



## Polaris Software Lab Ltd.

BUY

CMP: Rs.172

Target Price: 242

Industry: Information Technology

Stock Info	
Market Capital	Rs.1733 cr
Free float	Rs.853 cr
Equity Capital	Rs.49.5 cr
Avg. Trading Vol.	126987 (Qtly)
52 WK High/Low	215/142
Face Value	Rs. 5

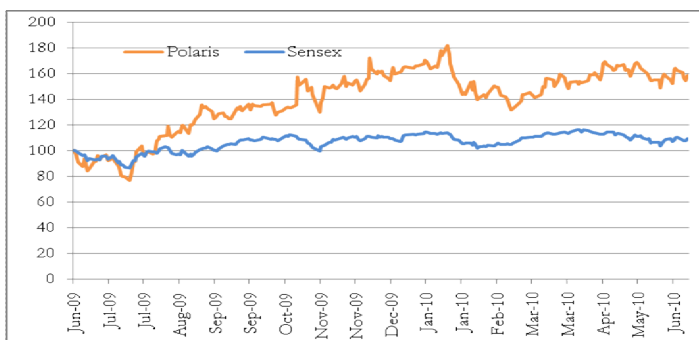
<b>BSE Group</b>	B/BSE 500
<b>BSE Code</b>	532254
<b>NSE Symbol</b>	POLARIS
<b>Bloomberg</b>	POL IN
<b>Reuters</b>	POLS.BO
<b>BSE Sensex</b>	19872
<b>NSE Nifty</b>	5982

Shareholding Pattern (30th Sept.'10)	
<b>Promoters</b>	29.0%
<b>Domestic Institutions</b>	16.1%
<b>Foreign Institutions</b>	17.6%
<b>Public &amp; Others</b>	33.5%
<b>Govt. Holdings</b>	0.0%

## Q2FY11 results highlights

- Results on expected lines:** Polaris posted their Q2FY11 results that were on expected lines. The company's top-line grew by 7.7% on a QoQ basis. Its net profit margin saw a lesser growth of 3.6% sequentially mainly on account of increased employee cost.
- Strong growth in all geographies:** Polaris showed robust growth in all geographies with Europe out-performing by growing 13% sequentially while Americas' growth was at 9%.
- Slight improvement in margins:** Polaris managed to slightly improve its margins sequentially despite a sharp increase in employee's cost and an appreciating rupee. Its' EBIDTA margins were at 15.5% as compared to 15.1% in Q1. The improvement was mainly on account of increased license sales of its Intellect suite of product which has a higher margin of 23% as compared to 14% in services.
- Robust employee intake:** Polaris increased its' employee base by a whopping 959 new recruits (on a net basis) which is its' highest intake in more than two years signaling the growth that the company is seeing in the coming quarters. The management also plans to take in another 1000 employees in 2HFY11E. However, we noted that a majority of the new recruits were laterals and going forward too we believe it would be the same. This would result in a sharper increase in employee cost as compared to IT companies who are hiring more freshers in order to increase the base of the pyramid resulting in lower cost. Also, Attrition at 20% remains a concern.
- Intellect showing good traction:** Polaris' Intellect suite of products continue to do well both on the global as well as on the domestic front. During the quarter, the Intellect products registered 17 wins. Intellect products' acceptance has been growing globally and this was evident by the fact that a second bank in the Americas went live with Intellect. Domestically too, a number of prominent organisations like SBI MF and Andhra Pradesh State Co-operative bank went live with it. We believe as the company's products continues to gain more recognition it will result in more deals which in turn in better margins for the company.
- Valuation:** At CMP, the stock is trading at 8.5x FY11E and 7.2x FY12E earnings of Rs.20.1 and Rs.23.9 per share respectively. The company's Q2 result though were on expected lines, could have been better but the appreciation in the rupee played spoil-sport. The management has also expressed concerns and has indicated that if the rupee crosses the critical mark of 45 to a dollar, the company will find the going a bit tough. According to them, beyond 45 every 100bps appreciation in the rupee will shave off ~Rs.3.5cr of its profit. The management however will implement cost control measures to keep its losses in check and has reiterated its previous guidance of 31-33% growth in dollar terms.

