

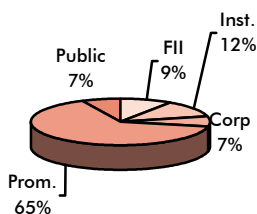
# Allied Digital Services

## Buy

<b>Price</b>	Rs800			
<b>Target Price</b>	%upside			
Rs1,240	55↑			
<b>Market Capitalisation</b>				
Rs13,832mn	(US\$346mn)			
<b>52 week range H/L (Rs)</b>	1,129/190			
<b>Shares o/s (mn)</b>	<b>Daily vol (mn)</b>			
17.29	0.02			
<b>Reuters</b>	<b>Bloomberg</b>			
ADIS.BO	ALDS IN			
<b>Perfm(%)</b>	<b>1M</b>	<b>3M</b>	<b>12M</b>	<b>YTD</b>
Absolute	8.4	(16.3)	N.A.	(2.0)
Rel to Sens	5.2	2.4	N A	22.4
<b>BSE Sensex</b>	<b>Nifty</b>			
16,244	4,887			

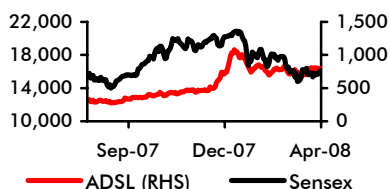
Source: Bloomberg

### Shareholding pattern (%)



Source: Capitaline

### Price performance



Source: Capitaline

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**Allied Digital Services (ADSL)** is a leading IT infrastructure management and technical support services outsourcing company with over two decades of experience in technology and enterprise IT infrastructures, implementing, managing and consulting on complex IT and business systems for global businesses. ADSL has over 1,250 committed professionals from different managerial and engineering background, operating across 92 locations in India. We expect ADSL's consolidated revenues to grow at a CAGR of 79% from Rs1,562.5mn during FY07 to Rs8934.4mn by FY10E. We initiate coverage on ADSL with a BUY recommendation and a target price of Rs1,240, indicating an upside of 55% from current levels.

## Investment Rationale

**Remote Management Services -a step to move up the value chain:** ADSL is all set to tap the big opportunity in remote infrastructure management .ADSL network operating center (NOC) service will work 24x7, staffed with experts having experience on desktops, servers, operating systems, messaging, databases, directory servers and backup systems. ADSL through its security operation center (SOC) will provide proactive protection and risk management for enterprise security to its customers round-the-clock. ADSL has a technology tie-up with e-Cop, one of the leading security operations players, having fully functional SOC in Malaysia, Hong Kong, Tokyo and the Middle East.

**Regulatory compliance of acts like HIPAA & BASEL-II to drive SOC:** Health Insurance Portability & Accountability Act (HIPAA) and Basel-II compliance would be the main drivers of the Security Operation Centre. In most of the corporates, security compliance is just a voluntary forensic audit, but with these acts coming into force, the "Information Security Compliance Reporting" would become mandatory and hence provide huge scalability potential.

**Differentiated Integrated solutions offerings to drive Solutions Business:** ADSL integrated solutions offering include complete security surveillance solutions, intelligent building management system & energy management system. One of the recent wins in this space has been the GMR order for Delhi Airport worth Rs.1,000 mn to be executed till FY10. Besides, ADSL sees healthy customer traction under this vertical, which we believe is quite positive for delivering future growth.

**Attractive valuations:** At the CMP of Rs. 800, the stock is available at 9.4x its consolidated FY10E EPS. We expect the stock to perform well as it delivers strong growth numbers over the next few quarters. We are initiating our coverage on the stock with a BUY recommendation and a target price of Rs.1,240 (14.5x its FY10E Earnings of Rs.85.1), indicating an upside of 55% from current levels.

### Key financials - consolidated entity

YE March (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Operating income	884	1,563	2,933	5,325	8,934
EBITDA	169	330	651	1,279	2,250
Net profit	119	228	428	812	1,472
EPS (Rs)	6.9	13.2	24.7	47.0	85.1
RoE (%)	78.1	54.3	34.8	35.6	43.0
RoCE (%)	53.8	47.0	32.7	34.1	41.6
P/E (x)	116.0	60.8	32.3	17.0	9.4

Source: Company, Ambit Capital Research estimates

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**Please refer to disclaimer section on the last page for further important disclaimer.**

# Key financials

## Balance sheet

Year to March (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Cash & equivalents	26.9	29.4	151.4	352.1	1,428.5
Debtors	290.6	596.3	1,062.6	1,567.0	1,936.4
Inventory	10.7	12.9	38.2	45.0	35.0
Loans & advances	102.7	128.7	281.2	510.6	856.7
Investments	1.5	28.9	28.9	28.9	28.9
Fixed assets	16.9	103.9	804.1	986.1	1,122.2
Other assets	(0.5)	5.1	5.1	5.1	5.1
Total assets	448.8	905.2	2,371.4	3,494.8	5,412.9
Current liabilities & provisions	111.9	239.1	418.4	729.3	1,175.3
Debt	85.3	79.6	79.6	79.6	79.6
Total liabilities	197.2	318.7	498.0	808.9	1,254.9
Shareholders' equity	47.4	127.7	172.9	172.9	172.9
Reserves & surpluses	205.5	458.8	1,700.5	2,512.9	3,985.0
Total networth	252.9	586.5	1,873.5	2,685.9	4,157.9
Net working capital	319.0	528.2	1,115.0	1,745.4	3,081.3
Net debt (cash)	58.4	50.2	(71.8)	(272.5)	(1,348.9)

## Income statement

Year to March (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Operating income	883.5	1,562.5	2,932.6	5,325.0	8,934.4
% growth		77%	88%	82%	68%
Operating expenditure	714.9	1,232.4	2,281.3	4,046.3	6,684.7
EBITDA	168.6	330.1	651.3	1,278.7	2,249.7
% growth		96%	97%	96%	76%
Depreciation	5.6	8.6	53.2	147.7	200.3
EBIT	163.0	321.5	598.1	1,131.0	2,049.4
Interest expenditure	8.0	11.0	11.0	10.3	11.0
Non-operational income / Exceptional items	5.3	1.7	8.8	16.0	26.8
PBT	160.3	312.2	595.9	1,136.6	2,065.2
Tax	41.0	84.6	168.2	324.2	593.1
PAT / Net profit	119.3	227.6	427.7	812.4	1,472.1
% growth		91%	88%	90%	81%

Source: Company, Ambit Capital Research estimates

# Key financials

## Cash flow statement

Year to March (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
EBIT	163.0	321.5	598.1	1,131.0	2,049.4
Other income (expenditure)	4.9	1.7	8.8	16.0	26.8
Depreciation	5.6	8.6	53.2	147.7	200.3
Interest	8.0	11.0	11.0	10.3	11.0
Tax	41.0	84.6	168.2	324.2	593.1
Incr (decr) in deferred tax liability	1.5	5.6	0.0	0.0	0.0
Incr (decr) in net working capital	207.6	206.7	464.8	429.7	259.5
Cash flow from operating activities	(84.6)	23.90	16.1	530.4	1,412.9
Incr (decr) in capital expenditure	6.7	101.2	753.4	329.7	336.5
Incr (decr) in investments	(0.2)	27.4	0.0	0.0	0.0
Cash flow from investing activities	(6.5)	(128.6)	(753.4)	(329.7)	(336.5)
Incr (decr) in borrowings	20.6	(5.7)	0.0	0.0	0.0
Issuance of equity	80.0	106.0	859.3	0.0	0.0
Dividend paid	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
Cash flow from financing activities	100.6	100.3	859.3	0.0	0.0
Net change in cash	9.5	(4.4)	122.0	200.7	1,076.4
Closing cash balance	26.7	22.5	151.4	352.1	1,428.5

