TULIP IT SERVICES

INR 283

Edelweiss
Ideas create, values protect

Lotus bloom

BUY

September 7, 2006

Priyanko Panja
+91-22-2286 4300
priyanko.panja@edelcap.com

Devyani Javeri
+91-22-2286 4348
devyani.javeri@edelcap.com

Presence in a fast-growing niche segment

IP VPN (Internet Protocol Virtual Private Network) technology is rapidly gaining popularity among Indian corporates as a cheaper alternative for enterprise connectivity. The Indian IP VPN market has grown at a CAGR of 31% over the past three years to INR 5.1 bn in FY06. We believe that the industry will continue to grow at a 33% CAGR over the next three years to INR 12 bn in FY09E. Tulip entered this space in H2FY06 and garnered a market share of ~16% by FY06. We expect its market share to more than double over FY07-08E as Tulip increases focus on the IP VPN segment.

Superior alternative to existing technologies

IP VPN is a cheaper and secure alternative to available technologies like private leased lines, IPLC, and ISDN. Key benefits include rapid rollout even over difficult terrains, scalability, flexibility, high uptime and traffic engineering. Wireless-based last mile also ensures faster deployment at lower costs while eliminating dependence on incumbent last mile owners.

IP VPN business to drive margins, share in revenues to grow significantly

Hitherto, Tulip's core business was network integration (NI) – Tulip was the fourth-largest network integrator in India in FY06. However, despite healthy topline growth, margins in this business were extremely squeezed (below 4% levels). We believe that Tulip's venture into IP VPN business will drive revenue growth and boost margins considerably. We expect an overall EBITDA margin of 23.6% (up 10.5%) and net margin of 18.4% (up 8.7%) in FY08E.

Government initiatives: A huge potential opportunity

GoI intends to spend ~INR 2.3 tn over the next five years under the National e-governance Plan (NeGP). Various state governments are floating tenders for public-private partnerships for setting up state and rural networks. Having successfully implemented a similar project in Kerela, we believe, Tulip will be able to capitalise on its past experiences and take advantage of future opportunities in this space.

Attractive valuations; potential acquisition target

We believe that the shift in revenue mix towards IP VPN will drive revenue growth and positively impact margins. At INR 283, the stock trades at 8.8x FY07E and 4.7x FY08E, and EV/ EBITDA of 7x FY07E and 3.6x FY08E. We believe that current valuations are extremely attractive in light of the exponential growth expected over the next two years and hold significant upside potential. We believe that Tulip could be a potential acquisition target by larger integrated telecom players given swift traction in IP VPN operations and a likely free cash flow positive status by FY08E. We initiate coverage with a **'BUY'** recommendation.

Reuters	:	TULP.BO
Bloomberg	:	TITSL IN

Market Data

52-week range (INR)	:	405 / 100
Share in issue (mn)	:	29.0
M cap (INR bn/USD mn)	:	8.2 / 177.5
Avg. Daily Vol. BSE/NSE ('000)	:	1,715.7

Share Holding Pattern (%)

Promoters	:	69.0
MFs, FIs & Banks	:	12.4
FIIs	:	1.2
Others	:	17.4

Financials

Year to March	FY05	FY06	FY07E	FY08E
Revenue	3,422	5,081	7,375	9,442
Rev. growth (%)	*24.7*	*48.5*	*45.1*	*28.0*
EBITDA (INR mn)	199	662	1,235	2,224
Net profit	134	491	928	1,738
Adjusted EPS (INR)	4.6	16.9	32.0	59.9
EPS growth (%)	*107.3*	*266.8*	*88.9*	*87.4*
P/E (x)	61.3	16.7	8.8	4.7
EV/ EBITDA	41.9	12.8	7.0	3.6
ROAE (%)	41.0	42.1	40.1	48.0

Investment Rationale

Presence in a fast-growing niche segment

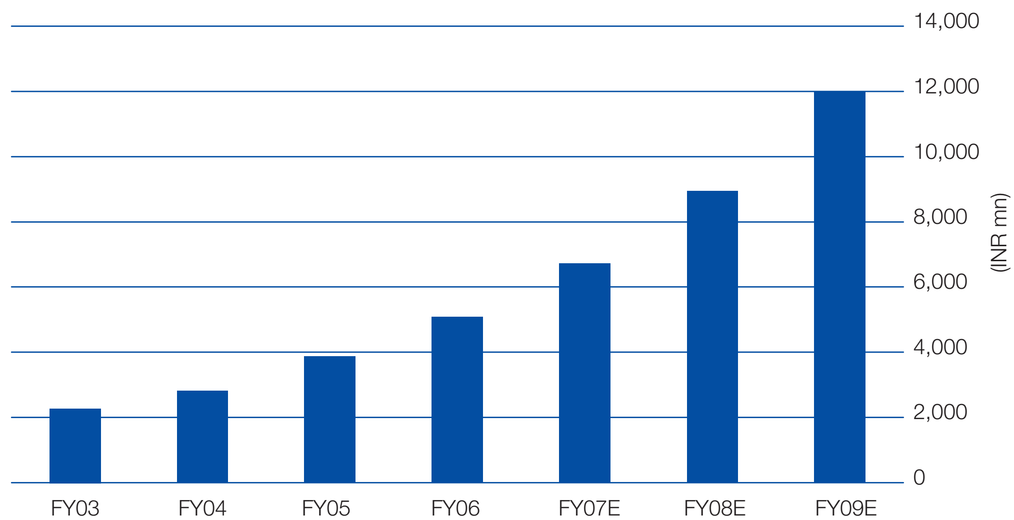
The need for enterprise connectivity continues to gain prominence in India, as companies expand to new geographies and real time communication among different locations becomes essential. Demand for connectivity is being fuelled, not only by large enterprises like banks and financial institutions (ATMs, branch connectivity, core banking solutions), IT and ITES, but also smaller manufacturing and service firms requiring affordable means to connect to their retailers, distributors, and customers. Corporates can choose from a variety of technologies like IPLC, ISDN, VSAT, VPN, and IP VPN for enterprise-wide connectivity while balancing organisation requirements with associated costs.

