ROLTA INDIA

Edelweiss
Ideas create, values protect

Revival stronger in engineering

January 22, 2010

Reuters : ROLT.BO *Bloomberg : RLTA IN*

Performance in line with expectations; uptick seen across segments

Rolta's Q2FY10 revenues were in line with our expectations, while net profits surpassed estimates due to improved operating margins. Revenue for the quarter grew 7.1%, while EBITDA grew 13.4% Q-o-Q. GIS and engineering segments posted commendable sequential growth of 9.2% and 7.8%, respectively, with margin improvement of 200bps in each segment. EBITDA margins (210bps) touched 38%, as greater solutions revenue booking and cost measures of earlier quarters yielded results. In Q3FY10, the company also bought back FCCB of USD 15 mn (accreted value USD 17.8 mn), gain of INR 130 mn on which is recognized by us in P/L. This is in line with our policy of also charging notional interest on FCCB in the P/L.

Engineering segment back on growth path; strong order bookings

Highlight of the quarter was the **sharp uptick of 33% in new order booking in the engineering segment**. 7.8% sequential revenue growth in the segment was proof of our continuing belief about improvement in capex spending leading to improved prospects for Rolta. **Total order book as at the quarter end stood at INR 17.1 bn (up 3% Q-o-Q).** While the drag on revenue growth of engineering segment will continue to be oil & gas vertical, management did indicate select order flow pick-up and overall stability. FY10 revenue outlook for EDA remains flat, but is likely to pick up going in FY11.

Geospatial Fusion Solution gaining traction

The GIS segment is witnessing steady growth with emerging economies providing stability. It is interesting to note that Rolta's Geospatial Fusion Solution is gaining traction. The company did its first implementation for the utility segment with Calcutta State Electricity Board (CSEB) and expects further acceptance within India. Increased revenue flow from fusion solution, with high profitability, has already started contributing to margin expansion.

Outlook and valuations: Growth momentum begins; maintain 'BUY'

Improvement in business environment leading to revival of industrial capex has benefited Rolta immediately in the form of increase in order flow and in quarterly revenue run rate. We see the company well-positioned with its solutions-based sales positioning to take advantage of the improving business environment and capture profitable growth. We estimate EPS of INR 16.2 for FY10 and INR 20.1 for FY11. At CMP of INR 193, the stock is trading at P/E of 11.9x FY10E and 9.6x FY11E earnings. We maintain **'BUY'** recommendation. On relative return basis, the stock is rated **'Sector Outperformer'.**

Financials

Year to June	Q210	Q110	*Growth %*	Q209	*Growth %*	FY09	FY10E
Revenue (INR mn)	3,756	3,505	*7.1*	3,619	*3.8*	13,728	15,307
Gross profit (INR mn)	1,782	1,659	*7.4*	1,640	*8.7*	6,274	7,209
EBITDA (INR mn)	1,423	1,255	*13.4*	1,261	*12.8*	4,685	5,296
Net profit (INR mn)	691	484	*42.7*	502	*37.5*	2,814	2,609
Diluted EPS (INR)	4.3	3.0	*42.7*	3.1	*37.4*	17.5	16.2
Diluted P/E (x)						11.0	11.9
EV/EBITDA (x)						8.4	7.2
EV/Revenues (x)						2.9	2.5

EDELWEISS 4D RATINGS	
Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Equalweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA		
CMP	:	INR 193
52-week range (INR)	:	209 / 40
Share in issue (mn)	:	161.1
M cap (INR bn/USD mn)	:	31.2 / 678.3
Avg. Daily Vol. BSE/NSE ('000)	:	7,797.1

SHARE HOLDING PATTERN (%)		
Promoters*	:	42.0
MFs, FIs & Banks	:	3.1
FIIs	:	32.4
Others	:	22.5
* *Promoters pledged shares (% of share in issue)*	:	*2.5*

PRICE PERFORMANCE (%)	Stock	Nifty	EW IT Index
1 month	4.5	2.9	4.9
3 months	2.3	0.6	19.8
12 months	144.3	88.2	178.7

Kunal Sangoi
+91-22-6623 3370
kunal.sangoi@edelcap.com

Viju George
+91-22-4040 7414
viju.george@edelcap.com

Pratik Gandhi
+91-22-4063 5578
pratik.gandhi@edelcap.com

Key highlights

- Consolidated revenues, at INR 3.76 bn, were up 7.2% Q-o-Q and 3.8% Y-o-Y. Gross profits for the quarter stood at INR 1.8 bn, a sequential improvement of 7.5%. Gross margins improved marginally 20bps on account of higher billing rate and increase in utilisation rate during the quarter.

