Intrinsyc Software International Inc.

ICS : TSX : C$0.49

SPECULATIVE BUY

Target: C$1.40

Peter Misek, CA, CPA, CFA 1.416.869.7920
peter.misek@canaccordadams.com
Dushan Batrovic, MBA 1.416.869.7399
dushan.batrovic@canaccordadams.com

COMPANY STATISTICS:

52-week Range:	C$0.39-1.30
Avg. Daily Vol. (000s):	416.0
Market Cap (M):	C$79.3
Shares Out (M) basic:	161.9
Shares Out (M) diluted:	161.9

EARNINGS SUMMARY:

FYE Aug	2006A	2007A	2008E	2009E
Revenue (M):	US$18.7	US$19.7	US$28.7	US$69.8
EV/Sales (x):	3.0	2.9	2.0	0.8
EPS:	US$(0.24)	US$(0.18)	US$(0.12)	US$0.01
P/E (x):	NM	NM	NM	46.5

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

INTRINSYC CLOSES DESTINATOR AND INTRODUCES GUIDANCE

Event

Intrinsyc announced that it has completed the acquisition of Destinator. In tandem with the release, management issued financial guidance, with F08 sales of US$26-29 million and a gross margin of 49-55%. This will include almost two quarters of Destinator contribution as the closing date of the transaction is July 10.

Impact

Positive. The consummation of the transaction should alleviate some of the deal risk that we believe has been hampering the stock. Additionally, Intrinsyc outlined a very aggressive cost-cutting strategy, which could see Destinator's historical opex decline by at least 50% to roughly US$13 million annually. Based on management's comments on the pipeline and early progress on integration, we believe Destinator's business has stabilized, which should easily justify the 1.4x price-to-sales multiple that Intrinsyc paid for the company.

Action

We are revising our financial model as follows: F08 revenue grows by US$3 million to US$29 million and F09 revenue to US$70 million from US$63 million. F08 EPS is being revised to (US$0.12) from (US$0.11) and F09 EPS to US$0.01 from US$0.05. We see significant merit in the transaction driven by: i) the ability to gain more share in the handset software stack, ii) cross-selling opportunities, iii) bankruptcy proceedings reducing integration risk, and iv) compelling valuation at 1.4x revenue. We therefore maintain our SPECULATIVE BUY rating and C$1.40 target based on our DCF and industry comps.

Valuation

Intrinsyc trades at 0.8x our F09 revenue estimate of US$70 million.

SUMMARY

Intrinsyc announced that it has completed the acquisition of Destinator. In tandem with the release, management issued financial guidance with F08 sales of US$26-29 million and a gross margin of 49-55%. This will include almost two quarters of Destinator contribution as the closing date of the transaction is July 10. Additionally, on the conference call management reiterated its goal of achieving at least four new Soleus design wins (one per quarter) for 2008. Given that only one deal has thus far been announced, we can expect to see an acceleration in Soleus activity for the remainder of 2008 – at least three new announcements over the next six months.

We expect that the consummation of the transaction will alleviate some of the deal risk that has been hampering the stock. Additionally, Intrinsyc outlined a very aggressive cost-cutting strategy, which could see Destinator's historical opex decline by at least 50% to roughly US$13 million annually. Based on management's comments on the pipeline and early progress on integration, we believe Destinator's business has stabilized, which should easily justify the 1.4x price to sales multiple that Intrinsyc paid for the company. We see significant merit in the transaction driven by: i) the ability to gain more share in the handset software stack, ii) cross-selling opportunities, iii) bankruptcy proceedings reducing integration risk, and iv) compelling valuation at 1.4x revenue. We therefore maintain our SPECULATIVE BUY rating and C$1.40 target based on our DCF and industry comps.

Stability of the Destinator business

With Destinator having filed for bankruptcy protection, questions of viability and appropriate value are bound to surface. Based on the information presented in the court documents and management's assessment, we believe the purchase price was reasonable. Through Destinator, Intrinsyc gains access to a high-growth mobile segment in location-based services by leveraging the target's 17 issued patents and numerous high-profile customers. Management gave a few examples of recent devices that have launched with Destinator software: the ASUS P750 and Motorola A1600/A1800.

Figure 1: Select handsets with Destinator software

Source: www.unwiredview.com, www.itmagia.ro

Estimate revisions

We are raising our F08 revenue to US$28.7 million from US$25.6 million, which puts us at the higher end of management's guided range. This figure assumes that Destinator will contribute US$5.5 million to F08, which is offset by a moderate reduction to our core Soleus projections. We believed it prudent to lower our Soleus assumptions as the pace of new contract wins has slowed relative to last year's pace (one win thus far in 2008). Our F08 EPS estimate declines by one cent to (US$0.12) as this transaction appears to be dilutive in the near term. This translates into a combined gross margin of 53.7% in F08 (guidance provided at 49-55%).

