Rolta India Ltd.

Initial Opinion **BUY**

Equity | India | Computer Services
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Dominant in growth niches, India IT play

Merrill Lynch

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25% upside, local PO at Rs540/GDR PO at USD13.1

We forecast 32% FY07-09 EPS CAGR on strong demand from Rolta's niche areas, especially engineering services and eSolutions and mix/leverage led EBIT margin expansion. Some 60% of revenues from India provide a hedge against Re appreciation and any US slowdown. Our PO is at 14x FY09e, at ~10% discount to our DCF value.

Dominant in high growth niches

Rolta's derives 59%, 29% and 12% revenues from Geographic Information Systems (GIS), engineering services (plant design) and eSolutions. We forecast GIS growth at ~25% as for peers like Infotech. Engineering services is at the start of a secular trend and forecast to grow at 24% CAGR until 2020. Rolta is well-entrenched with sticky client relationships, early start in engineering services, its partnerships with Intergraph & CA in India and JVs with Stone & Webster (SWRL) & Thales.

EBIT margin expansion helped by mix and leverage

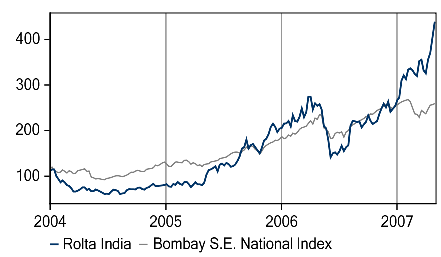
We forecast 90bps expansion over FY07-09 to 27.5% led by growing proportion of engineering services, increasing capability to provide end to end solutions post SWRL and Thales JV and likely operating leverage.

Visible growth with upside risk; Domestic play

Growing order book, which supports 45% of our 1yr revenue forecast, potential to penetrate Stone & Webster's engineering work and targeted US$500m/5yr rev from Thales JV supports our 35% rev CAGR over FY07-09. We see upside risk to estimates from new initiatives like ship design or liberalization of National Map Policy. Rolta stands out as a domestic play with 60% India revs. Risks: Non annuity business, risk related to acquisitions, dependence on partnerships.

Stock Data

Price (Common / GDR)	Rs439.00 / US$10.40
Price Objective	Rs540.00 / US$13.10
Date Established	7-May-2007 / 7-May-2007
Investment Opinion	C-1-7 / C-1-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs124.00-Rs444.60
Market Value (mn)	US$858
Shares Outstanding (mn)	79.9 / 79.9
Average Daily Volume	593,448
ML Symbol / Exchange	RLTAF / BSE
ML Symbol / Exchange	XLROF / LIN
Bloomberg / Reuters	RLTA IN / ROLT.BO
ROE (2007E)	17.2%
Net Dbt to Eqty (Dec-2006A)	-8.4%
Est. 5-Yr EPS / DPS Growth	28.0% / 28.0%
Free Float	59.2%



Estimates (Jun)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	902	1,274	1,739	2,330	3,035
EPS	14.2	18.9	21.7	29.1	37.9
EPS Change (YoY)	NA	33.3%	15.0%	34.0%	30.3%
Dividend / Share	3.5	3.7	4.3	5.7	7.4
Free Cash Flow / Share	7.04	(3.74)	5.15	6.84	17.63
GDR EPS (US$)	0.32	0.42	0.53	0.71	0.93
GDR Dividend / Share (US$)	0.08	0.08	0.10	0.14	0.18

Valuation (Jun)

	2005A	2006A	2007E	2008E	2009E
P/E	30.99x	23.25x	20.22x	15.09x	11.59x
Dividend Yield	0.790%	0.853%	0.970%	1.30%	1.69%
EV / EBITDA*	23.27x	15.38x	11.93x	8.92x	6.76x
Free Cash Flow Yield*	1.28%	-0.719%	1.18%	1.56%	4.03%

* For full definitions of *iQmethod* SM measures, see page 31.

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Refer to important disclosures on page 32 to 33. Analyst Certification on page 30. Price Objective Basis/Risk on page 30.

iQprofile SM Rolta India Ltd.

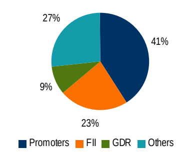
Key Income Statement Data (Jun)	2005A	2006A	2007E	2008E	2009E
(Rs Millions)					
Sales	4,146	5,349	7,020	9,594	12,854
Gross Profit	1,474	2,229	2,875	3,843	5,075
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	985	1,482	1,866	2,596	3,532
Net Interest & Other Income	(5)	(61)	79	81	127
Associates	NA	NA	NA	NA	NA
Pretax Income	980	1,421	1,946	2,676	3,660
Tax (expense) / Benefit	(86)	(147)	(207)	(321)	(476)
Net Income (Adjusted)	902	1,274	1,739	2,330	3,035
Average Fully Diluted Shares Outstanding	64	68	82	82	82
Key Cash Flow Statement Data					
Net Income (Reported)	902	1,274	1,739	2,330	3,035
Depreciation & Amortization	489	747	1,008	1,247	1,542
Change in Working Capital	NA	NA	NA	NA	NA
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	945	(633)	(635)	(1,329)	(1,615)
Cash Flow from Operations	2,336	1,387	2,113	2,248	2,962
Capital Expenditure	(1,887)	(1,640)	(1,700)	(1,700)	(1,550)
(Acquisition) / Disposal of Investments	66	(1,124)	(76)	(50)	(50)
Other Cash Inflow / (Outflow)	39	9	0	0	0
Cash Flow from Investing	(1,782)	(2,754)	(1,776)	(1,750)	(1,600)
Shares Issue / (Repurchase)	0	3,925	0	0	0
Cost of Dividends Paid	(221)	(254)	(348)	(466)	(607)
Cash Flow from Financing	(730)	1,907	(446)	(441)	(483)
Free Cash Flow	449	(252)	413	548	1,412
Net Debt	1,532	(789)	(778)	(835)	(1,714)
Change in Net Debt	(332)	(2,304)	12	(57)	(879)
Key Balance Sheet Data					
Property, Plant & Equipment	3,634	4,524	5,216	5,669	5,676
Other Non-Current Assets	65	1,191	1,267	1,317	1,367
Trade Receivables	2,889	3,262	3,846	5,126	6,691
Cash & Equivalents	331	887	778	835	1,714
Other Current Assets	771	979	1,029	1,079	1,129
Total Assets	7,689	10,843	12,136	14,025	16,577
Long-Term Debt	1,863	98	0	0	0
Other Non-Current Liabilities	172	253	253	253	253
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	1,088	1,078	1,078	1,078	1,078
Total Liabilities	3,123	1,429	1,331	1,331	1,331
Total Equity	4,566	9,414	10,805	12,695	15,246
Total Equity & Liabilities	7,689	10,843	12,136	14,025	16,577
iQmethod* SM - Bus Performance					
Return On Capital Employed	NA	17.2%	16.7%	19.6%	22.4%
Return On Equity	19.8%	18.2%	17.2%	19.9%	21.9%
Operating Margin	23.8%	27.7%	26.6%	27.1%	27.5%
EBITDA Margin	35.5%	41.7%	41.0%	40.1%	39.5%
iQmethod* SM - Quality of Earnings					
Cash Realization Ratio	2.6x	1.1x	1.2x	1.0x	1.0x
Asset Replacement Ratio	3.9x	2.2x	1.7x	1.4x	1.0x
Tax Rate (Reported)	8.8%	10.3%	10.6%	12.0%	13.0%
Net Debt-to-Equity Ratio	33.5%	-8.4%	-7.2%	-6.6%	-11.2%
Interest Cover	8.5x	10.1x	NM	NA	NA
Key Metrics					
Sales Growth (YoY)	NA	29.0	31.2	36.7	34.0
EBITDA GROWTH %	NA	51.2	29.0	33.7	32.1
EBIT Growth %	NA	50.5	25.9	39.1	36.1
Net Income Growth (%)	NA	41.2	36.5	34.0	30.3

* For full definitions of *iQmethod* SM measures, see page 31.

Company Description

Rolta is a mid-tier Indian IT services company providing geographical information system (GIS) services, engineering design services in plant design and eSolutions services mainly in IT security. Its key partnerships are with Intergraph, CA (Computer Associates) and JV's with Stone & Webster and Thales SA. Rolta derives about 60% revenues from Indian clients and is well entrenched in Indian defense and PSU segment.

Chart 1: Shareholding Pattern



Source: NSE

Stock Data

Shares / GDR	1.00
Price to Book Value	3.2x

Investment case

25% upside; Local PO Rs540/GDR PO USD13.1

Our PO of Rs540 is set at 14x FY09e PE, at ~10% discount to our DCF value, lower than the current FY08e PE of 15x and about 7% discount to our target PE for Infotech, its closest peer. Our GDR PO at USD13.1 is in line with the local PO considering that GDR historically has traded at par with local.