Although the IP VPN technology is relatively new in India, it is rapidly gaining popularity among Indian corporates as a cheaper alternative over other technologies. IP VPN has made it viable to connect hitherto unfeasible branches/outlets in remote locations or having lower bandwidth requirements (and therefore, not warranting expensive connectivity via higher bandwidth leased lines or VSAT).

Indian IP VPN market likely to double over FY07-09E

The Indian IP VPN market has grown at a CAGR of 31% over the past three years to INR 5.1 bn in FY06. We believe that the industry will grow at a CAGR of 33% over the next three years to INR 12 bn in FY09E, as the need for connectivity becomes critical, not only for large enterprises but also the small and medium enterprises (SME) segment.

Chart 1: IP/VPN services market



Source: TRAI, F&S

Market share of 16% within two quarters of IP VPN business commencement

Tulip entered the IP VPN space in December 2005 and has already garnered a market share of ~16% by March 2006. We believe a bright industry scenario is likely to place Tulip on an exponential growth trajectory. We reckon that with its large network spanning 540 plus cities across India, Tulip will be able to further consolidate and strengthen its position in the Indian IP VPN market.

Superior alternative to existing technologies

IP VPN is a cheaper and secure alternative to available technologies like private leased lines, IPLC, and ISDN. Within IP VPN, MPLS-based (multiprotocol label switching) architecture is a more preferable option (over IPSec architecture), primarily because it enables effective bandwidth utilisation through traffic engineering.

Key benefits over other technologies include rapid rollout even over difficult terrains, scalability, and flexibility coupled with high uptime and low latency. Most existing players including Sify (India's largest IP VPN service provider) depend on BSNL or MTNL's copper lines to provide connectivity in small towns and remote rural areas. Through wireless-based last mile, Tulip is able to overcome dependence on incumbent last mile owners while ensuring faster deployment (versus laying down fiber) at lower costs. While requiring little capex from the customer end, IP VPN provides virtually similar capabilities as other relatively more expensive options.

Key competitive strengths of IP VPN

Bandwith on demand and traffic engineering create a unique blend

Bandwidth on demand: Tulip can offer bandwidth ranging from 2 KBPS upto 1 GBPS, depending on client requirements. A client can be quickly upgraded to higher bandwidth, even temporarily.

Traffic engineering: MPLS IP VPN provides a great deal of flexibility to divert and route traffic around link failures and bottlenecks. It also makes it possible to manage different kinds of data streams based on the priority and service plan, thereby delivering desired network performance.

Network rollout time: A network can be rolled out quickly – within a week if an area is already connected to the network, four-six weeks in case of uncovered areas.

Interoperability and scalability: IP VPN is a completely open system architecture and is interoperable with all-common firewall and VPN solutions. IP VPN architecture also enables Tulip to tap potential opportunities from upcoming technologies like WiMAX. Existing BSRs and CPEs can be effortlessly upgraded to WiMAX standards at little incremental cost. Thus, Tulip's operations could be easily scaled to the WiMAX platform as and when implemented.

Secure: An SPR can connect to a BSR only when it is specifically authorised, thereby preventing unauthorised usage. MPLS VPNs use a technique called route distinguishers to provide traffic separation between VPNs of different customers. These are assigned automatically where the VPN is provisioned and are unique for a given customer.

In the table below, we have compared IP VPN with some of the available technologies and we believe that IP VPN offers some significant advantages over the others.

Table 1: Comparison with other available technologies

	MPLS-based VPN	VSAT	IPLC
Uptime	> 99.5%	>99%	>99%
Latency	Low	High	Low
Bandwidth	Bandwidth on demand	Low	Only 64 KBPS multiples
Cost	Low	Prohibitive (especially for SME segment)	Prohibitive (especially for SME segment)

Source: Company, Edelweiss research

** MPLS: Multiprotocol Label Switching   VSAT: Very Small Aperture Terminal*

IPLC: International Private Leased Circuit

IP VPN business to drive margins, share in revenues to grow significantly

We believe that Tulip's venture into IP VPN business will drive revenue growth and boost margins considerably. Hitherto, Tulip's core business was network integration (NI) – Tulip was the fourth largest network integrator in India in FY06. Over FY01-05, NI revenues grew at a CAGR of 69% to INR 3.4 bn in FY05. However, despite healthy topline growth, margins in this business were extremely squeezed (below 4% levels) due to competition from large players.

