Equity Research

February 1, 2010

BSE Sensex: 16358

INDIA

Allied Digital Services

BUY

Maintained

Order pipeline healthy

Rs233

Reason for report: Q3FY10 results review and earnings revision

Technology

Target price Rs265

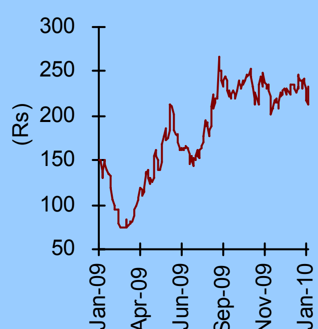
Earnings revision

(%)	FY10E	FY11E
Sales	↑ 1.0	↑ 2.2
EBITDA	↓ 2.8	↓ 2.6
EPS	↓ 2.3	↓ 2.7

Shareholding pattern

	Jun '09	Sep '09	Dec '09
Promoters	55.7	55.6	43.5
Institutional investors	25.0	18.1	31.6
MFs and UTI	9.7	5.2	8.3
Insurance Cos.	0.0	0.0	0.0
FIIs	15.3	12.9	23.3
Others	19.3	26.4	24.9

Price chart



Allied Digital Services' (ADSL) revenues grew 7.4% QoQ to Rs1.79bn (I-Sec: Rs1.76bn), with solutions and services posting 7.9% and 7.1% QoQ revenue growth respectively. Standalone services revenues grew a healthy 17.1% QoQ (55% YoY), while EnPointe Global Services' (EGS) dollar-denominated revenue growth was muted at 2.3% QoQ to US$11mn. Consolidated EBITDA margin declined 40bps QoQ to 19.9% (I-Sec: 20.8%) due to higher growth in solutions and 70bps decline in subsidiaries' EBITDA margin to 4%. PAT rose 8.3% QoQ to Rs272mn (I-Sec: Rs273mn). ADSL is witnessing increased traction in the US with few large deal wins, including some US state government projects. Besides, India-based services revenue CQGR grew a healthy 11.7% QoQ over the past four quarters and the growth momentum is expected to be maintained. We expect revenue and PAT CAGR of 18% and 21% over FY10E-12E.The stock trades at FY11E P/E of 8.3x and EV/E of 5.1x. Maintain BUY with target price of Rs265.

- **Order pipeline healthy.** ADSL enjoys an orderbook of ~Rs1.15bn for solutions and ~Rs4.22bn for services (including ~Rs2.72bn from EGS). As per the management, the Lenovo deal is live with two major customers (with ~22,000 devices) and 5-6 customers will likely be added in Q4FY10. Thus, revenues from the Lenovo deal are expected to kick in from Q4FY10. Besides, ADSL has won a multi-year, multi-million dollar contract to manage the total IT outsourcing project of a large US-based enterprise. The company has also signed a multi-year contract with a large OEM in India. We factor in 19% services revenue CAGR over FY10E-12E.
- **Inorganic plans.** ADSL has raised US$50mn via QIP in Q3FY10. About US$10mn would be used for organic expansion, while the balance would be used for acquisitions. The management indicated that due diligence is being done for a profitable Europe-based target company offering IMS and the transaction is expected to be closed over the next two quarters. We have factored in 21% equity dilution and 5% yield on US$40mn cash.
- **Margins of subsidiaries, still a concern.** Despite having acquired EGS since July '08, EBITDA margin of subsidiaries has remained at ~4%. Any further margin-dilutive acquisition would be a drag on consolidated margins.
- **Maintain BUY.** With lower-than-expected margins, we cut our FY10E-11E EBITDA and PAT estimate ~2-3%. Consistency in performance, improvement in subsidiaries' margins and increased transparency would be the key factors.