We expect the stock to be driven by our forecast 32% FY07-09 EPS CAGR. Our earnings forecast is driven by strong demand in Rolta's niches, specially engineering services and eSolutions, its dominant position supported by alliances/JVs with global majors like Intergraph and CA and mix/leverage led margin expansion.

Rolta's 60% revs from India, is a hedge against Re appreciation and any US slowdown.

#1. Present in high growth niches

Rolta offers services in GIS (Geographic Information Systems), engineering services (plant design, Computer Aided Design/Computer Aided Manufacturing) and eSolutions and derives ~59%, ~29% and ~12% revenues respectively.

- We expect steady 25% growth in GIS as seen in peers like Infotech
- Engineering services is one of the fastest growing service offerings from India. NASSCOM estimates offshore Engineering Services from India to grow to US$50bn by 2020, a CAGR of about 24%.
- We forecast 40-50% growth in eSolutions in line with growth witnessed by other offshore vendors in package implementation services

#2. Dominant position

GIS- Strong positioning in defense, Government

Rolta derives 35-38% of revenue from Indian government agencies including defense establishments and public sector units (PSUs). About 90% of this revenue comes from the defense clients in India.

Rolta is well positioned in the defense segment given many Indian defense establishments work on Intergraph platforms. Intergraph, a leading global provider of spatial information management (SIM) software, has an exclusive arrangement with Rolta under which Rolta is an exclusive reseller and service provider for Intergraph platforms in India.

Rolta is uniquely positioned in the Indian PSU segment too. Long selling cycles and importance of past relationships in the prequalification stage make it difficult for competition to easily penetrate these accounts.

Engg services- Demonstrated experience in plant design

Rolta was one of the early entrants in plant design services and has over 20 years of experience in this area. Its exclusive status for Intergraph platforms in India and the recent JV with Stone & Webster act as significant competitive advantages.

#3. Mix and leverage led margin improvement

Rolta's EBIT margins of 27% in FY07 are the highest amongst its mid-cap peers. We believe Rolta will improve EBIT margin further led by improvement in bill rates and lower depreciation & amortization as a % of revenue, once investments made in licenses in the current growth phase get amortized.

#4. Hedge against possible slowdown in the US

Rolta derives around 60% of its revenue from the Indian domestic markets. This reduces risk to revenue growth on possible slowdown in the US economy. Rupee appreciation has negligible impact on Rolta's EBITDA margin. We estimate 1% appreciation to have EBITDA margin impact of less than 10bps.

#5. Strong earnings growth with upside risk

We estimate Rolta will achieve 32% FY07-09 earnings growth driven by revenues with improving EBIT margins. Rolta's order book growing for the past four quarters supports 45% of our 1yr revenue forecast.

Potential to penetrate SWRL's engineering work and targeted US$500m/5yr rev from Thales supports our 35% rev CAGR over FY07-09. We see upside risk to estimates from new initiatives like ship design, gaming and potential liberalization of India's National Map Policy.

Attractive valuations

Rolta currently trades at 15xFY08E PE in line with its closest comparable Infotech Enterprises and at FY07 to FY07-09e EPSg of 0.6x. We believe these valuations are attractive, as discussed in the following sections.

Valuation

Valuation comparables

We believe Infotech Enterprises (Buy rated) is the closest comparable for Rolta. Infotech mainly competes with Rolta in GIS services, but derives less than 5% of revs from the domestic market, whereas in GIS the domestic market would be about 36% for Rolta. While Infotech offers engineering services it offers product engineering and not plant engineering services.

Other comparables would be mid-sized IT companies such as Hexaware, Geometric Software Services (Not rated), KLG Systel (Not rated) and KPIT (Not rated) given their presence in similar verticals.

Compares well with peers on operating metrics

Table 3 shows that Rolta compares favorably with its peers on:

- **Revenue realization per employee**

Rolta's revenue per employee is the highest amongst its mid cap peers. We believe this is a result of higher bill rates, increased proportion of reselling revenue and end-to-end solutions capability. We expect Rolta to show further improvement on this parameter once its JVs gather steam.

- **EBIT margins.** Its EBIT margins at ~27% are higher than peers who are in 13-20% range
- **Client base** is significantly more diversified
- **Comparable growth**

Rolta's peers fare better on

- **RoE.** Rolta's RoE is lower than its peers on account of higher investments in licenses leading to higher capex. However, the gap is expected to narrow over the next few years, as these investments pay off.

Table 1: Operating metrics comparison

	Rolta	Infotech Ent	KLG Systel	Hexaware
FY06 Revenue (USD mn)	120	81	12	152
FY07E Revenue (USD mn)	160	123	25	193
Currency	INR	INR	INR	INR
Revenue (mn) FY06	5,349	3,625	513	6787
Revenue (mn) FY07	7,025	5,425	1100	8482
Revenue (mn) FY08E	9,573	7,729	na	11539
Revenue (mn) FY09E	12,887	10,403	na	14977
EBIT (mn) FY06	1,482	486	71	874
EBIT (mn) FY07	1,869	878	217	1122
EBIT (mn) FY08E	2,594	1,324	na	1458
EBIT (mn) FY09E	3,555	1,747	na	2102
Revenue growth FY06/FY05	29.0%	41.0%	40.5%	24.3%
Revenue growth FY07/FY06	31.3%	49.7%	114.5%	25.0%
Revenue growth FY08/FY07E	36.3%	42.5%	na	36.0%
Revenue growth FY09/FY08E	34.6%	34.6%	na	29.8%
EBIT growth FY06/FY05	53.1%	60.8%	175.4%	43.2%
EBIT growth FY07/FY06	26.1%	80.5%	208.3%	28.4%
EBIT growth FY08/FY07E	38.8%	50.9%	na	29.9%
EBIT growth FY09/FY08E	37.0%	32.0%	na	44.2%
PAT (mn) FY06	1274	503	52	915
PAT (mn) FY07	1742	837	186	1,242
PAT (mn) FY08E	2329	1132	na	1,526
PAT (mn) FY09E	3055	1442	na	2,145
PAT growth FY06/FY05	41.3%	83.8%	104.9%	43.6%
PAT growth FY07/FY06	36.7%	66.2%	256.6%	35.7%
PAT growth FY08/FY07E	33.7%	35.3%	na	22.9%
PAT growth FY09/FY08E	31.2%	27.4%	na	40.6%
RoE FY06	18.2%	27.3%	11.4%	29.4%
RoE FY07	17.2%	33.7%	na	22.5%
RoE FY08E	20.1%	33.4%	na	18.8%
RoE FY09E	23.1%	31.1%	na	22.1%
EBIT margins FY06	27.7%	13.4%	13.7%	12.9%
EBIT margins FY07	26.6%	16.2%	19.8%	13.2%
EBIT margins FY08E	27.1%	17.1%	na	12.6%
EBIT margins FY09E	27.6%	16.8%	na	14.0%
PAT margins FY06	23.8%	13.9%	10.1%	13.5%
PAT margins FY07	24.8%	15.4%	16.9%	14.6%
PAT margins FY08E	24.3%	14.6%	na	13.2%
PAT margins FY09E	23.7%	13.9%	na	14.3%
Client concentration				
Top 5	21.0%	~53%	na	34%
Top 10	29.0%	~64%	na	48%
Employees (Mar 07 end)	3,811	5,131	na	5751
Revenue per employee (USD) in FY06	46,039	23,296	na	32218

Note: KLG Systel numbers for FY07 are 9m annualized

Source: : Merrill Lynch Research

Valuation comparison

Trading at a discount to DCF

Our DCF is based on cost of equity of 17.3%, WACC of 17.3% (as Rolta is a near zero debt company), Rf of 7.5%, terminal growth rate of 3% and beta of 1.23. These values give us a DCF based fair value of Rs582. Currently it is trading at a ~25% discount to its DCF value.