- **Margins reaching near-term peak:** EBITDA stood at INR 1.42 mn, up an impressive 13.4% Q-o-Q and 12.8% Y-o-Y. EBITDA margins posted sharp improvement of 210bps Q-o-Q at 37.9%, due to cost rationalisation, leverage on higher solution sales, lower SG&A spend, and higher utilisation. Rolta has done exceeding well in improving margins in the past two quarters to 37.9% from 33.8% in Q4FY09.

- Net profit, at INR 691 mn, was up at an impressive 49.1% sequentially (on account of higher other income due to FCCB buyback gains in previous quarter) and up 37.5% Y-o-Y. Net profit margin, at 18.4%, has seen a significant Q-o-Q improvement of 460bps. Tax rate has increased during this quarter to 18.4%. Tax rate will remain at 13.5-14% for FY10 and FY11.

- **Guidance:** Rolta is maintaining its FY10 revenue guidance in the INR 15.3 bn–15.7 bn range and EBITDA margins in the 33-35% range. This implies revenue growth of 12-15% over FY09. As per management commentary, Rolta will be able to reach upper end of guidance and margins will be maintained through cost rationalisation and increasing solutions' sales (currently 8-10% of revenues).

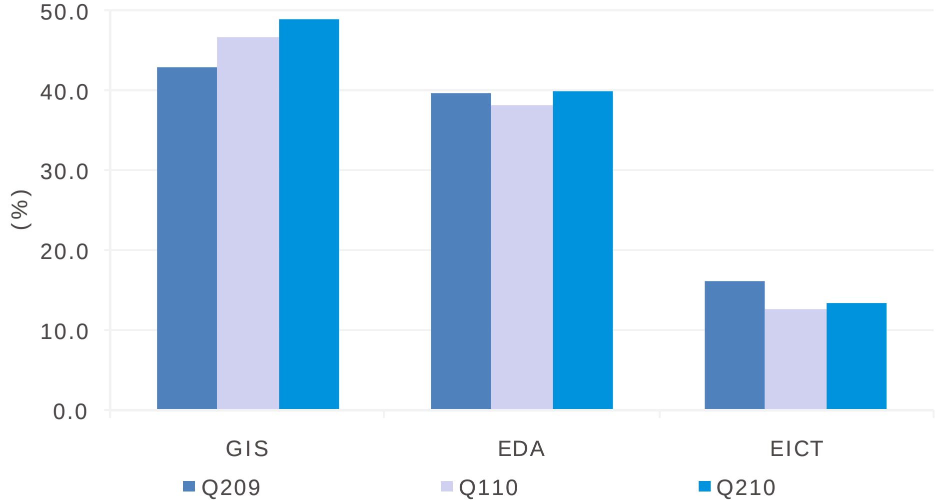
Segmental performance

- **GIS:** Consolidated revenues, at INR 1,867.9 mn, were up 9.2% Q-o-Q and 14.3% Y-o-Y. EBITDA margin increased sequentially over 220bps and now stands at 49.0%, highest in the company's history, on account of increasing solution sales and pricing despite utilisation declined marginally by 40bps, now at 81%. Rolta has increased operating margins (820bps) in the past three quarters primarily due to improvement in utilisation rate by 420bps along with moderate uptick in pricing in the past three quarters. However, the traction in the GIS segment seems to be cooling off as its order book grew by 2.1%; this was 14th successive quarter where GIS order book has reported sequential growth. On a reported basis, realisation saw an uptick of 0.9% Q-o-Q.

- **Engineering design:** Rolta reported consolidated revenues of INR 950.8 mn, up 7.8% Q-o-Q and down 13.1% Y-o-Y. Engineering design has seen an scorching order book growth of 8% Q-o-Q, highest among the three segments. EBITDA margin stood at 40.1%, an improvement of 179bps from the previous quarter. This sequential improvement along with strong revenue growth and sequential improvement in pricing indicates that the environment has become conducive for this segment which was under pressure in FY09.

