Rolta India

INR 268

Sailing on strong winds

BUY

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Solution provider approach has raised stature and realizations

Rolta has evolved, slowly but surely, as a solution provider across its services portfolio. The company has developed insights, capabilities, frameworks, and orientation of a multi-disciplinary solution player over the past decade. This in our view, has raised the companies stature and will continue improving company's realizations over the next few years.

Unique services portfolio

Rolta's three prime service lines — GeoSpatial Information Systems (GIS), Engineering Services Outsourcing (ESO), and eSolutions — now hold interrelated and unified relevance to its client base. The company's skills in the areas of mapping and designing across diverse segments and in a variety of end-user IT environments give it an edge. We see the three service lines growing, driven by growth factors in their own segments as well as the unique opportunities that these combined skills create.

Strong growth from JVs expected

Rolta has entered into two high potential jv, which are likely to raise its traction in high growth verticals such as power, energy and defence. Its 50:50 JV with Stone & Webster is pursuing engineering design opportunities in high growth refinery, petrochemicals, and energy sectors in India. Its 51:49 JV with Thales, the French defence and aerospace major, aims at targeting Indian and international defence spend in the area of high-tech warfare.

Engineering IT set for faster growth

Prospective investments in India's infrastructure, energy, environmental, high-tech, and defense sectors are expected to exceed USD 350 bn in the next five years. The recent comprehensive report on the future of global outsourced engineering services, commissioned by NASSCOM, predicts that India-based revenues of engineering services will reach USD 38-50 bn by 2020 compared to about USD 2 bn now. We see leading India based engineering services vendors as key beneficiaries.

Valuations

Currently Rolta trades at a P/E of 12.7x and 9.2x and EV/EBITDA of 6.9x and 4.8x on our FY07E and FY08E earnings respectively. We see the company to stay in the 28-30% organic growth trajectory through FY09E. We believe, the company's forward P/Es are likely to improve from the 10-13x range to 14-16x range over the next 12 months. Sustained revenue and EPS growth, large deal win possibilities, and M&A related upside will be key factors to raise the rating. We recommend **'BUY'** at present levels.

Financials

Year to June	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	5,349	6,924	9,667	13,195
Rev. growth (%)	29.0	29.5	39.6	36.5
EBITDA (INR mn)	2,229	2,817	3,843	5,199
Net profit (INR mn)	1,273	1,685	2,358	3,242
Adj. shares outstdg (mn)	67	80	81	81
Adj. EPS (INR)	18.9	21.1	29.2	39.9
EPS growth (%)	33.3	11.6	38.7	36.6
PE (x)	14.2	12.7	9.2	6.7
EV/EBITDA (x)	8.8	6.9	4.8	3.2
ROE (%)	18.2	16.8	20.2	23.2

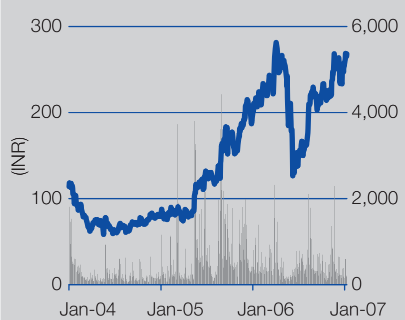
Reuters	:	ROLT.BO
Bloomberg	:	RLTA IN

Market Data

52-week range (INR)	:	285 / 124
Share in issue (mn)	:	79.9
M cap (INR bn/USD mn)	:	21.4 / 476.6
Avg. Daily Vol. BSE/NSE ('000)	:	1,234.1

Share Holding Pattern (%)

Promoters	:	40.8
MFs, FIs & Banks	:	2.0
FIIs	:	23.0
Others	:	34.3



Investment Rationale

Solution provider approach has raised stature and realizations

Rolta has evolved from providing piecemeal or project-based services to providing end-to-end solutions in its GIS, engineering, and eSolution businesses. Over the past decade, the company has made gradual progress and built capabilities, alliances, and a track record of successful large projects.

The company's ability to execute larger projects on an end-to-end basis has also raised its realisations. In the GIS business, the company has delivered projects that involved mapping the city of Dubai, enabling British Telecom to upgrade its nationwide cable network, and creating solutions for Indian ministry of Defence to create border and cross border maps to help decide army responses. This is a significant development, considering that until three to four years a large proportion of the company's GIS revenues came from relatively low-end work involving populating map databases in much smaller projects. We understand that Rolta is now working with three more city municipalities in the Middle East, three large telecom companies, and defense agencies in India and Middle East on large projects that involve end-to-end implementation.

The company's ESO business has grown strongly, especially during FY04-06. Net services revenues from ESO grew at a CAGR of 50.5%. In the coming years, we see a surge in demand for engineering services, especially in niche areas where Rolta has strengths. Rolta is one of the very few vendors in India which has worked on India's nuclear power projects, defence, and complex refinery projects.

Over the next three to five years, we foresee huge investments in India in refining, petrochemicals, nuclear power, fossil material power and other infrastructure projects. We see a continuing surge in demand for third party high-end engineering services. With its 60:40 revenue split between India-based and export revenues, we believe the company is well positioned to cater to the demand surge.

We see Rolta improving its realizations from winning end-to-end projects in both domestic and export markets. In its plant design services, the company has moved away from providing digital plant designs, 3D modeling, and data migration services to providing turnkey 'as built' plant designs. In its mechanical design services, it now provides higher proportion of PLM services than delivering 'part of the value chain' projects. We, however, note that the company's progress in this regard is superior in plant design services than mechanical design services.

Table 1: Demonstrating individual business performance and realisation improvement

GIS	FY04	FY05	FY06
Total revenue (INR mn)	2,378	2,750	3,290
Less : Third party s/w and subcontracting charges (INR mn)	978	1,075	1,175
Services revenue (INR mn)	1400	1675	2115
Growth (%)		*19.6*	*26.3*
No. of employees (Average)	955	1079	1312
Utilisation (%)	80.0	80.0	80.0
Average blended billing rate (USD per hr.)	17.3	18.7	19.4
Growth (%)		*8.1*	*3.7*

EDA	FY04	FY05	FY06
Total revenue (INR mn)	998	1,171	1,460
Less : Third party s/w and subcontracting charges (INR mn)	596	570	550
Services revenue (INR mn)	402	601	910
Growth (%)		*49.6*	*51.3*
No. of employees (Average)	265	376	508
Utilisation (%)	78.0	78.0	78.0
Average blended billing rate (USD per hr.)	18.4	19.8	22.2
Growth (%)		*7.6*	*12.1*

eSolutions	FY04	FY05	FY06
Total revenue (INR mn)	130	192	524
Less : Third party s/w and subcontracting charges (INR mn)	-	-	-
Services revenue (INR mn)	130	192	524.0
Growth (%)		*47.5*	*173.3*
No. of employees (Average)	40	50	102
Utilisation (%)	60.0	65.0	70.0
Average blended billing rate (USD per hr.)	61.2	68.3	84.9
Growth (%)		*11.6*	*24.3*

Source: Company

Consistently executing larger projects has raised Rolta's stature and market position, in our view. Over the years, the company has worked with many of the world's well known companies such as GE, Rolls Royce, Bechtel, Dow Chemicals, Shell, Reliance, Mitsui, Merck, Hong Kong Telecom, as well for defense establishments in India and abroad. We believe the company is now in a positive spiral, where accomplishments in each area of its operation will result in larger opportunities for its business groups. The results of the company's growing stature are also visible in its JVs with Stone & Webster and Thales.