Table 2: DCF sensitivity to terminal growth rate and WACC

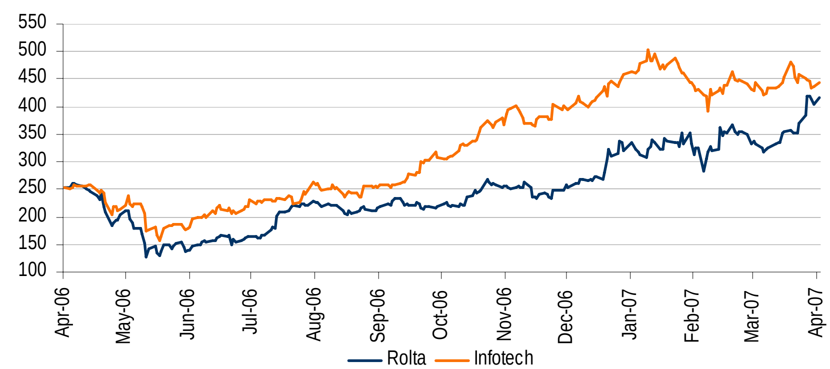
		Cost of equity				
		13.3%	15.3%	17.3%	19.3%	21.3%
	1%	813.6	660.5	548.6	463.8	397.8
	2%	852.2	684.6	564.2	474.3	405.1
Terminal growth rate	3%	898.3	712.5	582.0	486.2	413.2
	4%	954.2	745.3	602.5	499.5	422.3
	5%	1,023.6	784.5	626.3	514.8	432.4

Source: Merrill Lynch Research

Valuation in line with peers

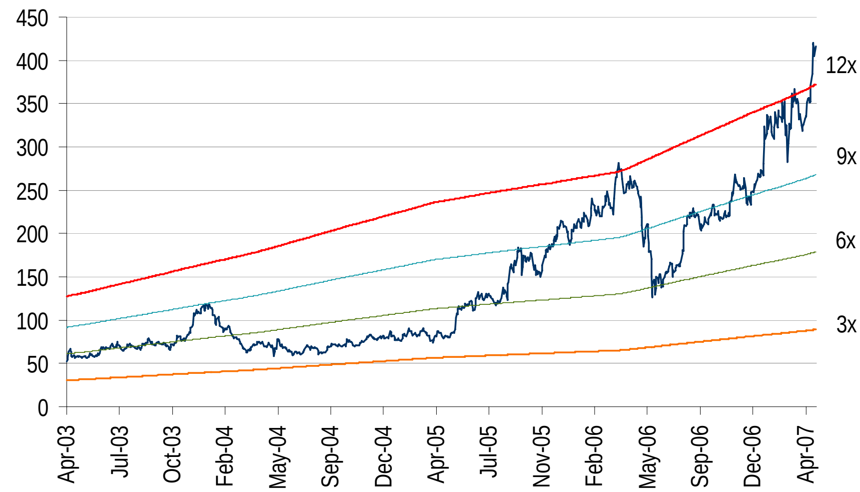
For the past two quarters Rolta has reported strong 10-11% qoq PAT growth. Order book has also shown improvements. Rolta's share price has gone up 60% YTD likely factoring in improving brand post JVs with global majors, strong revenue growth potential in uncontested niches and stable margin outlook. Its valuations are now largely in line with peers. We expect growth to drive the stock.

Chart 2: Stock performance catching up with Infotech



Source: Merrill Lynch, Bloomberg for prices

Chart 3: PE band chart: Stock getting re-rated post 2 strong quarters



Source: Merrill Lynch, Bloomberg for prices

Price target Rs540 on local/ USD13.1 on GDR

Our PO of Rs540 is based on 14x FY09E P/E, at a discount of 7% to closest peer Infotech's FY09E target multiple and a ~10% discount to our DCF value of Rs582. Our GDR PO at USD13.1 is in line with the local PO considering that GDR historically has traded at par with local.

Even though Rolta compares favorably to Infotech on end-to-end solutions capability, lesser client concentration and substantially higher margins, we have valued it at a slight discount to factor in lower RoE and accounting issues in the past.

Table 3: Valuation comparison table

Company		Geometric	Infotech	Hexaware	KPIT	Average	Rolta
Bloomberg Code		GMSS IN	INFTC IN	HEXW IN	NKPIT IN		RLTA IN
QRQ		Not Rated	C-1-7	C-1-7	Not Rated		C-1-7
Market Price (Rs.)		128	361	170	136	199	430
No of Shares		61	46	119	74	75	80
M CAP (Rs. mn)		7,841	16,440	20,230	10,064	13,644	34,357
M CAP (US$. mn)		180	378	465	231	313	789
Net Cash (Rs mn)		231	195	2,989	878	1,073	676
EV (Rs. mn)		7,610	16,245	17,241	9,186	12,570	33,681
Sales	FY07E	2,889	5,425	8,482	4,637	5,358	7,025
	FY08E	4,013	7,729	11,539	6,129	7,353	9,573
	FY09E	7,980	10,403	14,977	7,941	10,325	12,887
EBIT	FY07E	606	878	1,122	587	798	1,869
	FY08E	844	1,324	1,458	832	1,115	2,594
	FY09E	1,168	1,747	2,102	1,115	1,533	3,555
PAT	FY07E	364	837	1,242	505	737	1,742
	FY08E	472	1,132	1,526	688	954	2,329
	FY09E	889	1,442	2,145	927	1,351	3,055
EPS- basic	FY07E	5.9	18.3	9.9	6.8	10	21.7
	FY08E	7.7	24.5	11.7	9.0	13	29.1
	FY09E	14.5	31.2	16.4	11.1	18	38.1
EV/Sales^	FY07	2.6x	3.0x	2.0x	2.0x	2.3x	4.8x
	FY08	1.9x	2.1x	1.5x	1.5x	1.7x	3.5x
	FY09	1.0x	1.6x	1.2x	1.2x	0.0x	2.6x
EV/ EBIT^	FY07	12.6x	18.5x	15.4x	15.7x	15.8x	18.0x
	FY08	9.0x	12.3x	11.8x	11.0x	11.3x	13.0x
	FY09	6.5x	9.3x	8.2x	8.2x	8.2x	9.5x
P/E- basic	FY07	21.6x	19.6x	16.3x	19.9x	19.4x	19.7x
	FY08	16.6x	14.5x	13.3x	14.6x	14.8x	14.8x
	FY09	8.8x	11.4x	9.4x	10.9x	10.1x	11.2x
EBIT Margin	FY07	21.0%	16.2%	13.2%	12.7%	13.0%	26.6%
	FY08	21.0%	17.1%	12.6%	13.6%	14.9%	27.1%
	FY09	14.6%	16.8%	14.0%	14.0%	15.2%	27.6%
	FY07/06	29.3%	49.7%	25.0%	45.7%	35.4%	31.3%
Sales Growth	FY08/07	38.9%	42.5%	36.0%	32.2%	37.2%	36.3%
	FY08/06	34.0%	46.0%	30.4%	38.8%	36.3%	33.8%
	FY09/07	66.2%	38.5%	32.9%	30.9%	38.8%	35.4%
	FY07/06	88.2%	80.5%	28.4%	55.3%	55.0%	26.1%
EBIT Growth	FY08/07	39.3%	50.9%	29.9%	41.8%	39.7%	38.8%
	FY08/06	61.9%	65.0%	29.2%	48.4%	47.1%	32.3%
	FY09/07	38.8%	41.1%	36.9%	37.9%	38.6%	37.9%
	FY07/06	40.9%	66.2%	35.7%	55.0%	47.2%	36.7%
PAT Growth	FY08/07	29.8%	35.3%	22.9%	36.3%	29.6%	33.7%
	FY08/06	35.3%	50.0%	29.1%	45.4%	38.1%	35.2%
	FY09/07	56.4%	31.3%	31.4%	35.5%	35.4%	32.4%
ROE	FY07	22.4%	33.7%	22.5%	30.8%	24.7%	17.2%
	FY08	24.0%	33.4%	18.8%	29.6%	26.4%	20.1%
	FY09	28.2%	31.1%	22.1%	29.5%	27.7%	23.1%
PEG- FY07 PE/FY06-08 gr		0.61	0.39	0.56	0.44	0.51	0.56
PEG- FY07 PE/FY07-09 gr		0.38	0.63	0.52	0.56	0.55	0.61
BV	FY07	35.0	62.4	59.6	25.0	45.5	134.9
	FY08	47.2	85.2	67.1	33.0	58.1	158.2
	FY09	56.7	115.5	81.5	45.0	74.7	188.7
P/BV/RoE	FY07	16.3	17.2	12.7	17.7	16.0	18.5
	FY08	11.3	12.7	13.5	13.9	12.8	13.6
	FY09	8.0	10.1	9.4	10.3	9.4	9.9

NOTE: * ROE for peer set is simple average, ^ on current enterprise value

Source: Merrill Lynch Research, respective companies, Bloomberg for consensus

Overview

Rolta provides end-to-end IT solutions and services in Engineering Design Automation (EDA) and Geographic Information Services (GIS). Rolta's key alliances include its technical collaboration with Intergraph Corporation of US and its partnership with CA (erstwhile Computer Associates). It has also entered into JVs with Stone & Webster, a leading engineering, construction company and Thales SA., a leading international electronics and systems group.