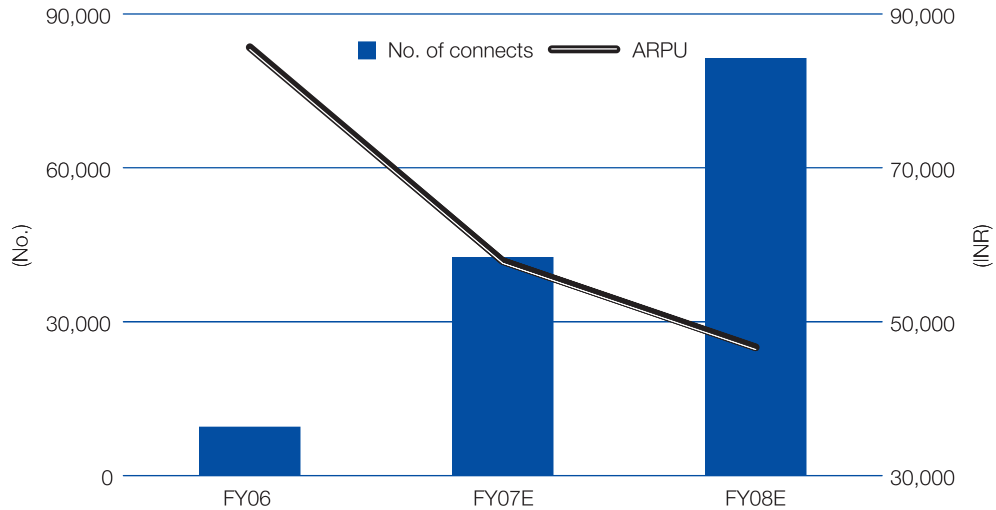
While initial capex requirements are high, margins also tend to be relatively higher than NI, as recurring operating costs and maintenance capex are considerably low. Also, once initial CPE costs are recovered from customers, profitability improves considerably as recurring charges ensure a steady revenue inflow even as associated costs grow less than proportionately.

Changing revenue mix to positively impact margins

In the latter half of FY06, Tulip started offering IP VPN connectivity to corporates. Both EBITDA and net margins more than doubled in FY06, as the revenue mix changed from 100% from the NI segment to 84%. We expect significant EBITDA and net margin expansion over the next two years, as we see increasing revenue contribution from the IP VPN business.

We see three key variables impacting Tulip's IP VPN business – number of connects, installation, and recurring revenues. We estimate a sharp jump in number of connects over the next two years – we expect ~43k connects by FY07E and ~81k connects by FY08E from 9.5k connects in FY06. We envisage the business will be increasingly commoditised going forward in the backdrop of intense competition from larger players. We expect tariffs (installation and recurring) to decline by 20% plus over FY07-08E; overall average revenue per user (ARPU) to fall by ~45% even as higher volumes will continue to drive revenue growth and help sustain margins.

Chart 2: Higher volumes to negate impact of ARPU decline

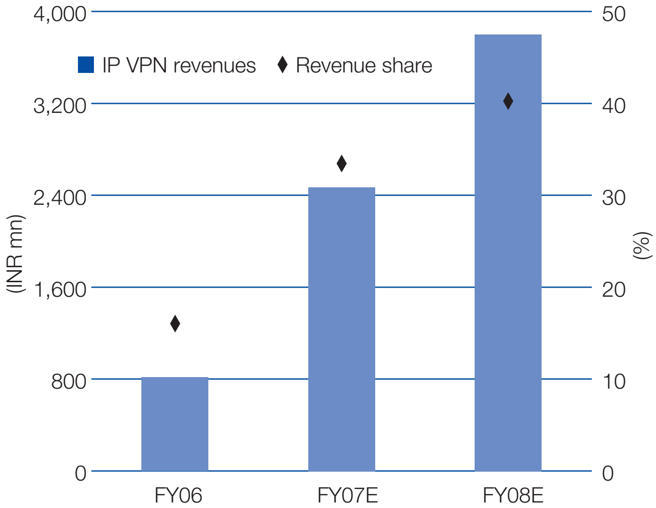


Subscriber base to be 9x over FY07-08E

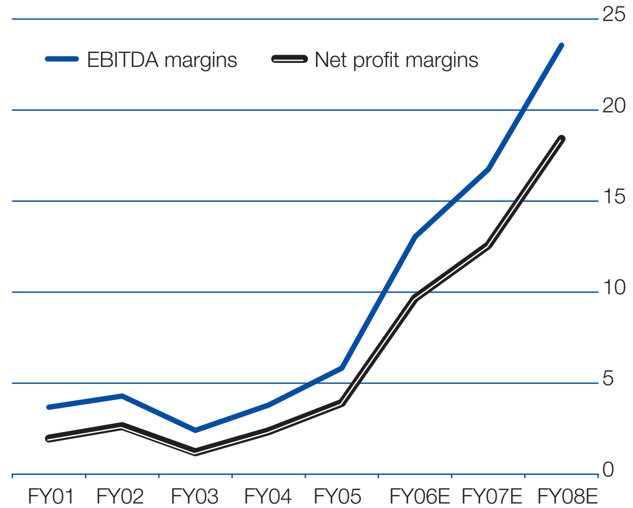
Source: Edelweiss research

We reckon share of IP VPN segment in Tulip's revenues to increase to 40% by FY08E. While we do see overall margins expanding from current 9% plus levels, we believe that they are unlikely to reach 35% plus levels that Tulip's peers are currently enjoying. A considerable share of low margin NI business coupled with intense competition in the IP VPN segment leading to lower tariffs is likely to strain overall margins for the industry including Tulip. We estimate overall EBITDA margin of 23.6% (up 10.5%) and net margin of 18.4% (up 8.7%) in FY08E.

