BUY
CMP Rs239

Allsec Technologies

COMPANY REPORT **September 07, 2006**

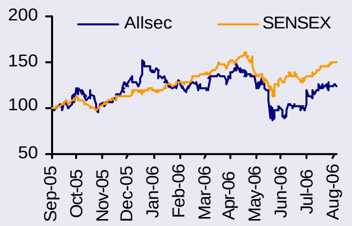
Stock Data

Target Price	Rs309
Sensex	11,961
Market Cap	Rs3.87bn
Average Volume	27,269
Face Value	Rs10
52 week H/L	Rs305/142
BSE Code	532633
NSE Code	ALLSEC
Reuters Code	ALLS.BO

Share Holding Pattern

Sept'06	(%)
Promoters	30.2
Institutions	58.3
Public	7.9
Others	3.6

Share Price Chart



Analyst
Rajiv Mehta
rajivm@indiainfoline.com
91-22-6749 1748

Head of Research
Sachin Neema
sachin.neema@indiainfoline.com
91-22-6749 1750

Strategic investment by Carlyle lends crebility, visibility and business prospects

Post successful completion of the upcoming (Oct 23rd - Nov 11th 2006) Carlyle's open offer, the group would hold 38.5% stake in Allsec, more than promoter's holding of 30.2%. We strongly believe that association with Carlyle would increase business prospects of Allsec with the group having sufficient motivation (majority stake) to help the company win business especially from its large investee companies. First Carlyle Ventures, Mauritius, (part of Carlyle Asia Growth Partners III), recently subscribed to 3.02mn equity shares and 0.16mn convertible warrants of the company at Rs260 per share/warrant, ~9% premium to market price. Further, the Carlyle Group has made an open offer to the remaining shareholders to acquire further 3.05mn shares at the same price.

Strong organic growth momentum to continue

Allsec has been one of the fastest growing BPO companies registering a revenue growth CAGR of 85.1% over the last four years. The growth momentum is expected to continue as CompuCredit, its anchor client, is growing fast in its business, opportunity for cross selling remains robust within other established relationships (especially the 2nd to 5th largest customers) and the new clients added (four in the last 15 months) are expected to start contributing materially soon. Further, with the recent 1000-seat expansion, the company has infrastructure in place to manage growth. From 2,578 people at the end of Q1 FY07, company plans to add about 800 in Q2-Q4 FY07 and 750 in H1 FY08.

Inorganic initiatives to further catalyze growth and help achieve essential scale

Allsec acquired B2K Corp, a 600-seat Bangalore based Technical Support call centre in January 2006 for about Rs120mn. B2K clocked revenues of Rs132mn and net loss of Rs46mn in FY06. The deal creates value for Allsec in terms of strengthening its Technical Support offering, providing regional diversification and inexpensive pricing (low price paid more than offsets inefficient operations). Company has already improved profitability of B2K since acquisition by improving its seat utilization. Further, from Rs810mn received from equity placement to Carlyle and warrant issue to Carlyle and promoters, the company is planning a bigger (US$15-20mn) acquisition this time.

Profitability to be sustained near the industry-best levels

Presently, company operates at best-of-the-breed margins in the BPO industry. Strong cost discipline within the company has given it a frugal cost structure. Even at current seat utilization of 1.1x (2,578 people on 2,300 seats), Allsec earns 27.7% OPM and 24.5% NPM. We believe that these levels would be more or less sustained going ahead. Any margin pressures from more than proportionate wage hikes and B2K's lower profitability would be offset by improving utilization. The company targets utilization of 1.6x by end FY07 and 1.8x by mid FY08. Utilization improvement is expected to come from growing daytime services (Quality Assurance and HR Processing) and client acquisition in non-US geographies.

Expect robust earnings CAGR of 48.3% over FY06-08

We estimate revenue CAGR of 49.1% and earnings CAGR of 48.3% on consolidated basis over the next two years. We have not factored any further inorganic growth (except B2K) due to difficulty in ascertaining the same and have rather preferred to value cash allocated towards it.

India Infoline

Recommend BUY, as the stock trades at discount to its fair value and our target price implies 30% upside

Our fair value calculations arrive at a range of Rs277-295 reflecting that the CMP trades at discount of 14-19% to stock's intrinsic value. The fair value per share range has been arrived at after assigning a FY07 EV/Sales range of 2-2.2x based on Price/Sales multiples of various M&As in the industry. Our one-year target price of Rs309, representing 30% upside, has been calculated based on our belief that stock would trade at FY08 EV/EBIDTA of 5.5x (similar to current level on FY07 numbers) one year hence. Company has a strong balance sheet with zero debt, high asset turnover and good liquidity.

Table: Financial Snapshot

Period (Rs mn)	FY04 (15)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Sales (Rs mn)	251	578	939	1515	2089
yoy % growth	-	130.5	62.6	61.3	37.9
Net Profit (Rs mn)	(170)	125	207	313	455
yoy % growth	-	(173.8)	65.3	51.2	45.6
OPM (%)	(40.6)	29.7	27.9	25.8	26.3
NPM (%)	(67.7)	21.7	22.0	20.6	21.8
EPS (Rs)	(38.6)	14.2	17.1	19.3	28.1
P/E (x)	-	16.8	14.0	12.4	8.5
EV/EBITDA (x)	(11.4)	12.5	9.7	5.5	3.6

Source: IIL Research

India Infoline

Investment Rationale

➢ Strategic investment by Carlyle… opens up huge opportunity

Preferential allotment at 9% premium to market price

Preferential allotment to Carlyle and promoters at premium to current market price

The company just placed 3.02mn equity shares to First Carlyle Ventures, Mauritius, (part of Carlyle Asia Growth Partners III) and 0.96mn convertible warrants comprising 0.8mn to promoters and 0.16mn to Carlyle at Rs260. The issue price is at about 9% premium to the current market price. Each warrant is convertible into one equity share at the above mentioned price within the first 18 months of the date of allotment. The proceeds from the issue were Rs810mn, comprising Rs785mn from equity placement and Rs25mn from warrants placement (being 10% of conversion price payable on issue). Post this, promoters and Carlyle Group holding stands at 30.2% and 19.7% respectively assuming full conversion of warrants. The change in shareholding pattern is highlighted below.

