

**ROLTA INDIA****INR 103****Battling headwinds****REDUCE**

April 21, 2009

**Q3FY09 results below expectations; revenues down 8.3% Q-o-Q**

Rolta's Q3FY09 results came in below our expectations. Revenues declined 8.3% sequentially vis-à-vis our expectation of flat revenues. Reported net profits of INR 1.3 bn for the quarter included reversal of exchange difference of INR 840 mn, excluding which, profits declined 2.2% sequentially. EBITDA margins declined 120bps led by sharper correction in pricing and dip in utilisation. Also, in Q3FY09, the company provided INR 118 mn as amortization of foreign exchange loss.

**Headwinds in engineering sharper than expected**

As highlighted in our earlier note "Cutting estimates on slowing orders" – dated March 23rd, sudden pause in the capex of client companies has impacted Rolta more than anticipated. New projects in the engineering vertical have been postponed and closure is taking longer. Even the already initiated projects have been put on the backburner, which has reduced the company's near term visibility (order book decline of 10% Q-o-Q). The impact of order cancellations and delays in the oil & gas (O&G) vertical (56% of EDA) led to decline in engineering revenues by 17.7% Q-o-Q. We expect the coming few quarters to be challenging for Rolta in the EDA segment in particular. Consequently, utilisation at current lower levels is expected to keep operating margins under pressure.

**EICT impacted due to cut back in implementations**

Revenues from TUSC (company acquired last year) have also declined as there have been cut backs in implementation and consulting projects (discretionary in nature). This has not only led to decline in utilisation sharply but also impacted profitability. Also, 70% of EICT segment's revenues are derived from the US geography which has been impacted by the current slowdown. However, some order wins in the UK, Canada, and Australia, have restricted decline in the order book in this segment to 5.4%.

**Outlook and valuations: Near term pain to continue; downgrade to 'REDUCE'**

EDA and EICT businesses are expected to continue to be under pressure on the back of lower order intake and sharp billing decline. This has resulted in the near-term revenue visibility declining, impacting expected growth rates (as witnessed in guidance reduction by 8% and 12% for revenue and net profits for FY09). We estimate Rolta's revenues to increase by a meager 5% in FY10, being driven by GIS. However, margin decline due to higher bench cost and higher interest cost will limit net profit growth to 3%. We estimate EPS of INR 15.6 in FY10 and INR 19 in FY11 at which the stock is trading at 6.6x and 5.4x, respectively. Over the past one month Rolta stock has returned 90%, much ahead of the BSE IT index return of 11%. We believe this is not likely to continue going forward given the company's weak Q3 performance and outlook. Hence, we downgrade the stock to 'REDUCE' from 'BUY'.

**Financials**

Year to June	Q309	Q209	Growth %	Q308	Growth %	FY08	FY09E
Revenue (INR mn)	3,320	3,619	(8.3)	2,884	15.1	10,722	13,754
Gross profit (INR mn)	1,498	1,640	(8.6)	1,312	14.2	4,961	6,148
EBITDA (INR mn)	1,115	1,261	(11.6)	1,008	10.6	3,897	4,684
Net profit (INR mn)	1,228	502	144.5	657	87.0	2,306	2,232
Diluted EPS (INR)	7.6	3.1	144.9	3.7	106.2	14.2	13.6
Diluted P/E (x)						7.2	7.5
EV/EBITDA (x)						4.6	4.0
Market cap / Rev. (x)						1.5	1.2

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Reuters : ROLT.BO  
Bloomberg : RLTA IN

**Market Data**

52-week range (INR) : 360 / 40  
Share in issue (mn) : 161.0  
M cap (INR bn/USD mn) : 16.6 / 329.7  
Avg. Daily Vol. BSE ('000) : 4,056.6

**Share Holding Pattern (%)**

Promoters\* : 41.4  
MFs, FIs & Banks : 3.5  
FIIs : 29.9  
Others : 25.2

\* Promoters pledged shares : 2.5  
(% of share in issue)

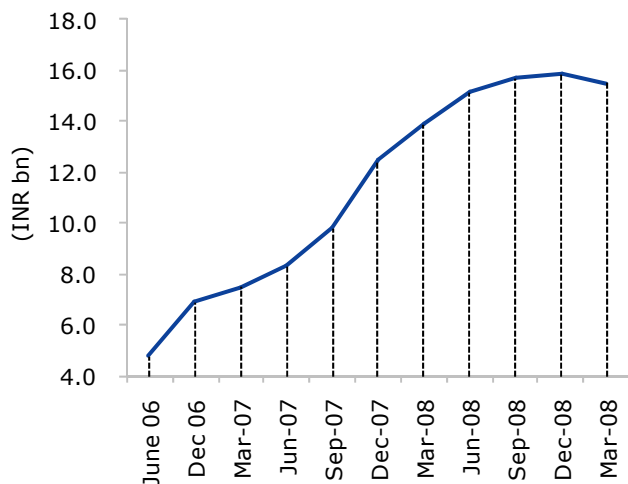
**Relative Performance (%)**

	Sensex	Stock	Stock over Sensex
1 month	22.4	90.4	68.0
3 months	25.1	25.6	0.5
12 months	(34.4)	(67.9)	(33.5)

