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THE stock of small-sized niche IT player Subex has fallen sharply in the past three months. The company had reported stagnant sales in the past few quarters. However, its performance is likely to improve gradually in the coming quarters on the back of a rise in demand for its products and the company's increased focus on product-related services. A restructuring and repayment schedule for its outstanding debt will also help it in reducing finance charges in the future thereby supporting net profitability.

BUSINESS: Bangalore-based Subex offers IT product solutions to the telecom

IT's Ringing Again

The revival in demand from global telecom players and reduced debt burden are expected to boost Subex's profits and profitability in the coming quarters

sector globally. Revenue assurance, services fulfilment and fraud management are some of its major solutions. Its clientele includes 16 of the top 20 global telecom operators. It has so far worked with more than 300 telecom companies across the world. The US, Europe, the Middle East and Asia are the major growth regions for the company. After suffering a steep fall in the first two quarters of FY11, the contribution of the US market increased to nearly 50% in Subex's total revenue. Its presence in the Asia Pacific region also improved during the quarter.

GROWTH INDICATORS: At the end of December 31, 2010, the company had orders worth \$413 million in the pipeline. Its

order intake rose by a robust 58% during the third quarter from the year-ago levels. This reflects a renewed momentum in the new business. The company has long been scouting for growth in the managed service business. In the past few quarters, it has won deals in this service segment. Further, the size of the deals is gradually increasing and is expected to increase to \$5 million in the next 3-5 years from the current size of less than \$2 million. Larger deals with longer durations ensure higher vendor-client engagements, which helps in better mining of client accounts.

The company has over 30 managed services clients. The proportion of this segment in the total revenue has increased to 15%

Call on Hold

Subex's Financials

(₹ CRORE)	DEC '10 QTR	TTM* ENDED DEC '10	Y-o-Y CHG (%)*
Net sales	126.8	488.9	06
Total income	126.8	518.1	-72
Salaries and wages	65.4	269.3	-149
Expenses	105.3	436.9	-159
PBDIT	36.1	145.4	203
Interest expenses	10.7	43.7	-90
Depreciation	2.7	11.1	-403
Net profit	21.5	81.3	1110
PBDIT margin (%)	28.5	29.7	490 bps
Net margin (%)	17.0	15.7	880 bps

*Trailing twelve months ended Dec '10

*Year-on-year % change over TTM ended Dec '09

bps=basis points

SOURCE: PROWESS

from 10% a year-ago. This has also improved its annuity revenue, which is recurring in nature and, hence, the larger its proportion, the higher is the revenue visibility. At the end of the December 2010

quarter, the share of annuity income rose to 45% from 32% within a year. The management expects it to cross 55% in the next two years.

FINANCIALS: Subex's revenue failed to grow substantially in the three years ended March 2010 after growing more than two-fold in the prior three years. The tapered performance in the past few quarters reflects the turbulence in the global telecom sector. Its revenue growth is improving gradually. In the nine months ended December 2010, it rose by a moderate 4% after falling by over 18% in the corresponding period of FY10. Despite a sluggish trend in its topline, Subex has been able to retain its profitability. In the past six quarters, it has restored its operating margin back to the level of 30%.

The company restructured its foreign currency convertible bonds (FCCBs) 18 months ago, which reduced its foreign currency loan exposure by one-fifth to \$141 million. Of this, \$44 million is converted to equity. It expects to pay \$12 million of debt

by March 2011. The lowering debt burden is expected to reduce its interest costs by nearly half in a year's time.

VALUATIONS: Subex plans to issue equity shares worth \$8 million on a preferential basis in the near term. Apart from that, the conversion of the balance foreign debt into equity is likely to nearly double its equity base to 103 million shares by FY12. Considering the fully diluted equity, its stock trades at a trailing P/E of 7.1. This is reasonable given the P/E range of 6-10 for mid and small IT companies. The company's product and managed services business is expected to grow at a faster clip in the next few quarters in the domestic and international markets. This together with improved profitability and lower interest burden make investment in Subex at the current valuation attractive.

CONCERNS: Currency fluctuations may tend to severely impact the growth in the short run and the company may not be able to stave off the currency loss through forex hedging given its smaller operations.

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