

**Telecoms, Media & Technology**  
**Diversified Telecoms**  
 Equity – India

**Neutral**

Target price (INR)	125.00
Share price (INR)	114.95
Potential return (%)	8.7

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	2.7	-23.2	-27.3
Relative <sup>A</sup> (%)	-8.9	-25.2	-28.3

Index<sup>A</sup> BOMBAY SE IDX

RIC TULP.BO  
 Bloomberg TTSL IN

Market cap (USDm) 337  
 Market cap (INRm) 16,668

Enterprise value (INRm) 35855  
 Free float (%) 31

Note: (V) = volatile (please see disclosure appendix)

**10 February 2012**

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# Tulip Telecom (TTSL IN)

N: Margins under pressure, balance sheet concerns remain

- ▶ **3Q FY2012 results below expectations**
- ▶ **Data centre business to exert pressure on margins near term**
- ▶ **Retain Neutral; cut estimates and target price to INR125 (from INR144)**

**3Q FY2012 results were disappointing with revenues c7% below our estimates and PAT c10% below estimates.** Consolidated revenues declined c2% qoq on slowing macros, which lead to reduction/delay in IT spends by corporate. However margins remained stable and management suggested that any kind of sales pressure should not result in any meaningful increase in bandwidth costs. PAT declined 10% qoq to INR784m (our estimate was INR868m) reflecting a 23% increase in interest costs and a higher tax rate of c25.3%.

**Tulip continues to underperform** the market (down 23% in the past three months) as its stretched balance sheet is still a concern. Net debt levels continue to rise because of rising working capital requirements (c18%) and investments in the Data Centre (DC). The move to secure debt financing for the data centre suggests that obtaining a PE/equity partner for the DC business is unlikely in the near to medium term. Furthermore mezzanine funding costs will be higher than the present average costs and likely to result in higher interest rate expenses.

**Factors that could lead to a further de-rating of the stock:** A slowdown in the core business (fibre bandwidth business) may lead to pressure on the stock price as we do not expect any meaningful revenues from DC in the short term. A slowdown in sales could impact the ability to buy bandwidth in bulk and may impact margins. We assume 15% revenue growth in FY13e and model a margin decline of 170bps. We believe that the DC business for the first few quarters will be margin dilutive and it will take a while before it acquires scale/critical mass.

**Catalysts:** An improvement in macro conditions (IT spending) and a reduction in domestic interest rates will be positive for the stock price, in our view. We believe the ability to secure an equity partner for the DC business and improved order visibility on the DC business as upside catalysts for the stock. We note order wins in the data centre business and their conversion into actual revenues will also be critical for the stock. The overall enhanced product portfolio provides downside support, in our view.

**Valuation and risks:** We retain our Neutral rating but cut our target price to INR125 (INR146) given margin pressures and higher interest payments. We continue to value Tulip on a mix of DCF and PE at 6x on FY13e earnings. We have cut our FY13 estimates by 24% to reflect declining margins, and higher interest costs and tax payments. Upside risks include the ability to gain market share via bundling data centre and core offerings. Downside risks include pricing pressure at the core business and a sharp reduction in IT spending.

## Financials & valuation

### Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
<b>Profit &amp; loss summary (INRm)</b>				
Revenue	23,510	27,847	31,913	36,008
EBITDA	6,631	7,891	8,512	10,113
Depreciation & amortisation	-1,714	-2,070	-2,716	-3,233
Operating profit/EBIT	4,917	5,821	5,796	6,880
Net interest	-853	-1,518	-2,072	-2,691
PBT	4,065	4,277	3,723	4,189
HSBC PBT	4,065	4,277	3,724	4,189
Taxation	-1,001	-1,075	-1,009	-1,257
Net profit	3,064	3,201	2,715	2,932
HSBC net profit	3,064	3,201	2,715	2,932

### Cash flow summary (INRm)

Cash flow from operations	4,101	6,066	6,655	8,838
Capex	-7,398	-8,531	-6,269	-6,444
Cash flow from investment	-9,291	-10,220	-6,269	-6,444
Dividends	0	0	0	0
Change in net debt	6,033	5,988	1,686	298
FCF equity	-4,150	-3,956	-1,687	-298

