

ITI

INR 44

Miles to go

REDUCE



ITI's Q4FY07 results were encouraging, marked by strong revenue growth and a near break-even at the operating level. Post three quarters of muted performance, topline quadrupled Q-o-Q to INR 11.4 bn largely on account of improved order execution. Pointing towards the first signs of a turnaround at the operating level, losses reduced significantly to INR 108 mn in Q4FY07 aided by strong topline growth and relatively lower operating expenditure. Overall FY07 results were marginally below expectations, which we reckon is primarily due to persistent delays in order intake for over two quarters from key customers (particularly BSNL's 60 mn line tender going into litigation).

Key quarterly highlights

- Net revenues quadrupled Q-o-Q to INR 11.4 bn; spurt in revenues was largely led by previously delayed orders getting executed and billed. Key orders booked in the quarter include ~1mn lines from MTNL and ~3 mn lines from BSNL. We believe that, barring any unexpected delays in order intake, revenue growth momentum should sustain particularly as orders for BSNL's 18 mn line tender start rolling in the latter half of FY08E. Order book at the quarter end stood at INR 12 bn; which included orders worth INR 6 bn from Alcatel.
- Strong revenue growth coupled with lower incremental raw material costs led to a sharp decline in EBITDA losses by ~84% Q-o-Q to INR 108 mn. ITI reported net profits for the first time in the last eight quarters; however this was largely on account of high other income of INR 1.1 bn (including INR 270 mn of grant-in-aid from the government) which more than offset the otherwise high interest expenses of INR 604 mn. We continue to believe financing costs are likely to continue to remain a key concern given high debt-in-books of ~INR 20 bn.

* Outlook

With legal clouds over BSNL's 60 mn line tender clearing, we are like to see strong order book accretion for ITI over the next few quarters. We see robust topline growth (driven largely by execution of BSNL's order) driving margins and leading to possible operating profits in FY08E; however we expect ITI to report net profits only in FY09E. We estimate revenues to grow at a 36% CAGR over FY08-09E to INR 32 bn, and estimate marginal net profits of INR 114 mn in FY09E. At INR 44, the stock trades at an EV/EBITDA of 14.2x and EV/sales of 0.9x FY09E estimates. We believe current valuations factor in most potential upsides and do not see a case for valuation re-rating particularly as execution risks continue to remain a key concern coupled with the possibility of a financial turnaround only in FY09E. We reiterate our 'REDUCE' recommendation

Financials

Year to March	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY06	FY07E
Revenues (INR mn)	11,444	8,232	39.0	2,714	321.7	16,607	17,768
EBITDA (INR mn)	(108)	(1,685)	93.6	(684)	84.3	(2,803)	(2,856)
Net profit (INR mn)	286	(1,505)	119.0	(1,203)	123.8	(4,036)	(3,771)
EPS (INR)	1.0	(5.2)	119.0	(4.2)	123.8	(14.0)	(13.1)
PE (x)							NA
EV/EBITDA (x)							20.2
ROAC (%)							4.7

April 27, 2007

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

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

Reuters : ITEL.BO
Bloomberg : ITI IN

Market Data

52-week range (INR) : 73 / 28
Share in issue (mn) : 288.0
M cap (INR bn/USD mn) : 12.7 / 310.3
Avg. Daily Vol. BSE/NSE ('000) : 1,207.2

Share Holding Pattern (%)

Promoters : 93.0
MFs, FIs & Banks : 0.4
FIIIs : 0.0
Others : 6.6

Financial snapshot

(INR mn)

Year to March	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY06	FY07E	FY08E
Net sales	11,444	8,232	39.0	2,714	321.7	16,607	17,768	30,593
Raw materials	9,591	7,449	28.7	2,335	310.8	13,764	15,275	23,116
Employee expenses	1,322	1,493	(11.5)	757	74.6	3,823	3,622	4,030
Other expenditure	639	975	(34.5)	306	109.1	1,824	1,726	1,945
Total expenditure	11,552	9,917	16.5	3,397	240.0	19,411	20,624	29,092
EBITDA	(108)	(1,685)	93.6	(684)	84.3	(2,803)	(2,856)	1,501
Depreciation	117	145	(18.9)	98	19.2	359	400	421
EBIT	(225)	(1,830)	87.7	(782)	71.3	(3,162)	(3,256)	1,080
Interest	604	601	0.5	510	18.5	2,248	2,101	2,046
Other income	1,117	928	20.3	90	1139.2	1,386	1,592	405
PBT	288	(1,503)	119.2	(1,202)	124.0	(4,024)	(3,765)	(561)
Provision for taxation	2	2		1	-	12	6	16
Extra-ordinary Items	358	2		0		253	358	0
Net profit	(72)	(1,507)	95.2	(1,203)	94.0	(4,288)	(4,128)	(577)
Adjusted net profit	286	(1,505)	119.0	(1,203)	123.8	(4,036)	(3,771)	(577)
Equity capital (FV 10)	2,880	2,880		2,880		2,880	2,880	2,880
Number of shares	288	288		288		288	288	288
EPS	1.0	(5.2)	119.0	(4.2)	123.8	(14.0)	(13.1)	(2.0)
EV/Sales						1.8	1.7	1.0
As % of net revenues								
Raw materials	83.8	90.5		86.0		82.9	86.0	75.6
Employee expenses	11.6	18.1		27.9		23.0	20.4	13.2
Other expenses	5.6	11.8		11.3		11.0	9.7	6.4
EBITDA	(0.9)	(20.5)		(25.2)		(16.9)	(16.1)	4.9
Net profit	2.5	(18.3)		(44.3)		(24.3)	(21.2)	(1.9)

