

29 July 2010

Allied Digital Services

Healthy margin to sustain; reiterate Buy

Rating: Buy

Target Price: Rs325

Share Price: Rs236

- **Strong order book heightens assurance.** Allied Digital Services' (ADSL) 1QFY11 revenue grew 4.8% qoq. The company has a strong order book of Rs5.65bn. A change in revenue mix favouring Services led to higher blended margins. We reiterate our Buy rating and maintain our target price of Rs325/share.
- **Key points.** ADSL's 1QFY11 revenue grew 4.8% qoq and 27.6% yoy. Margin was up 217bp yoy. Consolidated net profit rose 6.8% qoq and 43.7% yoy.
- **Guidance.** Management has guided for revenue of Rs9bn (EPGS: US\$53-54m) and PAT growth of 30-32% over FY10.
- **Order book.** The order book stands at ~63% of FY11e sales. The Solutions order book of Rs1.25bn would be executed in the next 3-4 months; 52-53% of this comprises Hardware. The Services order book is Rs4.4bn, executable in the next 12 months. We expect revenue growth in International Services to rise 2QFY11 onwards.
- **Organic growth.** Revenue (ex acquisitions) in the quarter was up 36.5% yoy and 7.9% qoq to Rs1,437m. EBITDA margin was 30.5%, up 192bp yoy and down 277 qoq. Net profit was up 43.1% yoy and 6.1% qoq, to Rs322m.
- **Valuation.** At our target price, the stock would trade at 9.5x FY11e earnings. At this valuation, ADSL would trade at ~50% discount to the average of large-cap FY11e target multiple (19.1x).

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Key data	ALDS IN /ADIS.BO
52-week high/low	Rs280/Rs161
Sensex/Nifty	17957/5398
3-m average volume	US\$0.7m
Market cap	Rs10.9bn/ US\$236.6m
Shares outstanding	46.5m
Free float	56.6%
Promoters	43.4%
Foreign Institutions	26.1%
Domestic Institutions	8.4%
Public	22.1%

Quarterly results

Year-end 31 Mar	1QFY10	1QFY11	% yoy	FY09	FY10	% yoy
Sales (Rsm)	1,588	2,026	28	5,251	6,975	33
EBITDA (Rsm)	296	421	42	1,012	1,382	37
EBITDA margin (%)	18.6	20.8	+217bps	19	20	+54bps
Interest (Rsm)	15	13	(14)	43	53	25
Depreciation (Rsm)	16	31	91	50	86	72
Other income(Rsm)	3	37	1,044	70	43	(38)
PBT (Rsm)	268	414	55	989	1,286	30
Tax (Rsm)	37	80	117	175	208	19
Tax rate (%)	13.8	19.4	+553bps	18	16	(149)bps
PAT (Rsm)	228	331	46	798	1,060	33

Source: Company, Anand Rathi Research

Financials

Year-end 31 Mar	FY11e	FY12e
Sales (Rsm)	8,998	10,591
Net profit (Rsm)	1,567	1,868
EPS (Rs)	33.6	40.1
Growth (%)	47.6	19.2
PE (x)	7.0	5.9
PBV (x)	1.4	1.1
RoE (%)	21.3	20.9
RoCE (%)	25.5	26.1
Dividend yield (%)	0.8	1.3
Net gearing (%)	(18.3)	(31.7)

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rsm)

Year end 31 Mar	FY08	FY09	FY10	FY11e	FY12e
Net sales	2,973	5,521	6,975	8,998	10,591
Sales growth (%)	90.5	85.7	26.3	29.0	17.7
- Op. expenses	2,318	4,561	5,593	6,901	8,076
EBIDTA	655	959	1,382	2,098	2,515
EBITDA margins (%)	22.0	17.4	19.8	23.3	23.8
- Interest	14	56	53	48	22
- Depreciation	33	50	86	154	229
+ Other income	38	59	43	69	131
- Tax	211	168	208	396	527
PAT	435	745	1,078	1,569	1,868
PAT growth (%)	89.6	71.3	44.8	45.6	19.0
Consolidated PAT	435	769	1,060	1,567	1,868
FDEPS (Rs/share)	12.6	21.2	22.8	33.6	40.1
CEPS (Rs/share)	27.0	43.7	25.0	37.0	45.0
DPS (Rs/share)	-	1.0	-	2.0	3.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rsm)