Table 4: Rolta India Snapshot

Revenues	US$120m (FY06)
No. of offices	15 full fledged offices in India
Employees	Over 3,800 employees
Revenue Mix	Geographic Information Services (~59%); Engineering Design services (~29%); eBusiness solutions and services (~12%)
Partnerships	Intergraph, Computer Associates, IBM, Microsoft, Oracle
Joint Ventures	Stone & Webster Inc. USA; Thales SA., France
Subsidiaries	US, UK, UAE, Saudi Arabia, Netherlands, Canada, Germany
Geography Mix	India 60%; Rest of the world 40%
Clients	Large domestic client base including Ministry of Defense, ONGC, BSNL, MTNL, Reliance; International clients include British Telecom, Saudi Telecom, Dubai Municipality
Listings	NSE, BSE for locals and London Stock Exchange for GDRs

Source: Company

Table 5: Shareholding

Entity	Holding
Promoters	40.8%
FII	23.0%
GDR	9.2%
Others	27.1%
Total	100.0%

Source: NSE

Evolution over time

Rolta began operations in 1982 as a generic IT services provider. After 1986 it opted for niche focus in CAD/CAM and GIS. Post Intergraph partnership, subsequent alliance with Computer Associates, and recent JVs with Stone & Webster and Thales SA., Rolta has evolved into an end-to-end solutions provider.

Table 6: Key milestones

1982	#Company incorporated to provide services like data processing, inter branch reconciliation services to banks, development and export of business application software
1985	#Identified CAD/CAM/GIS as focus area
1986	#Entered into Intergraph alliance as exclusive distributor in India
1987	#Procured first major customer- Survey of India
1990	#Came out with an Initial Public Offering on Indian stock markets
1991-1996	#Established manufacturing facility for Graphic workstations under technology transfer from Intergraph #Established its first international subsidiary- Rolta International Inc, USA
1997-2001	#Established multiple subsidiaries to cater to various geographies #Entered Internet Service Provider business in Mumbai- launched RoltaNet #Agreement with PTC to distribute solutions in India
2003	#Entered into a services agreement with CA for North America
2004	#Established Stone & Webster Rolta Ltd- a 50% JV with defense major Stone & Webster
2005	#Signed an agreement with Intergraph for providing services to Intergraph customers in Americas #CA partnership for North America extended for 3 more years #GDRs issued; listed on LSE
2006	#CA partnership extended to UK, Europe, Middle East and Africa through a separate 3yr agreement #Entered into agreement with Thales SA of France to form 51% JV

Source: Company

Experienced management team

Rolta is an early entrant in the CAD/CAM/GIS business. Its management has vast experience in these areas. Rolta has also hired key people from its alliance partners and inducted them in the management. The most recent addition to the management team, Mr Ben Eazzetta, president of international operations has come from Intergraph Corp.

Table 7: Stable and experienced Rolta management team

	Designation	Profile
		#Member of executive committee of FICCI, leading industry association of India
Mr K K Singh	Chairman and Managing Director	#Over 35 years management experience
		#Has been with Rolta for over 18years
		#Served in various managerial capacities in the IT industry
Mr A D Tayal	Joint Managing Director- Defense and Joint Ventures	#Holds bachelor degree in commerce and an MBA
		#Over 35 years of experience
		#Ex employee of IBM
Mr A P Singh	Joint Managing Director- GIS, EDA and eSolutions	#Holds B. Tech and MBA
Mr Aditya Singh	Joint Managing Director, domestic sales except defense	#Post graduation in commerce and business administration with a doctorate in international marketing
		#Over 6 years of experience with Intergraph
		#Over 12 years experience with Exxon Company, USA
		#Ex president of Intergraph's SG&I (Security, Government and Infrastructure) division
		#Ex vice president and co-founder of Industria.com
Mr Ben Eazzetta	President of International Operations	#Holds bachelor's of science in nuclear engineering and master's in mechanical engineering
		#Ex managing director of Intergraph- Middle East
Mr John M Sasser	President, Head of Middle East operations	#Ex vice president of Tetratech International
		#Has over 25 years experience in IT
Mr Mark Edwards	Head of European operations	#Holds BS from Texas university and MBA
		#Associate member of The Institute of Chartered Accountants of India
Mr. H. Ashar	Director, Finance and Chief Financial Officer	#Has over 10 years of experience in finance, accounts, taxation and audit
		#Over 40 years of experience including 12yr at IBM
Mr. A. Chakrabarti	Director, Business Operations- GIS	#Holds a masters degree in Statistics
Mr. S. K. Shirguppi	Director, Business Operations- Engineering Design Automation group	#Over 15 years of work experience in the process and petrochemical engineering industry #Has been with Rolta for over a decade
Dr. S. R. Bhot	Director, Business Operations- eSolutions Strategic Business Group	#Over 15 years of work experience in IT #Holds Masters in Science and a PhD
		#Over 32 years of experience in sales, marketing, software development and customer support
Mr. K. R. Vaidyanathan	Director, Sales and marketing, Business Development	#Has been with Rolta for over 15 years #Holds a masters degree in science

Source: Company

Business description

Rolta is organized into three main business groups and has two joint ventures.

1. GeoEngineering/GIS

Rolta provides digital mapping services to its clients (mainly defense, utilities and cities). Digital mapping services include taking physical pictures of the topography, converting this into digital format and managing database of these digital maps. Rolta provides end-to-end solutions in the Indian and Bangladesh markets that include hardware, software and services. Outside this region it provides only services and goes together with vendors such as Intergraph, PTC and IBM.

#Defense: Rolta's business here is mainly domestic with some portion of revenue coming from defense organizations in the UAE.

Rolta has recently signed a JV with Thales SA of France. The JV will enable it to take up turnkey projects that include integrated hardware, software, consulting and services work for defense clients. The JV will start contributing revenue in FY08.

Table 8: Thales JV arrangement

Name of the JV	Rolta Thales Ltd
Formed in	Aug-06, to be incorporated by the end of Jun 07 qtr.
Holding	51% with Rolta and 49% with Thales
	#A leading international electronics and systems group and currently vendor of Indian defense forces.
	#Serves defense, aerospace and security markets worldwide
	#About 70,000 employees worldwide
	#Revenue of about EUR13bn in 2005.
Thales profile	#JV is with one of the six divisions of Thales- Land and Joint Systems division
Target	JV expected to generate USD500mn cumulative revenue by 2011 including consulting, hardware and software

Source: Merrill Lynch Research, Company

#Utilities: Rolta offers digital mapping services to utility companies across geographies. It offers services in digitizing land-based maps as well as in migration from legacy technology to new technology. In this business, Rolta works directly for the client (ie utilities) and seldom undertakes any sub-contracting work.

Orders in this vertical are typically of the size of US$0.5mn-US$2mn spread over 12-18month.

Key clients in this vertical are BT (UK), Verizon, Cingular, AT&T as well as domestic clients such as BEST, BSNL, MTNL and Torrent power.

#City mapping: Rolta offers city mapping services to various town-planning authorities, municipalities etc mainly in the US and Middle East. As a part of its services, it maps cities in 3D format for further use by clients.

#General GIS services: Rolta here offers specific solutions such as vehicle tracking and emergency response systems (eg the Dial-100 initiative with Mumbai Police) to its clients.

2. Engineering design

Rolta's work in engineering design is different from the work done by its Indian peers. Its work revolves around plant and process design whereas other Indian IT vendors focus mainly on engineering products design. Rolta's services can broadly be categorized into the following:

#Engineering Design Automation

Rolta has an exclusive alliance with Intergraph in India. Its clients are engineering, procurement and construction (EPC) companies such as L&T and Engineers India. As a part of this business, Rolta sells Intergraph software to clients, does customization work and provides integration services in addition to 24x7 support.

Table 9: Intergraph partnership

Nature	Partnership is exclusive for India, renewable every 3yr
	#A leading global provider of spatial information management (SIM) software provider
	#Nasdaq-listed, ~USD580 million revenue in CY05
	#Market capitalization of about $1.5 billion
Intergraph	#About 50 per cent of the company's total revenues comes from the US
Profile	#Asia Pacific revenues on upsurge driven by growth in China and India.
Rolta	
Work	Reseller, customization, integration and 24x7 support
Clients	Engineering, Procurement and Construction companies such as L&T

Source: Merrill Lynch Research, Company

#Engineering design services

Rolta provides process design for the power sector and plant design services for all types of plants. In Indian markets, Rolta can take up turnkey projects, including hardware, software and services, through the JV with Stone & Webster. In the international markets, it provides only specialized services.

