

BUY

Price	Rs77
Target Price	Rs129
Investment Period	12 months

Stock Info

Sector	IT
Market Cap (Rs cr)	1,002
Beta	1.07
52 WK High / Low	120 / 25
Avg Daily Volume	462430
Face Value (Rs)	10
BSE Sensex	15,388
Nifty	4,571
BSE Code	532628
NSE Code	3IINFOTECH
Reuters Code	TIIN.BO
Bloomberg Code	III@IN

Shareholding Pattern (%)

Promoters	39.5
MF/Banks/Indian FIs	13.5
FII/ NRIs/ OCBs	11.2
Indian Public/ Others	35.8

Abs.	3m	1yr	3yr
Sensex (%)	34.9	7.7	44.1
3i Infotech (%)	65.1	(30.3)	8.5

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Performance Highlights

■ **Poor performances in Products, Transaction Services Businesses reduce Top-line:** 3i posted a 1.5% qoq contraction in its 1QFY010 Top-line. The Products and Transaction Services Segments recorded disappointing performances during the quarter, each registering a 10% qoq contraction in their respective Top-lines. The global economic turmoil has clearly played its part in adversely impacting 3i's Top-line. Apart from this, Rupee appreciation during the quarter also adversely impacted the company. However, a face-saving performance was recorded by the company's IT Services Business, which clocked a strong 20% qoq increase in Top-line. On a yoy basis, overall Top-line increased 27.6%, with 22.9% growth coming from the company's inorganic initiatives and the balance 4.7% growth coming from its organic pursuits. Segment-wise, the company's Transaction Services Business was the key contributor to growth, with business spiking 96.9% yoy. This business contributed over 75% of the incremental growth during the quarter. The Software Products Business grew by a mere 0.5% yoy, while IT Services posted a 16.9% yoy growth.

In the Software Products Business, 3i Infotech witnessed a decline across segments – Insurance, Banking and Capital Markets. Insurance proved to be the most resilient, declining by 1.6% qoq, Banking fell by nearly 10% qoq while Capital Markets crashed 21% qoq. On a yoy basis, Insurance grew 16.7%, Banking 9.7%, while Capital Markets crashed 25.9%. ERP saw a 1.6% qoq decline, while yoy it grew strongly by 29.7%. 3i's order book registered marginal growth of 0.3% qoq to Rs1,450cr (Rs1,445cr).

■ **Margins soar on lower SG&A costs:** 3i Infotech saw expansion of 30bp qoq in EBITDA Margins in 1QFY2010 due to lower SG&A costs (down by 231bp qoq as a % of Sales). Segment-wise, it was the IT Services Business that saw handsome Gross Margin expansion of 684bp qoq, whereas Product Gross Margins fell by 573bp qoq and Transaction Services Gross Margins fell by 92bp qoq. On a yoy basis, EBITDA Margins rose by 46bp.

■ **Higher Interest, Depreciation impact Bottom-line:** Despite higher Margins, 3i's Bottom-line for the quarter saw an 8.8% qoq decline (excluding one-time items) due to higher Interest and Depreciation (up 22.4% and 22.5% qoq, respectively). On a yoy basis, Bottom-line grew marginally by 0.4% excluding one-time items. This quarter, 3i Infotech bought back and cancelled FCCBs of €6mn and US \$8.5mn equivalent to Rs82.4cr at a discount. On a net basis, Rs27.9cr was shown as a one-time gain including which Bottom-line fell 4.1% qoq, but grew 47.9% yoy.

