

ROLTA INDIA**INR 55****Cutting estimates on slowing orders****BUY**

March 23, 2009

We recently met Rolta India's (Rolta) management to get an update on the company's business and change in strategy, if any, in the current environment. We gather that order accretion across segments has slowed down. Sudden pause in the capex of client companies has impacted Rolta's engineering revenues more than anticipated. The impact of order cancellation and delays in the oil & gas (O&G) vertical could affect this segment even more adversely. Even as the management expects higher project flows from the power vertical and better traction in chemicals, revenues in engineering could decline 5% in 2010. GIS order book remains healthy, supported by defense and government orders. Growth in the EICT segment, however, is likely to decelerate due to its high exposure to the US. We have revised our FY10 estimates to take cognizance of the current situation and estimate EPS of INR 17.5 (down 22%) from earlier INR 22.4. However, the sharp correction in the stock by almost 40% in past one month, more than captures the slowdown and risks from earnings downgrade.

Update on business segments

- **Strength to sustain in GIS business:** Increased defense budget and better prospects in terms of homeland security opportunity could more than offset weakness in utilities and telecom segments. For FY10, we expect growth in the GIS segment to remain in double digits, at 12%, with stable operating margins.
- **Oil & gas to drag growth in EDA:** The O&G vertical contributes 56% to EDA revenues. Projects in this vertical have been significantly postponed. Even the already initiated projects have been put into the backburner, which has reduced the company's near term visibility. Consequently, the utilisation is likely to reduce, and the segment could suffer margin decline of 150-200bps in FY10E.
- **High US exposure to impact EICT:** Pressure on the EICT segment is mounting because of its high dependence on the US. The company has, however, had some order wins in the UK, Canada and Australia, in a bid to diversify its presence.

Outlook and valuations: Near-term pain factored in price; maintain 'BUY'

The sharp 40% correction in the stock in past one month more than captures the slowdown and risks from earnings downgrade. Further, despite slowdown in growth rates, potential upside from the Thales JV (defense contracts) and sharp increase free cash flow generation from the next fiscal and gain on FCCB buy-back are positives. At CMP of INR 55, the stock is trading at P/E of 3.1x our FY10E earnings. We continue to maintain our 'BUY' recommendation on the stock.

Financials

Year to June	FY08	FY09E	FY10E	FY11E
Revenues (INR mn)	10,722	14,390	15,226	17,718
Rev. growth (%)	50.8	34.2	5.8	16.4
EBITDA (INR mn)	3,897	4,969	5,162	6,042
Growth (%)	36.0	27.5	3.9	17.0
Net profit (INR mn)	2,306	1,951	2,860	3,271
Shares outstanding (mn) - diluted	162.6	163.5	163.5	163.5
Diluted EPS (INR)	14.1	11.9	17.5	20.0
EPS growth (%)	30.1	(15.2)	46.6	14.4
Diluted PE (x)	3.9	4.6	3.1	2.7
EV/EBITDA (x)	2.7	2.4	2.2	1.5
ROAE (%)	20.7	33.2	20.4	20.2

Kunal Sangoi

+91-22-6623 3370

kunal.sangoi@edelcap.com

Viju George

+91-22-4040 7414

viju.george@edelcap.com

Reuters : ROLT.BO
Bloomberg : RLTA IN

Market Data

52-week range (INR) : 360 / 40
Share in issue (mn) : 160.9
M cap (INR bn/USD mn) : 8.9 / 175.6
Avg. Daily Vol. BSE ('000) : 3,056.2

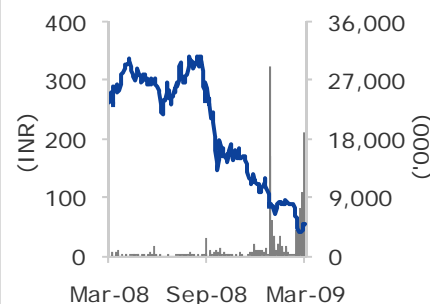
Share Holding Pattern (%)

