BMA TODAY

## Equity Research Pakistan

# In Focus

### Software & Computer Services

**Current Price: PKR 19**

**Omar Rafiq**
omar.rafiq@bmacapital.com

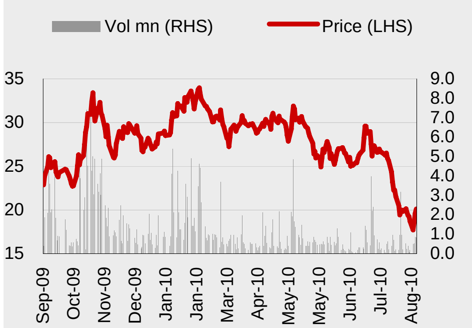
**Stock Statistics**

| | | |
|---|---|---|
| Ticker | | NETSOL |
| Mkt Cap | USD mn | 18 |
| 12M ADT | mn shares | 1.25 |
| Shares Outstanding | mn | 78 |

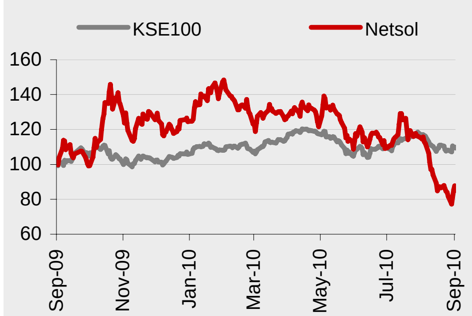
**Stock Performance**

| | 1M | 3M | 12M |
|---|---|---|---|
| Absolute % | -26.1 | -25.1 | -15.0 |
| Relative to KSE % | -19.6 | -27.2 | -24.2 |

**Price and Volume Graph**




**NETSOL vs KSE100 Relative Index Chart**




# NETSOL: Dilution Shadowing Impressive FY10

- **NETSOL announced its FY10 result on Friday September 03, 2010. The company announced PAT of PKR952mn (EPS: PKR12.22) compared to PAT of PKR294mn (EPS: PKR3.77) recorded last year**
- **The company is under process of acquiring its parent's subsidiaries (NTNA and NTE) for a total consideration of PKR1.76bn**
- **The nature of transaction will that be of an equity transfer to the parent; 61mn additional shares (other than rights are to be issued to NTWK**
- **Post acquisition dilution is to be in the order of 1.76x while NTWK's share in Netsol is likely to increase from 58% to 76%**
- **We currently do not have a stance on Netsol given the uncertainties surrounding the post acquisition earnings potential of the company**

Netsol Technologies Pakistan (NETSOL) announced its FY10 result on Friday September 03, 2010. The company announced PAT of PKR952mn (EPS: PKR12.22) compared to PAT of PKR294mn (EPS: PKR3.77) recorded last year.

For 4QFY10, the company recorded PAT of PKR326mn (EPS: PKR4.19), up 2.6x from last year.

The company also announced dividend of PKR1.25/share.

**Financial snapshot – NETSOL FY10**

| PKR mn | 4QFY10 | 4QFY09 | ▲chg | FY10 | FY09 | ▲chg |
|---|---|---|---|---|---|---|
| Revenue | 626 | 343 | 82% | 1,845 | 1,081 | 71% |
| Cost of sales | 132 | 180 | -26% | 530 | 629 | -16% |
| Gross Profit | 493 | 163 | 202% | 1,315 | 453 | 191% |
| Operating expenses and income | 160 | 34 | 371% | 336 | 132 | 154% |
| Operating Profit | 333 | 129 | 157% | 979 | 320 | 206% |
| Financial charges | 6 | 3 | 110% | 25 | 20 | 27% |
| PAT | 326 | 126 | 160% | 952 | 294 | 224% |
| EPS - PKR | 4.19 | 1.61 | | 12.22 | 3.77 | |

Source: BMA Research

Strong earnings growth came on the back of strong licenses sale with the company managing to sell three additional contracts during 4QFY10 which helped secure 82% YoY growth in revenues. Further, depreciation of PKR versus the USD also led to improved gross margins as both cost of sales and operating expenditures remained primarily denominated in PKR.

## Expanding Horizons: Dilution for minority shareholders

NETSOL recently announced its intentions of acquisition of two companies (subsidiaries of NTWK (Netsol Technologies) – parent organization) for a total consideration of PKR1.76bn. The transaction envisaged, is to be financed by transfer of equity to NTWK. The announcement is to be followed by transfer of additional 61mn shares of NETSOL (other than rights) to NTWK in lieu of 100% ownership rights to NTNA (Netsol North America) and NTE (Netsol Europe).



BMA Capital Management Ltd, 801 Unitower, I.I.Chundrigar Road, Karachi , 74000, Pakistan
For further queries, please contact: bmaresearch@bmacapital.com or call UAN: 111-262-111

Equity Research Pakistan

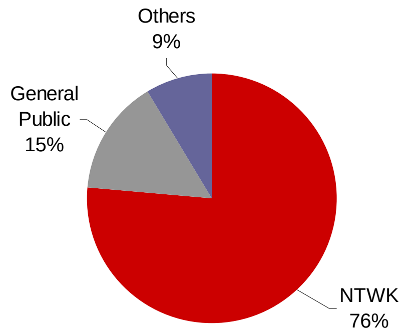
# In Focus

## Software & Computer Services

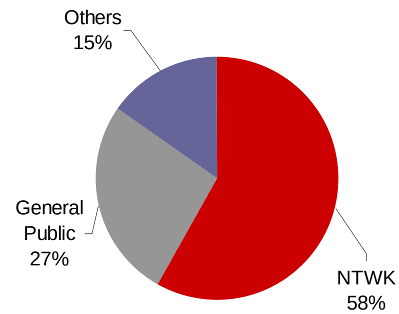
Additional 61mn shares are to increase NTWK's holding in NETSOL from 58% to 76% and result in dilution to the tune of 1.76x for existing shareholders. The acquisition price of shares of these subsidiaries is to be PKR705/share for NTNA and PKR1,781/share for NTE.

**NETSOL Shareholding Pattern**

Post acquisition




Pre acquisition




Source: BMA Research

As per management, the acquisition is to expand and augment its market share in the North American and European market to strengthen its revenue base. Though we believe that the acquisition is likely to increase the topline for Netsol, the immediate incremental revenues are unlikely to counter dilution effects in light of the acquisition consideration paid. Further, as both NTNA and NTE were wholly owned subsidiaries of NTWK, from the parent's perspective, revenue sharing agreements would have served the same purpose and thus acquisition to expand revenue base is unlikely to be a defendable case for NTWK.

### Outlook: Uncertainties surrounding the post-acquisition scenario

We currently do not have a stance on NETSOL given the uncertainties surrounding the post acquisition earnings potential of the company. Both NTNA and NTE operate in highly competitive business environments which should pose as a challenge for the company to harness and exploit. Further, cost of doing business in both the North American as well as the European region is substantially higher and therefore costs are likely to go up post acquisition and therefore revenue and costs initially are unlikely to move in tandem.

Given the dilution and the uncertainties in the post acquisition scenario, we would like to advice caution on the stock despite the recent 33% decline in share price for NETSOL since July 19, 2010 (date of announcement of interest in acquisition of NTNA and NTE).



BMA Capital Management Ltd, 801 Unitower, I.I.Chundrigar Road, Karachi , 74000, Pakistan
For further queries, please contact: bmaresearch@bmacapital.com or call UAN: 111-262-111