

Allied Digital Services Limited

Decent 4Q FY08, robust FY09 outlook

- **Allied Digital (ALDS) reported a decent 4Q FY08:** Revenues grew 3% Q/Q with strong 40%+ Q/Q growth in the services segment offset by a ~10% decline in the solutions segment. EBITDA margins expanded 4% Q/Q with higher services contribution. However, lower other income and higher taxes led to net profit growth of just 2% Q/Q, still ahead of expectations.
- **Solutions weak on lower procurement services:** ALDS has set up a procurement assistance group to reduce the low-margin hardware procurement business. While this led to a ~10% Q/Q decline in solutions revenues in 4Q FY08, going forward we believe that this step will both improve margins and lower the working capital requirements of ALDS.
- **Strong FY09 outlook:** ALDS management guided to 70% Y/Y revenue growth in FY09 with further margin expansion. The company has a strong order book of Rs780-800MM in its solution business executable over the next 3-4 months.
- We are cutting our FY09/FY10 revenue estimates by 5%-6% in line with management guidance with the reduction in the hardware procurement business. However, we expect better margins from higher services contribution leading to just a 2% cut in our FY09/FY10 EPS estimates. Overall, we expect a 69% revenue CAGR and a 75% EPS CAGR over FY08-10E.
- **Investment view:** We remain positive with a Dec-08 price target of Rs1,200, implying 43% upside. ALDS is trading at ~18x FY09E EPS, ahead of its peers but justified, in our view, as domestic IT exposure (90%+ of ALDS revenues) shields ALDS from: 1) concerns about a US slowdown; and 2) rupee appreciation.

Reuters: ADIS.BO, Bloomberg: ALDS IN

Rs in millions, year-end March

	FY07A	FY08A	FY09E	FY10E	FY07A	FY08A	FY09E	FY10E			
Sales	1,560	2,972	5,113	8,498	YE BPS (Rs)	45.9	109.0	152.4	232.5	52-Week range (Rs)	190.0-1,129.0
Operating Profit	322	629	1,212	2,173	ROE (%)	54.6	35.5	35.6	43.3	Shares Outstg	17MM
EBITDA	330	662	1,264	2,248	ROIC (%)	48.3	39.2	37.3	43.4	Avg daily volume	0.03MM
Pre Tax Profit	312	645	1,232	2,193	Qtr EPS (Rs)	1Q	2Q	3Q	4Q	Avg daily value (US\$)	0.6MM
Net profit	229	439	810	1,463	EPS (FY08)	7.2	5.9	7.0	7.2	Index (Sensex)	17,378
EPS (Rs)	19.0	27.3	46.6	83.6	EPS (FY09E)	7.2	9.5	13.6	16.3	Free float	17%
P/E (x)	44.2	30.8	18.0	10.0	EPS (FY10E)	18.5	20.2	21.7	23.2	Div Yld FY08 (%)	0.0%
P/Sales(x)	9.3	4.9	2.8	1.7	Local	1M	3M	12M		Exchange rate	Rs40.5/US\$1
P/BV (x)	18.3	7.7	5.5	3.6	Abs. Perf.(%)	9.4	4.8	n.m.		Market Cap (US\$)	358.9MM
Cash	29	682	437	1,028	Rel. Perf.(%)	3.1	9.1	n.m.		Price Target (12/08)	Rs1200

Source: Company data, Bloomberg, JPMorgan estimates

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Overweight

Rs840.00

29 April 2008
Price Target: Rs1,200.00

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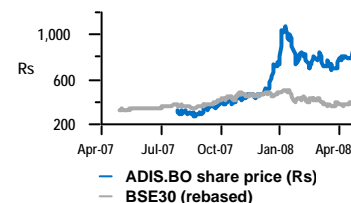
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Price Performance



	YTD	-1M	-3M	-12M
Absolute	-11.7%	4.5%	-0.3%	138.9%
Relative	4.5%	0.6%	6.0%	116.2%

Source: RIMES, Reuters.

Decent 4Q FY08

Revenues were lower than expected due to a ~10% Q/Q decline in solution revenues as ALDS exits the low-margin hardware procurement business (~6% of revenues in FY08). However, ALDS saw strong 40%+ Q/Q growth in the services segment leading to 4% Q/Q EBITDA margin expansion.

We note that both operating profit and net profit exceeded our estimates.