## Ratio Analysis

Year to March (%)	FY06	FY07	FY08E	FY09E	FY10E
EBITDA margin	19.1	21.1	22.2	24.0	25.2
EBIT margin	18.4	20.6	20.4	21.2	22.9
Net profit margin	13.5	14.6	14.6	15.3	16.5
Return on capital employed	53.8	47.0	32.7	34.1	41.6
Return on equity	78.1	54.3	34.8	35.6	43.0
Current ratio (x)	3.9	3.2	3.7	3.4	3.6

## Valuation parameters

Year to March (%)	FY06	FY07	FY08E	FY09E	FY10E
EPS (Rs)	6.9	13.2	24.7	47.0	85.1
Diluted EPS (Rs)	6.9	13.2	24.7	47.0	85.1
Book value per share (Rs)	14.5	33.9	108.3	155.3	240.4
P/E (x)	116.0	60.8	32.3	17.0	9.4
P/BV (x)	55.0	23.6	7.4	5.2	3.3
EV/EBITDA (x)	81.5	41.6	21.1	10.7	6.1
EV/Sales (x)	15.5	8.8	4.7	2.6	1.5

Source: Company, Ambit Capital Research estimates

## Risks & Concerns

- Debtor days for ADSL increased to 90-120 days during FY05-07 period, primarily due to increased focus on large projects in solutions business which typically have a longer execution period. Revenue recognition happens when the goods are dispatched; however the payments are based on the milestones such as against delivery, implementation, testing and acceptance. We believe that going forward the debtor days would come down and range between 80-90 days, since ADSL receives quarterly advances from clients in its RMS vertical. RMS (NOC/SOC) is expected to contribute 25% to FY10 revenues as compared to 5% in FY08E; hence a change in business mix would warrant a reduction in debtor days. Also the concern is further mitigated as there has been no major instances of bad debts reported in the financial or the provisioning been done for the same.
- ADSL doesn't own any IP in the Remote Infrastructure Management Space (SOC/NOC) and has some key relationships with the vendors like E-cop, Echelon etc. Hence, any failure to service these relationships would affect future cash flows of the company. Formation of ADSL-eCop marketing JV (joint venture) would help in minimizing this concern.
- ADSL works in a technology domain where attrition is a major concern. Going forward as it invests in manpower for SOC/NOC; its talent pool would be vulnerable to poaching by global companies planning to set up offshore centers. ADSL believes that it has sound HR policies in place to retain these employees and manage attrition.
- The slowdown of the US economy and the appreciating rupee would be other areas of concerns, as with increased revenue contribution from the services business (which would primarily be exports-oriented), an appreciating rupee could hit the margins, while the slowdown would impact the volumes. Since security compliance would be a subject of meeting regulatory requirement, we expect US economic slowdown will pose a minimal risk, while currency risk would be mitigated to a large extent as ADSL has taken a strategic step by signing information security contracts in Indian Rupee for majority of SOC engagements.

# Investment Rationale

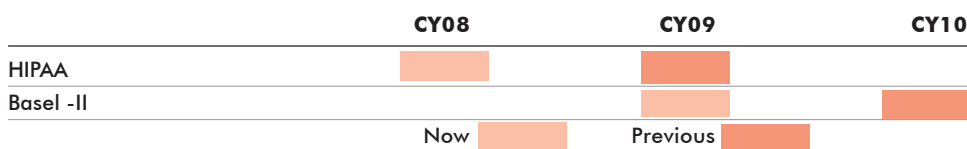
## Remote Management Services -a step to move up the value chain

ADSL intends to leverage its expertise in system integration business by investing in setting up new strategic business units - Network Operating Centre (NOC), Security Operating Centre (SOC), this would be a natural extension to the existing business lines. NOC service will work 24x7, staffed with experts having experience on desktops, servers, operating systems, messaging, databases, directory servers and backup systems. The NOC service would be charged on a monthly pay-as-you-go basis per device. NOC will cover monitoring and management of a wide variety of devices, platforms and applications. Remote services will enhance ADSL's network support portfolio and shall improve profitability by achieving more revenue per employee as the same specialist resource shall be addressing multiple customers using NOC. To start with ADSL is targeting its existing customers and will gradually take it to international markets with highly competitive pricing by taking advantage of lower costs of technical manpower in India.

SOC will provide proactive protection and risk management for enterprise security to its customers round-the-clock. ADSL would be one of the early movers in the country to provide Managed Security Services (MSS) such as highly specialized 24x7 Information Security Surveillance Service powered by the advanced event correlation engine and incident handling technology. SOC will be operational 24x7x365, managing one of the most difficult and complex tasks in information-security today. ADSL has tied-up with Singapore-based e-Cop, one of the leading commercial security operations players, having fully functional commercial SOC in Malaysia, Hong Kong, Tokyo and the Middle East. ADSL through its SOC would address the large corporates, and BFSI companies in India and overseas, who are most vulnerable to security threats and want to mitigate the same in an efficient manner.

## Regulatory compliance of acts like HIPAA & BASEL-II to drive SOC

Health Insurance Portability & Accountability Act (HIPAA) and Basel-II compliance would be the main drivers of the security operation centre. In most of the corporates, security compliance is just a voluntary forensic audit, but with these acts coming into force, the "Information Security Compliance Reporting" would become mandatory. HIPAA implementation has been advanced by a year from CY09 to CY08 and Basel-II from CY10 to CY09. The market size for information security monitoring & compliance monitoring was pegged at US\$32mn in CY06, US\$68mn (Counter Paine & E-Cop contributed US\$36mn & balance was split between the Big-4) in CY07. Independent studies by Yankee Group and Frost & Sullivan projects this market to grow to US\$90bn & US\$86bn by CY11 on account of HIPAA and BASEL-II.

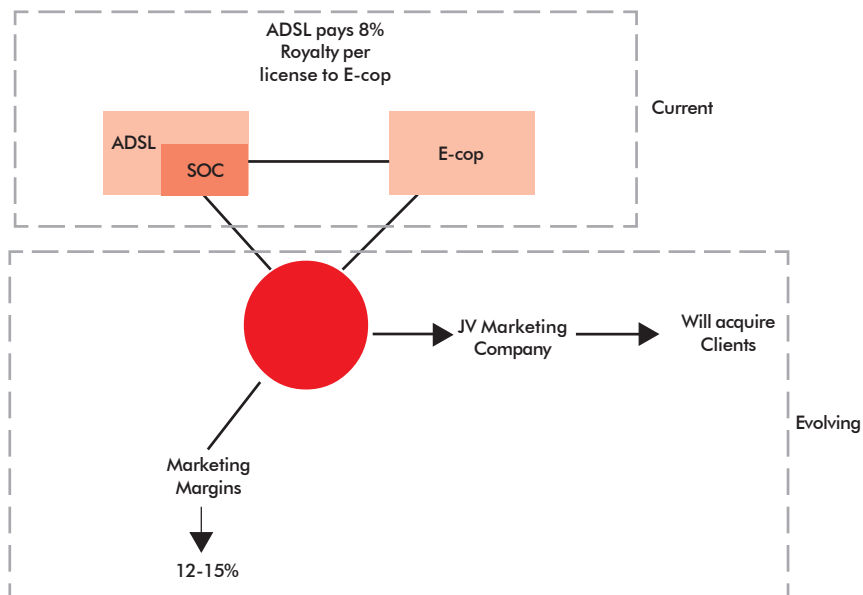


Source: Industry

Presently the market share is split between Counter Paine (British telecom subsidiary), eCop, EDS & Secure Source (a UK Government Enterprise, which is more like a forensic operator rather than a sales organization), while others players like IBM Global Services would get into this space by FY10.

