

R Systems International

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Shareholding (%)

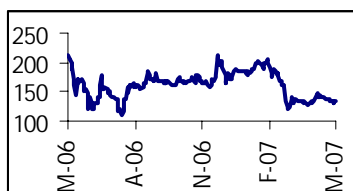
Promoters	40.3
MFs	8.8
Others	50.9

Share price performance

52-week high/low (Rs)	221/108		
	-1m	-3m	-12m
Abs (%)	0.5	-30.1	-36.4
Rel* (%)	-5.0	-27.4	-46.4

*to Nifty

Stock chart



Results in line; downgrade to 'Accumulate'

R Systems International Ltd's Q1CY07 results were in line with estimates, with sequential increase of 6% in revenue to Rs594mn. The company reported net profit of Rs21mn in Q1CY07 as against a loss of Rs65mn in Q4CY06. Though the company has been able to show industry average growth in revenue, lower growth in net profit remains a concern. We are also concerned about higher losses in the ECnet business. Losses in ECnet increased from Rs7mn in Q4CY06 to Rs11.1mn in Q1CY07.

We expect R Systems to report an EPS of Rs10.9 and Rs14.4 in CY07E and CY08E respectively. The company is currently quoting at CY07E and CY08E PER of 12.3x and 9.3x respectively, which is at 4.8% and 8% premium to its peers. We believe that it should quote at a discount on account of its lower margin. We are also concerned about the appreciating rupee and rising salaries that could impact profitability. Therefore, we downgrade the stock from 'Buy' to 'Accumulate' with a target price of Rs144. At our target price, the stock would be quoting at 13.2x CY07E and 10x CY08E earnings.

Key highlights of Q1CY07 are:

- ▲ **Revenue grew 6% sequentially:** Though revenue increased 8% sequentially in dollar terms, due to 2% rupee appreciation, in INR terms it grew 6% sequentially to Rs594mn. Growth was on account of:
 - a) Volume growth of 7%
 - b) 1% higher realisations
- ▲ **EBITDA margin expands by 50bps:** Though R Systems' gross margin expanded by 160bps in Q1CY07 on account of:
 - a) Higher offshore/onsite revenue mix (63.7/36.3 in Q1CY07 vs. 61.9/38.1 in Q4CY06)
 - b) Higher utilisation (71.2% in Q1CY07 vs. 67.6% in Q4CY06)
 - c) Lower travel cost
 EBITDA margin expanded by 50bps due to:
 - a) Higher salary cost
 - b) Higher provisioning for doubtful debts

Accumulate
Rs134

May 11, 2007

Market cap

Rs bn 2

US\$ mn 44

Avg 3m daily volume

64,839

Avg 3m daily value

Rs mn 9

Shares outstanding (mn)

14

Reuters

RSYS.BO/RSYSTEMS.NS

Bloomberg

RSYS IN

Sensex

13,796

Nifty

4,077

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- c) Higher visa costs

Gross margin expanded 160bps despite:

- a) 15% offshore and 3-4% onsite increase in salaries
- b) Rupee appreciation
- c) Higher losses in ECnet

We expect margin to expand further going forward, from 8.8% in CY07E to 10% in CY08E. This is likely on account of:

- a) Lower losses in ECnet
- b) Higher offshore/onsite mix
- c) Cost overrun in one of the projects impacting profitability in Q4CY06 and Q1CY07
- d) Benefits from economies of scale

- ▲ **Losses in ECnet swells:** Though the company guided for a lower loss of Rs4mn in ECnet in Q1CY07, it actually increased to Rs11.1mn as against a loss of Rs7mn in Q4CY06. In order to increase ECnet's profitability, the company has raised prices, which is expected to help the company break-even in Q4CY07.
- ▲ **Financials:** We expect R Systems to post an EPS of Rs10.9 and Rs14.4 in CY07E and CY08E respectively. Though the company's margin is expected to increase; rupee appreciation is expected to impact the company most, on account of higher offshore/onsite revenue mix. We have estimated Rs/USD rate of Rs41 in CY07E and Rs40.5 in CY08E.
- ▲ **Valuation:** The stock is currently quoting at CY07E and CY08E PER of 12.3x and 9.3x respectively, which is at 4.8% and 8% premium to its peers. We believe that the company should be quoting at a discount to its peers and not at a premium, due to lower margin and its vulnerability to the appreciating rupee. Therefore, we downgrade the stock from 'Buy' to 'Accumulate' with a one year price target of Rs144. We have valued the company at 10x CY08E, which is at a discount of 15% to the current average FY08E PER of its peers.

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Table 1. Peer comparison

Company	Price			EPS			PE		
		FY07	FY08E	FY09E	FY07	FY08E	FY09E		
Aztec*	93.2	8.8	12.8	16.0	10.6	7.3	5.8		
Zensar*	289.3	23.8	31.4	50.0	12.2	9.2	5.8		
Geometric*	117.9	6.2	9.6	12.2	19.0	12.3	9.7		
Infotech*	360.0	17.6	23.8	30.6	20.5	15.1	11.8		
KPIT	136.5	6.7	9.8	14.3	20.4	13.9	9.5		
R Systems	132.4	5.7	10.9	14.4	23.1	12.1	9.2		
Average					16.5	11.6	8.5		

* - Consensus estimates

Source: IISL research, company, Bloomberg

Table 2. Quarterly result table

Rs mn	Q1CY07	Q1CY06	QoQ (%)	Q4CY06	YoY (%)
Revenue	594	441	34.5%	560	6.0%
Software development expenses	387	279	38.6%	374	3.5%
Gross profit	207	162	27.5%	186	11.0%
GPM	34.9%	36.8%		33.3%	
Selling and marketing expenses	167	117	43.5%	152	9.8%
EBITDA	39	46	-13.5%	34	16.0%
EBITDA margin	6.6%	10.3%		6.1%	
Depreciation	18	11	56.9%	16	8.9%
Other income	7	5	41.9%	12	-42.9%
Interest	0	2	-76.0%	1	-12.0%
Restructuring/Non-recurring	-	-		60	
PBT	28	38	-24.1%	(30)	-195.7%
Tax	7	5	59.4%	36	-79.1%
Tax rate	26.2%	12.5%		-119.8%	
PAT before exceptional items	21	33	-36.0%	(65)	-132.1%

Source: IISL research, company

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Table 3. Forecasts

YE December	CY06	CY07E	CY08E
Net sales	2,039	2,508	2,881
% change	29.6	23.0	14.9
Net income	78	148	196
% change	-37.7	90.7	31.9
EPS (Rs.)	5.7	10.9	14.4
% change	-37.7	90.7	31.9
P/E (x)	23.4	12.3	9.3
ROE (%)	13.1	11.0	8.2
ROCE (%)	10.9	8.2	13.9

Source: IISL research, company

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