- **Enterprise information and communication technology (EICT):** The EICT segment's revenue at INR 936.8 mn grew 2.7% in the quarter. EBITDA margin, at 13.6%, was up 80bps from the previous quarter. Order book position dipped 1.7% from the previous quarter. This segment has been hit the most on the past on account of higher exposure to US geography; however as the recovery in US is quicker and faster than expected management have turned optimistic about this segment.

Chart 1: Sequential and Y—o-Y margin performance for all business segments



Source: Company, Edelweiss research

- **Headcount addition though a small number came after three quarters of decline:** Headcount during the quarter has seen an addition of seven employees; this was on the back of net reduction of more than 800 employees over the past three quarters. Total employee count now stands at 4,763. As the solution proportion increases going forward revenues will be de-link with manpower growth, thus headcount addition should not be looked as a lead indicator unlike tier-I players where hiring guidance has been revised upwards and strong net addition reported in this quarter.

- **Order book uptick continued:** Rolta's order book grew 2.9% sequentially. Current order book stands at INR 17.1 bn.

Chart 2: Order book break-up segment wise

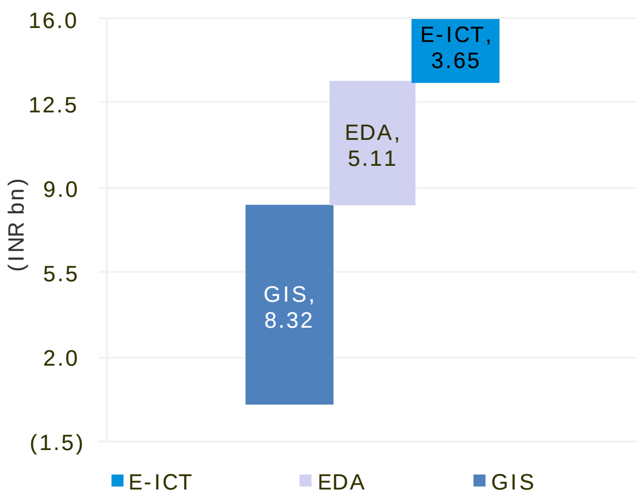


Chart 3: New order bookings continued to trend up

Source: Company, Edelweiss research

- The company had INR 1.55 bn (INR 2.0 bn for Q1FY10) in cash and cash equivalents and debt of over INR 11 bn, inclusive of FCCB debt at the end of the quarter, so net debt is around INR 9.45 bn. The decline in the cash balance is on account of outflow for dividend and some capex.

- **DSOs decline:** Debtor days for the company stands at 134 days vis-à-vis 133 days in the previous quarter. Management is confident of bringing down DSO further to below 120 days by FY10 end.

Financials snapshot **(INR mn)**

Year to June	Q210	Q110	*Growth %*	Q209	*Growth %*	FY09	FY10E	FY11E
Total revenues	3,756	3,505	*7.1*	3,619	*3.8*	13,728	15,307	17,872
Cost of revenues	1,973	1,846	*6.9*	1,980	*(0.3)*	7,455	8,097	9,490
Gross profit	1,782	1,659	*7.4*	1,640	*8.7*	6,274	7,209	8,382
SG&A	359	405	*(11.2)*	378	*(5.1)*	1,588	1,913	2,091
EBITDA	1,423	1,255	*13.4*	1,261	*12.8*	4,685	5,296	6,291
Depreciation	670	621	*7.8*	413	*62.1*	1,867	2,120	2,240
EBIT	753	634	*18.8*	848	*(11.2)*	2,818	3,176	4,051
Interest expense*	182	160	*13.3*	115		512	531	547
Other income	210	99	*111.6*	(132)	*(259.4)*	903	380	300
PBT	781	573	*36.4*	602	*29.8*	3,208	3,025	3,804
Tax	92	90	*2.0*	101	*(9.2)*	402	423	571
Adjusted net profit	689	482	*42.9*	501	*37.7*	2,807	2,601	3,233
Minority interest	(2)	(2)	-	(2)	-	(7)	(8)	0
Reported net profit*	691	484	*42.7*	502	*37.5*	2,814	2,609	3,233
EPS fully diluted (INR)	4.3	3.0	*42.7*	3.1	*37.4*	17.5	16.2	20.1
as % of net revenues								
Gross profit	47.5	47.3		45.3		45.7	47.1	46.9
SG&A	9.6	11.5		10.5		11.6	12.5	11.7
EBITDA	37.9	35.8		34.8		34.1	34.6	35.2
Adjusted net profit	18.3	13.8		13.8		20.4	17.0	18.1
Reported net profit	18.4	13.8		13.9		20.5	17.0	18.1
Tax rate	11.8	15.8		16.9		12.5	14.0	15.0