ADSL currently has an agreement for technology transfer with e-Cop and the relationship is going to a next level with a formation of Allied-Ecop Joint Venture marketing company, the talks are in advance stages and a marketing pact would seal a long term relationship for the two entities. We have drawn out a likeable structure of this JV in the following.

**Changing business structure in ADSL - eCop relationship**

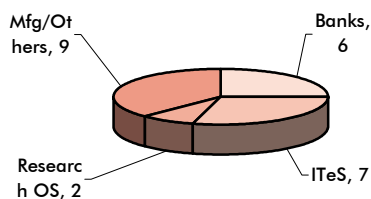


Source: Company, Ambit Capital Research

Currently, ADSL pays 8% royalty to e-Cop for each product licence and in case of a JV, ADSL's SOC will bill to the JV Company, which in turn would add marketing margins and bill to the end customers. Marketing margins will be shared proportionately to the JV holding, which would be finalized soon.

Moreover, ADSL is in talks with Big 4 (KPMG, PwC, Deloitte, and E&Y) to co-brand the "Business Impact Analysis" report for their end clients on a value-sharing basis. It also has a business relationship with a domestic IT product company in banking domain to offer SOC services to its clients.

**ADSL SOC client profile**



Source: Company

Currently, ADSL has a client base of 24 with 7 domestic clients (3 banks) and 17 global clients (of which 12 clients would be billed in Indian Rupee), another 17 prospective clients are in "Vulnerability Scan & Penetration Testing (VSPT)" stage. We believe that ITeS companies are using it as a tool for client acquisition and hence are converting voluntarily, while the banks intend to secure their business data as some vulnerability audits by ADSL has shown security threats on their network.

Looking into the tremendous potential in SOC, ADSL is ramping up its 15-seater SOC to 150-seater by June/July-2008.

Revenues (Rs Mn)	FY08E	FY09E	FY10E
SOC Revenues	89	667	1569
NOC Revenues	44	333	785
NOC + SOC Revenues	133	1,000	2,354

Source: Ambit Capital Research

ADSL is also ramping up its Network Operating Centre (NOC) from 22 seats to 150 seats by Aug-2008 through a combination of organic & inorganic initiatives.

## Differentiated Integrated solutions offerings drive Solutions Business

ADSL in line with the system integration skills, has ventured into integrated solutions, offering complete security surveillance solutions like digital CCTV/IP surveillance system, smart cards, biometric access control, fire detection, and asset tracking devices using RFIDs, video conferencing / communication solutions, intelligent building management system & energy management system.

ADSL has a technology tie-up with Echelon for its intelligent building management system (IBMS) & energy management solutions (EMS). IBMS solution ranges from lighting control systems, HVAC controls, access control and security systems and are based on Lonworks Device Networking platform designed for Control Networks. EMS helps in saving energy and can be deployed at buildings, homes and factories, thereby reducing 30-40% of energy cost. Average deal size in IBMS could be in the range of Rs.60-150 mn with gross margins as high as 18%, which is higher than the normal gross margins of 11% for system integration. This line of business will improve overall revenue mix related to the solutions business and provide value addition to the clients as energy costs will be effectively under control.

ADSL through its IBMS and EMS initiative wants to target malls, hotels, multiplexes, airports, SEZ's etc. One of the recent wins in this space has been the GMR order for Delhi Airport worth Rs.1,000 mn to be executed till FY10. Besides, ADSL sees healthy customer traction under this vertical, which we believe is quite positive for delivering future growth.

Revenue (Rs mn)	FY07	FY08E	FY09E	FY10E
Integrated Solutions	70	246	491	811
Growth (%)		250	100	65

Source: Company, Ambit Capital Research

## Inorganic initiatives to ensure scale & expand global footprint

ADSL had planned to utilize 41% of the IPO proceeds of Rs860mn for strategic acquisitions. Part of this proceeds were utilized towards acquisition of 51% stake in Digicomp Solutions, a company into maintenances services and servicing clients like Samsung, IBM, USI, MSI, ASUS, etc, for Rs.200mn (includes Rs.100mn to be invested in infrastructure upgradation). Besides this, ADSL is also looking for opportunities in NOC business line in overseas markets, the move would help in cross selling SOC services to clients acquired through the inorganic route & outsource work to offshore centre to drive its profitability. ADSL has already identified few targets and is at advance stages of negotiations to close them. A recent board decision to raise upto \$100mn through FCCB or other financial instruments, in one or more tranches, talks about management vision to sustain growth momentum.

## Healthy domestic IT spend to help maintain growth momentum in Solutions business

The Dataquest-IDC Mega Spenders 2007 survey states that the growth rate of IT spend by the top enterprises is expected to be 26% in 2007-08, taking the combined spend to Rs.8,9740 mn. With more and more domestic companies investing in technology up gradation; service providers like ADSL are expected to benefit.

ADSL expects major IT investment to come in from BFSI, Telecom, Retail & Manufacturing verticals, areas where company has established presence through installed client base. IT Revenue from retail segment is expected to grow to \$1.07bn by 2010, at a CAGR of 44%, according to report - 'India's Retail Industry: IT Market Trends and Opportunities, 2006-2010,' by Springboard Research.

Typically a system integration engagement adds 12-15% realization for the first year and thereafter client may award an annual maintenance contract which could add another 12-15% of client's yearly billings to ADSL revenues. ADSL's role as an IT consultant helps client in valuable feedback like technology advancement which would help in increasing uptime of critical processes, or any other newer and advanced solutions, which could be cost-effective and productivity-receptive. This helps in getting more business per client and seals long-term relationship with an opportunity to upsell & cross sell the other solutions and services.

With recent big wins in integrated solutions and strong traction in the systems integration business, we believe that ADSL is well-poised to be a major beneficiary of booming IT spending in the domestic sphere.

## Investment in Setting up a Global Delivery Centre

ADSL is investing Rs330mn from IPO proceeds in setting up a Global Delivery Centre (GDC). The GDC, covering around 5,000 square feet besides 7,500 square feet of common facility area, will house 250 technical professionals. It will also provide space for other business activities such as IT Service Delivery Centre, Remote Management Services, Software Solutions, Data Centre and Centre of Excellence (CoE). CoE encompasses a training centre, proof of concept for solution business and quality assurance division. ADSL also intends to further widen its reach by adding more footprints in India and globally in countries like USA, UK, Australia, Middle East and South East Asia. The Company intends to have a direct presence in these geographies serving the multi-national enterprise customers through Global Service Delivery Centre (GSDC). It intends to achieve this through local acquisitions in these geographies or through direct tie-ups.

# Key Strengths

## Direct Business Model

ADSL's direct presence at 92 locations countrywide, supporting 450 cities in India not only helps in better understanding of the business objective, strategy & IT alignment of the clients, but also eliminates middlemen like dealers, resellers & franchise. Leveraging on these advantages of being a direct vendor, ADSL plays the role of a trusted advisor to its customers. ADSL has taken an initiative called "Special Interest Group", which focuses on transforming itself into a technology-focused, value-creating company in the future. This makes ADSL a technology-driven and a customer-centric organization with a high client retention ratio.

