

# 3Q miss, bleak outlook; cut to Underperform



## RESEARCH

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### Slash earnings on significant 3Q miss; Cut to Underperform

Rolta's recurring 3Q PAT came in 28% below our estimates, led by a sharp slowdown in the engineering services and enterprise solutions business, which management expects will linger for a few quarters. We cut EPS estimates by 23-45% over FY09-11E assuming a 6-14% cut in revenues, resultant margin-hit and a surge in interest costs given recent increase in debt levels. Cut PO to Rs70 at 6x FY10E PE (30% downside potential), a 40-50% discount to Tier-1 vendors, in line with historical discount.

### Demand slowdown worse than expected

3Q revenues declined 8% QoQ, driven by an 18% decline in engineering services and a 12% decline in the enterprise solutions business. The corresponding order books fell 10% and 5% QoQ. While we had recently cut estimates to factor in a likely slowdown in engineering services, the actual revenue slowdown was much worse, and is likely to be more prolonged. Consequently, margins declined 150bp on a recurring basis during the quarter.

### B/S quality deteriorates; FCCB redemption a challenge

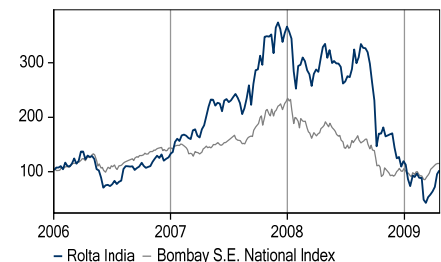
With a plunge in FY09 free cash flow (FCF) due to slowdown and spend on SEZ and acquisitions, Rolta raised more debt in the quarter. Given our forecast drop in earnings, our FCF estimates over FY09-11E have been cut by 60%, and we believe Rolta will face challenges in the redemption of its US\$150mn FCCB due in 2012.

### Further downside risk from Thales JV

Rolta incorporated the Thales JV in June 2007 to capitalize on offset-related work in defense. Given elections in India, we believe order flows might be pushed out to December 2009 at the earliest, posing further risk to our FY10 estimates.

### Stock Data

Price (Common / GDR)	Rs102.45 / US\$1.25
Price Objective	Rs79.00 to Rs70.00 / US\$1.90 to US\$1.00
Date Established	22-Apr-2009 / 22-Apr-2009
Investment Opinion	C-3-8 / C-3-8
Volatility Risk	HIGH / HIGH
ML Symbol / Exchange	RLTAF / BSE
ML Symbol / Exchange	XLROF / LIN
Bloomberg / Reuters	RLTA IN / ROLT.BO



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Refer to important disclosures on page 5 to 8. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3.

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## Financials

Table 1: Profit and Loss statement

Yr ending Jun 30, Rs mn	FY07	FY08	FY09E	FY10E	FY11E
Net sales	7,114	10,722	13,640	13,915	16,263
Total expenditure	4,248	6,825	9,109	9,573	11,243
Material Cost	1,928	2,560	1,896	1,414	1,671
Staff cost	1,690	3,201	5,612	6,343	7,451
Other expenditure	630	1,064	1,601	1,816	2,122
<b>EBITDA</b>	<b>2,866</b>	<b>3,897</b>	<b>4,531</b>	<b>4,342</b>	<b>5,019</b>
Depreciation	1,018	1,383	1,787	2,057	2,358
<b>EBIT</b>	<b>1,848</b>	<b>2,515</b>	<b>2,744</b>	<b>2,286</b>	<b>2,661</b>
Interest	7	0	127	231	231
Other income	103	472	391	183	227
PBT	1,943	2,986	3,009	2,238	2,657
Provision for tax	217	388	371	297	469
<b>PAT before minority</b>	<b>1,726</b>	<b>2,599</b>	<b>2,637</b>	<b>1,940</b>	<b>2,188</b>
Minority interest	-	9	6	4	-
<b>PAT Recurring</b>	<b>1,726</b>	<b>2,607</b>	<b>2,643</b>	<b>1,944</b>	<b>2,188</b>
MTM FCCB		(302)	-		
<b>PAT post FCCB</b>	<b>1,726</b>	<b>2,306</b>	<b>2,643</b>	<b>1,944</b>	<b>2,188</b>
EPS- Diluted	11	15	15	11	12