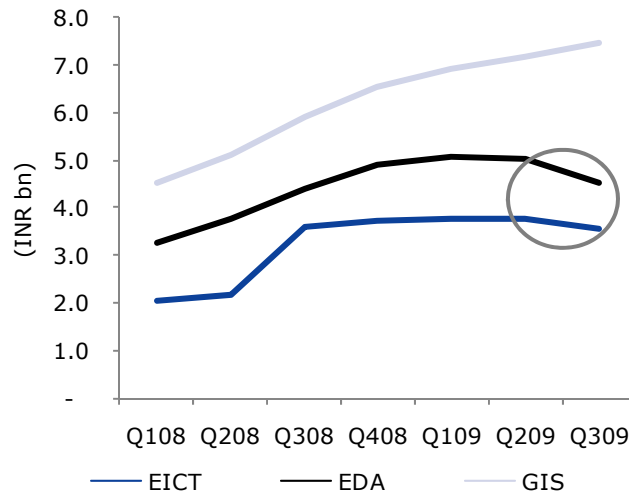
**GIS business going strong**

Performance in the GIS segment was relatively better with 0.4% Q-o-Q revenue growth and increase in orders sequentially. The segment's order book improved 4.4% sequentially. Increased defence budget and better outlook in terms of homeland security opportunity from the government could partly offset weakness in utilities and telecom segments in GIS.

**Chart 1: Order book dip driven by drop in EDA**



**Chart 2: Segment-wise movement in order book**



Source: Company

**Table 1: Pricing decline across all segments**

Billing Rate (USD/hour)	Q109	Q209	Q309
GIS	20.9	21.6	21.1
Q-o-Q growth (%)	0.3	3.3	(2.3)
EDA	28.8	29.3	27.0
Q-o-Q growth (%)	0.3	1.7	(7.8)
e-Solutions	151.3	152.1	145.9
Q-o-Q growth (%)	2.7	0.5	(4.1)

Source: Company

**Key highlights**

- Consolidated revenues, at INR 3.3 bn, were down 8.3% Q-o-Q and up 15.1% Y-o-Y; gross profits for the quarter stood at INR 1.5 bn, a sequential decline of 8.6%. Gross margins declined 20bps Q-o-Q, from 45.3% to 45.1%, due to billing rate pressure and impact of acquisitions.
- EBITDA stood at INR 1.1 bn, down 11.6% Q-o-Q and up 10.6% Y-o-Y. EBITDA margins declined 130bps Q-o-Q on account of pricing decline and drop in utilisation rate.
- Net profit, at INR 1.2 bn, jumped 144.5% Q-o-Q and 87.0% Y-o-Y. This is primarily on account of reversal of forex loss of INR 840 mn, excluding which, margins would have declined by 220bps Q-o-Q.
- Guidance:** Rolta has guided that it will close FY09 with revenues in the range of INR 13.60 bn-13.75 bn (from earlier INR 14.8-15bn) and net profit between INR 2.55 bn and INR 2.65 bn (from earlier INR 3.25-3.3bn). This implies Q4 revenues are likely to be flat to negative 3.7%.
- The company has opted for the revised AS-11 rule; accordingly, the effect of exchange difference of FCCB earlier debited in P/L is now being reversed (INR 840 mn charged in the previous two quarters).