## Vendor Neutral Approach

Being a "Technology Provider", ADSL provides a vendor-independent technology solutions to its customers without any bias to any particular vendor. It conceptualizes a particular turnkey project depending on customer-specific requirements. The execution takes place in a very cost-effective manner in which the clients benefit the most. Its strong technical expertise in system integration business has helped the company in providing consultancy services to clients to integrate their businesses in the most cost-effective manner. This strategy has helped the Company in maintaining its existing accounts and also in acquiring some key competitors' accounts.

## Virtual Integration between Principals & Customers

ADSL provides a virtual integration between the Principals and Customers. It provides onsite service to clients - including spares, repairs, replacements etc. Most of the annuity business in solutions comes from annual maintenance contracts entered into with these clients. ADSL plays a role of value added reseller (VARs), with a differentiation of not being a muted partner, but playing an active role of an advisor.

## Strong Management Team

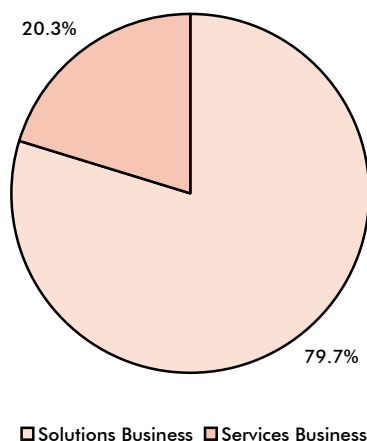
ADSL has a strong management team with an eye to look beyond the growth barriers for opportunities, which can maximize the shareholders value, be it in implementing best practices or looking for strategic initiatives like inorganic opportunities to maximize product penetration etc. The strategic initiatives like expanding services portfolio to include SOC and NOC talks about management's vision to have an early mover advantage in these high end services segment.

# Company Profile

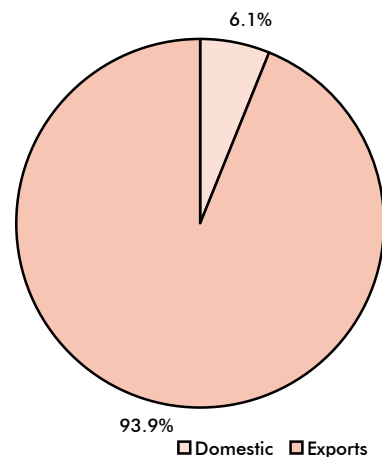
ADSL is a leading IT infrastructure management and technical support services outsourcing company with over two decades of experience in technology and enterprise IT infrastructures, implementing, managing and consulting on complex IT and business systems for global businesses.

The company enables its client to seamlessly align IT with the changing business imperatives thereby enabling in maximizing the benefits and returns. With proven excellence in operations management, high-quality infrastructure, the company provides a proven, reliable outsourced alternative to the global customers. These capabilities provide cross selling and up selling of value-added solutions including technology infrastructure management, simple-to-complex technical support solutions, security lifecycle services and professional services for design and deployment of technology infrastructure. ADSL has over 1,250 committed professionals from different managerial and engineering background, operating across 92 locations in India.

**Business Mix**



**Domestic vs Exports revenue**

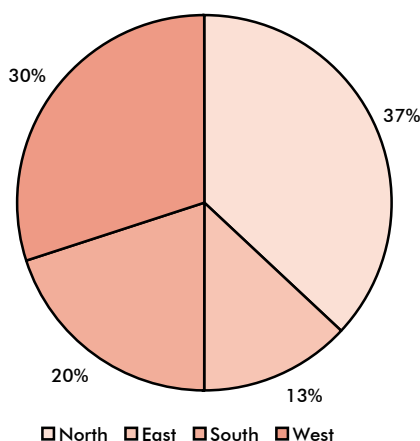


Source: Company

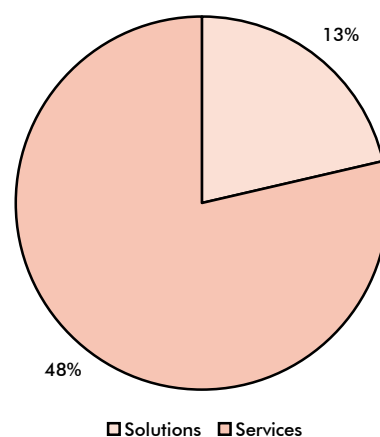
For the fiscal year ended March 31, 2007, its revenues stood at Rs1,563mn wherein, the solutions business contributed 79% and the services contributed 20% to its total revenues, while 1% were the other receipts.

During FY07, India contributed 93.9% to the revenue, while the exports contributed 6.1%.

**Allied Digital All India Layout**



**EBIDTA Mix**



Source: Company

# Business Details

## ADSL Solutions Business

Solutions business is the systems integration business where in the ADSL sets up the entire IT Infrastructure on a turnkey basis. It has tied-up with strategic partners to provide these solutions. It can be anything from high-end servers to storage devices or data security solutions, enterprise management solutions, telecom solutions, etc. Solutions business is spread across four strategic business units (SBUs) as shown below & provides a one-stop-shop for all the client requirements. In FY07, the solutions business contributed 79% to total revenues and by FY10, We expect its contribution to come down to 54.3% of overall revenues.

### Solutions SBUs

SBU1	SBU2	SBU3	SBU4
<b>IT Solutions</b>	<b>Networking &amp; Communications solutions</b>	<b>Integrated Solutions</b>	<b>Software Solutions</b>
Enterprise Computing	Premises Distribution Systems	Security & Safety Devices	Customer Relation Management (CRM)
Storage solutions	Enterprise Switching Solutions	Asset Tracking Devices	Supply Relationship Management (SRM)
Information Security	Wireless Solutions	Video Conferencing / Communication	Manufacturing Resource Management(MRM)
Message & Collaboration	Wide Area Networking Solutions	Intelligent Building Management Solutions	People Relationship Management(PRM)
Enterprise Management Solutions	Technology Consulting	Energy Management Solution	Finance Management(FM)
Convergence	Need Analysis & Audit		Quality Management(QM)
Thin Client Computing	Network Planning & Implementation		Enterprise Development Interface(EDI)
Telecom Solutions			External Device Interface(EDI)
			Enterprise Business Intelligence(EBI)
			Document Management System(DMS)
			Knowledge Management(KM)

Source: Company

Though the market for value added resellers (VARs) is highly competitive, ADSL has been able to get big corporate clients on account of its direct pan-India presence and strong services support for mission-critical devices.

ADSL's strategy of delivering value to clients helped it to get breakthrough in key competitor accounts, which talk's about the service & client focus with which ADSL approaches each customer.

### ADSL's Solutions SBU-wise clients, partnership, competition & market size

Description	SBU1	SBU2	SBU3	SBU4
Clients	BPCL , HPCL, Deloitte & Touché	SBI, Gail, RIL, BSNL, Holcim, Pfizer, Tata Indicom.	Gujarat Ambuja Cipla, MTNL, Reliance Retail	Plain burgh, IMAS, Bhawan Group
Partnership	HP, IBM, Novel Microsoft , EMC	Cisco, Nortel, Enterasys, Call Up, Avaya.	GE Securities, Echelon, Cisco, Quantum Auto.	Epicor, IMAS, Redhat
Competition	Wipro, HCL, CMC, Tata Elxsi	Wipro, Data Craft , HCL,3D Networks, Gemini Comm.	Siemens, Zicom Honeywell, Johnson Contr.	Wipro, HCL, Mastek, iGATE
Market Size	\$5.4 Bn			\$35 Bn
EBIDTA (%)	11 - 12		18 - 20	65 – 70
Revenue Share FY07	68%		4%	6%

Source: Company

## Services Business

Services business has been subdivided into IT Services & Remote Managed Services. ADSL provides test & repair services with 12 centers across India. It currently provides on-site support and test & repair/services through its technical BPO & is getting into product line support, walk-through installation, trouble shooting, change support, and applications support, for which it will target the following verticals.