Unique services portfolio

In our opinion, the company is able to add enhanced value on account of its expertise in GIS, engineering, and IT businesses. While undertaking large turnkey engineering projects, Rolta has been able to integrate eServices in the engineering environment. We note that industry trends in engineering outsourcing now accord higher importance to having functionalities such as web enabling of design automation and manufacturing applications. In refining and power sectors, laser and photogrammetry services hold relevance while designing the plant drawing. Large number of projects in the broad manufacturing arena will require skills that lie at the intersection of GIS, engineering, and IT in various combinations. Rolta is uniquely positioned in the offshore space to meet this demand.

The company has extended its capabilities in GIS, engineering, and IT to start new and high potential service lines. Rolta now offers ship building design services that largely draw from its EOS business. It aims at offering its design services to both defense (naval) and private ship building yards globally.

Table 2: Rolta — Phases of service offerings transformation

Segment / Period	GIS	EDA	eSolutions
Pre 1997	• Focused on relatively untapped GIS as a growth area and tied up with Intergraph Corporation, US for exclusive distributorship in India for its entire range of products (hardware and software). • Set up a development and delivery center in Mumbai, one of the largest commercial photogrammetry and GIS facilities to address the global business demand. • Major contract for digital mapping system from nodal agencies in India • Won a significant contract from Saudi Telecommunications Corporation for GIS data conversion of outside plant network models and building plans to the Intergraph environment. • Set up a subsidiary in US to Focus on services business and started with low end GIS services like data conversion.	• Identified engineering design as a growth area and tied up with Intergraph Corporation, US for exclusive distributorship in India for its entire range of products (hardware and software). • Providing Intergraph solutions of plant design automation to Indian EPCs and owner/operators. • Many large orders from government departments in mechanical, electronic engineering and plant engineering domains.	• Software development and support to GIS and EDA divisions. • Establishment & maintenance of IT network to support GIS & EDA business segments.
1997 - 2003	• Strong growth from mapping and GIS solutions sales to Central and State governments, defence and government agencies. • Data conversion services and data modeling services to medium & large size overseas customers. • Expanded global operations by setting up subsidiaries in Netherlands, UK, Middle East, Germany and Canada.	• The company entered in to an agreement with Parametric Technology Corporation TC to distribute its MDA solutions, including collaborative product commerce in India and agreement for services globally. • The company started providing engineering design services in the domain of power and process in India and overseas.	• Added to the width of technology services offerings. Entered into technological alliances with leaders such as IBM, Microsoft, Computer Associates etc. • Launched internet services, eSecurity and eBusiness services. • Consulting services in security & networking domains to domestic and overseas customers.
2003 – 2006	• Started taking up large turnkey end-to-end projects for telecom, electricity, city mapping, defence etc. worldwide for providing complete range of GIS and photogrammetry solutions & services.	• Joint venture with Stone & Webster to cater to detailed engineering design services and address the EPCM market in India with expected demand for engineering services from nuclear power projects.	• Definitive services agreement with CA to provide expert implementation, customisation and integration services to CA's customers across North America, Middle East & Europe for three years.

	• Further strengthened its partnership with Intergraph with the signing of an agreement to provide specialized services to Intergraph's GIS, photogrammetry, utility and telecommunications customers in Americas.	• Providing high-end engineering services and turnkey projects for designing petrochemical and power plants and also doing process engineering.	• Established a group for development of gaming applications and character animation
	• Joint Venture with Thales, aimed at leveraging Thales' high-end defense technology knowhow and solutions and Rolta's leadership position in India's defense related GIS market	• Started providing ship design services and executed two projects from Indian shipyards	
	• Having executed several complex web enabled geo-spatial data projects requiring multiple technologies, domain knowledge, skills and expertise, the company is uniquely positioned to address the increased outsourcing demand of large-scale data maintenance, digital mapping & photogrammetry, GIS data migration and data modelling from large-sized companies around the world.	• The company will address the increased demand for high-end engineering emerging from refineries and petrochemical plants in India on account of planned investments in India's infrastructure, energy, environmental, high-tech and defence sectors.	• Expanding partnership with CA across the globe for providing expert implementation, customisation and integration services to CA customers for security and network management solutions.
Future Direction	• The company, with its global technology partnerships and decades of geospatial domain experience, is uniquely positioned to capitalise the emerging business opportunities due to liberalisation in the core infrastructure areas like telecom, electric, roads, airports, power, railways, defence, homeland security, urban development, town planning and environmental protection in India.	• With its technology partnerships and years of domain experience, the company is well positioned to capitalize the outsourcing demand of high-end engineering services from large EPC and owner operators across the globe.	• With diverse domain knowledge and expertise, the company is also exploring business association with other IT giants for providing implementation, customisation and integration services to their customers for security and network management solutions.
	• JV with Thales will expand and strengthen its portfolio of services and solutions with the cutting-edge technology from Thales for Indian defence and homeland security market.	• SWRL's focus is on taking up medium to large EPCM projects in power and process sectors and is also uniquely positioned to address the demands of nuclear power plants in India. • With initiatives such as ship design services, the company is well positioned to address the demand from leading shipyards in India and overseas.	• The company would address the demand of design services for serious gaming and character animation in India and overseas.

Source: Company, Edelweiss research

Rolta has also set its sights on rapidly growing the gaming business. Gaming is one of the fastest growing categories in the IT industry. Rolta has delivered several projects in the defense space that simulate real-life combat situations using its technological know how. We understand that the company has interesting early leads in this service line.

We understand that the company has serious growth plans to expand its IT services business, which accounted for 9.9% of its FY06 revenues. It is in talks with Oracle and SAP to raise its role as an implementation partner across geographies. Whilst the ERP space has no dearth of quality implementation partners, we see a niche for the company in the manufacturing industry. Rolta has customer relationships in a wide array of industries such as refining, petrochemicals, energy, EPC contracting, infrastructure and industrial products, in addition to government agencies and the defence sector. Rolta already has relationships with two of the largest ERP vendors, which we see getting scaled sharply over the next two to three years.