Year end 31 Mar	FY08	FY09	FY10e	FY11e	FY12e
Share capital	173	181	233	233	233
Reserves & surplus	1,638	2,998	6,404	7,867	9,572
Shareholders' fund	1,811	3,179	6,636	8,100	9,804
Debt	157	901	701	300	250
Minority interests	-	36	51	54	54
Capital employed	1,968	4,117	7,389	8,454	10,109
Fixed assets	203	1,881	2,440	3,137	3,308
Investments	475	50	50	100	100
Working capital	1,222	2,021	2,634	3,439	3,343
Cash	70	165	2,264	1,779	3,358
Capital deployed	1,968	4,117	7,389	8,454	10,109
No. of shares (m)	17.3	18.2	46.5	46.6	1.0
Net Debt/Equity (%)	4.8	23.3	(23.6)	(18.3)	(31.7)
W C turn (days)	150	134	138	139	115

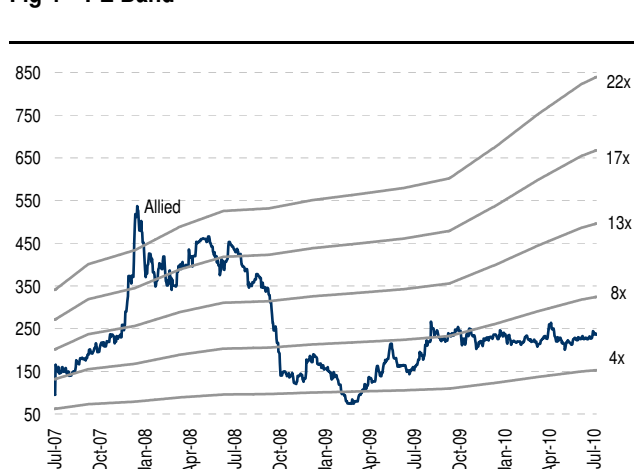
Source: Company, Anand Rathi Research

Fig 3 – Cash flow statement (Rsm)

Year end 31 Mar	FY08	FY09	FY10e	FY11e	FY12e
Consolidated PAT	435	742	1,063	1,567	1,868
+ Depreciation	39	65	86	154	229
Cash profit	474	807	1,149	1,720	2,097
- Incr/(Decr) in WC	723	799	613	804	(95)
Operating cash flow	(249)	7	536	916	2,192
- Capex	132	1,728	646	850	400
Free cash flow	(380)	(1,721)	(110)	66	1,792
- Dividend	-	43	-	109	163
+ Equity raised	789	663	2,412	9	(0)
+ Debt raised	78	744	(200)	(401)	(50)
- Investments	446	(425)	-	50	-
- Misc. items	-	(27)	3	-	-
Net cash flow	40	95	2,099	(485)	1,579
+ Opening cash	29	70	165	2,264	1,779
Closing cash	70	165	2,264	1,779	3,358