	Before the proposed offer	After the proposed issue of equity shares	After the proposed issue of equity shares & warrants*
Promoters (%)	33.5	28.9	30.2
FIIs (%)	17.0	13.6	12.8
MFs (%)	14.0	11.2	10.6
VC Funds (%)	20.3	36.1	34.9
Individuals (%)	10.5	8.4	7.9
Private Corporate Bodies (%)	3.0	2.4	2.3
NRI/Others (%)	1.7	1.3	1.3
O/S equity shares (mn nos)	12.2	15.2	16.2

Source: Company

** assuming full conversion of warrants*

Additional open offer for 20% voting rights

Carlyle open offer to increase stake further

As per the SEBI regulations, the Carlyle Group has announced an open offer to the remaining shareholders to acquire further 3.05mn shares of the company representing 20% of the voting rights at Rs260/share. Post the successful completion of this offer, the Carlyle stake would increase to 38.5% (more than promoter holding) on fully diluted equity of Rs162mn.

Strategic stake to motivate Carlyle to enhance business flow to company

Association with Carlyle increases business prospects of the company

We feel that Carlyle deal would be strategically very beneficial for Allsec. Our belief is based on following reasons:

√ Carlyle Group has more than 500 corporate and real estate investments globally with approx US$41.9bn worth of assets under management.

√ This deal has opened doors for Allsec to pitch and tap Carlyle’s investee companies for outsourcing services by referencing him.

√ Even a single or couple of accounts conversion would mean huge business for Allsec on current scale.

√ Though there is no apparent arrangement as such, we feel that Carlyle would be sufficiently motivated to do it in order to maximize ROI on its Allsec investment.

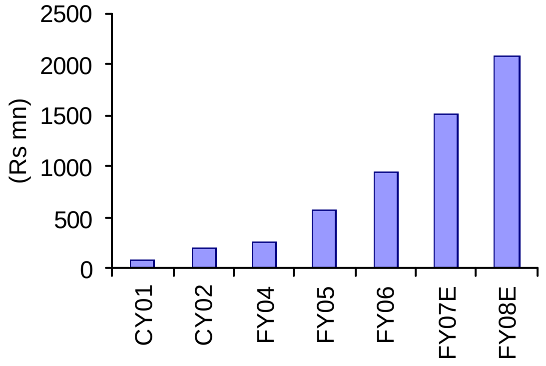
√ Association of Carlyle Group lends credibility and visibility to the company, which would help in securing fresh business from other large global companies as well.

Further, we feel that strategic investment by Carlyle also reflects long-term sustainability of company’s business model

India Infoline

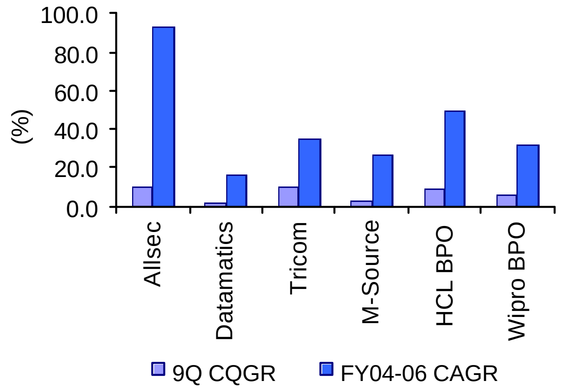
➢ Organic revenue growth has been strong… momentum to continue

Chart: Revenue Growth



Source: IIL Research

Chart: Revenue Growth Comparison



Source: IIL Research

One of the fastest growing BPO companies with 85% revenue CAGR over CY02-FY06

Allsec has been one of the fastest growing BPO companies registering a revenue growth CAGR of 85.1% over the last four years. In line with any BPO or IT company, it has grown with an anchor client strategy. The anchor client is CompuCredit, a US based Tier II credit card services company. This key account has grown from Rs71mn in CY02 to Rs376mn in FY06 representing a CAGR of 74.3%. In FY06, it contributed 40% of revenues and is 800+ people engagement today. Starting with just customer acquisition five years back, company currently provides the entire Customer Lifecycle Management (CLM) services suite to CompuCredit. However, since last 1-1.5 years, company has been focusing on growing other accounts faster and adding new clients to de-risk its business model. These efforts have paid with the next four (2nd to 5th largest clients) currently contributing 40% cumulatively (each similar in size) to revenues and client base increasing from 16 at end FY05 to 20 today. We believe that Allsec should be able to maintain its organic growth momentum in the coming years but expect some moderation in growth rate due to high base effect. Our confidence in continuation of growth momentum comes from following

Expect growth momentum to continue but growth rate to moderate

CompuCredit has displayed strong growth in its business

√ CompuCredit continues to do well in its business. Over the last four years, its revenues have grown by 64.6% while earnings have grown more than proportionally. Its share price has risen from just below US$5 to near US$27 currently. So, business traction from CompuCredit is anticipated to remain strong. Also, it holds strategic 5.7% stake in the company on the current equity.

Huge potential exists for mining other clients

√ The growth potential amongst other existing clients remains strong with sufficient room for client mining. Presently, almost all of these clients are being either served just one part (tele sales, customer service, lead generation, collections, market research, etc) of the CLM suite or are being offered just one of the main offerings (like CLM suite, Tech Support, QA or HR services) of the company. So, the opportunity for cross selling remains robust. We expect strong ramp-up in non-CompuCredit large clients (2nd to 5th largest), which are just 150-200 people engagement at present.

Pace of new client additions has been good

√ Lastly, company has been adding new clients at a healthy pace with its strong 6-8 people experienced sales team. Over the last 15 months, it has added 4 new clients. Considering that sales cycle for the company is long (typically 8-9 months), material contribution from these new accounts is expected in the coming years.

India Infoline

Infrastructure is in place to manage growth

√ Further, Allsec has its infrastructure in place to manage growth after recently adding 1000-seat new facility next to old facility in Chennai. From the Q1 FY07 seat utilization of 1.1x (2,578 people on 2,300 seats), company is targeting to achieve 1.6x by fiscal end and 1.8x by mid FY08. The targeted utilization levels imply strong manpower additions of 822 in Q2-Q4 FY07 and 740 in H1 FY08. The above hiring plans also indicate robust revenue visibility.