## Segmental performance

- **GIS:** Consolidated revenues, at INR 1562.5 mn, remained flat (0.9%) Q-o-Q and rose 14.0% Y-o-Y. EBITDA margin declined sequentially 230bps and now stands at 40.8%. The company is gaining traction in the GIS segment which has resulted its order book growing 4.4% Q-o-Q in the current challenging environment.
  - **Engineering design:** Rolta reported consolidated revenues of INR 900.1 mn, down 17.7% Q-o-Q and 1.7% Y-o-Y. EBITDA margin stood at 35.4%, a decline of 440bps from the previous quarter. The engineering segment's performance was worst amongst the three segments, with maximum pricing decline of 7.8% and order book shrinking by 10% sequentially.
  - **Enterprise information and communication technology (EICT):** The EICT segment is witnessing the impact of global slowdown which has led to a sharp revenue (INR 857.7 mn) decline of 12.2% in the quarter. The decline in revenue was led by 8% decline in volumes and 4% due to pricing. EBITDA margin stood at 12.7% vis-à-vis 16.2% in the previous quarter.
- Rolta saw a net decline of 266 professionals during the quarter, taking its total employee strength to 5,292. Utilisation has dropped across segments; however, the dip was the most in EDA and EICT (11.2% and 9.1%) segments compared to the previous quarter.
  - The company's order book has declined for the first time in the past three years. Current order book stands at INR 15.5 bn (down 2.5% Q-o-Q), of which 65% orders will be executed in FY10, 10-12% in FY11, and the balance in Q4FY09.
  - Rolta has set up a 1,500 seat SEZ facility, nearby its current facility in Mumbai. It also has plans to setup another 1,500 seat capacity in the NCR region, Delhi.
  - The company had ~INR 2.5 bn in cash and cash equivalents and debt of ~INR 2.0 bn, apart from the convertible bond liability (USD 150 mn), at the end of the quarter.
  - Debtor days for the company now stand at 142 days, up 10 days on sequential basis, on account of the difficult current environment.

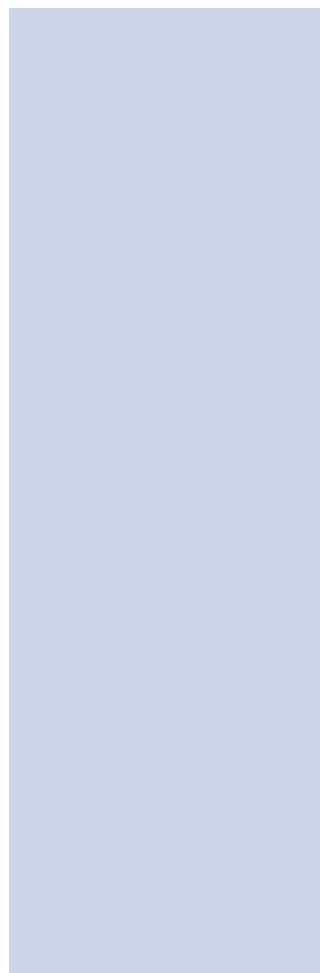
## Outlook and valuations: Near term pain to continue; downgrade to 'REDUCE'

EDA and EICT businesses are expected to continue to be under pressure on the back of lower order intake and sharp billing decline. This has resulted in the near-term revenue visibility declining, impacting expected growth rates (as witnessed in guidance reduction by 8% and 12% for revenue and profits for FY09). We estimate Rolta's revenues to increase by a meager 5% in FY10, being driven by GIS. However, margin decline due to higher bench cost and higher interest cost will limit net profit growth to 3%. We estimate EPS of INR 15.6 in FY10 and INR 19 in FY11 at which the stock is trading at 6.6x and 5.4x, respectively. Over the past one month Rolta stock has returned 90%, much ahead of the BSE IT index return of 11%. We believe this is not likely to continue going forward given the company's weak Q3 performance and outlook. Hence, we downgrade the stock to '**REDUCE**' from '**BUY**'.

<b>Financials snapshot</b>		<b>(INR mn)</b>						
<b>Year to June</b>	<b>Q309</b>	<b>Q209</b>	<b>Growth %</b>	<b>Q308</b>	<b>Growth %</b>	<b>FY08</b>	<b>FY09E</b>	<b>FY10E</b>
Total revenues	3,320	3,619	(8.3)	2,884	15.1	10,722	13,754	14,458
Cost of revenues	1,822	1,980	(8.0)	1,571	16.0	5,761	7,606	7,995
Gross profit	1,498	1,640	(8.6)	1,312	14.2	4,961	6,148	6,463
SG&A	383	378	1.3	305	25.9	1,064	1,464	1,547
EBITDA	1,115	1,261	(11.6)	1,008	10.6	3,897	4,684	4,916
Depreciation	498	413	20.4	353	40.9	1,383	1,787	1,734
EBIT	617	848	(27.2)	655	(5.7)	2,515	2,898	3,182
Interest expense	161	115	40.4	0		0	506	493
Other income	871	(132)	(762.7)	105	727.9	170	192	251
PBT	1,328	602	120.6	760	74.7	2,685	2,583	2,940
Tax	101	101	(0.2)	103	(1.8)	388	357	397
Adjusted net profit	1,227	501	145.0	657	86.7	2,297	2,226	2,543
Minority interest	(1.8)	(1.93)	-	-	-	(9)	(6)	0
Reported net profit	1,228	502	144.5	657	87.0	2,306	2,232	2,543
EPS fully diluted (INR)	7.6	3.1	144.9	3.7	106.2	14.2	13.6	15.6