Strong growth from JVs expected

Rolta has entered into two high potential joint ventures, which are likely to raise its traction in high growth verticals such as power, energy, chemicals, and defense.

Stone & Webster Rolta Ltd. (SWRL) is a 50:50 JV, which -plans to pursue engineering design opportunities in high growth refinery, petrochemicals, and energy sectors in India. As part of the JV agreement, Stone & Webster will transfer its crucial process technology know-how that ensures techno-commercial feasibility of the processes imperative in the targeted industries. Rolta, with its extensive experience in process engineering, will provide its IT know how and execution capabilities in multi-platform-based environments. SWRL will offer engineering, design, procurement, and construction management services, primarily to refinery, petrochemicals, and power projects in India. SWRL has already executed a few projects for Reliance Industries, IPCL, Essar Oil, and IOC. Internationally, it has executed numerous projects for Stone & Webster's process and power projects group.

Substantial investments are expected in the refinery, petrochemicals and power sectors, which are SWRL's focus areas. Our infrastructure team believes that the investment prospects in the entire energy space are likely to touch INR 2.3 tn (~USD 51 bn) by FY12. The two key spaces within this, E&P (exploration and production) and refining are likely to attract investments of USD 20 bn and USD 15 bn, respectively. India's power sector is expected to witness new capacity addition of about 100,000 MW by 2012. The Indian government has announced that it will take India's installed capacity of nuclear power to 40,000 MW compared to 3,900 MW currently. We note that Rolta has already worked on a number of nuclear power projects in India and Stone & Webster has extensive experience in global nuclear EPC projects. Rolta's approach to exploit the huge potential investments through a JV route provide it avenues to deploy its IT expertise with Stone & Webster's technical know how and impressive reference list. We see this JV as one of the very few entities in the global offshore space that is capable of executing large, complex and multi-year projects in the targeted sectors.

Rolta announced a 51:49 JV with French defense and aerospace major Thales. This JV envisages servicing Indian and international civil and military defence markets. Thales will transfer technology for developing state-of-the-art command, control, communications, computers, intelligence, surveillance, target acquisition and reconnaissance (C4ISTAR) information systems to the JV.

This JV has set ambitious revenue plans over the next five-year period. While revenues will be negligible in the first year (FY07), the JV envisages cumulative earning revenues of USD 500 mn by 2011 which includes consulting, hardware and software costs. We believe that net of the pass-through hardware costs, Rolta will earn EBITDA margins in the 35-45% range.

Rolta has done extensive work within the defense sector in India. It derives about 15% of its revenues from defense, of which about 12-13% accrues from Indian defense. Rolta also has UAE government as a client for defense-related work.

Engineering IT set for faster growth

Engineering services outsourcing (ESO) has posted strong growth over FY03-06, ahead of overall IT revenues growth. ESO had hitherto lagged enterprise IT growth, which has formed the basis of India's remarkable emergence as a preferred IT offshoring destination internationally.

Table 3: Revenues from engineering and R&D services of the Indian IT industry

(USD bn)	FY03	FY04	FY05	FY06
Engineering and R&D services	0.9	1.7	2.2	2.9
Growth (%)		88.9	29.4	31.8

Source: NASSCOM

Key factors responsible for a spurt in outsourcing and offshoring of engineering and R&D services are as follows:

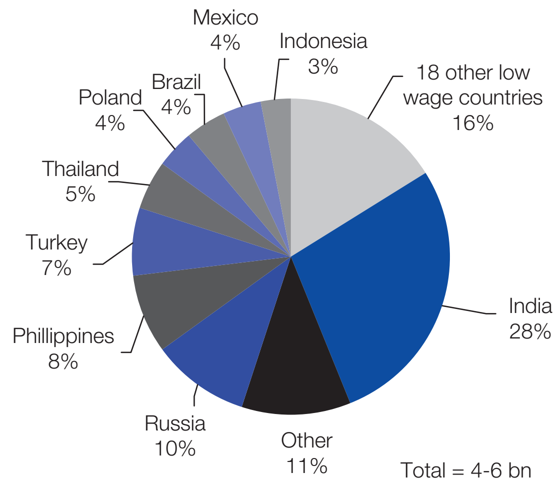
- Technology creators such as Parametric Technologies, Intergraph, UGS, and IBM-Dasssualt systems have vastly improved the process of product development, product engineering, and collaboration over the past decade. The digitization of product engineering process has lent itself to higher collaboration and outsourcing.

- Companies in the manufacturing sector in general are faced with challenges of shortening the product development cycle, raise the number of offerings, and increase cost competitiveness. These challenges, over a period of time, have melted the resolve of companies to do product engineering work in-house and use outsourcing and offshoring as mitigating measures.

- A recent comprehensive survey conducted by consulting firm Booz, Allen & Hamilton revealed that increasing number of companies in developed markets are viewing offshoring as a means to increase capacity of critical resources in a cost-effective manner, rather than just as a tool for saving costs.

- Developed economies are likely to face shortage of technical talent—a combination of an aging workforce and a shrinking talent pool. In an innovation-driven business world, ability to ramp up quality engineering talent in a timely manner is crucial. India is estimated to have 28% of global suitable talent pool for engineering and BPO services, significantly ahead of China's share of 11%.

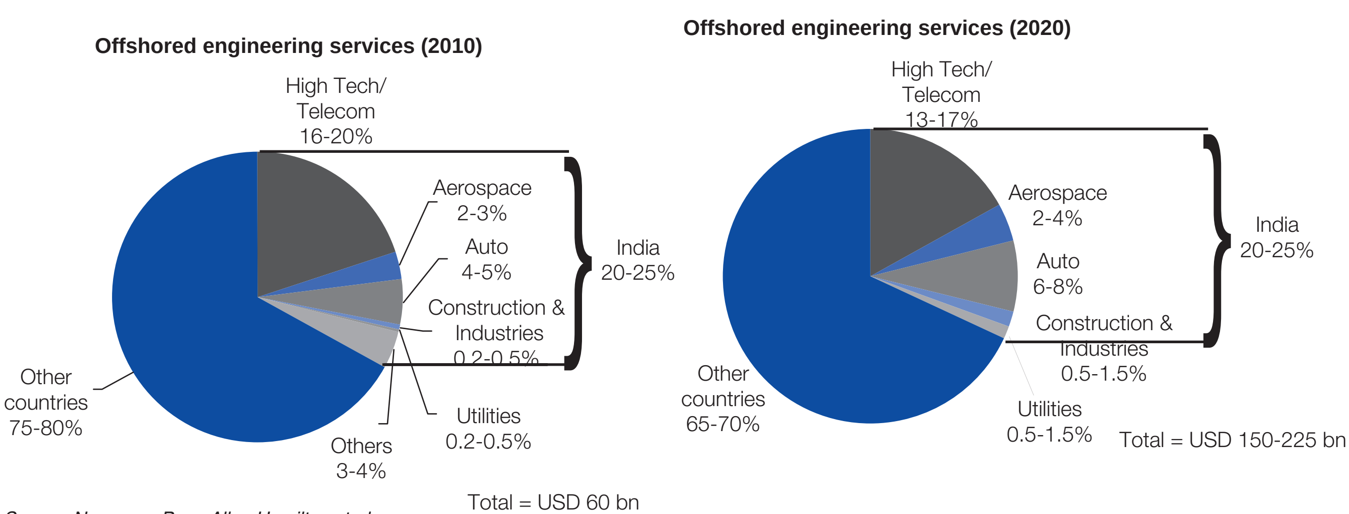
Chart 1: Aggregate suitable talent pool for offshore ES & BPO