➢ Inorganic initiatives to accentuate growth... and help achieve critical mass

B2K acquisition... a good deal for the company

The acquisition fits Allsec well

√ B2K, a 600-seat Bangalore based Technical Support call centre was acquired by the company in January 2006.
√ The acquisition strengthens Allsec's Tech Support services offering, which was running on small scale before this.
√ Provides geographic diversification, as company's all other facilities are located in Chennai.
√ Being in another city, this facility acts as a disaster recovery and business continuity centre, which holds significance both for clients and the company.
√ Acquisition price of ~Rs120mn appears inexpensive for a 600-seat ready-to-use facility

Low price paid on cost/seat basis

Capex Details	I	II	III (B2K)
Seats added	500	1,000	600
Cost of expansion (Rs mn)	161	380	120
Capex/Seat (Rs)	322,000	380,000	**200,000**
Completion date	August'02	Dec'05	Jan'05
Seats post expansion	675	17,00	2,300

**I & II are organic expansions done by the company*

√ Company paid little less than 1x FY06 sales of B2K. B2K recorded revenues of Rs132mn and net loss of Rs46mn in FY06. Lower price paid on account of negative profitability of B2K.

Improvement in B2K profitability on track

√ Efforts towards turning around B2K are on track with seat utilization being improved 100% from 0.25x (150 people) at the time of purchase to 0.5x (300 people) today. Company is confident of reaching B2K breakeven in full year FY07 and recouping its investments over the next 3 years. Based on the strong cost discipline of the company and availability of adequate room for improving utilization, we believe that Allsec could very well achieve its targets.
√ Full acquisition was just completed in June 2006 and the financials would be merged for full year in FY07 as against just two months in FY06.

Another acquisition in the offering but this time its big

Amount allocated between US$15-20mn for the next acquisition

From the money received (Rs810mn) from equity placement to Carlyle and warrant issue to Carlyle and promoters, the company is looking at various inorganic growth opportunities. This time Allsec is targeting a bigger company with an amount allocated between US$15-20mn for this acquisition. The actual size (revenues) of the target company would however depend on its profitability level. Allsec has already identified few companies and is in the process of evaluation. Company is interested in target companies that provides domain knowledge, has a mix of voice and non-voice service offerings and provides opportunity for enhancing the overall utilization of the company (a different geography from US such as Australia, UK, etc which represents migration opportunities). Within India, company is eying north, may be Noida or Gurgaon.

Scale driving company's inorganic initiatives

Scale has become need of the day in the industry

The rationale behind company's aggression with respect to inorganic growth is to achieve critical scale quickly. We believe that this strategy, though fraught with risk, would become inevitable for all small and mid-sized BPO players in some time. We have already seen some consolidation happening amongst large and medium sized players in the industry. Some of the competitors of Allsec like WNS, Transworks, ICICI OneSource, M-Source are 4-7x its size. Organic growth alone would not be sufficient to bridge gap with these players. We believe, that with size would come scale benefits, credibility, visibility (higher than normal due to high profitability level of the company) and valuation.

Since the actual size (revenues & seat capacity), profitability, timing of the acquisition is difficult to ascertain, we have not factored it into our projections and rather prefer to value the cash allocated.

- **Operates at best-of-the-breed margins… has levers in place to fight pressures**

Chart: Margin Comparison FY06

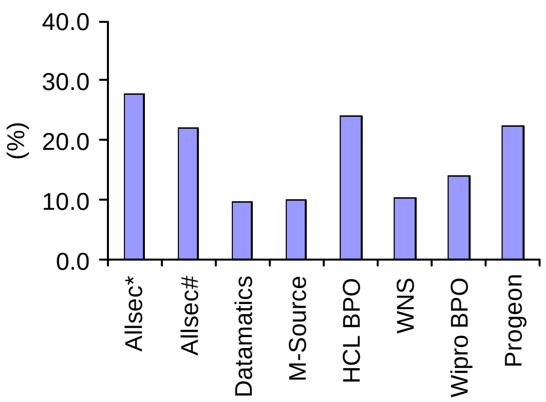
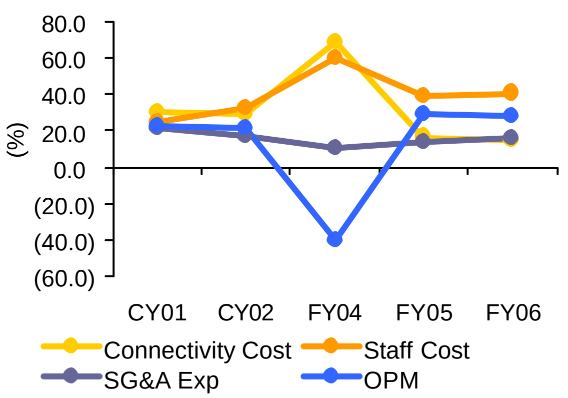


Chart: Margin Analysis



Allsec-OPM, Allsec#-NPM, Datamatics-OPM, M-Source-NPM, HCL BPO-OPM, WNS-OPM, Wipro BPO-PBIT and Progeon-NPM*

Source: IIL Research

Source: IIL Research

Frugal operating structure derived from management's cost focus

Reasons behind relatively low cost structure of the company

√ Company operates out of relatively low cost location, Chennai. Majority of the other BPOs are based in relatively expensive locations of Mumbai, Bangalore, Gurgaon, etc. So, comparatively company ends up paying lower lease rentals (just ~3% of revenues in FY06) on properties.

√ Allsec does not follow "feets on the streets" approach for business development. It rather has a dedicated small, senior in experience, domain focused sales team that has the capability of working deeper with clients. Though these people are expensive, they generally start contributing to topline in between 9-15 months of joining. Further, they have the potential to bring big business. Existing sales team comprises of 6-8 people including senior management.

√ Company faces lower attrition (30% in FY06) as compared to the industry especially in the voice segment.

√ Better general & administrative cost management, as company believes in making very functional rather than jazzy investments.

√ Strong cost discipline within the company. Management very focused on cost and profitability.