Table 10: Engineering design services

Client type	Nature of work	Services offered
		#Process design in case of power companies
EPC companies such as L&T, Engineers India Limited (EIL), Bechtel	Outsourced design work from design centers of EPC companies	#Plant design including digital mapping of plants involving locational design for the plant and in some cases specification of parts too
Owner operators of plants such as Reliance, ONGC, Dow Chem. of UK etc.	Direct work	

Source: Merrill Lynch Research, Company

Rolta has also successfully integrated its eSolutions services in the engineering design automation portfolio (ex. Web-enabling product design for internal coordination). These include product design and detailing, engineering analysis, web-enabled design automation and manufacturing applications.

JV with Stone & Webster improves positioning- This JV is the offshore base for Stone & Webster. It has imparted Rolta with a capability to take advantage of Stone & Webster's current client base as well as participate in bidding for the turnkey EPC projects.

Table 11: Stone & Webster JV arrangement

Name of the JV	Stone & Webster Rolta Ltd
Formed in	May-04
Ownership	50% with Rolta and 50% with Stone & Webster
Stone and Webster profile	#A leading engineering- construction company #Offers consulting, development, engineering and construction services #Clients are Power and Petrochemical companies across the world
Current employee strength of the JV	~305 people, mostly offshore

Source: Merrill Lynch Research, Company

Table 12: SWRL JV client profile

Clients	Work performed	Client acquired through	Current contribution of SWRL revenue
International Owner operators like Dow Chem, 3M	Offshore Plant design	Stone and Webster	~80%
Indian Owner operators like Reliance, IPCL, IOCL, Essar	EPC work	Direct	~20%

Source: Merrill Lynch Research, Company

#eSolutions

Rolta's eSolutions business group offers IT and network security services to clients. It is a Systems Integration partner for CA for eSecurity products. Work done for CA constitutes the bulk of the work done by Rolta in eSolutions. Rolta is also in talks with other vendors such as IBM, Oracle and Sun for similar partnerships.

CA partnership: Rolta has an exclusive agreement with CA under which Rolta has a dedicated team for CA work across the globe. In return CA has promised the minimum quantum of work to be given to Rolta. Additionally, Rolta also acts as a reseller of CA products. About 70% of the work for CA clients is currently done onsite.

Table 13: CA partnership

Nature	Definitive agreement for CA clients in US, UK, EU, Middle East and Africa; presently extended till 2009
Work	Onsite and offshore work for CA clients worldwide; also acts as a reseller
Clients	CA clients in US, UK, EU, Middle East and Africa; some work in APAC too
Set up	Rolta has a dedicated team for CA

Source: Merrill Lynch Research, Company

Growth drivers

#Domestic IT business on a growth path

According to NASSCOM, in FY06 India's IT services spend stood at US$4.3bn including domestic spend in engineering services and R&D at US$0.9bn. IT spending in India is forecast to grow at over 20% p.a. as per NASSCOM, faster than IT spend by businesses and government agencies in India than their North American, European and APAC counterparts.

Rolta derives 60% of total revenue from domestic business, with 35-38% of total revenue coming from government agencies including defense and PSUs.

#Engineering outsourcing from India set to grow

Engineering and design services are part of the higher value added Knowledge Process Outsourcing (KPO), which include research, design and legal services, among others. As per Evalueserve (a market research and business intelligence firm), engineering services are expected to grow at 29% p.a. up to 2010 (Table 15).

Table 14: Growth estimates for KPO

KPO Sectors	FY-03	FY-10E	CAGR (FY03-10E)
Data Search, Integration and Management	0.3	5	50%
Biotech and Pharmaceuticals	0.3	3	40%
Engineering and Design	0.4	2	29%
Remote Education and Publishing	0	2	NM
Research and Development	0.2	2	39%
Animation and Simulation Services	0.1	1.4	46%
Equity, Financial, Insurance Research	0	0.4	NM
Market Research and Competitive Intelligence	0	0.4	70%
Paralegal Content and Services	0	0.3	NM
Medical Content and Services	0	0.3	NM
Research and Information Services in HR	0	0.2	NM
Total (USD bn)	1.3	17	46%

Source: Evalueserve

According to NASSCOM, global engineering services spend in 2004 stood at US$750bn and is slated to cross US$1 trillion by 2020. NASSCOM estimates offshore engineering services revenue to grow to US$150bn-US$225bn by 2020 from the existing US$10-US$15bn in 2004. India's share of this business could increase to US$50bn by 2020, indicating a CAGR of about 24%.

We expect this growth to be driven by:

- Shift towards outsourcing of higher-end business processes like high end consulting and process design as confidence in outsourcing and offshoring continues to increase
- Scarcity of highly trained talent pool in developed countries
- Indian firms investing in moving up the value chain

#Work from defense and power sector to drive growth

Rolta's JVs with Stone & Webster, USA and Thales SA, France will help in achieving higher growth in defense and power sector work.

Table 15: India's power capex

Rsbn	FY03-05	FY06-08E
Generation	793.1	1014.2
T&D	186.4	405.7
Total	979.5	1419.9
Total (US$bn)	22.8	31.6

Source: Merrill Lynch Estimates

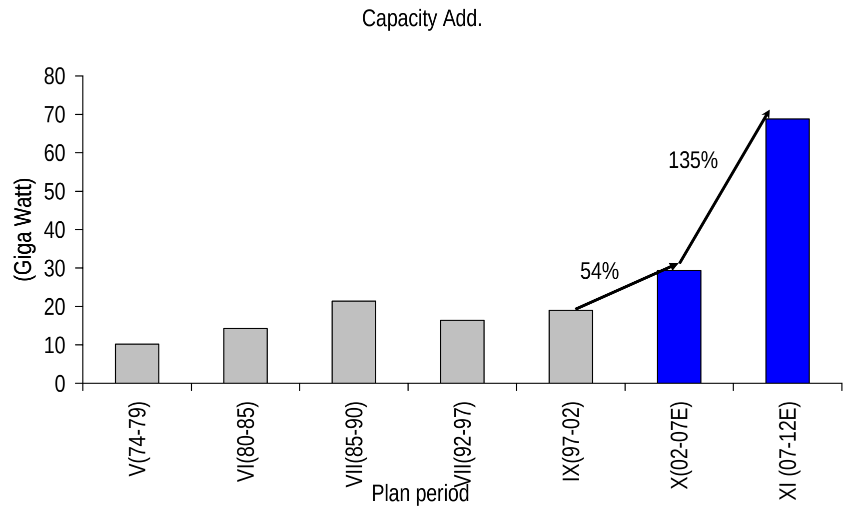
1. Stone & Webster Rolta Ltd.

SWRL stands a chance of reporting high growth given:

Planned capacity addition in power generation in India: The Indian government plans to increase power sector capacity by 135% in the Eleventh Five Year Plan period (2007 to 2012) to 69GW.

According to Merrill Lynch estimates India's power capex will be in the range of US$32bn (over FY06-08) of which the R&D component will be to the tune of 1%. We believe SWRL stands to benefit from these investments given its strong position in the domestic markets. Also, technology from Stone & Webster can prove to be a significant competitive advantage in bidding for new contracts in power projects.

Chart 4: 135% increase in proposed capacity addition in XIth plan period



Source: Merrill Lynch Research

Increased share of work from Stone and Webster should add to growth: SWRL acts as an offshoring design center for Stone & Webster and performs about 15-20% of engineering work of Stone and Webster. We believe this penetration into Stone & Webster will improve going forward and could go to over 40% within the next three years. Rolta plans to employ 1,000 people in SWRL by FY08 end from 305 currently.

2. Thales JV

The Thales JV proposes to service Indian and international civil and military defense markets. Rolta aims to earn about US$500mn revenue from this JV within a span of five years including consulting, hardware and software costs.

India's military budget was about US$20bn in FY06 and is expected to grow about 7% annually over the next five years. Under the **2005 offset clause** foreign arms makers are required to give Indian firms sub-contracted work worth 30% of the value of defense contracts awarded to them in India. This could divert some US$10bn into Indian firms in the next decade as India's defense spending increases.

Rolta is well positioned to tap this opportunity as we believe a substantial chunk of this will flow into IT though we can not comment on the quantum of work that could come its way.

#Possible near term triggers

Changes in National Map Policy will open new avenues

The National Map Policy governs the creation and usage of maps in India. This policy vests the Survey of India (SOI) and a few other government bodies with the responsibility of producing, maintaining and disseminating the topographic map database of the whole country.

Private sector organizations operate in this environment by seeking authorization on a case-by-case basis for specific projects. Pursuant to the current demand, the government may amend this policy to allow private companies in this area. This will open a new business opportunity for Rolta where it can produce and sell maps to private players.

