



**impetus advisors**

research@impetusadvisors.com

**10 Oct 2007**

For Private Circulation Only  
Important disclosure on the last page

## Spanco Telesystems & Solutions

Multi-dimensional growth ahead

Spanco Telesystems & Solutions is mainly in the field of System Integration & networking solution for telecom, defence PSU Utilities & Governments in India. It provides turnkey solutions to meet their networking infrastructure requirements. The company is going to have strong growth on the back of strong growth in telecom & networking and huge capex planned in these sectors over next 2-3 years.

**DCF Value (1-yr out) Rs.397**

**Current Price Rs.197**

**+101%**

The stock currently trades at 6.7x and 5.1x the estimated consolidated EPS for FY08 (Rs.29) and FY09 (Rs.39) respectively. We expect strong EPS growth of 81% in FY08 & 32% in FY09. Our value estimate is based on expected strong growth in revenues, entry into lucrative high value added related businesses like RFID, BPO for Railways, and entry into newer geographies.

### Key Data

Market Cap	Rs.4.07 bn US\$103mn
Shares Outstanding	207 mn
52 week High-Low	Rs.300 / Rs.125
Avg Trading Volume	No. of shares
30 Days	123,000
365 Days	132,000
BSE Scrip Code	508976
BSE Group	S

### Shareholding % **30 Jun 07**

Promoters	30.44
Institutions	20.19
Others	49.36

### Multiple Valuation **YE Mar-08E**

EV/EBITDA	3.1x
EV/ EBIT	4.2x
Market Cap/Sales	0.6x
P/E	6.7x

### Products & Services

### Customers

System Integration	Telecom companies
Networking Solutions	Defence organisations
BPO Services	PSU Utilities
RFID Managed Services	Governments

### Key Investment Points

- Spanco has, over the years, developed a core competency in offering telecom & network system integration. The Company is now attractively positioned to capitalize on the boom in the infrastructure market and expects to bag a significant chunk of these investments.
- The company is one of many vendors pre-approved by the defence ministry and has long association in handling those projects. Hence, it can leverage the huge outlay planned in improving the defence connectivity & security.
- It has formed a JV in the Middle East to replicate its Indian business model there.
- International BPO business is expected to scale up rapidly in its niche areas of gaming & debt collection. It recently acquired BPO unit space of GTL on lease.

### Value Kickers

- Spanco's JV with Spice group bagged a 10-year contract to set up, operate and maintain call centres for the Indian Railways. We estimate this contract to be hugely value accretive for the company.
- It's entering into RFID solution space, which has huge growth potential. It acquired 51% in an RFID middleware company and may acquire another company in this space.

### Points of Concern

- Scalability & Timely Implementation of contracts is important, as its order size & numbers of orders are going to increase going forward.
- Working capital management, especially receivables, is an area to watch out for. A worsening of receivables may stretch its balance sheet.



---

## Introduction

Spanco Telesystems and Solutions Limited, is an active player in the field of Telecom System Integration for telecom carriers in India, providing solutions to meet the networking infrastructure requirements of its clients. Spanco Telesystems is engaged in providing telecommunication, information technology-enabled consultancy services and international call centre business. It has alliances with Nortel Networks, Airspan, HP, IBM, etc and is involved in various network infrastructure projects with the defence, public sector units, utilities, enterprises and other institutions. The company hived off its domestic BPO operations in Sparsh effective 01 Jan 06.

## Business Summary

The company has, over the years, developed a core competency in offering telecom system integration. Telecom System Integration refers to setting up of infrastructure for communication and transfer of voice, data and video by bringing the different mediums of communication together. Telecom System Integration involves providing solutions to meet the networking infrastructure requirements of the clients.

The telecom business is primarily structured across four key segments-Defence, PSU / Utilities, Government & Service Providers. The companies across these segments float tenders / bids for addressing their networking and network infrastructure requirements. Spanco participates in these bids contributing some critical components and value added integration services, either directly or in consortium or at the backend with large companies like IBM, BEL, UT Star COM, Ericsson, Nokia, HP, and ITI. In system integration, it undertakes turnkey responsibilities for setting up networks; whereas in software development; it develops applications & software testing capabilities for turnkey projects. In the network engineering division, Spanco also acts as an intermediary between the network equipment providers and the telecom operators.

