

TULIP TELECOM



Growth intact

Fibre business continues to gain traction

Tulip Telecom's (TTSL) Q4FY11 and FY11 results were in line with our expectations. Q4FY11 revenue grew ~6% Q-o-Q, with the fibre business contributing an estimated 50% (versus ~33% in Q3FY11). In a seasonally strong quarter, EBITDA margin expanded 110bps Q-o-Q and 40bps Y-o-Y led by higher contribution from the fibre business. Fibre now accounts for above 80% of TTSL's new order intake. Despite healthy Q4FY11 operating performance, rise in net interest costs and higher tax rate led to tepid net profit growth.

Net debt continues to rise; cost of debt up 130bps Y-o-Y

TTSL's net debt rose ~23% Q-o-Q and ~55% Y-o-Y to INR 15.3 bn in Q4FY11, led by high capex outgo (INR 5.25 bn on core business and INR 2.15 bn for acquisition of data centre) and continued rise in working capital requirements in FY11. Net debt/equity is currently at 1.26x and average cost of debt has increased from 8.6% in FY10 to 9.9% in FY11. The cost may rise further in the current rising interest rate scenario. TTSL's capex remains high in FY12 (ex-data centre capex guidance at INR 4.5 bn and data centre capex at INR 2.5 bn). Moreover, FCCBs are coming up for redemption in August 2012 (USD 97 mn outstanding). In case FCCBs do not get converted, management intends to refinance them and may need to raise further debt of ~INR 1.5 bn for meeting the interest payment on FCCB. We understand that the company may consider diluting equity (at the parent level) to maintain its debt/equity levels at <1.

Outlook and valuations: Attractive; maintain 'BUY'

We have now incorporated data centre (DC) financials in our estimates. Our FY12 and FY13 estimates are thus lower 8.2% and 2.4%, respectively, as the DC is expected to post net loss in the initial two years of operation. We have assumed that, as intended, TTSL will be able to raise INR 2.5 bn through stake sale in DC to a PE/strategic investor and will incur DC capex of INR 2.5 bn in FY12 and INR 2 bn in FY13. The company has stated that it expects to close the DC stake sale in the next two-three months. We believe the high capex outgo and rising debt and cost of debt are currently an overhang on the stock. The stake sale in the DC and/or in the BWA JV with Qualcomm could thus be a re-rating factor for the stock. On our revised estimates, TTSL continues to trade at attractive valuations of 8.2x and 7.2x. We maintain '**BUY/Sector Outperformer**' recommendation/rating on the stock.

May 13, 2011

Reuters: TULP.BO Bloomberg: TTSL IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Underweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 164
52-week range (INR)	:	201 / 132
Share in issue (mn)	:	145.0
M cap (INR bn/USD mn)	:	24 / 531
Avg. Daily Vol. BSE/NSE ('000):	:	456.9

SHARE HOLDING PATTERN (%)

Promoters*	:	69.0
MFs, FIs & Banks	:	1.9
FIIIs	:	17.8
Others	:	11.3
* Promoters pledged shares (% of share in issue)	:	11.6

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecomm. Index
1 month	1.8	(5.2)	(1.6)
3 months	(1.3)	3.3	10.7
12 months	(9.3)	6.4	21.2

Financials

Year to March	Q4FY11	Q4FY10	% change	Q3FY11	% change	FY11	FY12E
Revenues (INR mn)	6,382	5,307	20.3	6,026	5.9	23,511	28,934
EBITDA (INR mn)	1,886	1,545	22.1	1,715	10.0	6,631	7,904
Adj. net profit (INR mn)	855	658	30.1	816	4.8	3,073	3,265
Diluted EPS (INR)	5.3	4.1	30.1	5.0	4.8	18.9	20.1
Diluted P/E (x)						8.7	8.2
EV/EBITDA (x)						6.1	5.2
ROAE (%)						28.7	22.2

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Financials snapshot

(INR mn)