Chart 3: Growth share of IP VPN in revenue mix...



... to lead to significant margin improvement



Source: Company, Edelweiss research

Government initiatives: A huge potential opportunity

Both central and state governments are taking serious steps to promote e-governance and e-literacy particularly in rural India. Some of the few initiatives in this regard are as follows:

- The GoI intends to spend ~INR 2.3 tn over the next five years under the National E-governance Plan (NeGP). The NEGP is aimed at leveraging IT to improve the quality, accessibility and effectiveness of government services to citizens and businesses. ~INR 1.3 tn will be spent on 26 mission mode projects (MMP) covering areas such as land records, transport, registration, income tax, central excise, and common services.

INR 33 bn to be spent by 22 state governemnts to setup networks

- Around 22 Indian states are in the process of setting up statewide area networks (SWANs) at a cost of ~INR 33 bn (to be completed by 2007). Various state governments including Punjab, Jharkhand, and Himachal Pradesh (HP) are floating tenders for setting up SWANs for e-governance purposes and rural networks to promote rural e-literacy and e-commerce via public-private partnerships.

- IT-enabled service delivery centres (common service centres or CSCs) to be launched in 100,000 villages by 2007 to provide e-services at an investment of ~INR 50-60 bn.

- A National Mission Mode Project on e-Governance in municipalities is being formulated by the Ministry of Urban Development (MUD), which plans to cover 423 cities and towns having population of 10,000 and above for implementation during the period 2006-10.

Tulip has successfully implemented 'Akshaya' e-governance project in the Malappuram district of Kerela. Around 500 plus centers were connected via wireless IP VPN technology, thereby overcoming the problem of laying optic fibre in a difficult terrain.

We believe that Tulip will be able to capitalise on past experience and exploit future opportunities in this space. It intends to participate in tenders floated by state governments for setting up SWANs and connecting them through the wireless IP VPN technology.

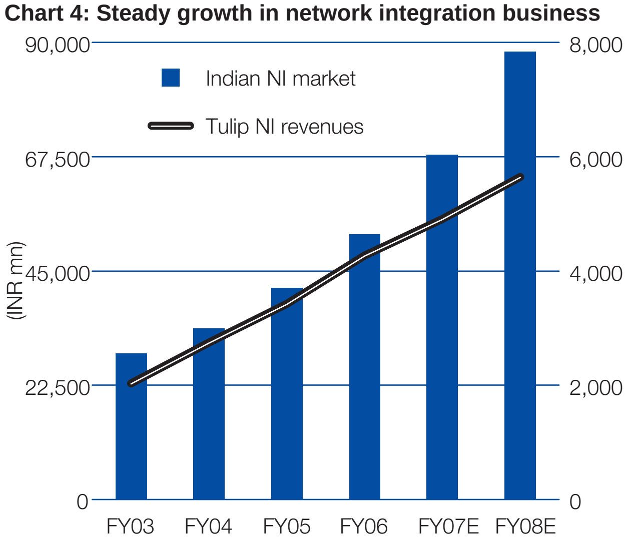
Financials and Valuations

IP VPN business to gain momentum, overall margins to expand significantly

We believe that the IP VPN business will lead Tulip on an exponential growth trajectory. We expect the shift in revenue mix towards IP VPN to significantly drive margins over the next two years.

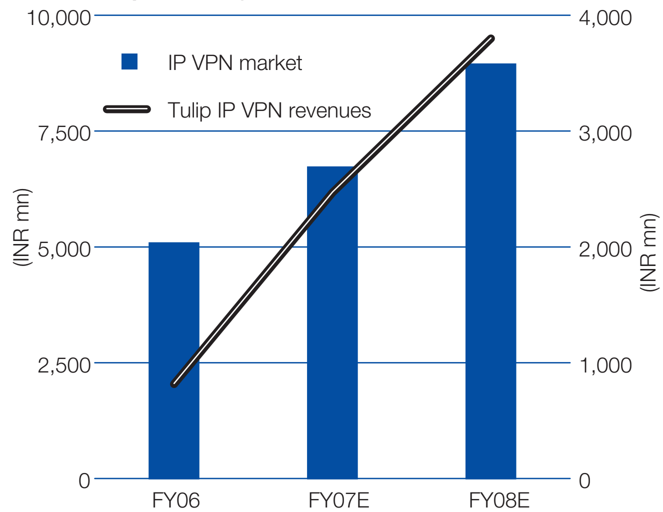
We estimate revenues to grow at 36% CAGR over the next two years to INR 9.4 bn, driven by the IP VPN business. Over the next few years, we expect Tulip's NI business to grow at slower pace compared with the industry, as it gradually decreases focus on this business segment. We estimate NI revenues to grow at 15% CAGR over the next two years to INR 6.5 bn in FY08E. We expect a gradual decline in revenue share to ~60% by FY08E from ~84% in FY06. We believe that there is scope for NI margins to improve with Tulip increasing focus on higher margin areas like consultancy and managed services. We expect NI margins in the range of 6-7% over our forecast period versus ~4% in FY06.