** Accrued interest on FCCB taken in interest expenses and thus commensurate gain of FCCB buy-back also reversed in profit and loss account*

Company Description

Rolta is one of the leading providers of GIS and engineering design and automation (EDA) services. In GIS, Rolta provides and develops digital map-based solutions, servicing customers in segments like defence, environmental protection, utilities, emergency services, and public planning. In EDA, 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. It also provides security and IT infrastructure, software development, testing, and gaming services through its EICT group. The company's past twelve months (TTM) revenues stood at INR 13.8 bn (USD 294 mn) and it employs over 4,750 people.

Investment Theme

Outsourcing of engineering services is expected to reach USD 38-50 bn by 2020 against USD 2 bn currently, as per the Nasscom-Booz Allen Hamilton study. As one of the leading offshore engineering services firms for the manufacturing industry, Rolta is poised to grab the increasing opportunities. Nevertheless, in the current environment, as capex spending has eased, Rolta has seen uptick in new orders. Moreover, with increased emphasis and spending plans on upgrading defence technologies, opportunity for Rolta is significant. In addition, visibility for JVs with Shaw Group and Thales Group is also looking up. We see Rolta placed in a strong position to explore the high opportunity segments of GIS and engineering along with its focus on transitioning towards solutions approach.

Key Risks

Key risks to our investment theme include: (a) substantial proportion of revenues from non-annuity sources; (b) non pick-up of growth in other verticals of the EDA segment; and (c) inability to monetize the Fusion solutions could impact profitability.

Financial Statements

Income statement **(INR mn)**

Year to June	FY08	FY09	FY10E	FY11E	FY12E
Revenues	10,722	13,728	15,307	17,872	20,660
Cost of revenues	5,761	7,455	8,097	9,490	11,157
Gross profit	4,961	6,274	7,209	8,382	9,504
Total SG&A expenses	1,064	1,588	1,913	2,091	2,583
EBITDA	3,897	4,685	5,296	6,291	6,921
Depreciation & Amortization	1,383	1,867	2,120	2,240	2,560
EBIT	2,515	2,818	3,176	4,051	4,361
Interest expense	-	512	531	547	557
Other income	170	952	380	300	500
Profit before tax	2,685	3,258	3,025	3,804	4,304
Tax	388	402	423	571	646
Core profit	2,297	2,856	2,601	3,233	3,658
Profit after tax	2,297	2,856	2,601	3,233	3,658
Net profit after extra ord. & minority interest	2,306	2,814	2,609	3,233	3,658
Shares outstanding (mn)	161	161	161	161	161
EPS (INR) basic	14.2	17.5	16.2	20.1	22.7
Diluted shares (mn)	163	161	161	161	161
EPS (INR) diluted	14.1	17.5	16.2	20.1	22.7
CEPS (INR)	23.0	29.6	29.3	34.0	38.6
Dividend per share	3.0	3.0	3.0	3.5	4.0
Dividend (%)	30.0	30.0	30.0	35.0	40.0
Dividend pay out (%)	24.7	20.2	21.7	20.4	20.6

Common size metrics - as % of revenues

Year to June	FY08	FY09	FY10E	FY11E	FY12E
Cost of revenues	53.7	54.3	52.9	53.1	54.0
Gross margin	46.3	45.7	47.1	46.9	46.0
SG&A expenses	9.9	11.6	12.5	11.7	12.5
EBITDA margin	36.3	34.1	34.6	35.2	33.5
EBIT margin	23.5	20.5	20.7	22.7	21.1
Net profit margins	21.4	20.8	17.0	18.1	17.7

Growth metrics (%)