Promoters* : 40.3
MFs, FIs & Banks : 2.9
FIIs : 35.3
Others : 21.6

* Promoters pledged shares : 2.6
(% of share in issue)

Relative Performance (%)

	Sensex	Stock	Stock over Sensex
1 month	1.6	(39.3)	(40.9)
3 months	(7.4)	(56.2)	(48.7)
12 months	(41.4)	(79.4)	(38.1)



Growth outlook bleak; estimates revised down

We have revised down our FY10E and FY11E estimates by 20% each to take into account the company's current business pressures that will impact FY10E. For FY10E, we have assumed the GIS segment to grow 12%, engineering segment to decline 5% and EICT to grow 7%.

Table 1: Summary of revision in estimates

INR mn	Earlier		Revised		% change	
	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
Revenue	17,762	20,383	15,226	17,718	(14.3)	(13.1)
EBITDA	6,146	7,032	5,162	6,042	(16.0)	(14.1)
PAT	3,658	4,090	2,860	3,271	(21.8)	(20.0)
EPS (INR)	22.4	25.0	17.5	20.0	(21.9)	(20.0)

Source: Edelweiss research

Defense order tenders could float by H2FY10

Rolta's JV from Thales could be a big beneficiary in the C41STAR information system implementation by Indian defense. Efforts towards this have already accelerated in terms of 14% increase in capital outlay for defense services in the interim budget 2009-10 compared with 8-10% increase in the earlier years. As per the management estimates, IT spend in this budget is expected to be INR 50-60 bn per annum, including hardware, software and services portion. The company has already started to display proof-of-concept with the defense ministry targeting to get a healthy share of the spent. The management did mention that it expects the tenders to come out by H2FY10. However, we believe that it will be a long drawn process and revenue accretion could take longer than FY10. Accordingly, we haven't factored in any revenues coming in from the Thales JV for FY10E.

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 eSolutions group. The company's past twelve months (TTM) revenues stood at INR 13.2 bn (USD 271 mn) and it employs ~5,560 people.

Investment Theme

Outsourcing of engineering services is expected to reach USD 38-50 bn by 2020, compared to USD 2 bn now, as per the Nasscom-Booz Allen Hamilton study. As one of the leading offshore engineering services firms for the manufacturing industry, Rolta is well-poised to grab the increasing opportunities. The company has acquired WhittmanHart Consulting, which has ~70 consultants and provides consulting in the Business Intelligence (BI), particularly Oracle's Hyperion products, and Enterprise performance management (EPM) arenas. The company has entered into two high-potential JVs, which are likely to raise its traction in high growth verticals such as power, energy, and defence. Its 50:50 JV with Stone & Webster pursues 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.

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	FY07	FY08	FY09E	FY10E	FY11E	
Revenues	7,112	10,722	14,390	15,226	17,718	
Cost of revenues	3,618	5,761	7,926	8,435	9,763	
Gross profit	3,494	4,961	6,463	6,791	7,955	
Total SG&A expenses	628	1,064	1,494	1,629	1,914	
EBITDA	2,866	3,897	4,969	5,162	6,042	
Depreciation & Amortization	1,018	1,383	1,638	1,734	1,808	
EBIT	1,848	2,515	3,331	3,428	4,234	
Interest expense	7	-	473	493	493	
Other income	103	170	569	372	401	
Profit before tax	1,943	2,685	3,428	3,306	4,141	
Tax	214	388	386	446	870	
Core profit	1,729	2,297	3,042	2,860	3,271	
Profit after tax	1,729	2,297	3,042	2,860	3,271	
Minority int. and extra ord. item - (paid)/recd.	0	(9)	(1,091)	0	0	
Net profit after extra ord. & minority interest	1,729	2,306	1,951	2,860	3,271	
Shares outstanding (mn)	159	161	161	161	161	
EPS (INR) basic	10.9	14.2	12.1	17.7	20.3	
Diluted shares (mn)	160	163	163	163	163	
EPS (INR) diluted	10.8	14.1	11.9	17.5	20.0	
CEPS (INR)	17.3	23.0	35.7	28.4	31.5	
Dividend per share	5.0	3.1	4.0	4.5	5.0	
Dividend (%)	50.0	30.9	40.0	45.0	50.0	
Dividend pay out (%)	27.2	25.3	38.7	29.7	28.9	