Table 1: Actuals and estimates

Rs in millions, year-end March	Actual	Expected	Change
Revenue	820	897	-8.6
Gross Profit	224	220	2.0
EBIT	190	175	8.8
EBITDA	201	185	8.5
Pre Tax Profit	195	183	6.5
Net Profit	124	119	4.4
EPS (Rs)	7.2	6.9	4.4
Margins (%)			
Gross Margin	27.4	24.5	2.9
Operating Margin	23.2	19.5	3.7
EBITDA Margin	24.5	20.7	3.9
Net Margin	15.1	13.2	1.9

Source: Company data, JPMorgan estimates.

Robust business outlook

Management guided to revenue growth of 70% Y/Y in FY09 with margin expansion. The solution order book position was strong at Rs780-800MM. On the NOC/SOC business, management guided to FY09 revenues of at least Rs700MM.

Further, ALDS indicated decent margin improvement in FY09 with greater services contribution and improvement in NOC/SOC margins with greater utilization.

Estimate changes

Table 2: Estimate changes

Rs in millions, year-end March

	New			Old			Change (%)		
	FY08	FY09E	FY10E	FY08E	FY09E	FY10E	FY08	FY09E	FY10E
Revenue	2,972	5,113	8,498	3,049	5,426	8,914	-2.5	-5.8	-4.7
Gross Profit	723	1,423	2,524	718	1,507	2,671	0.6	-5.5	-5.5
EBIT	629	1,212	2,173	613	1,236	2,226	2.5	-1.9	-2.4
EBITDA	662	1,264	2,248	646	1,305	2,327	2.4	-3.2	-3.4
Pre Tax Profit	645	1,232	2,193	633	1,256	2,247	1.9	-1.9	-2.4
Net Profit	439	810	1,463	433	826	1,500	1.2	-2.0	-2.5
EPS (Rs)	27.3	46.6	83.6	27.0	47.5	85.8	1.1	-1.9	-2.5
Margins (%)									
Gross Margin	24.3	27.8	29.7	23.6	27.8	30.0	0.8	0.1	-0.3
EBIT Margin	21.2	23.7	25.6	20.1	22.8	25.0	1.0	0.9	0.6
EBITDA Margin	22.3	24.7	26.5	21.2	24.1	26.1	1.1	0.7	0.3
Net margin	14.8	15.8	17.2	14.2	15.2	16.8	0.5	0.6	0.4

Source: Company reports, JPMorgan estimates.

We are cutting our FY09/FY10 revenue estimates by 5%-6% given the reduction in the hardware procurement business, in line with management guidance

On margins, we expect decent expansion from higher services contribution leading to just a 2% cut in our EPS estimates

Valuation – Dec-08 price target of Rs1,200/share

Our DCF-based Dec-08 price target remains unchanged at Rs1,200, implying 43% upside. Our DCF assumptions include a 39% revenue CAGR over FY07-17E, terminal sales growth of 3%, long-term EBIT margin of 18%, cost of capital of 12.8% and long-term ROIC of 27%. Our price target assumes a trailing P/E multiple of 32x and forward multiple of 16x.

Trading multiples: The stock is trading at a P/E of 18x FY09E EPS with a 75% EPS CAGR over FY08-10E. Given the strong domestic demand outlook with corresponding low risk from rupee appreciation, we expect the stock to move up gradually, after the sharp 4x jump from its IPO price.

Risks to our PT include 1) weakness in the project-based SI business; 2) supply-side tightness; 3) wage inflation; and 4) muted off-take in remote IT management services.