Market Cap	Rs10.8bn/US$233mn
Reuters/Bloomberg	ADIS.BO/ALDS IN
Shares Outstanding (mn)	46.2
52-week Range (Rs)	280/73
Free Float (%)	56.5
FII (%)	23.3
Daily Volume (US$'000)	2,488
Absolute Return 3m (%)	3.2
Absolute Return 12m (%)	56.1
Sensex Return 3m (%)	2.9
Sensex Return 12m (%)	73.6

Year to March	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	5,557	6,954	8,215	9,700
Net Income (Rs mn)	769	1,047	1,299	1,534
EPS (Rs)	21.2	25.4	28.1	33.2
% Chg YoY	68.8	19.6	10.6	18.2
P/E (x)	11.0	9.2	8.3	7.0
CEPS (Rs)	22.3	27.6	30.9	36.9
EV/E (x)	11.6	6.6	5.1	4.0
Dividend Yield (%)	0.5	0.5	0.5	0.5
RoCE (%)	26.9	19.6	17.7	17.7
RoE (%)	31.1	22.2	19.0	18.8

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Please refer to important disclosures at the end of this report

Table 1: Q3FY10 results review

(Rs mn, year ending March)

	Q3FY10	Q2FY10	Q3FY09	% chg (QoQ)	% chg (YoY)	I-Sec estimates	% Variation
Net Sales	**1,788**	**1,665**	**1,489**	**7.4**	**20.1**	**1,757**	**1.8**
Cost of Goods Sold	1,112	1,006	923	10.5	20.5	1,051	5.7
Employee Expenses	200	201	185	(0.7)	8.2	213	(6.4)
Other Expenses	121	120	101	0.7	19.9	126	(4.0)
Total Expenses	**1,433**	**1,328**	**1,208**	**7.9**	**18.6**	**1,391**	**3.0**
EBITDA	**356**	**337**	**281**	**5.5**	**26.8**	**366**	**(2.8)**
Interest	12	15	10	(22.9)	14.6	15	(22.9)
Depreciation & amortization	27	19	13	43.2	108.7	23	15.2
Other Income/ (expense)	17	4	31	371.4	(47.3)	22	(25.0)
Recurring pre-tax income	**334**	**307**	**289**	**8.8**	**15.6**	**350**	**(4.5)**
Taxation	57	51	48	11.7	**18.6**	71	(19.3)
Minority Interest	5	5	0			6	(13.3)
Reported Net Income	**272**	**251**	**241**	**8.3**	**12.9**	**273**	**(0.5)**
Recurring Net Income	**272**	**251**	**241**	**8.3**	**12.9**	**273**	**(0.5)**
Ratios (%)							
EBITDA margins	19.9	20.3	18.8				
Recurring Net profit margins	15.2	15.1	16.2				

Source: Company data, I-Sec Research

Table 2: Revenue CAGR of 18% over FY10E-12E

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Revenues				
Solutions	**2,767**	**3,047**	**3,556**	**4,169**
- Enterprise Solutions	2,323	2,523	2,897	3,339
- Integrated Solutions	445	524	659	829
Infrastructure Management Services	**2,790**	**3,907**	**4,659**	**5,531**
-T-BPO + IMS	892	1,069	1,333	1,620
-NOC + SOC	250	554	756	1,026
-Digicomp	**189**	**236**	**292**	**353**
-EGS	**1,459**	**2,048**	**2,278**	**2,532**
Total	**5,557**	**6,954**	**8,215**	**9,700**
Growth Rate (%)				
Solutions	**18.1**	**10.1**	**16.7**	**17.2**
- Enterprise Solutions	15.4	8.6	14.8	15.3
- Integrated Solutions	34.7	17.9	25.8	25.8
Infrastructure Management Services	**343.3**	**40.0**	**19.3**	**18.7**
-T-BPO + IMS	80.0	19.8	24.7	21.6
-NOC + SOC	87.0	121.7	36.4	35.7
-Digicomp		**24.8**	**23.8**	**20.9**
-EGS		**40.4**	**11.3**	**11.1**
Total	**87.0**	**25.1**	**18.1**	**18.1**
Revenue break-up (%)				
Solutions	***49.8***	***43.8***	***43.3***	***43.0***
- Enterprise Solutions	*41.8*	*36.3*	*35.3*	*34.4*
- Integrated Solutions	*8.0*	*7.5*	*8.0*	*8.5*
Infrastructure Management Services	***50.2***	***56.2***	***56.7***	***57.0***
-T-BPO + IMS	*16.1*	*15.4*	*16.2*	*16.7*
-NOC + SOC	*4.5*	*8.0*	*9.2*	*10.6*
-Digicomp	***3.4***	***3.4***	***3.6***	***3.6***
-EGS	***26.3***	***29.5***	***27.7***	***26.1***
Total	***100.0***	***100.0***	***100.0***	***100.0***

Source: Company, I-Sec Research

Table 3: Subsidiaries – Drag on margins

(%)

