

Intrinsyc Software International Inc.

ICS : TSX : C\$0.69

SPECULATIVE BUY

Target: C\$1.40 ↓

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COMPANY STATISTICS:

52-week Range: C\$0.39-1.30
 Avg. Daily Vol. (000s): 452.4
 Market Cap (M): 104.1
 Shares Out (M) basic: 150.9
 Shares Out (M) diluted: 150.9

EARNINGS SUMMARY:

FYE Aug	2005A	2006A	2007A	2008E	2009E
Revenue (M):	US\$17.5	US\$18.7	US\$19.7	US\$25.6	US\$63.2
EV/Sales (x):	4.0	3.8	3.6	2.8	1.1
EPS:	US\$(0.11)	US\$(0.24)	US\$(0.18)	US\$(0.11)	US\$0.05
P/E (x):	NM	NM	NM	NM	14.7

SHARE PRICE PERFORMANCE:



COMPANY SUMMARY:

Intrinsyc Software is a mobility software and services company, based in Vancouver, BC. The company's technologies and services enable companies to identify and create solutions to make mobile devices connect and work. Intrinsyc creates and licenses mobile and embedded software products to OEMs, as well as a suite of server-based interoperability solutions. Additionally, the company provides engineering services to support these products.

All amounts in C\$ unless otherwise noted.

Technology – Software –Software and Services

TRIMMING TARGET ON NEAR-TERM CONTRACT ISSUES; LONG-TERM THESIS INTACT

Event

Intrinsyc reported strong top-line results in Q1, handily beating our and consensus expectations. Sales came in at US\$5.6 million vs. our US\$5.1 million and consensus of US\$4.7 million related to a particularly strong services quarter based on a newly signed Symbian contract. Additionally, Soleus contributed almost US\$0.5 million this quarter vs. less than US\$0.2 million last quarter, which is higher than we had anticipated. The GAAP loss per share was US\$0.03, in line.

Impact

Mixed to slightly negative. The revenue overachievement was somewhat soured by the disclosure that one of the company's design wins was cancelled and the MOU with a Japanese OEM had not yet transitioned into a full software engagement.

Action

In summary, we are a bit disappointed by the contract cancellations/ delays, which lead us to trim our 2009 revenue forecast to US\$63 million from US\$67 million. Nevertheless, we continue to see significant opportunity in front of the company. Management's guidance for one Soleus design win per quarter is intact, and we still expect to expect the first Soleus royalty sales in Q2, followed by a material jump in the back half of the year. With the stock now trading at about 1x our 2009E revenue and with one-third the market cap in cash, we maintain our bullish outlook on the stock. As such, we reiterate our SPECULATIVE BUY rating but are lowering our target to C\$1.40 from C\$1.60 based on our DCF.

Valuation

Intrinsyc trades at a discount at 1.1x F09 EV/sales vs. peers at 2.3x.

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Outlook and recommendation

Intrinsyc reported strong top-line results in Q1, handily beating our and consensus expectations; however the achievement was somewhat soured by the disclosure that one of the company's design wins was cancelled and the MOU with a Japanese OEM had not yet transitioned into a full software engagement. On both counts, management stressed that the issues were not tied to any fundamental problems with Soleus or Intrinsyc's relationship with its customers. The quashed design win pertains to Intrinsyc's March 2008 announcement that it had secured a 3rd device with an existing Soleus licensee. The customer, due to cost factors, had apparently elected to rationalize its product roadmap, thereby focusing resources on fewer new handsets. While management indicated it expects no material impact to its projected volumes with this customer, we would hesitate to concur at this stage. In the case of the Japanese OEM, we believe the delayed MOU could be related to a potential increase in scope of the project. As such, we are not overly concerned by this delay.

The Q1 revenue overachievement was related to a particularly strong services quarter based on a new Symbian contract that has recently been signed. Additionally, Soleus contributed almost US\$0.5 million this quarter vs. less than US\$0.2 million last quarter, which is higher than we had anticipated.