Year to June	FY08	FY09	FY10E	FY11E	FY12E
Revenues	50.8	28.0	11.5	16.8	15.6
EBITDA	36.0	20.2	13.0	18.8	10.0
EBIT	36.1	12.1	12.7	27.5	7.7
PBT	38.2	21.3	(7.2)	25.8	13.1
Net profit	32.8	24.3	(8.9)	24.3	13.1
EPS	30.1	24.2	(7.3)	23.9	13.1

Balance sheet (INR mn)

As on 30th June	FY08	FY09	FY10E	FY11E	FY12E
Equity share capital	1,609	1,610	1,610	1,610	1,610
Share premium account	2,822	2,577	2,577	2,577	2,577
Reserves	7,411	10,054	12,098	14,673	17,576
Total shareholders funds	11,841	14,242	16,285	18,860	21,764
Borrowings	6,938	9,967	9,640	9,187	7,745
Minority interest	15	8	(0)	(0)	(0)
Deferred tax liability	459	479	520	520	520
Sources of funds	**19,253**	**24,696**	**26,446**	**28,567**	**30,028**
Goodwill and other intangible asset	2,000	3,010	3,010	3,010	3,010
Gross fixed assets	10,583	16,518	20,918	23,118	25,118
Less: Accumulated depreciation	4,090	4,047	6,167	8,407	10,967
Net fixed assets	6,493	12,471	14,751	14,711	14,151
Capital WIP	1,729	2,793	1,500	1,200	1,350
Investments	2,816	354	0	0	0
Deferred tax asset	63	72	72	72	72
Cash & bank balances	2,598	1,376	2,447	3,515	4,441
Debtors	5,018	5,951	5,871	6,855	7,924
Inventories	215	105	136	204	265
Loans and advances	1,160	1,305	1,631	2,120	2,502
Total current assets	8,991	8,736	10,085	12,694	15,133
Sundry creditors	1,998	1,794	1,884	1,978	2,374
Provisions	841	946	1,088	1,142	1,314
Total current liabilities	2,840	2,740	2,972	3,120	3,687
Working capital	6,152	5,996	7,113	9,574	11,446
Application of funds	**19,253**	**24,696**	**26,446**	**28,567**	**30,028**
Book value per share (BV) (INR)	73.7	88.5	101.1	117.1	135.1

Free cash flow

Year to June	FY08	FY09	FY10E	FY11E	FY12E
Net profit	2,306	2,814	2,609	3,233	3,658
Depreciation	1,383	1,867	2,120	2,240	2,560
Others	84	73	184	247	57
Gross cash flow	3,772	4,754	4,914	5,720	6,276
Less:Changes in working capital	180	1,151	46	1,393	945
Operating cash flow	3,592	3,603	4,868	4,328	5,330
Less: Capex	3,444	7,635	3,107	1,900	2,150
Free cash flow	**148**	**(4,032)**	**1,761**	**2,428**	**3,180**

Cash flow statement (INR mn)

Year to June	FY08	FY09	FY10E	FY11E	FY12E
Cash flow from operations	4,910	3,515	5,145	5,869	6,843
Cash for working capital	(180)	(1,151)	(46)	(1,393)	(945)
Operating cashflow (A)	3,592	3,603	4,868	4,328	5,330
Net purchase of fixed assets	(3,444)	(7,635)	(3,107)	(1,900)	(2,150)
Net purchase of investments	(1,815)	2,467	354	0	0
Others	(1,633)	(1,234)	380	300	500
Investments cashflow (B)	(6,891)	(6,402)	(2,373)	(1,600)	(1,650)
Dividends	0	(576)	(565)	(660)	(754)
Proceeds from issue of equity	49	8	0	0	0
Proceeds from LTB/STB	(540)	3,846	(858)	(1,000)	(2,000)
Financing cash flow (C)	(492)	1,577	(1,424)	(1,660)	(2,754)
Change in cash (A+B+C) + (D)	(3,791)	(1,223)	1,071	1,068	926

Ratios

Year to June	FY08	FY09	FY10E	FY11E	FY12E
ROAE (%)	20.7	22.2	17.0	18.4	18.0
ROACE (%)	15.5	13.8	12.5	14.7	14.9
Debtors (days)	150	146	141	130	131
Payable (days)	47	50	44	39	38
Cash conversion cycle	103	95	97	91	92
Current ratio	3.2	3.2	3.4	4.1	4.1
Debt/EBITDA	1.8	2.1	1.8	1.5	1.1
Interest cover (x)	NA	6	6	7	8
Fixed assets turnover (x)	1.9	1.4	1.1	1.2	1.4
Total asset turnover(x)	0.6	0.6	0.6	0.6	0.7
Equity turnover(x)	1.0	1.1	1.0	1.0	1.0
Debt/Equity (x)	0.6	0.7	0.6	0.5	0.4
Adjusted debt/Equity	0.6	0.7	0.6	0.5	0.4