	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10
Standalone EBITDA margin	22.7	23.9	24.3	26.2	28.2	27.2
Subsidiaries EBITDA margin	10.2	4.9	2.7	3.6	4.7	4.0
Consolidated EBITDA margin	18.8	18.0	17.7	18.6	20.3	19.9
Drag on consolidated EBITDA margin	(3.9)	(6.0)	(6.6)	(7.6)	(7.9)	(7.3)

Source: Company, I-Sec Research

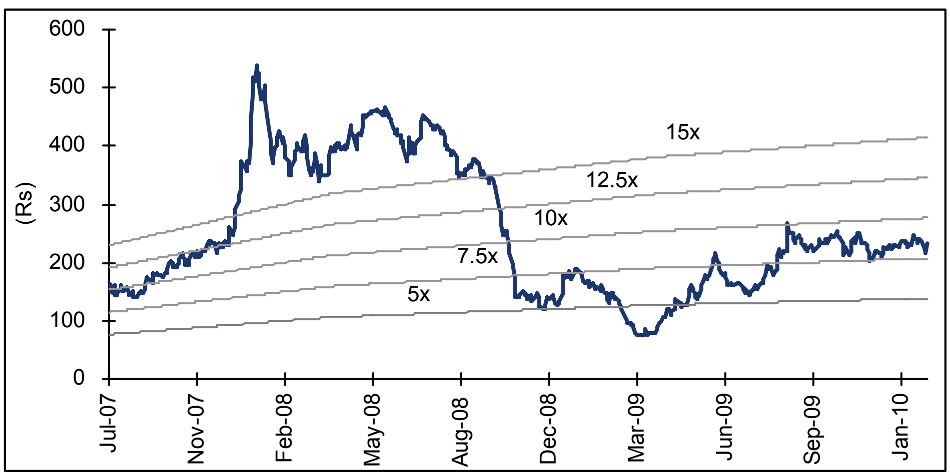
Table 4: Valuations based on FY11 EV/EBITDA

(Rs mn)

Business Segments	**EBITDA**	**% of EBITDA**	**Target multiple**	**EV**	**% to EV**
Enterprise Solutions	486	29	5.0	2,428	23
TPO + IMS + Digicomp	599	36	7.0	4,193	40
NOC + SOC	358	22	7.0	2,506	24
En Pointe	210	13	6.0	1,260	12
Total EV	**1,653**	**100**	**6.3**	**10,387**	**100**
Add Cash				2,587	
Less Debt				651	
Equity Value				**12,323**	
No. of Shares outstanding (mn)				46.2	
Per Share Value (Rs)				**265**	

Source: Company, I-Sec Research

Chart 1: Rolling P/E bands



Source: I-Sec Research

Financial Summary

Table 5: Profit and Loss Statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Income (Sales)	**5,557**	**6,954**	**8,215**	**9,700**
of which Solutions	2,767	3,047	3,556	4,169
of which Others	2,790	3,907	4,659	5,531
Operating Expenses	**4,561**	**5,572**	**6,492**	**7,547**
EBITDA	**996**	**1,382**	**1,723**	**2,153**
% margins	*17.9*	*19.9*	*21.0*	*22.2*
Depreciation & Amortisation	23	91	132	169
Gross Interest expense	56	55	55	54
Other Income	22	41	100	130
Recurring PBT	**940**	**1,276**	**1,636**	**2,060**
Add: Extraordinaries	0	0	0	0
Less: Taxes	168	209	294	474
Less: Minority Interest	3	20	43	52
Net Income (Reported)	**769**	**1,047**	**1,299**	**1,534**
Recurring Net Income	**769**	**1,047**	**1,299**	**1,534**