### Balance sheet summary (INRm)

Intangible fixed assets	0	1,244	1,244	1,244
Tangible fixed assets	18,980	24,203	27,756	30,967
Current assets	14,547	17,390	18,832	18,876
Cash & others	5,000	5,000	5,000	5,000
Total assets	35,018	44,493	49,489	52,743
Operating liabilities	2,882	3,380	3,974	3,999
Gross debt	19,753	25,742	27,428	27,726
Net debt	14,753	20,742	22,428	22,726
Shareholders funds	12,345	15,337	18,052	20,985
Invested capital	25,645	34,457	38,858	42,088

### Ratio, growth and per share analysis

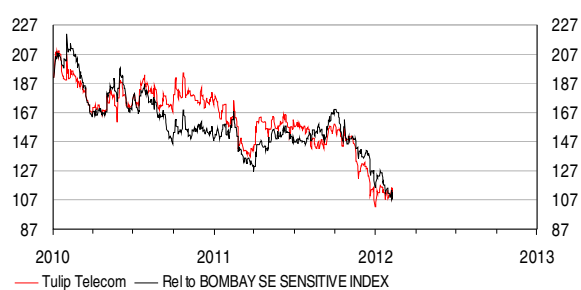
Year to	03/2011a	03/2012e	03/2013e	03/2014e
<b>Y-o-y % change</b>				
Revenue	19.6	18.4	14.6	12.8
EBITDA	26.3	19.0	7.9	18.8
Operating profit	26.2	18.4	-0.4	18.7
PBT	11.4	5.2	-12.9	12.5
HSBC EPS	11.5	4.5	-15.2	8.0
<b>Ratios (%)</b>				
Revenue/IC (x)	1.1	0.9	0.9	0.9
ROIC	17.0	14.5	11.5	11.9
ROE	28.3	23.1	16.3	15.0
ROA	12.5	10.9	9.0	9.4
EBITDA margin	28.2	28.3	26.7	28.1
Operating profit margin	20.9	20.9	18.2	19.1
EBITDA/net interest (x)	7.8	5.2	4.1	3.8
Net debt/equity	119.5	135.2	124.2	108.3
Net debt/EBITDA (x)	2.2	2.6	2.6	2.2
CF from operations/net debt	27.8	29.2	29.7	38.9
<b>Per share data (INR)</b>				
EPS reported (fully diluted)	21.13	22.08	18.72	20.22
HSBC EPS (fully diluted)	21.13	22.08	18.72	20.22
DPS	0.00	0.00	0.00	0.00
Book value	85.14	105.78	124.50	144.72

### Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	1.3	1.3	1.2	1.1
EV/EBITDA	4.5	4.5	4.4	3.7
EV/IC	1.2	1.0	1.0	0.9
PE*	5.4	5.2	6.1	5.7
P/Book value	1.4	1.1	0.9	0.8
FCF yield (%)	-27.3	-26.2	-11.2	-2.0
Dividend yield (%)	0.0	0.0	0.0	0.0

Note: \* = Based on HSBC EPS (fully diluted)

### Price relative



Source: HSBC

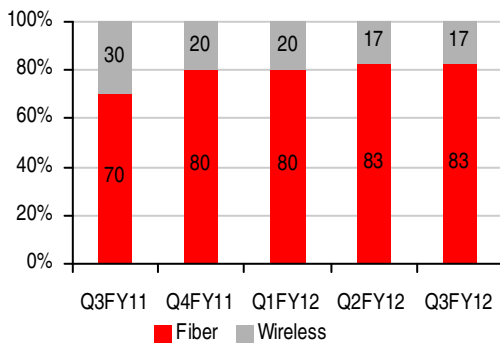
Note: price at close of 09 Feb 2012

**Figure 1: Tulip Telecom 3QFY12**

( Figs in INRm unless specified)	Actual	HSBC Estimates	2QFY12	3QFY11	Actual vs HSBC	QoQ	YoY	Consensus	Variance
Overall Business									
Revenue	6,865	7,404	7,029	6,026	-7.3%	-2.3%	13.9%	7,234	-5.1%
EBITDA	1,992	2,069	2,032	1,715	-3.7%	-2.0%	16.2%	2,117	-5.9%
EBITDA Margin (%)	29.0%	27.9%	28.9%	28.5%	3.8%	0.1%	0.6%	29.3%	-0.2%
Net Profit	785	868	871	816	-9.6%	-9.9%	-3.8%	910	-13.8%
EPS (INR)	5.4	6.0	6.0	5.6	-9.6%	-9.9%	-3.8%	6.3	-13.8%