Table 3: Allied Digital P&L

Rs in millions, year-end March

	FY08				FY09E				FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
	1Q	2Q	3Q	4Q	1QE	2QE	3QE	4QE							
Revenue	651.5	708.1	792.9	819.5	926.4	1,120.4	1,402.8	1,663.1	392	517	887	1,560	2,972	5,113	8,498
Gross Profit	150.4	163.0	185.3	224.2	225.8	294.2	410.1	493.2	46	82	207	393	723	1,423	2,524
EBIT	137.9	148.0	152.6	190.3	187.5	247.8	352.1	424.4	13	49	163	322	629	1,212	2,173
EBITDA	142.5	154.9	163.1	201.1	198.3	260.1	365.9	439.6	15	53	169	330	662	1,264	2,248
Pre Tax Profit	135.6	148.9	165.4	195.2	193.7	253.9	357.0	427.6	8	43	160	312	645	1,232	2,193
Net Profit	91.9	101.8	121.1	123.9	124.7	165.7	235.7	283.8	3	12	120	229	439	810	1,463
EPS (Rs.)	7.2	5.9	7.0	7.2	7.2	9.5	13.6	16.3	0.3	1.1	10.5	19.0	27.3	46.6	83.6
Margins (%)															
Gross Margin	23.1	23.0	23.4	27.4	24.4	26.3	29.2	29.7	11.8	15.9	23.3	25.2	24.3	27.8	29.7
Operating Margin	21.2	20.9	19.2	23.2	20.2	22.1	25.1	25.5	3.2	9.6	18.4	20.6	21.2	23.7	25.6
EBITDA Margin	21.9	21.9	20.6	24.5	21.4	23.2	26.1	26.4	3.9	10.2	19.0	21.2	22.3	24.7	26.5
Net Margin	14.1	14.4	15.3	15.1	13.5	14.8	16.8	17.1	0.8	2.4	13.6	14.7	14.8	15.8	17.2
Sequential Growth (%)															
Revenue	34.7	8.7	12.0	3.4	13.0	20.9	25.2	18.6	(2.7)	31.8	71.6	75.9	90.5	72.0	66.2
Gross Profit	7.9	8.4	13.7	21.0	0.7	30.3	39.4	20.2	7.2	77.8	151.7	90.1	84.0	96.9	77.3
EBIT	19.3	7.3	3.1	24.7	(1.5)	32.2	42.1	20.5	(25.3)	290.8	230.4	97.1	95.6	92.7	79.3
EBITDA	19.0	8.7	5.3	23.3	(1.4)	31.2	40.7	20.2	(13.7)	246.1	220.9	95.6	100.4	91.0	77.9
Net Profit	14.7	10.8	19.0	2.3	0.7	32.8	42.3	20.4	(58.0)	287.8	872.5	90.6	91.3	84.6	80.6
EPS	12.6	(18.0)	18.6	2.3	0.7	32.0	42.3	20.4	(58.0)	287.8	851.8	81.4	43.6	70.9	79.4

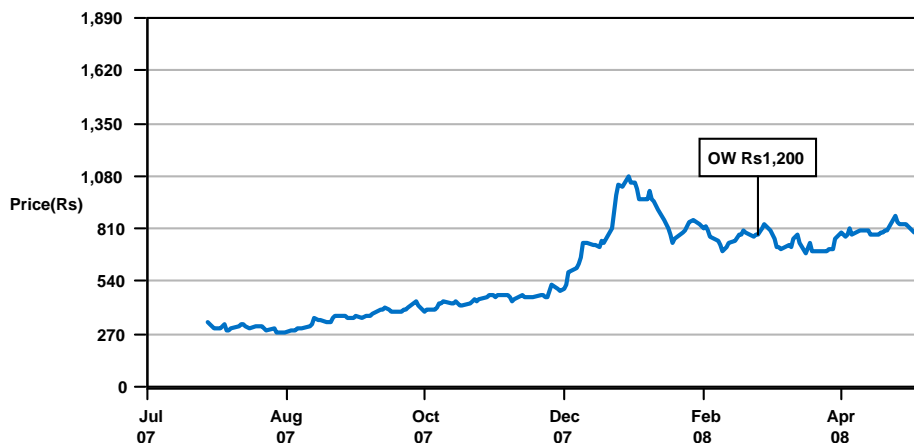
Source: Company data, JPMorgan estimates.

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Allied Digital Services Limited (ADIS.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
27-Feb-08	OW	778.95	1200.00

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends. Initiated coverage Feb 27, 2008. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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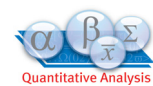
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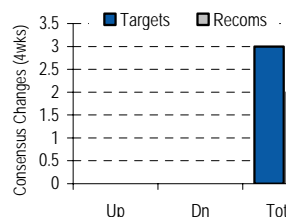
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All Data As Of 29-Apr-08

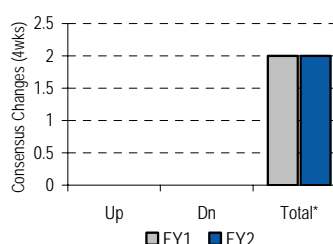
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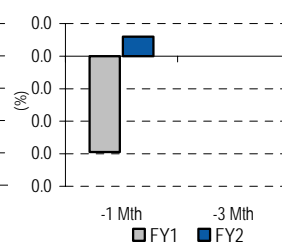
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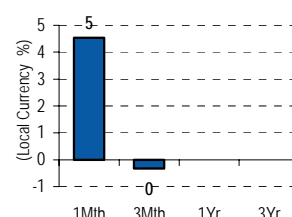
EPS Revisions