Year to March	Q4FY11	Q4FY10	% change	Q3FY11	% change	FY11	FY12E	FY13E
Total revenues	6,382	5,307	20.3	6,026	5.9	23,511	28,934	33,876
Raw materials	3,991	3,301	20.9	3,888	2.7	15,188	19,040	22,468
Staff costs	272	223	21.8	237	14.4	946	1,077	1,214
Other costs	233	238	(2.0)	186	25.0	745	914	1,048
Total expenses	4,496	3,762	19.5	4,311	4.3	16,880	21,030	24,730
EBITDA	1,886	1,545	22.1	1,715	10.0	6,631	7,904	9,146
Depreciation	470	155	202.6	441	6.6	1,714	2,410	3,004
PBIT	1,416	1,390	1.9	1,274	11.2	4,917	5,494	6,142
Interest	267	185	44.5	212	25.9	853	1,329	1,493
Other income	(11)	(80)	-	11	(194.8)	10	72	42
PBT	1,139	1,125	1.3	1,073	6.1	4,073	4,238	4,691
Tax	283	467	(39.3)	257	10.2	1,001	1,108	1,173
Extra-ordinary items	-	-	-	-	-	-	-	-
Reported net profit	855	658	30.1	816	4.8	3,073	3,130	3,518
Profit/(Loss) in ass. companie	-	-	0.0	-	0.0	-	(135)	(170)
Profit after minority interest	855	658		816		3,073	3,265	3,688
Diluted EPS (INR)	5.3	4.1	30.1	5.0	4.8	18.9	20.1	22.7

as % of net revenues

Raw materials	62.5	62.2		64.5		64.6	65.8	66.3
Staff costs	4.3	4.2		3.9		4.0	3.7	3.6
Other costs	3.7	4.5		3.1		3.2	3.2	3.1
EBITDA	29.6	29.1		28.5		28.2	27.3	27.0
Adjusted net profit	13.4	12.4		13.5		13.1	11.3	10.9
Tax rate	24.9	41.5		24.0		24.6	26.1	25.0

Table 1: Tulip Data Center Services FY11 financial snapshot

	INR mn
Operating Profit	(9)
Fixed Assets	910
Goodwill	1,244
Net Current Assets	(21)
P&L Debit balance / Misc. Expenses	13
Capital Employed	2,146
Shareholders' funds	2,146

Source: Company

Table 2: Break-up of order intake in Q4FY11

Particulars	% of total
Data Connectivity	68
Managed Services (incl Data Centre)	21
Network Integration	11

Source: Company

Table 3: Debt profile

Debt	FY10	FY11
Long Term Debt as a % of Total Debt	76	89
Short Term Debt as a % of Total Debt	24	11
Average Cost of Debt (%)	8.6	9.9

Source: Company

- **Company Description**

TTSL's principle business entails providing enterprise connectivity services through wireless and fibre last mile network. It provides intercity and intra-city wireless IP VPN connectivity to enterprises in over 1500 locations. In the last 18 months, TTSL has also rolled out its own fibre network of ~6000 km spanning 50+ cities, with initial presence in CBDs of ~250 cities. TTSL has also entered the ILD segment and is setting up six international PoPs. It has also received the FCC 214 licence which will enable it to sell data connectivity services in the US. Besides enterprise connectivity, TTSL provides network integration and management services as well. In July 2010, TTSL acquired a 13% minority stake in a BWA JV with Qualcomm for INR 1.4 bn.

- **Investment Theme**

We are positive on TTSL's business prospects as an integrated provider of network equipment and connectivity for enterprises. With a wide network footprint covering urban & rural areas, we see continued traction in the IP VPN business driving revenue growth and profitability for TTSL. The rollout of fibre network is expected to materially enhance TTSL's addressable market and ability to compete for high bandwidth customers, thereby leading to higher realizations and better profitability.

- **Key Risks**

Competition from larger integrated telcos like Bharti Airtel, Reliance Communications, and BSNL is the key risk for TTSL. With the SME segment (currently the key market for TTSL) being considered as a lucrative opportunity by large players, added competitive pressure may increase the risk quotient for TTSL. Also, the emergence of new cost-effective and more efficient technologies may impact TTSL's business, as adopting new technologies or switching over to new service offerings may require significant capex that may not be viable for TTSL.

Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net revenues	16,144	19,664	23,511	28,934	33,876
Direct costs	11,497	12,953	15,188	19,040	22,468
Employee costs	712	817	946	1,077	1,214
Other expenses	568	640	745	914	1,048
Total operating expenses	12,777	14,409	16,880	21,030	24,730
EBITDA	3,367	5,255	6,631	7,904	9,146
Depreciation and amortisation	414	1,353	1,714	2,410	3,004
EBIT	2,953	3,902	4,917	5,494	6,142
Interest expenses	462	716	853	1,329	1,493
Other income	(393)	30	10	72	42
Profit before tax	2,097	3,216	4,073	4,238	4,691
Provision for tax	81	899	1,001	1,108	1,173
Core profit	2,016	2,316	3,073	3,130	3,518
Extraordinary items	482	-	-	-	-
Profit after tax	2,498	2,316	3,073	3,130	3,518
Profit/(Loss) in ass. companies	-	-	-	(135)	(170)
Profit after minority interest	2,498	2,316	3,073	3,265	3,688
Equity shares outstanding (mn)	145.0	145.0	145.0	145.0	145.0
EPS (INR) basic	13.9	16.0	21.2	22.5	25.4
Diluted shares (mn)	162.2	162.2	162.2	162.2	162.2
EPS (INR) fully diluted	12.4	14.3	18.9	20.1	22.7
CEPS (INR)	16.8	25.3	33.0	37.3	43.8
Dividend per share	0.8	1.6	1.6	1.6	1.6
Dividend payout (%)	5.4	11.7	8.8	8.7	7.7

Common size metrics- as % of net revenues

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	79.1	73.3	71.8	72.7	73.0
Depreciation	2.6	6.9	7.3	8.3	8.9
Interest expenditure	2.9	3.6	3.6	4.6	4.4
EBITDA margins	20.9	26.7	28.2	27.3	27.0
Net profit margins	12.5	11.8	13.1	10.8	10.4

Growth metrics (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	32.4	21.8	19.6	23.1	17.1
EBITDA	37.1	56.1	26.2	19.2	15.7
PBT	4.4	53.3	26.7	4.0	10.7
Net profit	7.7	14.9	32.7	6.2	13.0
EPS	7.7	14.9	32.7	6.2	13.0

Balance sheet					(INR mn)
As on 31st March	FY09	FY10	FY11	FY12E	FY13E
Equity capital	290	290	290	290	290
Reserves & surplus	6,539	8,989	11,835	14,524	17,940
Shareholders funds	6,829	9,279	12,125	14,814	18,230
<i>Minority interest</i>	-	-	-	1,260	1,090
Secured loans	5,141	5,476	12,231	11,234	10,237
Unsecured loans	6,083	6,715	5,538	7,300	9,000
Borrowings	11,224	12,191	17,769	18,533	19,237
Sources of funds	18,054	21,470	29,894	34,607	38,557
Gross block	9,437	14,502	21,870	28,870	34,370
Accumulated Depreciation	1,061	2,414	4,138	6,548	9,552
Net block	8,376	12,088	17,732	22,322	24,818
Capital work in progress	3,772	1,209	-	-	-
Total fixed assets	12,148	13,296	17,732	22,322	24,818
Goodwill	-	-	1,244	1,244	1,244
Investments	-	-	1,549	1,549	1,549
Inventories	916	688	992	1,244	1,468
Sundry debtors	3,242	5,320	6,344	8,720	10,209
Cash and equivalents	3,470	3,470	2,504	1,117	960
Loans and advances	1,103	1,559	2,546	2,749	3,218
Total current assets	8,732	11,037	12,385	13,830	15,856
Sundry creditors and others	2,363	2,117	2,321	2,885	3,393
Provisions	458	721	669	1,425	1,490
Total CL & provisions	2,821	2,838	2,990	4,311	4,883
Net current assets	5,911	8,199	9,395	9,519	10,973
Net deferred tax	(9)	(29)	(32)	(32)	(32)
Misc expenses not w/o	4	4	4	4	4
Uses of funds	18,054	21,470	29,894	34,607	38,557
Book value per share (BV) (INR)	47	64	84	102	126

Free cash flow					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net profit	2,498	2,316	3,073	3,130	3,518
Depreciation	414	1,353	1,714	2,410	3,004
Others	146	492	(1)	135	170
Gross cash flow	3,058	4,161	4,786	5,675	6,692
Less: Changes in W. C.	(173)	(2,312)	(2,163)	(1,510)	(1,611)
Operating cash flow	2,885	1,849	2,623	4,165	5,081
Less: Capex	8,499	2,185	6,150	7,000	5,500
Free cash flow	(5,614)	(336)	(3,527)	(2,835)	(419)