- Consumer Electronics Companies
- PC/Notebook/Server OEM Companies
- Package Software Companies
- Network & Communication Products Companies
- Telecom and Internet Service Providers

### Services SBUs

SBU5	SBU6	
IT Services	Remote Managed Services	
	NOC	SOC
TRC-Test and Repair/Service Centre	End User Helpdesk	24x7 Information Security Surveillance Services
T-BPO Technical BPO	Remote Desktop Management	24x7 Manage Detection Service
Incident Based Support	Remote Servers Management	Logs Analysis Service
AMC Annual Maintenance Contract	Remote Network Management	Managed Microsoft Security Service
FMS Onsite Infrastructure/Facilities		
EMS Enterprise Management Services		
Infrastructure Solutions/Professional Services		

Source: Company

**Unisys Operations:** ADSL became an authorized service provider to Unisys (a \$5.76bn company) in 2004. The Company now serves the clients of Unisys India i.e. Dell, Nokia, British Telecom & Reuters. For a new project coming in for bidding Unisys invites for a bid and players like ADSL submit a bid then, Unisys adds a mark-up to come to a final bid.

Remote Managed Services will be provided through Network Operating Centre (NOC) & Security Operating Centre (SOC).

**ADSL's Services SBU-wise clients, partnership, competition & market size.**

Description	SBU5		SBU6
	Technical BPO	IT Infrastructure Managed Services	Remote Managed Services
Clients	Dell, BT, Nokia, Reuters (Unisys) etc	Raymond's, Kingfisher, OTIS, Reliance, etc	McDonalds, Emerson
Partnership	Unisys, IBM, Fujitsu-Siemens, EDS	IBM Global Services, Unisys, EDS	e-COP, HP, LANDesk
Competition	Wipro, Slash Support, Sutherland	Wipro, HCL, CMC, etc	Wipro, MindTree, Sify, HCL Comnet
Market Size	\$6 bn	\$500 mn	\$6 bn
EBIDTA (%)	45 – 50	35 - 40	50 – 55
Revenue Share	8%	4%	1%

Source: Company

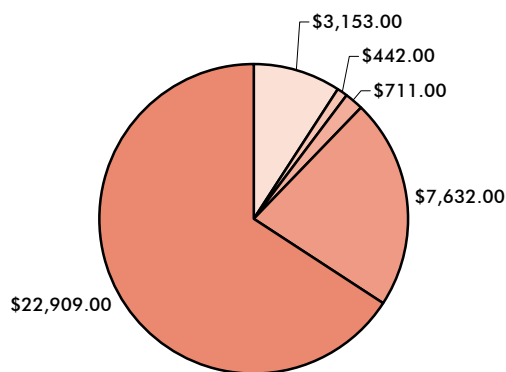
The opportunity showcased presents an immense value proposition and the Company is all set to tap the early mover advantage.

# Industry Overview

## Managed Services / Remote Management Services - An Outlook

To determine the relative business benefits of remote systems management, International Data Corporation (IDC) conducted in-depth interviews with the enterprises using remote management services. From the results, IDC was able to quantify the average cost savings.

### Average annual cost saving per 100 users from RMS



Cost Reduction IT efficiency Captured Revenue IT Productivity User Productivity

Source: IDC 2004

For the company's surveyed, the average numbers of desktops managed by each fulltime equivalent employees rose from 823 to 1,085 registering an increase of 32%.The improved management efficiency yielded an average payroll savings of \$220-\$625 each year.

## Infrastructure Outsourcing Sector

Nasscom and Forrester Research in their reports have highlighted the tremendous potential in the infrastructure outsourcing sector. Forrester estimates that this market has global potential to the tune of \$111bn, out of which, India's share could be as high as \$1.0bn. Gartner's estimates even surpass this figure. Indian companies, providing IT infrastructure outsourcing services to the US, European clients, are aiming to use their price advantage and at the same time also ensuring that they have the other requisites i.e. knowledge of the industry base; domain knowledge of the project; end-to-end service capabilities; inculcating relationships with clients, and adapting to specific client requirements, to attract the clients.

## Integrated Solutions

According to a recent study undertaken by Frost & Sullivan namely "Indian Market for Fire and Security Systems, HVAC Controls and Integrated Building Management Systems", the total market for integrated building management systems (IBMS) is estimated at \$46.5mn during FY06. Besides IBMS, the research service provides market size estimates for standalone product groups such as Building Automation Systems (BAS), Fire Detection and Alarm Systems (FDAS), Surveillance Systems (CCTV Systems), and Electronic Access Control Systems (EACS).

## Global Overview

The global demand for third-party technical support and help desk services is expected to reach \$23 billion in 2008, displaying a combined CAGR of 9.6%. According to IDC, the worldwide market for outsourced technical support services will increase from \$11.1bn in 2003 to \$16.9bn in 2008, representing a CAGR of 8.8%. Over the same period, the outsourced help desk services market is expected to increase at a CAGR of 12%, from \$3.5bn to \$6.1bn in 2008.

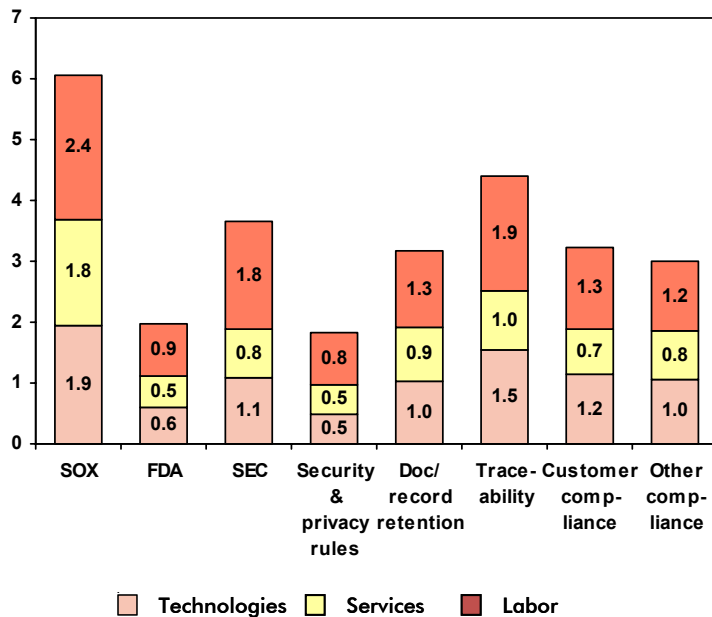
## Compliance is a Key Driver of Spend

A wide array of regulations impact customers in a broad range of vertical markets . . .

