Innovation • Insight • Integrity

Annual Report 2010-11

Empowering Business Transformation

3i Infotech®

Innovation • Insight • Integrity

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Company Details

Board of Directors

Mr. Hoshang N. Sinor, Chairman

Dr. Ashok Jhunjhunwala, Director

Dr. Bruce Kogut, Director

Mr. Dileep C. Choksi, Director

Mr. Samir Kumar Mitter, Director

Ms. Vishakha Mulye, Director

Mr. V. Srinivasan, Managing Director & Global CEO

Mr. Amar Chintopanth, Deputy Managing Director & Chief Financial Officer

Principal Bankers

Axis Bank Ltd.

ICICI Bank Ltd.

IDBI Bank Ltd.

Standard Chartered Bank

Auditors

Lodha & Company

R.G.N. Price & Co.

Legal Advisors

Amarchand & Mangaldas & Suresh A. Shroff & Co.

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Executive Management

V. Srinivasan, Managing Director & Global CEO

Amar Chintopanth, Deputy Managing Director & Chief Financial Officer

Chandrashekar M.S., President & Global Head – Software Products

Kathleen Hamburger, President – North America & Global Head – BPO

Padmanabhan Iyer, President & CEO – Elegon Infotech Limited (Subsidiary of 3i Infotech)

Pankaj Chawla, President – India, Middle East, APAC & Africa

Som Sarma, President - Western Europe & Global Head - IT Services

Sripat Pandey, Global Head – Mergers & Acquisitions

Shivanand R. Shettigar, Company Secretary and Head - Legal & Compliance

Corporate Office

3i Infotech Limited

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Next to Marol Telephone Exchange,
Andheri (E), Mumbai - 400 093, India
Tel: +91 22 39145700
Fax: +91 22 39145520

Registered Office

3i Infotech Limited

Tower # 5, 3rd to 6th Floors,
International Infotech Park,
Vashi, Navi Mumbai - 400 703,
India
Tel: +91 22 67928000
Fax: +91 22 67928095


Kites rise highest against the wind,
not with it.
- Winston Churchill

Chairman's Message

Dear Members,

The global economic environment has shown relatively a stable situation after the turbulence seen during the previous two years. While the United States is showing signs of recovery, some of the European countries continue to face severe fiscal constraints. Talking specifically about IT Industry, we find the overall business environment slowly changing towards more optimism, though it is still far from the growth years it had witnessed prior to the meltdown. The developed markets continue to be sluggish and all research reports indicate that this situation is not going to improve in the near future. The emerging markets on the other hand continue to be on the growth path, although the volume of IT spend in these markets is quite low. Since the IT Industry depends largely on the developed markets for volumes, we have challenges on hand to sustain the growth in the near future.

There are three factors which have affected the company during last two years. One, our well-intentioned initiative in the area of e-governance in India by setting up Citizens Service Centers (CSCs) turned out to be not as successful as expected. This resulted in an adverse impact on our resources, which will take some time to recoup. Two, our various acquisitions in BFSI space, while giving large revenues and adequate EBIDTA margins, resulted in strain on our cash-flows and increased interest burden. Three, the meltdown in global financial markets resulted in our FCCBs not being converted into equity, thereby adding to our debt burden. The company has taken these issues in its stride and has boldly faced the challenges posed by these factors, without significantly affecting the revenue stream.

The focus of the Company now is on its core strengths of products and services. Exiting from non-remunerative businesses such as CSCs, etc. will help the company in consolidating its position. It will help the company greatly in terms of reduced cost and better cash-flow management. You have firmly stood by the management all these years and, I am sure, you will continue to support the management in its endeavor to work towards building a better share-holder value.

Warm Regards,

Hoshang N. Sinor

Managing Director & Global CEO's Message

Dear Members,

In this annual update to you, while thanking you all for the unstinted support given to the Company, I would like to take the opportunity to share with you the highlights of the operations for the year ended March 31, 2011. I would also like to cover the challenges faced by the Company, the steps taken by the Company to meet these challenges and the outlook, moving ahead.

Highlights of the Year

The financial year ended March 2011, saw our consolidated revenues at ₹ 2,587.48 crores as compared to revenues of ₹ 2,468.75 crores for the previous year. While at the outset this looks like a growth of 4.8%, when we look at the segments of businesses, the IT Solutions business grew by 13.8% to ₹ 1,767.54 crores, while the Transaction Services business showed a decline of 10.4% to ₹ 819.94 crores. In dollar terms growth in IT Solutions business was 19.1% and the decline in Transaction Services business was 6.3%.

Therefore, while our IT Solutions business engine has continued to work well, the Transaction Services business, unfortunately, had to suffer a setback, mainly due to the decline in the retail cheque and bill processing business in USA. This decline is a result of the market volumes dropping in the retail segment in USA. While the volumes have dropped, it is significant to note that we have not lost customers in this business and continue to service a good number of Fortune 500 Companies in that region.

On the margins side, our operating margins have been fairly stable at 20.2% for FY 2011, as compared to 20.4% for FY 2010. Our operations therefore continue to give us stable margins despite the challenging times through a prudent cost rationalization process in the Transaction Services business and a growth in the higher margin IT Solutions business.

Our net margins before exceptional items are at 9.8% for FY 2011 as compared to 10.8% for FY 2010. The decline is due to the increase in interest cost and depreciation.

In order to ensure that we continue to take care of your interests for the support provided to us, the Board of Directors have recommended a 15% dividend for the year.