Source: Company data, I-Sec Research

Table 6: Balance Sheet

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Assets				
Total Current Assets	2,873	5,608	6,338	7,243
of which cash & deposits	165	2,270	2,557	2,787
Total Current Liabilities & Provisions	687	823	929	1,121
Net Current Assets	**2,186**	**4,785**	**5,409**	**6,122**
Investments	**50**	**30**	**30**	**30**
Of which Other Marketable	*50*	*30*	*30*	*30*
Net Fixed Assets	**417**	**925**	**1,543**	**2,274**
Goodwill	**1,125**	**1,125**	**1,125**	**1,125**
Capital Work-in-Progress	**339**	**354**	**369**	**384**
Total Assets	**4,116**	**7,219**	**8,476**	**9,935**
of which cash and equivalents	*215*	*2,300*	*2,587*	*2,817*
Liabilities				
Borrowings	**901**	**681**	**651**	**621**
Deferred Tax Liability	**16**	**16**	**16**	**16**
Minority Interest	36	90	133	142
Equity Share Capital	181	231	231	231
Face Value per share (Rs)	*5*	*5*	*5*	*5*
Reserves & Surplus	2,982	6,200	7,445	8,925
Net Worth	**3,163**	**6,431**	**7,676**	**9,156**
Total Liabilities	**4,116**	**7,219**	**8,476**	**9,935**

Source: Company data, I-Sec Research

Table 9: Quarterly trends

(Rs mn, year ending March 31)

	Mar-09	Jun-09	Sep-09	Dec-09
Net sales	1,462	1,588	1,665	1,788
% growth (YoY)	*78.4*	*74.2*	*11.8*	*28.8*
EBITDA	259	296	337	356
Margin (%)	*17.7*	*18.6*	*20.3*	*19.9*
Other income	20	3	4	17
Add: Extraordinaries	0	0	0	0
Net profit	217	228	251	272

Source: Company data, I-Sec Research

Table 7: Cash Flow Statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Cash flow before Working Capital changes	**996**	**1,380**	**1,719**	**2,149**
Working Capital Inflow / (Outflow)	(1,152)	(593)	(672)	(837)
Taxes Paid	92	(208)	(85)	(179)
Operating Free Cash flows	**(63)**	**579**	**962**	**1,132**
Capex	**(1,706)**	**(615)**	**(765)**	**(915)**
Changes in Traded Investments	424	20	0	0
Interest income	22	41	100	130
Interest Paid	(56)	(55)	(55)	(54)
Issue of Share Capital / Dividend paid	581	2,222	(54)	(54)
Process from Borrowings	780	(166)	12	(21)
Increase/(Decrease) in Cash	**(17)**	**2,026**	**200**	**218**

Source: Company data, I-Sec Research

Table 8: Key Ratios

(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
Per Share Data (Rs)				
EPS(Basic Recurring)	21.2	25.4	28.1	33.2
Diluted Recurring EPS	21.2	25.4	28.1	33.2
Recurring Cash EPS	22.3	27.6	30.9	36.9
Dividend per share (DPS)	1.2	1.2	1.2	1.2
Book Value per share (BV)	87.3	156.0	166.0	198.1
Growth Ratios (%)				
Operating Income	87.0	25.1	18.1	18.1
EBITDA	50.4	38.7	24.7	25.0
Recurring Net Income	77.5	38.2	25.7	18.2
Diluted Recurring EPS	68.8	19.6	10.6	18.2
Diluted Recurring CEPS	62.3	24.0	12.1	19.1
Valuation Ratios (x)				
P/E	11.0	9.2	8.3	7.0
P/CEPS	10.5	8.4	7.5	6.3
P/BV	2.7	1.5	1.4	1.2
EV / EBITDA	11.6	6.6	5.1	4.0
EV / Operating Income	2.1	1.3	1.1	0.9
Operating Ratio				
Direct operating exps / Sales (%)	75.3	73.4	72.0	70.9
SG&A/Sales (%)	6.8	6.8	7.1	6.9
Other Income / PBT (%)	2.4	3.2	6.1	6.3
Effective Tax Rate (%)	17.8	16.4	18.0	23.0
NWC / Total Assets (%)	53.1	66.3	63.8	61.6
Asset Turnover (x)	13.3	7.5	5.3	4.3
Receivables (days)	123.2	145.0	140.0	140.0
Payables (days)	30.0	30.0	30.0	30.0
D/E Ratio (x)	0.3	0.1	0.1	0.1
Return/Profitability Ratio (%)				
Recurring Net Income Margins	13.8	15.1	15.8	15.8
RoCE	26.9	19.6	17.7	17.7
RoNW	31.1	22.2	19.0	18.8
Dividend Payout Ratio	5.5	4.6	4.2	3.5
Dividend Yield	0.5	0.5	0.5	0.5
EBITDA Margins	17.9	19.9	21.0	22.2

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)
BUY: +10% outperformance; **HOLD**: -10% to +10% relative performance; **SELL**: +10% underperformance

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