

DECEMBER 16, 2011

ACCUMULATE

MEDIUM RISK

PRICE Rs.1980

TARGET Rs.2288

## TECHNOLOGY

### SHARE HOLDING (%)

Promoters	80.4
FII	5.5
FI / MF	5.0
Body Corporate	0.7
Public & Others	8.4

### STOCK DATA

Reuters Code ORCL.BO  
Bloomberg Code OFSS.IN

BSE Code 532466  
NSE Symbol OFSS

Market Capitalization\* Rs. 166.2 bn  
US\$ 3.1 bn

Shares Outstanding\* 83.94 mn

52 Weeks (H/L) Rs.2375 /1699

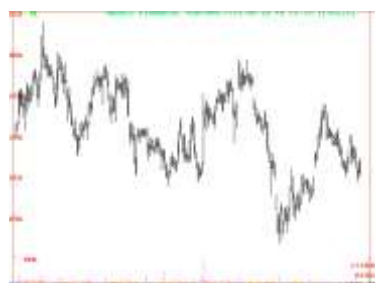
Avg. Daily Volume (6m) 5068 Shares

### Price Performance (%)

1M	3M	6M
(4)	9	(12)

200 Days EMA: Rs.2058

\*On fully diluted equity shares



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Oracle Financial Services Software Ltd (OFSS) is a majority (80%) owned subsidiary of Oracle Corporation, the world's largest business software company. OFSS is a world leader in providing IT solutions to the financial services industry. It has two major business segments - The Products Business (comprising of market leading, high margin & fast growing product suites i.e. FLEXCUBE - a Core Banking solutions product and Reveleus - a Business Intelligence, Risk & Compliance product), and the Consulting Services Business (offering consulting, application, technology services, and BPO services). It derives about 2/3rd of its Revenues from its Product Business, which has delivered a Revenue CAGR of 16% in last 4 years (FY07-11), while its EBT margins has expanded from 33.7% to 48% during the period. In the past 3-4 years, OFSS has completely transformed its Services Business which has led to a substantial 700 bps improvement in its EBT margins from 17% to 24%.

### Oracle FLEXCUBE Positioned among World's Top Core Banking Solutions

Most Banks and Financial Institutions around the world are increasingly focusing on deploying Core Banking Solutions (CBS) for their organizations. Oracle FLEXCUBE is OFSS' CBS offering and has been deployed in over 500 financial institutions across 125 countries. It is top ranked and complete banking product suite for retail, consumer, corporate, investment & asset management and investor servicing solutions. Market size for CBS is expected to be USD 24 bn and the penetration of third party solutions is still very low at about 20%. Hence, this market provides significant opportunities for leading CBS vendors like OFSS. Since emerging economies are not bogged down by the problem of legacy solutions (unlike developed economies), majority of CBS deployment is expected to happen in emerging countries going forward. Hence, the global technology vendors expect strong growth opportunities coming from EMEA region (the Europe, the Middle East, and Africa) and the Asia-Pacific for their core banking solutions. Citibank is the largest customer for FLEXCUBE, which has been deployed across Citi entities globally and continues to be a strong growth driver for OFSS. Moreover, Oracle Corp.'s strong penetration across 145 countries with its 380,000 customer base including all 100 of Fortune 100 companies is yet to be leveraged by OFSS and remains a key future growth driver. Additionally, with its leading market positioning, strong EU penetration & significant presence in the high growth emerging markets, we believe FLEXCUBE is poised to grow rapidly in the coming years.

### Oracle Reveleus- Leading Product for Business Intelligence, Enterprise Risk & Analytics

The current turbulence in the global financial marketplace has led to a serious credit & capital crisis. Increasing government mandates are calling for tighter risk management & regulatory compliance. Laws & regulations such as the U.S. Bank Secrecy Act, Anti-Money Laundering, Basel II & III, Sarbanes-Oxley, Dodd-Franc Act, the U.S. Patriot Act, etc are setting extensive corporate governance standards & creating new reporting requirements. Banks & Financial institutions need an integrated approach that combines a diverse set of compliance & risk solutions to help them address not only present regulatory needs, but also the emerging and future risk & regulatory requirements. Oracle Reveleus empowers financial institutions with analytical tools, which have in-depth modeling and statistical capabilities within a broad, extensible risk and compliance architecture. It is ranked amongst leading solutions for enterprise risk & analytics and widely adopted by top banks in US & Europe. Today, major tier-I clients, such as Citibank, Wachovia (Wells Fargo), SunTrust Banks, ABN AMRO, Lloyds TSB, BMO Financial Group, Dresdner Bank, Investec, Development Bank of Singapore, etc rely on Oracle Reveleus solutions. The growing success of Oracle Reveleus has garnered numerous analyst and media endorsements, awards & other recognition. Given its products strengths, strong positioning and ability to convert the current turmoil in the financial markets into a big opportunity, we believe Reveleus will be one of the fastest growing high margin product for OFSS over the coming 2-3 years.

### Focus on High Margin Projects in Services Business

With its strong domain expertise in financial services, OFSS provides complete technology solutions to banks & institutions. In past 3-4 years, OFSS has transformed its services business by reducing biz from low margin projects & focusing on high margin contracts. Hence, while its services business has delivered Revenue CAGR of just 2% during FY07-11, its EBT margins have expanded from 17% to 24%. Given that OFSS has largely transformed its services business into a much improved margin profile with focus on high value addition, consulting & innovative service offerings, we expect its services business to grow steadily going forward.

## OUTLOOK & VALUATION

With its best-in-class solutions in core banking & risk analytics and its offerings in consulting, application & technological services, OFSS is well positioned to serve the global financial institutions & banks. Its diversified geographical spread with significant presence in fast growing emerging markets and higher contribution (about 67%) from its high margin product business provide further stability to its financial growth. OFSS has delivered decent growth during FY07-11 as its Revenues & APAT grew at a CAGR of 10% & 32% respectively. Going forward, we expect its consolidated Revenues to grow by 7.5% & 13.0% in FY12E & FY13E, respectively and its APAT to decline by 5.0% in FY12E (decline in APAT due to higher tax provisioning), while to grow by 12.5% in FY13E. At CMP of Rs. 1980, the stock is trading at 15.6x & 13.8x its FY12E & FY13E earnings respectively. Given its leadership position in IT product's offerings, Global presence of Oracle, and its strong balance sheet with high Net cash of Rs. 33.4 bn (Rs.398 per share), we initiate our coverage on the stock with an "Accumulate" rating and a target price of Rs. 2,288 (based on 16x its FY13E EPS of Rs.143).