Significant breakthrough in new services like Gaming

Deriving on the synergy with its defense services, it is initially focusing on War gaming. Rolta is pursuing Gaming services as a new initiative in eSolutions. Company stated that this is USD40mn large market and it will look for strategic partner in this segment. A partnership with a significant player will act as a trigger for the stock.

Acquisition in GIS

During the December 2006 earnings call, management mentioned that it was at an advanced stage of discussion for an acquisition in GIS space. While, details of this acquisition are unavailable, we do not expect it to dilute equity.

Competitive differentiators

#End-to-end solutions capability

Rolta offers end-to-end solutions in plant design through SWRL and in GIS on its own. The Thales JV, in our opinion, further strengthens GIS capability in case of defense clients. Also, Rolta's expertise in GIS, engineering and IT business enables it to integrate eServices in the engineering environment.

Rolta's competitors are mainly focused in pockets of the value chain.

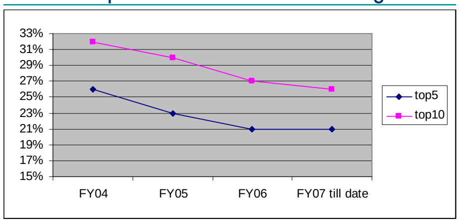
#Sticky relationships with domestic clients

Rolta derives about 60% revenue from Indian clients. About 35-38% of its total revenue comes from the Government of India and PSUs. We believe that the government as a client is difficult to break into and this will act in favor of Rolta.

#Marquee and diversified client base

Rolta's marquee client base including Indian multinationals like Reliance and ONGC and foreign multinationals like British Telecom lend it referenceability and greater revenue visibility in terms of ability to penetrate the client and generate repeat business.

Chart 5: Top client contribution reducing...



Source: Company

Rolta has managed to reduce its dependence on top 10 clients (from 32% in FY04 to 29% in FY06). Its top client contributes less than 5% of the revenue. Moreover, its client base is spread over multiple verticals such as telecom, refineries, petrochemical, power companies etc, which we believe reduces over-dependence on a single client as well as on a single vertical.

Table 16: Top 10 clients in alphabetical order

FY04	FY05	FY06
British Telecom	British Telecom	British Telecom
CA (erstwhile Computer Associates)	CA (erstwhile Computer Associates)	CA (erstwhile Computer Associates)
Dept. of Naval Intelligence	Dubai Municipality	Dubai Municipality
Indian Oil Corp Ltd	Engineers India Ltd	Ministry of Defence
LGE	Ministry of Defense	ONGC
Ministry of Defence	Montana Dakota	Quest Communication
ONGC	Petrofac International	Reliance
Reliance	Quest Communication	Saudi Telecom
Saudi Telecom	Reliance	SNC Lavlin
Telus Communication	Saudi Telecom	Verizon

Source: Company

#Successful partnership track record

Rolta has a successful track record in partnerships. Its key partners include Intergraph in EDA and GIS, CA (erstwhile Computer Associates) in eSolutions, in addition to the JVs it has signed with Stone & Webster and Thales SA in EDA and GIS, respectively.

#Low employee attrition

Rolta employs over 3,800 personnel of whom 60-65% are engineering graduates and 5-10% are engineering post graduates. Despite employing highly skilled manpower, Rolta is successful in maintaining attrition at a reasonable 8-9% level due to better compensation, quality of work and career management.

Rolta is also setting up Rolta Academy, where it will train about 700 employees p.a. This should improve the company's ability to recruit fresh engineers from campus, which currently form a negligible proportion of new recruitment.

#Well placed in the industry landscape

Rolta competes with different players in independent lines of its business. The table below lists the competition and Rolta's competitive advantages in various service lines.

Table 17: Competition landscape

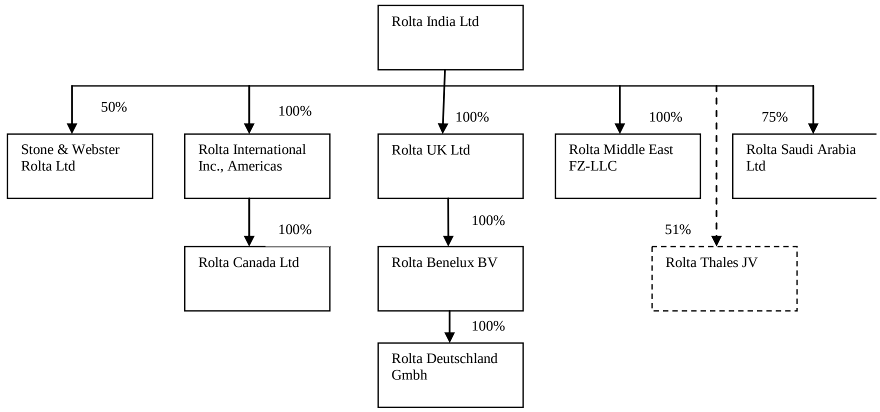
Business Line	Competition	Rolta's competitive advantage
Engineering Design		
Engineering Design Automation tools reseller	#Aviva- direct engagement model in India without any design services # Bentley- reseller of Autoplant from Autodesk	#Exclusive partnership with Intergraph in India to act as reseller and also for supporting services #IT services portfolio to complement the product sold
Plant Design Services	#L&T e-engineering division #KLG Systel #Engineers India Ltd #Bechtel #Jacobs Engineering #Alstom #Reliance	#One of the early entrants in the service line #Over 20yr of experience #JV with Stone & Webster offers high end capabilities that enables bidding for turnkey projects
GIS		
Defense	#No significant competition	#Long standing association with the Defense organizations in India #Many Indian defense installations work on Intergraph products for which Rolta is an exclusive reseller #JV with Thales SA offers high end capabilities that will enable bidding for turnkey projects
Utilities	#Infotech Enterprises	#End to end service offering capability whereas competition is mainly focused on pockets of the value chain
City Mapping/ General GIS Services	#Many smaller players like Technigrafix	#Scale economies
eSolutions	#Most of the Indian IT companies	#Preferred partner alliance with CA for eSecurity products; The sole Indian offshore partner for CA #Focus on eSecurity niche helps client acquisition

Source: Merrill Lynch Research

#Advantage of local presence

Rolta has local subsidiaries in the US, Germany, the UK, Europe, Canada, Middle East and Saudi Arabia. In large contracts, especially in government contracts and in contracts involving some data collection, local presence has proved a definite advantage.

Exhibit 1: Group structure



Source: Company

Financial and operating analysis

Strong revenue growth & margin jump in FY06 & 9mFY07

FY05 a sluggish year in terms of operations

Over FY04-06, Rolta reported a CAGR of 24% in revenue, 28% in EBITDA and 40% in PAT. FY05 was a sluggish year with revenues growing at 19% yoy and EBITDA margin dropping 320bps to 35.5%. FY05 revenue growth was lower at 20% due to a delay in execution of government projects pending government permissions. Its cost of revenue also shot up due to high manpower costs because of a ramp-up in manpower in anticipation of government work and higher sub contracting cost for the Dubai Municipality project.

However, lower depreciation (on asset block getting written off) and lower tax outgo (from effective 14.6% to 8.8% helped Rolta grow PAT at 41% in FY05.

Revenues and margins recover from FY06

In FY06 and in 9mFY07, revenue growth recovered to ~30% YoY and PAT grew at 41% and 35% respectively on higher value engineering design automation and e-solutions growing as a proportion of mix from 33% to 41%.

Realized bill rates in 9mFY07 showed an increase of 1% in GIS and 8% in EDA, indicating a strong demand environment. **EBITDA margins were largely stable** with wage increases getting offset by price increases across segments and scale economies.

For the **quarter ending March 2007**, Rolta's revenue grew 10% QoQ and 31% YoY. PAT grew 11% sequentially and 38% YoY. **EBIT margins showed an improvement of 100bps sequentially** due to improved utilization.

