

27 April 2011

## Rotala

| Year End | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|---------|---------|-----------|
| 11/09    | 40.6         | 1.9       | 7.1      | 0.0     | 5.0     | N/A       |
| 11/10    | 44.6         | 1.9       | 5.8      | 0.9     | 6.1     | 2.5       |
| 11/11e   | 53.7         | 2.3       | 6.7      | 1.1     | 5.3     | 3.0       |
| 11/12e   | 56.7         | 2.7       | 7.8      | 1.2     | 4.6     | 3.4       |

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

## Investment summary: Commercial opportunity

Rotala's results were broadly in line with our expectations and demonstrated that the group had managed to progress despite challenges around fuel and competitor behaviour. With further progress anticipated in 2011, supported by the recent acquisition of Preston Bus Ltd (PBL), we feel Rotala's agility and increasing focus on commercial routes will provide further opportunities for expansion over the coming years. In addition, the initial Competition Commission report is anticipated in the next few months and we believe this will be supportive of businesses such as Rotala.

## Results demonstrate progress

Revenues increased by 10% to £44.6m (2009: £40.6m), gross profit increased by 5% to £8.2m (2009: £7.8m) with gross margins decreasing to 18% as a result of increased fuel costs. Administrative expenses rose 8% to £4.6m, primarily as a result of full-year costs of new depots in Worcester and Bath opened in late 2009. With interest cost largely unchanged, adjusted PBT rose slightly to £1.9m. EPS was 5.8p (2009: 7.1p) as a result of the increased number of shares in issue.

## Strategy developing to plan

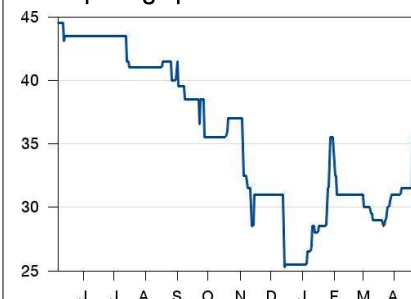
We forecast a period in which Rotala will seek to integrate PBL and develop the Preston-based hub. In addition, we believe that as larger competitors retrench from certain unprofitable routes, organic growth in commercial routes will continue. Overall, we view the results as providing further evidence that the strategy is working and will continue to develop as per our December 2010 Outlook note. We await the outcome of the Competition Commission review, which we feel should provide further support to smaller companies in the space.

## Valuation: Discount dismisses agility

We feel Rotala's current rating of 5.3x CY11 EPS, a 46% discount to the peer group, does not reflect the group's agility or its position to develop over the coming year. The 2010 results have demonstrated that the strategy is driving top-line growth and we anticipate further operational delivery in 2011.

Price 35.6p  
Market Cap £12m

### Share price graph



### Share details

Code ROL  
Listing AIM  
Sector Transportation  
Shares in issue 34.6m

### Price

52 week High Low  
44.5p 25.5p

### Balance Sheet as at 30 November 2010

|                   |      |
|-------------------|------|
| Debt/Equity (%)   | 102  |
| NAV per share (p) | 57.9 |
| Net debt (£m)     | 19.4 |

### 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, the South West, Preston and around Heathrow airport.

### Valuation

|              | 2010 | 2011e | 2012e |
|--------------|------|-------|-------|
| P/E relative | 70%  | 63%   | 60%   |
| P/CF         | 1.8  | 2.2   | 1.9   |
| EV/Sales     | 0.7  | 0.6   | 0.6   |
| ROE          | 10%  | 12%   | 13%   |

### Geography based on revenues (2010)

| UK   | Europe | US | Other |
|------|--------|----|-------|
| 100% | 0%     | 0% | 0%    |

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## Prelims demonstrate progress and opportunity

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The prelims demonstrated that Rotala has continued to make progress, both in terms of organic growth and positioning for developments in the market.