## KEY FINANCIALS (Consolidated)

Y/E Mar.	Revenue (Rs mn)	APAT (Rs mn)	AEPS (Rs)	AEPS (% Ch.)	P/E (x)	ROCE (%)	ROE (%)	P/BV (x)
FY11	29,969.3	11,232.0	133.9	45.1	14.8	22.3	23.2	3.1
FY12E	32,216.6	10,670.7	127.1	(5.0)	15.6	19.1	18.1	2.6
FY13E	36,402.3	12,008.3	143.0	12.5	13.8	18.8	17.2	2.2

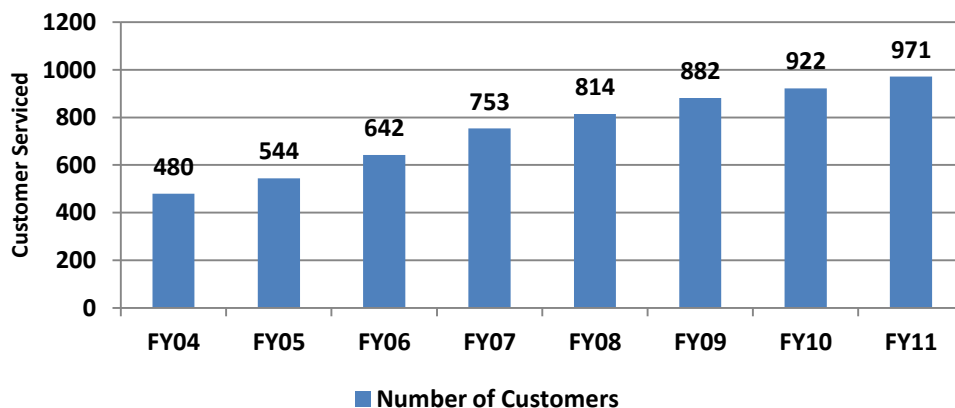
## COMPANY BACKGROUND

OFSS was incorporated in 1989 as Citigroup’s entity named Citicorp Information Technology Industries Ltd (CITIL). In 1995, CITIL gained recognition for establishing world-class processes & quality standards, attained SEI CMM Level 4, and it became the first financial software firm in the world (one out of six companies worldwide) to achieve this distinction at that time. In 1997, CITIL introduced a complete banking product suite for retail, consumer, corporate, investment & internet banking, consumer lending, asset management and investor servicing, including payments (SWIFTNet & SEPA) under the name of FLEXCUBE. In 2000, CITIL was renamed as i-flex Solutions Ltd (i-flex) and in year 2002 it entered into capital market with public issue of 3.96 mn shares. In 2005, it was acquired by Oracle Corp (Oracle), which bought Citigroup’s 41% stake in i-flex followed by an open offer for additional 20% stake from existing shareholders. In 2008, the name of the company was changed to Oracle Financial Services Software Ltd (OFSS). Oracle currently owns 80.4% stake in OFSS through its subsidiary – Oracle Global (Mauritius) Ltd.

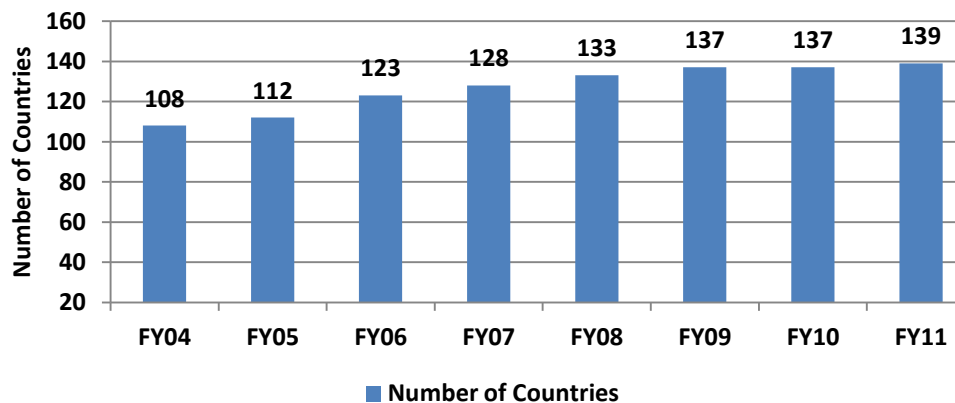
OFSS is a world leader in providing IT solutions to financial services industry. Oracle and Java are registered trademarks of Oracle Corp and its affiliates. FLEXCUBE, Daybreak, Mantas and Reveleus, are trademarks of OFSS and are registered in several countries. OFSS has two major segments - the Products Business (comprising product licensing, customization, implementation & support) and Services Business which offers consulting, application, technology services, & BPO services.

Over the years, OFSS has serviced over 971 banks & financial institutions in 139 countries and continue to add new customers through its portfolio of products and services.

### Customers Serviced



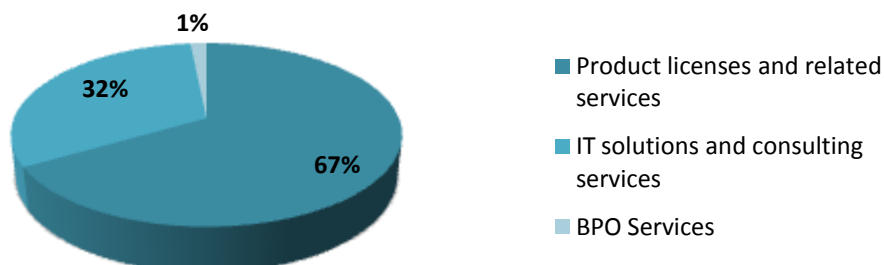
### Country Presence



## BUSINESS METRICS

The high margin product business constitutes 2/3<sup>rd</sup> of OFSS's consolidated Revenues, while its IT services & consulting services and BPO businesses constitutes 1/3<sup>rd</sup> of its Revenues.

### Revenue Contribution %



## Products Business

OFSS's Products Revenues comprise license fees, professional fees for implementation & enhancement services and annual maintenance contract (Post Contract Support – PCS) fees.

**License fee:** As per its standard licensing arrangements for products, OFSS provides the user a perpetual right to use the product for a pre defined number of users and sites upon the payment of a license fee. The license fee is a function of a variety of quantitative and qualitative factors, including the number of copies sold, the number of users supported, the number & combination of the modules sold, and the number of sites & geographical locations supported. The licenses are non exclusive, personal, and non transferable and royalty free.

**Implementation fee:** OFSS's customers can optionally avail services related to the implementation of products at their sites, integration with other systems or enhancements to address their specific requirements. They are charged a service fee on a fixed price basis or a time & material basis.

**Annual Maintenance Contract fee:** Customers usually sign an Annual Maintenance Contract (AMC) with OFSS under which, the Company provides technical support, maintenance, problem resolution and upgrades for the licensed products. These support agreements cover a period of 12 months and generate other revenue streams for the company.

The Revenues generated from Products Business of OFSS depends on factors such as the number of new customers added, milestones achieved, implementation time, etc. Hence, the Revenues typically vary from year to year. The AMCs generate steady Revenues and grow to the extent of new customers entering into the support phase of their lifecycle. During the last five years, the percentage of Products Revenues from these streams has been as follows.

Product Revenues % by Type	FY07	FY08	FY09	FY10	FY11
License Fees	29%	23%	22%	18%	21%
Implementation Fees & enhancement fees	54%	59%	58%	59%	54%
AMC	17%	18%	20%	23%	25%

The contribution from emerging markets (APAC & MEA) to its products Revenues has increased from 39% in FY07 to 45% in FY11, on account of strong demand for its products in these regions.

