

## Intrinsyc Software International Inc.

ICS : TSX : C\$0.65

**SPECULATIVE BUY**

**Target: C\$1.75**

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### COMPANY STATISTICS:

52-week Range: C\$0.34 - 0.77  
 Avg. Daily Vol. (000s): 154.4  
 Market Cap (M): C\$77.5  
 Shares Out (M) basic: 119.3  
 Shares Out (M) diluted: 119.3

### EARNINGS SUMMARY:

FYE Aug	2005A	2006A	2007A	2008E	2009E
Revenue (M):	17.5	18.7	19.7	29.7	69.1
EV/Sales (x):	3.3	3.1	2.9	2.0	0.8
EPS:	(0.11)	(0.24)	(0.18)	(0.10)	0.09
P/E (x):	NM	NM	NM	NM	7.1

### 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

## CONFIDENCE IN THE PIPELINE; ON TRACK FOR A STRONG 2008

### Event

Intrinsyc reported Q4/F07 results in line with expectations. Revenue was posted at C\$4.5 million (down 8% Y/Y) versus our C\$4.6 million estimate and consensus of C\$4.4 million. The company's loss per share was one cent better than our estimates at (C\$0.03). Intrinsyc announced the intent to change its fiscal year end from August 31 to December 31 and to begin reporting in US currency.

### Impact

We believe that Intrinsyc's Q4 results were solid but do not tell the whole story. The company is moving forward with its product development and is just beginning to realize value from its sizeable pipeline of prospects. While providing no guidance, management re-affirmed its goal of signing one Soleus deal per quarter, a target that we believe could prove to be conservative.

### Action

Our estimates remain unchanged. Overall, we believe that Intrinsyc is making solid progress positioning itself in the high growth mobile OS market. In our view, Intrinsyc offers good stability with its engineering business and tremendous upside potential with the Soleus platform. Hence, we reiterate our SPECULATIVE BUY recommendation and C\$1.75 target price, based on our DCF analysis.

### Valuation

Intrinsyc trades at a discount to peers on an F08 EV/Sales basis trading at 2.0 times, well below the industry average of 4.0 times. We believe the company should be trading at higher multiples than the peer average due to its impressive growth potential in F08 and beyond.

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**Q4/F07 results**

Intrinsyc reported Q4/F07 results in line with expectations. Revenue was posted at C\$4.5 million (down 8% Y/Y) versus our C\$4.6 million estimate and consensus of C\$4.4 million. The company's loss per share was one cent better than our estimates at (C\$0.03). Intrinsyc burned C\$3.3 million in free cash, ending the quarter with C\$19.6 million or C\$0.16 per share in cash and equivalents. Services revenue declined slightly Q/Q from C\$4.3 million to C\$4.0 million. Software increased from C\$0.5 million to C\$0.6 million in the same time frame. Gross margins fell 270 basis points sequentially; however improved 240 basis points on a Y/Y basis. Foreign exchange negatively impacted the top line growth rate about 4% on a Y/Y basis.

**Figure 1: Q4/F07 results**

(C\$ millions)	Q4/F07A	CA Q4/F07E	B/(W)	Q3/F07A	Q4/F06A	Consensus	% Change Q/Q	% Change Y/Y
<b>Revenue</b>	<b>4.5</b>	<b>4.6</b>	-0.0	<b>5.1</b>	<b>4.9</b>	<b>4.4</b>	-11.3%	-7.9%
Gross Profit	2.2	2.3	-0.0	2.6	2.3		-15.9%	-3.2%
% of Revenue	49.1%	49.6%		51.8%	46.7%			
Total Op Ex	6.4	7.0	-0.6	6.6	6.5		-2.1%	-0.9%
% of Revenue	141.4%	153.9%		128.3%	131.5%			
EBITDA	-4.0	-4.5	0.6	-3.7	-4.0		NA	NA
% of Revenue	-87.4%	-99.8%		-72.5%	-80.9%			
GAAP Net Income	-4.1	-4.6	0.5	-4.4	-4.4		NA	NA
% of Revenue	-90.6%	-101.3%		-85.7%				
<b>GAAP EPS - diluted</b>	<b>(0.03)</b>	<b>(0.04)</b>		<b>(0.05)</b>	<b>(0.05)</b>		NA	NA
<b>Adjusted EPS - diluted</b>	<b>(0.03)</b>	<b>(0.04)</b>	0.0	<b>(0.04)</b>	<b>(0.05)</b>	<b>(0.04)</b>	NA	NA

Source: Canaccord Adams, Company reports, Bloomberg

**Soleus Update**

Intrinsyc released Soleus version 1.01 in August 2007. Key advancements to the product include language localization and the ability to automatically switch between languages, user interface improvements and the ability to migrate to Windows Mobile 6.0. Management noted that future R&D would be focused on developing a 3G version of the product. As well, the company is looking at movement and gesture-based user interfaces.