Having shared with you the highlights for the year, let me proceed to take you through the challenges faced by the Company and the steps we have taken to overcome this and move the growth engine forward again.

A Glimpse into the Past

As you are all aware we entered the IT arena in the year 2000 - 01, when the first meltdown had started, as both the Y2K boom and the dot com boom had by then moved to the trough side of the business cycle.

If at that time we had endeavored to remain a pure IT Services Company, we would not have found a place in the market, as enough entry barriers had got built by the companies then in existence. These companies had over the years of existence built competencies, scale and relationships which had created entry barriers to new entrants in the pure vanilla IT Services space.

We therefore had to think differently to penetrate and grow. Accordingly, our first strategy was to have a global footprint and not just a developed markets focus and so we went ahead establishing a significant presence in the emerging markets. This required us to look at IT Solutions and hence we adopted a product strategy to cater to emerging markets.

We did this by a combination of acquisitions and organic growth and by FY 2008 we were a Company which had become a leading IT products company with a mix of 1:1 between products and services, a significant presence in the growing emerging markets and a global branding for our software products.

At this point in time we anticipated a surge in the IT enabled retail business in India and after due consideration of the market potential and the intention of the Government to IT enable all citizen services, we made a significant investment commitment to this business. In addition, as a natural extension of our domain based IT Solutions business, we entered into the Transaction Services business through a combination of organic and inorganic growth.

All these investments for growth were funded through a combination of internal accrual, equity issuances, mezzanine finance (Foreign Currency Convertible Bonds) and pure debt. This combination of funding was adopted as a measure of balanced funding of the required investments, ensuring that the return to equity shareholders was most efficient.

This therefore was the strategy adopted by the Company which led us to a size with an annual revenue run rate of over half a billion dollars by mid 2008, with operating margins of around 20% and net margins of around 10%. Further at that time the company was geared in all respects for an organic growth of around 30% to 35% with commitments made for acquisition earn-outs, space addition, significant bench strength, investment in new markets, etc.

Global Financial Meltdown and its Implications

Starting from end 2008 we had to face a global financial meltdown which was one of the worst. During the meltdown the most affected sector was Banking and Financial Services and as all of you know the large part of revenues of the company comes from that sector. With this meltdown business dried down, liquidity vanished, discretionary spend (a very important pre-requisite for the IT Products business) stopped and from a scenario of growth and optimism one had to suddenly face an environment of gloom, and that too with huge commitments made for growth. The organization therefore had to shift all its strategies from a growth environment to suddenly conserving and containing. This put a significant strain on the business and cash flows.

Some of the factors which went adversely for the Company were as follows:

- Due to the market melt down and the share prices for the company taking a major beating, the mezzanine finance taken by the company suddenly became pure debt;

- The Citizen Service Center business in India just did not pick up for various reasons, including non availability of data in the required form, owing to which the Company had to cut losses and stop investments and quickly exit this business, taking a write-off of around ₹ 260 crores on this business;

- All the earn out commitments on acquisitions became due for payment and had to be met;

- With these financial commitments the interest cost started eating into the operating margins generated by the businesses;

Contd...

- The Transaction Services business, where huge investments were made anticipating a growth of 6 to 8%, saw significant decline in volumes in the US.

Thus, it was time for us to take concrete steps to get back to stability in business.

Challenging Times required Innovative Solutions

Having faced the above situation, we have gone about taking some specific steps to ensure that we remain stable and create a platform for growth. The steps taken are listed below:

- We exited the retail business to ensure there was no future investment or cash burn in that business;

- We undertook significant cost rationalization steps in the areas of Software Product development and Transaction Services, including also moving many of our products to more contemporary technologies;

- Our IT Services business has taken the route of domain based IT Services, rather than a pure technology based IT Services and that has given us a better competing power in the market;

- We have spent a lot of time and focus in our debt management, some of which are as follows:

  - Buy back of Foreign Currency Convertible bonds of around USD 50 million at a discount;

  - Refinancing of shorter term loans with longer term loans to ensure stability;

  - Availing foreign currency loans, commercial paper, etc. to the extent possible to lower the interest cost.

Moving Ahead

While on the one hand we have taken the above steps, on the other we have been concentrating on growing our business, maintaining employee morale, improving product and service delivery, and investing in sales and marketing.

As you might have seen while the large Indian players in the IT industry have been able to grow well in the last 2 years, the global players and the mid cap Indian players have not been able to grow significantly. The constraints faced by the Indian mid cap players are (a) Dependence on pure technology based IT Services in the developed markets, (b) Lack of brand, (c) Lack of bench strength, etc. Added to these the employee visa related issues in the developed countries have also started affecting the ability of the companies in mobilizing required people.

As indicated earlier your company's key differentiators are (i) Software Product focus in the emerging markets and (ii) Domain led IT Services focus in both developed and emerging markets. While the management is confident that this differentiation is likely to bring accelerated growth to our business still we may be affected by some of the other factors affecting the mid cap IT companies.

Further the salaries in India are continuously rising at a much faster rate than the salary increase or inflation in most of the other countries. This may result in our inability to pass on the wage increase to the customers and may result in lower operating margins in future.

Employees our Strength

The very nature of the knowledge intensive IT industry underlines the importance of the knowledge worker and establishes that the employee is the focal point. At 3i Infotech, we work on a strong belief that employees are our most valued assets, and that too assets whose value keeps appreciating year after year.

Identifying, nurturing and developing talent is of paramount importance to us. Employee development, engagement and communication