We believe that Polaris is on track and will do better in the coming quarters. We therefore maintain our target price of Rs.242 per share and reiterate our "Buy" call on the stock



Particulars (Rs. in cr)	FY10	FY11E	FY12E
<b>Net Revenue</b>	1353.8	1552.2	1814.3
<b>Growth %</b>	(1.8)	14.7	16.8
<b>Net Profit</b>	152.8	198.8	236.0
<b>Growth %</b>	16.9	29.8	19.0
<b>EPS (Rs)</b>	15.4	20.1	23.9
<b>P/E</b>	11.1	8.5	7.2
<b>P/BV</b>	1.9	1.6	1.4

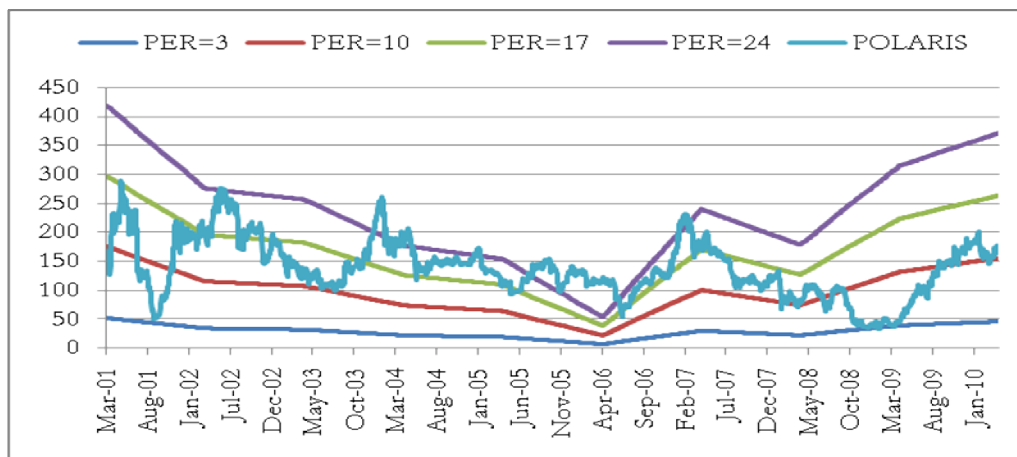
## Background

Founded in 1993, Polaris Software Lab Ltd. is one of the world's most sophisticated banking and insurance software company. Headquartered in Chennai, Polaris has been the outsourcing partner for 10 of the top 15 global banks and 6 of the top 10 global insurance companies.

It has relationship offices in more than 21 countries like US, UK, Canada, Australia, France, Germany, etc. It also has 6 fully owned business solutions centres in Chennai, Hyderabad, Mumbai and Gurgaon. Polaris has the distinction of being the world's first CMMi (Capability Maturity Model Integrated) level 5 company.

Polaris began its journey more than two decades ago by partnering with Citibank to create India's first ATM system. As a result of its association with Citibank, it gained experience in creating mission critical solutions with leading edge functionality and also successful outsourcing models that enabled Polaris to meet and exceed global standard. In 2003, Polaris went on to acquire Citibank's banking IT arm. Citibank has always been an important part of the company and currently its has close to 21 per cent stake in it. Citigroup is also its single largest client and contributes ~40 per cent of its total revenues.

## PE Band



Source: Arianth Research

Fig: PE band of Polaris

## Q2 FY11 result

Rs. in cr	Q2FY11	Q1FY10	YoY%chng.	Q1FY11	QoQ%chng.
Net Sales	388.3	338.3	14.8%	360.57	7.7%
Other Operating Income	-0.4	-8.6	-95.5%	7.4	-105.3%
Other Income	5.6	4.1	38.0%	6.91	-19.1%
<b>Total Income</b>	<b>393.5</b>	<b>333.8</b>	<b>17.9%</b>	<b>374.88</b>	<b>5.0%</b>
<b>Total Expenditure</b>	<b>327.7</b>	<b>284.9</b>	<b>15.0%</b>	<b>312.37</b>	<b>4.9%</b>
PBIDT	65.8	48.9	34.5%	62.51	5.3%
Interest	0.3	0.2	52.9%	0.24	8.3%
PBDT	65.6	48.8	34.5%	62.27	5.3%
Depreciation	8.4	8.7	-3.5%	7.81	7.9%
Tax	9.0	4.8	86.5%	7.86	14.4%
<i>effective tax rate%</i>	<i>15.7%</i>	<i>12.0%</i>		<i>14.4%</i>	
<b>Reported Profit After Tax</b>	<b>48.2</b>	<b>35.2</b>	<b>36.8%</b>	<b>46.6</b>	<b>3.3%</b>
<b>EPS</b>	<b>4.86</b>	<b>3.57</b>	<b>36.1%</b>	<b>4.71</b>	<b>3.2%</b>