Key Financials (Consolidated)

Y/E March (Rs cr)	FY2008	FY2009	FY2010E	FY2011E
Net Sales	1,205	2,286	2,335	2,629
% chg	83.9	89.6	2.1	12.6
Net Profit*	169	275	196	223
% chg	75.3	62.3	(28.6)	13.6
EBITDA Margin (%)	21.2	19.0	19.5	19.0
FDEPS (Rs)*	12.3	19.9	14.2	16.1
P/E (x)	6.2	3.8	5.4	4.7
P/BV (x)	1.4	1.0	0.9	0.8
RoE (%)	27.3	30.8	17.5	17.1
RoCE (%)	15.8	14.6	10.7	11.3
EV/Sales (x)	1.7	1.3	1.2	1.0
EV/EBITDA (x)	7.9	6.6	6.1	5.3

Source: Company, Angel Research; *Adjusted for Preference dividend

Exhibit 1: Segment-wise Revenue Break-up – IT Services saves the blushes

(Rs cr)	1QFY09	4QFY09	1QFY10	% chg qoq	% chg yoy
Software Products					
Revenues	187	209	188	(10.2)	0.5
Gross profit	99	115	92	(19.6)	(7.1)
Gross margins (%)	53.1	54.8	49.1	(573 bps)	(405 bps)
IT Services					
Revenues	180	176	211	19.7	16.9
Gross profit	68	64	91	42.2	34.1
Gross margins (%)	37.6	36.3	43.2	684 bps	556 bps
Transaction Services					
Revenues	101	222	199	(10.0)	96.9
Gross profit	29	63	55	(13.0)	87.8
Gross margins (%)	28.8	28.4	27.5	(92 bps)	(134 bps)
Total					
Revenues	468	607	598	(1.5)	27.7
Gross profit	196	242	238	(1.5)	21.2
Gross margins (%)	41.9	39.8	39.8	(1 bp)	(211 bps)

Source: Company, Angel Research

Completes acquisition of JP Morgan Treasury Services' Lockbox Business

During the quarter, effective June 30, 2009, 3i Infotech completed the acquisition of JP Morgan Treasury Services' National Retail Lockbox Business for a total consideration of Rs45cr. The acquisition involves transfer of JP Morgan employees of the division to Regulus. Regulus will be able to process 700mn payments annually post completion of the acquisition. The company has annualised revenues of around US \$40-45mn.

Buys back FCCBs worth €6mn and US \$8.5mn at a discount

3i Infotech this quarter continued with its FCCB buy backs, with a total of €6mn and US \$8.5mn of the third and fourth issues, respectively amounting to Rs82.4cr getting bought back at a discount. The company recorded a profit of Rs27.9cr as a one-time gain from these transactions. The total amount of FCCBs outstanding now include US \$20.2mn of the first issue, NIL of the second issue, €20mn of the third issue and US \$66.367mn of the fourth issue.

Board approves capital raising through QIP of up to Rs500cr

3i Infotech's Board has approved capital raising through the QIP route of up to Rs500cr subject to shareholder and other approvals. The money raised would largely be utilised for repayment of debt. The company had over Rs2,100 crore of debt on its books at the end of 1QFY2010, while its Net Worth stood at Rs1,066cr, implying a Debt-Equity ratio of around 2:1. Repayment of debt would imply significant savings in Interest costs for the company, given that its average cost of debt is 12-12.5%. Thus, it would imply Interest cost savings of Rs50-55cr for the company.

Over the longer term, 3i expects to lower its Debt-Equity ratio to 1:1. The QIP issue would lead to a significant reduction in the ratio to around 1.1:1, given that the Net Worth would increase significantly, while debt falls to that extent. As regards pricing, 3i will be determining this in accordance with SEBI norms. This we believe is a crucial factor, as it would determine the amount of equity dilution that the company will witness.

We have done a brief scenario analysis in FY2011 for the company at various levels of QIP pricing (*refer Exhibits 2, 3 & 4*). We have also assumed 11% Interest cost, which would lead to cost savings to that extent, thus boosting Bottom-line adjusted for taxes. **Our analysis suggests that 3i Infotech will have to make the QIP issue at Rs154 a share to ensure there is no EPS dilution post the issue, implying a post-dilution P/E of around 9.5x FY2011E EPS. At this price, there would be no EPS dilution in our FY2011 estimates.** Nonetheless, it should be noted that the company has yet to get shareholder and other approvals for the issue, which could take time.