Company Background

ITI manufactures a range of telecom equipment like electronic switching and transmission equipment, optical fibre equipment, digital exchanges, V-SAT equipment, and telephone instruments. Hitherto a fixed line equipment manufacturer, ITI recently diversified its products and upgraded its facilities to meet the needs of the fast-growing mobile segment. It has ventured into manufacture of GSM and CDMA-WLL equipment through technical collaborations with Alcatel of France and ZTE of China. ITI caters to various sectors like defence, power, steel, oil, and railways. PSU telcos MTNL and BSNL, and the Defence forces are its principal customers.

Investment Thesis

ITI enjoys assured orders from BSNL and MTNL, as ~25-30% of the tenders floated by these telcos are reserved for ITI. Of BSNL's tender for 60 mn GSM lines, ~18 mn lines have been reserved for ITI. We believe the execution of this tender is likely to drive topline growth for ITI over FY08-09E, leading to improving margins and a possible financial turnaround, though, only in FY09E. Given our expectations of marginal net profits of INR 114 mn in FY09E (INR 0.39 per share), we see little scope for valuation re-rating and believe that any potential upsides have largely been factored in. Also, downside risks to our estimates in the form of delay in order intake and operating inefficiencies continue to persist.

Key Risks

Any improvement in order executions or greater operating efficiencies could lead to stronger margins and possibility of a financial turnaround in FY08E vis-à-vis our expectation of FY09E. Increased market opportunity on account of aggressive capex plans of domestic telcos and potential export opportunity from Alcatel (ITI's technological partner) could yield upsides to our revenue and profitability estimates for FY08-09E.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Income from operations	13,179	16,607	17,768	30,593	32,969
Direct costs	11,887	13,764	15,275	23,116	24,748
Employee costs	3,367	3,823	3,622	4,030	4,136
Other expenses	3,379	1,824	1,726	1,945	1,954
Total operating expenses	18,634	19,411	20,624	29,092	30,839
EBITDA	(5,455)	(2,803)	(2,856)	1,501	2,130
Depreciation and amortisation	317	359	400	421	437
EBIT	(5,772)	(3,162)	(3,256)	1,080	1,693
Interest expenses	2,075	2,248	2,101	2,046	2,010
Other income	2,703	1,386	1,592	405	448
Profit before tax	(5,144)	(4,024)	(3,765)	(561)	130
Provision for tax	-	12	6	16	17
Extraordinary items	(2,045)	253	358	-	-
Reported profit	(3,098)	(4,288)	(4,128)	(577)	114
Adjusted net profit	(5,144)	(4,036)	(3,771)	(577)	114
Shares outstanding	288	288	288	288	288

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Operating expenses	141.4	116.9	116.1	95.1	93.5
Depreciation	2.4	2.2	2.2	1.4	1.3
Interest expenditure	15.7	13.5	11.8	6.7	6.1
EBITDA margins	(41.4)	(16.9)	(16.1)	4.9	6.5
Net profit margins	(39.0)	(24.3)	(21.2)	(1.9)	0.3

Growth metrics (%)

Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Revenues	10.0	26.0	7.0	72.2	7.8
EBITDA	(82.6)	48.6	(1.9)	152.5	41.9
PBT	(0.2)	21.8	6.4	85.1	123.2
Net profit	(0.2)	21.5	6.6	84.7	119.7
EPS	69.4	21.5	6.6	84.7	119.7

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Net profit	(3,098)	(4,288)	(4,128)	(577)	114
Add: Depreciation	317	359	400	421	437
Add: E.O.adjustments	2,122	246	84	-	-
Gross cash flow	(659)	(3,683)	(3,644)	(156)	551
Less: Changes in W. C.	(350)	(1,319)	(3,273)	(847)	(750)
Operating cash flow	(308)	(2,364)	(372)	691	1,301
Less: Change in investments	-	(46)	-	-	-
Less: Capex	(744)	467	450	500	300
Free cash flow	436	(2,786)	(822)	191	1,001

