Edison investment research

8 September 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	5.4	N/A
11/10	44.6	1.9	5.8	0.9	6.6	2.3
11/11e	53.7	2.1	6.1	1.1	6.3	2.9
11/12e	56.7	2.3	6.5	1.2	5.9	3.1

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

Investment summary: Progress and challenges

Rotala's interims showed that strategic progress across the group is continuing apace with the successful integration of Preston Bus Limited, further routes opening and new contract wins. Operationally, the most significant impact remains the cost of fuel and this has led us to ease our FY11 and FY12 forecasts. With the strategic acquisition of PBL being integrated and a focus on expanding the commercial opportunities for the group, we feel Rotala remains well placed to deal with the opportunities that are arising from the shake-up in the local bus market and the operational pressures on larger operators.

Results demonstrate strategic progress, impact of fuel

Revenues increased by 18% to £26.6m (2010: £22.5m), gross profit increased by 6% to £4.1m (2010: £3.9m), with gross margins further squeezed to 15% as a result of increased fuel costs. Administrative expenses rose only 4% to £2.4m, despite the cost of the new depot in Preston for most of the period. With interest costs largely unchanged, PBT rose 15% to £0.9m (2010: £0.8m). EPS increased by 13% to 2.75p (2010: 2.44p) while the dividend was increased by 33% to 0.4p.

Strategic developments bedding down

The period saw several further developments in the group that all add important new streams of work and have enabled Rotala to increasingly shift the exposure to commercial bus operations, which are less prone to local authority pressures. This was aided by the January 2011 acquisition of PBL, which also opened up a new hub for the group around Preston, as well as a further depot lease in Avonmouth to enable expansion of the South West operations into this area.

Valuation: Discount remains, operational progress to help

We feel Rotala's current rating of 6.2x CY11 EPS, a 36% discount to the peer group, does not fully reflect the opportunity the group has in the local bus market. We feel that, as each set of results demonstrates further progress and confidence in operational improvements grows, this discount should reduce.

Price	38.5p
Market Cap	£14m

Share price graph

Share details

Code	ROL
Listing	AIM
Sector	Transportation
Shares in issue	35.2m

Price

52 week	High	Low
	40.5p	25.5p

Balance Sheet as at 31 May 2011

Debt/Equity (%)	108
NAV per share (p)	58.0
Net debt (£m)	22.2

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, Preston and around Heathrow airport.

Valuation

	2010	2011e	2012e
P/E relative	77%	72%	77%
P/CF	1.9	2.5	2.2
EV/Sales	0.7	0.6	0.6
ROE	10%	11%	11%

Geography based on revenues (2010)

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

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Interims show continued growth, managing challenges

The interims demonstrated that Rotala's growth strategy is working with the balanced exposure allowing overall growth despite a challenging environment. The benefits of driving efficiency and cost out of acquired companies also showed through so that, despite the headwind of volatile fuel prices, further substantial improvement in profitability was achieved.

Financials

The interims showed continuing progress was being made by Rotala:

- Revenues were up 18% to £26.6m. The increase was driven primarily through commercial services growth, although there was also modest growth in contracted services, even when discounting the impact of the PBL acquisition.
- Gross profit increased by 6% to £4.1m, tempered again by fuel cost volatility, which remains unhedged until there is a clearer directional view. As a result, gross margins declined from 17% to 15% in the half.
- Operating profit increased by 8% to £1.7m (2010: £1.6m). Administrative costs increased by only 4% to £2.4m, despite the additional cost of the PBL depot during the period.
- Finance expenses were largely unchanged, allowing PBT to increase by 15% to £0.9m and EPS up 18% to 2.75p (2010: 2.44p). The dividend was increased by 33% to 0.3p.
- The improved cash performance continued, with a 94% increase in net cash flow from operating activities to £2.3m (2010: £1.2m). This contributed to a reduction in total debt:EBITDA from 3.3x to 2.7x, a trajectory management is keen to maintain.

Business stream performance demonstrates strength of model

While there were variances in business stream performance driven predominantly by the pressures of differing budgets, we feel that this demonstrates the strength of the combined model.

Contracted services (38% of H111 revenue)

The contracted services encompass local authority and private bus networks. Despite expectations of difficult growth in this area, revenue increased by 8% to £10.3m, largely driven by the addition of PBL. However, underlying organic growth of c 2% was also achieved through a combination of newly won smaller aviation contracts around Heathrow and RPI driven price increases.

Outlook: We expect the contracting environment to remain challenging in contracted services as local authority budgets remain under pressure. Given the modest growth in H1, we maintain our belief that this will continue through to the full year, however further growth will remain subdued.

Commercial services (52% of revenue)

Commercial services are provided on non-contracted routes. H111 showed a strong increase in revenues of 32% to £13.8m, again principally driven by the largely commercial PBL business. The benefits of the investment in new routes and depots across the South West and West Midlands were also seen, being transposed into revenue growth.

Outlook: H1 demonstrated the growth potential in commercial and we expect it to be the core driver for Rotala in the coming years. Commercial services are expected to account for c 60% of revenues with the addition of PBL.