The company noted that services revenue contributed 84% in Q4/F07, compared to 88% last quarter. Software revenue was up from 10% last quarter to 13%, with Soleus contributing C\$81,000 of this total. This is the first time management has disclosed the Soleus figure – this is one we will clearly be keeping our eyes on in the future. Q4 Soleus revenue only includes upfront license and maintenance revenue. No royalties are expected until the first half of 2008. Soleus related R&D and S&M were C\$2.9 million in Q4/F07.

After two quarters of significant sequential declines, we expect this figure to stabilize in the C\$3 million range for the next few quarters.

**Figure 1: Soleus expense analysis**

(C\$ '000)	28-Feb-06	31-May-06	31-Aug-06	30-Nov-06	28-Feb-07	31-May-07	31-Aug-07
Soleus related R&D and S&M	2,510	2,930	3,580	3,370	3,800	3,300	2,900
Sequential Growth	63.0%	16.7%	22.2%	-5.9%	12.8%	-13.2%	-12.1%
as % of revenue	52.4%	66.8%	72.7%	67.1%	75.5%	64.6%	63.9%

Source: Company reports, Canaccord Adams

### Google Android

When asked about Google's new Android announcement, management responded that it was encouraged by the initiative. We continue to believe that the Open Handset Alliance's (OHA) focus on the mass feature phone segment validates the track that Intrinsic has been on with Soleus. Given the complexity of building an ecosystem with 30+ members, management believes that developing a production-ready product will be a time-consuming process. As the mass market appears ready for higher multimedia applications today, we do not anticipate that OEMs and ODMs will wait indefinitely. As a result, we like Intrinsic's chances of securing a position of critical mass with several customers before Android comes to market. Additionally, management noted that it is in the process of adapting Soleus to Linux-based environments. We believe this could result in Intrinsic eventually joining the OHA as well.

### PND Market

We believe that Personal Navigation Device (PND) makers will be looking to add more wireless/telephony capabilities to their devices throughout 2008. This in our view will be driven by device vendors' need to both capture map data in real time and to eventually distribute map updates wirelessly. For more detail on trends in the PND and broader location technologies markets, please refer to research from Canaccord Adams' technology analyst, Jeff Rath. We believe that Intrinsic is in a position to benefit from the convergence of GPS-centric devices and mobile handsets. To date, all three of the company's Soleus design wins have originated from GPS-enabled devices. We expect the activity in this segment to accelerate, particularly heading into 3GSM and CeBIT early next year.

### Pipeline Update

Management remains consistent in its pipeline commentary. The company sees about 30 unique customers, representing approximately 100 million annual units as the immediately addressable market opportunity. Management remains committed to signing about 1 Soleus deal per quarter. Given the pipeline activity we are witnessing, we believe this goal could prove to be conservative.

Intrinsic elaborated upon an additional opportunity around silicon and chip makers. We had considered this market as a secondary prospect; however management's enthusiastic tone would seem to suggest that the potential is closer than we had initially assumed. The concept here is silicon makers bundling the software with their hardware in order to offer

a full turnkey solution to service providers. Management referred to a market size representing a few hundred million units per year.

#### **Cash and cash flow**

Intrinsyc recorded free cash flow in the quarter of (C\$3.5) million, compared to (C\$2.8) million in Q3/F07 and (C\$3.9) million in Q4/F07. Cash balances at the end of the quarter totaled C\$19.6 million, down from C\$21.4 million the previous quarter and C\$22.5 million Y/Y. Accounts receivables equaled C\$3.1 million for the quarter, up C\$0.1 million Q/Q and down \$0.7 million Y/Y. Finally, prepaid expenses were C\$0.5 million for the quarter, up over C\$0.2 million sequentially and up C\$0.2 million from the prior year.

#### **Costs and margins**

Gross margin in the quarter was 49%, down slightly from last quarter at 51% but up over Q4/F06 at 47%. Operating expenses were C\$6.4 million for the quarter compared to our estimate of C\$7.0 million and down slightly from Q3/F07. This was a result of reduced R&D expenses and G&A expenses of C\$2.8 million and C\$1.3 million respectively, offset by slightly higher S&M expenses of C\$1.8 million.

#### **Estimate revisions**

Intrinsyc announced two financial reporting changes that have been approved by the company's Board of Directors. Firstly, the company intends to change its fiscal year end from August 31 to December 31, effective January 1, 2008. The company stated that this change will better align with the business cycle with that of its customers. Intrinsyc intends to report a stub period of September 1 – December 31, 2007 in March of 2008. Secondly, Intrinsyc intends to begin reporting financials in U.S. currency given that the majority of sales are recorded in US dollars. Intrinsyc is currently in the process of obtaining the necessary approvals from the TSX and Revenue Canada and expects approval before year end.