Balance sheet (INR mn)					
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	2,880	2,880	2,880	2,880	2,880
Redeemable preference capital	3,000	3,000	3,000	3,000	3,000
Reserves & surplus	(12,938)	9,313	5,185	4,607	4,721
Shareholders funds	(7,058)	15,193	11,065	10,487	10,601
Secured loans	8,799	11,807	11,807	11,807	11,807
Unsecured loans	7,502	8,000	8,000	8,000	8,000
Borrowings	16,301	19,807	19,807	19,807	19,807
Grant-in-aid	1,551	1,272	915	915	915
Sources of funds	10,794	36,272	31,787	31,209	31,323
Gross block	9,318	36,315	36,815	37,315	37,615
Depreciation	7,352	7,683	8,083	8,504	8,941
Net block	1,967	28,632	28,733	28,811	28,674
Capital work in progress	42	50	0	0	0
Total fixed assets	2,008	28,682	28,733	28,811	28,674
Investments	50	4	4	4	4
Inventories	5,528	4,122	4,198	5,720	6,124
Sundry debtors	14,202	16,625	16,307	21,792	23,971
Cash and equivalents*	1,774	2,190	1,011	1,202	2,202
Loans and advances	2,707	3,029	3,111	4,283	5,440
Total current assets	24,212	25,967	24,628	32,997	37,737
Sundry creditors and others	14,825	16,651	20,000	28,500	32,464
Provisions	982	1,814	1,579	2,104	2,629
Total CL & provisions	15,807	18,465	21,578	30,604	35,093
Net current assets	8,405	7,502	3,050	2,394	2,644
Others	331	84	0	0	0
Uses of funds	10,794	36,272	31,787	31,209	31,323
* includes restricted cash	1,551	1,272	915	915	915
Adjusted Book value per share (INR)	(25)	53	38	36	37

Ratios

Year to March	FY05	FY06	FY07UA	FY08E	FY09E
ROAE (%)	NA	NA	NA	NA	1.1
ROACE (%)	NA	NA	NA	4.7	6.8
Current ratio	1.5	1.4	1.1	1.1	1.1
Debtors (days)	393	365	335	260	265
Fixed assets t/o (x)	5.9	1.1	0.6	1.1	1.1
Average working capital t/o (x)	1.7	2.1	3.4	11.2	13.1
Debt/Equity	(2.3)	1.3	1.8	1.9	1.9

Valuations parameters

Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Adjusted EPS (INR)	(17.9)	(14.0)	(13.1)	(2.0)	0.4
Y-o-Y growth (%)	(0.2)	21.5	6.6	84.7	119.7
CEPS (INR)	(16.8)	(12.8)	(11.7)	(0.5)	1.9
PE (x)	NA	NA	NA	NA	111.5
Price/BV(x)	(1.8)	0.8	1.1	1.2	1.2
EV/Sales (x)	2.3	1.8	1.7	1.0	0.9
EV/EBITDA (x)	NA	NA	NA	20.2	14.2

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



Naresh Kothari – 2286 4246

Head, Institutional Equities

Vikas Khemani – 2286 4206

Head, Institutional Equities

INDIA RESEARCH

SECTOR

INSTITUTIONAL SALES

Shriram Iyer - 2286 4256	Head – Research	Nischal Maheshwari - 2286 4205
Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Shabnam Kapur - 2286 4394
Vishal Goyal, CFA - 2286 4370	Banking & Finance	Balakumar V - (044) 4263 8283
Revathi Myneni - 2286 4413	Cement	Ashish Agrawal - 2286 4301
Sumeet Budhraj - 2286 4430	FMCG	Nikhil Garg - 2286 4282
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Swati Khemani - 2286 4266
Priyanko Panja - 2286 4300	Infrastructure, Engineering, Telecom	Neha Shahra - 2286 4276
Hitesh Zaveri - 2286 4424	Information Technology	Priya Ramchandran - 2286 4389
Parul Inamdar - 2286 4355	Information Technology	Anubhav Kanodia - 2286 4361
Priyank Singhal - 2286 4302	Media, Retail	Tushar Mahajan - 2286 4439
Prakash Kapadia - 4097 9843	Mid Caps	Harsh Biyani - 2286 4419
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Nirmal Ajmera - 2286 4258
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Ankit Doshi - 2286 4671
Manika Prem Singh - 4019 4847	Economist	Dipesh Shah - 2286 4434
Sunil Jain - 2286 4308	Alternative & Quantitative	
Yogesh Radke - 2286 4328	Alternative & Quantitative	

Email addresses: firstname.lastname@edelcap.com

e.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

This document has been prepared by Edelweiss Securities Private Limited (Edelweiss). Edelweiss and its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. Analyst holding in stock: no.