Valuation parameters

Year to June	FY08	FY09E	FY10E	FY11E	FY12E
Diluted EPS (INR)	14.1	17.5	16.2	20.1	22.7
Y-o-Y growth (%)	*30.1*	*24.2*	*(7.3)*	*23.9*	*13.1*
CEPS (INR)	23.0	29.6	29.3	34.0	38.6
Diluted PE (x)	13.7	11.0	11.9	9.6	8.5
Price/BV(x)	2.6	2.2	1.9	1.6	1.4
EV/Revenues (x)	3.0	2.9	2.5	2.1	1.7
EV/EBITDA (x)	8.3	8.4	7.2	5.8	5.0
EV/EBITDA (x)+1 yr forward	6.9	7.4	6.1	5.3	
Dividend yield (%)	1.6	1.6	1.6	1.8	2.1

Company	Absolute reco	Relative reco	Relative risk
HCL Technologies	Hold	SU	H
Hexaware Technologies	Buy	SO	H
Info Edge	Buy	SO	M
Infosys Technologies	Hold	SU	L
Infotech Enterprises	Buy	SO	H
Mphasis	Hold	SP	M
Patni Computer Systems	Hold	SU	M
Rolta India	Buy	SO	H
Tata Consultancy Services	Buy	SO	L
Wipro	Buy	SP	L

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

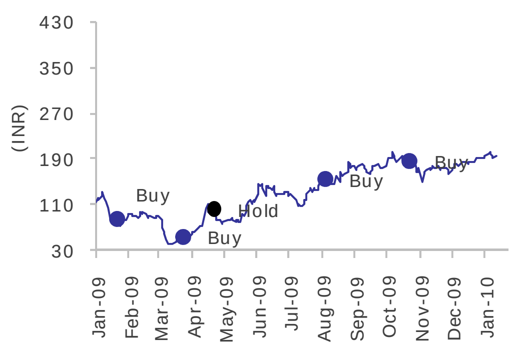
Edelweiss Securities Limited, 14th Floor, Express Towers, Nariman Point, Mumbai – 400 021, Board: (91-22) 2286 4400, Email: *research@edelcap.com*

Naresh Kothari	Co-Head	Institutional Equities	naresh.kothari@edelcap.com	+91 22 2286 4246
Vikas Khemani	Co-Head	Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Nischal Maheshwari	Head	Research	nischal.maheshwari@edelcap.com	+91 22 6623 3411

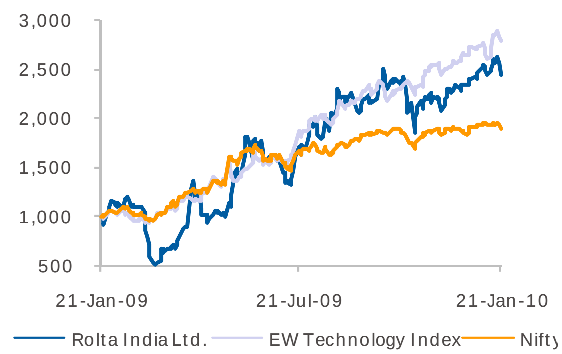
Coverage group(s) of stocks by primary analyst(s): Information Technology

HCL Tech, Hexaware Technologies, Infosys, Infotech, Info Edge, Mphasis, Patni, Rolta, TCS, and Wipro

Rolta



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	95	54	11	162

* 2 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	104	46	12

Recent Research

Date	Company	Title	Price (INR)	Recos
20-Jan-10	Wipro	Modest quarter with Elevated expectations; *Result Update*	725	Buy
15-Jan-10	TCS	Packing a powerful punch, once again; *Result Update*	792	Buy
12-Jan-10	Infosys Technologies	Coming back with a bank; *Result Update*	2,588	Hold

Access the entire repository of Edelweiss Research on www.edelresearch.com