Product Revenue % by Geography	FY07	FY08	FY09	FY10	FY11
USA	21%	17%	14%	18%	19%
Middle East & Africa	20%	19%	20%	18%	20%
Asia Pacific	19%	19%	18%	22%	25%
Europe	39%	44%	45%	40%	32%
Latin America and Caribbean	1%	1%	3%	3%	5%

OFSS's Core banking & analytical applications solutions have been deployed across Citigroup entities globally and they have been the largest contributor to its products Revenues.

Client contribution to Product Revenue	FY07	FY08	FY09	FY10	FY11
Top Customer	6%	8%	6%	5%	10%
Top 5 Customers	22%	23%	18%	20%	25%
Top 10 Customers	35%	34%	28%	29%	32%
Citigroup and its entities	15%	11%	9%	11%	11%

## OFSS's Core Banking Solutions Offerings

### Oracle FLEXCUBE

FLEXCUBE is a comprehensive, integrated and modular core banking solution that caters to all the needs of a modern financial institution and its multiple business segments. It is a multi-currency system and uses one of the most reliable and leading technology platforms. The proven scalable architecture ensures handling of huge volumes efficiently and the modular structure allows the bank to choose the set of functional modules that it wishes to offer its customers. Developed on client/server distributed architecture, FLEXCUBE uses the Oracle relational database and offers unlimited freedom to the bank to choose any leading UNIX or Windows NT-based hardware. It caters to multiple and diverse delivery channels, ATMs, PDAs, debit cards and banking over the internet. It can meet the requirements of a wide range of financial institutions, retail & commercial banks, investment banks, custodians, depositaries, and trust & asset management companies,

Oracle FLEXCUBE suite includes FLEXCUBE Core banking, FLEXCUBE Universal banking solution (Conventional and Islamic versions), FLEXCUBE Direct banking solution (FLEXCUBE@ internet banking), FLEXCUBE Investor Services, FLEXCUBE Lending Suite (Daybreak), FLEXCUBE Corporate banking, FLEXCUBE Retail banking; FLEXCUBE Private banking etc.

#### Oracle FLEXCUBE Core Banking:

Oracle FLEXCUBE Core Banking helps banks overcome challenges of intense competition, reduced margins, and increased customer expectations by creating a unique competitive advantage built upon improved profitability and an extended customer reach. With Oracle FLEXCUBE Core Banking, banks gain a cost advantage through straight processing & exception handling. In addition, the solution also supports regulatory requirements in key markets through a highly secure data management system, which can easily be integrated with third-party solutions.

#### Oracle FLEXCUBE Universal Banking:

Oracle FLEXCUBE Universal Banking, a SWIFT-certified application, is a comprehensive solution for retail, corporate, and investment banking. The application offers world-class functionality coupled with regional flavors of banking that helps customers stay ahead of competition. Oracle FLEXCUBE Universal Banking has proven success in supporting new business models such as Islamic banking, direct banking, and microfinance.

#### Oracle FLEXCUBE Islamic Banking:

Oracle FLEXCUBE Islamic Banking offers a comprehensive back-office processing environment for a wide range of Islamic financial products. Its extensibility framework enables banks to configure and launch new products swiftly. A single instance of Oracle FLEXCUBE Islamic banking can support both Islamic as well conventional banking products, thereby offering unmatched potential business models for the bank. Customers of Oracle FLEXCUBE Islamic Banking include Islamic banks, Islamic banking subsidiaries of conventional banks and Islamic window operations of conventional banks.

#### Oracle FLEXCUBE Direct Banking:

Oracle FLEXCUBE Direct Banking allows financial institutions to serve customers in a virtual environment, differentiate themselves from competition, and drive additional revenue. It offers a 360-degree view of customer relationships and transactional information across channels. This allows financial institutions to understand customers' needs, improve customer relationship management, and rapidly identify cross-sell and up-sell opportunities.

#### **Oracle FLEXCUBE Private Banking:**

Oracle FLEXCUBE Private Banking helps banks address diverse financial goals of mass affluent customers. It provides a unified portfolio view that enables advisors to customize financial plans. This application also enables banks to simulate, rebalance and capture orders while continuously monitoring and analyzing portfolio performance. Oracle FLEXCUBE Private Banking seamlessly integrates with front and back office systems for managing transactions and with market feeds to fetch securities master and price details, providing an end-to-end wealth management advisory ecosystem.

#### **Oracle FLEXCUBE Enterprise Limits and Collateral Management:**

Oracle FLEXCUBE Enterprise Limits and Collateral Management integrates with bank's existing IT application landscape and offers a single source for managing online, real-time exposure across the enterprise. Its process centric architecture enables banks in centralized collateral management, enterprise-wide limits definition, and effective exposure management as well as resource utilization.

#### **Oracle FLEXCUBE Investor Servicing:**

Oracle FLEXCUBE Investor Servicing is a comprehensive transfer agency and fund distribution system with multi-entity, multi-jurisdiction, multi-currency, multi-lingual, and multi-time zone features to serve global fund managers and fund distributors. Designed to address the complex challenges faced by transfer agents and fund distributors, the process-enabled application helps financial institutions reduce operational costs with complete support for complex fund structures, intermediary hierarchies and multi-level investor account structures. Oracle FLEXCUBE Investor Servicing today manages funds for its customers in more than 25 countries across the world.

#### **Oracle FLEXCUBE Lending and Leasing:**

Oracle FLEXCUBE provides functional coverage across lending leasing and mortgage lifecycle for consumer, commercial, syndicated, Islamic and SME functions. The solution supports the complete business lifecycle across origination, servicing and collections.

**Day Break:** Daybreak is a consumer lending system which automates all aspects of financing from origination, to servicing and collections for installment loans, consumer leases, revolving products and home equity lines of credit. It forms a part of Oracle FLEXCUBE lending suite.

### **OFSS's Financial Services Analytical Applications**

#### **Oracle Reveleus**

Reveleus is a risk & control product and a suite of business intelligence & analytical applications for the financial services industry. Reveleus provides pre-built, cross-functional analytics built from Oracle's in-depth banking domain expertise. It improves quality and consistency of information, thereby helping organizations reduce risk and improve efficiencies in information gathering, analysis and distribution. Reveleus' pre-packaged analytical applications provide deep subject-area analytical expertise across a broad range of departmental needs. These are easily extensible to meet customer-specific requirements.

#### **Oracle Reveleus Internal Capital Adequacy Assessment Process (ICAAP) offering**

Oracle Reveleus ICAAP offering enables institutions to identify, measure, & manage risk across the organization, compute capital required to cover risk and comply with regulatory requirements. It provides a holistic enterprise-wide view of risk that enables both operational and strategic decision making. It also provides an enterprise wide view of risk and simultaneously meets all regulatory Basel II ICAAP requirements. It enables robust capital planning to ensure that banks possess adequate capital to meet their current & future regulatory and economic capital requirements under baseline and stressed scenarios. It provides optimal capital allocation and risk adjusted performance measurement across various lines of business and legal entities.

**Oracle Mantas:** Oracle Mantas is a behavior detection platform. It is a comprehensive solution for detecting risk, enhancing customer relationships and addressing regulatory requirement in the anti money laundering, trading and broker compliance awards.

## Consulting Services Business

OFSS's Services Business offers Consulting Services, Application Services, and Technology Services to financial institutions.