Table 18: 9m FY07 performance

	9m ending Mar 07	9m ending Mar 06	YoY
Net sales	5083.2	3904.1	30.2%
Total expenditure	3016.8	2308.1	30.7%
(Increase)/decrease in stock in trade	37.5	42.0	-10.5%
Consumption of raw materials	1312.1	982.3	33.6%
Staff cost	1211.5	883.6	37.1%
Other expenditure	455.7	400.2	13.9%
EBITDA	2066.4	1596.0	29.5%
Depreciation	737.2	502.8	46.6%
EBIT	1329.2	1093.2	21.6%
Interest	4.1	112.0	-96.4%
Other income	58.7	30.6	92.1%
PBT	1383.9	1011.8	36.8%
Provision for tax	145.9	91.9	58.7%
PAT	1238.0	919.9	34.6%

Margins	9m ending Mar 07	9m ending Mar 06	YoY
EBITDA	40.7%	40.9%	-23bps
EBIT	26.1%	28.0%	-185bps
PAT	24.4%	23.6%	79bps
Tax rate	10.5%	9.1%	146bps

Source: Company

Estimate 35% revenue CAGR for FY07-09

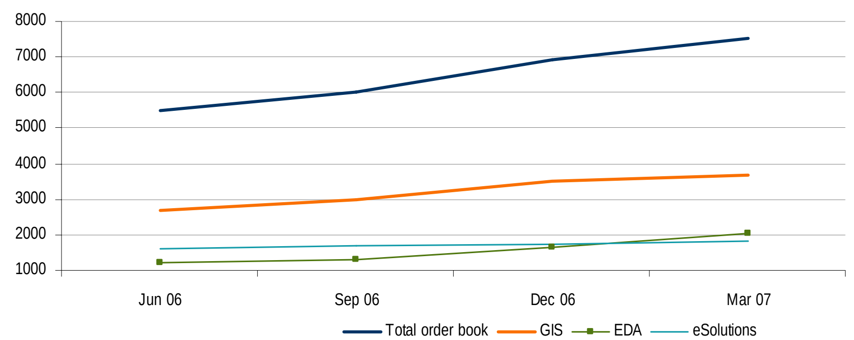
We expect Rolta's revenue to grow at a CAGR of about 35% over FY07-09 led by growth in its current business and growth from JVs.

Strong order book improves visibility

Rolta's current order book stands at about Rs7.5bn, executable over the next 1-2.5 years. This, if averaged over quarters, forms about 45% of our estimated revenue for the next 12months.

Moreover, Rolta's order book size has been increasing for the past four quarters. Company's pipeline is also strong at Rs15bn. We believe, historically the company's success rate has been ~50-60% w.r.t. the pipeline. This implies higher traction for Rolta's business as well as higher revenue visibility.

Chart 6: Increasing order book size (INR million)



Source: Company

Partnerships to impart financial benefits

Partnerships with CA, Intergraph and JVs with Stone & Webster and Thales inc. should contribute to Rolta's growth significantly.

We expect the CA alliance and the SWRL and Thales JVs to cumulatively account for around 15% of Rolta's top line by FY09. Additionally, its exclusive partnership with Intergraph will provide an incumbency advantage, especially with respect to the work from India's defense establishments.

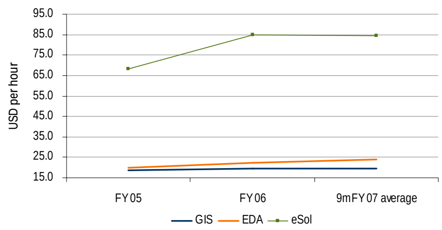
#JVs expand the scope of target market

Rolta's JVs with Stone & Webster Ltd and Thales SA significantly expand the scope of work that Rolta can undertake. With the Stone & Webster JV, it can pitch for complete EPC projects in India. Meanwhile, the Thales JV imparts similar capability with regard to the turnkey defense contracts that involve hardware, software and services components.

#Key alliances impart credibility

Rolta's alliances with CA and Intergraph provide credibility as well as higher client access. This provides an incumbency advantage wherever CA and Intergraph form existing platforms (eg. Many defense installations in India operate on Intergraph platforms thus providing a sticky client base for Rolta).

Chart 7: Increasing bill rates



Source: Company, Merrill Lynch Research

Margins could expand; Forecast 38% EBIT CAGR

Rolta works on an "owned licenses model" where all its software licenses are owned. This entails higher capex and higher depreciation. Rolta's peer companies operate mainly on "leased licenses model" or a combination of the two models. This results in a higher cost of revenue. Hence, EBIT is the relevant margin to compare instead of EBITDA.

Rolta's EBIT margins of 28% in FY06 were the highest amongst its mid-cap peers. This is an outcome of the higher bill rates it gets from clients which in turn is a result of its end-to-end solutions capability with strong niche market focus.

We believe Rolta will improve EBIT margin given:

- Higher bill rates that it can charge its customers due to niche focus and end to end solutions capability
- Rolta amortizes cost of licenses over a period of around three years. We expect this amortization as a % of revenue to come down once investments made in licenses in the current growth phase are fully amortized.

We have assumed EBIT margins to increase from 26.6% to 27.5% over FY07-09 despite a 16% wage inflation and Rupee appreciation vs USD of 5% in FY08 and ~3% in FY09, based on:

- ~4% increase in realized bill rates in FY08 across segments given high demand in power projects, refineries and with the Thales JV becoming operational.
- A 230bps decline in depreciation as a % of total revenue over the next two years as Rolta leverages current high capex incurred in the growth phase.
- Utilization is assumed at 80% in GIS, 78% in EDA and 70% in eSolutions

PAT forecast to grow 32% CAGR over FY07-09

We assume the tax rate going up from the current 11% level to 13% by the end of FY09 as facilities are likely to come out of STPI (Software Technology Parks of India) exemption. Thereby PAT is forecast to grow at 32% CAGR over FY07-09.

Balance sheet ratios likely to improve

Rolta historically had high **debtor days** of over seven months (223 days in FY06). Higher revenue from the government clients with lengthy receivable cycles resulted in this. Rolta aims to reduce DSOs to between 180 and 200 days by FY07 given increasing proportion of business from international clients and the private sector. We project DSOs to decrease from 223 in FY06 to 190 in FY09.

Rolta's **RoE** is lower than that of its mid cap peers (17% in FY07e). This is largely due to higher investments in licenses as it operates on an "owned license model", most of its campuses being owned campuses and larger DSOs. We expect Rolta's RoE to improve by 570bps from FY07 to FY09 as benefits from the scale-based productivity improvements kick in and it reduces DSOs with more work from private clients.

85% CAGR in free cashflow over FY07-09

- We forecast a 85% jump in free cash flow over FY07-09 on jump in operating cash flow, lower debtor days and leveraging existing asset base, mainly licenses.

- Our FY08 capex is based on the addition in number of employees and Rolta's current capex of about Rs1.5mn per seat, higher than other Indian IT companies at Rs0.4mn to Rs0.5mn per seat. This is essentially due to its "owned license model".

- Consequent to higher capex per seat, depreciation stands at about 14% of revenue which is higher than 7-9% in case of other IT companies. Rolta writes off the capex on software licenses over a period of three years. We believe that, once such expenditure is written off, depreciation as a % of revenue would come down in future.

Risks and concerns

Non annuity-based business

Rolta's business is non-annuity based business. This exposes it to non-refilling risk when projects finish. The risk is higher at the completion of any large assignment.

Accounting issues in the past

Rolta has faced a SEBI inquiry in the past on the presentation of its financial statements. The issue involved inclusion of inter-departmental transactions in company sales and costs of revenue without any impact on PAT. In 2004, it was cleared by SEBI after incremental disclosures.

Risk related to acquisitions

Rolta is likely to seek inorganic growth in GIS, as was mentioned on its 2Q FY07 earnings call. We believe acquisition-driven growth is riskier than organic growth.

Higher debtor days

Rolta's higher debtor days (more than six months) are an outcome of a large part of its business being project-based and also with a significant part of the domestic business coming from the Government of India.

Projects being mostly fixed bid, retentions of payments at the client end increase debtor days. In the case of governments, the payment cycle is generally long. Rolta is trying to reduce this by increasing the proportion of international business as well as private business. However, this risk rarely results in payment default by clients as the risk of bad debts in the case of government work is low.

Risk due to dependence on partnerships

Rolta has exclusive reseller and service agreement with Intergraph w.r.t India geography. Moreover it also has a dedicated team for CA. Any adverse changes/discontinuation in these partnerships will pose risks to revenue.

Industry risks: Wages, increasing taxes, rupee appreciation

Rolta faces wage inflation risks that are common to the IT industry. An appreciating rupee may have a negative impact on earnings. Moreover, by March 2009, tax holidays in India for IT/BPO are expected to expire.

Rolta currently has maintained its attrition in 8-9% range. Attrition may go up as the fight for resources intensifies in IT.