We are raising our F09 revenue from US$63.2 million to US$69.8 million. This is based on Destinator contributing about US$15 million in revenue, which would represent a roughly 25% growth rate on the company's historic sales. Once again, we partially offset the incremental growth by reducing our Soleus projections to account for fewer contract wins thus far in 2008. Our EPS falls to US$0.01 from US$0.05 as we believe this transaction will be near-term dilutive.

Our financial projections do not include any one-time restructuring (expected to be about US$1.5-2.0 million over the next 12 months) or amortization of acquired intangible assets.

Figure 2: Estimate revisions

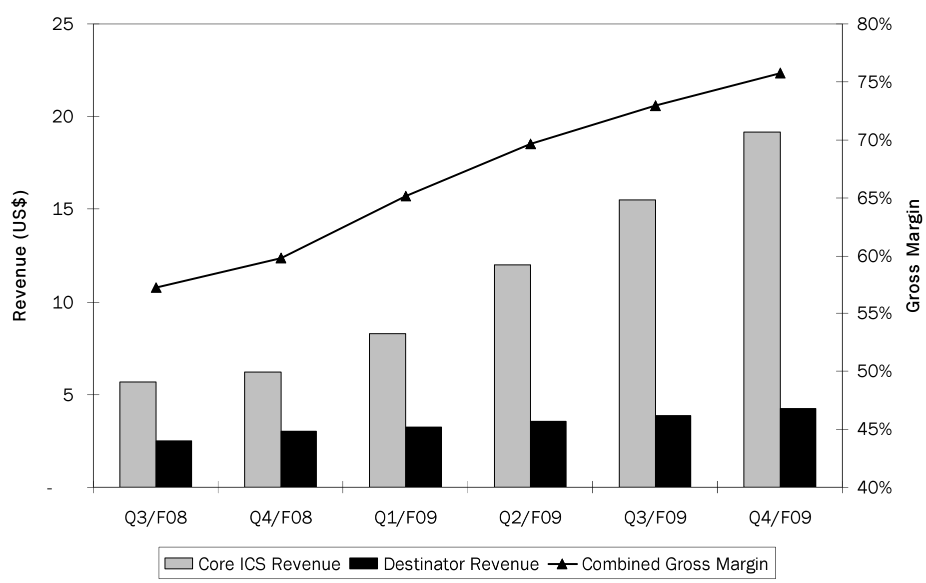
		F08	F09
Revenue (M)			
	Revised	28.7	69.8
	Original	25.6	63.2
Adjusted EPS			
	Revised	(0.12)	0.01
	Original	(0.11)	0.05

Source: Canaccord Adams

Combined company financial profile

Destinator's historical financials included a substantial portion of map resale revenue, which artificially boosted headline numbers. Although the company recorded almost US$30 million in its F07 (ending January), we estimate that more than half was derived by reselling map data from providers such as NAVTEQ. Intrinsyc is recording only sales net of map data resale, which would result in an annual revenue figure closer to US$12 million. As a result, we expect that Destinator's gross margins will likely improve to roughly 75% relative to the previously reported 40-45% range. Consequently, management believes that the portion of software revenue will grow from 11% in F07 to 32-37% in F08. This has a very meaningful impact to Intrinsyc's gross margin profile. As shown below, we have gross margins improving steadily to about 75% by the end of F09 due both to Destinator and to growth in the Soleus royalty line.

Figure 3: Revenue breakdown and gross margin



Source: Canaccord Adams

Transaction details

Intrinsyc paid about US$16 million, which consists of US$8.5 million in cash and 11 million issued shares. As of March 31, Intrinsyc held US$35 million in cash on the balance sheet. As such, we estimate that Intrinsyc currently has about US$23 million in cash, which assumes a cash burn of roughly US$4 million in Q2. Management noted that Intrinsyc's share count currently stands at 161.9 million. The purchase price translates into a 1.4x multiple on Destinator's trailing revenue.

Valuation

Intrinsyc currently trades at 0.8x our new F09 revenue estimate of US$70 million. This is based on our assumed Q2 ending cash balance of US$23 million and 162 million issued shares. Our US$1.40 target price translates into a 2.9x multiple, which we believe is reasonable given the company's growth profile.

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.

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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:*

	Date	Analyst	Rating	Target Price
1)	05/24/07	PM	Spec Buy	1.75
2)	01/11/08	PM	Spec Buy	1.60

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

Distribution of Ratings:
Global Stock Ratings
(as of 4 July 2008)

	Coverage Universe		IB Clients
Rating	#	%	%
Buy	353	61.8%	38.0%
Speculative Buy	59	10.3%	61.0%
Hold	136	23.8%	24.3%
Sell	23	4.0%	13.0%
	571	100.0%	

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

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