## System Integration (Clients)

- **Carriers**- BSNL, VSNL, Tata Teleservices
- **Defence**- Ministry of Defence, DRDO, MCTE
- **PSU/Utilities**-Railways, ONGC, Airport Authority of India, NTPC, PNB
- **Enterprise Networks/Call Centre**-Intelenet Global Services, TCS, MTNL

## International Call Centre-RESPONDEZ

Respondenz is a state-of-the-art international call centre in Mumbai serving clients in the US and UK. The services offered are primarily Voice-based Inbound and Outbound services. The company is leveraging its expertise gained through setting up end-to-end technology platforms for international call centres across the country and its successful experience of domestic call centre operations for the leading names in the Indian business environment. The company expects to focus on adding value by taking up assignments under high-growth verticals comprising gaming & debt collection. Global Respondenz Inc., U.S.A is a 100% subsidiary of Spanco Telesystem whereas Global Respondenz Services Limited is an associate with 49.69% stake.

## Sector Outlook

We expect huge investments in three distinct areas of India's telecom industry:

- Augmentation of existing networks to cater to incremental subscribers
- To address the growing needs of applications, services and products as preferred by customers
- Network revamp on account of technology obsolescence



---

<b>Potential Market for Spanco Telesystem</b>	<b>Rs Cr</b>
BSNL GSM Opportunity	20,000
BSNL Broadband	1,500
Bharti 61 million lines expansion	25,000
Tata Tele Services (Wi Max)	200
Defence	2,000
Swans	3,300
Oman Tel	100

By virtue of a sustained presence, experience, and learning in this market for the last 10 years, Spanco is attractively positioned to capitalize on the boom in the infrastructure market and expects to bag a significant chunk of these investments.

#### **It's a play on strong capex growth in Telecom Sector**

The telecom industry is one of the fastest growing industries in India. The tele-density has increased from 2% in 1998 to 18.3% in March 2007. We expect tele-density to increase to 36% by 2010. Most of the Indian wireless operators currently have significant capex plans. The sharp decline in handset prices and tariffs has significantly increased the addressable market and operators are now expanding their footprints to capture this growth potential. It is estimated that Indian wireless operators need a capex outlay on telecom of \$10.5-11 billion in FY08.

#### **Defence budget allocation of Rs.96,000 crore**

The company is one of the 18 vendors pre-approved by the defence ministry and has a long association in handling those projects. It's a likely beneficiary of the huge outlay planned in improving the defence connectivity & security.

#### **Capturing RFID Space with acquisition of 51% equity stake in Skandsoft Technologies**

Spanco has entered the RFID space to capitalize on the large untapped opportunity in India and abroad. The company acquired 51% equity stake in **Skandsoft Technologies** in Q2 FY07 for Rs.56mn to strengthen its position in the RFID space. The company has a patented platform (middleware), SETU, which allows organizations to make the optimal usage of RFID technology.

The company wants to capture the middleware segment in RFID space and expects to bag some projects from companies for which it is currently handling pilot projects. The company is also looking for acquisitions in Europe & America for RFID technology and customer base.

#### **Tapping Middle East Opportunity**

The company formed a subsidiary Spanco Limited, Dubai for its overseas ventures in the Middle East. Spanco Ltd Dubai has ventured into the Middle East market by entering into a JV "**Spanco-GKS**" with Golden Key Solutions of Oman. The company expects to replicate the Indian Telecom Systems Integration business in the gulf region. It will seek more partnerships with local partners for addressing business opportunity through this JV. The company has earmarked around \$4-5mn of capex for its Middle East ventures.



<b>Spanco Telesystem-Addressable Market Rs.Cr</b>		
<b>Business Stream</b>	<b>Market Size</b>	<b>Target FY08</b>
<b>System Integration</b>		
Defence	1800	125
Service Providers	5000/50000	225
PSU/Utilities	300	60
SWANs	750/2000	
Govt	500	70
AMC & Support		30
<b>Software + Call Centre</b>		40
<b>Network Engg Division</b>	2000	90
<b>Total</b>		<b>650</b>

### Railway contract with IRCTC

Bharat BPO Services Ltd, a 50:50 JV between Spanco and Spice group in Jan 2007 bagged a 10-year contract to set up, operate and maintain call centres for the Indian Railways. The company tied up with BSNL as a TSP (Telecom Service Provider) to carry the calls to the Call Centre. The JV will also set up four regional call centres (139 service) in four regional zones in India. The Call centres will start functioning within this financial year.