Financial tables

Table 19: Profit and loss statement

Yr ending Jun 30, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Net sales	4,146	5,349	7,020	9,594	12,854
Total expenditure	2,672	3,120	4,145	5,751	7,779
Material Cost	1,317	1,393	1,866	2,544	3,392
Staff cost	899	1,221	1,649	2,275	3,230
Other expenditure	457	506	630	933	1,157
EBITDA	1,474	2,229	2,875	3,843	5,075
Depreciation	489	747	1,008	1,247	1,542
EBIT	985	1,482	1,866	2,596	3,532
Interest	116	146	4	0	0
Other income	111	85	83	81	127
PBT	980	1,421	1,946	2,676	3,660
Provision for tax	86	147	207	321	476
PAT before minority	894	1,274	1,739	2,355	3,184
Minority interest	8	-	-	(25)	(149)
PAT post minority	902	1,274	1,739	2,330	3,035
No of shares (mn)- Basic wtd avg	63.7	67.5	80.1	80.1	80.1
No of shares (mn)- Diluted wtd avg	63.7	67.8	81.7	81.7	81.7
EPS- Basic	14.2	18.9	21.7	29.1	37.9
EPS- Diluted	14.2	18.8	21.3	28.5	37.2
Growth	FY05	FY06	FY07E	FY08E	FY09E
Revenue	18.3%	29.0%	31.2%	36.7%	34.0%
EBITDA	8.5%	51.2%	29.0%	33.7%	32.1%
EBIT	32.2%	50.5%	25.9%	39.1%	36.1%
PAT	41.2%	41.2%	36.5%	34.0%	30.3%
Margins	FY05	FY06	FY07E	FY08E	FY09E
EBITDA	35.5%	41.7%	41.0%	40.1%	39.5%
EBIT	23.8%	27.7%	26.6%	27.1%	27.5%
PAT	21.8%	23.8%	24.8%	24.3%	23.6%
Tax rate	8.8%	10.3%	10.6%	12.0%	13.0%

Source: Merrill Lynch Research, Company

Table 20: Balance sheet

Yr ending Jun 30, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Sources of Funds					
Shareholders' funds					
Share Capital	637	799	799	799	799
Researves and Surplus	3,929	8,615	10,006	11,870	14,298
Total	4,566	9,414	10,805	12,669	15,098
Minority interest	-	-	-	25	149
Loan Funds					
Secured Loans	1,863	98	-	-	-
Deferred Tax liability	172	253	253	253	253
Total	2,034	351	253	253	253
Total sources of funds	6,601	9,765	11,059	12,948	15,499
Application of Funds	FY05	FY06	FY07E	FY08E	FY09E
Gross Block	7,104	6,695	8,395	10,095	11,645
Less: Depreciation/amortisation/impairment	3,892	2,852	3,860	5,108	6,650
Net Block	3,212	3,843	4,534	4,987	4,995
CWIP	422	682	682	682	682
Total Fixed assets	3,634	4,524	5,216	5,669	5,676
Goodwill on consolidation	65	67	67	67	67
Investments	-	1,124	1,200	1,250	1,300
Deferred tax assets	-	0	0	0	0
Current assets, loans and advances					
Inventories	191	234	284	334	384
Sundry debtors	2,889	3,262	3,846	5,126	6,691
Cash and bank balance	331	887	778	835	1,714
Other current assets	31	2	2	2	2
Loans & Advances	549	742	742	742	742
Total Current assets, loans and advances	3,990	5,128	5,653	7,039	9,533
Less: Current liabilities and provisions	1,088	1,078	1,078	1,078	1,078
Net Current assets	2,902	4,050	4,575	5,961	8,456
Total	6,601	9,765	11,059	12,948	15,499

Source: Merrill Lynch Research, Company

Table 21: Cash flow

Rs million	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operating activities					
PAT	894	1,274	1,739	2,330	3,035
Depreciation	489	747	1,008	1,247	1,542
Amortisation of goodwill	1	0	-	-	-
Interest expenses	116	146	4	-	-
provision for tax	86	147	207	321	476
exchange difference adjustment	1	0	-	-	-
Others	(28)	(17)	-	-	-
Operating profit before working capital changes	1,557	2,297	2,958	3,898	5,053
Trade and other receivables	313	(542)	(585)	(1,279)	(1,565)
Inventories	413	(43)	(50)	(50)	(50)
Others (traded payable)	214	(88)	-	-	-
Cash generated from operations	2,498	1,624	2,323	2,569	3,438
interest received	2	10	-	-	-
interest paid	(113)	(164)	(4)	-	-
direct taxes paid (net of refunds)	(51)	(82)	(207)	(321)	(476)
Net cash from operating activities	2,336	1,387	2,113	2,248	2,962
Free cash flow	449	(252)	413	548	1,412
Cash flow from investing activities					
Purchase of fixed assets	(1,887)	(1,640)	(1,700)	(1,700)	(1,550)
Sale of fixed assets	39	9	-	-	-
Purchase of investments (net)	66	(1,124)	(76)	(50)	(50)
Profit on sale of investment	-	0	-	-	-
others (inclludes goodwill impairment, dividend received)	-	17	-	-	-
Net cash used in investing activities	(1,782)	(2,737)	(1,776)	(1,750)	(1,600)
Cash flow from financing activities					
Proceeds from secured loans	(509)	(1,764)	(98)	-	-
Dividend and dividend tax paid	(221)	(254)	(348)	(466)	(607)
Proceeds from issue of share capital	-	4,056	-	-	-
share issue expenses	-	(131)	-	-	-
Minority	-	-	-	25	124
Net cash from financing activities	(730)	1,907	(446)	(441)	(483)
Net increase in cash and cash equivalents	(177)	557	(110)	57	879
Opening cash	508	331	887	778	835
Closing cash	331	887	778	835	1,714

Source: Merrill Lynch Research, Company

Table 22: Key ratios

Margins	FY05	FY06	FY07E	FY08E	FY09E
EBITDA	35.5%	41.7%	41.0%	40.1%	39.5%
EBIT	23.8%	27.7%	26.6%	27.1%	27.5%
PAT	21.8%	23.8%	24.8%	24.3%	23.6%
Tax rate	8.8%	10.3%	10.6%	12.0%	13.0%
Per Share Data	FY05	FY06	FY07E	FY08E	FY09E
Basic EPS (INR)	14.2	18.9	21.7	29.1	37.9
Diluted EPS (INR)	14.2	18.8	21.3	28.5	37.2
Basic EPS (USD)	0.32	0.42	0.49	0.68	0.90
Diluted EPS (USD)	0.32	0.42	0.48	0.66	0.88
CEPS (INR)	21.8	30.0	34.3	44.7	57.1
Dividend Payout %	24.5%	19.9%	20.0%	20.0%	20.0%
Dividend Per Share (INR)	3.47	3.74	4.26	5.70	7.43
Book-value (INR)	71.7	139.6	134.9	158.2	188.5
PE- Basic	29.7	22.2	19.3	14.4	11.1
PE- Diluted	29.7	22.3	19.7	14.7	11.3
GDR PE- Basic	30.2	23.0	19.8	14.4	10.8
GDR PE- Diluted	30.2	23.1	20.2	14.7	11.0
INR/USD	43.8	44.6	44.0	43.0	42.0
Growth Ratios	FY05	FY06	FY07E	FY08E	FY09E
Revenue	18.3%	29.0%	31.2%	36.7%	34.0%
EBITDA	8.5%	51.2%	29.0%	33.7%	32.1%
EBIT	32.2%	50.5%	25.9%	39.1%	36.1%
PAT	41.2%	41.2%	36.5%	34.0%	30.3%
EPS diluted	41.2%	32.7%	13.2%	34.0%	30.3%
Return Ratios	FY05	FY06	FY07E	FY08E	FY09E
RONW	19.6%	18.2%	17.2%	20.1%	22.9%
RONW ex cash	19.1%	18.8%	17.9%	20.9%	24.4%
ROCE	16.9%	19.8%	18.7%	21.6%	24.2%
ROCE ex cash	16.4%	20.5%	19.6%	22.6%	25.9%
Other Key Metrics	FY05	FY06	FY07E	FY08E	FY09E
Assets Turnover	0.6	0.5	0.6	0.7	0.8
DSO	254	223	200	195	190
Current assets as a % of sales	0.96	0.96	0.81	0.73	0.74
Cash and cash equivalents	331	887	778	835	1714
Accounts receivable, net	2889	3262	3846	5126	6691
Free cash flow	449	-252	413	548	1412

Source: Merrill Lynch Research, Company

Price Objective Basis & Risk

Our PO on local at Rs540 is at 14x FY09e PE at 7% discount to our target multiple for Infotech Enterprises and at about 10% discount to the DCF value. Our GDR PO at USD13.1 is at par with the local PO.

Risks: a) Non annuity nature of business b) risk related to possible acquisitions c) risk posed due to high dependence on partnerships d)industry wide risk of increasing wages, increasing taxes, rupee appreciation

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Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Buy	114	41.76%	Buy	21	20.39%
Neutral	146	53.48%	Neutral	31	22.79%
Sell	13	4.76%	Sell	1	9.09%

Investment Rating Distribution: Global Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1562	45.16%	Buy	415	30.09%
Neutral	1615	46.69%	Neutral	446	30.65%
Sell	282	8.15%	Sell	49	19.76%

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