Charter services (10% of revenue)

Charter services are by their very nature volatile and difficult to predict, and revenues were essentially flat year-on-year at £2.5m. Both 2011 and 2010 benefitted from additional revenues due to poor weather replacement services.

Outlook: With the one-off impacts of weather repeated in 2011, we assume Rotala will manage to at least maintain the level of business in 2011. Beyond that, visibility remains volatile.

Market and corporate development

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

- Preston Bus Ltd acquisition – The PBL acquisition provides Rotala with an increasing component of commercial operations over which it has greater control and flexibility to manage prices to offset increasing costs. In addition, PBL provides Rotala with a new hub around Preston. For further information see our January 2011 note.
- Competition Commission – The initial report of the Competition Commission's enquiry into the local bus market was published in May 2011, which concluded that competition is inhibited by features of the local market. We see any subsequent remedies as likely to provide further opportunities for Rotala.
- Fleet modernisation – The group ordered 15 hybrid buses to be delivered in Q4 utilising a £1.6m subsidy from the government's Green Bus Fund. Other fleet modernisation has continued with 30 vehicles sold and a further 30 expected in H2, while 12 conventionally powered vehicles have been ordered for delivery. With an average fleet age of only 7.5 years, this is one of the levers the group uses to improve efficiency and win customers.
- Financing – Following the approach to holders of Convertible Unsecured Loan Stock issued in 2008 to extend the life of the loan stock to December 2014, holders of £2.3m of the outstanding loan stock have committed to the extension (coupon 8%, conversion 45p/share). The remaining holders of £1.7m, which expires and is repayable on 31 December 2011, will be financed through cash generated and existing bank facilities.

Forecasts reflect impact of volatile fuel prices

With volatile fuel prices continuing to affect costs, we have decided to take a much more prudent view and are reducing our forecasts to reflect this continuing headwind, as detailed in Exhibit 1.

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.
2011e	6.8	6.1	-10	2.3	2.1	-8	6.8	6.6	-3
2012e	7.2	6.5	-10	2.7	2.3	-15	7.2	6.8	-6

Source: Edison Investment Research

Exhibit 2: Financials

£'000s	2007	2008	2009	2010	2011e	2012e
Year end 30 November	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	19,348	35,677	40,561	44,644	53,650	56,730
Cost of Sales	(15,413)	(28,980)	(32,735)	(36,430)	(44,080)	(46,725)
Gross Profit	3,935	6,697	7,826	8,214	9,569	10,005
EBITDA	1,106	4,485	6,013	6,298	6,640	6,831
Operating Profit (before GW and except.)	248	2,478	3,532	3,577	3,840	3,931
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
Operating Profit	99	3,335	3,180	3,323	3,566	3,701
Net Interest	(879)	(2,131)	(1,652)	(1,673)	(1,710)	(1,650)
Profit Before Tax (norm)	(631)	347	1,880	1,904	2,130	2,281
Profit Before Tax (FRS 3)	(780)	1,204	1,528	1,650	1,856	2,051
Tax	0	0	0	0	0	0
Profit After Tax (norm)	(631)	347	1,880	1,904	2,130	2,281
Profit After Tax (FRS 3)	(780)	1,204	1,528	1,650	1,856	2,051
Average Number of Shares Outstanding (m)	16.9	20.8	26.6	33.0	34.9	35.2
EPS - normalised (p)	(3.7)	1.7	7.1	5.8	6.1	6.5
EPS - normalised & fully diluted (p)	(3.7)	1.7	5.6	4.8	5.1	5.4
EPS - FRS 3 (p)	(4.6)	5.8	5.7	5.0	5.3	5.8
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	17.8	17.6
EBITDA Margin (%)	5.7	12.6	14.8	14.1	12.4	12.0
Operating Margin (before GW and except.) (%)	1.3	6.9	8.7	8.0	7.2	6.9
BALANCE SHEET						
Fixed Assets	24,255	35,527	36,065	37,853	37,989	38,025
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	0	0	0
Current Assets	4,035	6,191	8,177	6,466	6,626	6,797
Stocks	145	694	603	779	739	699
Debtors	3,879	4,988	5,647	4,559	4,759	4,970
Cash	11	509	1,927	1,128	1,128	1,128
Current Liabilities	(7,520)	(11,843)	(10,907)	(8,847)	(7,847)	(7,347)
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)
Long Term Liabilities	(11,526)	(18,462)	(15,735)	(16,368)	(17,989)	(16,670)
Long term borrowings	(11,185)	(18,403)	(15,735)	(16,368)	(17,989)	(16,670)
Other long term liabilities	(341)	(59)	0	0	0	(0)
Net Assets	9,244	11,413	17,600	19,104	18,779	20,806
CASH FLOW						
Operating Cash Flow	334	4,646	4,069	6,644	5,460	6,120
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	619	0
Dividends	0	0	0	(149)	(300)	(400)
Net Cash Flow	1,625	466	6,219	6,587	(1,621)	1,320
Opening net debt/(cash)	4,958	14,211	22,978	19,965	19,371	20,992
HP finance leases initiated	(10,878)	(9,233)	(3,206)	(5,993)	0	0
Other	0	0	0	0	0	0
Closing net debt/(cash)	14,211	22,978	19,965	19,371	20,992	19,673

Source: Edison Investment Research, company accounts