**Consulting Services:** It offers integrated consulting services and provides comprehensive business & technology solutions, which enable financial services enterprises in improving process efficiency, optimizing costs, meeting risk & compliance requirements, defining IT architecture and managing transformation process. It offers consulting services in the areas of business transformation, risk & compliance, program management, IT architecture, IT governance and process improvement.

**Application Services:** In application Services, OFSS provides comprehensive customized IT solutions for banking, securities and insurance. These high quality IT solutions reflect the division's domain expertise in financial services, including the knowledge gleaned from specialized practice lines like payments, business intelligence, CRM, Oracle technology and applications & testing.

**Technology Services:** Within technology services, it offers expertise in conceptualization, design, evaluation, implementation and management of IT infrastructure for financial institutions under two service lines of technology management services and remote infrastructure management.

**Support services:** OFSS also offers support services for FLEXCUBE and analytical applications for financial services. These services help customers accelerate adoption, achieve faster return on their application investments, reduce the time & effort, and cost of operating their applications.

OFSS provides its services through offshore centers located in India, onsite teams operating at its customers' premises and its development centers located in other parts of the world. The offshore services Revenues consists of Revenues from work conducted at its development centers in India and for Indian customers at their locations, while the onsite Revenues consist of work conducted at customer premises outside India & development centers outside India.

### Services Revenues by Geography

Revenue % by Geography	FY07	FY08	FY09	FY10	FY11
USA	62%	56%	54%	57%	55%
Middle East & Africa	8%	5%	6%	4%	4%
Asia Pacific	16%	19%	23%	23%	24%
Europe	14%	20%	17%	16%	16%
Latin America and Caribbean	0%	0%	0%	0%	1%

Client contribution to Services Revenue	FY07	FY08	FY09	FY10	FY11
Top Customer	5%	13%	8%	6%	12%
Top 5 Customers	19%	34%	26%	27%	41%
Top 10 Customers	30%	48%	41%	41%	59%
Citigroup and its entities	44%	36%	36%	37%	46%

The composition of its onsite and offshore Revenues is determined by the project lifecycle. Typically, the work involving the design of new systems or relating to a system rollout is conducted onsite, while the core software development, maintenance and support activities are conducted offshore. During FY11, the company received 48% of its Services Revenues from onsite work and 52% from offshore work.

Services Revenue Breakup	FY07	FY08	FY09	FY10	FY11
On-site	69%	64%	63%	50%	48%
Off-shore	31%	36%	37%	50%	52%

The contracts relating to its services business are either time & material contracts or fixed price contracts. During FY11, the percentage of total services Revenues from time & material contracts was 64%, while 36% of its Services Revenues attributable to fixed price contracts.

Services Business Metrics	FY07	FY08	FY09	FY10	FY11
Fixed Price	12%	14%	23%	34%	36%
Time & Material Basis	88%	86%	77%	66%	64%

## INVESTMENT RATIONALE

### Oracle FLEXCUBE Positioned among World’s Top Core Banking Solutions

#### Global Core System Replacements to Drive Growth of Core Banking Solutions Business

Core systems enable banks & financial institutions to create, process, and manage their products & services. However, most of the core systems currently in place at banks around the globe are built on outdated technologies and support past bank strategies & processes. Presently, banks need more flexible systems to more easily adjust to a changing environment & new regulatory requirements, expand their product portfolios, and integrate with new solutions. Hence, to remain competitive and offer customers flexibility in services, most banks & financial institutions around the world are increasingly focusing on deploying Core Banking Solutions (CBS) for their organizations. This creates many opportunities for IT vendors providing Core banking solutions to financial institution across the globe.

The additional critical factors driving banks to replace their core systems are as follows.

- **More standardized platforms:** As product needs to grow regardless of geography, the global tier-I banks are looking to replace existing systems for greater standardization.
- **Changes in bank focus:** Since the 2008 crisis, the compliance & risk management has become a key driver of core system replacement. The Banks require tighter system integration to more easily address the demands of regulators & auditors, and more sophisticated controls to restrict risky products. Many require a new core system or additional core components.
- **Easier product creation & maintenance:** The big challenge for many banks is creating new products. It can take some institutions between 6-8 months to create a new product, from the point of conceptualization to testing and product launch.
- **Need for more holistic view of data:** As customers demand more consolidated information. This type of customer view is also required for banks to better serve their customers and better predict current and future needs.

As described in Table, some of the key differences between Core banking solutions and legacy systems are becoming more apparent to institutions looking to position themselves in the market.

#### Key Differences between Legacy and Next-Generation Core Systems

LEGACY SYSTEMS	CORE BANKING SOLUTIONS
Batch processing with nightly postings	Real-time processing
Built using old technology, platforms, and programming languages	Advantage of more modern technologies such as SOA, Web services, and more modern flexible technologies & platforms
Products and development operate in silos	Shared components that can be utilized across products
Inflexible user interface	Modern, flexible interface with enhanced search capabilities, greater graphics, and user-specific views and customization
Limited, siloed customer view	Centralized customer information file with 360 degree view of customer.

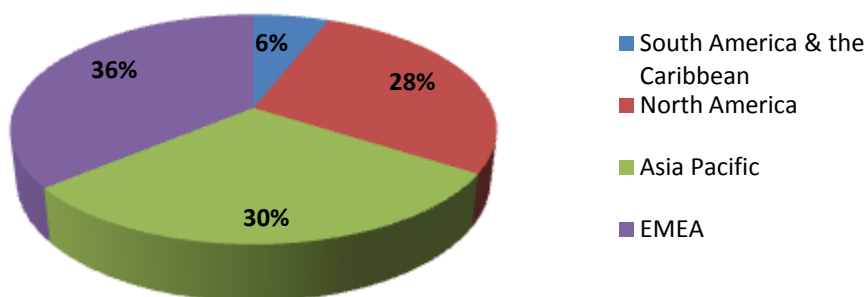
#### Oracle FLEXCUBE- Best-in-Class Core Banking Solution for Global Financial Institutions

Oracle FLEXCUBE CBS solution acquired during the August 2005 acquisition of i-Flex Solutions and has been deployed in 500 financial institutions across 125 countries. FLEXCUBE is complete banking product suite for retail, consumer, corporate, investment & asset management and investor servicing solutions. Despite the challenging environment over the last couple of years, Oracle FLEXCUBE enjoyed 38 deployments during 2011 and 56 during 2010. Many banks with more than USD 500 bn in assets size are currently live with this solution. The largest institution running this solution has approximately USD 2,993 bn assets. It is currently ranked as the best core banking product competing with products like T24 (TEMENOS), TCS BāNCS, FIS, and Finacle etc. In addition to scalability and large number of deployments, another key strength its customers enjoy when going live with its core banking solution is its modern interface and the potential strength of its analytical capabilities. Oracle has recently made several enhancements to its Oracle FLEXCUBE solution, which is currently in its 11<sup>th</sup> version. A key focus area of the product has been the continued investment in the Oracle.