### Capex

The project would entail a total capex of Rs 80-100 crore for technology and other operational infrastructure and will be spent in FY08. In addition to this there would be an operational expenditure of Rs 30 crore annually. The incremental capex for the project will be low and company expects to recover the total capex within 3-4 years.

### Revenue Stream

- Revenue sharing with the telecom service provider (BSNL) for all incoming calls
- SMS revenues for various services
- Commission on tickets, taxis, and hotels booked through the call centre (premium services)
- Advertising revenues
- Outbound campaigns or new service launches

For every call, the JV will get around 30%, while the rest will go to BSNL. In the case of a premium call, sharing could be upto 50%. We believe that there is lot of potential in this revenue model as daily traffic expected is 30 mn calls a day which is expected to increase further going forward. The company has pegged value of the contract at Rs.1,000 crore for a period of 10 years. With 400mn passengers annually, even if the company captures Rs.2.50 per person by way of various revenue streams listed above, the annual revenue could be Rs.1bn.

### Capex funded through Equity dilution

Spanco made preferential allotment of 3.08 million shares to Monet Limited (an arm of ChrysCapital) and 1.09 million shares to UTI Investment Advisory Services Ltd at Rs.214.91 per share in Mar-07. The company also made a preferential allotment to the promoters of 0.65mn shares at Rs.210 per



share in Mar-07. Monet invested close to Rs.66 crore for around 15% stake while UTI Investment Advisory Services invested around Rs.23 crore for 5.3% stake. The company also issued 1.5 million warrants to Monet & 1.35 million warrants to the promoters at a price of Rs.210. The diluted equity after the preferential allotment is Rs.206.5mn and after conversion of warrants (by Sep-08), it will be Rs.235mn.

## Concerns

### **Timely Execution of turnkey projects**

As bulk of the growth will continue to come from the telecom vertical, scalability & timely implementation of turnkey contracts is important. As order size & numbers of orders are going to increase going forward, any hiccup on implementation front can lead to lower than estimated revenues and profits.

### **Receivables in telecom business**

Spanco had 171 days (PY 161 days) of receivables at end Mar-07 based on annual sales and 154 days (PY 130 days) based on half yearly sales. Overall receivable days will go down going forward, as railway project will not have significant debtors. Yet, there is a need to watch out for receivable position in telecom segment. Any worsening on this front can stretch balance sheet and may require further funding. Due to high and growing receivables days, even its operating cash flows are negative – something that we do not normally take kindly. We are making exception this time looking at the strong growth and diversification of business into other less working capital intensive business segments. This, however, continues to remain the biggest risk for the company. We, however, understand that year-end receivables are higher than average receivable during the year. As per the company management, average receivables during the year are 120-125 days.



## Spanco Telesystems & Solutions Limited –Group Structure

### Subsidiaries

**Spanco (S) Pte Ltd,  
Singapore (100%)**

**Spanco Great IT Ltd  
(100%)**

**Spanco Europe Ltd  
(100%)**

**Global Respondenz  
Inc, USA (100%)**

**Spanco Limited,  
Dubai, UAE  
(100%)**

**Spanco Global  
Solutions Pvt Ltd  
(100%)**

**Skandsoft Technologies Pvt Ltd  
RFID Business  
(51% Stake)**

### Joint Ventures

**Spanco -GKS  
JV between Spanco Ltd Dubai &  
Golden key Solutions  
(51% Stake)**

**Bharat BPO Services Ltd  
JV with Spice group  
(50% Stake)**

### Associate

**Global Respondenz  
Services Limited  
(49.69% Stake)**



## Income Statement

Rs. Mn.	Mar-07	Mar-08P	Mar-09P
Revenues	4468	7245	10345
EBIT	601	1124	1608
PBT	488	856	1292
PAT	337	605	908
Adj. PAT	333	605	908
EPS Rupees	16.15	29.28	38.63

## Ratios

	Mar-07	Mar-08P	Mar-09P
Revenue Gr %	104.5	62.7	42.8
EPS Growth %	31.8	81.3	31.9
RoE %	15.8	19.6	22.6
D/E x	0.7	0.7	0.5
Receivable days	171	171	171
L&A/Revenues%	29.7	28.0	26.0
Creditors' days	144	122	122