India Infoline

Any exceptional wage hike remains a threat but appears unlikely

Selling & Marketing cost to remain under check

B2K integration to pressurize profitability in FY07 and FY08

Sufficient headroom for utilization improvement

Non-voice revenue share to increase with company's focus on QA and HR services

Potential pressure on margin from wage inflation and B2K integration

In the current organic cost structure, we believe that any real threat to the operating margin could come only from any exceptional wage hikes in the next two years. This is also provided if attrition goes out of control from the current level of 30%. Over the last two years, company has managed regular salary increases pretty well. As far as selling & marketing cost is concerned, any exceptional increase may not be required in the coming years despite company's thrust towards adding new clients and increasing regional reach. Company has been following a very cost-efficient client acquisition strategy by employing small but highly experienced sales team. This 6-8 people sales team in purely engaged in client acquisitions (does not allocate time in follow-up formalities) and has been able to bring clients regularly. Company does expect any additions in the sales team in the coming years. Further, the association with Sales Force and Carlyle should enable company to win large clients without incurring any major selling & marketing cost. Company has already won its first client through Sales Force in Q1 FY07.

B2K, the 600-seat facility just acquired by the company has negative profitability (34% at net level in FY06) due to lower seat utilization (high manpower and general & administration costs in proportion to sales). Its financials would be consolidated for full year in FY07 as against just for two months in FY06. B2K is expected to breakeven in the current year and further improve on its profitability in FY08 with increasing utilization. However, the relatively lower profitability of this acquisition (as compared to Allsec stand-alone) in FY07 and FY08 is anticipated to exert downward pressure on integrated company's margin.

Room for utilization improvement to act as solid defense

We expect improving seat utilization (no of employees/seat capacity) to offset any margin pressures emanating from more than expected wage hikes and lower profitability of B2K. Company has been working on a twin strategy for improving utilization

√ From negligible revenue contribution of non-voice services in 2002, company has brought it today to 19%. Company's focus on non-voice has been tactical, to use it as a filler in daytime to improve asset turnover and utilization. It has to just incur marginal cost in providing these services. The non-voice offerings, Quality Assurance (Call Quality Monitoring) and HR processing, have been receiving good traction. Company targets 25% non-voice revenue share by the end of this fiscal.

- The Quality Assurance practice today employees more than 300 people with a large Fortune 500 PC manufacturer as the anchor account (~85-90% of QA team deployed for him). Recently, company entered into a partnership with Sales Force, an Australia based call centre, to provide these services to its clients in Australia and New Zealand. The tenure of the partnership is three years and company expects its QA team to ramp up to 1,200 people over the next two years as a result of this.

- For HR services (payroll processing and tax management), company has a team of 25-30 people and provides services to MNCs in India (Accenture, Tesco, etc) and domestic companies like Kotak Bank. Company has plans to expand this practice by targeting domestic clients.

India Infoline

Concious efforts towards tapping non-US geographies underway

√ Voice based services like CLM and Tech Support are provided by the company mainly during nighttime due to US client concentration. In the last one year, company has intensified efforts towards tapping new geographies with different to opposite time zones to US like Europe and Australia in order to provide these services during daytime and thereby improve utilization. In the last 6-8 months, company has created presence (through third parties) in these geographies. As an initial breakthrough, company added one client from Australia in Q1 FY07 through its association with Sales Force.

From current 1.1x, company targets utilization of 1.6x by FY07 end and 1.8x by mid FY08

Before the recent 1000-seat capacity expansion, company was operating at a seat utilization level of 1.8x. Company intends to reach a utilization level of 1.6x on the combined (including B2K) seat capacity of 2,300 by the end of the year. Further, it targets to take it to 1.8x by mid FY08. The company has already improved B2K's seat utilization significantly. We believe that company would generate enough business to reach the above targets and thereby fight margin pressures smartly.

➢ Healthy balance sheet… Debt free, high asset turnover & good liquidity

Particulars	FY05	FY06	FY07P	FY08P
Net Worth (Rs mn)	190	699	1985	2311
Loan Funds (Rs mn)	72	2	0	0
D/E (x)	0.4	0	0	0
Net Fixed Assets (Rs mn)	138	389	354	454
NFATR (x)	4.2	2.4	4.3	4.6
Net Work Cap (Rs mn)	83	288	422	448
NWC/Sales (%)	14.4	30.6	27.9	21.4
NWC/Cap Emp (%)	31.8	38.4	20.7	19.0
Debtor Days	60	80	61	55
WC Cycle (days)	20	40	24	20
ROE (%)	66.1	29.6	15.8	19.7
NPM (%)	21.7	22.0	20.6	21.8
TATR (S/CE) (x)	2.2	1.3	0.7	0.9
Equity Multiplier (x)	1.4	1.1	1.0	1.0
ROCE (%)	49.4	27.7	16.0	20.1

Source: IIL Research

Zero debt, high asset turnover and high liquidity imparts strength to balance sheet

√ Company became debt free in FY06 by repaying debt from the IPO proceeds

√ Asset turnover in FY06 impacted by more than doubling of seat capacity (from 700 to 1,700) in December 2005. To improve in FY07 and FY08 with significant increase in utilization of new seats.

√ Liquidity presently healthy and expected to improve further with decline in debtor days and strong internal cash accruals.

√ Current cash & liquid investments (C&CE) near Rs950mn. We have not factored acquisition due to difficulty in ascertaining the same and rather assumed that money remains invested in liquid funds. We expect company to end FY07 and FY08 with C&CE of Rs1,450 (71% of capital employed) and Rs1,630 (69% of capital employed)

√ Based on our above assumption, ROE and ROCE for FY07 and FY08 would appear lower despite fast asset turnover and sustained net margins.

India Infoline

➢ **Current valuation does not fully factor potential upside… recommend BUY**

I) Relative valuation

Peroid (Rsmn/US$mn)	FY06 Allsec	FY06 Datamatics	FY06 Tricom	FY06 WNS	FY07E Allsec	FY07E Datamatics	FY07E Tricom	FY07E WNS
M-Cap	2,887	2,152	820	951	3,869	2,152	820	1,027
Debt	2	0	37	0	0	0	37	0
C&CE	196	1,042	13	18.5	1,450	1,042	13	18.5
EV	2,693	1,110	845	932	2,419	1,110	845	1,008
EBIDTA	276	136	48	20.7	441	108	145	21.9
EV/EBITDA	9.7	8.2	17.7	45.0	**5.5**	10.3	5.8	46.0
Revenues	939	1,392	145	203	1,515	1,456	328	212
EV/Sales	2.9	0.8	5.8	4.6	**1.6**	0.8	2.6	4.8

** WNS is listed on NYSE and therefore its figures are in US$*
** Debt and C&CE have been assumed at FY06 levels in FY07 for other players*
** FY07 sales and EBITDA are annualized figures of Q1 FY07 for other players*