US Regulation	Manufacturing/Tech	Financial services	Insurance	Banking	Health-care	Pharma	Govt.
Sarbanes-Oxley Act of 2002	Major	Major	Major	Major	Major	Major	Major
FDA 21 CFR part 11	Minor	Minor	Minor	Minor	Minor	Major	Medium
SEC 17A-4	Minor	Major	Minor	Medium	Minor	Minor	Minor
Health Insurance Portability & Accountability Act (HIPAA)	Minor	Minor	Major	Minor	Major	Medium	Minor
Gramm-Leach-Bliley Act	Minor	Major	Minor	Medium	Minor	Minor	Minor
California SB 1386	Medium	Medium	Medium	Medium	Medium	Medium	Medium
USA PATRIOT Act	Minor	Major	Major	Major	Minor	Minor	Minor
Check 21-Legislation	Medium	Major	Medium	Major	Medium	Medium	Minor
FISMA	Minor	Minor	Minor	Minor	Minor	Minor	Major
Government Paperwork Elimination Act	Minor	Minor	Minor	Minor	Minor	Minor	Major
ITAR	Major	Minor	Minor	Minor	Minor	Minor	Major
E-Signatures Act of 2000 (ESIGNCA)	Medium	Medium	Medium	Medium	Medium	Medium	Medium

■ Minor Impact   
 ■ Medium Impact   
 ■ Major Impact

. . . driving expected total spend on compliance to \$27B in 2009



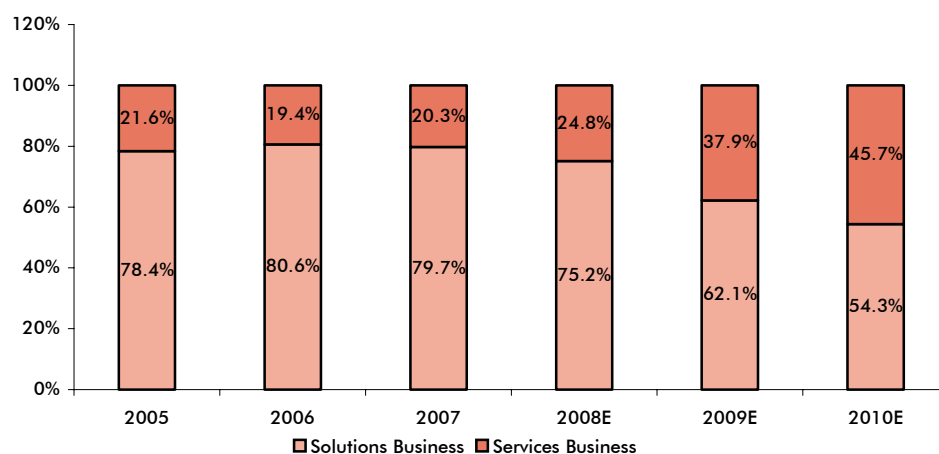
o Includes all aspects of compliance, a significant subset of which is IT security

Source: IDC 2005; AMR Research "2006 Compliance Tech Spending To Top \$8.8b"

# Consolidated Financial Analysis

ADSL's has two lines of business, solutions business & services, while solutions contributed 79% to the total FY07 revenues, services contributed 20.1%. During the period FY04-07, the services business grew at a CAGR of 77%, while solutions business grew at 55% CAGR. This is primarily due to ADSL strategy to increase the services share of revenue and move away from the conventional system integration business. The Company has invested Rs 19.9mn on the training and certification of 130 engineers in FY05 to enhance its services competence. Moreover, from March 2005, ADSL was appointed as authorized service provider by Unisys to provide support services for its Indian clients, which contributed significantly to the growth of services business in FY06 & FY07. Going forward we believe that the solutions business would grow at a CAGR of 58%, while the Services Business would grow at a CAGR of 131.7% for the period FY07-10E, resulting in a change in revenue mix with high margins services business contribution increasing from 20.3% in FY07 to 45.7% in FY10E.

## Changing Business Mix (%)



Source: Company, Ambit Capital Research

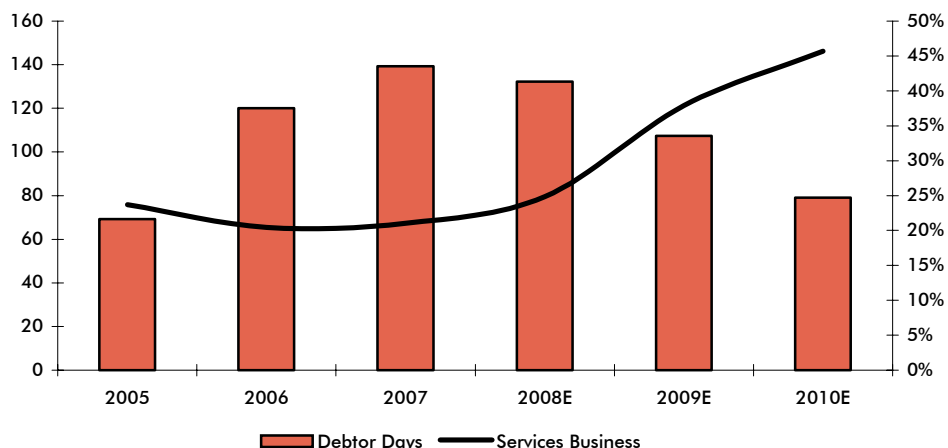
## Order Book

ADSL has a robust order book with Rs2,300mn. contribution from solution business and Rs1,400mn coming in from services. While orders in the solutions business have to be executed till H1FY09, time frame in services is end FY09. Opportunities in NOC/SOC would add incremental revenues to the services order book and ADSL is seeing an excellent traction under this business vertical.

## Debtors Days

Value added reseller business (system integration) is predominantly a high debtor's day's business with payment recognition based on project milestone. Debtor days has been in excess of 120days for ADSL. Going forward with the contribution of Remote Management Services (SOC/NOC) going up, we expect the debtors days to come down and stabilize between 80-90 days as payment for this vertical is received in a quarter advance. This will not only help in better working capital management but also lower incidents of doubtful debts.

Improving debtor days with growing services' contribution

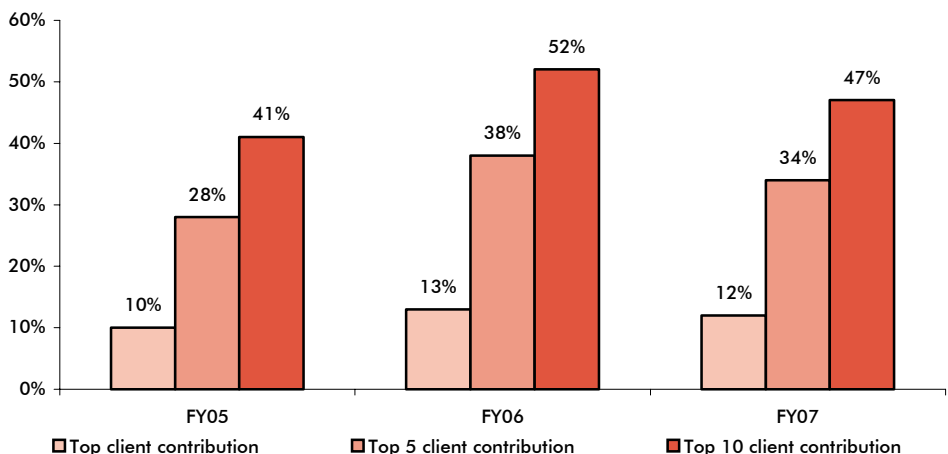


Source: Company, Ambit Capital Research

### Client Concentration

ADSL's model is de-risked with revenue evenly distributed between clients. The top client contributed 12% in FY07 and top client keeps changing every year as ADSL deals with the end-customers directly and not with the resellers. Thus a high top client concentration will not impact its performance.