Intrinsyc also announced that it is considering closing its UK engineering services operation. The company is engaged in a consultation process, which should be completed over the next four weeks. If Intrinsyc proceeds with the closure, the company expects to incur a C\$0.8 million charge in the current quarter. Management estimates the savings from the closure to be approximately C\$2.0 million annually with minimal impact to revenues as it expects to absorb the engineering workload through other offices.

We have kept our estimates unchanged at this time, pending the completion of the consultation process and approval of the financial changes. For Q1/F08 our revenue estimate is C\$5.2 million with EPS at (C\$0.03). For F08, we project revenues of C\$29.7 million and EPS of (C\$0.10). In F09, we are at C\$69.1 million and C\$0.09.

#### **Outlook and recommendation**

We believe that Intrinsyc's Q4 results were solid but do not tell the whole story. The company is moving forward with its product development and is just beginning to realize value from its sizeable pipeline of prospects. While providing no guidance, management re-affirmed its goal of signing one Soleus deal per quarter, a target that we believe could prove to be conservative. We expect Intrinsyc to release its 3G platform in early 2008, which could spark a few more large customers within the active pipeline of roughly 30 to engage Soleus. We believe that the PND market will continue to migrate towards

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wireless/telephony-enabled solutions, which should benefit Intrinsic as a facilitator of that convergence. With three Soleus wins to date and several more on the way in our view, we continue to expect a significant sales ramp in the back half of 2008.

Overall, we believe that Intrinsic is making solid progress positioning itself in the high growth mobile OS market. In our view, Intrinsic offers good stability with its engineering business and tremendous upside potential with the Soleus platform. Hence, we reiterate our SPECULATIVE BUY recommendation and C\$1.75 target price, based on our DCF analysis.

### Valuation

Intrinsic trades at a discount to peers on an F08 EV/Sales basis trading at 2.0 times, well below the industry average of 4.0 times. We believe the company should be trading at higher multiples than the peer average due to its impressive growth potential in F08 and beyond.

**Figure 2: Comparables**

			LAST	Revenue			EPS			EV/Sales		P/E	
				F07	F08	Growth	F07	F08	Growth	F07	F08	F07	F08
Access	4813	:TSE	434,000	26,212	32,787	25%	-40,982	-40,025	-2%	6.5	5.2	NM	NM
Aplix	3727	:TSE	257,000	6,128	6,639	8%	-78,467	6,001	NM	4.2	3.9	NM	42.8
Trolltech	TROLL	:OS	11.20	229.5	312.0	36%	-0.60	-0.16	NM	1.9	1.4	NM	NM
Call Genie	GNE.	:V	\$1.08	2.3	12.6	NM	-0.13	-0.08	NM	NM	5.0	NM	NM
Red Hat	RHT	:N	\$21.00	488.0	608.0	25%	0.66	0.83	26%	7.8	6.2	31.8	25.3
Research In Motion	RIMM	:Q	\$124.38	4,222.0	7,650.0	81%	1.54	3.07	99%	16.2	8.9	80.8	40.5
Wind River	WIND	:Q	\$11.74	328	371	13%	0.30	0.49	63%	2.8	2.4	39.1	24.0
Zamano	ZMNO	:L	0.33	21	25	23%	0.04	0.05	20%	0.7	0.6	0.1	0.1
Zi Corp.	ZICA	:Q	\$1.04	13	15	19%	-0.11	-0.04	NM	3.2	2.7	NM	NM
<b>Average</b>						<b>29%</b>			<b>41%</b>	<b>5.4</b>	<b>4.0</b>	<b>38.0</b>	<b>26.5</b>
<b>Median</b>						<b>24%</b>			<b>26%</b>	<b>3.7</b>	<b>3.9</b>	<b>35.5</b>	<b>25.3</b>
<b>Intrinsic</b>	<b>ICS.</b>	<b>:T</b>	<b>\$0.65</b>	20	30	51%	-0.17	-0.10	70%	2.9	2.0	NM	NM
Intrinsic	ICS.	:T	\$1.75	20	30	51%	-0.17	-0.10	70%	9.6	6.4	NM	NM

Source: Canaccord Adams estimates, Bloomberg, Company reports

### Investment risks

The main risks to our outlook include the competitive environment intensifying, design wins take longer than expected to close, design wins to not translate 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 Intrinsic's ASPs down significantly, and broader macroeconomic forces impacting the market.

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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.

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Global Stock Ratings  
(as of 1 November 2007)

Rating	Coverage Universe		IB Clients	
	#	%	#	%
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Speculative Buy	55	10.5%	69.1%	
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	523	100.0%		

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

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