Cash flow metrics					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating cash flow	2,885	1,849	2,623	4,165	5,081
Financing cash flow	676	952	5,306	1,449	262
Investing cash flow	(2,679)	(1,342)	(7,699)	(7,000)	(5,500)
Net cash flow	882	1,460	230	(1,386)	(157)
Capex	(8,499)	(2,185)	(6,150)	(7,000)	(5,500)
Dividends paid	(136)	(271)	(271)	(271)	(271)

Profitability & liquidity ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
ROAE (%)	35.7	28.8	28.7	22.2	20.3
ROACE (%)	18.8	19.7	19.7	17.9	17.5
Current ratio	3.1	3.9	4.1	3.2	3.2
Debtors (days)	59	79	91	95	102
Average working capital t/o (x)	2.3	2.8	2.7	3.1	3.3
Debt/Equity	1.6	1.3	1.5	1.3	1.1
Debt/EBITDA	3.3	2.3	2.7	2.3	2.1
Adjusted debt/Equity	1.6	1.3	1.5	1.3	1.1

Operating ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
Total asset turnover	1.0	1.0	0.9	0.9	0.9
Fixed asset turnover	2.7	1.9	1.6	1.4	1.4
Equity turnover	2.9	2.4	2.2	2.1	2.1

Du pont analysis

Year to March	FY09	FY10	FY11	FY12E	FY13E
NP margin (%)	12.5	11.8	13.1	10.4	9.9
Total assets turnover	1.0	1.0	0.9	0.9	0.9
Leverage multiplier	2.8	2.5	2.4	2.4	2.2
ROAE (%)	35.7	28.8	28.7	22.2	20.3

Valuations parameters

Year to March	FY09	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	12.4	14.3	18.9	20.1	22.7
<i>Y-o-Y growth</i>	7.7	14.9	32.7	6.2	13.0
CEPS (INR)	16.8	25.3	33.0	37.3	43.8
Diluted P/E (x)	13.2	11.5	8.7	8.2	7.2
Price/BV(x)	3.5	2.6	2.0	1.6	1.3
EV/Sales (x)	2.0	1.7	1.7	1.4	1.2
EV/EBITDA (x)	9.4	6.2	6.1	5.2	4.6
Dividend yield (%)	0.5	1.0	1.0	1.0	1.0



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	HOLD	SO	L	Idea Cellular	HOLD	SP	M
Mahanagar Telephone Nigam Ltd	HOLD	SU	M	Reliance Communication	REDUCE	SU	H
Tulip Telecom	BUY	SO	H				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss
Ideas create, values protect



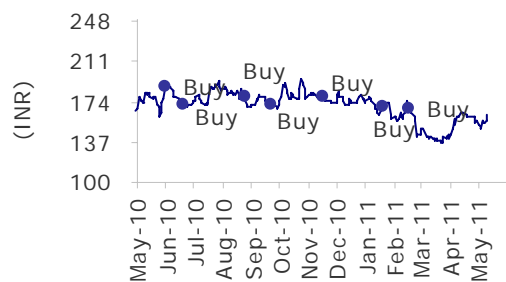
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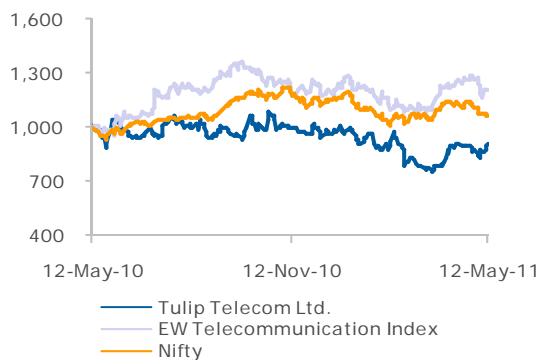
Coverage group(s) of stocks by primary analyst(s): Telecom

Bharti Airtel, Idea Cellular, Reliance Communication, Tulip Telecom

Tulip Telecom



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	51	17	189
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	111	61	17	

Recent Research

Date	Company	Title	Price (INR)	Recos
12-May-11	Bharti Airtel	Investments to dent free cash flow; <i>Company update</i>	366	Hold
05-May-11	Bharti Airtel	'Bottom out' theory will have to wait; <i>Result Update</i>	358	Hold
15-Feb-11	Tulip Telecom	Mixed bag; <i>Result Update</i>	93	Buy

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