Client Concentration



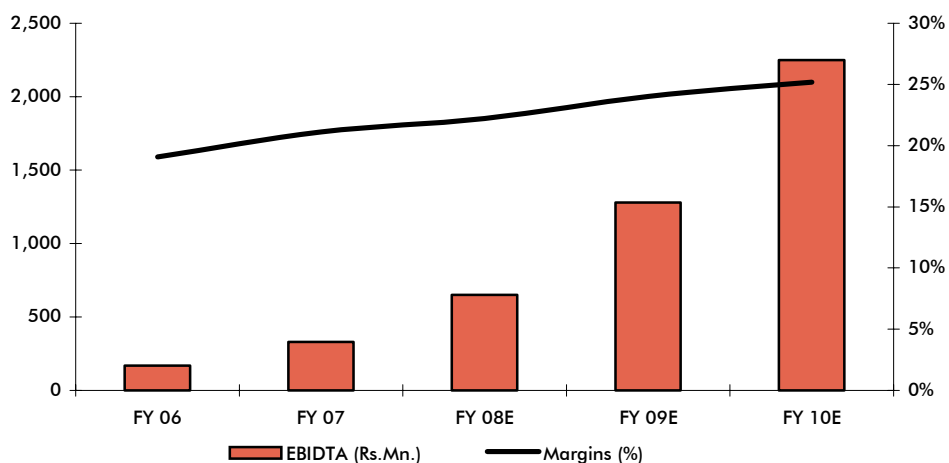
Source: Company

### Operating Profit to Grow at 89.5% CAGR in FY07-10E

ADSL endeavors to expand operating margin at 21%+. Its OPM was at 19.1% during FY06, which saw an expansion of 204 bps to 21.1% during FY07 as a result of higher share of revenues from the services business, which is a high margin business. We expect ADSL operating margins to expand as the contribution of high margin (in excess of 45%) services business grows to 45.7% by FY10E and we peg it around 22-25% in FY08E and FY10E.

Its operating profit grew 95.8% YoY to Rs330mn in FY07. This robust jump in the operating profit was a result of strong growth in solutions business at 75.1%, while the services business growth was about 81.5%. The operating profit is estimated to increase to Rs651 mn in FY08E (YoY growth of 97.3%) and then to Rs1,279mn in FY09E (YoY growth of 96.3%) & to Rs2,250mn in FY10E (YoY growth of 75.9%), exhibiting a CAGR of 89.5% during FY07-FY10E.

**EBIDTA and EBIDTA margins (%)**

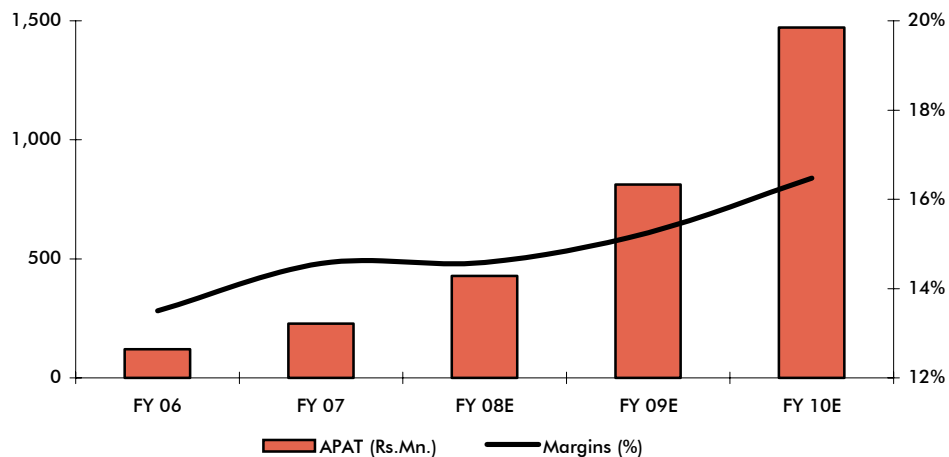


Source: Company, Ambit Capital Research

**APAT to grow at 86.3% CAGR in FY07-FY10E period**

ADSL's net profit grew 90.8% YoY to Rs228mn in FY07. Going forward, net profit of the company is estimated to grow to Rs428mn in FY08E, registering a YoY growth of 87.9%, then to Rs812mn in FY09E with a growth of 89.9% YoY, & then to Rs1,472mn in FY10E, registering a YoY growth of 81.2%, i.e. at a CAGR of 86.3% for the FY07-FY10E period. ADSL is trying to get a SEZ status for its Remote Management Infrastructure Services facility, which would result in an upside to our estimates, as we have not built the scenario in our model.

**APAT and APAT margins (%)**

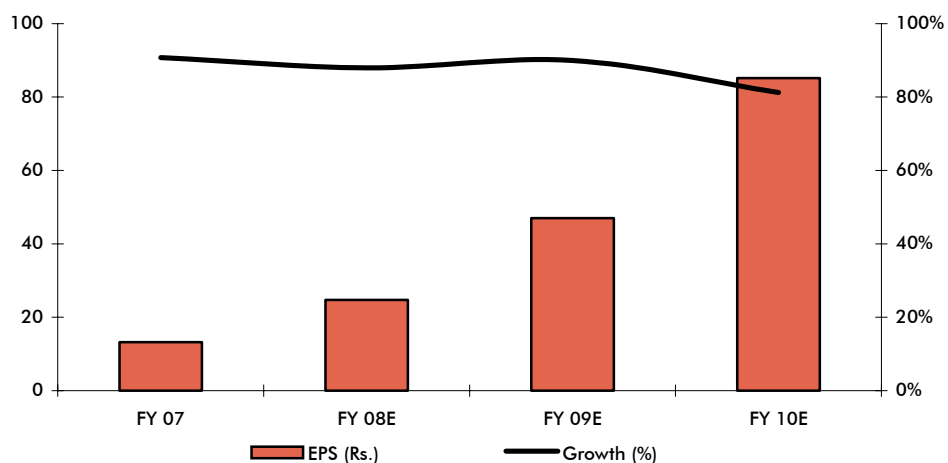


Source: Company, Ambit Capital Research

**EPS to Register Strong Growth**

ADSL's equity capital as on Dec 31, 2008 stood at Rs173mn. During FY07-10E, we expect that the EPS would grow by 87.9% YoY to Rs24.7 in FY08E and then to Rs47 in FY09E a YoY growth of 89.9% & Rs85.1 in FY10E with a YoY growth of 81.2%. This would result in a robust organic EPS CAGR of 86.3% in FY07-FY10E.

## EPS and EPS growth (%)



Source: Company, Ambit Capital Research

## Financial Performance For Q3FY08

ADSL has delivered robust growth in the top line as well as the bottom line for Q3FY08. Some of the key highlights of its financial performance for same period given here under:

During Q3FY08 & 9MFY08, its revenues grew by 83.2% YoY to Rs793mn & 99.9% YoY to Rs2,153mn respectively.

EBIDTA grew by 78.7% YoY to Rs163mn for Q3FY08 and by 115.9% YoY to Rs460mn for 9MFY08. Net profit grew by 80.6% YoY to Rs121mn for Q3FY08 and by 107% YoY to Rs315mn for 9MFY08.

We expect the services business to contribute about 25% to the FY08E revenues and is expected to contribute 45.7% by FY10E. This would happen due to faster growth in the services business, which is expected to grow at 131.7%, while the solutions business is expected to grow at 58%. Since the services margins are in the range 45%-50%, the blended margins for ADSL will improve due to changing business mix.

Remote Management Services had contributed about 1% to the overall Revenues in FY07; and we expect it to contribute Rs133mn (5% of overall revenue) in FY08E.