Chart 4: Steady growth in network integration business



Source: Company, Edelweiss research

Chart 5: Exponential growth in IP VPN business



Source: Company, Edelweiss research

We expect sharp growth in IP VPN revenues as Tulip expands its geographical reach to over 1,000 cities by FY08E. We expect revenues of INR 3.8 bn in FY08E, which is more than a 300% increase over FY06.

Current valuations undermine potential growth

While we anticipate a declining tariff scenario in the backdrop of rising competition, we expect economies of scale to kick in with wider reach and higher volumes (number of connects) which will help sustain segmental revenue growth and profitability. We expect overall EBITDA margins to expand by over 1,000bps to 23.6%, and net margins by 870bps to 18.4% by FY08E. We estimate net profits of INR 0.9 bn in FY07E and INR 1.7 bn in FY08E.

We believe that Tulip is significantly undervalued compared with other companies operating in this space. Over the medium to long term, as clarity on technological standardisation on sunrise technologies like WiMAX emerges, we expect Tulip to peg its business model to a stable technological platform. This is likely to alleviate concerns on stability of business and growth.

Sustained high return ratios provide scope for valuation re-rating

IP VPN to bridge the valuation gap

Drawing parallels from the Indian telecom service provider space in the past (concerns clouding Bharti Airtel's stock valuation out of CDMA rollout impact and the subsequent re-rating with post stabilisation of business growth), we reckon this trigger to be key in valuation re-rating of the stock. Currently, on an EV/EBTIDA basis, we estimate Bharti's Infotel business (enterprise and data business) to be valued at 23.5x FY07E. Comparatively, at an EV/EBITDA of 7.1x FY07E, Tulip is trading at a significant discount. While Bharti operates on a relatively larger scale and size, we believe there is some scope for reduction in the gap in relative valuations, especially as Tulip is moving on a high growth trajectory with its high margin ROE accretive IP VPN business.

We also expect valuation re-rating as benefits of emerging business streams start kicking in, in the form of positive FCF and sustained high return ratios. We expect return ratios to improve considerably from FY06 levels and estimate an ROAE of 48% and ROACE of 45% in FY08E. We believe that Tulip will turn free cash flow (FCF) positive by FY08E on account of a highly scalable and relatively asset-light business model. This is in sharp contrast with large scale national telecom service players like Bharti, which have been unable to generate positive FCFs despite several years of operation. We believe that FCF positive status is likely to be a huge positive trigger, as it will give Tulip considerable leeway to fund further growth or enter new market segments.

We have used DCF methodology to calculate Tulip's fair value.

Table 2: Tulip - DCF sensitivity

		Discount Rate (%)			
		10.0	12.0	14.0	16.0
	0.0	604	506	437	386
Terminal Growth rate (%)	2.5	791	628	523	449
	5.0	1,165	837	656	**541**
	7.5	2,289	1,279	891	686

Source: Edelweiss research

We have calculated Tulip's likely fair value under three scenarios of sub-par (2.5%), at-par (5%) and super-normal growth (7.5%) which reflect our long term Indian telecom industry growth expectations.

Even at 0% terminal growth rate in core business post FY08, we get a fair value of INR 386, which is 36% above the current market price of INR 284. We believe that a 5% terminal growth in line with the industry post FY08E is the most likely scenario. At a discount rate of 16% which we believe sufficiently reflects a high growth moderate risk nascent business, we have arrived at a likely fair value of INR 541 per share. Equity value derived from DCF methodology supports our belief that current valuations are extremely attractive and hold significant upside potential.

Potential acquisition target

Underlying growth and high return ratios place Tulip on the acquisition radar

Rapid ramp-up in IP VPN operations and sustaining high return ratios imply Tulip tracking a high growth trajectory over FY07-08E. This coupled with a likely FCF positive status within two years of commencement of operations and strong nation-wide network presence leads us to believe that Tulip could be an attractive acquisition target for larger integrated telecom players.

Risks and Concerns

Competition from integrated players may strain Tulip's profitability and market share

We believe that the Indian IP VPN market can be segregated into two broad categories comprising integrated wholesale players and small retail resellers. Reliance Communications, Bharti Airtel, and BSNL are some of the large players in the IP VPN (MPLS) market. Among these, Reliance has the largest MPLS network spanning over 170 cities across India and commands 25% plus market share (in FY06). In the smaller resale segment, Sify is the largest player with a market share of ~43% in October 2005. The rest of the market is fragmented with a number of small players including Tulip, Railtel, and Powergrid leasing out fibre. Except Tulip, all other players, including Sify, depend on BSNL/MTNL copper lines for last mile.

In the near term, we see new players entering the lucrative IP VPN market; also, the large wholesale players are likely to increase their focus on this segment.We believe that increased competition, particularly from larger integrated players, will directly hit tariffs and ultimately strain industry profitability and margins.