## Profit and Loss Statement

(consolidated)

## Cash Flow Statement Extract

Y/E March (Rs. in cr)	FY09	FY10	FY11E	FY12E
<b>Net Sales</b>	<b>1377.9</b>	<b>1353.8</b>	<b>1552.2</b>	<b>1814.3</b>
<i>YoY%</i>	<i>25.4</i>	<i>-1.8</i>	<i>14.7</i>	<i>16.9</i>
Software dev. expense	885.4	870.1	1014.5	1157.5
SGA	259.0	261.6	290.0	344.0
Op. profit before int., dep	233.5	222.0	247.7	312.9
Fin. charge	0.7	0.9	1.1	1.4
Depreciation	50.5	35.0	33.7	42.0
Other income	24.8	19.1	23.8	26.0
Fx. gains/loss	-56.4	-26.4	-	-
Profit before tax	150.6	178.8	236.6	295.4
Total tax	20.9	25.5	37.8	59.0
<b>PAT</b>	<b>129.8</b>	<b>153.3</b>	<b>198.8</b>	<b>236.5</b>
<i>Effective tax rate%</i>	<i>13.9</i>	<i>14.3</i>	<i>16.0</i>	<i>19.9</i>
Share of pft/loss of associate cos.	0.9	-0.4	-0.4	-0.4
<b>Net Profit</b>	<b>130.7</b>	<b>152.8</b>	<b>198.3</b>	<b>236.0</b>
<i>YoY%</i>	<i>78.5</i>	<i>16.9</i>	<i>29.8</i>	<i>19.0</i>

Y/E March (Rs.in cr)	FY09	FY10	FY11E	FY12E
Profit before taxation	151.6	178.8	236.6	295.4
Add: Depreciation	50.5	35.0	33.7	42.0
Other items	-22.9	-13.5	-13.0	-13.0
(Inc.)/Dec in WC	93.1	82.9	0.0	7.2
Direct Taxes	-30.1	-29.1	-38.4	-59.0
<b>Net cash provided by operating activities</b>	<b>242.1</b>	<b>254.2</b>	<b>219.5</b>	<b>272.7</b>
(Inc)/ Dec in FA	-35.5	-34.7	-37.0	-42.0
Int. & Dividend received	11.2	16.37	16.37	16.37
Acquisition of subsidiary	-37.0	-34.7	-	-
Other items	-133.1	-145.3	-	-
<b>Cash Inflow/ (outflow) from Investments</b>	<b>-194.5</b>	<b>-198.3</b>	<b>-20.6</b>	<b>-25.6</b>
Issue of equity shares	0.0	0.1	-	-
Dividends paid	-34.4	-34.6	-34.6	-34.6
Other items	-0.5	3.7	-	-
<b>Cash Inflow/ (outflow) from Financing</b>	<b>-34.9</b>	<b>-30.8</b>	<b>-34.6</b>	<b>-34.6</b>
Translation loss/gain	15.9	-9.3	-	-
<b>Net Cash Inflow/(outflow)</b>	<b>28.6</b>	<b>15.9</b>	<b>164.2</b>	<b>212.5</b>
Cash acquired on Laser Soft acquisition	-	2.5	-	-
Cash at beginning	76.7	105.4	123.7	287.9
<b>Net Cash carried forward</b>	<b>105.4</b>	<b>123.7</b>	<b>287.9</b>	<b>500.4</b>