## Balance Sheets

Rs. Mn.	Mar-07	Mar-08P	Mar-09P
<b>Assets</b>			
Net Block	551	1949	1949
Capital WIP	538	-	-
Net Curr. Assets	2161	3584	4913
Excess Cash	1450	-	-
<b>Liabilities</b>			
Equity Capital	207	207	235
Reserves	2575	3088	4375
Debt	2047	2290	2242

## Interim Performance

Rs. Mn. Months	Sep-06 3	Dec-06 3	Mar-07 3	Jun-07 3
Revenues	1217	1358	1118	1021
EBITDA	166	187	190	149
EBIT	144	166	165	122
PBT	128	139	149	129
PAT	91	101	111	93
Eq Capital	158	158	207	207
Ann EPS Rs.	23.03	25.41	21.58	17.94
EBIT Margin	11.8%	12.2%	14.8%	11.9%
Other income/PBT	1.3%	9.2%	10.0%	14.8%
Tax/PBT	28.6%	27.9%	25.4%	28.2%

## Multiple Valuation

	Mar-07	Mar-08P	Mar-09P
EV/EBITDA x	6.8	3.1	2.2
EV/EBIT x	7.8	4.2	2.9
Mkt. Cap/Sales x	0.9	0.6	0.4
P/E x	12.2	6.7	5.1
Price/Book x	1.5	1.3	1.0

## Free Cash Flow

Rs. Mn.	Mar-07	Mar-08P	Mar-09P
NOPLAT	413	794	1130
Change in Net Working Capital	872	1471	1375
<b>Operating Cash Flows</b>	<b>(460)</b>	<b>(677)</b>	<b>(245)</b>
Net Capex & others	616	763	(61)
<b>Free Cash Flow</b>	<b>(1075)</b>	<b>(1440)</b>	<b>(183)</b>
Non-opr. Cash flow	29	25	1
<b>Cash Flow to Investors</b>	<b>(1047)</b>	<b>(1415)</b>	<b>(183)</b>

## Financing Cash Flow

Rs. Mn	Mar-07	Mar-08P	Mar-09P
Post-tax Interest	105	214	223
Repayment/ (issue) of Debt	(1504)	(243)	48
Equity Share Dividend	32	43	91
Equity Buyback/(Issue)	1093	-	545
Inc / (Dec) in surplus cash/Investments	1413	(1430)	-
<b>Financing Cash Flow</b>	<b>(1047)</b>	<b>(1350)</b>	<b>(160)</b>

## DCF Valuation

Key Assumptions	Rs. Mn.	%
Terminal Growth Rate		3.0
WACC		15.5
Cost of Equity		17.2
Terminal ROIC		17.5
<b>Per share Value (Rs.)</b>	<b>397</b>	1-yr out

## Notes



## **Important Disclosure**

**This material has been prepared by Impetus Advisors, Mumbai, India ([www.impetusadvisors.com](http://www.impetusadvisors.com)).**

**The views expressed herein correctly reflect Impetus Advisors' views. Owners, analysts, and/or employees of Impetus Advisors hold shares of the company.**

This document is not for public distribution and has been furnished to you solely for your information and may not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to inform themselves of, and to observe such restrictions.

This material is for the personal information of the authorised recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. No person associated with Impetus Advisors is authorised to call or initiate contact with you for the purposes of elaborating or following up on the information contained in this document. The material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such.

Neither Impetus Advisors, nor any person connected with it, accepts any liability arising from the use of this document. The recipient of this material should rely on their own investigations and take their own professional advice. Opinions expressed are our current opinions as of the date appearing on this material only. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice.

No part of this material may be duplicated in any form and/or redistributed without Impetus Advisor's prior written consent.

## **About Impetus Advisors**

**Impetus Advisors is an independent equity research boutique, which specialises in identifying multi-bagger stock ideas among Indian equities. It provides equity research to institutional and high networth investors.**

**Impetus Advisors also provides customised equity research outsourcing services to Institutional & High Net Worth Investors.**

**Impetus Advisors is an independent research outfit. It is into neither stock broking nor merchant banking nor any other activity which can potentially conflict with equity research.**

**Please visit [www.impetusadvisors.com](http://www.impetusadvisors.com) for details. Write to [research@impetusadvisors.com](mailto:research@impetusadvisors.com) with your contact numbers to know how you can benefit from our research-backed investment ideas.**