Period	CMP (Rs/US$)	FY06 EPS (Rs/US$)	FY06 P/E (x)	FY06 EV/EBIDTA (x)	FY06 EV/Sales (x)	FY07E EPS (Rs/US$)	FY07E P/E (x)	FY07E EV/EBIDTA (x)	FY07E EV/Sales (x)
Allsec	239	17.1	14.0	9.7	2.9	19.3	12.4	5.5	1.6
Datamatics	53	4.7	11.2	8.2	0.8	2.6	20.4	10.3	0.8
Tricom	181	9.4	19.3	17.7	5.8	22.0	8.2	5.8	2.6
WNS	27	0.5	51.9	45.0	4.6	0.5	51.9	46.0	4.8

** FY07 EPS for other players is an annualized figure of Q1 FY07*

II) Company valuation from recent M&As

Acquirer	Acquiree	Deal Size	Date	P/S multiple
Wipro	Spectramind	Rs4.7bn	2002	2.5x
IBM	Daksh	Rs7bn/US$150mn	May-04	2.5x
ICICI Onesource	ASG	US$40mn	Oct-04	1.6x
Oak Hill/GA Partners	GECIS	US$500mn	Nov/Dec-04	~2.1x
EXL	Inductis	US$20-40mn	Jul-06	1-2x
Perot Systems	eServ	US$28mn	Aug-06	1.1x
Average P/S multiple	-	-		~1.9x

Source: IIL Research & Industry

Huge cash and high profitability calls for non-P/E valuation of the company

We choose to value the company using EV/EBIDTA and EV/Sales multiples based on following rationale

√ To account huge cash in the books - Company has lot of C&CE currently and is expected to end FY07 and FY08 with even higher balances in absence of any acquisitions (which is what we have assumed)

√ To factor one-of-the-best operating efficiency – Allsec profitability is much higher than even some of the bigger players in the game.

We believe that Allsec should be valued slightly higher than the average P/S multiple of 1.9x for various M&As in the past. We assign a FY07 EV/Sales multiple range of 2-2.2x after considering following prime factors to arrive at our fair value per share (FVPS) range for the company.

2-2.2x FY07 EV/Sales range gives us a FVPS range of Rs277-295

√ Size of the company ie expected US$33mn in FY07
√ High profitability of the company
√ Carlyle's presence
√ On the flipside, voice-based nature

Our target price of Rs309 implies 30% upside

By calculating backwards based on the assigned FY07 EV/Sales range, we arrive at a FVPS range of Rs277-295 implying that stock trades at discount of 14-19% to its intrinsic value. We arrive at a one-year target price of Rs309, representing 30% upside, after assuming that stock would trade at FY08 EV/EBIDTA of 5.5x (similar to current level on FY07 numbers) one year hence.

Concerns

BOT arrangement for 500 people with CompuCredit

Excercise of option unlikely by CompuCredit

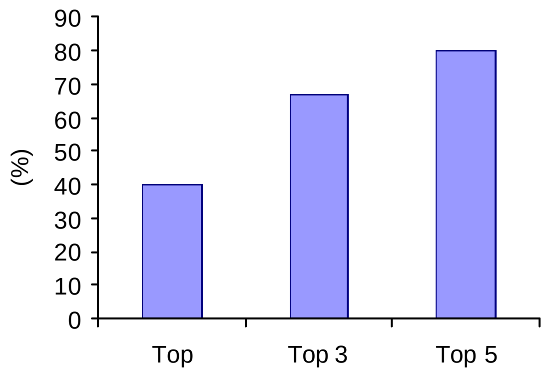
➢ Risk of potential erosion of revenues and earnings from BOT arrangement with CompuCredit

Allsec had entered into a revised Master Services Agreement (MSA) with CompuCredit on January 3, 2005, which contains a Build-Operate-Transfer (BOT) arrangement. As per the arrangement, CompuCredit is entitled to purchase a dedicated 500-seat facility (including transfer of employees) located at Velachery, Chennai on or after March 31, 2009 but before March 31, 2011. If the transfer option is exercised, company could suffer material loss of revenues and earnings. However, we feel that CompuCredit's exercise of option is less likely due to following reasons

- √ Presently, company operates more than 800 seats for CompuCredit and by 2009 it is expected to attain big size based on the current pace of growth (CY02-FY06 CAGR of 74.3%). So, at that time it may not make sense for CompuCredit to purchase part of the seats (the MSA is only for 500 seats).
- √ By 2009, the relationship will be 8-year old and would have become very sticky by that time.
- √ Company is trying to grow other accounts relatively faster in order to reduce dependence on CompuCredit.
- √ CompuCredit owns strategic ~5.7% stake in the company based on the current equity.

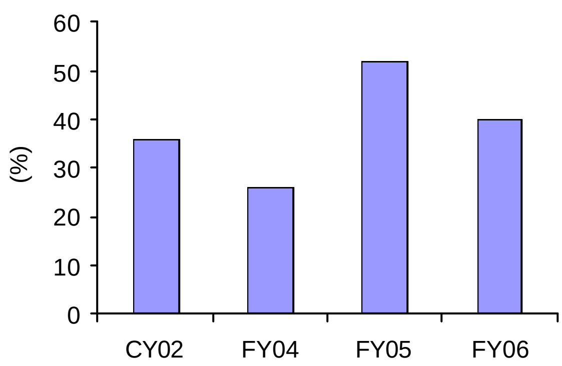
➢ High dependence on the Top client, CompuCredit

Chart: Client Concentration FY06



Source: Company

Chart: CompuCredit Concentration



Source: Company

CompuCredit contributes 40% to revenues but dependence on it has declined in FY06

Company is highly dependent on its anchor client CompuCredit, which contributed 40% of its revenues in FY06. The high dependence attaches company's fate significantly to CompuCredit's business. In the 15-month period FY04, company suffered huge loses as CompuCredit faced problems in its business. So, any significant reduction in the volume of work from CompuCredit could adversely affect company's revenues and profitability. Apart from CompuCredit, the dependence is not too high on any other single customer as the next four large clients contribute almost equally to revenues. On the positive side, the company has been able to reduce dependence on CompuCredit in FY06 by growing other clients faster and adding new clients.

However, it has to be remembered that high client concentration (but not as high as Allsec currently) is an accepted practice in this industry. A strategic commitment from at least one anchor client is imperative for growth and cost-effective operations.