Source: BAS-ML Research, Company

Table 2: 3Q Quarterly Analysis

	Mar 09 E	Dec 08	QoQ	Mar 08	YoY	ML e	Variation
Net sales	3320	3619	-8.3%	2884	15.1%	3586	-7.4%
Total expenditure	2256	2358	-4.4%	1876	20.2%	2385	-5.4%
<b>EBITDA</b>	<b>1065</b>	<b>1261</b>	<b>-15.6%</b>	<b>1008</b>	<b>5.7%</b>	<b>1200</b>	<b>-11.3%</b>
Depreciation	498	413	20.4%	353	40.9%	434	14.7%
<b>EBIT</b>	<b>567</b>	<b>848</b>	<b>-33.1%</b>	<b>655</b>	<b>-13.3%</b>	<b>767</b>	<b>-26.0%</b>
Interest	58	11	404.9%	0	NM	29	102.0%
Other income	81	95	-14.7%	105	-22.9%	69	17.3%
FCCB - MTM	840	-227		0	NM	0	NM
PBT	1431	705	102.9%	760	88.3%	807	77.2%
Provision for tax	101	101	-0.2%	103	-1.7%	121	-16.4%
<b>PAT</b>	<b>1330</b>	<b>604</b>	<b>120.3%</b>	<b>657</b>	<b>102.4%</b>	<b>686</b>	<b>93.8%</b>
Minority Int	2	2	-5.7%	0	NM	-2	-179.1%
<b>PAT- Post Minority</b>	<b>1331</b>	<b>606</b>	<b>119.9%</b>	<b>657</b>	<b>102.7%</b>	<b>684</b>	<b>94.7%</b>
<b>Recurring PAT</b>	<b>491</b>	<b>832</b>	<b>-41.0%</b>	<b>657</b>	<b>-25.2%</b>	<b>684</b>	<b>-28.2%</b>
<b>Margins</b>	<b>Mar 09 E</b>	<b>Dec 08</b>	<b>QoQ</b>	<b>Mar 08</b>	<b>YoY</b>	<b>ML e</b>	<b>Variation</b>
EBITDA	32.1%	34.8%	-277bps	34.9%	-288bps	33.5%	-141bps
EBIT	17.1%	23.4%	-634bps	22.7%	-561bps	21.4%	-430bps
PAT	40.1%	16.7%	2337bps	22.8%	1732bps	19.1%	2103bps
Tax rate	7.1%	14.4%	-731bps	13.6%	-648bps	15.0%	-792bps

Source: BAS-ML Research, Company

## Investment thesis

### Rollta India

While we like Rollta for its differentiated offerings in the high growth area of engineering services for plant design and Geographic Information Systems, we see significant near term challenges in Engineering division. Key concerns include delays in deal flows from engineering clients given tough business conditions and increasing debt profile for the company.

## Price objective basis & risk

### Rollta India (RLTAF / XLROF)

Our PO (local stock) of Rs70 is at a 6x FY10E PE, a 40-50% discount to tier one vendors, and in line with the stock's historical discount range. Our PO (for the GDR) of USD1 is at par with the local PO. Risks: a) Non-annuity nature of business. b) Risk related to possible acquisitions. c) Risk due to high dependence on partnerships. d) Industry-wide risk of increasing wages, increasing taxes, and rupee appreciation. Upside Risks : significant wins from defence for Thales JV and earlier than anticipated recovery in engineering and enterprise solutions business.

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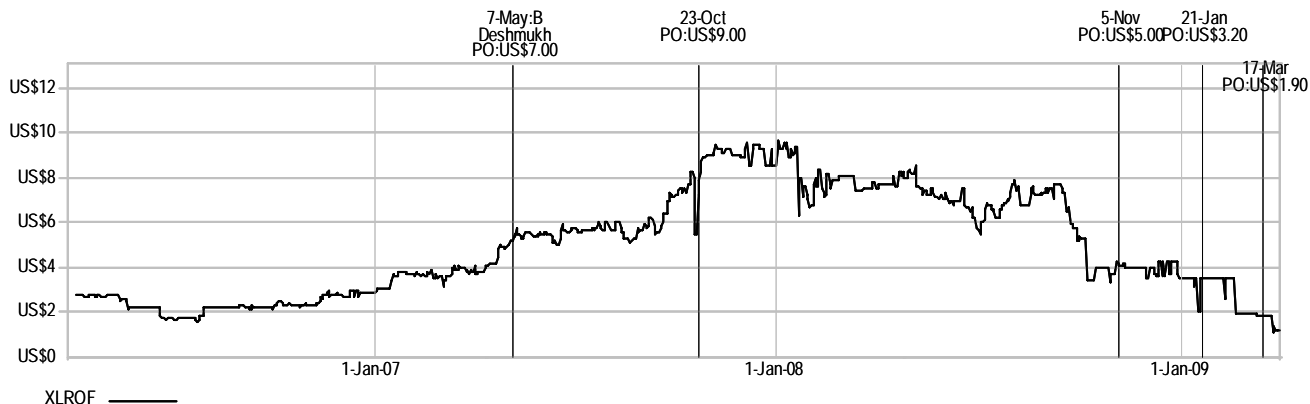


B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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### XLROF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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Buy	83	40.10%	Buy	32	43.24%
Neutral	46	22.22%	Neutral	23	58.97%
Sell	78	37.68%	Sell	27	36.99%

### Investment Rating Distribution: Global Group (as of 01 Apr 2009)

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