Since Tulip is a relatively smaller player vis-à-vis the likes of Bharti, Reliance or BSNL, in an increasingly competitive industry scenario, its ability to sustain the high margins that it currently enjoys is uncertain. While our estimates factor in tariffs declining by 20% plus over the next two years, a more than anticipated downside to our tariff estimates is possible. Also, integrated players may bundle several services together, thereby providing more attractive offerings to potential customers. Tulip may not be able to compete with them on this front.

However, replicating Tulip's nationwide network coverage would be difficult, particularly for smaller players who may not have the required expertise and capability. Tulip's IP VPN network spanning 540 plus cities is larger than even Sify's network of over 150 cities. Moreover, Tulip is likely to maintain its presence in the SME segment, since the larger players will remain more focused on the high-volume wholesale segment. Shortage of spectrum will be another issue, particularly in the large cities, thereby, compelling new players to operate in the unlicensed bands fraught with interference.

Technology changes may lead to upgradation pains

Easy upgradation to WiMAX as and when commercial rollout happens

New cost-effective and more efficient technologies may directly impact Tulip's business – particularly since it operates in a niche segment and offers a single technology to its customers. WiMAX (Worldwide Interoperability for Microwave Access) is being touted as the next big technology for providing low-cost wireless broadband connectivity over long distances. While the technology is still in the testing stages abroad with specifications yet to be ratified, the time-line for commercial rollout has been fixed around 2006 end. Adopting WiMAX technology will be relatively easier for Tulip, as existing BSRs could be effortlessly upgraded to WiMAX standards. Existing CPEs are also WiMAX compliant, thereby implying little cost to customers when switching to WiMAX. However, cost of obtaining spectrum for WiMAX could be prohibitive and could strain Tulip's cash reserves. Also, threat from new technologies other than WiMAX still persists. Adopting new technologies or switching over to new service offerings may require significant capex that may not be viable for Tulip.

Lower bandwidth customers could affect revenue growth momentum

Lower ARPU SME segment could hit profitability without substantial volumes

While the SME segment does represent a vast untapped market for enterprise connectivity, cost efficiency is crucial as bandwidth requirement and ARPU per customer is usually low. While IP VPN is a low-cost competent technology and therefore, quite well-suited for this segment, it is important that volumes are substantial to offset the imapct of lower ARPUs. Otherwise, topline growth is likely to be hampered, which in turn, will ultimately affect Tulip's profitability and margins.

Business Overview

Company background

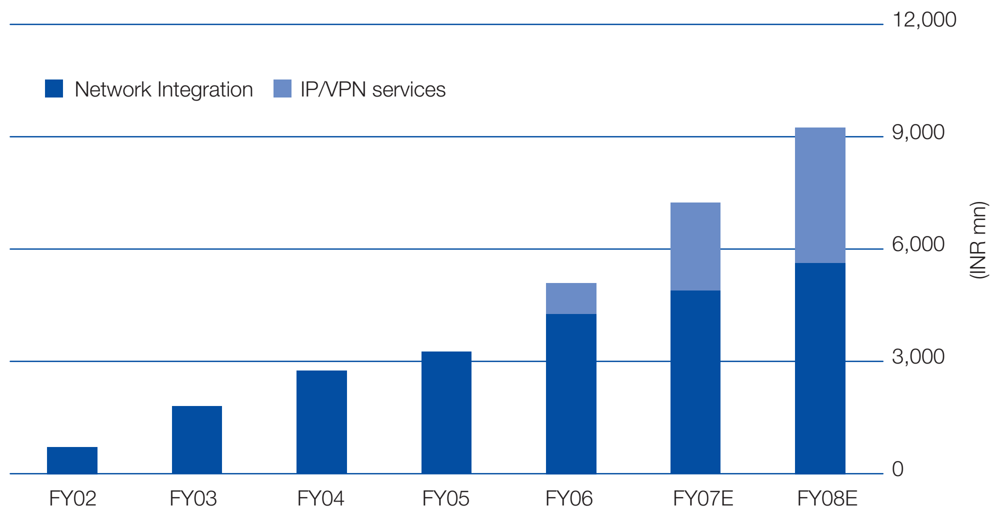
Tulip IT Services (TITSL), established in 1992, initially operated as a trader of software products. Subsequently, the company diversified into trading of hardware products, providing NI services, and more recently inter-city and intra-city IP VPN wireless connectivity.

The company has pioneered the concept of wireless last mile connectivity for high speed data transfer in India. It has a wide network across 540 cities comprising leased lines and fibre optic cables from multiple service providers coupled with its own MPLS based wireless network.

Business segments

TITSL has two principle lines of business – network integration and management services and IP VPN wireless connectivity.

Chart 6: Revenue mix



Source: Company, Edelweiss research

Network integration and management services

NI comprises network design, equipment selection and supply, integration and implementation, and network management and maintenance. Tulip provides the entire gamut of services from network design and development to remote network management and maintenance. Tulip was the fourth-largest network integrator in India in FY06 with a market share of 7.8%.

We estimate NI revenues to grow at 15% CAGR over the next two years to INR 6.5 bn in FY08E. We expect NI margins in the range of 6-7% over our forecast period versus ~4% in FY06 as Tulip increases focus on higher margin areas like consultancy and managed services.

Segmental contribution to revenue stood at 84% in FY06. We expect the share to decline to ~60% by FY08E, as we expect increasing contribution from relatively new IP VPN business.