Source: NASSCOM, Booz Allen Hamilton study

A recent in-depth study conducted by Booz, Allen & Hamilton, which was commissioned by Nasscom, on Engineering services indicated that potentially India can reach revenues of USD 12-16 bn by 2010 and USD 38-50 bn by 2020, compared with USD 2.9 bn achieved in FY06. The report estimates that in 2004, world's gross engineering spend aggregated to USD 746 bn and the same will reach USD 1,100 bn by 2020. Industries such as hi-tech/telecom, automotive, aerospace, industrial products and utilities account for bulk of the spend.

Chart 2: India poised to grow its market share for perod through 2020



Source: Nasscom, Booz Allen Hamilton study

Popular offshoring destinations such as India, China, and Mexico offer advantages that help shorten time to market, help raise capacity to innovate and increase productivity of internal creative resources at a competitive rate. A large number of leading global corporations now use vendors in India for their engineering design requirements. We believe that existing customers of India-based EOS vendors have diverted a small proportion (1-10%) of their engineering design spend. A vast majority of manufacturing and industrial products companies in the developed world have destinations such as India, China, and Mexico on the radar, but are yet to take advantage of the value proposition proffered.

Risk and Concerns

Substantial proportion of revenues from non-annuity sources

Unlike in enterprise IT, ESO projects are characterized by having large proportion in non-annuity revenues. In GIS, key user industries such as telecom, transportation, power, and government regularly undertake projects to create certain map-based applications. Often, the telecom or power company will cease to be a client at the end of the project, but may return in future for some other requirements. Similarly, in the engineering services area, Rolta specializes in process industries such as refineries, hydrocarbons with emphasis on petrochemicals and power. It is engaged by EPC contractors or end users for designing new plants or parts thereof. The company has historically experienced troughs and peaks in its businesses as many projects end with less than proportionate project commencements. Rolta now adds about 80-100 clients a year, but loses about 50-60 upon project completion. In a lean period, this can cause under absorption of its fixed costs, largely owing to lower utilization of its human resources.

The trends in Rolta's user industries, however, are on a sharp up tick. Large investments in refinery, hydrocarbon, power, and infrastructure sectors are on the anvil. India is also in the midst of receiving larger proportion of engineering outsourcing spends than before. We see this risk factor to have low intensity during the forecast period.

Talent shortage can affect projected growth rates

About 222,000 engineers graduate in India every year. In addition, about 195,000 students graduate with a three-year diploma every year. However, out of the 1,400 colleges that award engineering graduate degrees, only about 10% are recognized as providing world-class education. Players in the Indian IT industry lament that only 10-15% of the engineers that they interview are readily deployable on jobs. A vast majority of engineers need further training of two to six months, mostly at the vendor's end, before deployment on the job. It is estimated that in 2008-09, the Indian IT industry could face shortage of quality talent, which could affect growth rates.

To mitigate this risk, most large IT services companies in India have created education and training facilities. Rolta has now established an academy which trains diploma holders and engineers. The company also utilizes services of sub-contractors for a variety of low-end and manpower intensive tasks. It now has multiple vendors to whom it sub-contracts parts of projects. We understand that the total number of people engaged through sub contractors, though for lower-end jobs, is about 1,200-1,500.

Large proportion of revenues from domestic market

Unlike its peers, Rolta earns about 60% of its revenues from India-based customers. Realizations in developed markets tend to be higher and these projects also lend credibility to the company, which helps it bag larger projects in the future. However, Rolta has chosen to deploy relatively smaller proportion of its talent and infrastructure in markets which can offer higher realizations. The company, however, believes that its leadership in the domestic market has helped it build turnkey project execution capabilities, which most similar or smaller firms lack. Cultivating strength in delivering solutions is used as a mitigating factor to raise realizations.

We understand that the company is increasingly focusing on international markets and we expect the proportion of India-based revenues to fall to 45% of the total revenues by FY09E.

Valuations

Rolta currently trades at a P/E of 12.6x and 9.1x on its consolidated EPS of INR 21.1 and INR 29.2 for FY07E and FY08E, respectively. Based on EV/EBITDA, the stock trades at 6.7x and 4.7x on its FY07E and FY08E EBITDA, respectively.

Considering the strong macro environment and Rolta's leadership position in GIS and engineering services businesses, we believe the company is well poised to achieve 28-30% organic growth through FY09E. In addition, the Thales JV, in which Rolta has 51% share, is expected to contribute ~ USD 45 mn to its topline in FY09E, which will shift the growth trajectory to 38-40%.

Table 4: Valuation parameters

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Adjusted EPS (INR)	14.2	18.9	21.1	29.2	39.9
Y-o-Y growth (%)	*41.3*	*33.3*	*11.6*	*38.7*	*36.6*
BVPS (INR)	71.7	117.8	133.7	156.2	188.4
PER (x)	18.9	14.2	12.7	9.2	6.7
Pr/CF (x)	15.4	10.6	8.0	6.2	4.8
P/BV (x)	4.7	2.3	2.0	1.7	1.4
EV/EBITDA (x)	15.6	8.8	6.9	4.8	3.2
EV/Revenues (x)	5.5	3.7	2.8	1.9	1.3
Market cap/Revenues (x)	5.2	4.0	3.1	2.2	1.6