**Majority of growth expected from banks in Europe and Emerging Markets**

The approximate market size for CBS is expected to be USD 24 bn and the penetration of third party solutions is still very low at about 20%. Hence, this market provides significant opportunities for leading CBS vendors like OFSS. Since emerging economies (Middle East & Africa and Asia Pacific) and Europe are not bogged down by the problem of legacy solutions (unlike developed economies), majority of CBS deployment is expected to happen in emerging countries & European regions going forward. Hence, the global technology vendors expect strong growth opportunities coming from EMEA region (the Europe, the Middle East, and Africa) and the Asia-Pacific for their core banking solutions.

**Forecast Breakdown of Core System Replacement Spending in 2011 by Region**

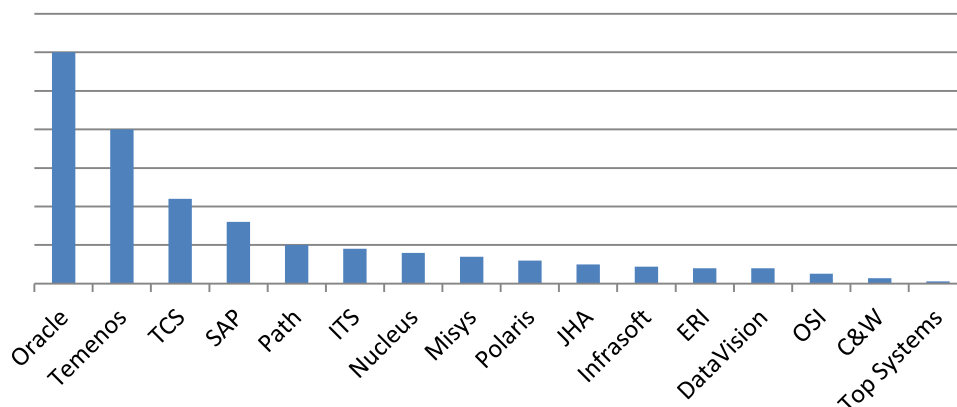


**Forecast core system replacement spending, 2011 Source: Aite Group**

**Oracle Leadership in CBS Space & its Positioning in Emerging Markets to Drive FLEXCUBE Growth**

OFSS is a leader in the global core banking space, as evidenced by its consistently high number of core replacements. Its strong global brand, proven scalability of its core offering, and its broad product suite has enabled OFSS to continue to grow its market share across all the regions. Citibank is the largest customer for FLEXCUBE, which has been deployed across Citi entities globally and continues to be a strong growth driver for OFSS. Moreover, the strong penetration across 145 countries of Oracle with its 380,000 customer's base including all 100 of Fortune 100 companies, which is yet to be leveraged by OFSS, and remains a key future growth driver. Additionally, with its market leadership positioning, strong EU penetration and significant presence in the high growth emerging markets, we believe OFSS FLEXCUBE is poised to grow rapidly in the coming years.

**Ranking of Top IT Vendors based on Core Banking Deployments:**



Source: Celent Big Leagues Table 2010



## Oracle Reveleus - Leading Product for Business Intelligence, Enterprise Risk & Analytics

### Industry dynamics driving the Growth of Business Intelligence, Risk & Analytics Products

The current turbulence in the global financial market has led to a serious credit & capital crisis. Since 2008, the boards at financial institutions have come to pay greater attention to the process they use to review the performance of their institutions. Consequently, there has been wider adoption of risk adjusted performance measurement. The increasing Government mandates are calling for tighter risk management & regulatory compliance. Laws & regulations such as the U.S. Bank Secrecy Act/Anti-Money Laundering, Basel II & III, Sarbanes-Oxley, Dodd-Franc Act, the U.S. Patriot Act, etc are setting extensive corporate governance standards & creating new reporting requirements. Banks & Financial institutions need an integrated approach that combines a diverse set of compliance & risk solutions to help them address not only present regulatory needs, but also the emerging and future risk & regulatory requirements. Currently, the financial institutions look for a software provider with in depth domain expertise that offers comprehensive solutions and has the capability to meet their needs across numerous compliance and risk requirements.

### Developed Strong Analytical Applications for Financial Services Industries

Over the years, OFSS has invested in building and delivering critical components that are part of the Oracle Financial Services Analytical Applications suite, and is now one of the leading players in this space with the ability to deliver applications to financial institutions for compliance, enterprise risk, liquidity, capital management, performance management and customer analytics. Oracle Financial Analytical Applications enable financial institutions to measure and meet risk-adjusted performance objectives, cultivate a risk management culture through transparency, lower the costs of compliance & regulation, and improve insight into customer behavior.

Banking Solutions Offerings through Oracle Analytical Applications:

Banking Solutions Offerings	Oracle Analytical Applications
Risk identification & materiality assessment	Oracle Financial Services ICAAP Assessments
Risk Quantification and integrated stress testing	Oracle Financial Services Market Risk Oracle Financial Services Retail Credit Risk Oracle Financial Services Corporate Credit Risk Oracle Financial Services Asset Liability Management Oracle Financial Services Liquidity Risk Management Oracle Financial Services Operational Risk Oracle Financial Services Advanced Analytical Applications Infrastructure
Regulatory and economic capital calculations Performance measurement and capital planning Regulatory compliance and reporting	Oracle Financial Services Basel II Oracle Financial Services ICAAP Oracle Financial Services Economic Capital Advanced Oracle Financial Services Operational Risk Economic Capital Oracle Financial Services Basel II Analytics
Risk analytics and dashboards	Oracle Financial Services ICAAP Analytics Oracle Financial Services Market Risk Analytics Oracle Financial Services Asset Liability Management Analytics Oracle Financial Services Basel II Analytics

### Oracle Mantas – Leading Solution for Fraud Detection & Anti Money laundering

Financial fraud continues to be a significant expense for many financial institutions. Fraud in financial institutions exposes them to both monetary loss and reputation risk. One of the greatest challenges faced in managing fraud is handling huge volumes of fragmented data from disparate sources. Hence, a comprehensive solution must include the ability to scour vast amounts of data, provide an integrated view across data streams and must possess the tools to analyze, investigate, & enrich data, thereby transforming it into meaningful, valuable, and actionable intelligence on preventing and detecting potential fraud. The regulators in Africa, Asia and South America have made changes in their regulations with regard to fraud and financial crime. The increasing sophistication of fraudulent activity continues to force financial institutions to be continuously on their guard.

OFSS has evolved Oracle Mantas, which was acquired in 2006, to automate the surveillance of the trading activity of energy & commodities market participants and for compliance for trading desks & brokers in the leading economies. Oracle Mantas solutions are deployed in over 70 countries. Its Behavior Detection platform integrates detection, prevention, investigation, and resolution of suspicious financial activity across multiple channels, jurisdictions, lines of businesses, and customer lifecycle stages, while Oracle Mantas Anti-Money Laundering (AML), Fraud, Know Your Customer (KYC), Broker Compliance, and Trading Compliance are part of a comprehensive suite of applications designed to deliver value to financial firms at a low total cost of ownership (TCO). For the fourth consecutive year, Oracle Mantas has emerged the winner in the best anti-money laundering solution provider (AML) category Waters' readers.