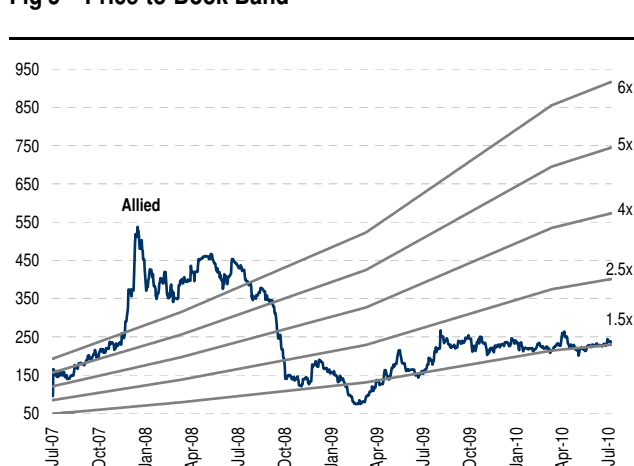
Source: Company, Anand Rathi Research

Fig 4 – PE Band



Source: Capitaline, Anand Rathi Research

Fig 5 – Price-to-Book Band



Source: Capitaline, Anand Rathi Research

Fig 6 – EV/EBITDA



Source: Capitaline, Anand Rathi Research

Results Review

ADSL's 1QFY11 revenue grew 4.8% qoq. The margin was up 217bp yoy. Consolidated net profit increased 6.8% qoq. The order book stands at Rs5.65bn, which is ~63% of FY11e sales.

Revenue analysis

- Revenue for 1QFY11 was Rs2,026m versus our estimated Rs2,092m
- EPGS revenue clocked in at US\$11.4m versus our estimated US\$11.5m.
- Services revenue was Rs1,155m versus our estimated Rs1,219m.
- Solutions revenue was Rs872m versus our estimated Rs871m.
- Standalone revenue stood at Rs1,437m, up 36.5% yoy and 7.9% qoq.

Fig 7 – Quarterly details

Rs (m)	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11
ADSL Standalone	283	306	373	423	504	607	624
Growth % (yoy)	-	-	51.9	51.5	78.0	98.7	67
Growth % (qoq)	1.3	8.0	21.9	13.5	19.1	20.6	3
En Pointe global services	436	448	500	516	502	497	531
Growth % (yoy)	-	-	3,324.7	12.2	15.1	11.0	6
Growth % (qoq)	(5.3)	2.7	11.7	3.2	(2.8)	(1.0)	7
Total Services Revenue	719	753	873	939	1,005	1,104	1,155
Growth % (yoy)	-	-	235.7	27.1	39.9	46.6	32
Growth % (qoq)	(2.8)	4.8	15.9	7.6	7.1	9.8	5
Solutions	670	709	715	726	783	831	871
Growth % (yoy)	-	-	9.8	(3.2)	16.9	17.2	22
Growth % (qoq)	(10.6)	5.8	0.9	1.5	7.9	6.0	5
Total revenues	1,389	1,462	1,588	1,665	1,788	1,934	2,026
Growth % (yoy)	75.2	78.4	74.3	11.8	28.8	32.3	27.6
Growth % (qoq)	(6.7)	5.3	8.6	4.9	7.4	8.1	4.8

Source: Company, Anand Rathi Research

EBITDA margin

EBITDA margin was 20.8%, up 217bp yoy and 48bp qoq. The yoy margin expansion stemmed from lower employee costs (down ~333bp) due to increase in offshore and SG&A costs (up ~175bp). This was partially offset by the rise in COGS (of ~291bp) chiefly due to the increase in software license cost.

The standalone margin was 30.5%, up 192bp yoy, though down 277bp qoq.

Non-operating items

Other income – ‘Other income’ including forex gain was Rs37m cis-a-vis our expectation of Rs21m.

Effective tax rate – The tax rate stood at 19.4% versus our assumption of 20%.

PAT growth

Consolidated net profit was Rs331m, up 43.7% yoy and 6.8% qoq.

