

2 November 2007

BUY

Price	Target Price
Rs202	Rs383

Sensex	19724
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Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	(19)	(20)	20
Rel. to Sensex	(14)	(39)	(43)	(21)

Source: Bloomberg

Stock Details

Sector	Telecom
Reuters	SPTS.BO
Bloomberg	SPAN@IN
Equity Capital (Rs mn)	207
Face Value (Rs)	10
52 Week H/L	300/149
Market Cap (Rs bn)	4.2
Daily Avg Vol. (No of shares)	67996
Daily Avg Turnover (US\$mn)	0.4

Shareholding Pattern (%)(30th Sep.'07)

Promoters	30.4
FII/NRI	23.6
Institutions	12.0
Private Corp.	17.4
Public	16.5

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Spanco Telesystems

Result
Update

Below expectations

Spanco Telesystems reported Q2FY08 results below our expectations. Owing to a lower growth of 11% yoy in the telecom business, Spanco's Q2 net sales grew by a mere 12% yoy to Rs1360mn. The lower sales growth was due to the delay in completion of few large contracts, which are expected to be completed in Q3FY08. While the EBIDTA increased by 16% yoy to Rs193mn, the EBIDTA margins for the quarter expanded by 50bps yoy to 14.2%. The increase in the EBIDTA margins was due to lower proportion of hardware component in the telecom business. On a segmental basis, the PBIT from Telecom business increased by 180bps where as the PBIT for the international BPO operations declined by 920bps yoy primarily owing to the appreciation in currency. The PAT for the quarter increased by 20% yoy to Rs109mn. The EPS for the quarter stood at Rs4.6. Post lower than expected Q2 results, we are lowering our revenue and PAT estimates for FY08 by 10% and 16% respectively. We also introduce our FY09 estimates with net sales of Rs9481 and earnings of Rs842. We maintain our BUY recommendation on the stock with a price target of Rs395 using SOTP approach (10x FY09E EPS of Rs35.8 and Rs25 per share for IRCTC contract).

Result update

The net sales for the quarter grew by mere 11% yoy to Rs1360mn due to lower than expected growth in the Telecom business, which was on account of delay in completion of few large orders, which would be completed in Q3FY08. The improvement in EBIDTA margins by 50bps led to a 16% yoy growth in the operating profits. The PAT for the quarter grew by 20% yoy to Rs109mn. On segmental basis, the PBIT margins for telecom business expanded by 180bps to 15%, while the PBIT margins in the international BPO declined by 920bps yoy to 10.3% mainly due to rupee appreciation.

Revising FY08 estimates and introducing FY09 estimates

Post lower than expected Q2 results; we are lowering our FY08 revenue estimate by 10% to Rs6979mn and PAT estimate by 16% to Rs562mn respectively. Our revision is higher in profitability due to lower margins in the international BPO business on account of rupee appreciation. We also introduce FY09 estimates with net sales of Rs9481mn and PAT of Rs842mn accruing into a fully diluted EPS of Rs35.8. Our FY09 estimates factor the aggressive expansion of BPO operations from the current 650 seats to 2000 seats by mid FY09.

Outlook and Valuations

We continue to remain bullish on Spanco due to the robust expansion activity in the industry, which provides immense growth opportunity for the company. We have lowered our earnings estimate for FY08 by 16% to Rs23.9 and have introduced estimates for FY09 with earnings of Rs35.8 per share. Over FY07-09E, we expect net sales to increase by 49% CAGR to Rs9481mn and PAT to increase by 61% CAGR to Rs842mn. We revise our price target upwards from Rs311 per share to Rs383 per share based on SOTP approach (10x EPS for FY09 and Rs25 per share for the IRCTC project). We maintain our BUY recommendation on the stock.

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	RoCE (%)	EV/EBITDA	P/BV	Div Yld (%)	AEPS (Rs)	P/E (Diluted)
FY06	2,001	410	20.5	168	27.7	9.0	2.3	0.9	10.6	19.0
FY07	4,266	650	15.2	327	19.3	7.8	1.5	0.9	15.8	12.8
FY08E	6,979	1,023	14.7	562	19.0	6.0	1.2	1.0	23.9	8.4
FY09E	9,481	1,484	15.7	842	23.2	4.6	1.0	1.5	35.8	5.6

Estimates revised for FY08

	Old estimate	New estimate	% Change
Revenues	7772	6,979	-10%
EBIDTA	1154	1,023	-11%
PAT	673	562	-16%
EPS	28.6	23.9	-16%

We have downgraded our revenue, EBIDTA and PAT estimates for FY08 by 10%, 11% and 16% respectively. The revision in profitability is higher because of the currency pressure affecting the margins in the BPO business.