In summary, we are a bit disappointed by the contract cancellations/delays, which leads us to trim our 2009 revenue forecast to US\$63 million from US\$67 million. Nevertheless, we continue to see significant opportunity in front of the company. Management's guidance for one Soleus design win per quarter is intact, and we still expect to see our first Soleus royalty sales in Q2, followed by a material jump in the back half of the year. With the stock now trading at about 1x our 2009E revenue and with one-third the market cap in cash, we maintain our bullish outlook on the stock. As such, we reiterate our SPECULATIVE BUY rating but are lowering our target to C\$1.40 from C\$1.60 based on our DCF.

Q1/F08 results

Intrinsyc reported its Q1/F08 results with revenues of US\$5.6 million and a GAAP loss per share of US\$0.03. The top-line results were above our estimate by roughly US\$0.4 million on account of better than expected services revenues in the quarter. On the bottom line, the loss of US\$0.03 was in line with our expectations. Consensus called for revenues of US\$4.7 million and EPS of (US\$0.03).

Revenue during the quarter was driven by US\$ 4.3 million in wireless services revenue, US\$0.7 million in software licence revenue and US\$0.6 million in hardware revenue.

Overall Soleus revenue, including services and support, was US\$0.5 million, up from under US\$0.2 million in the transition period. This was split US\$210,000 for software licences and US\$255,000 for services.

Figure 1: Q1/F08 results

(US\$ millions)	Q1/F08	CA Q1/F08E	B/(W)	Transition Period	Q2/F07A	Consensus	% Change Q/Q	% Change Y/Y
Revenue	5.6	5.1	0.4	5.3	4.3	4.7	5.6%	29.2%
Gross Profit	2.5	2.4	0.1	1.9	2.1		32.4%	20.8%
% of Revenue	45.7%	47.6%		36.4%	48.8%			
Total Op Ex	6.7	6.7	0.0	8.4	5.9		-20.5%	14.7%
% of Revenue	120.9%	130.0%		160.6%	136.2%			
EBITDA	-3.5	-3.8	0.3	-7.0	-3.2		NM	NM
% of Revenue	-62.4%	-74.1%		-132.5%	-74.8%			
GAAP Net Income	-3.8	-4.0	0.2	-7.3	-3.6		NM	NM
% of Revenue	-69.1%	-78.3%		-139.7%	-84.7%			
GAAP EPS - diluted	(0.03)	(0.03)		(0.03)	(0.05)		NM	NM
Adjusted EPS - diluted	(0.03)	(0.03)	0.0	(0.03)	(0.05)	(0.03)	NM	NM

Source: Bloomberg, Canaccord Adams

Progress on Soleus

Management maintained its target of signing one Soleus design win per quarter. The first Soleus-enabled handset (MSI 5608) is still projected for commercial launch in Q2. The product is currently in field trials. Intrinsyc is expecting to ship Soleus to Samsung in Q3 with Samsung's customer expected to launch in Q4. Quanta's device will require the release of Soleus 2.0 (3G platform), which is expected to be available this quarter. Management expects Quanta to announce its launch in Q3, with commercial availability likely in Q4. Intrinsyc's second silicon customer (unnamed) is targeting commercial launch in the second half of this year as well.

Costs and margins

Gross margins in the quarter were 46% compared with 36% in the transition period and 49% in Q2/F07. The improvement in gross margins over the prior period was a result of higher software revenues (13% of total revenue, up from 10% in the prior period) and improved execution on wireless services revenue. Management noted that gross margins for the wireless services business is targeted in the 35-40% range, while Soleus licence gross margins are expected to be around 90%.

Operating expenses for the period totalled US\$6.7 million vs. US\$8.4 million in the prior period and US\$5.9 million Y/Y. R&D costs were US\$2.5 million, or 46% of revenue, down from the transition period of US\$3.4 million (64% of revenue). G&A expenses came in at US\$1.8 million, or 33% of revenue, down from US\$2.2 million (41% of revenue) in the prior period. Sales and marketing expenses were US\$1.8 million, or 33% of revenue compared with US\$2.4 (45% of revenue) in the last results.

