

Equities

15 May 2011 | 6 pages

Tulip Telecom Ltd (TULP.BO)

Alert: 4Q Ahead on Strong Business Momentum

4Q EBITDA beats expectations – Tulip Telecom’s 4Q EBITDA at Rs1.9bn (+9% qoq; 21% yoy) came in ahead as revenues grew 6% qoq and margins expanded 80bps qoq. The benefits of operating leverage in fiber are clearly visible with a sustained margin improvement - 230bps in the last 4 qtrs. The company expects a further 50-75bps margin expansion in FY12E on the back of this. PAT at Rs827m also came in ahead.

Fiber remains the growth engine – The company continues to expand its fiber network – now across 300 cities (had started off with 10 cities initially). Business momentum in fiber has remained strong, constituting 80% (70% in 3Q) of the new order wins in the data connectivity segment (55% of the total order wins) in 4Q. Meanwhile the company disclosed deceleration in the wireless data segment.

Data centre: global aspirations – Company claims that the Bangalore based data centre has 430k sq ft of developable space (900k total), EBITDA BE at ~120k sq ft (Q2'13E) and expects it to become operational in Aug 11. It is in the process of laying fiber connecting Mumbai-Bangalore-Chennai (the 2 landing stations), incurring a cumulative capex of Rs600m (Rs480m to date) which will help it attract international clients.

Capex intensity has been high – The company incurred capex of ~Rs7.7bn in FY11 (Rs2.3bn on data centre acquisition). While capex guidance for FY12E is an additional Rs7bn (24% of revenues), we expect a slight improvement in leverage (FY12E Net debt/EBITDA at 2.0x v/s 2.1x in FY11).

Maintain Buy – The company has started to benefit from fiber in terms of scale economies and higher profitability. Revenues from the data centre, though, may take 18-24 months to ramp up, but will help improve the company’s revenue visibility. The stock is trading at 8.0x FY12E PER, relatively cheap given medium-term growth potential. Disruptive pricing from new competition in data connectivity and a slower ramp-up in data centre revenues are the key downside risks.

Figure 1. Quarterly summary

Rs m	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	QoQ	YoY
Net sales	5,307	5,252	5,853	6,026	6,380	5.9%	20.2%
Total opex	(3,762)	(3,834)	(4,193)	(4,311)	(4,513)	4.7%	20.0%
EBITDA	1,545	1,417	1,660	1,715	1,866	8.9%	20.8%
EBITDA margin	29.1%	27.0%	28.4%	28.5%	29.3%	0.8%	0.1%
Net profit	795	642	780	816	827	1.3%	4.0%
Net profit margin	15.0%	12.2%	13.3%	13.5%	13.0%	-0.6%	-2.0%

Source: Citi Investment Research and Analysis, Company data

Company Update

Buy/Medium Risk	1M
Price (13 May 11)	Rs163.65
Target price	Rs210.00
Expected share price return	28.3%
Expected dividend yield	1.0%
Expected total return	29.3%
Market Cap	Rs24,171M US\$539M

Price Performance (RIC: TULP.BO, BB: TTSL IN)



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Tulip Telecom Ltd

Valuation

We set our 12-month target price at Rs210 based on 10x Mar-12 P/E. We prefer P/E over discounted cash flow (DCF) as: 1) nature of the business (both VPN and NI) results in low revenue visibility beyond 1-2 years; and 2) it plans to expand in new services like Managed services, start supplying bandwidth to state electricity boards as part of the APDRP scheme and enter the data-centre business; the size of these opportunities is a difficult variable to estimate over a longer time frame. The target P/E is at a discount to P/Es of other capex-leverage companies that are comparable in terms of EPS CAGR and ROE despite medium term growth potential. The target multiple is also at a discount to the broader market.

Risks

Our quantitative risk-rating system, which tracks 260-day share price volatility, assigns a High Risk rating to Tulip. We, however, believe that a Medium risk rating is more appropriate given Tulip's presence in the high growth segment of data connectivity (IP VPN) with increasing IT budgets of corporates /Government, its strong market position and headstart over larger telcos in the rural areas, notwithstanding risks of adverse regulatory changes, technology obsolescence and growing competitive intensity as it starts to compete with larger operators. Other company-specific risks include management's ability to augment bandwidth and make necessary changes in organization structure to effectively handle rapid growth in scale and scope of operations and any value destructive acquisition. These risk factors could impede the stock from reaching our target price.

Appendix A-1

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Tulip Telecom Ltd (TULP.BO)

Ratings and Target Price History Fundamental Research

Analyst: Gaurav Malhotra, CFA

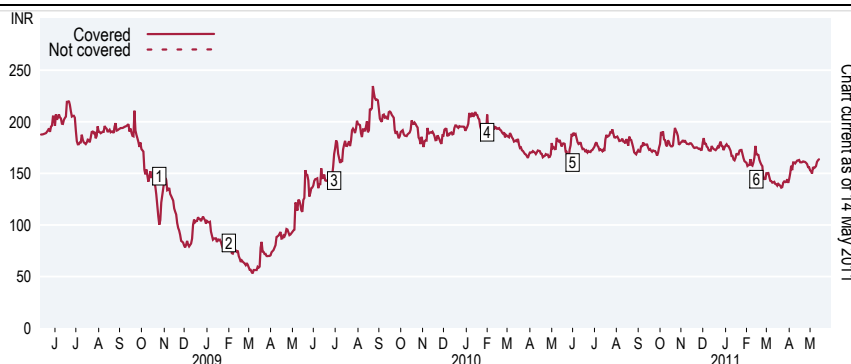


Chart current as of 14 May 2011

	Date	Rating	Target Price	Closing Price
1	26-Oct-08	1M	*146.00	108.48
2	2-Feb-09	1M	*125.00	77.78

	Date	Rating	Target Price	Closing Price
3	30-Jun-09	1M	*198.00	168.77
4	1-Feb-10	1M	*230.00	207.03

	Date	Rating	Target Price	Closing Price
5	1-Jun-10	1M	*224.00	186.10
6	15-Feb-11	1M	*210.00	168.50

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tulip Telecom Ltd (TULP.BO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Gaurav Malhotra, CFA



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Data current as of 31 Mar 2011

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	Buy	Hold	Sell	Buy	Hold	Sell
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