Source: Edelweiss research

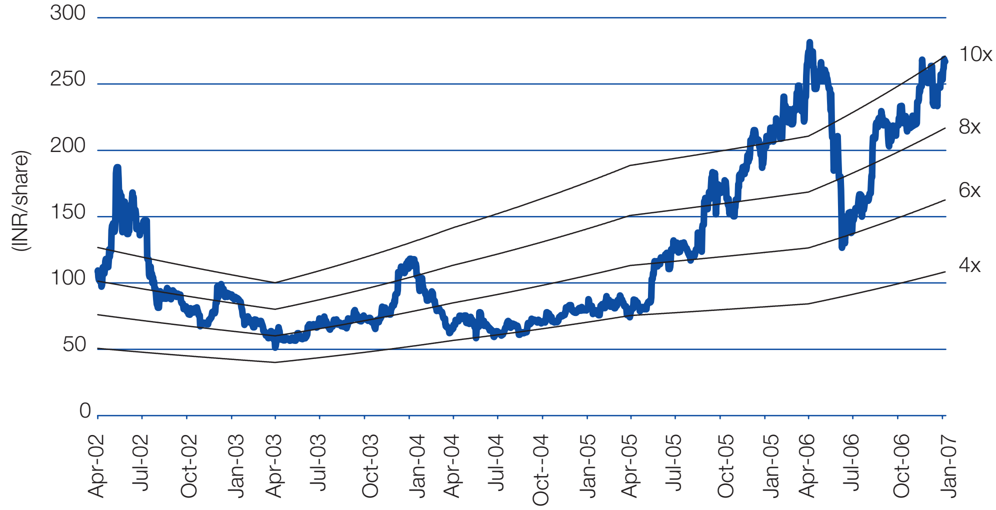
Table 5: Comparative valuation with other mid-caps IT companies

	Market Cap	PE (x)		EV/EBITDA (x)		EV/Revenues (x)	
	(USD mn)	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Geometric Software *	160	18.3	12.1	8.6	5.6	2.0	1.4
Hexaware Technologies **	564	20.0	15.3	16.1	11.5	2.6	2.1
iGATE Global	282	27.3	12.5	12.7	6.4	1.4	1.0
Infotech Enterprises	341	18.3	13.8	16.6	8.9	2.7	1.9
KPIT Cummins	219	19.0	13.3	13.2	9.2	2.2	1.6
Rolta India ***	482	12.7	9.2	6.9	4.8	2.8	1.9
Sasken Communications	388	33.4	17.6	19.8	11.0	3.6	2.5
Median		19.0	13.3	13.2	8.9	2.6	1.9

Source: Edelweiss research ** does not include Modern Engg financials* *** Year end Dec* **** Year end June*

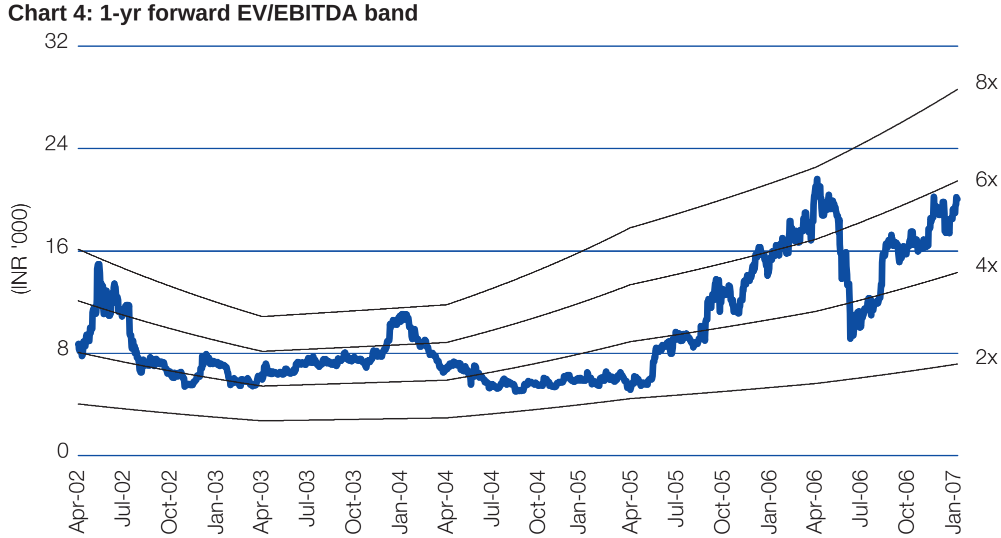
We forecast EPS growth in FY08 and FY09 at 39% and 37%, respectively. We see the company's forward P/E ratios improving from the 10x-13x range to 14x-16x range over the next 12 months. Strong macro environment, large deal win possibilities, M&A, and sustained EPS growth will be the key factors to raise the rating.

Chart 3: 1-yr forward PE band



Source: Edelweiss research

Chart 4: 1-yr forward EV/EBITDA band



Source: Edelweiss research

Business Analysis

Outsourcing in GIS and ESO, after trailing the outsourcing of enterprise IT, is witnessing a strong surge. We also note that this phase of engineering outsourcing is marked by: (1) larger and end-to-end projects; (2) higher complexity of projects; and (3) larger and experienced vendors are favoured.

Only a few years ago outsourcing and offshoring of GIS and engineering projects was characterized by low-end jobs and smaller size. The vendor space was crowded with multitude of players with limited differentiation. Over the past decade, a few players, including Rolta, have emerged as solution providers in a variety of niches.

Leadership position in the GIS segment

Rolta is one of the leading providers and developers of digital map-based GeoSpatial Information Services (GIS) servicing customers in segments like defense, environmental protection, utilities, emergency services, and public planning. The company also caters specialized services to the fleet management and disaster planning for public safety agencies such as police, fire and ambulance.

Rolta now has a highly skilled and dedicated team of over 1,500 professionals working on GIS projects. The company has executed large projects for 3D city modeling using high-end photogrammetry technology and created digital networks for telecom, electric, gas and water companies across the world, which reaffirms its standing as a leading provider of GIS services. The efficient interfacing of operational resources has helped the company complete multi-million dollar projects for various clients. Rolta has acquired technology and established long standing strategic business partnerships with world leaders in the GIS field—Intergraph and Z/I Imaging for end-to-end mapping, photogrammetry and GIS solutions. These relationships ensure that Rolta remains abreast of evolving technologies and updates its competency.

In recent years, Rolta's differentiated offerings and experience in managing bigger projects have resulted in the company winning larger projects involving end-to-end service offerings. It has been able to create a positive spiral for itself through good relationships with technology partners and has been able to get higher realisations.

Engineering design automation (EDA): Strong growth driver

In EDA services, Rolta focuses on computer-aided plant design and mechanical engineering solutions. The company provides a combination of software skills and component manufacturing services through its EDA group. The group also covers a wide range of plant data, product data, and plant/product lifecycle management requirements in the Indian market and a broad spectrum of services for consulting and engineering in plant information management and mechanical design globally.

The company has enhanced its leadership position in India and secured large contracts for providing engineering design automation solutions and design services to major engineering, procurement EPCs and owner operators. Internationally, the company has executed large contracts in plant information management for customers in the US, Europe, and the Middle East. Oil and gas is one of the core verticals where Rolta has developed expertise with execution of various projects.

Recently, many companies have announced their plans to invest in refinery, petrochemicals, nuclear, fossil, and hydro power sectors, which will result in large, end-to-end project outsourcing. We believe, these projects are likely to flow to Rolta as it has the relevant experience and requisite expertise.