Cash and cash flow

The company recorded free cash flow in the quarter of (US\$5.2 million, driven by the net loss and an increase in accounts receivable of almost US\$2 million to US\$5.5 million. During the quarter the company raised US\$30 million through an offering of 28.6 million shares. At the end of the quarter the company had US\$35.2 million in cash, or US\$0.23 per share. This is based on the company's March-end basic share count of 150.9 million.

Estimate revisions

We are maintaining our F08 estimates and trimming our F09 forecast on account of the apparent contract delays/cancellations observed this quarter. Our F08 revenue and EPS remain at US\$25.6 million and (US\$0.11), respectively. Our F09 revenue declines to US\$63 million from US\$67 million and our EPS drops by one cent to US\$0.05.

Figure 2: Estimate revisions

	Q2/F08	F08	F09
Revenue (M)			
Revised	5.8	25.6	63.2
Original	5.7	25.6	66.9
Adjusted EPS			
Revised	(0.03)	(0.11)	0.05
Original	(0.03)	(0.11)	0.06

Source: Canaccord Adams

Valuation

Intrinsyc trades at a discount to peers on both an F09E EV/sales and P/E basis. The company trades at 1.1x F09E revenue vs. peers at 2.9x and 14x P/E vs. peers at 20x. Based on Intrinsyc's growth potential, we believe that the discount is not justified.

Figure 3: Comparables

			Price	Revenue			EPS			EV/Sales		P/E	
				2008	2009	Growth	2008	2009	Growth	F08	F09	F08	F09
Access	4813	:TSE	308	33	38	16%	305	4,378	NM	4.9	4.2	NM	NM
Call Genie	GNE	:V	\$0.51	8	25	NM	-0.20	-0.05	NM	2.6	0.8	NM	NM
Esmertec	ESMN	:EB	SFr. 8.80	60	71	19%	0.37	0.65	75%	3.3	2.7	23.5	13.5
Red Hat	RHT	:N	\$22.10	673	808	20%	0.80	0.90	12%	5.7	4.7	27.7	24.7
Research In Motion	RIMM	:Q	\$140.84	11,667	15,992	37%	4.75	7.00	47%	6.7	4.9	29.7	20.1
TrollTech	TROLL	:OS	15.00 kr	293	386	32%	0.05	0.64	NM	2.3	1.8	NM	23.5
Wind River	WIND	:Q	\$8.29	369	401	9%	0.43	0.53	24%	1.6	1.4	19.4	15.6
Zi Corp	ZIC	:T	\$0.50	15	15	0%	0.00	0.00	NM	1.5	1.5	NM	NM
Average						19%			40%	3.9	2.9	25.1	19.5
Median						20%			36%	3.3	2.7	25.6	20.1
Intrinsyc*	ICS	:T	\$0.69	26	63	147%	-0.11	0.05	-320%	2.7	1.1	NM	13.8
Intrinsyc	ICS	:T	\$1.40	26	63	147%	-0.11	0.05	-320%	6.9	2.8	NM	28.0

Source: Bloomberg, Baseline, Canaccord Adams

* Assumed CAD/USD rate of 1.0 - F08 and F09 estimates are in USD

Investment risks

The main risks to our outlook include the competitive environment intensifying, design wins taking longer than expected to close, design wins not translating into material revenue due to failed device launches, ESG division revenue erosion, and key management leaving the firm. Other risks include litigation, adverse F/X trends, slower-than-expected growth in the mobile device market, faster-than-expected ASP erosion at handset OEM/ODMs pressuring Intrinsyc's ASPs down significantly, and broader macroeconomic forces impacting the market.

14 May 2008

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Site Visit:

An analyst has visited Intrinsyc's material operations in Vancouver, BC, Canada. No payment or reimbursement was received from the issuer for the related travel costs.

Price Chart:*

* Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

Distribution of Ratings:

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(as of 1 May 2008)

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	#	%	%
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Speculative Buy	61	11.4%	59.0%
Hold	129	24.1%	19.4%
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	536	100.0%	

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Intrinsyc Software International Inc.	1A, 2, 3, 7

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