Common size metrics - as % of revenues

Year to June	FY07	FY08	FY09E	FY10E	FY11E
Cost of revenues	50.9	53.7	55.1	55.4	55.1
Gross margin	49.1	46.3	44.9	44.6	44.9
SG&A expenses	8.8	9.9	10.4	10.7	10.8
EBITDA margin	40.3	36.3	34.5	33.9	34.1
EBIT margin	26.0	23.5	23.1	22.5	23.9
Net profit margins	24.3	21.4	21.1	18.8	18.5

Growth metrics (%)

Year to June	FY07	FY08	FY09E	FY10E	FY11E
Revenues	33.0	50.8	34.2	5.8	16.4
EBITDA	28.6	36.0	27.5	3.9	17.0
EBIT	24.7	36.1	32.5	2.9	23.5
PBT	36.8	38.2	27.7	(3.5)	25.3
Core profit	35.8	32.8	32.4	(6.0)	14.4
EPS	15.1	30.1	(15.2)	46.6	14.4

Balance sheet					
(INR mn)					
Year to June	FY07	FY08	FY09E	FY10E	FY11E
Equity share capital	801	1,609	1,615	1,615	1,615
Share premium account	4,092	2,822	2,816	2,816	2,816
Reserves	5,573	7,411	8,606	10,615	12,942
Total shareholders funds	10,466	11,841	13,037	15,046	17,373
Borrowings	6,177	6,938	7,436	7,904	8,398
Minority interest	0	15	12	12	12
Deferred tax liability	346	459	520	750	850
Sources of funds	16,989	19,253	21,004	23,712	26,632
Goodwill and other intangible asset	60	2,000	2,000	2,000	2,000
Gross fixed assets	8,283	10,583	14,822	18,031	19,823
Less: Accumulated depreciation	3,619	4,090	5,728	7,462	9,270
Net fixed assets	4,664	6,493	9,094	10,568	10,553
Capital WIP	1,463	1,729	1,500	1,150	1,200
Investments	976	2,816	3,000	4,200	5,500
Deferred tax asset	0	63	63	63	63
Cash & bank balances	6,390	2,598	1,358	1,490	2,595
Debtors	3,770	5,018	5,519	5,924	6,650
Inventories	206	215	268	349	453
Loans and advances	885	1,160	1,567	1,958	2,350
Total current assets	11,251	8,991	8,712	9,720	12,048
Sundry creditors	758	1,998	2,398	2,877	3,453
Provisions	668	841	968	1,113	1,280
Total current liabilities	1,426	2,840	3,365	3,990	4,732
Working capital	9,825	6,152	5,347	5,730	7,316
Application of funds	16,989	19,253	21,004	23,712	26,632
Book value per share (BV) (INR)	65.7	73.7	80.7	93.2	107.6

Free cash flow

Year to June	FY07	FY08	FY09E	FY10E	FY11E
Net profit	1,729	2,306	1,951	2,860	3,271
Depreciation	1,018	1,383	1,638	1,734	1,808
Others	(14)	84	1,056	352	193
Gross cash flow	2,734	3,772	4,645	4,945	5,272
Less: Changes in working capital	404	180	436	252	480
Operating cash flow	2,330	3,592	4,209	4,694	4,792
Less: Capex	2,648	3,444	4,010	2,859	1,843
Free cash flow	(318)	148	199	1,835	2,949