Growth drivers

Corporates expanding their presence to multiple locations need to deploy and maintain large efficient networks on a nationwide basis. This, coupled with government initiatives to promote e-governance and set up state wide area networks will boost the domestic NI market.

We envisage network expansion and upgradation coupled with managed network maintenance services driving the NI market growth. We believe that key growth drivers for NI market in India will be banks and financial institutions (connecting branches and ATMs, implementing core banking solutions), IT and ITEs companies (BPOs), manufacturing and service companies (connecting dealers, customers, retailers, distributors), and government initiatives (promoting e-governance and e-literacy).

IP VPN services

Tulip offers IP VPN services under the ‘Tulip Connect’ brand. A VPN is a private data network that makes use of public telecommunication infrastructure maintaining privacy through the use of tunneling protocol and security procedures (*source: TRAI*). VPN is a secure and cheap alternative to private leased lines. Besides providing data integrity and protection against unauthorised access and intrusion, IP VPN is an extremely scalable network architecture enabling rapid network roll-out. Even though Tulip ventured into this segment in the second half of FY06, its share in FY06 revenues stood at a significant 16%. Over FY07-08E, we expect revenue share to jump to 40%.

Brief overview of network set-up

Tulip provides inter-city and intra-city connectivity through a mix of leased fibre optic lines from multiple service providers and wireless last mile access based on WipLL technology.

For inter-city connectivity, Tulip leases fibre from service providers like BSNL, Bharti, Reliance, VSNL, GAIL, Railtel, and Powergrid. The network uses a DS3 backbone (45 MBPS) as primary and back-up link. The mesh network architecture ensures continuous connectivity even if a particular link fails. Presently, Tulip is using licensed frequency (2.7 – 2.9 GHz) in major towns and unlicensed frequency (2.4 GHz) in small towns.

Intra-city, a wireless network is created using non-line of sight (NLOS) and line of sight (LOS) radios. Base stations radios (BSRs) are installed atop buildings – each having a range of 2-4 km NLOS and 20 km LOS. Each BSR has a capacity of 4 MBPS shared and can support up to 126 subscribers. Subscriber premise radios (SPRs) or customer premise equipment (CPEs) are affixed on subscriber’s walls or on a pole up to three meters high and connect to the nearest BSR within a range of 5 km. The BSR connects to (SPRs) and (CPEs) within its range and allocates its bandwidth capacity of 4 MBPS amongst its subscribers as per individual requirements.

BSRs may be connected to a base station distribution unit (BSDU), ~6 BSRs per BSDU. Each Point of Presence (PoP) can house up to six BSDUs. Currently, Tulip has around 2,000 PoPs set up across the country. The main network operating centre (NOC) is located at Mumbai, a backup NOC at Delhi along with ten regional NOCs located across 10 other hub cities.

Rural connect

Through ‘Rural connect’, Tulip aims to capture the opportunity from central and state government initiatives to promote e-literacy in rural areas and e-governance programmes. The GoI intends to spend ~INR 2.3 tn over the next five years under National E-governance Plan (NeGP). Around INR 33 bn has been sanctioned by 22 states for setting up state wide area networks (SWANs).Tulip has successfully completed ‘Akshaya’, a pilot project in Mallapuram district of Kerela in October 2005 to promote e-literacy. Governments of various states like Haryana, Maharashtra, Punjab, West Bengal etc are now floating tenders for similar public-private partnership projects. We believe that these projects imply a huge potential opportunity for Tulip.

Financial Statements

Income statement (INR mn)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Income from operations	2,744	3,422	5,081	7,375	9,442
Direct costs	2,520	3,088	4,142	5,690	6,626
Employee costs	51	62	99	141	167
Other expenses	68	73	179	308	426
Total operating expenses	2,639	3,223	4,419	6,140	7,218
EBITDA	104	199	662	1,235	2,224
Depreciation and amortisation	7	10	43	86	123
EBIT	97	189	619	1,149	2,101
Interest expenses	21	35	64	114	122
Other income	2	6	12	39	60
Profit before tax	78	160	567	1,073	2,039
Provision for tax	13	27	76	146	301
Extraordinary items	(1)	(5)	4	-	-
Reported profit	66	139	488	928	1,738
Adjusted net profit	65	134	491	928	1,738
Shares outstanding	12.0	20.0	29.0	29.0	29.0
Dividend per share	-	-	1.0	1.0	1.0
Dividend payout (%)	-	-	5.9	3.1	1.7

Common size metrics as % of net revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	96.2	94.2	87.0	83.3	76.4
Depreciation	0.3	0.3	0.8	1.2	1.3
Interest expenditure	0.8	1.0	1.2	1.6	1.3
EBITDA margins	3.8	5.8	13.0	16.7	23.6
Net profit margins	2.4	3.9	9.7	12.6	18.4

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Revenues	35.2	24.7	48.5	45.1	28.0
EBITDA	114.2	90.9	232.2	86.5	80.1
PBT	109.6	106.7	253.7	89.2	90.0
Net profit	162.9	107.3	266.8	88.9	87.4
EPS	162.9	107.3	266.8	88.9	87.4

Balance sheet (INR mn)