Impressive growth and scale up in eSolutions and security services

Rolta's eSolutions business group has successfully evolved from a mere support and maintenance division into a full fledged IT and security services group. Over the years, network security along with IT infrastructure has gained prominence across all organizations due to rising security breaches and threats, leading to increased spending in these areas. Rolta has, in its eSolutions and security services, developed practices catering to this requirement. Rolta's new generation technologies have made RFID a viable and cost effective solution to address the rising need. The company has been adding to its width of technology services offerings by entering into alliances with leaders like IBM, Microsoft, Computer Associates, among others.

Table 6: Portfolio of software development and eSolutions services

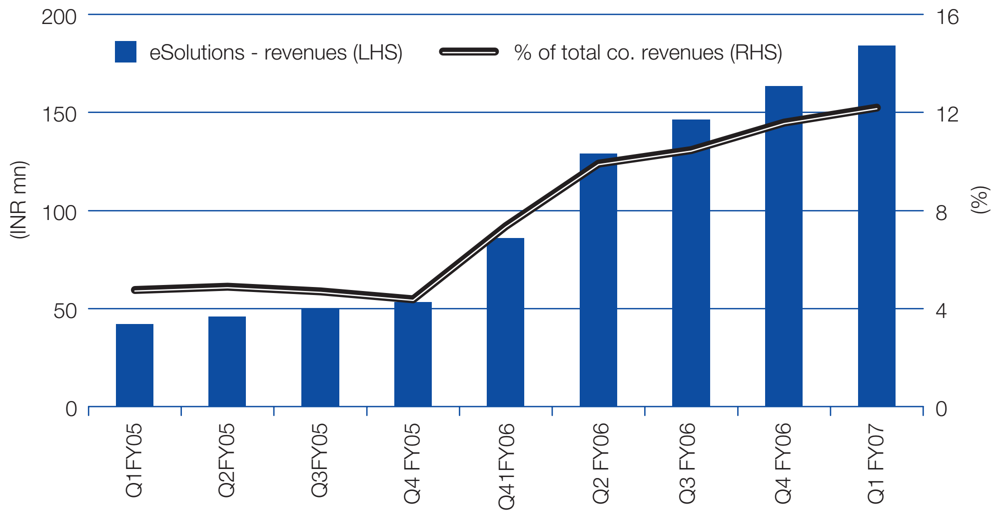
Security and IT infrastructure management services	• Identity and access management • Security information management • Network and IT resource management • Business services optimisation • IT governance and project and portfolio management
Software development, testing & packaging	• Software application development services • Software application maintenance services • Software application re-engineering services • Software migration services • Functionality testing services • Migration testing/packaging services • Global collaboration performance testing • User acceptance testing • Installation and compatibility testing • Packaged application testing
RFID	• Asset management • Library/Document management • Vehicle access control • Inventory control • Integration with network management system
Gaming services console	• Full cycle development of games for PC & next generation • Artwork outsourcing services • Game programming • Tools development • Other outsourcing services—Testing, audio, etc.

Source: Company

Rolta has entered into a definitive agreement to provide expert implementation, customization and integration services to CA customers across North America. As per the agreement, Rolta's onshore and offshore resources will supplement services provided by CA Technology Services' internal staff across the full spectrum of CA's data security, network and systems management and service management solutions The company has also, realising the market potential for gaming applications and character animation, set up a development group specifically focusing on solution offerings to this segment.

Rolta's eSolutions group has evolved successfully over the past few years, making a higher contribution to overall business. The focus on developing practices in emerging areas and growing the same has led to share of eSolutions increasing from a mere 4.8% in Q1FY05 to 12.2% in Q1FY07. Revenues during the same period have grown at an impressive CQGR of 12.5% as shown in the chart below.

Chart 5: Revenue contribution from eSolutions group



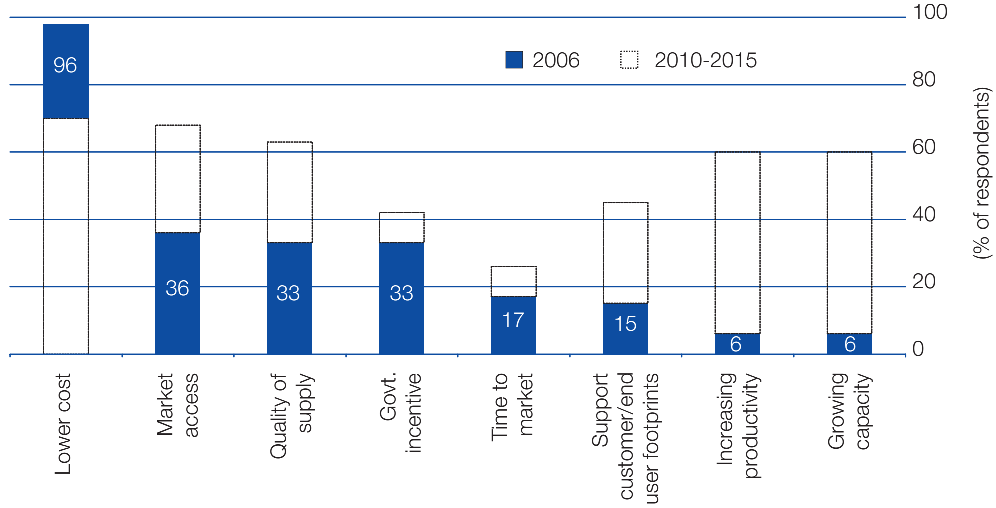
Source: Company, Edelweiss research

Operating environment for ESO likely in a decade long improvement zone

Engineering related outsourcing that has traditionally lagged enterprise IT outsourcing is in a catch up mode. While there are some similar drivers that are causing outsourcing from both these vast spaces to grow – there is one significant driver that is more prominent in engineering outsourcing. In engineering space, the end users view outsourcing first as a mode to expand the design and innovation capacity at an affordable cost rather than as a tool to replace their current spending pattern.

The value proposition of offshoring engineering services, which hitherto was primarily on lower costs of manpower is shifting in favour of strategic factors such as faster time to market, access to quality manpower, accessing newer markets through services created at lower costs, increasing productivity of creative sources in the home market and importantly growing capacity to innovate.

Chart 6: Shift in relative importance of strategic, non-cost drivers



Source: Nasscom, Booz Allen Hamilton study

A recent comprehensive study on the potential of engineering outsourcing conducted by Booz Allen & Hamilton has found that the factors that drive offshoring will continually change in favour of factors such as higher capacity, productivity and market access. The prospects of stronger economies in the emerging markets also necessitate that the engineered products get created at lower costs raising their affordability, competitiveness and market relevance.