Fig 8 – Quarterly details

	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11
Services	719	753	873	939	1,005	1,104	1,155
Solutions	670	709	715	726	783	831	871
Total revenues	1,389	1,462	1,588	1,665	1,788	1,934	2,026
Growth (yoy)	75.2	78.4	74.3	11.8	28.8	32.3	27.6
Growth (qoq)	(6.7)	5.3	8.6	4.9	7.4	8.1	4.8
COGS	853	909	982	1,006	1,112	1,211	1,312
As a % of revenues	61.4	62.2	61.9	60.4	62.2	62.6	64.8
Employee cost	181	191	203	201	200	211	192
As a % of revenues	13.0	13.1	12.8	12.1	11.2	10.9	9.5
SG&A expenses	106	103	107	120	121	120	101
As a % of revenues	7.6	7.0	6.7	7.2	6.8	6.2	5.0
Total Operating costs	1,140	1,203	1,292	1,328	1,433	1,541	1,605
EBITDA	249	259	296	337	356	393	421
EBITDA margin	18.0	17.7	18.6	20.3	19.9	20.3	20.8
Growth (yoy)	52.9	28.7	32.7	20.2	42.8	51.7	42.5
Growth (qoq)	(11.2)	3.9	14.2	14.1	5.5	10.4	7.2
- Interest expense	13	15	15	15	12	11	13
- Depreciation	14	14	16	19	27	25	31
+ Other income	13	20	3	4	17	20	37
PBT	235	250	268	307	334	377	414
- Taxes	40	42	37	51	57	62	80
Effective tax rate	16.8	17.0	13.8	16.7	17.2	16.5	19.4
PAT	196	207	231	256	277	315	334
- Minority interests		-		5	5	5	3
Consolidated PAT	196	207	231	251	272	310	331
Net margin	14.1	14.2	14.5	15.1	15.2	16.0	16.3
Growth (yoy)	61.7	67.0	46.5	4.1	38.7	49.8	43.7
Growth (qoq)	(18.7)	5.8	11.3	8.8	8.3	14.2	6.8
- Extraordinary expense	17	-	3	-	-	-	-
Reported profits	179	207	228	251	272	310	331
Diluted shares	36.3	36.3	36.3	36.3	46.5	46.5	46.6
FDEPS	4.9	5.7	6.3	6.9	5.8	6.7	7.1
Growth (yoy)	41.0	59.0	38.2	4.1	18.3	17.0	13.5
Growth (qoq)	(25.5)	15.5	9.9	10.1	(15.4)	14.2	6.6

Source: Company, Anand Rathi Research

Other key points

- **Guidance** – Management guided for FY11 revenue of Rs9bn, of which EPGS will register US\$53-54m revenue. PAT is expected to be 30-32% (Rs1.38 - 1.40bn) higher than in FY10.
- The order book is ~63% of FY11e sales. The Solutions order book was Rs1.25bn, to be executed over the next 3-4 months. Of this, 52-53% comprised Hardware. The Services order book stood at Rs4.4bn, executable in the next 12 months. We expect revenue growth in International Services to climb up 2QFY11 onwards.
- The company is constantly hiring at the senior level to widen management bandwidth.
- Debt, capex, cash and liquid assets stood at Rs900m, Rs600m and Rs1.8bn respectively.
- DSO days were 140.

Change in estimates

We revise our FY11e and FY12e EPS slightly, to Rs33.6 and Rs40.1 respectively. We maintain our target price of Rs325 and reiterate our Buy rating.

Fig 9 – Changes in estimates

(Rsm)	FY11e			FY12e		
	Old	New	%chg	Old	New	%chg
Sales	9,294	8,998	(3.2)	10,940	10,591	(3.2)
EBITDA	2,115	2,098	(0.8)	2,516	2,515	(0.0)
EBITDA margin (%)	22.8	23.3	55	23.0	23.8	75
Depreciation	144	154	7.0	207	229	10.9
Interest	67	48	(28.6)	36	22	(39.0)
Other income	84	69	(17.9)	158	131	(17.4)
Tax	398	396	(0.5)	535	527	(1.5)
Tax rate (%)	20.0	20.1	13	22.0	22.0	0
Consolidated PAT	1,591	1,567	(1.5)	1,897	1,868	(1.5)
FDEPS (Rs)	34.2	33.6	(1.5)	40.7	40.1	(1.5)

Source: Company, Anand Rath Research

Major estimate changes

- Volume assumptions for FY11 and FY12 are based on a combination of healthy traction and comments regarding greater revenue assurance.
- Interest cost is expected to decrease as management is expected to repay significant amount of debt in FY11.

Valuation

We retain our target price of Rs325, implying target multiple of 9.5x FY11e FDEPS of Rs33.6 (maintaining our earlier target multiple of 9.5x). We retain our Buy rating on the stock.

