

Buy

Price Rs906

Target Price Rs1,295

Market Capitalisation

Rs16,347mn (US\$381mn)

52 wk range H/L (Rs) 1,129/190

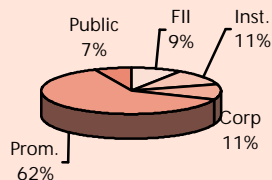
Shares o/s (mn)	Daily vol (mn shares)
18.04	0.02

Reuters	Bloomberg
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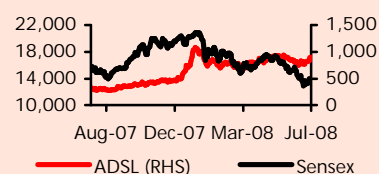
Performance (%)

	1M	3M	12M	YTD
Absolute	5.6	15.1	N.A.	11.1
Sensex	19.1	35.1	N.A.	67.3

Source: Bloomberg

Shareholding pattern (%)

Source: Capitaline

Price performance

Source: Capitaline

Analyst

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Allied Digital Services

Allied Digital Services Limited (ADSL) has acquired a 80.5% stake in IT Infrastructure Management/Remote Management Services provider EnPointe Global Services LLC.(EPGS), a carved out subsidiary of EnPointe Technologies Inc. (EPTI) a Nasdaq listed company with Revenues of over USD 340mn,for a total consideration of USD 30mn.

Funding- The transaction will be funded by a mix of cash and equity swap with an upfront payment of USD 10mn through bridge financing loan and issuance of additional 745,000 shares of ADSL to EPTI. Further, ADSL would infuse an additional cash of USD 4mn in EPGS while EPTI would bring in USD 1mn to meet the immediate operational requirements of EPGS.

Profitability Analysis

Rs mn	CY06	CY07	FY09E	FY10 E
Revenue	1,909.2	1,767.3	1,290.0	2,064.0
COGS	1,195.4	980.4	715.6	1,073.3
Gross Profit	713.8	786.9	574.4	990.7
Gross Margins %	37.4	44.5	44.5	48.0
Selling & Marketing	343.7	459.5	261.9	469.1
General & Administrative	181.4	176.7	146.2	232.2
Operating Income	188.8	150.7	166.4	289.3
OPM%	9.9	8.5	14.5	16.0
Interest Expense	3.5	13.7	-	-
Minority	-5.2	2.9	-	-
Net Profit	190.4	134.1	166.4	289.3

Source: Ambit Capital Research estimates, EPTI Annual Report

We have estimated the financials EPGS by segregating the services revenue of EPTI from the Annual report. EPTI services revenue was USD41.1mn for SepCY07 with 44.5% gross margins while we estimate its net margins to be in the range of 7-8%.ADSL would consolidate EPGS from Q2FY09 and we expect EPGS to deliver a topline of Rs.1290 and PAT of Rs166.4mn for FY09 and Rs2064mn & Rs289.3mn for FY10.

ADSL is working towards offshore service delivery for the US clients, we believe that this initiative would help in margins expansions to 15-20% range from current 10-11%.We built in a conservative approach and estimate it to be in the range of 15-16% for FY09 and FY10 largely due to the integration risk and overall US economy slowdown.

EPGS acquisition is EPS accretive to ADSL, but the key lies in retaining people which could be a key challenge, though it will receive on going marketing and business support from USD 340mn EPTI under the terms of agreement.

EPTI has been operating for last 15 years in US, across 44 states and has a client base which includes several Fortune 1000 corporate across BFSI, Healthcare, Retail, Manufacturing, aviation, transportation sectors. This would give ADSL a direct access to existing client base with a non-linear opportunity to cross sell its remote management services & managed security services.

Key financials

YE March (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Operating income	883.5	1,562.5	2,972.6	6,225.0	9,968.9
EBITDA	168.6	330.1	662.2	1,442.4	2,553.3
Net profit	119.3	227.6	429.4	892.9	1,659.7
EPS (Rs)	6.9	13.2	24.7	49.5	92.0
RoE (%)	78.1	54.3	34.8	33.8	39.1
RoCE (%)	53.8	47.0	32.7	32.6	36.2
P/E (x)	131.3	68.8	36.6	18.3	9.8

Source: Ambit Capital Research Estimates,Company

ADSL has already taken steps to ramp up its NOC/SOC to service this opportunity across its focus vertical like BFSI & healthcare which have to comply with Information Security Reporting after HIPAA and BASEL -II makes it mandatory.

