Update

Edison investment research

26 January 2011

Rotala

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
11/08	35.7	0.3	1.7	0.0	17.6	N/A
11/09	40.6	1.9	7.1	0.0	4.2	N/A
11/10e	45.4	1.9	5.8	0.8	5.2	2.7
11/11e	54.5	2.5	7.3	1.0	4.1	3.3

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Investment summary: Acquisition and new hub

Rotala's acquisition of Preston Bus Ltd (PBL) from Stagecoach highlights precisely the strategy, rationale and benefits of its business model. With Stagecoach agreeing with the Competition Commission to sell its Preston operations, we feel we may have witnessed real evidence of the long-term potential of the strategy. The £3.2m acquisition is anticipated to be earnings enhancing in the current year and provides not only increased revenue, but also a new hub from which the group can expand.

Strategically attractive acquisition

The acquisition of PBL provides Rotala with a fourth strategic hub. Preston is located roughly the same distance from the head office as the South Western hub. This allows management control and opens up a new regional market untapped by the group until now. With developments continuing apace and over 10 million passenger journeys already undertaken each year, we see growth potential in the region.

Demonstrates the power of the model

The very nature of this deal highlights the opportunity for Rotala. This is driven by a combination of national companies looking to offload marginal routes, Competition Commission activity, and through the acquisition of small independent operations. Rotala has benefitted from each of these drivers over the past five years and we anticipate this will continue.

Deal immediately accretive

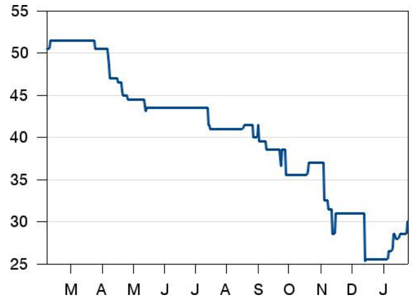
PBL is being acquired on a debt-free basis, funded via a hire purchase facility of £2.4m, a bridging loan of £618k and the remainder from existing facilities. The bridging loan will be replaced with subsequent placings. As a result of the acquisition and initial placing, we are raising our FY11 EPS forecasts by 4% to 7.3p.

Valuation: Discount provides opportunity

Rotala trades at a substantial 60% P/E discount to the major operators. We feel this provides an opportunity for those who are seeking to invest in the regional bus story and the potential impact of the Competition Commission investigation.

Price	30p
Market Cap	£10m

Share price graph



Share details

Code	ROL
Listing	AIM
Sector	Transportation
Shares in issue	33m

Price

52 week	High	Low
	51.5p	25.3p

Balance Sheet as at 31 May 2010

Debt/Equity (%)	99.8
NAV per share (p)	55.8
Net borrowings (£m)	18.4

Business

Rotala is engaged in the provision of commercial bus operations, subsidised bus routes and contracted private bus networks. It primarily operates in the West Midlands, South West and around Heathrow airport.

Valuation

	2009	2010e	2011e
P/E relative	50%	59%	52%
P/CF	2.0	2.5	2.0
EV/Sales	0.7	0.7	0.6
ROE	11%	10%	13%

Geography based on revenues (2009)

UK	Europe	US	Other
100%	0%	0%	0%

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Rotala is a research client of Edison Investment Research Limited

Deal highlights strategy

We feel this acquisition demonstrates the final strand to the acquisition story for Rotala with the push from the Competition Commission for larger operators to relinquish total control in areas of poor competition. Coming on the back of examples of small operator consolidation and larger operators exiting what they consider unprofitable operations, we feel Rotala will enter a period of operational improvement to bring PBL up to its performance standards, although this would not preclude further acquisitions.

PBL – what does it bring?

PBL is being acquired from Stagecoach and it runs a fleet of 85 vehicles with c 240 employees operating in and around Preston from a freehold operating and engineering depot in Deepdale.

- Services are mainly local and on a commercial basis, although it does also carry out some tendered services such as school contracts on behalf of the local council.
- Preston has a historically high level of bus use and current operations provide about 10 million passenger journeys each year.
- Further growth potential is supported by plans to build a new shopping centre and refurbish the bus terminal.

As a result, we view PBL as an excellent strategic fit for the group, providing another strategic hub and providing access to an area of the country as yet untapped by the group. Given Preston's location approximately equidistant from the Birmingham HQ as Bristol/Bath, we feel management control should not be an issue.

Financing structure in place

Rotala is paying £3.2m for PBL on a debt-free basis. This is being financed through a hire-purchase facility, secured on the vehicles owned by PBL, of £2.4m, a bridging loan of £617,500 from the group's bankers and the remainder from existing debt facilities.

The bridging loan is repayable in two tranches, one of £460,000 by 28 February 2011 and one of £157,500 by 28 May 2011:

- The first tranche will be repaid by way of a placing of c 1.65m shares (equivalent to 5% of capital) at a price of 28p per share to raise £461k. Chairman John Gunn has committed to subscribe £107k in this placing.
- The company will then seek authority at its May AGM to raise up to another 5% of capital that should provide enough headroom to issue a further 562,500 shares at 28p per share. In the meantime, Simon Dunn (CEO), Robert Dunn (board member) and John Gunn (Chairman) have committed to make a loan to the company of £157,500, which will bear an interest rate of 3% and will convert into ordinary shares at 28p per share once the authority has been approved.