Our target multiple of 9.5x FY11e EPS is at 50% discount to the average IT Services large-cap FY11e target multiple. Our average FY11 target PE multiple for large caps is 19.1x.

The stock trades PEs of 7x and 6x our FY11e and FY12e earnings respectively.

Risks

- Delay in acquiring clients or on-boarding of a client could significantly delay earnings projections.
- Dependence on tie-ups – Part of ADSL's business depends on its partners. It may lose that business if the tie-up snaps.

Fig 10 – Income statement

Year end 31 Mar	FY08	FY09	FY10e	FY11e	FY12e
ADSL	714	1,113	1,906	2,937	3,466
Growth (%)	117.5	55.9	71.3	54.1	18.0
En Pointe	-	1,628	2,014	2,306	2,699
Total Services + En Pointe	714	2,740	3,920	5,244	6,165
Growth (%)	117.5	284.0	43.0	33.8	17.6
Total Solutions	2,259	2,780	3,055	3,755	4,427
Growth (%)	83.4	23.1	9.9	22.9	17.9
Total Revenues	2,973	5,521	6,975	8,998	10,591
Growth (%)	90.5	85.7	26.3	29.0	17.7
Hardware & license costs	2,005	3,446	4,310	5,504	6,037
as % of revenues	67.5	62.4	61.8	61.2	57.0
Manpower costs	223	737	815	943	1,350
as % of revenues	7.5	13.3	11.7	10.5	12.8
Other costs	90	379	468	453	688
as % of revenues	3.0	6.9	6.7	5.0	6.5
Total Costs	2,318	4,561	5,593	6,901	8,076
as % of revenues	78.0	82.6	80.2	76.7	76.3
EBITDA	655	959	1,382	2,098	2,515
EBITDA margin (%)	22.0	17.4	19.8	23.3	23.8
Other Income	38	59	43	69	131
Interest expense	14	56	53	48	22
Depreciation	33	50	86	154	229
PBT	646	912	1,286	1,965	2,395
Total Tax	211	168	208	396	527
Effective tax rate (%)	32.7	18.4	16.2	20.1	22.0
PAT	435	745	1,078	1,569	1,868
Minority Interest	-	3	15	3	-
Extraordinary expense	-	(27)	3	-	-
Reported PAT	435	769	1,060	1,567	1,868

Source : Company, Anand Rath Research

Fig 11 – Balance sheet

Year end 31 Mar	FY08	FY09	FY10e	FY11e	FY12e
Equity	173	181	233	233	233
Reserves	1,637	2,982	6,388	7,851	9,556
Shareholders' funds	1,810	3,163	6,620	8,084	9,788
Debt	157	901	701	300	250
Minority interest	-	36	51	54	54
Capital employed	1,967	4,101	7,373	8,438	10,093
Fixed assets	203	1,881	2,440	3,137	3,308
Investments	475	50	50	100	100
Deferred tax assets	(1)	(16)	(16)	(16)	(16)
Cash	70	165	2,264	1,779	3,358
Working capital	1,222	2,021	2,634	3,439	3,343
Capital deployed	1,967	4,101	7,373	8,438	10,093

Source : Company, Anand Rath Research

Fig 12 – Cash flow statement

Year end 31 Mar	FY08	FY09	FY10e	FY11e	FY12e
PAT	435	742	1,063	1,567	1,868
+ non-cash expense	39	65	86	154	229
Cash profit	474	807	1,149	1,720	2,097
- Increase/(decrease) in working capital	723	799	613	804	(95)
Operating cash flow	(249)	7	536	916	2,192
- Capex	132	1,728	646	850	400
Free cash flow	(380)	(1,721)	(110)	66	1,792
+ Equity raised	789	663	2,412	9	(0)
+ Debt raised	78	744	(200)	(401)	(50)
- Investments	446	(425)	-	50	-
- Dividend paid	-	43	-	109	163
- Misc. expense	-	(27)	3	-	-
Net change in cash	40	95	2,099	(485)	1,579
Opening cash	29	70	165	2,264	1,779
Closing cash	70	165	2,264	1,779	3,358

