

I-Flex Solutions

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Shareholding (%)

Foreign Promoters	55.8
Others	44.2

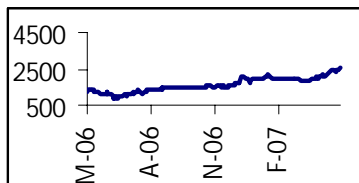
Share price performance

52-week high/low (Rs) 2542/832

	-1m	-3m	-12m
Abs (%)	21.2	29.7	99.9
Rel* (%)	14.2	29.6	86.6

*to Nifty

Stock chart



Valuations stretch: downgrade to 'Reduce'

I-Flex Solutions (I-Flex) reported a lower than expected Q4FY07, with 5.3% and 0.5% sequential increase in revenue and net profit to Rs5.8bn and Rs777mn respectively. Nevertheless, the company has good order pipeline as indicated by a tank size of US\$82.5mn (highest ever) and deferred revenue of Rs3.4bn.

On account of lower than expected Q4FY07, we are decreasing our FY08E and FY09E EPS estimates by 4.4% and 9.3% to Rs51.2 and Rs65.8 respectively, implying a two year EPS CAGR of 38.7%.

Currently, the stock is quoting at FY08E and FY09E PER of 49.2x and 38.4x respectively. The stock has outperformed the indices as well as its peers in the last few months, which we believe is on account of market expectation of another open offer from Oracle, rather than on fundamentals. Though synergies with Oracle have started yielding results for the company in its products business, we believe that the current stock price factors this. Therefore, we downgrade the stock from 'Accumulate' to 'Reduce'. However, an open offer from Oracle remains the key risk to our recommendation.

Key highlights of Q4FY07 results are:

- ▲ **Implementation fee drives product revenue:** During Q4FY07, I-Flex's product revenue grew 1% sequentially, driven by 12% sequential increase in implementation fee. License fee on the other hand declined 11% sequentially to Rs705mn. In FY07, license fee grew only 0.7% YoY to Rs2.7bn, reducing its share in products revenue to 24.5% in FY07, lowest in the last six years. Though we are disappointed with the slower growth in license fee, a tank size of US\$82.5mn at the end of Q4FY07 indicates good visibility. We expect products revenue to grow at a two year (FY07-09E) CAGR of 39.8% to Rs21.4bn in FY09E as against Rs10.97bn in FY07.

Reduce

Rs2522

03 May 2007

Market cap

Rs bn 204

US\$ mn 4,983

Avg 3m daily volume

55.717

Avg 3m daily value

USD mn 3

Shares outstanding (mn)

81

Reuters

IFLX.BO/I-FLEX.NS

Bloomberg

IFLEX IN

Sensex

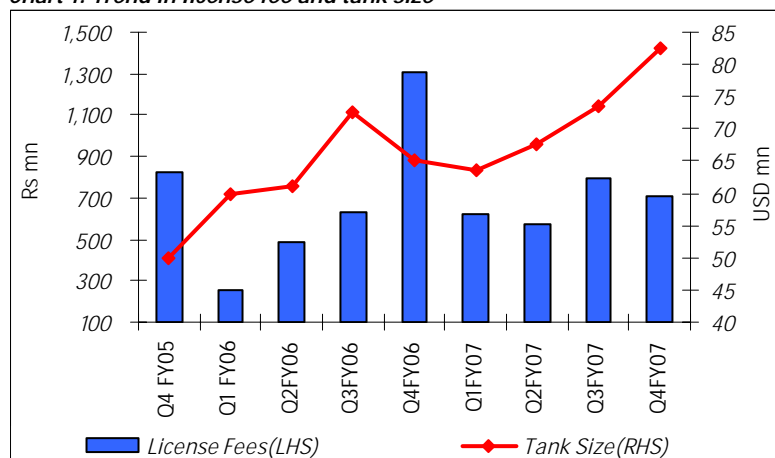
13,872

Nifty

4,088

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Chart 1: Trend in license fee and tank size



Source: IISL research, company

▲ **Services revenue grew 10.1% sequentially:** I-Flex's revenue from services business grew 10.1% sequentially to Rs2.4bn driven by 18.5% sequential increase in non-citi business.