Change in Estimates						
Rs mn	New		Old		Change(%)	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Income	6,225.0	9,968.9	5,325.0	8,934.4	16.9	11.6
Gross Profit	2,507.7	4,255.1	1,997.6	3,572.0	25.5	19.1
EBITDA	1,442.4	2,553.3	1,278.7	2,249.7	12.8	13.5
EBIT	1,346.6	2,425.5	1,131.0	2,049.4	19.1	18.4
PBT	1,294.5	2,407.6	1,136.6	2,065.2	13.9	16.6
PAT / Net profit	892.9	1,659.7	812.4	1,472.1	9.9	12.7
EPS(Rs)	49.5	92.0	47.0	85.1	5.3	8.1
Margins (%)						
Gross Profit	40.3	42.7	37.5	40.0	2.8	2.7
EBITDA	23.2	25.6	24.0	25.2	-0.8	0.4
EBIT	21.6	24.3	21.2	22.9	0.4	1.4
PBT	20.7	23.9	21.1	22.9	-0.5	1.0
PAT / Net profit	14.3	16.6	15.3	16.5	-0.9	0.2
RoCE	32.6	36.2	34.1	41.6	-1.5	-5.3
RoE	33.8	39.1	35.6	43.0	-1.8	-3.9

Source: Ambit Capital Research estimates

We have incorporated the EPGs financials from Q2FY09 which would have resulted in a growth of 24%, but we have tweaked our old revenue estimate by 7% on the standalone basis owing to ADSL strategy of advising clients to buy black boxes directly for the repeat business/AMC business. We believe this would help improve margins and ease pressure on working capital requirement, hence we are keeping the margins intact on the standalone basis as against reduced revenue growth on the same.

Consolidated margins would be under pressure due to the acquisition of EPGs, we expect the overall operating margins for ADSL to be 23.2% while EPGs could deliver a 14.5% margins for FY09. Going forward in FY10 the margins would improve to 25.6% as the service delivery would happen on an offshore model.

PAT margins would see a 91bps dip due to the lower margins contribution of 12.9% from EPGs for FY09; we expect margins to expand by 17bps for FY10. We have assumed that the acquisition costs would be expensed in FY09 hence the PAT growth would be 9.9%, lower than the revenue growth.

Return ratios would be under pressure due to acquisition of EPGs.

Q1FY08 Earnings Preview			
Consolidated (Rsmn)	Q1FY09E	Q4FY08	YoY(%)
Total Revenue	975	819.5	19.0
EBIDTA	258.4	210.0	23.0
EBIDTA mgn(%)	26.5	25.6	
Depreciaton	13	10.8	20.4
Interest	6	4.0	50.0
Tax	83.0	71.3	
Net Profit	156.3	123.9	26.2
NPM (%)	16.0	15.1	
EPS(Rs)	8.7	7.2	21.0

Source: Ambit Capital Research estimates

We expect ADSL to deliver robust growth for Q1FY09 .We estimate it to deliver a revenue of Rs975mn a 19% growth QoQ, EBIDTA of Rs258.4mn a 23% growth QoQ and PAT of Rs 156.3mn a 26.2% growth QoQ.We expect EPS to grow at 21% QoQ to Rs8.7, slightly lower than PAT growth on the back of 4% equity dilution for funding EPGS acquisition.

Outlook and valuation

Attractive valuations: ADSL has delivered a robust performance for FY08 and going forward we expect the growth momentum to continue.Acquisition of EPGS would aid in expanding global footprint and give an opportunity to cross-sell services to existing clients. We remain positive on the overall prospects of the company.

At the CMP of Rs 906, the stock is available at 9.8x its consolidated FY10E EPS. We expect the stock to perform well as it delivers strong growth numbers over the next few quarters. We have incorporated the EPGS financials into our estimates and retain our **BUY** recommendation on the stock with enhanced target price of Rs1,295 using DCF-Methodology (14x its FY10E Earnings of Rs92) ,indicating an upside of 42.9% from current levels.