### Financials

The 2010 prelims showed further progress by Rotala:

- Revenues were up 10% to £44.6m. The increase was generated across the board and showed the benefits of the developments made in the group throughout the last two years in terms of new depots, commercial route and fleet expansion.
- Gross profit increased by 5% to £8.2m, tempered by rising fuel costs that meant Rotala incurred an additional £1m in costs on an equivalent basis to 2009. As a result, gross margins declined from 19% to 18%.
- Adjusted operating profit increased slightly to £3.6m (2009: £3.5m). Administrative costs increased by 8% to £4.6m, primarily as a result of a full year of costs associated with the new depots opened in Worcester and Bath at the end of 2009.
- Finance expenses were largely unchanged, allowing adjusted PBT to increase slightly to £1.9m although with an increased number of shares in issue, adjusted EPS declined 18% to 5.8p (2009: 7.1p). A final dividend of 0.6p is being proposed with progress thereafter.
- In our view, the group's improved cash performance was important, with a 99% increase in net cash flow from operating activities to £5.5m (2009: £2.8m), demonstrating the underlying cash conversion potential of the group.

### Business stream performance

Management monitors revenues across business streams, depending on the payment route:

#### **Contracted services (42% of 2010 revenue)**

Contracted services encompass local authority and private bus networks. Revenues increased by 7.6% to £18.8m as new contracts were won in the West Midlands in 2009 under the Diamond brand and benefits were derived from new depots in Bath and Worcester. The growth was slowed by a reduction in local authority work in Bristol and in aviation work around Heathrow by a major customer.

**Outlook:** The government spending review and the recession have made the contracting environment difficult. While local authority spend on transport will remain under pressure, private contracting appears to have rebounded towards the end of 2010 and the environment seems to have improved. Overall, we feel this should support modest growth in contracted revenues in 2011.

#### **Commercial services (49% of 2010 revenue)**

Commercial services are provided on non-contracted routes. 2010 showed a strong, broad-based increase in revenues of 12.3% to £21.8m. Improvements were seen in the West Midlands and the South West, with the new depots having a marked effect and the increase in Bristol-based commercial services more than offsetting the slower contracting revenues in that area.

**Outlook:** We see commercial services as one of Rotala's growth drivers, with opportunity to commence services where larger players decide to withdraw, due to its lower cost base. In addition, Rotala's use of high-specification buses has the potential to generate a loyal customer

base. Commercial services are expected to account for c 60% of revenues with the addition of PBL.

#### Charter services (9% of revenue)

This includes private hire work, as well as chartered chauffeur-driven cars that are subcontracted out. This latter category saw a contraction in 2010, while there was an increase in one-off private-hire revenues and a particularly strong contribution from disruption work as a result of the severe weather and a series of transport strikes. This meant revenues increased by 10% to £4.0m.

**Outlook:** We feel this element of the business is potentially the most unpredictable, due to its very nature. This was highlighted by the one-off Rotary Club contract in 2009, which accounted for £1.1m of revenues and was successfully replaced in 2010. We are encouraged by this and assume Rotala will manage to at least maintain the level of business in 2011.

## Market and corporate development

There are a number of additional factors that will affect the growth and performance of the group:

- **Government spending review** – the government's decision to reduce the Bus Service Operators Grant that shields c 80% of fuel duty by 20% affects c 75% of Rotala's business. We believe there is enough time for Rotala to adjust fare structures to offset this before it comes into force in 2012, with an anticipated resultant increase of c 5%.
- **Preston Bus Ltd acquisition** – we refer to our [January 2011 update note](#) on the PBL acquisition and highlight the opportunity to develop this new hub, which we believe will provide enhanced growth for the group over the coming years. We estimate it will account for c 18% of revenues in 2012.
- **Competition Commission** – the initial report of the Competition Commission's enquiry into the local bus market is due to be published in the coming months and we agree with Rotala's assessment that the outcome is unlikely to be detrimental to smaller operators.
- **Fleet modernisation** – Rotala has one of the youngest fleets in the industry with c 20% of the fleet replaced in 2010 and an industry-leading average age of 7.5 years. 98% of the fleet is compliant with the Disability Discrimination Act.
- **Financing** – RBS has been appointed as Rotala's new clearing bankers providing a consolidation of banking facilities, mortgages and vehicle financing at improved rates.

## Forecasts

Exhibit 1 shows 2010 results were broadly in line with our forecasts. We have tempered our 2011 forecasts due to higher fuel costs. We have introduced 2012 with 5% sales growth and improved central costs following the acquisition of PBL, generating EPS growth of 18%.