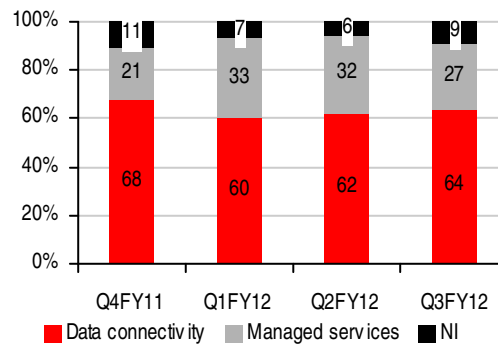
Source: Company data, Bloomberg, HSBC

**Figure 2: New order input split between fibre and wireless**



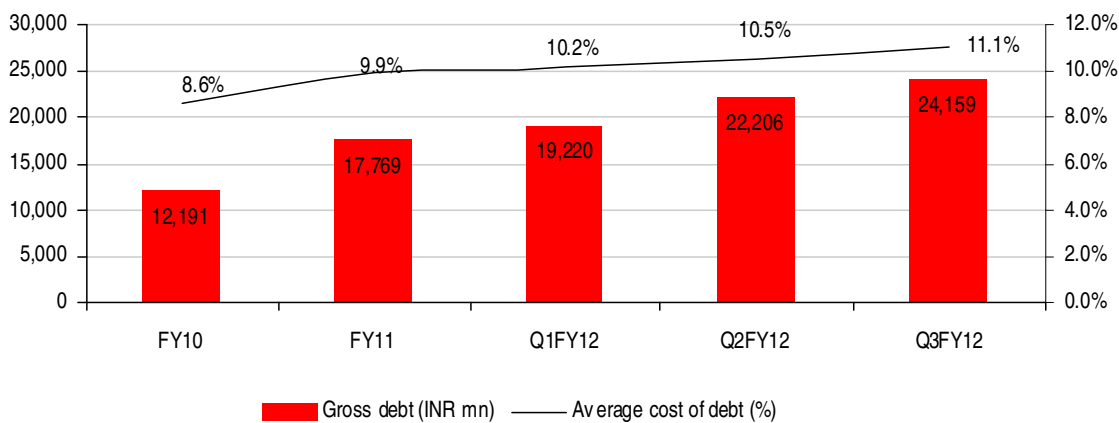
Source: Company Data

**Figure 3: Break up of Order Intake**



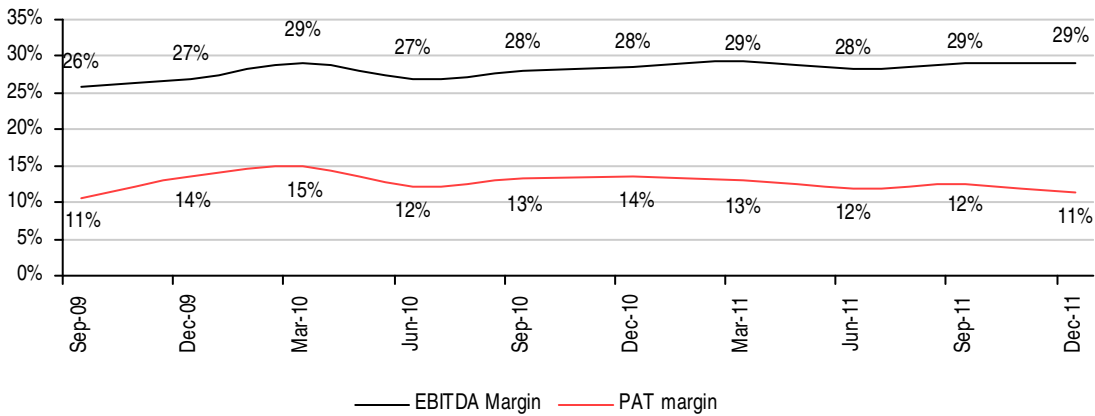
Source: Company Data

**Figure 4: Debt Profile**



Source: Company Data

Figure 5: Financial Performance



Source: Company Data

Figure 6: Key events for the Tulip stock and likely timelines

Event	Expected time frame	Key factor to be watched	What is in the price?
PE induction at the data centre level	Uncertain	Company now looking to debt financing, suggesting that an equity/PE partner is unlikely currently.	Not in the price as there has been considerable delay.
Ability to unlock investments in Qualcomm venture	At least 9-12 months away	Any progress by the present LTE players towards launch of LTE services would be positive.	Not in the price as low visibility on both the telecom policy and launch by LTE players.
FCCB repayment	August 2012	Management suggested that it expects to have refinancing approvals by FY12e	Timely repayment will address investor concerns. Recent management comments positive but stock price not reflecting it. Should provide downside support.
Replacement of CEO	Anytime soon.	With tough macro conditions, losing senior management is a negative for the company. A delay in replacement could lead to delays in execution.	Stock has corrected 5% post the weak 3Q results. Any delay could in replacement could lead to a further correction or prevent upside.

Source: HSBC

## Valuation and risks

We value Tulip Telecom's business using the average of PE and discounted cash flow methodologies at INR125 (from INR143), attaching equal weightings to each. For our DCF analysis, we assume a cost of equity of 15% and a cost of debt of c11%; we assume a target debt-to-total capital ratio of 30% and Weighted average cost of capital (WACC) at 13% to arrive at a fair value of INR132 per share (previously INR139). Our DCF valuations have been cut as we cut our EBITDA by c6% for the next three years given our assumptions that the DC business will take time to get scale and put pressure on consolidated margins. For our PE methodology, we use a PE multiple of 6x (using the 12-month average