Impact on forecasts

For the year to 30 April 2010 PBL's turnover was £7.75m, generating a loss before tax of £132k. PBL's management has forecast revenues to April 2011 of £9.5m, while the unaudited seven-month period to 30 November 2010 showed revenues of £5.6m.

We are forecasting a revenue contribution to Rotala from PBL of c £8m and once PBL is run through Rotala's business model, we anticipate a contribution to operating profit of c £360k. Taking increased interest into account, we forecast PBT will rise by c £200k to £2.5m, giving an EPS increase of 4% to 7.3p following the associated share increase.

Valuation

Rotala trades at a substantial discount to its larger quoted peers, with a P/E of 4.1x CY11 EPS equating to a 60% discount to the major transport groups and a 20% discount on an EV/EBITDA basis.

Exhibit 1: Peer group relative valuation, priced at 25 January 2010

Companies	Year end	Price (p)	Mkt Cap (£m)	CY 2011e P/E	CY 2011e EV/Sales	CY 2011e EV/EBITDA
Rotala	Nov	30	10	4.1	0.6	4.3
National Express	Dec	246	1275	9.6	1.0	5.8
First Group	Dec	385	1,882	9.3	0.6	5.0
Go-Ahead	Mar	1297	557	11.5	0.3	4.6
Stagecoach	Apr	205	1474	9.2	0.7	5.9
Average excluding Rotala				9.9	0.6	5.3
Average including Rotala				8.8	0.6	5.1

Source: Edison Investment Research

We believe that this reflects the small-cap nature and early stage of development. We believe this deal shows, though, that there is value uplift potential in the strategy. If we place the shares on a 25% discount on a P/E basis, this would imply a price of 55p per share at a small premium on EV/EBITDA.

Exhibit 1: Financials

£'000s	2007	2008	2009	2010e	2011e
Year end 30 November	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	19,348	35,677	40,561	45,386	54,461
Cost of Sales	(15,413)	(28,980)	(32,735)	(36,270)	(43,633)
Gross Profit	3,935	6,697	7,826	9,116	10,828
EBITDA	1,106	4,485	6,013	6,116	7,028
Operating Profit (before GW and except.)	248	2,478	3,532	3,516	4,228
Intangible Amortisation	(91)	(132)	(142)	(120)	(140)
Exceptionals	0	1,073	(126)	(126)	(126)
Share based payments	(58)	(84)	(84)	(60)	(60)
Operating Profit	99	3,335	3,180	3,210	3,902
Net Interest	(879)	(2,131)	(1,652)	(1,600)	(1,710)
Profit Before Tax (norm)	(631)	347	1,880	1,916	2,518
Profit Before Tax (FRS 3)	(780)	1,204	1,528	1,610	2,192
Tax	0	0	0	0	0
Profit After Tax (norm)	(631)	347	1,880	1,916	2,518
Profit After Tax (FRS 3)	(780)	1,204	1,528	1,610	2,192
Average Number of Shares Outstanding (m)	16.9	20.8	26.6	32.9	34.3
EPS - normalised (p)	(3.7)	1.7	7.1	5.8	7.3
EPS - FRS 3 (p)	(4.6)	5.8	5.7	4.9	6.4
Dividend per share (p)	0.0	0.0	0.0	0.8	1.0
Gross Margin (%)	20.3	18.8	19.3	20.1	19.9
EBITDA Margin (%)	5.7	12.6	14.8	13.5	12.9
Operating Margin (before GW and except.) (%)	1.3	6.9	8.7	7.7	7.8
BALANCE SHEET					
Fixed Assets	24,255	35,527	36,065	36,323	36,381
Intangible Assets	9,041	9,803	9,661	9,519	9,377
Tangible Assets	15,214	25,701	26,381	26,781	26,981
Investments	0	23	23	23	23
Current Assets	4,035	6,191	8,177	8,761	9,483
Stocks	145	694	603	553	513
Debtors	3,879	4,988	5,647	6,281	7,043
Cash	11	509	1,927	1,927	1,927
Current Liabilities	(7,520)	(11,843)	(10,907)	(9,407)	(8,407)
Creditors	(4,483)	(6,759)	(4,750)	(3,250)	(2,250)
Short term borrowings	(3,037)	(5,084)	(6,157)	(6,157)	(6,157)
Long Term Liabilities	(11,526)	(18,462)	(15,735)	(16,283)	(18,223)
Long term borrowings	(11,185)	(18,403)	(15,735)	(16,283)	(18,223)
Other long term liabilities	(341)	(59)	0	0	0
Net Assets	9,244	11,413	17,600	19,395	19,234
CASH FLOW					
Operating Cash Flow	334	4,646	4,069	3,977	5,232
Net Interest	(682)	(1,769)	(1,298)	(1,500)	(1,400)
Tax	0	0	0	0	0
Capex	740	629	(377)	(3,000)	(3,000)
Acquisitions/disposals	(1,690)	(3,312)	0	0	(3,200)
Financing	2,923	272	3,825	0	460
Dividends	0	0	0	(25)	(33)
Net Cash Flow	1,625	466	6,219	(548)	(1,940)
Opening net debt/(cash)	4,958	14,211	22,978	19,965	20,513
HP finance leases initiated	(10,878)	(9,233)	(3,206)	0	0
Other	0	0	0	(0)	0
Closing net debt/(cash)	14,211	22,978	19,965	20,513	22,453

Source: Company accounts/Edison Investment Research

Edison Investment Research

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