Exhibit 2: Equity dilution on account of QIP – Scenario Analysis (%)				
Funds raised (Rs cr)	Price at which QIP money raised (Rs)			
	54	77	100	154
300	40.3	28.2	21.8	14.1
400	53.8	37.6	29.0	18.8
500	67.2	47.0	36.3	23.5

Source: Company, Angel Research

Exhibit 3: PAT at different levels of fund raising – Scenario Analysis (Rs cr)				
Funds raised (Rs cr)	Price at which QIP money raised (Rs)			
	54	77	100	154
300	254.1	254.1	254.1	254.1
400	264.6	264.6	264.6	264.6
500	275.0	275.0	275.0	275.0

Source: Company, Angel Research

Exhibit 4: EPS estimates at different levels of fund raising and pricing (Rs)				
Funds raised (Rs cr)	Price at which QIP money raised (Rs)			
	54	77	100	154
300	13.1	14.4	15.1	16.1
400	12.5	13.9	14.9	16.1
500	11.9	13.6	14.6	16.1

Source: Company, Angel Research; Note: Our FY2011 EPS estimates are Rs16.1, thus implying no dilution if the QIP is done at Rs154 per share.

Outlook and Valuation

Going ahead, we expect 3i Infotech to record a CAGR of 7.3% in Top-line over FY2009-11E, while Bottom-line is expected to record a compounded de-growth of 10% over the same period (excluding one-time items). At the CMP, the stock is trading at 4.7x FY2011E EPS. The company continues to buy back its FCCBs at a discount, which we believe is a catalyst for re-rating of the stock. Improvement in the quality of its Balance Sheet is also another key factor that the company will need to focus on, given that Goodwill accounted for a significant 164% of its FY2009 Net Worth.

Through the QIP Issue, 3i Infotech will buy back its debt and this will result in its Debt-Equity ratio improving to 1.1:1 from 2:1 at present. This will significantly improve the quality of its Balance Sheet and lead to substantial savings in Interest costs of Rs50-55cr, which will offset the likely equity dilution to a large extent. Moreover, following an economic recovery anticipated in FY2011E, we believe 3i Infotech will also be able to return to strong growth rates from that fiscal onwards. Management has addressed a number of investor concerns in its conference call, which we believe is a positive and reflective of the company's efforts to be transparent regards these issues. **Thus, owing to these factors, we recommend a Buy on the stock with a revised Target Price of Rs129 (Rs93 earlier), assigning a P/E of 8x FY2011E EPS (6x earlier).**

Exhibit 5: 1QFY2010 Performance (Consolidated)

Y/E March (Rs cr)	FY2010 1Q	FY2009 4Q	% chg (qoq)	FY2009 1Q	% chg (yoy)	FY2009	FY2008	% chg
Total Revenue	598	607	(1.5)	468	27.6	2,286	1,205	89.6
Operating Costs	479	488	(1.8)	377	26.9	1,851	950	94.8
EBITDA	119	119	0.0	91	30.6	434	255	70.4
Interest	34	28	22.4	18	89.5	95	51	88.0
Depreciation & Amortisation	29	23	22.5	12	141.8	70	24	187.1
Other Income / (Expense)	4	4	13.8	3	39.0	19	18	4.2
Income before Income Taxes	61	72	(15.3)	64	(5.9)	288	198	45.5
Income Taxes	(2)	5		6		22	15	45.9
Net Income before Minority Interest	63	67	(5.6)	58	8.3	266	183	45.4
Exceptional Items	28	26		-		26	-	
Min. Interest & Share of Assc. Profits	4	2		(1)		10	7	
Profit after Tax	87	90	(4.1)	59	47.9	282	177	59.7
Diluted EPS (Rs)	6.5	6.8	(4.9)	4.2	53.9	21.0	12.7	66.1
EBITDA Margin (%)	19.9	19.6		19.5		19.0	21.1	
Net Profit Margin (%)	14.5	14.9		12.5		12.3	14.6	
Effective Tax Rate (%)	(3.7)	6.9		9.8		7.6	7.6	

Source: Company, Angel Research



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Sebi Registration No : INB 010996539

Ratings (Returns) : Buy (Upside > 15%)
Reduce (Downside upto 15%)

Accumulate (Upside upto 15%)
Sell (Downside > 15%)

Neutral (5 to -5%)