**as % of net revenues**

Gross profit	45.1	45.3		45.5		46.3	44.7	44.7
SG&A	11.5	10.5		10.6		9.9	10.6	10.7
EBITDA	33.6	34.8		34.9		36.3	34.1	34.0
Adjusted net profit	36.9	13.8		22.8		21.4	16.2	17.6
Reported net profit	37.0	13.9		22.8		21.5	16.2	17.6
Tax rate	7.6	16.9		13.6		14.4	13.8	13.5



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### Company Description

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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 13.6 bn (USD 270 mn) and it employs ~5,300 people.

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### Investment Theme

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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 come under pressure, Rolta has been facing delays in orders and execution of orders already won, as per its clients' need. Moreover, revenues in the IT services (EICT) segment are expected to remain muted as implementation projects are paused and pricing has come under pressure. In addition, the visibility of revenue flow from JVs with Shaw Group and Thales Group is quite low, currently. We see Rolta facing challenges as headwinds have intensified; the company could take at least two quarters to come back on the growth trajectory.

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### Key Risks

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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

<b>Income statement</b>		<b>(INR mn)</b>				
<b>Year to June</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09E</b>	<b>FY10E</b>	<b>FY11E</b>	
Revenues	7,112	10,722	13,754	14,458	17,310	
Cost of revenues	3,618	5,761	7,606	7,995	9,538	
Gross profit	3,494	4,961	6,148	6,463	7,772	
Total SG&A expenses	628	1,064	1,464	1,547	1,869	
EBITDA	2,866	3,897	4,684	4,916	5,903	
Depreciation & Amortization	1,018	1,383	1,787	1,734	1,808	
EBIT	1,848	2,515	2,898	3,182	4,095	
Interest expense	7	-	506	493	493	
Other income	103	170	241	251	391	
Profit before tax	1,943	2,685	2,633	2,940	3,992	
Tax	214	388	357	397	838	
Core profit	1,729	2,297	2,275	2,543	3,154	
Profit after tax	1,729	2,297	2,275	2,543	3,154	
Net profit after extra ord. & minority interest	1,729	2,306	2,231	2,543	3,107	
Shares outstanding (mn)	159	161	161	161	161	
EPS (INR) basic	10.9	14.2	13.8	15.7	19.2	
Diluted shares (mn)	160	163	163	163	163	
EPS (INR) diluted	10.8	14.1	13.6	15.6	19.0	
CEPS (INR)	17.3	23.0	25.4	26.5	31.0	
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	33.9	33.4	30.4	

### Common size metrics - as % of revenues

<b>Year to June</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09E</b>	<b>FY10E</b>	<b>FY11E</b>
Cost of revenues	50.9	53.7	55.3	55.3	55.1
Gross margin	49.1	46.3	44.7	44.7	44.9
SG&A expenses	8.8	9.9	10.6	10.7	10.8
EBITDA margin	40.3	36.3	34.1	34.0	34.1
EBIT margin	26.0	23.5	21.1	22.0	23.7
Net profit margins	24.3	21.4	16.5	17.6	18.2

### Growth metrics (%)

<b>Year to June</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09E</b>	<b>FY10E</b>	<b>FY11E</b>
Revenues	33.0	50.8	28.3	5.1	19.7
EBITDA	28.6	36.0	20.2	4.9	20.1
EBIT	24.7	36.1	15.2	9.8	28.7
PBT	36.8	38.2	(1.9)	11.7	35.8
Net profit	35.8	32.8	(0.9)	11.8	24.0
EPS	15.1	30.1	(3.0)	14.0	22.2

**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	8,886	10,579	12,742
Total shareholders funds	10,466	11,841	13,317	15,010	17,172
Borrowings	6,177	6,938	7,469	7,937	8,431
Minority interest	0	15	10	10	56
Deferred tax liability	346	459	520	750	850
<b>Sources of funds</b>	<b>16,989</b>	<b>19,253</b>	<b>21,316</b>	<b>23,707</b>	<b>26,510</b>
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	19,995
Less: Accumulated depreciation	3,619	4,090	5,877	7,611	9,419
Net fixed assets	4,664	6,493	8,945	10,420	10,575
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	2,062	1,932	2,603
Debtors	3,770	5,018	5,276	5,625	6,497
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	9,173	9,864	11,903
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	5,807	5,874	7,171
<b>Application of funds</b>	<b>16,989</b>	<b>19,253</b>	<b>21,316</b>	<b>23,707</b>	<b>26,510</b>
Book value per share (BV) (INR)	65.7	73.7	82.5	92.9	106.3