#### **Oracle Mantas Financial Crimes Management Activities**

- Integrated key dimensions including detection, prevention, investigation and resolution across multiple channels, jurisdictions, lines of business, and customer life-cycle stages
- Pre-configured, industry-recognized library of advanced anti-money laundering scenarios
- Multiple detection methodologies like Link Analysis, Text Mining, Profiling, to analyze behavior patterns and detect anomalies
- Advanced Risk Derivation and Risk Scoring models to identify potential perpetrators across customer life cycle stages

#### **Oracle Reveleus – Best positioned to leverage the strong demand environment**

Oracle Reveleus is a suite of Oracle Analytical Applications and empowers financial institutions with analytical tools, which have in-depth modeling and statistical capabilities within a broad, extensible risk and compliance architecture. It is ranked amongst leading solutions for enterprise risk & analytics and widely adopted by top banks in US & Europe. Today, major tier-I clients, such as Citibank, Wachovia, Wells Fargo, SunTrust Banks, ABN AMRO, Lloyds TSB, BMO Financial Group, Dresdner Bank, Investec, Development Bank of Singapore, etc rely on Oracle Reveleus solutions. The growing success of Oracle Reveleus has garnered numerous analyst and media endorsements, awards & recognitions, which include award winning solutions for Enterprise risk management, Governance, Risk, and Compliance (GRC), Enterprise Performance Management (EPM), and Customer Insight for financial services.

Leveraging Oracle's relationships with large banks that use enterprise financial applications and business intelligence applications, OFSS is engaged in encouraging these banks to use Oracle Financial Services Analytical Applications to support business decisions and drive efficiency through a consistent set of data & metrics. Given its products strengths, strong positioning and ability to convert the current turmoil in the financial markets into a big opportunity, we believe Oracle Reveleus will be one of the fastest growing high margin product over the coming 2-3 years.

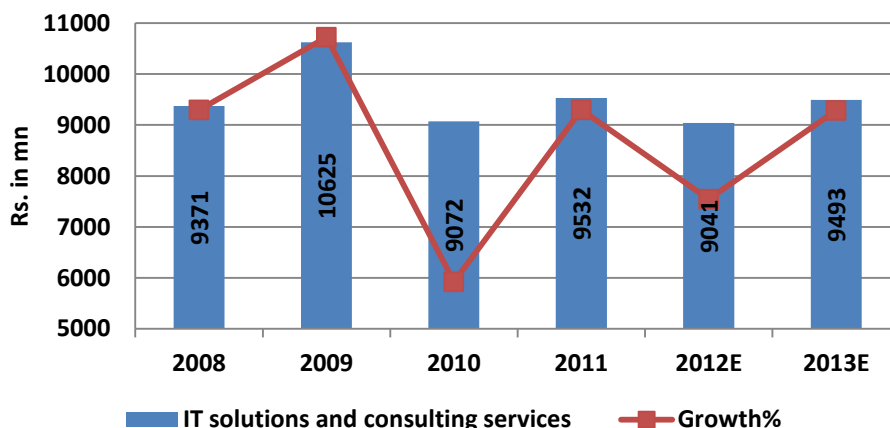
#### **Focus on High Margin Projects in Services Business**

OFSS's Consulting Services play a key & strategic role to its customer engagements. Leading banks across the world prefer to sign deals that include services along with the application licenses. The support services for its applications also continue to grow and banks see this service as vital for operations at their banks. Hence, with its strong domain expertise in financial services, OFSS provides complete technology solutions to banks & institutions.

In past 3-4 years, OFSS has transformed its services business by reducing low margin projects and focusing more on high margin contracts. Consequently, its services business employees has reduced significantly from 5,024 in FY08 to 2,830 in Q2FY12, which led to significant improvement in its services business EBIT Margins. Hence, while its services business has delivered Revenue CAGR of just 2% during FY07-11, its EBT margins have expanded from 17% to 24%.

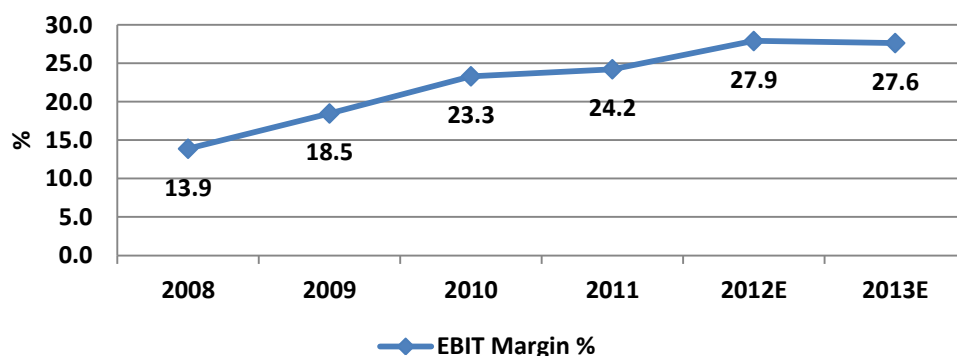
**Revenues Growth in Services Business:** Its Services Revenues have remained stagnant mainly due to transformation initiative taken by the management to improve margins.

### Services Revenue Growth Trend



Its Services EBT margins have expanded from 13.9% in FY08 to 24.2% in FY11. OFSS expects its margins to stabilize at 27-28% as much of its transformation in services business has completed.

### Services EBIT Margin %



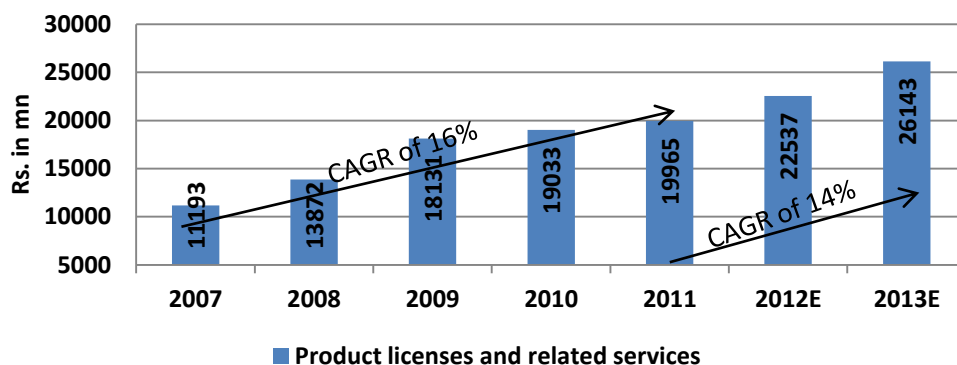
Given that OFSS has largely transformed its services business into a much improved margin profile with focus on high value addition, consulting & application services offerings, we expect its services business to grow steadily going forward.

### Strong Financials & Healthy Balance Sheet with High Net Cash

OFSS has delivered decent financials during last four years (FY07-11) as its Revenues & APAT has shown a CAGR of 10% & 31% respectively. The revenue growth has been driven by its high margins products business, which accounts for 2/3<sup>rd</sup> of total Revenues.