Rolta has invested substantially in infrastructure, technology know how and most importantly building domain capabilities over the past twenty years. Our discussions with the company revealed its readiness to execute an ambitious growth plan to leverage positive operating environment, which we see lasting over a decade.

Impressive client relationships and diversification

Rolta's top ten clients reflect the company's predominant focus on defense, telecom, energy, and government segments. The company's business is characterised by project-based capital expenditure and non-annuity based revenues. The FY04-FY06 period showed a number of signs that signaled early phase of a large capital expenditure cycle. Sectors such as telecom, refineries, petrochemicals and power, and verticals, where Rolta strengths lie, have substantially higher capital expenditure outlays over the next few years. The company's extensive client relationships, aided by its JVs with Stone & Webster and Thales, will ensure a growing share of the enlarging pie.

Table 7: Top 10 client list for the past three years

FY04	FY05	FY06
CA	Dubai Municipality	Dubai Municipality
ONGC	British Telecom	British Telecom
British Telecom	Reliance	Reliance
Ministry of Defence	CA	CA
LGE	Ministry of Defence	Ministry of Defence
Dept. of Naval Intelligence	Montana Dakota	SNC Lavlin
Reliance	Quest Communication	Quest Communication
IOCL	Petrofac International	Verizon
Saudi Telecom	Saudi Telecom	Saudi Telecom
Telus communication	EIL	ONGC

Source; Company ** client name sequence is not based on revenue contribution*

The company has done well to reduce its dependence on the top clients and has diversified its revenue stream across a larger client base.

We note that as compared to a time and material based engineering services companies, Rolta's fixed price and solution based approach has created operating leverage that will be harness over the coming years.

Table 8: Client details

	FY04	FY05	FY06
Total revenues (INR mn)	3,506	4,146	5,349
Growth (%)		*18.3*	*29.0*
Client additions	75	86	102
Active clients	307	372	448
QoQ Growth in Active Clients		21.2	20.4
Revenue contribution (%)			
Top 10 clients	31.9	30.0	26.7
Beyond top 10	68.1	70.0	73.3
Revenue contribution (INR mn)			
Top 10 clients	1,118	1,244	1,428
Growth (%)		*11.2*	*14.8*
Beyond top 10	2,387	2,902	3,921
Growth (%)		*21.6*	*35.1*

Source: Company, Edelweiss research

Financials

GIS and EDA businesses that currently contribute 88% to the total company revenues are expected witness strong growth over the FY07E-FY09E period. GIS including revenues from S&W JV are expected to grow at 22% CAGR over FY07E-FY09E. Moreover, during the same period we expect the revenues from EDA, which is in a pick up mode to grow at a CAGR of 32.1%.

Table 9: Segmental financials

GIS (INR mn)

Year to June	FY05	FY06	FY07E	FY08E	FY09E	FY07-09 CAGR (%)
Revenues	2,750	3,290	3,869	4,630	5,558	19.9
Growth (%)		*19.6*	*17.6*	*19.7*	*20.0*	
EBITDA	1,065	1,436	1,670	2,014	2,420	20.4
Growth (%)		*34.8*	*16.4*	*20.6*	*20.2*	
Margin (%)	38.7	43.6	43.2	43.5	43.5	
PAT	655	831	988	1,190	1,473	22.1
Growth (%)		*26.8*	*18.9*	*20.4*	*23.8*	
Margin (%)	23.8	25.2	25.5	25.7	26.5	

EDA

Year to June	FY05	FY06	FY07E	FY08E	FY09E	FY07-09 CAGR (%)
Revenues	1,171	1,460	2,052	2,771	3,581	32.1
Growth (%)		*24.7*	*40.5*	*35.0*	*29.2*	
EBITDA	374	612	837	1,125	1,464	32.3
Growth (%)		*63.7*	*36.9*	*34.4*	*30.2*	
Margin (%)	31.9	41.9	40.8	40.6	40.9	
PAT	219	323	480	665	868	34.4
Growth (%)		*47.4*	*48.5*	*38.5*	*30.4*	
Margin (%)	18.7	22.1	23.4	24.0	24.2	

eSolutions

Year to June	FY05	FY06	FY07E	FY08E	FY09E	FY07-09 CAGR (%)
Revenues	192	524	807	1,126	1,550	38.5
Growth (%)		*173.6*	*54.0*	*39.4*	*37.7*	
EBITDA	30	161	250	371	508	42.5
Growth (%)		*429.9*	*55.4*	*48.4*	*36.9*	
Margin (%)	15.9	30.7	31.0	33.0	32.8	
PAT	25	100	161	232	322	41.3
Growth (%)		*298.0*	*62.3*	*43.6*	*39.0*	
Margin (%)	13.0	19.0	20.0	20.6	20.8	

Source: Company, Edelweiss research

Rolta's revenue growth trajectory is expected to rise significantly with revenue contribution from S&W and Thales JV. Financials of the Thales JV in which Rolta has a 51% share, will be consolidated in the parent company while the operations of the S&W JV will be consolidated with only 50% of Rolta' share. We estimate both these JVs to contribute ~ USD 26 mn in FY08E and USD 56 mn in FY09E.

Segmental financials (contd.)

S&W JV (50%) (INR mn)

Year to June	FY05	FY06	FY07E	FY08E	FY09E	FY07-09 CAGR (%)
Revenues	33	75	196	379	468	54.5
Growth (%)		126.4	162.7	93.2	23.5	
EBITDA	5	21	59	119	155	61.7
Growth (%)		355.6	188.1	102.2	29.4	
Margin (%)	13.6	27.4	30.1	31.5	33.0	
PAT	3	20	54	106	130	55.3
Growth (%)		622.2	176.7	96.7	22.6	
Margin (%)	8.2	26.1	27.5	28.0	27.8	

Thales JV - 100%

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Revenues				762	2,038
Growth (%)					167.6
EBITDA				213	655
Growth (%)					207.2
Margin (%)				28.0	32.1
PAT				164	448
Growth (%)					173.9
Margin (%)				21.5	22.0

Consolidated

Year to June	FY05	FY06	FY07E	FY08E	FY09E	FY07-09 CAGR (%)
Revenues	4,146	5,349	6,924	9,667	13,195	38.0
Growth (%)		29.0	29.4	39.6	36.5	
EBITDA	1,474	2,229	2,817	3,843	5,202	35.9
Growth (%)		51.3	26.4	36.4	35.4	
Margin (%)	35.5	41.7	40.7	39.8	39.4	
PAT	902	1,273	1,684	2,357	3,241	38.8
Growth (%)		41.1	32.3	40.0	37.5	
Margin (%)	21.8	23.8	24.3	24.4	24.6	

Source: Company, Edelweiss research

On a consolidated basis we expect Rolta's revenues and PAT to grow at a CAGR of 38% and 39% respectively over FY07E-09E period. Operating margins (EBITDA margins) are expected to remain in the range of 40-41% which is one of the highest in the industry.