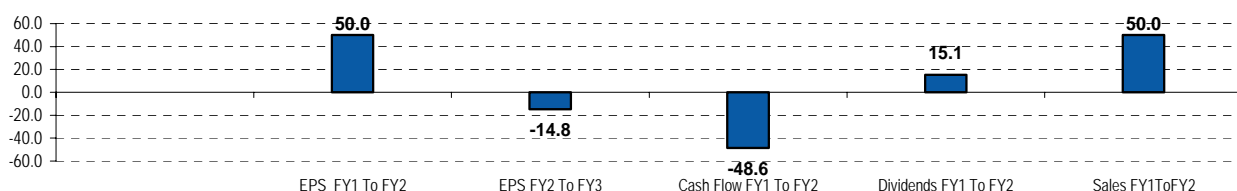
EPS Momentum (%)



Historical Total Return (%)



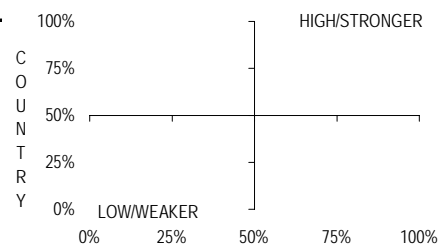
Consensus Growth Outlook (%)



Quant Return Drivers (A Score >50% indicates company ranks 'above average')

Score 0% (worst) to 100% (best)	vs Country Peers	vs (regional) IBES Industry Peers
Valuations: P/E Vs Market (12mth fwd EPS)	83%	91%
Valuations: P/E Vs Sector (12mth fwd EPS)	94%	97%
Valuations: EPS Growth (forecast)	90%	97%
Momentum: 12 Month Price Momentum		
Momentum: 1 Month Price Reversion	56%	41%
Quality: Return On Equity (forecast)	96%	96%
Quality: Earnings Risk (Variation in Consensus)	0%	0%
Earnings&Sentiment: Earnings Momentum		
Earnings&Sentiment: Change in Recomms	3%	4%
Earnings&Sentiment: Net Revisions Fy2 EPS	65%	61%

JPMorgan Composite Q-Score



COMPOSITE Q-SCORE** (0% To 100%)

Regional IBES Industry Peers (Closest by Size, Consensus. ADV = Average daily value traded in US\$m over the last 3 mths)

Code	Name	Country	USD MCAP	ADV	PE FY1	Q-Score**
2389-JP	Opt Inc.	Japan	482	1.65	56.2	26%
3313-HK	Meadville Holdings Ltd.	China	480	0.30	5.9	100%
532700-IN	Entertainment Network (India) Ltd.	India	468	0.16	-122.8	7%
PRG-AU	Programmed Maintenance Services Ltd.	Australia	432	1.08	14.6	27%
3770-JP	Zappallas Inc.	Japan	361	8.82	33.7	89%
532875-IN	Allied Digital Services Ltd.	India	360	0.23	29.1	
532638-IN	Shoppers Stop Ltd.	India	352	0.05	278.6	2%
8161-HK	China LotSynergy Holdings Ltd.	Hong Kong	324	1.73	22.0	10%
BBC-AU	Babcock & Brown Communities Group	Australia	322	0.98	10.0	50%
095660-KR	Neowiz Games Corp.	South Korea	314	1.37	12.0	47%
ILF-AU	ING Real Estate Community Living Group	Australia	308	0.50	6.7	39%

Country Peers (Closest by Size, Consensus. ADV = average daily value traded in US\$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score**
524494-IN	IPCA Laboratories Ltd.	Pharmaceuticals: Other	395	0.18	10.6	82%
532840-IN	Advanta India Ltd.	Chemicals: Agricultural	390	0.17	28.4	9%
524372-IN	Orchid Chemicals & Pharmaceuticals Ltd.	Pharmaceuticals: Major	384	19.21	15.0	14%
500304-IN	NIIT Ltd.	Miscellaneous Commercial Services	368	0.64	21.6	46%
532794-IN	Zee News Ltd.	Broadcasting	366	0.88	42.3	93%
532875-IN	Allied Digital Services Ltd.	Information Technology Services	360	0.23	29.1	
532609-IN	Bharati Shipyard Ltd.	Trucks/Construction/Farm Machinery	353	0.43	15.7	84%
532638-IN	Shoppers Stop Ltd.	Department Stores	352	0.05	278.6	3%
532175-IN	Infotech Enterprises Ltd.	Packaged Software	345	0.09	15.8	22%
513250-IN	Jyoti Structures Ltd.	Engineering & Construction	338	0.40	17.5	54%
500420-IN	Torrent Pharmaceuticals Ltd.	Pharmaceuticals: Major	329	0.13	11.0	67%

Source: Factset, Thomson and JPMorgan Quantitative Research. For an explanation of the Q-Snapshot, please visit <http://jpmorgan.hk.acrobat.com/qsnapshot/>
Q-Snapshots are a product of JPMorgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.'

Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the JPMorgan analysts' recommendation.

* Total number of target prices, recommendations or EPS forecasts that make up consensus. ** The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe.

Allied Digital Services Limited: Summary of financials

Income statement						Ratio Analysis					
Rs in millions, year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E	% , year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E
Revenues	887	1,560	2,972	5,113	8,498	Gross Margin	23.3	25.2	24.3	27.8	29.7
Cost of Goods Sold	680	1,168	2,249	3,689	5,974	EBITDA margin	19.0	21.2	22.3	24.7	26.5
Gross Profit	207	393	723	1,423	2,524	Operating Margin	18.4	20.6	21.2	23.7	25.6
						Net Margin	13.6	14.7	14.8	15.8	17.2
SG&A	44	71	94	211	352						
Operating Profit (EBIT)	163	322	629	1,212	2,173	SG&A/Sales	4.9	4.6	3.2	4.1	4.1
EBITDA	169	330	662	1264	2248						
Interest Income	5.3	1.7	30.1	36.4	35.9	Sales growth	71.6	75.9	90.5	72.0	66.2
Interest Expense	-8.0	-11.0	-13.8	-16.0	-16.0	Operating Profit Growth	230.4	97.1	95.6	92.7	79.3
Investment Income (Exp.)	0.0	0.0	0.0	0.0	0.0	Net profit growth	872.5	90.6	91.3	84.6	80.6
Non-Operating Income (Exp.)	0.0	0.0	0.0	0.0	0.0	EPS (Reported) growth	851.8	81.4	43.6	70.9	79.4
Earnings before tax	160	312	645	1,232	2,193						
Tax	-40	-83	-206	-422	-730	Interest coverage (x)	20.3	29.2	45.6	75.7	135.8
Net Income (Reported)	120	229	439	810	1463	Net debt to total capital	17.3	7.5	n.m.	n.m.	n.m.
Net Income (Adjusted)	120	229	439	810	1463	Net debt to equity	23.1	8.6	n.m.	n.m.	n.m.
INR											
EPS (Reported)	10.5	19.0	27.3	46.6	83.6	Asset Turnover	196.5	172.4	121.5	138.3	154.5
EPS (Adjusted)	10.5	19.0	27.3	46.6	83.6						
BPS	21.4	45.9	109.0	152.4	232.5	ROE	78.4	54.6	35.5	35.6	43.3
DPS	-	-	-	1.5	2.0	ROIC	53.5	48.3	39.2	37.3	43.4
Shares Outstanding (bn)	11.8	12.8	17.3	17.5	17.6	ROCE	53.1	46.8	32.6	33.8	41.9
Balance sheet						Cash flow statement					
Rs in millions, year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E	Rs in millions, year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E
Cash and cash equivalents	27	29	682	437	1,028	Net Income	120	229	439	810	1,463
Accounts receivable	291	596	1,078	2,187	3,063	Depr. & Amortisation	6	9	33	52	76
Deferred tax	11	13	27	55	77	Change in working capital	-208	-207	-233	-779	-609
Others	103	129	109	221	309	Other	0	0	0	0	0
Current assets	432	767	1,896	2,900	4,478	Cash flow from operations	-82	31	239	83	930
LT investments	2	29	29	29	29	Capex	-7	-94	-450	-300	-300
Net fixed assets	18	104	521	769	993	Disposal/ (purchase)	0	-32	5	0	0
Others	0	5	0	0	0	Cash flow from investing	-6	-127	-445	-300	-300
Total assets	451	905	2,446	3,698	5,500	Free cash flow	-88	-63	-211	-217	630
Liabilities						Equity raised/ (repaid)	79	104	859	1	1
Provisions	0	0	0	0	0	Debt raised/ (repaid)	21	-6	0	0	0
Payables	112	239	482	953	1,331	Other	0	0	0	0	0
Others	0	0	0	0	0	Dividends paid	0	0	0	-30	-40
Total current liabilities	112	239	482	953	1331	Cash flow from financing	99	98	859	-28	-39
Long term debt	85	80	80	80	80						
Other liabilities	0	0	0	0	0	Net change in cash	11	3	653	-245	591
Total liabilities	198	319	562	1032	1410	Beginning cash	17	27	29	682	437
Shareholders' equity	253	586	1884	2666	4090	Ending cash	28	30	682	437	1,028

Source: Company data, JPMorgan estimates.