Integration of the next big acquisition could be fraught with difficulties

➢ Risks attached to inorganic growth plans

Company recently acquired B2K Corp that is loss making and is prospecting acquisition of a big company with US$15-20mn allocated for it. The above strategy exposes company to risks related to successfully turning around B2K and right identification and successful integration of the new acquisition.

India Infoline

Background

Allsec commenced commercial operations in January 2001 with an initial capacity of 100 seats. Since then, it has experienced rapid growth and has significantly expanded operations to 2,300 seats and about 2,500 people today. The company provides both voice and non-voice based BPO services out of its delivery centers in Chennai & Bangalore (added through acquisition of B2K).

Service offerings of the company

➢ **Voice services (81% of revenues)**

√ **Customer Lifecycle Management (CLM/CRM)**

- Inbound services – Inbound voice-based offerings comprise customer care, support and retention.
- Outbound services – Outbound voice-based offerings comprise tele-sales, collections management, lead generation and market research

√ **Tech support services –** *Inbound technical support/helpdesk services*

➢ **Non-Voice services (19% of revenues)**

√ **Third party call quality assurance** - A unique offering that highlights quality practices at Allsec. Also called as call quality monitoring (CQM) services. In this company monitors inbound and outbound calls made by other call centres (captive or third party) and assesses them on several parameters including call handling skills, soft skills, diagnostic and resolution skills and provides performance reports and feedback.

√ **HR Processing** – Assisting clients and his employees by payroll processing, claims & benefits administration, income tax configuration, etc.

Presently, company's main vertical focus is BFSI, which currently contributes more than 70% of revenues.

Key clients and services offered to them by Allsec

A second tier credit card services company in US (CompuCredit) – Starting just with customer acquisition about 5 years back, Allsec today provides complete customer lifecycle management suite encompassing customer acquisition, support, retention, collections and recovery to this anchor client, which currently contributes about 40% of revenues and holds 5.7% strategic stake in the company.

A US based ISP providing dial-up internet service – Allsec's services to this company include provision of in-bound helpdesks to customers in the areas of signup for the internet service, troubleshooting technical issues, billing, cancellation and customer query handling through e-mail.

A Fortune 500 PC manufacturer based in US – Allsec provides third party call quality monitoring services to this company. Allsec evaluates quality and provides feedback on client's in-house technical helpdesk, customer support, tele-sales, leasing & financing and collections divisions.

India Infoline

Presently has 19 clients with 3 added in FY06

Arrangement with Sales Force for acquiring customers for QA services

A large automobile manufacturer in US – Allsec is offering helpdesk services to this company's customers and email support to its suppliers.

Other big clients of the company include a student loan consolidator and a leading mortgage & debt consolidation lender. Allsec currently has in all 19 clients with 3 added in FY06. Almost all of them are based in US. Company shares 3-year contracts with majority of the clients, which are reviewed every year. Yearly review is done with respect to performance, financial health, billing rates/pricing, etc. The average sales cycle is about 8 months and it takes more 2-3 months before a new client starts contributing to revenues. Presently, Allsec has 800+ people deployed for CompuCredit and about 150-200 people each for some of the other key relationships.

Unique partnership with Sales Force, an Australia based call centre - In February, Allsec signed a deal with Sales Force to provide its call quality management (CQM) services as a product rather than as a service. Through this partnership, Sales Force would offer this services to its clients and other call centres (captive & third party) in Australia and New Zealand. The tenure of the agreement is three years. Allsec expects its CQM team to ramp up to 1,200 people from current 300 people over the next two years as a result of this deal. Under this arrangement, company has already added one client in Q1 FY07.

Management Team & Board of Directors

Name	Designation
Mr A Saravanan	President
Mr R Jagadish	CEO
Dr Bala Balachandran	Chairman
Mr Anantha Narayanan	Director
Mr A Sankarakrishnan	Director
Mr Vinod Ganjoor	Director
Mr Dilipkumar Patel	Director
Mr Balaji	CFO
Mr Vaithiyanathan	VP-Operations
Mr B Sathiya Seelan	VP-HR
Mr Arun Sowdas	GM-Technology

Mr A Saravanan, President, has done his B.Sc in Physics and is a qualified Chartered Accountant. In addition to being the President, he is also a Director of Allsectech Inc, company wholly owned subsidiary. As President and Whole Time Director, he is responsible for business development, strategy and finance and also directly oversees marketing initiatives across all geographies.

Prior to setting up the Allsec group of companies with Mr. Jagadish, he worked for Ashok Leyland Finance Limited as a Finance Executive, Overseas Sanmar Finance Limited as a Senior Officer Marketing and Pioneer Leasing Limited as Vice President. In all, he has over 17 years of experience in finance and management across different industry segments. Presently, He holds 17.1% in the company.

Mr R Jagadish, Chief Executive Officer, has completed his B.Sc in Physics and is a qualified Chartered Accountant from India and a Management Accountant from the Chartered Institute of Management Accountants, London. In addition to being the CEO, he is also a Director of Allsectech Inc, company's wholly owned subsidiary. As our Chief Executive Officer and Whole Time Director, he is responsible for all day-to-day operations, human resources, delivery and client servicing initiatives.

India Infoline

Prior to setting up the Allsec group of companies with Mr. Saravanan, he worked for Ashok Leyland for 4 years in various departments including management information systems, budgets and planning & treasury. Mr Jagadish has over 17 years of experience in enterprise creation and corporate management. Presently, He holds 17.1% in the company.

Dr Bala Balachandran, Chairman, Mr Bala is an eminent economist and distinguished professor of accounting, information system & decision sciences and director of the Accounting Research Centre at J. L. Kellogg Graduate School of Management (Kellogg), North-Western University, Evanston, Illinois. He has held several key positions in Kellogg over the last few decades. He advises several global corporations including Bank of Montreal, Motorola and Harris Bank. He is also a consultant for the US Air Force, Federal Aviation Administration and Pennsylvania Blue Shield. He has over 40 years of experience in accounting and expertise in management. Amongst Indian companies, he holds directorship with Godrej Consumer Products Ltd and CRISIL. As a Chairman of Allsec, he advises company on strategies and corporate governance.

Details about the IPO of the company

Allsec became the first of pure play third-party BPO companies to be listed on the bourses after 5 years of operations in May 2005.