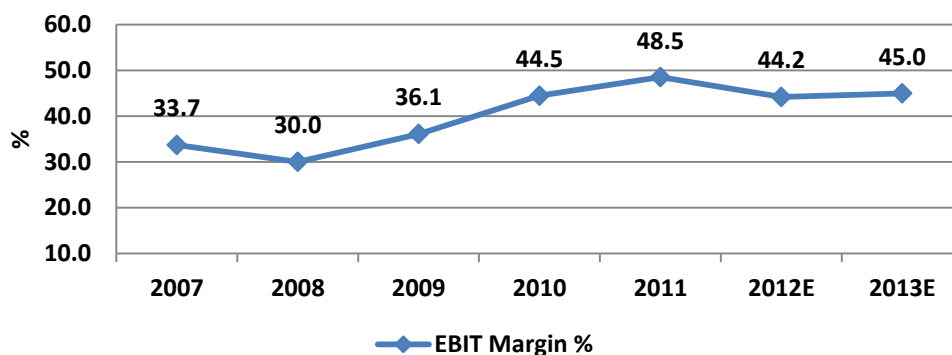
**Consistent Growth in Products Business:** OFSS has been delivering consistent growth in its products business. During FY07-11, its products business has growth at a CAGR of 16%. Although the growth was slower during last two years due to lower contribution from licensing fee Revenues, it is expected to pick up & we expect OFSS to deliver 14% CAGR in its products business during FY11-13.

### Products Revenue Growth Trend

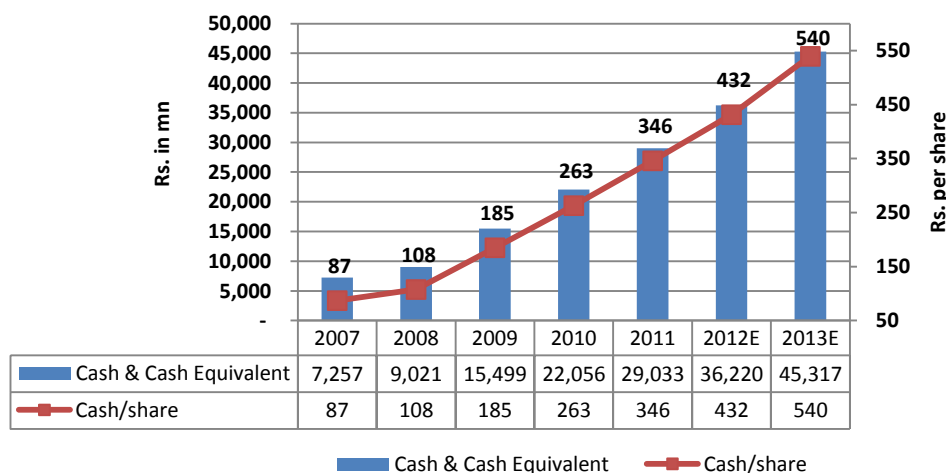


**Healthy EBIT Margins Product Business:** The EBIT margins of products business have also improved significantly from 33.7% in FY07 to 48.5% in FY11. Going forward, we expect its products business EBIT margins to remain strong at 44-45% level.

### Product's EBIT Margin %



Over the years, the Company has been able to increase its cash position and as on Sept'11, it had cash & cash equivalents of Rs. 33.4 bn (Rs.398 per share) in its balance sheet, which is expected to increase to Rs. 45.3 bn (Rs.540 per share) by FY13. Given its strong cash position, OFSS will continue to explore prospective acquisition opportunities.



## Q2FY12 PERFORMANCE ANALYSIS

- During Q2FY12, its Revenues grew by 1.7% YoY to Rs. 7,561.7 mn. Its Revenues from Software Products business grew by 4.3% YoY to Rs. 5,244.7 mn, while the Revenues from its Services business declined 7.6% YoY to Rs. 2,117.9 mn. Its EBITDA margins stood at 32.8%, while EBITDA decreased by 11.7% YoY to Rs. 2,483.5 mn, while its RPAT decreased by 20.8% YoY to Rs. 2,086.7 mn. However, its APAT (Adjusted for provision of Rs. 865.6 mn against a legal claim from a customer) grew by 7.1% YoY.
- The Company has added 7 new customers for its Product business & 5 customers for its Services business during the quarter. Sixteen customers completed deployment in Q2FY12 for core banking operations, while more than 10 existing customers purchased additional products.
- In terms of contribution, the top client contributed about 12% to the revenues, while Top 5 & Top 10 clients contributed about 29% and 38%, respectively.
- The Company signed new licenses of \$9 million in the quarter. Wins for product deployment span China, Gambia, Guyana, Jordan, Luxembourg, Malawi, Mauritius, Qatar, South Africa, UAE, US and Zambia.
- In Q2FY12, the Revenues contribution from USA, Europe & Latin America stood at 36%, 19% & 1.0% respectively, while Revenue contribution from Asia pacific and MEA region stood at 28% & 15% respectively.
- During the quarter, OFSS added 748 people including 476 fresh Recruits. Net of Attrition 168 employees were added to take its total employee strength to 9,509. At the end of Q2FY12, number of employees of its Products business & Services business stood at 5,271 & 2,830 respectively.
- Oracle has enhanced its Oracle FLEXCUBE offerings, releasing new versions of Oracle FLEXCUBE Universal Banking and Oracle FLEXCUBE Investor Servicing for financial institutions. Oracle FLEXCUBE Universal Banking 11.3 is a core banking solution that addresses needs across retail, corporate and investment banking. The upgrade provides a new, complete extensibility framework that enables users to internally tailor the product to adapt to dynamic market and customer requirements, thus reducing the need for engineering-led enhancements.
- Oracle updated its leading Basel II application that provides open, quick, out-of-the-box compliance with Basel II guidelines in multiple jurisdictions, while enabling strategic decision making and capital planning with the extensibility to meet future regulatory requirements. With this new release, Oracle Financial Services Basel-II now supports the capital adequacy compliance requirements for Islamic banking products based on SHARIAH law.
- In Q2FY12, OFSS ended with Rs. 33.4 bn of cash or cash equivalent.

## OUTLOOK & VALUATION

With its best-in-class solutions in core banking & risk analytics and its offerings in consulting, application & technological services, OFSS is well positioned to serve the global financial institutions & banks. Its diversified geographical spread with significant presence in fast growing emerging markets and higher contribution (about 67%) from its high margin product business provide further stability to its financial growth. OFSS has delivered decent growth during FY07-11 as its Revenues & APAT grew at a CAGR of 10% & 32% respectively. Going forward, we expect its consolidated Revenues to grow by 7.5% & 13.0% in FY12E & FY13E, respectively and its APAT to decline by 5.0% in FY12E (decline in APAT due to higher tax provisioning), while to grow by 12.5% in FY13E. At CMP of Rs. 1980, the stock is trading at 15.6x & 13.8x its FY12E & FY13E earnings respectively. Given its leadership position in IT product's offerings, Global presence of Oracle, and its strong balance sheet with high Net cash of Rs. 33.4 bn (Rs.398 per share), we initiate our coverage on the stock with an "Accumulate" rating and a target price of Rs. 2,288 (based on 16x its FY13E EPS of Rs.143).