Source : Company, Anand Rathi Research

Fig 13 – Key ratios @ Rs236

Year end 31 Mar	FY08	FY09	FY10e	FY11e	FY12e
Diluted shares (m)	34.6	36.3	46.5	46.6	46.6
FDEPS (Rs)	12.6	21.2	22.8	33.6	40.1
CEPS (Rs)	27.0	43.7	25.0	37.0	45.0
BV (Rs)	52.3	87.1	142.3	173.6	210.1
ABV (Rs)	52.3	87.1	142.3	173.6	210.1
P/E (x)	18.8	11.1	10.4	7.0	5.9
P/C (x)	8.7	5.4	9.4	6.4	5.2
P/B (x)	4.5	2.7	1.7	1.4	1.1
DPS (Rs)	-	1.0	-	2.0	3.0
Dividend yield (%)	-	0.4	-	0.8	1.3
Dividend payout (%)	-	5.5	-	7.0	8.8
EV/Sales (x)	2.9	1.7	1.4	1.1	0.7
EV/EBITDA (x)	13.2	9.7	6.8	4.5	3.1
EBIT/Sales (x)	22.2	17.5	19.2	22.4	22.8
Sales/Average CE (x)	2.3	1.8	1.2	1.1	1.1
Debt/Equity (x)	0.1	0.3	0.1	0.0	0.0
RoCE (%)	50.1	31.9	23.3	25.5	26.1
Average CE/Average Equity (x)	1.1	1.2	1.2	1.1	1.0
PBT/EBIT (x)	1.0	0.9	1.0	1.0	1.0
PAT/PBT (x)	0.7	0.8	0.8	0.8	0.8
ROE (%)	36.3	30.0	22.0	21.3	20.9
Net gearing (%)	4.8	23.3	(23.6)	(18.3)	(31.7)
Working capital turnover (days)	150	134	138	139	115

Source : Company, Anand Rathi Research

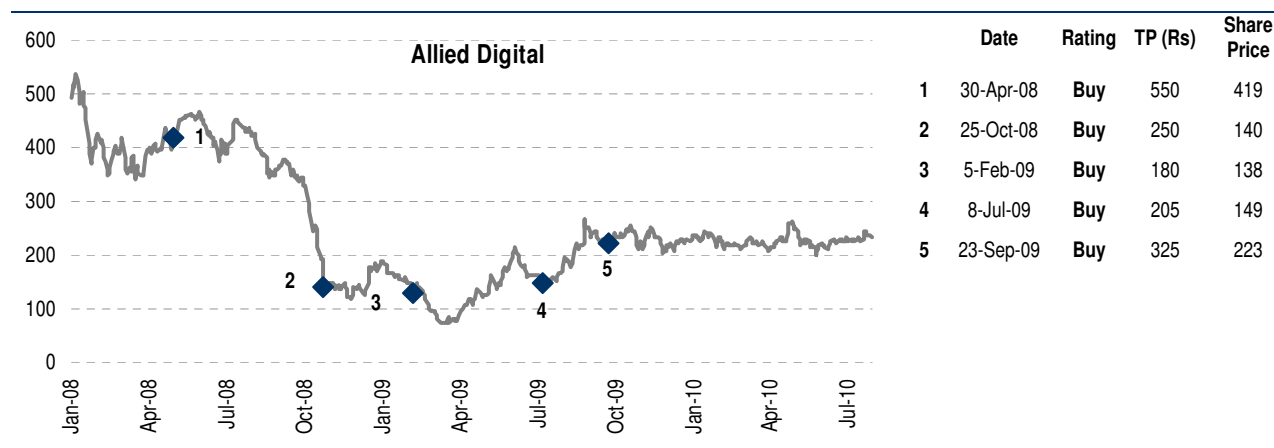
Appendix 1

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The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

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Ratings Guide

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>20%	5-20%	<5%
Mid/Small Caps (<US\$1bn)	>30%	10-30%	<10%

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	Buy	Hold	Sell
Anand Rathi Research stock coverage (89)	45%	12%	43%
% who are investment banking clients	7%	0%	0%

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