Quarterly result update

	Q2FY08	Q2FY07	Change %	FY07
Telecom	1253.4	1130.9	10.8	3947.3
Respondez	106.8	85.9	24.4	350.1
Total Revenue	1360.2	1216.8	11.8	4297.3
(Incr)/Dcr in stocks	-64.0	-112.2	-43.0	-69.5
Consumption of RM	879.1	958.3	-8.3	2908.5
Staff Cost	118.7	70.0	69.7	313.1
Others exp.	233.1	134.3	73.5	510.3
Total Expenditure	1167.1	1050.4	11.1	3662.4
<i>% of revenue</i>	85.8	86.3	-0.6	85.2
EBIDTA	193.2	166.3	16.1	634.9
Margin, %	14.2	13.7		14.8
Interest	25.4	18.1	40.5	100.4
Depreciation	29.0	21.5	34.9	88.7
PBT	138.8	126.8	9.5	445.8
Other Income	15.4	1.3	1132.3	32.6
Tax	47.4	33.3	42.3	112.4
Deferred tax	-2.4	4.0	-159.7	18.3
<i>Tax rate (%)</i>	32.5	29.4	10.2	29.3
PAT	109.1	90.7	20.3	347.7
Equity	235.0	235.0	0.0	235.0
EPS, Rs	4.6	3.9	20.3	14.8

Cost of sales (%)

Consumption of RM	59.9%	69.5%	(961)	66.1%
Staff Cost	8.7%	5.8%	298	7.3%
Others exp.	17.1%	11.0%	610	11.9%

Segmental performance

(Rs mn)	Q2FY08	Q2FY07	Change %	FY07
Telecom	1253.4	1130.9	10.8	3947.3
PBIT	188.2	149.0	26.3	553.8
PBIT %	15.0	13.2	183	14.0
BPO services	106.8	85.9	24.4	350.1
PBIT	11.0	16.7	-34.4	77.0
PBIT %	10.3	19.5	-919	22.0
Total Revenue	1360.2	1216.8	11.8	4297.3
PBIT	199.2	165.8	20.2	630.7
PBIT %	14.6	13.6	102	14.7

Profit & Loss

	FY06	FY07	FY08E	FY09E
Net Sales	2,001	4,266	6,979	9,481
Growth (%)	91.6	113.2	63.6	35.9
Expenses	1,592	3,616	5,956	7,997
Raw Materials	588	3,047	4,667	6,060
% of sales	29.4	71.4	66.9	63.9
Employee Cost	516	307	518	913
% of sales	25.8	7.2	7.4	9.6
Selling/Admin Cost	488	261	772	1,024
% of sales	24.4	6.1	11.1	10.8
EBIDTA	410	650	1,023	1,484
Growth (%)	85.0	58.7	57.4	45.1
EBIDTA %	20.5	15.2	14.7	15.7
Other income	9	59	65	50
Interest	75	141	220	230
Depreciation	136	89	110	210
PBT	207	479	758	1,094
Current tax	38	143	196	252
Deferred tax	1	9	-	-
PAT	168	327	562	842
Growth (%)	71.0	94.2	72.0	49.8

Balance Sheet

	FY06	FY07	FY08E	FY09E
Equity Share Capital	158	207	235	235
Reserves & surplus	1,230	2,559	3,583	4,343
Net worth	1,388	2,766	3,818	4,578
Deferred tax liability	1	13	13	13
Loan Funds	542	2,042	2,142	2,242
Total Liabilities	1,931	4,821	5,974	6,833
Gross Block	567	803	1,053	1,303
Less: Depreciation	193	272	382	592
Net block	374	532	671	711
Capital work in progress	245	396	296	296
Investment	16	606	1,123	1,273
Inventories	91	89	191	260
Sundry debtors	959	1,894	2,581	3,507
Cash & bank balance	71	1,134	749	151
Loans & advances	670	1,701	2,008	2,857
Other assets	-	-	-	-
Current liabilities	(434)	1,426	(1,530)	(2,078)
Provisions	(61)	(104)	(115)	(143)
Net current assets	1,295	3,288	3,884	4,553
Total Assets	1,931	4,821	5,974	6,833

Cash Flow Statement

	FY06	FY07	FY08E	FY09E
Pre-tax profit	207	479	758	1,094
Depreciation	136	89	110	210
Interest Provided	75	141	220	230
Interest Paid	(75)	(141)	(220)	(230)
Others	19	2	1	-
Chg in working cap	(735)	(1,183)	(993)	(1,295)
Tax paid	(38)	(143)	(196)	(252)
Operating cash Inflow	(411)	(757)	(320)	(243)
Capital expenditure	(80)	(386)	(150)	(250)
Free Cash Flow	(492)	(1,143)	(470)	(493)
Investments	-	(590)	(517)	(150)
Equity Capital Raised	532	1,034	545	-
Loans Taken / (Repaid)	129	1,500	100	100
Dividend (incl tax)	(12)	(36)	(43)	(55)
Others	(195)	-	-	-
Net chg in cash	(37)	764	(385)	(598)
Opening cash position	107	70	1,134	749
Closing cash position	70	1,134	749	151

Ratios

	FY06	FY07	FY08E	FY09E
EBITDA %	20.5	15.2	14.7	15.7
EBIT %	14.1	14.5	14.0	14.0
NPM %	8.4	7.7	8.1	8.9
ROCE %	27.7	19.3	19.0	23.2
ROE %	16.8	15.7	17.1	20.1
ROIC %	14.9	18.2	22.3	23.6
EPS	10.6	15.8	23.9	35.8
Cash EPS	19.2	20.1	28.6	44.8
Book Value	87.7	133.9	162.5	194.8
PER (x)	19.0	12.8	8.4	5.6
Price / CEPS (x)	10.5	10.0	7.1	4.5
Price / BV (x)	2.3	1.5	1.2	1.0
EV / Sales (x)	1.8	1.2	0.9	0.7
EV / EBITDA (x)	9.0	7.8	6.0	4.6
DPS (Rs)	1.8	1.8	2.0	3.0
Dividend Yield (%)	0.9	0.9	1.0	1.5
Debtors T/O	153	150	135	135
Creditors T/O	79	122	80	80

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