of one-year forward PER) on FY2013e earnings to arrive at a fair value of INR112 per share (from INR 147, now lower as we have cut our FY2013e estimates by 24%). Separately, we value Tulip's investment in the Qualcomm venture at c50% discount to book value or at INR3 (no change) reflecting the uncertainty over the ability to monetize investments in the Qualcomm BWA venture in the near to medium term. Using our blended approach, we arrive at a 12-month target price of INR125.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%. Our target price implies a potential return of 8.7%, which is within the Neutral band; therefore, we are reiterating our Neutral rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key upside risks include the ability to gain market share via bundling data centre offerings with core offerings. Key downside risks include pricing pressure at the core business given the poor macro environment, a sharp reduction in IT spending and an inability to monetize the Qualcomm investment.

Figure 7: Change in estimates

(INRm)	FY2012e	FY2013e
<b>Sales</b>		
New	27,847	31,913
Old	28,957	33,542
Change	-4%	-5%
<b>EBITDA</b>		
New	7,891	8,512
Old	8,224	9,261
Change	-4%	-8%
<b>Net profit</b>		
New	3,201	2,715
Old	3,458	3,550
Change	-7%	-24%

Source: HSBC estimates

Figure 8: Target price computation of core business

(INR)	New	Old
DCF value @13% WACC	132	139
PE at 6X FY13 EPS	112	147
Assigning 50% weight to each	122	143
BWA investment	3	3
Target price	125	146

Source: HSBC estimates

# Disclosure appendix

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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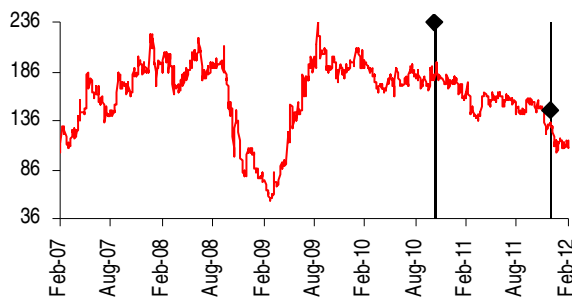
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<b>Overweight (Buy)</b>	52%	(26% of these provided with Investment Banking Services)
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## Share price and rating changes for long-term investment opportunities

Tulip Telecom (TULP.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

### Recommendation & price target history

From	To	Date
N/A	Overweight	20 October 2010
Overweight	Neutral	06 December 2011
Target Price	Value	Date
Price 1	235.00	20 October 2010
Price 2	146.00	06 December 2011

Source: HSBC

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