Issue details

No of shares offered (in mn)	3.14
% to post issue capital	26.3%
Issue Price (Rs)	135
Issue Size (Rs mn)	424
Date of issue	13-Apr-05
Date of listing	9-May-05
Listing Price (Rs)	

Objects of the issue

Purpose	Rs mn
Setting up a new 1000-seat facility	280
Repayment of loan	100
Working capital	80

Share issues before IPO

Date	No of Shares	Issue Price (Rs)	Name of the Party
20-Mar-02	100,000	10	Mr Saravanan & Mr Jagdish
3-Oct-00	3,400,000	10	Mr Saravanan & Mr Jagdish
3-Oct-00	550,000	10	IDBI & Mr Balachandran
20-Sep-01	250,000	10	IDBI
24-Apr-02	27,500	30	Euronet & KMVCF
4-Jun-02	27,500	30	Euronet & KMVCF
14-Jan-05	2,117,317	39.6	Euronet
14-Jan-05	1,668,092	29.6	KMVCF
31-Jan-05	684,362	51.7	CompuCredit

**The shareholding of KMVCF has declined to about 420,000 shares today*

India Infoline

Quarterly Financials

Period (Rs mn)	Q1 FY05	Q2 FY05	Q3 FY05	Q4 FY05	Q1 FY06	Q2 FY06	Q3 FY06	Q4 FY06	Q1 FY07
Sales	124	152	139	161	183	240	241	259	277
% qoq growth	-	22.3	(8.3)	15.9	13.7	30.9	0.5	7.7	6.6
Expenditure	(89)	(107)	(103)	(117)	(131)	(170)	(169)	(186)	(200)
Operating profit	35	45	36	44	53	70	72	74	77
% qoq growth	-	28.2	(20.9)	22.8	20.1	33.3	2.7	2.2	4.1
OPM (%)	28.3	29.7	25.6	27.1	28.7	29.2	29.9	28.3	27.7
Other income	1	(1)	0	0	0	1	1	9	11
Interest	(4)	(4)	(3)	(3)	(2)	(2)	(1)	(0)	(0)
Depreciation	(10)	(10)	(11)	(10)	(10)	(18)	(16)	(17)	(20)
PBT	23	30	21	31	41	51	56	65	67
Tax	0	0	8	6	(1)	7	(1)	(1)	1
ETR (%)	-	-	(38.5)	(18.9)	1.6	(14.4)	1.2	2.0	(1.2)
PAT	23	30	29	37	40	58	56	63	68
% qoq growth	-	33.7	(3.1)	26.3	8.5	45.4	(4.7)	13.9	7.2
NPM (%)	18.2	19.9	21.1	23.0	21.9	24.3	23.1	24.4	24.5
Equity	43.5	43.5	43.5	88.2	119.6	120.6	120.6	120.8	120.8
EPS (Rs) Annualized	20.8	27.8	26.9	16.8	13.4	19.3	18.4	21.0	22.5
Cost Components									
(as a % to sales)									
Connectivity cost	20.7	18.6	15.8	12.5	13.4	14.4	15.9	17.5	13.4
Staff cost	35.2	34.5	39.2	42.7	42.6	40.4	38.1	35.0	41.6
Other exp	15.7	17.2	19.4	17.6	15.4	16.1	16.1	19.2	17.4
Total Expenditure	71.7	70.3	74.4	72.9	71.3	70.8	70.1	71.7	72.3

India Infoline

Financials

Projected Income Statement

Period (Rs mn)	FY04 (15)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Net sales	251	578	939	1,515	2,089
Operating expenses	(352)	(406)	(677)	(1,124)	(1,539)
Operating profit	(102)	172	262	391	549
Other income	0	0	15	50	65
PBIDT	(102)	172	276	441	614
Interest	(15)	(14)	(5)	0	0
Depreciation	(49)	(41)	(68)	(115)	(140)
Deferred revenue expenses w/off	(7)	(1)	(0)	0	0
Profit before tax (PBT)	(173)	115	203	326	474
Tax	3	10	4	(13)	(19)
Profit after tax (PAT)	(170)	125	207	313	455

Projected Balance Sheet

Period (Rs mn)	FY04 (15)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Sources					
Equity Share Capital	177	88	121	162	162
Preference Share Capital	0	0	49	49	49
Share Premium	0	124	461	1,486	1,486
Other reserves	(152)	(23)	117	337	663
Net Worth	25	190	699	1,985	2,311
Loan Funds	115	72	2	0	0
Total	140	262	749	2,034	2,360
Uses					
Gross Block	238	257	599	679	919
Accd Depreciation	(78)	(119)	(209)	(324)	(464)
Net Block	159	138	389	354	454
Capital WIP	0	16	2	0	0
Total Fixed Assets	159	154	391	354	454
Goodwill	0	0	48	48	48
Investments	0	0	0	1,200	1,400
Total Current Assets	79	151	466	672	783
Total Current Liabilities	(104)	(68)	(178)	(250)	(335)
Net Working Capital	(25)	83	288	422	448
Miscellaneous expenditure	2	10	0	0	0
Def Tax assets	3	15	22	10	10
Total	140	261	749	2,034	2,360

India Infoline

Projected Cash Flow

Period (Rs mn)	FY04 (15)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Pre Tax income from operations	(173)	115	188	276	409
Depreciation	49	41	68	115	140
Expenses (deferred)/written off	(2)	(8)	9	0	0
Deferred Tax Asset/liability	(3)	(11)	(8)	12	0
Pre tax cash from operations	(128)	137	258	403	549
Other income/prior period ad	0	0	15	50	65
Net cash before tax	(128)	137	273	453	614
Tax	3	10	4	(13)	(19)
Cash profits	(125)	147	277	440	595
(Inc)/Dec in trade working capital					
-Sundry debtors	(55)	(41)	(110)	(50)	(60)
-Sundry creditors	104	(39)	39	52	45
-Others	0	3	71	21	40
Net trade working capital	49	(77)	(0)	23	25
Operating activities	(76)	70	277	463	620
(Add)/Dec in fixed assets	(209)	(36)	(305)	(78)	(240)
(Add)/Dec in Goodwill	0	0	(48)	0	0
(Add)/Dec in Investments	0	0	0	(1,200)	(200)
(Inc)/Dec in Loans/advances	(19)	(8)	(37)	(104)	(71)
Investing activities	(228)	(44)	(390)	(1,382)	(511)
Inc/(Dec) in debt	115	(43)	(71)	(2)	0
Inc/(Dec) in equity/premium	177	35	419	1,066	(0)
Direct add/(red) to reserves-Spl.item	18	16	1	0	0
Dividends	0	(12)	(69)	(92)	(129)
Financing activities	309	(3)	281	972	(129)
Cash generated/(utilized)	5	23	168	54	(20)
Cash at start of the year	0	5	28	196	250
Cash at end of the year	5	28	196	250	230