▲ **Consolidated EBITDA margin fell by 40bps:** Though EBITDA margin in the services business improved by 840bps, on account of higher proportion of offshore revenue and higher utilisation; a 390bps fall in the products EBITDA margin, due to lower license fee booking and higher G&A, led to a 40bps fall in consolidated EBITDA margin to 27.9%. The margin was also impacted negatively by higher losses in the KPO business in Q4FY07.

However, we expect the company's consolidated EBITDA margin to improve going forward, because of:

- Higher license fee revenue, expanding EBITDA margin of the products business
- Improving services margin, as the company adds more at the entry level and improve utilisation and realisation.
- Benefits from economies of scale

▲ **Forecasts:** Due to lower than expected Q4FY07 results, we are revising our FY08E and FY09E EPS estimates downwards by 4.4% and 9.3%, to Rs51.2 and Rs65.8 respectively, implying a two year EPS CAGR of 38.7%.

▲ **Valuation:** I-Flex's increasing synergies with Oracle has enabled it to report higher traction in its products business, resulting in a revenue growth of 44.8% in the products business in FY07, highest in the last four years. However, we believe that at the current FY08E and FY09E PER of 49.2x and 38.4x, the stock is valued fairly and factors these synergies. Though the stock has outperformed the underlying indices and its peers in the last few months, we believe that this is due to the expectation of another open offer from Oracle rather than on fundamentals. Therefore, we downgrade the stock from an

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'Accumulate' to 'Reduce'. However, another open offer from Oracle at a price higher than the current market price is a key risk to our recommendation.

Table 1. Quarterly result table

Rs mn	Q4FY07	Q3FY07	QoQ (%)	Q4FY06	YoY (%)
Revenue	5,794	5,502	5.3%	4,577	26.6%
Products	3,206	3,172	1.1%	2,619	22.4%
Services	2,445	2,222	10.1%	1,891	29.3%
KPO	143	108	32.7%	67	112.8%
Cost of Revenues	3,208	3,092	3.8%	2,279	40.8%
Gross Profit	2,586	2,410	7.3%	2,298	12.5%
GPM	44.6%	43.8%		50.2%	
Selling and Mktg	747	737	1.3%	566	31.9%
General and Admn	747	609	22.8%	419	78.3%
EBITDA	1,093	1,064	2.6%	1,313	-16.8%
EBITDA Margin	18.9%	19.3%		28.7%	
Depreciation	247	260	-4.8%	152	63.0%
Other than temp. diminution in value of securities available for sale	-	-		-	
Share of associate company gain/loss	2	3	-36.4%	1	172.1%
Interest and Other income	26	(2)		105	-74.9%
PBT	874	806	8.5%	1,267	-31.0%
Provision for tax	97	33	196.3%	98	-1.0%
Tax Rate	11.1%	4.1%		7.8%	
PAT	777	773	0.5%	1,169	-33.6%
NPM	13.4%	14.0%		25.5%	

Source: IISL research, company

Table 2. Estimates

Rs mn	FY06	FY07	FY08E	FY09E
Net Sales	14,835	20,381	27,579	36,283
% change	30.1	37.4	35.3	31.6
Net Income	2,190	2,768	4,148	5,326
% change	8.0	26.4	49.8	28.4
EPS (Rs.)	28.7	34.2	51.2	65.8
% change	8.0	19.0	49.8	28.4
P/E (x)	87.9	73.8	49.2	38.4
ROE (%)	17.6	15.7	17.5	19.0
ROCE (%)	19.7	15.6	18.0	19.9

Source: IISL research, company

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