Cash flow statement

(INR mn)					
Year to June	FY07	FY08	FY09E	FY10E	FY11E
Cash flow from operations	2,951	4,910	5,171	5,570	6,015
Cash for working capital	(404)	(180)	(436)	(252)	(480)
Operating cashflow (A)	2,330	3,592	4,209	4,694	4,792
Net purchase of fixed assets	(2,648)	(3,444)	(4,010)	(2,859)	(1,843)
Net purchase of investments	165	(1,815)	(184)	(1,200)	(1,300)
Others	51	(1,633)	(525)	372	401
Investments cashflow (B)	(2,433)	(6,891)	(4,719)	(3,687)	(2,742)
Dividends	0	0	(756)	(850)	(945)
Proceeds from issue of equity	6,001	49	0	0	0
Proceeds from LTB/STB	(396)	(540)	25	(25)	0
Financing cash flow (C)	5,605	(492)	(731)	(875)	(945)
Change in cash (A+B+C) + (D)	5,502	(3,791)	(1,240)	132	1,105

Ratios

Year to June	FY07	FY08	FY09E	FY10E	FY11E
ROAE (%)	17.4	20.7	33.2	20.4	20.2
ROACE (%)	15.0	15.5	19.3	18.3	20.8
Debtors (days)	180	150	134	137	130
Payable (days)	33	47	56	63	65
Current ratio	7.9	3.2	2.6	2.4	2.5
Debt/EBITDA	2.2	1.8	1.5	1.5	1.4
Interest cover (x)	251				
Fixed assets turnover (x)	1.7	1.9	1.8	1.5	1.7
Total asset turnover(x)	0.5	0.6	0.7	0.7	0.7
Equity turnover(x)	0.7	1.0	1.2	1.1	1.1
Debt/Equity (x)	0.6	0.6	0.6	0.5	0.5
Adjusted debt/Equity	0.6	0.6	0.6	0.5	0.5

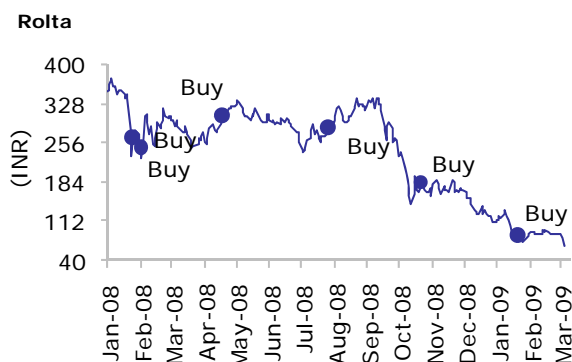
Valuation parameters

Year to June	FY07	FY08	FY09E	FY10E	FY11E
Diluted EPS (INR)	10.8	14.1	11.9	17.5	20.0
Y-o-Y growth (%)	15.1	30.1	(15.2)	46.6	14.4
CEPS (INR)	17.3	23.0	35.7	28.4	31.5
Diluted P/E (x)	5.1	3.9	4.6	3.1	2.7
Price/BV(x)	0.8	0.7	0.7	0.6	0.5
EV/Revenues (x)	1.1	1.0	0.8	0.7	0.5
EV/EBITDA (x)	2.6	2.7	2.4	2.2	1.5
EV/EBITDA (x)+1 yr forward	1.9	2.1	2.3	1.8	
Dividend yield (%)	9.1	5.6	7.3	8.2	9.1

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

Geometric, HCL Tech, Hexaware, Infosys, Infotech, Mastek, Mphasis, Patni, Rolta, Sasken, Satyam, TCS, Take Solutions and Wipro



Recent Research

Date	Company	Title	Price (INR)	Recoms
12-Mar-09	IT	Who's moving up in the global market cap stakes?; Sector Update		
03-Mar-09	Infosys Technologies	To guide or not to guide; what will Infosys do?; Company Update	1,198	Accum.
27-Feb-09	Mphasis	Riding the slowdown on strong parentage; Result Update	168	Buy
17-Feb-09	Hexaware Technologies	Escalating business and margin pressures; Result Update	31	Sell

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	74	63	30	10	182

* 4 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	68	46	68

Rating Interpretation

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

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