India Infoline

Key Ratios

Period	FY04 (15)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Per share ratios					
EPS (Rs)	(38.6)	14.2	17.1	19.3	28.1
Div per share (Rs)	0.0	1.2	5.0	5.0	7.0
Book value per share (Rs)	5.6	21.5	57.9	122.6	142.8
Valuation ratios					
P/E (x)	(6.2)	16.8	14.0	12.4	8.5
P/BV (x)	42.4	11.1	4.1	1.9	1.7
M Cap/Sales (x)	4.2	3.6	3.1	2.6	1.9
EV/Sales (x)	4.6	3.7	2.9	1.6	1.1
EV/EBIDTA (x)	(11.4)	12.5	9.7	5.5	3.6
Profitability ratios					
OPM (%)	(40.6)	29.7	27.9	25.8	26.3
PAT (%)	(67.7)	21.7	22.0	20.6	21.8
ROCE (%)	(113.0)	49.4	27.7	16.0	20.1
RONW (%)	(684.2)	66.1	29.6	15.8	19.7
Income Generation ratios					
NFATR (x)	1.6	4.2	2.4	4.3	4.6
TATR-S/CE (x)	1.8	2.2	1.3	0.7	0.9
ETR (x)	10.1	3.0	1.3	0.8	0.9
ROE De-composition					
NPM (%)	(67.7)	21.7	22.0	20.6	21.8
TATR-S/CE (x)	1.8	2.2	1.3	0.7	0.9
Equity Multiplier (x)	5.6	1.4	1.1	1.0	1.0
Du-Pont ROE (%)	(684.2)	66.1	29.6	15.8	19.7
Component ratios					
Connectivity & other costs (%)	69.2	16.7	15.5	11.5	10.9
Staff costs (%)	60.5	39.6	40.9	43.7	46.2
Selling & Admin expense (%)	10.9	14.1	15.7	19.0	16.6
Liquidity ratios					
Current ratio (x)	0.8	2.2	2.6	2.7	2.3
Debtors days	80	60	80	61	55
Creditors days	151	41	40	37	35
WC cycle (days)	(71)	20	40	24	20
Net WC/Sales (%)	(9.9)	14.4	30.6	27.9	21.4
Net WC/TCE (%)	(17.8)	31.8	38.4	20.7	19.0
Leverage ratios					
Debt / Total equity (x)	4.6	0.4	0.0	0.0	0.0
Debt service ratios					
Interest/Sales (%)	6.0	2.4	0.5	-	-
ICR (x)	(10.1)	9.4	40.8	-	-
Payout ratios					
Dividend payout (%)	0.0	8.3	29.2	25.9	24.9
Tax payout (%)	1.8	(8.5)	(2.1)	4.0	4.0

India Infoline

Appendix

About CompuCredit – Anchor client of the company

CompuCredit is a US based sub-prime provider and direct marketer of branded credit cards. Company also offers fee-based products and services, including credit life insurance, card registration, telecommunications products, memberships in preferred buying clubs, travel services and debt waiver programs in the event of disability or unemployment of the client.

Financial Performance

Particulars (US$'000)	2002 (12)	2003 (12)	2004 (12)	2005 (12)
Total Revenue	212,573	460,353	575,652	948,585
Cost of Revenue	0	157,971	0	0
Gross Profit	212,573	302,382	575,652	948,585
SG&A	156,094	47,215	297,354	472,169
Other Operating Exp	39,868	22,690	94,155	159,253
Operating Profit	16,611	232,477	184,143	317,163
OPM (%)	7.8	50.5	32.0	33.4
Interest	7,579	6,534	4,729	33,971
EBT	9,032	225,943	179,414	283,192
Income Tax	3,161	66,992	56,350	98,493
EAT	5,871	158,951	123,064	184,699
Minority Interest	0	37,233	22,345	13,349
Other Adj	4,168	4,284	4,404	0
AEAT	1,703	117,434	96,315	171,350
NPM (%)	0.8	25.5	16.7	18.1
EPS (US$)	0.04	2.34	1.93	3.34
Pre-tax ROE (%)	2	33	26	37
Post-tax ROE (%)	1	21	15	22

Chart: 4-year stock price pattern

Source: Nasdaq

Our Recent Publications

Indoco Remedies Ltd: The right remedy - August 18, 2006

Divi's Laboratories Ltd - August 03, 2006

Dishman Pharmaceuticals and Chemicals Ltd - August 02, 2006

Opto Circuits (India) Ltd - August 01, 2006

Cadila Healthcare Ltd - July 31, 2006

Toll Free 1600-22-6555 **Email info@5pmail.com**

5paisa.com is the trade name of India Infoline Securities Pvt Ltd (IISPL), a wholly owned subsidiary of India Infoline Ltd. IISPL is a member of the National Stock Exchange of India (NSE) and The Stock Exchange, Mumbai (BSE). IISPL is also a Depository Participant with NSDL.

This report is for information purposes only and does not construe to be any investment, legal or taxation advice. It is not intended as an offer or solicitation for the purchase and sale of any financial instrument. Any action taken by you on the basis of the information contained herein is your responsibility alone and India Infoline Ltd (hereinafter referred as IIL) and its subsidiaries or its employees or directors, associates will not be liable in any manner for the consequences of such action taken by you.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, but do not represent that it is accurate or complete. IIL or any of its subsidiaries or associates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this publication. The recipients of this report should rely on their own investigations. IIL and/or its subsidiaries and/or directors, employees or associates may have interests or positions, financial or otherwise in the securities mentioned in this report.

India Infoline Ltd, 15th Floor, P.J.Tower, Dalal Street, Mumbai -01. Tel 91-22-67491700.

India Infoline Research can be also accessed on Bloomberg (Code IILL), Thomson First Call and ISI Emerging markets.

IT'S ALL ABOUT MONEY, HONEY!