# Valuation

We have valued ADSL on DCF-methodology and arrive at a target price of Rs1,240, indicating an upside of 55% from current levels over a 12-month horizon

## Valuation assumptions

### Cost of Equity

Risk Free Rate India	8%
India Equity Premium	6.00%
Company Beta	1.35
Cost of Equity	16.1%

### Cost of Debt

Average borrowing rate (before tax)	12%
Tax rate	28%
Cost of Debt (after tax)	8.7%

Source: Ambit Capital Research

## DCF model

(Rs mn)	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E
EBIT* (1-t)	428	805	1,455	1,747	2,301	3,091	3,783	4,535	5,189	5,688
Add :Depreciation	53	148	200	229	313	343	360	373	393	421
Less: Delta working capital	(465)	(430)	(259)	(656)	(781)	(975)	(952)	(1,000)	(891)	(692)
Less: Capital expenditure	(753)	(330)	(336)	(293)	(378)	(418)	(466)	(311)	(427)	(552)
Fresh Equity	859									
Free cash flow to firm	122	194	1,059	1,028	1,456	2,041	2,724	3,596	4,264	4,865
Time from T0	0	1	2	3	4	5	6	7	8	9
Discounted value	120	165	783	657	804	975	1,125	1,285	1,317	1,299

## Valuation table

Discounted value from FY09E till FY17E (Rs mn)	8,410
Terminal value (Rs mn)	9,833
Total value (Rs mn)	18,243
Debt (Rs mn)	80
Cash (Rs mn)	352
Investments (Rs mn)	29
Total shareholders' value (Rs mn)	18,545
No. of shares (mn)	17
Value per share (Rs)	1,072
1-yr forward value per share (Rs)	1,240
Upside (%)	55

## Sensitivity analysis

		Terminal growth				
		1.0%	1.5%	2.0%	2.5%	3.0%
WACC	14.5%	1324	1355	1388	1425	1464
	15.0%	1262	1290	1320	1353	1388
	15.6%	1189	1214	<b>1240</b>	1269	1299
	16.0%	1152	1175	1199	1226	1254
	16.2%	1132	1154	1177	1203	1230

Source: Ambit Capital Research

# Annexure 1

## Swot Analysis

Strengths	Weakness
Technology tie up with e-Cop for SOC has given ADSL an early mover advantage in high growth RIM business.	ADSL doesn't own the product IP and has only a technology tie-up with e-Cop
Huge scalability with HIPAA and BASEL -II coming into effect	ADSL doesn't have a global footprint and hence sales cycle could be longer
ADSL is in talks with e-Cop for setting up a marketing joint venture company and expects to close this agreement soon, this would enable them to seal a long term relationship	System Integration conventionally is a high debtor days business. Any delay in recovery could affect the working capital requirements of the company
e-Cop is a subsidiary of certis which in turn is a subsidiary of Temasek (Investment arm of Singapore). The threat of acquisition for e-Cop is minimal as significant revenues accrue from services to Singapore Government, hence even in event of e-Cop tying up with someone else it will keep providing technology support to ADSL.	ADSL has a limited brand visibility in overseas markets so it will have to tie-up with bigger brands to address SOC opportunity, though e-Cop is an established name in this segment
Opportunities	Threats
Market for Security Analysis is expected to grow from current \$65mn to \$90bn by CY11	Increasing competition
Big-4 have shown an intention to work with ADSL for co-branding Security Analysis Reporting for their clients	British Telecom through acquisition of counter-paine is planning to start a SOC in India
Other avenues could be e-Cop offshoring some of the clients to India	IBM Global services is expected to increase their focus on this space over next couple of years
IT-ITES services providers may use security compliance as a marketing tool to gain market share	Exchange rate fluctuations, as SOC revenues would be predominantly exports

# Annexure 2

## SOC - case study for a mid-size Bank

We have done a case study for a mid-size bank having 100 branches and arrive to Rs.256 mn of annual expenditure on compliance reporting for BASEL-II. This bank can be managed 24x7 by a single seat at the SOC (a SOC seat can manage 1200 devices). We feel that this would be a huge compliance cost for the bank. Going forward we believe that the rates would moderate as competition comes in and the volumes increase. Since the current regulations doesn't mandate "Security Compliance Reporting" most of these conversion are voluntary and in some cases ADSL, has done a "Network Segregation" to monitor only mission critical devices, which has resulted in a reduction of total devices from 667 to say 40-50 devices. ADSL currently has a total of 1250 devices under SOC and this is expected to be ramped up to 2600 devices in next two months.

Once the HIPAA and BASEL-II become mandatory all devices would require monitoring and "Network Segregation" will get restricted, post which we expect the volumes to increase resulting in a moderation in the prices and hence better economics to the client.

### Compliance cost for a mid size bank

Branches	100
Regional Offices	20
Corporate Office	1
Data Center	2
<hr/>	
Devices Per Bank Branch	5
Devices Per Regional Offices	7
Devices for Corporate office	7
Devices for Data Centre	10
<hr/>	
	Total
Bank Branch	500
Regional Office	140
Corporate Office	7
Data Center	20
Total Devices	667
<hr/>	
No. of devices managed/SOC seat	1500
Monthly charge/device	\$800
Total Monthly Revenue from Bank	\$533,600
Exchange Rate	40
Annual Revenue(Rs mn)	256
Per device cost from bank angle/month (Rs'000)	32000

# Annexure 3

## Cyclops Architecture

### Security Monitoring Console

Provides an integrated and comprehensive overview of your organisation's security posture .Allows your organisation's security professional to analyse and handle security incidents simultaneously

### Security Event Manager (Evm)

Process security events from various security devices over different communication protocols .Supports multi-stage incident inference and correlation

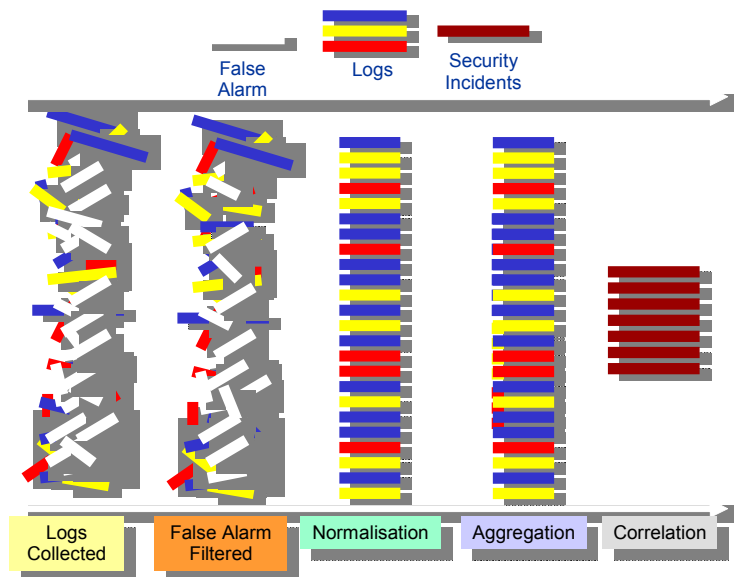
### Knowledge Repository

Stores all security incidents and correlating.

### Secure Remote Viewer

Offers instant visibility of the organisation's security posture Available in both web and application mode with comprehensive graphical trend analysis and reports

### Vulnerability identification process



Source: Company

Cyclops ESM is an advanced enterprise security system that provides insights into security incidents before, during, and after they occur. Powered by e-Cop's proprietary common inference engine for security event handling (CIESEH) technology, CESM helps security professionals perform multi-stage incident correlation, dynamic data mining and trend analysis. Its unique capability to unify different communication protocol used by different security devices, provides security professionals a common platform to manage security incidents

Enterprise security system collects logs which are then filtered for false alarms by processing security events from various security devices over different communication protocols. These are then normalized and aggregated .The incident correlation analysis helps in segregating the threat on the system. Security incidents and correlating information is stored on a consistent basis for future use.

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