.00	10.00
Total No. of Shares	16.45	16.45	16.45	16.45
EPS	12.72	15.08	16.16	15.58

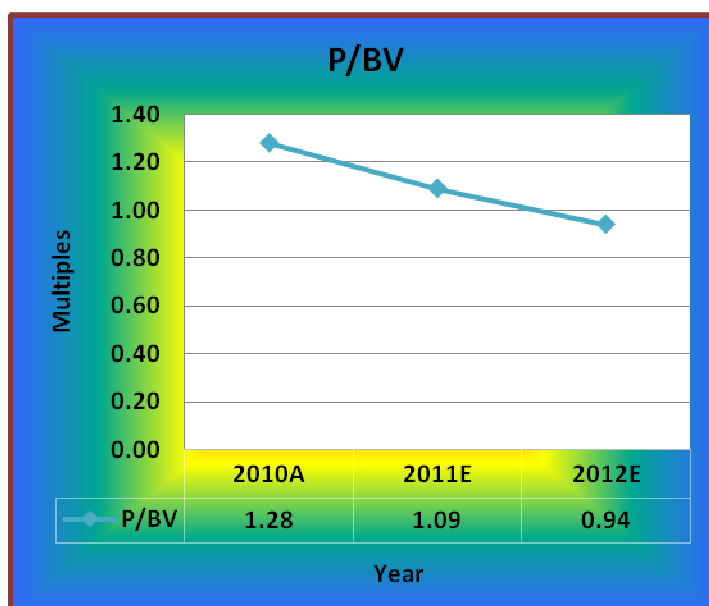
Key Ratios

Particulars	FY09	FY10	FY11E	FY12E
EPS (Rs.)	51.79	56.03	60.11	64.67
EBITDA Margin (%)	17%	20%	21%	21%
PAT Margin (%)	12%	12%	12%	12%
P/E Ratio (x)	8.52	7.87	7.34	6.82
ROE (%)	18%	16%	15%	14%
ROCE (%)	26%	27%	25%	25%
EV/EBITDA (x)	5.97	4.58	4.86	5.08
Debt-Equity Ratio	0.12	0.23	0.21	0.19
Book Value (Rs.)	295.79	344.80	404.91	469.58
P/BV	1.49	1.28	1.09	0.94

Charts







Outlook and Conclusion

- At the current market price of Rs.441.00 the stock is trading at a P/Ex of 7.34x for FY11E and 6.82x for FY12E.
- The EPS of the stock is expected to be at Rs.60.11 and Rs.64.67 for FY11E and FY12E respectively.
- On the basis of price to book value, the stock trades at 1.09x and 0.94x for FY11E and FY12E respectively.
- The Net sales and PAT of the company is expected to grow at a CAGR of 8% and 8% respectively over FY09 to FY12E.
- Zylog acquires Brainhunter, a Consulting and Engineering Services Company in Canada
- A subsidiary of Zylog Systems USA, Zylog Systems India (ZSL) plans to invest Rs 200 crore to expand its 'Wi5' wireless broadband services in five metropolitan cities Delhi, Mumbai, Bangalore, Hyderabad and Kolkata in coming two years. With a launch of Wi5 services, the company expects a business of Rs 500 crore in the next five years.
- Zylog Systems also plans to expand its presence in e-governance segment by acquiring two overseas companies by the end of the current year.

- The company has installed 250 wireless nodes across Chennai and 4,000 more nodes are anticipated to be operational in the city in 12-15 months.
- Nomad Digital, UK based Wi-Fi technology major, along with Zylog Systems has forayed a joint venture to provide wireless internet access to India's massive railway network.
- Company Plans to expand its presence in e-governance segment by acquiring two overseas companies by the end of the current year.
- Company has clinched orders from two large foreign banks for Cheque Truncation product, Front-End Cheque Truncation System (FeCTS).
- We recommend a “BUY” on the stock with a target price of Rs.507.00 for medium to long term.

Industry Overview

Sector structure/Market size

The Indian information technology industry has played a key role in putting India on the global map. Thanks to the success of the IT industry, India is now a power to reckon with. According to the National Association of Software and Service Companies (NASSCOM), the apex body for software services in India, the revenue of the information technology sector has risen from 1.2 per cent of the gross domestic product (GDP) in FY 1997-98 to an estimated 5.8 per cent in FY 2008-09.

India's IT growth in the world is primarily dominated by IT software and services such as Custom Application Development and Maintenance (CADM), System Integration, IT Consulting, Application Management, Infrastructure Management Services, Software testing, Service-oriented architecture and Web services.

As per NASSCOM's latest findings:

- Indian IT-BPO sector grew by 12 per cent in FY 2009 to reach US\$ 71.7 billion in aggregate revenue (including hardware). Of this, the software and services segment accounted for US\$ 59.6 billion.
- IT-BPO exports (including hardware exports) grew by 16 per cent from US\$ 40.9 billion in FY 2007-08 to US\$ 47.3 billion in FY 2008-09.