As on 31st March	FY04	FY05	FY06	FY07E	FY08E
Equity capital	120	200	290	290	290
Reserves & surplus	67	266	1,576	2,474	4,184
Shareholders funds	187	466	1,866	2,764	4,474
Secured loans	123	238	756	1,076	986
Borrowings	123	238	756	1,076	986
Sources of funds	310	704	2,622	3,840	5,459
Gross block	82	227	800	1,244	1,691
Depreciation	21	31	73	159	282
Net block	61	196	727	1,085	1,409
Total fixed assets	61	196	727	1,085	1,409
Investments	0	0	20	20	20
Inventories	184	206	263	439	692
Sundry debtors	394	602	1,457	1,912	2,448
Cash and equivalents	30	88	467	552	1,206
Loans and advances	26	24	142	207	265
Total current assets	634	919	2,329	3,110	4,611
Sundry creditors and others	370	380	368	200	250
Provisions	11	22	86	175	330
Total CL & provisions	381	403	454	374	580
Net current assets	253	516	1,875	2,736	4,031
Net deferred tax	(6)	(10)	(2)	(2)	(2)
Misc expenses not w/o	1	1	1	1	1
Uses of funds	310	704	2,622	3,840	5,459
Book value per share (BV)	16	23	64	95	154

Cash flow statement (INR mn)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Net profit	66	139	488	928	1,738
Add: Depreciation	7	10	43	86	123
Add: E.O.adjustments	(0)	0	0	-	-
Add: Deferred tax	2	4	(10)	-	-
Gross cash flow	75	153	521	1,013	1,862
Less: Dividends	-	-	1	1	1
Less: Changes in W. C.	157	205	979	775	642
Operating cash flow	(82)	(52)	(459)	237	1,218
Less: Change in investments	0	-	20	-	-
Less: Capex	29	145	574	444	447
Free cash flow	(111)	(197)	(1,054)	(207)	771

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	48.2	41.0	42.1	40.1	48.0
ROACE (%)	45.2	37.4	37.2	35.6	45.2
Current ratio	1.7	2.3	5.1	8.3	8.0
Debtors (Days)	52	64	105	95	95
Fixed assets t/o (x)	44.7	17.4	7.0	6.8	6.7
Average working capital t/o (x)	16.3	8.9	4.2	3.2	2.8
Debt/Equity	0.7	0.5	0.4	0.4	0.2

Valuation parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
Adjusted EPS(INR)	2.2	4.6	16.9	32.0	59.9
Y-o-Y growth	*162.9*	*107.3*	*266.8*	*88.9*	*87.4*
CEPS (INR)	6.0	7.2	18.4	34.9	64.2
PE (x)	127.0	61.3	16.7	8.8	4.7
Price/BV(x)	18.1	12.1	4.4	3.0	1.8
EV/Sales (x)	3.0	2.4	1.7	1.2	0.8
EV/EBITDA (x)	79.4	41.9	12.8	7.0	3.6

NOTES

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

Edelweiss
Ideas create, values protect

Naresh Kothari - 22864246	Head, Institutional Equities
Vikas Khemani - 22864206	Co-Head, Institutional Equities

INDIA RESEARCH			SECTOR
Shriram Iyer	-	2286 4256	Head – Research
Gautam Roy	-	2286 4305	Airlines, Textile
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
KN Srinivasan	-	4019 4946	Automobiles
Vishal Goyal	-	2286 4370	Banking & Finance
Revathi Myneni	-	2286 4413	Cement
Sumeet Budhraja	-	2286 4430	FMCG, Power
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom
Hitesh Zaveri	-	2286 4424	Information Technology
Pritesh Vinay	-	2286 4429	Metals, Mining
Priyank Singhal	-	2286 4302	Media, Retail
Prakash Kapadia	-	2286 4432	Mid Caps
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals
Nimish Mehta	-	2286 4295	Pharmaceuticals
Pakhi Jain	-	2286 4427	Pharmaceuticals, Agrochemicals
Swati Khemani	-	2286 4266	Textile
Manika Premsingh	-	4019 4847	Economist
Sachin Arora	-	2286 4512	Alternative & Quantitative
Sunil Jain	-	2286 4308	Alternative & Quantitative
Yogesh Radke	-	2286 4328	Alternative & Quantitative

INSTITUTIONAL SALES		
Nischal Maheshwari	-	2286 4205
Rajesh Makharia	-	2286 4202
Shabnam Kapur	-	2286 4394
Ashish Maheshwari	-	2286 4418
Amish Choksi	-	2286 4201
Deepak Rao	-	2286 4204
Balakumar V	-	(044) 4263 8283
Monil Bhala	-	2286 4363
Ashish Agrawal	-	2286 4301
Nikhil Garg	-	2286 4282
Neha Shahra	-	2286 4276
Priya Ramchandran	-	2286 4389
Anubhav Kanodia	-	2286 4361
Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
Nirmal Ajmera	-	2286 4258
Ankit Doshi	-	2286 4671
Ravi Pilani	-	4009 4533
Dipesh Shah	-	2286 4434

Email addresses: firstname.lastname@edelcap.com **e.g.** naresh.kothari@edelcap.com *unless otherwise specified*

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

Edelweiss Research is also available on Bloomberg EDEL <GO>, Thomson First Call, Reuters and Factset.