## Balance Sheet

Y/E Mar. (Rs. in cr)	FY09	FY10	FY11E	FY12E
<b>Sources of Funds:</b>				
Equity Capital (FV-5)	49.3	49.5	49.5	49.5
Reserves	723.3	822.9	987.2	1194.5
<b>Shareholder's Equity</b>				
Total Debt	0.4	2.5	2.5	2.5
Deferred Tax Liability	6.7	3.0	3.0	3.0
<b>Total Liabilities</b>	<b>779.7</b>	<b>877.9</b>	<b>1042.2</b>	<b>1249.5</b>
<b>Application of Funds:</b>				
Gross Block	528.3	559.9	596.9	638.9
Less: Acc. depreciation	313.7	345.2	382.2	422.2
<i>Net Block</i>	<i>214.6</i>	<i>214.7</i>	<i>214.7</i>	<i>216.7</i>
CWIP	1.14	12.5	12.5	12.5
Goodwill	19.9	50.6	50.6	50.6
Investments	244.3	389.7	389.7	389.7
Deferred tax asset	9.7	6.5	6.5	6.5
<b>Current Assets:</b>				
Debtors	203.1	174.6	195.6	218.7
Cash and equivalent	105.4	123.7	287.9	500.4
Loans and Advances	232.5	208.4	230.9	249.9
<i>Total</i>	<i>541.1</i>	<i>506.7</i>	<i>714.5</i>	<i>968.9</i>
Current Liabilities	204.3	246.2	286.2	329.4
Provisions	46.6	56.4	59.9	65.9
<i>Net current asset</i>	<i>290.1</i>	<i>204.1</i>	<i>368.4</i>	<i>573.6</i>
<b>Total Assets</b>	<b>779.7</b>	<b>877.9</b>	<b>1042.2</b>	<b>1249.5</b>

## Important Ratios

Y/E March	FY09	FY10	FY11E	FY12E
<b>Performance Ratios</b>				
EBIDTA %	16.9	16.4	15.9	17.2
Net Profit %	9.5	11.3	12.8	13.0
Sales/share (SPS)(Rs.)	139.6	137.1	157.2	183.7
Price/SPS	1.2	1.3	1.1	0.9
Dividend %	55	70	70	70
Cash per share	10.7	12.5	29.2	50.7
Assets Turnover	1.8	1.5	1.5	1.5
<b>Du Pont Analysis</b>				
PAT / Net Sales	9.5	11.3	12.8	13.0
Net Sales / Assets	1.8	1.5	1.5	1.5
Assets / Equity	1.0	1.0	1.0	1.0
ROE %	16.9	17.5	19.1	18.9
<b>Valuation Ratios</b>				
Diluted EPS	13.2	15.3	20.1	23.7
Cash EPS	18.4	19.0	23.5	28.2
P/E	12.9	11.1	8.5	7.2
P/BV	2.2	1.9	1.6	1.4
EV/ EBIDTA	6.8	7.2	5.8	3.9
EV/ Sales	1.1	1.2	0.9	0.7
ROCE%	29.9	25.3	23.8	25.0

**ARIHANT - Research Desk**

For more information contact:

[research@arihantcapital.com](mailto:research@arihantcapital.com)

Tel: 022-42254830/32

**Head Office**

3<sup>rd</sup> Floor, Krishna Bhuvan,  
67 Nehru Road, Vile Parle (East),  
Mumbai-400057.  
Tel: (91-22) 42254800  
Fax: (91-22) 42254880

**Registered Office**

Arihant House  
E-5 Ratlam Kothi  
Indore-452003, (M.P.)  
Tel: (91-731) 3016100  
Fax: (91-731) 3016199

**Stock Rating Scale**

	<b>Absolute Return</b>
BUY	: >20%
ACCUMULATE	: 12-20%
HOLD	: 5-12%
REDUCE	: <5%

Disclaimer: Arihant capital markets limited is not soliciting any action based upon it. This document has been prepared and issued on the basis of publicly available information, internally developed data and other sources believed to be reliable. However we do not represent that it is accurate or complete and it should not be relied upon such. Whilst meticulous care has been taken to ensure that the facts stated are accurate and opinions given are fair and reasonable, neither the analyst nor any employee of Arihant is in any way responsible for its contents. The firm or its employees may trade in investments, which are the subject of this document or in related investments and may have acted upon or used the information contained in this document or the research or the analysis on which it is based. Before its publication the firm, its owners or its employees may have a position or be otherwise interested in the investment referred to in this document. This is just a suggestion and the firm or its employees will not be responsible for any profit or loss arising out of the decision taken by the reader of this document. No matter contained in this document may be reproduced or copied without the consent of the firm.

**ARIHANT capital markets ltd.**

3<sup>rd</sup> Floor Krishna Bhuvan, 67, Nehru Road, Vile Parle (E) Mumbai 400057. Tel. 022-42254800. Fax: 022-42254880  
Visit us at: [www.arihantcapital.com](http://www.arihantcapital.com)