Moreover, according to a study by Springboard Research, the Indian IT services market is estimated to remain the fastest growing in the Asia-Pacific region with a CAGR of 18.6 per cent.

Despite the uncertainty in the global economy, the top three IT majors— Infosys, TCS and Wipro—have seen revenue growth from all important sources of income: from the North American and European regions, in the financial services vertical and from application maintenance and development (ADM) offerings between fiscal years 2008 and 2009.

At present, there are 60 million Internet users in the country. According to Manufacturer's Association of IT (MAIT), the number of active Internet entities rose to 8.6 million by March 2009 from 7.2 million units in March 2008.

MAIT has outlined 'Goal 511', an ambitious target that talks about 500 million Internet users, 100 million broadband connections, and 100 million connected devices by 2012.

A latest study by MAIT estimated that the total PC sale in India is likely to grow by 7 per cent in 2009-10, with total sales expected to cross 7.3 million units.

Outsourcing

A research by Gartner forecasts India as the undisputed leader in the outsourcing space in the year 2008. India's most prized resource is its readily available technical work force. India has the second largest English-speaking scientific professionals in the world, second only to the US. It is estimated that India has over 4 million technical workers, over 1,832 educational institutions and polytechnics, which train more than 67,785 computer software professionals every year. The enormous base of skilled manpower is a major draw for global customers.

According to NASSCOM, software and services exports (including exports of IT services, BPO, engineering services and R&D and software products) reached US\$ 47 billion in FY 2008-09, contributing nearly 78 per cent to the total software and services revenue of US\$ 59.6 billion.

India continues to be the most preferred destination for companies looking to offshore their IT and back-office functions. It also retains its low-cost advantage and is among the most financially attractive locations when viewed in combination with the business environment it offers and the availability of skilled people, according to global management consultancy AT Kearney.

India has retained its numerous Uno position even as some other well-established outsourcing hubs dropped in their attractiveness to be replaced by new emerging destinations in AT Kearney's latest ranking of the top outsourcing destinations across the globe. The top three countries in the 2009 Global Services Location Index (GSLI) remain the same — India, China and Malaysia.

Domestic Markets

India's domestic market has also become a force to reckon with, as the existing IT infrastructure evolves both in terms of technology and depth of penetration.

According to NASSCOM, domestic IT market (including hardware) reached US\$ 24.3 billion in FY 2008-09 as against US\$ 23.1 billion in FY 2007-08, a growth of 5.3 per cent.

India Inc's demand for IT services and products has bolstered growth in the domestic sector with deal sizes going up remarkably and contracts worth US\$ 50 million-US\$ 100 million up for grabs.

The market for enterprise networking equipment in India is estimated to grow from US\$ 1 billion in 2008 to US\$ 1.7 billion by 2012, recording a compounded annual growth rate (CAGR) of 15 per cent during this period, according to a study by Springboard Research.

Investments

- Infosys Technologies Ltd will invest US\$ 70 million over the next three quarters of the current financial year towards increasing its sales and marketing staff overseas, building new capabilities and hiring local resources for its international centres.
- The Andhra Pradesh Government expects the IT-related SEZs and Software Technology Parks of India (STPI) in the State to receive about US\$ 3.27 billion investments in the next five years.
- HCL Technologies has entered into a strategic partnership with South Africa's UCS Group. As part of the all-cash deal, HCL will acquire UCS's enterprise solutions SAP practice focused on the retail sector for US\$ 7.7 million.

Rural Penetration

According to a report of the Internet and Mobile Association of India (IAMAI), rural India has 3.3 million active internet users. Since rural India was mapped for the first time, the year-on-year growth of internet users in rural India could not be estimated.

The research also notes there are 5.5 million people who claim to have used Internet at some point in time.

Government Initiatives

- The government set up the National Taskforce on Information Technology and Software Development with the objective of framing a long term National IT Policy for the country.

- Enactment of the Information Technology Act, which provides a legal framework to facilitate electronic commerce and electronic transactions.
- The government-led National e-Governance Programme, has played an important role in increasing internet penetration in rural India.

Road Ahead

The Indian information technology sector continues to be one of the sunshine sectors of the Indian economy showing rapid growth and promise.

According to a report prepared by McKinsey for NASSCOM, the exports component of the Indian industry is expected to reach US\$ 175 billion in revenue by 2020. The domestic component will contribute US\$ 50 billion in revenue by 2020. Together, the export and domestic markets are likely to bring in US\$ 225 billion in revenue, as new opportunities emerge in areas such as public sector and healthcare, and as geographies including BRIC and Japan opt for greater outsourcing.

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