#### Exhibit 1: Edison Investment Research forecasts

Note: Figures in £m except per share data.

|       | EPS |     |        | PBT |     |        | EBITDA |     |        |
|-------|-----|-----|--------|-----|-----|--------|--------|-----|--------|
|       | Old | New | % chg. | Old | New | % chg. | Old    | New | % chg. |
| 2010  | 5.8 | 5.8 | 0      | 1.9 | 1.9 | 0      | 6.1    | 6.3 | +3     |
| 2011e | 7.3 | 6.7 | -8     | 2.5 | 2.3 | -8     | 7.0    | 6.8 | -3     |
| 2012e | -   | 7.8 | N/A    | -   | 2.7 | N/A    | -      | 7.2 | N/A    |

Source: Edison Investment Research

**Exhibit 2: Financials**

| Year end 30 November                            | £'000s | 2007            | 2008            | 2009            | 2010            | 2011e           | 2012e           |
|---|--------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|   |        | IFRS            | IFRS            | IFRS            | IFRS            | IFRS            | IFRS            |
| <b>PROFIT &amp; LOSS</b>                        |        |                 |                 |                 |                 |                 |                 |
| <b>Revenue</b>                                  |        | <b>19,348</b>   | <b>35,677</b>   | <b>40,561</b>   | <b>44,644</b>   | <b>53,650</b>   | <b>56,730</b>   |
| Cost of Sales                                   |        | (15,413)        | (28,980)        | (32,735)        | (36,430)        | (43,898)        | (46,313)        |
| Gross Profit                                    |        | 3,935           | 6,697           | 7,826           | 8,214           | 9,752           | 10,417          |
| <b>EBITDA</b>                                   |        | <b>1,106</b>    | <b>4,485</b>    | <b>6,013</b>    | <b>6,298</b>    | <b>6,822</b>    | <b>7,244</b>    |
| <b>Operating Profit (before GW and except.)</b> |        | <b>248</b>      | <b>2,478</b>    | <b>3,532</b>    | <b>3,577</b>    | <b>4,022</b>    | <b>4,344</b>    |
| Intangible Amortisation                         |        | (91)            | (132)           | (142)           | (64)            | (84)            | (104)           |
| Exceptionals                                    |        | 0               | 1,073           | (126)           | (126)           | (126)           | (126)           |
| Share based payments                            |        | (58)            | (84)            | (84)            | (64)            | (64)            | 0               |
| <b>Operating Profit</b>                         |        | <b>99</b>       | <b>3,335</b>    | <b>3,180</b>    | <b>3,323</b>    | <b>3,748</b>    | <b>4,114</b>    |
| Net Interest                                    |        | (879)           | (2,131)         | (1,652)         | (1,673)         | (1,710)         | (1,650)         |
| <b>Profit Before Tax (norm)</b>                 |        | <b>(631)</b>    | <b>347</b>      | <b>1,880</b>    | <b>1,904</b>    | <b>2,312</b>    | <b>2,694</b>    |
| <b>Profit Before Tax (FRS 3)</b>                |        | <b>(780)</b>    | <b>1,204</b>    | <b>1,528</b>    | <b>1,650</b>    | <b>2,038</b>    | <b>2,464</b>    |
| Tax   |        | 0               | 0               | 0               | 0               | 0               | 0               |
| <b>Profit After Tax (norm)</b>                  |        | <b>(631)</b>    | <b>347</b>      | <b>1,880</b>    | <b>1,904</b>    | <b>2,312</b>    | <b>2,694</b>    |
| <b>Profit After Tax (FRS 3)</b>                 |        | <b>(780)</b>    | <b>1,204</b>    | <b>1,528</b>    | <b>1,650</b>    | <b>2,038</b>    | <b>2,464</b>    |
| Average Number of Shares Outstanding (m)        |        | 16.9            | 20.8            | 26.6            | 33.0            | 34.6            | 34.6            |
| EPS - normalised (p)                            |        | (3.7)           | 1.7             | 7.1             | 5.8             | 6.7             | 7.8             |
| EPS - FRS 3 (p)                                 |        | (4.6)           | 5.8             | 5.7             | 5.0             | 5.9             | 7.1             |
| Dividend per share (p)                          |        | 0.0             | 0.0             | 0.0             | 0.9             | 1.1             | 1.2             |
| Gross Margin (%)                                |        | 20.3            | 18.8            | 19.3            | 18.4            | 18.2            | 18.4            |
| EBITDA Margin (%)                               |        | 5.7             | 12.6            | 14.8            | 14.1            | 12.7            | 12.8            |
| Operating Margin (before GW and except.) (%)    |        | 1.3             | 6.9             | 8.7             | 8.0             | 7.5             | 7.7             |