<b>PROFIT &amp; LOSS (Consolidated)</b>				
	(Rs.mn)			
Y/E Mar.	FY10	FY11	FY12E	FY13E
<b>Net Sales</b>	<b>28,740</b>	<b>29,969</b>	<b>32,217</b>	<b>36,402</b>
Soft dev. cost	13,602	13,344	14,812	16,589
Selling expenses	2,398	2,743	2,939	3,189
G&A expenses	2,459	2,663	2,786	3,036
<b>EBITDA</b>	<b>10,281</b>	<b>11,220</b>	<b>11,680</b>	<b>13,588</b>
Depreciation	489	408	414	435
<b>EBIT</b>	<b>9,792</b>	<b>10,812</b>	<b>11,266</b>	<b>13,153</b>
Interest Income	700	1,395	2,571	3,292
Other Income	13	46	48	50
Exchange Gain/loss	(1,569)	227	199	300
<b>PBT</b>	<b>8,936</b>	<b>12,480</b>	<b>14,084</b>	<b>16,795</b>
Tax	1,198	1,370	4,279	4,787
<b>RPAT</b>	<b>7,737</b>	<b>11,110</b>	<b>9,805</b>	<b>12,008</b>
Extraordinary adj.	0	122	866	0
<b>APAT</b>	<b>7,737</b>	<b>11,232</b>	<b>10,671</b>	<b>12,008</b>

<b>BALANCE SHEET (Consolidated)</b>				
	(Rs.mn)			
As on 31 <sup>st</sup> Mar.	FY10	FY11	FY12E	FY13E
Share Capital	419	419	420	420
Share application	8	1	1	1
Reserves & Surplus	42,477	53,637	63,442	75,451
<b>Net Worth</b>	<b>42,904</b>	<b>54,057</b>	<b>63,863</b>	<b>75,871</b>
Deferred tax liability	(367)	(664)	(730)	(803)
<b>Capital Employed</b>	<b>42,537</b>	<b>53,394</b>	<b>63,133</b>	<b>75,068</b>
<b>Net Block</b>	<b>8,363</b>	<b>9,346</b>	<b>10,035</b>	<b>10,509</b>
Cap. WIP	1,304	640	350	250
Investments	10	10	10	10
Sundry Debtors	6,782	8,206	9,190	10,293
Cash & Bank Bal	22,046	29,023	36,211	45,308
Loans & Advances	7,725	9,338	10,738	12,349
Other Current Assets	2,328	3,976	4,572	5,121
Current Assets	38,881	50,543	60,712	73,071
Curr Liab & Prov.	6,021	7,144	7,974	8,771
<b>Net Current Assets</b>	<b>32,860</b>	<b>43,398</b>	<b>52,738</b>	<b>64,300</b>
<b>Total Assets</b>	<b>42,537</b>	<b>53,394</b>	<b>63,133</b>	<b>75,068</b>

<b>FINANCIAL RATIOS STATEMENT (Consolidated)</b>				
Y/E Mar.	FY10	FY11	FY12E	FY13E
<b>Growth (%)</b>				
Net Sales	(1.8)	4.3	7.5	13.0
APAT	5.0	45.2	(5.0)	12.5
EBITDA	32.6	9.1	4.1	16.3
<b>Profitability (%)</b>				
EBITDA Margin	35.8	37.4	36.3	37.3
Adj. PAT Margin	26.9	37.5	33.1	33.0
ROCE	25.1	22.3	19.1	18.8
ROE	19.8	23.2	18.1	17.2
<b>Per Share Data (Rs)</b>				
Adj. EPS	92.3	133.9	127.1	143.0
Adj. CEPS	97.4	133.7	117.2	148.2
BVPS	511.6	644.3	760.9	903.5
<b>Valuations (X)</b>				
PER	21.5	14.8	15.6	13.8
PEG	4.4	0.3	(3.1)	1.1
P/BV	3.9	3.1	2.6	2.2
EV / EBITDA	14.0	12.2	11.1	8.9
EV / Net sales	5.0	4.6	4.0	3.3
Dividend Yield (%)	0.0	0.0	0.0	0.0
<b>Turnover Days</b>				
Debtors days	96.4	91.3	98.5	97.7
Creditors days	157.4	144.5	158.5	154.2
<b>Gearing Ratio</b>				
Total Debt to Eq.	0.0	0.0	0.0	0.0

<b>CASH FLOW STATEMENT (Consolidated)</b>				
	(Rs.mn)			
Y/E Mar.	FY10	FY11	FY12E	FY13E
PAT	7,740	11,110	9,805	12,008
Depreciation & Amortization	276	(153)	311	326
Chg in Deferred tax	(62)	(297)	(66)	(73)
Chg in Working cap	(1,256)	(3,561)	(2,152)	(2,465)
<b>Cash flow from operations</b>	<b>6,699</b>	<b>7,099</b>	<b>7,897</b>	<b>9,797</b>
Chg in Gross PPE	53	(829)	(1,000)	(800)
Chg in WIP	(291)	664	290	100
Chg in Investments	(0)	0	0	0
Chg in others	0	0	0	0
<b>Cash flow from investing</b>	<b>(239)</b>	<b>(165)</b>	<b>(710)</b>	<b>(700)</b>
Chg in debt	0	0	0	0
Chg in Share Capital	(13)	(7)	0	(0)
Chg in reserves	108	51	(0)	0
Dividend	0	0	0	0
<b>Cash flow from financing</b>	<b>96</b>	<b>44</b>	<b>0</b>	<b>0</b>
<b>Chg in cash</b>	<b>6,556</b>	<b>6,978</b>	<b>7,187</b>	<b>9,097</b>
Cash at start	15,490	22,046	29,023	36,211
<b>Cash at end</b>	<b>22,046</b>	<b>29,023</b>	<b>36,211</b>	<b>45,308</b>

Source: Company, Sushil Finance Research Estimates

## Rating Scale

This is a guide to the rating system used by our Institutional Research Team. Our rating system comprises of six rating categories, with a corresponding risk rating.

### Risk Rating

Risk Description	Predictability of Earnings / Dividends; Price Volatility
<b>Low Risk</b>	<b>High predictability / Low volatility</b>
<b>Medium Risk</b>	<b>Moderate predictability / volatility</b>
<b>High Risk</b>	<b>Low predictability / High volatility</b>

### Total Expected Return Matrix

Rating	Low Risk	Medium Risk	High Risk
<b>Buy</b>	<b>Over 15 %</b>	<b>Over 20%</b>	<b>Over 25%</b>
<b>Accumulate</b>	<b>10 % to 15 %</b>	<b>15% to 20%</b>	<b>20% to 25%</b>
<b>Hold</b>	<b>0% to 10 %</b>	<b>0% to 15%</b>	<b>0% to 20%</b>
Sell	Negative Returns	Negative Returns	Negative Returns
Neutral	Not Applicable	Not Applicable	Not Applicable
Not Rated	Not Applicable	Not Applicable	Not Applicable

#### Please Note

- Recommendations with "Neutral" Rating imply reversal of our earlier opinion (i.e. Book Profits / Losses).
- \*\* Indicates that the stock is illiquid With a view to combat the higher acquisition cost for illiquid stocks, we have enhanced our return criteria for such stocks by five percentage points.
- **Stock Review Reports:** These are Soft coverage's on companies where Management access is difficult or Market capitalization is below Rs. 2000 mn. Views and recommendation on such companies may not necessarily be based on management meeting but may be based on the publicly available information and/or attending Company AGMs. Hence Stock Reviews may be just one-time coverage's with an occasional Update, wherever possible.

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