Table 10: Revenue and PAT contribution break-up

Revenues	FY05	FY06	FY07E	FY08E	FY09E
GIS	66.3	61.5	55.9	47.9	42.1
EDA	28.3	27.3	29.6	28.7	27.1
eSolutions	4.6	9.8	11.7	11.6	11.7
S&W JV	0.8	1.4	2.8	3.9	3.5
Thales JV	-	-	-	7.9	15.4
Total	100.0	100.0	100.0	100.0	100.0

PAT	FY05	FY06	FY07E	FY08E	FY09E
GIS	72.6	65.3	58.7	50.5	45.4
EDA	24.3	25.4	28.5	28.2	26.8
eSolutions	2.8	7.8	9.6	9.8	9.9
S&W JV	0.3	1.5	3.2	4.5	4.0
Thales JV	-	-	-	6.9	13.8
Total	100.0	100.0	100.0	100.0	100.0

Source: Company, Edelweiss research

Financial Statements

Income statement (INR mn)

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Revenues	4,146	5,349	6,924	9,667	13,195
Cost of revenues	2,216	2,614	3,427	4,873	6,677
Gross profit	1,930	2,735	3,497	4,794	6,518
Operating expenditure	457	506	681	951	1,320
EBITDA	1,474	2,229	2,817	3,843	5,199
Depreciation	489	747	998	1,100	1,240
EBIT	985	1,482	1,818	2,743	3,959
Total other income	111	85	102	56	65
Provision for investments	-	-	-	-	-
Net interest	(116)	(147)	(12)	(5)	-
Profit before tax	980	1,420	1,907	2,794	4,024
Tax	86	147	222	364	575
Profit after tax	894	1,273	1,685	2,430	3,449
Extraordinary Income(loss)	-	-	-	-	-
Minority int. and others	(8)	-	-	(72)	(207)
Reported PAT	902	1,273	1,685	2,358	3,242
Adjusted EPS basic (INR)	14.2	18.9	21.1	29.2	39.9
CEPS (INR)	21.8	29.9	33.5	42.8	55.2
Dividend (%)	35	40	45	50	60
Dividend pay out (%)	28	29	24	19	17

Common size metrics as % of net revenues

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Cost of revenues	53.4	48.9	49.5	50.4	50.6
Gross Profit	46.6	51.1	50.5	49.6	49.4
Operating expenses	11.0	9.5	9.8	9.8	10.0
EBITDA margin	35.5	41.7	40.7	39.8	39.4
EBIT margin	23.8	27.7	26.3	28.4	30.0
PAT margin	21.8	23.8	24.3	24.4	24.6

Growth metrics (%)

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Revenues	18.3	29.0	29.5	39.6	36.5
EBITDA	8.5	51.2	26.4	36.4	35.3
EBIT	32.2	50.5	22.7	50.9	44.3
Net income	41.3	41.1	32.4	39.9	37.5
EPS	41.3	33.3	11.6	38.7	36.6

Balance sheet (INR mn)

As on 30th June	FY05	FY06	FY07E	FY08E	FY09E
Equity share capital	637	799	805	810	818
Share premium account	440	4,203	4,203	4,203	4,203
Reserves	3,489	4,412	5,689	7,590	10,278
Total shareholders funds	4,566	9,414	10,697	12,603	15,299
Preference shares issued by subsidiary	-	-	-	-	-
Borrowings	1,863	98	-	-	-
Deferred tax liability	172	253	253	253	253
Minority Interest	-	-	-	72	279
Sources of fund	6,601	9,765	10,950	12,928	15,831
Gross fixed assets	7,169	6,762	8,819	10,434	11,471
Depreciation	3,892	2,852	3,851	4,951	6,191
Net fixed assets	3,277	3,910	4,968	5,483	5,281
Capital WIP	422	682	120	110	90
Investments	-	1,124	1,230	1,550	1,600
Deferred tax asset	-	0	0	0	0
Cash & bank balances	331	887	886	1,259	3,031
Debtors	2,889	3,262	3,832	4,635	5,965
Loans & advances	580	745	968	1,210	1,513
Total current assets	3,990	5,128	5,979	7,469	10,965
Sundry creditors	657	538	673	841	1,051
Provisions	431	540	674	843	1,054
Application of funds	6,600	9,765	10,950	12,928	15,831
Book value per share (BV) (INR)	72	118	134	156	188

Cash flow statement (INR mn)

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	1,609	1,973	2,953	3,867	5,110
Cash for working capital	727	(586)	(852)	(1,118)	(1,724)
Net operating cashflow(A)	2,336	1,387	2,101	2,749	3,385
Net purchase of fixed assets	(1,848)	(1,631)	(1,495)	(1,605)	(1,018)
Net purchase of investments	66	(1,124)	(106)	(320)	(50)
Others	-	17	-	-	-
Cash flow from investments(B)	(1,782)	(2,737)	(1,601)	(1,925)	(1,068)
Dividends	(221)	(254)	(409)	(457)	(554)
Proceeds from issue of equity	-	3,925	6	5	8
Proceeds from LTB/STB	(509)	(1,764)	(98)	-	-
Interest paid & other items	-	-	-	-	-
Cash flow from financing (C)	(730)	1,907	(501)	(452)	(546)
Exchange rate differences (D)	-	-	-	-	-
Change in cash(A+B+C) + (D)	(177)	557	(1)	372	1,772

Ratios

Year to June	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	19.8	18.2	16.8	20.2	23.2
ROCE (%)	12.1	14.4	16.2	19.7	22.5
Debtor Days	254.4	222.6	202.0	175.0	165.0
Fixed asset T/0	1.4	1.5	1.6	1.9	2.5

Valuation parameters

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Adjusted EPS (INR)	14.2	18.9	21.1	29.2	39.9
Y-o-Y growth (%)	*41.3*	*33.3*	*11.6*	*38.7*	*36.6*
BVPS (INR)	71.7	117.8	133.7	156.2	188.4
PER (x)	18.9	14.2	12.7	9.2	6.7
Pr/CF (x)	15.4	10.6	8.0	6.2	4.8
P/BV (x)	4.7	2.3	2.0	1.7	1.4
EV/EBITDA (x)	15.6	8.8	6.9	4.8	3.2
EV/Revenues (x)	5.5	3.7	2.8	1.9	1.3
Market cap/Revenues (x)	5.2	4.0	3.1	2.2	1.6

NOTES

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Manika Premsingh	-	4019 4847	Economist
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Priya Ramchandran	-	2286 4389
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Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	**Reduce**	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	**Sell**	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	**Trading Sell**	Expected to depreciate more than 10% over a 45-day period