| <b>BALANCE SHEET</b>                            |        |                 |                 |                 |                 |                 |                 |
| <b>Fixed Assets</b>                             |        | <b>24,255</b>   | <b>35,527</b>   | <b>36,065</b>   | <b>37,876</b>   | <b>38,012</b>   | <b>38,048</b>   |
| Intangible Assets                               |        | 9,041           | 9,803           | 9,661           | 9,597           | 9,533           | 9,469           |
| Tangible Assets                                 |        | 15,214          | 25,701          | 26,381          | 28,256          | 28,456          | 28,556          |
| Investments                                     |        | 0               | 23              | 23              | 23              | 23              | 23              |
| <b>Current Assets</b>                           |        | <b>4,035</b>    | <b>6,191</b>    | <b>8,177</b>    | <b>6,443</b>    | <b>6,603</b>    | <b>6,774</b>    |
| Stocks  |        | 145             | 694             | 603             | 779             | 739             | 699             |
| Debtors   |        | 3,879           | 4,988           | 5,647           | 4,536           | 4,736           | 4,947           |
| Cash  |        | 11              | 509             | 1,927           | 1,128           | 1,128           | 1,128           |
| <b>Current Liabilities</b>                      |        | <b>(7,520)</b>  | <b>(11,843)</b> | <b>(10,907)</b> | <b>(8,847)</b>  | <b>(7,847)</b>  | <b>(7,347)</b>  |
| Creditors                                       |        | (4,483)         | (6,759)         | (4,750)         | (4,716)         | (3,716)         | (3,216)         |
| Short term borrowings                           |        | (3,037)         | (5,084)         | (6,157)         | (4,131)         | (4,131)         | (4,131)         |
| <b>Long Term Liabilities</b>                    |        | <b>(11,526)</b> | <b>(18,482)</b> | <b>(15,735)</b> | <b>(16,368)</b> | <b>(17,966)</b> | <b>(16,234)</b> |
| Long term borrowings                            |        | (11,185)        | (18,403)        | (15,735)        | (16,368)        | (17,966)        | (16,234)        |
| Other long term liabilities                     |        | (341)           | (59)            | 0               | 0               | 0               | 0               |
| <b>Net Assets</b>                               |        | <b>9,244</b>    | <b>11,413</b>   | <b>17,600</b>   | <b>19,104</b>   | <b>18,802</b>   | <b>21,242</b>   |
| <b>CASH FLOW</b>                                |        |                 |                 |                 |                 |                 |                 |
| <b>Operating Cash Flow</b>                      |        | <b>334</b>      | <b>4,646</b>    | <b>4,069</b>    | <b>6,644</b>    | <b>5,642</b>    | <b>6,532</b>    |
| Net Interest                                    |        | (682)           | (1,769)         | (1,298)         | (1,136)         | (1,200)         | (1,400)         |
| Tax   |        | 0               | 0               | 0               | 0               | 0               | 0               |
| Capex   |        | 740             | 629             | (377)           | 1,190           | (3,000)         | (3,000)         |
| Acquisitions/disposals                          |        | (1,690)         | (3,312)         | 0               | 0               | (3,200)         | 0               |
| Financing                                       |        | 2,923           | 272             | 3,825           | 38              | 460             | 0               |
| Dividends                                       |        | 0               | 0               | 0               | (149)           | (300)           | (400)           |
| Net Cash Flow                                   |        | 1,625           | 466             | 6,219           | 6,587           | (1,598)         | 1,732           |
| <b>Opening net debt/(cash)</b>                  |        | <b>4,958</b>    | <b>14,211</b>   | <b>22,978</b>   | <b>19,965</b>   | <b>19,371</b>   | <b>20,969</b>   |
| HP finance leases initiated                     |        | (10,878)        | (9,233)         | (3,206)         | (5,993)         | 0               | 0               |
| Other   |        | 0               | 0               | 0               | 0               | 0               | 0               |
| <b>Closing net debt/(cash)</b>                  |        | <b>14,211</b>   | <b>22,978</b>   | <b>19,965</b>   | <b>19,371</b>   | <b>20,969</b>   | <b>19,237</b>   |

Source: Edison Investment Research, company accounts

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