

Zylog Systems Ltd

Business momentum back on track

Fundamental Grade **3/5 (Good fundamentals)**
Valuation Grade **5/5 (CMP has strong upside)**

Industry **IT Services**

Zylog System Ltd's (Zylog's) Q3FY12 revenue in dollar terms was in line with CRISIL Research's expectations while revenue in rupee terms and EBITDA margin exceeded our expectations driven by the rupee depreciation. PAT was below expectations because of higher-than-expected depreciation from capitalisation of certain products and higher interest due to rupee depreciation. At 46%, tax rate (post adjustment of forex translational gain) was significantly higher than expected. The company has paid tax at the rate of 44% in 9MFY12 and we have factored in 37% tax for the full year based on management guidance. We have increased earnings estimate by ~3% for FY12 and ~8% for FY13 driven mainly by revision in exchange rate. However, the macroeconomic environment in the US, Europe and Canada remains a key monitorable. We expect Zylog's business momentum to continue and maintain our fundamental grade of **3/5**.

Q3FY12 result analysis

- Revenue in dollar terms grew 4.5% q-o-q (6.5% y-o-y) to US\$ 113 mn. Revenue from products and solutions grew by 6.5% q-o-q (4.8% y-o-y) to US\$ 42.4 mn and revenue from IT services grew at 3.3% q-o-q (9.3% y-o-y) to US\$ 70.7 mn. Revenue in rupee terms grew by 16.5% q-o-q (22.3% y-o-y) to Rs 5.8 bn driven by rupee depreciation.
- EBITDA increased by 11.4% q-o-q (5.6% y-o-y) to Rs 939 mn. EBITDA margin declined by 73 bps q-o-q (254 bps y-o-y) to 16.1% driven by higher software development and employee cost which increased by 17.6% q-o-q (24% y-o-y) due to rupee depreciation as Zylog has a strong onsite presence. The company reclassified certain line items from software development cost to employee cost which led to the employee cost increasing by 49% q-o-q. Selling, general and administration expenses were up 16.9% q-o-q (39% y-o-y).
- The company added 316 employees in this quarter, mostly at offshore locations. Also, both onsite and offshore utilisation rates improved.
- Depreciation increased by 24.3% q-o-q (25.8% y-o-y) as the fixed asset base increased and interest cost increased by 21.7% q-o-q (decline of 9% y-o-y). The other income included forex gain of Rs 174 mn. As a result, adjusted PAT remained flat q-o-q (decline of 7.8% y-o-y) at Rs 371 mn. The adjusted EPS was Rs 22.6.

Valuation: Current market price has strong upside

We continue to use the discounted cash flow method to value Zylog. We maintain our fair value estimate at Rs 656 per share. At the current market price of Rs 500, the valuation grade is **5/5**.

KEY FORECAST

(Rs mn)	FY09	FY10	FY11	FY12E	FY13E
Operating income	7,511	9,802	19,183	21,871	24,048
EBITDA	744	2,070	3,170	3,616	3,780
Adj PAT	389	568	993	1,692	1,918
Adj EPS-Rs	23.7	34.5	60.3	102.9	116.6
EPS growth (%)	(58.3)	45.9	74.8	70.5	13.4
Dividend yield (%)	3.8	1.5	1.9	1.8	1.9
RoCE (%)	9.6	21.1	23.6	20.9	18.3
RoE (%)	8.7	10.6	15.4	21.1	19.5
PE (x)	21.1	14.5	8.3	4.9	4.3
P/BV (x)	1.7	1.4	1.2	0.9	0.8
EV/EBITDA (x)	10.3	4.7	3.4	3.0	2.6

NM: Not meaningful; CMP: Current market price

Source: Company, CRISIL Research estimate

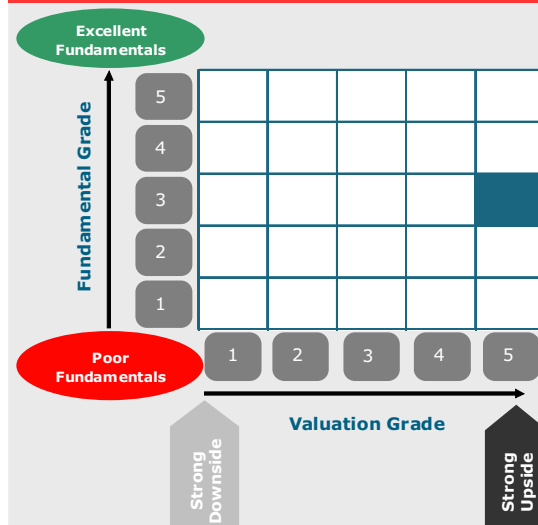


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Fair Value **Rs 656**

CMP **Rs 500**

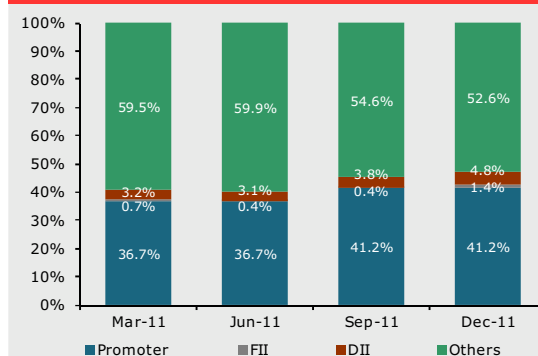
CFV MATRIX



KEY STOCK STATISTICS

NIFTY / SENSEX	5382/17749
NSE / BSE ticker	ZYLOG
Face value (Rs per share)	10
Shares outstanding (mn)	16.4
Market cap (Rs mn)/(US\$ mn)	8,216/165
Enterprise value (Rs mn)/(US\$ mn)	10,722/216
52-week range (Rs) (H/L)	505/330
Beta	1.1
Free float (%)	58.8
Avg daily volumes (30-days)	134,694
Avg daily value (30-days) (Rs mn)	61.1

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
ZYLOG	24%	11%	23%	38%
NIFTY	11%	3%	4%	3%

ANALYTICAL CONTACT

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