Allied Digital - financial summary

Balance Sheet

(Rs mn) (year end- Mar)	FY06	FY07	FY08E	FY09E	FY10E
Cash & equivalents	26.9	29.4	151.4	517.5	1,756.8
Debtors	290.6	596.3	1,062.6	1,798.4	2,022.3
Inventory	10.7	12.9	38.2	45.0	35.0
Loans & advances	102.7	128.7	281.2	596.9	955.9
Investments	1.5	28.9	28.9	28.9	28.9
Fixed assets	16.9	103.9	804.1	1,077.6	1,419.1
Goodwill				698.8	698.8
Other assets	(0.5)	5.1	5.1	5.1	5.1
Total assets	448.8	905.2	2,371.4	4,768.1	6,921.9
Current liabilities & provisions	111.9	239.1	418.4	814.8	1,252.3
Debt	85.3	79.6	79.6	509.6	509.6
Minority Interest				32.4	88.9
Total liabilities	197.2	318.7	498.0	1,356.8	1,850.8
Shareholders' equity	47.4	127.7	172.9	180.4	180.4
Reserves & surpluses	205.5	458.8	1,700.5	3,230.9	4,890.7
Total networth	252.9	586.5	1,873.5	3,411.3	5,071.1
Net working capital	319.0	528.2	1,115.0	2,143.1	3,517.7
Net debt (cash)	58.4	50.2	(71.8)	(7.9)	(1,247.2)
Total liabilities & equities	448.8	905.2	2,371.4	4,768.1	6,921.9

Income statement

(Rs mn) (year end- Mar)	FY06	FY07	FY08	FY09E	FY10E
Operating income	883.5	1,562.5	2,972.6	6,225.0	9,968.9
% growth		77%	90%	109%	60%
Operating expenditure	714.9	1,232.4	2,310.4	4,782.6	7,415.6
EBITDA	168.6	330.1	662.2	1,442.4	2,553.3
% growth		96%	101%	118%	77%
Depreciation	5.6	8.6	32.9	95.8	127.8
EBIT	163.0	321.5	629.3	1,346.6	2,425.5
Interest expenditure	8.0	11.0	13.8	40.8	45.9
Non-operational income / Exceptional items	5.3	1.7	30.4	(11.3)	28.0
PBT	160.3	312.2	645.9	1,294.5	2,407.6
Tax	41.0	84.6	216.5	369.2	691.5
Minority Interest				32.4	56.4
PAT / Net profit	119.3	227.6	429.4	892.9	1,659.7
% growth		91%	89%	108%	86%

Cash flow

(Rs mn) (year end- Mar)	FY06	FY07	FY08E	FY09E	FY10E
EBIT	163.0	321.5	598.1	1,346.6	2,425.5
Other income (expenditure)	4.9	1.7	8.8	(11.3)	28.0
Depreciation	5.6	8.6	53.2	95.8	127.8
Interest	8.0	11.0	11.0	40.8	45.9
Tax	41.0	84.6	168.2	369.2	691.5
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	661.9	135.3
Cash flow from operating activities	(84.6)	23.90	16.1	359.2	1,708.6
Incr (decr) in capital expenditure	6.7	101.2	753.4	1,068.0	469.4
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)	(1,068.0)	(469.4)
Incr (decr) in borrowings	20.6	(5.7)	0.0	430.0	0.0
Issuance of equity	80.0	106.0	859.3	645.0	0.0
Cash flow from financing activities	100.6	100.3	859.3	1,075.0	0.0
Net change in cash	9.5	(4.4)	122.0	366.2	1,239.3

Allied Digital - financial summary (contd.)**Ratio analysis (%)**

	FY06	FY07	FY08E	FY09E	FY10E
EBITDA margin	19.1	21.1	22.3	23.2	25.6
EBIT margin	18.4	20.6	21.2	21.6	24.3
Net profit margin	13.5	14.6	14.4	14.3	16.6
Return on capital employed	53.8	47.0	32.7	32.6	36.2
Return on equity	78.1	54.3	34.8	33.8	39.1
Current ratio (x)	3.9	3.2	3.7	3.6	3.8

Valuation parameters

	FY06	FY07	FY08E	FY09E	FY10E
EPS (Rs)	6.9	13.2	24.7	49.5	92.0
Diluted EPS (Rs)	6.9	13.2	24.7	49.5	92.0
Book value per share (Rs)	14.5	33.9	108.3	189.1	281.1
P/E (x)	131.3	68.8	36.6	18.3	9.8
P/BV (x)	62.3	26.7	8.4	4.8	3.2
EV/EBITDA (x)	96.3	49.2	24.5	11.3	6.4
EV/Sales (x)	18.4	10.4	5.5	2.6	1.6

Source: Company, Ambit Capital Research estimates

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