**Free cash flow**

Year to June	FY07	FY08	FY09E	FY10E	FY11E
Net profit	1,729	2,306	2,231	2,543	3,107
Depreciation	1,018	1,383	1,787	1,734	1,808
Others	(14)	84	370	472	249
Gross cash flow	2,734	3,772	4,388	4,749	5,164
Less: Changes in working capital	404	180	192	196	626
Operating cash flow	2,330	3,592	4,196	4,552	4,538
Less: Capex	2,648	3,444	4,010	2,859	2,014
<b>Free cash flow</b>	<b>(318)</b>	<b>148</b>	<b>187</b>	<b>1,694</b>	<b>2,524</b>

**Cash flow statement**

(INR mn)

Year to June	FY07	FY08	FY09E	FY10E	FY11E
Cash flow from operations	2,951	4,910	4,914	5,373	5,907
Cash for working capital	(404)	(180)	(192)	(196)	(626)
Operating cashflow (A)	2,330	3,592	4,196	4,552	4,538
Net purchase of fixed assets	(2,648)	(3,444)	(4,010)	(2,859)	(2,014)
Net purchase of investments	165	(1,815)	(184)	(1,200)	(1,300)
Others	51	(1,633)	192	251	391
Investments cashflow (B)	(2,433)	(6,891)	(4,002)	(3,807)	(2,922)
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)
<b>Change in cash (A+B+C) + (D)</b>	<b>5,502</b>	<b>(3,791)</b>	<b>(536)</b>	<b>(130)</b>	<b>671</b>

**Ratios**

Year to June	FY07	FY08	FY09E	FY10E	FY11E
ROAE (%)	17.4	20.7	18.4	18.0	19.9
ROACE (%)	15.0	15.5	16.7	16.8	20.2
Debtors (days)	180	150	137	138	128
Payable (days)	33	47	58	67	67
Current ratio	7.9	3.2	2.7	2.5	2.5
Debt/EBITDA	2.2	1.8	1.6	1.6	1.4
Interest cover (x)	251				
Fixed assets turnover (x)	1.7	1.9	1.8	1.5	1.6
Total asset turnover(x)	0.5	0.6	0.7	0.6	0.7
Equity turnover(x)	0.7	1.0	1.1	1.0	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**

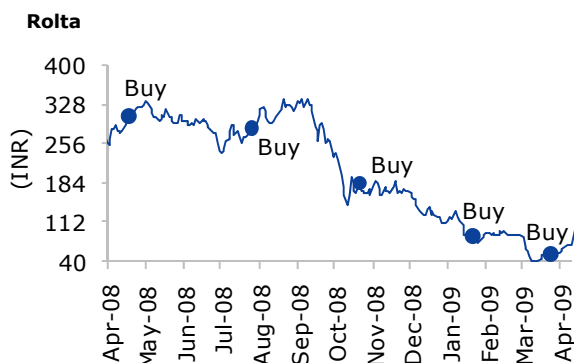
Year to June	FY07	FY08	FY09E	FY10E	FY11E
Diluted EPS (INR)	10.8	14.1	13.6	15.6	19.0
Y-o-Y growth (%)	15.1	30.1	(3.0)	14.0	22.2
CEPS (INR)	17.3	23.0	25.4	26.5	31.0
Diluted PE (x)	9.5	7.3	7.5	6.6	5.4
Price/BV(x)	1.6	1.4	1.2	1.1	1.0
EV/Revenues (x)	2.1	1.7	1.4	1.3	1.0
EV/EBITDA (x)	5.3	4.6	4.0	3.7	2.9
EV/EBITDA (x)+1 yr forward	3.9	3.8	3.9	3.1	
Dividend yield (%)	4.9	3.0	3.9	4.4	4.9



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

HCL Tech, Infosys, Infotech, Mphasis, Patni, Rolta, Satyam, TCS, and Wipro



### Recent Research

Date	Company	Title	Price (INR)	Recons
17-Apr-09	IT	To bulge or not to bulge?; <i>Result Update</i>		
15-Apr-09	Infosys Technologies	FY10 guidance disappointing on multiple fronts; <i>Result Update</i>	1,371	Accum.
08-Apr-09	IT	Certainty still at a premium; <i>Result Preview</i>		
24-Mar-09	IT	Variable wage payout In FY10 is no fair game <i>Sector Update</i>		

### Distribution of Ratings / Market Cap

#### Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	48	44	23	8	126

\* 3 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	61	36	29

### 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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