February 10, 2012

Tulip Telecom (TULITS)

₹ 115

WHAT'S CHANGED...

PRICE TARGET .... Changed from ₹ 160 to ₹ 141
EPS (FY12E) .... Changed from ₹ 21.5 to ₹ 19.1
EPS (FY13E) .... Changed from ₹ 22.9 to ₹ 20.2
RATING .... Unchanged

Huge debt a concern...

Tulip Telecom reported its Q3FY12 numbers, which were lower than our estimates with topline at ₹ 686.6 crore against our expectation of ₹ 727.2 crore, registering growth of 14.0% YoY but de-growing 2.3% QoQ attributable to the headwinds in the macroeconomic environment. EBITDA for the quarter was at ₹ 199.1 crore at 29.0% of revenues, growing 16.0% YoY and de-growing 2.0% QoQ. The bottomline was marred by higher interest cost related to rising debt levels including high cost mezzanine funding. PAT stood at ₹ 77.3 crore against our expectation of ₹ 91.6 crore. Interest costs rose sharply by 23.8% QoQ to ₹ 42.7 crore.

Highlights of the quarter

The company continues to see high traction on the newly laid fibre optic cable business, with about 83% of the new orders received in Q3FY12 on fibre optics. The company also added various new clients in this quarter, which included NTT Communications, Sahara Para Banking, Axis Bank, Tata Mutual Fund and CBI among others.

Data Connectivity formed ~64% of total revenues, managed services including data centre formed ~27% whereas network integration saw a healthy growth and contributed ~ 9% to total revenues.

Valuation

In light of the lower revenue growth forecast by the management and increasing finance charges, we have lowered our EPS estimates for FY12 by ₹ 21.9 to ₹ 19.1 and for FY13 from ₹ 22.9 to ₹ 20.2. At the current market price of ₹ 115, the stock is trading at 6.0x FY12E diluted EPS of ₹ 19.1 and 5.7x FY13E diluted EPS of ₹ 20.2. We have valued the stock at 7x FY13E EPS and arrived at a target price of ₹ 141, which implies an upside of 23%. The high levels of debt can remain an overhang on the stock. We maintain our **BUY** rating on the stock.

Exhibit 1: Valuation Metrics

(₹ Crore)	Q3FY12	Q3FY12E	Q3FY11	Q2FY12	QoQ (Chg %)	YoY (Chg %)
Net Sales	686.6	727.2	602.2	702.9	-2.3	14.0
EBITDA	199.1	210.8	171.6	203.2	-2.0	16.0
EBITDA Margin (%)	29.0	29.0	28.5	28.9	9 bps	50 bps
Depreciation	52.6	55.6	44.1	50.2	4.7	19.2
Interest	42.7	37.0	21.2	34.5	23.8	101.8
Reported PAT	77.3	91.6	81.7	87.1	-11.3	-5.5
EPS (₹)	4.7	5.6	5.0	5.3	-11.3	-5.5

Source: Company, ICICIdirect.com Research

Rating matrix

Rating	:	Buy
Target	:	₹ 141
Target Period	:	12 months
Potential Upside	:	23%

Key Financials

(₹ Crore)	FY10	FY11E	FY12E	FY13E
Net Sales	1966.4	2351.1	2730.3	3203.4
EBITDA	525.5	663.1	779.8	869.6
Net Profit	231.6	306.4	313.4	331.7
EPS (₹)	14.1	18.6	19.1	20.2

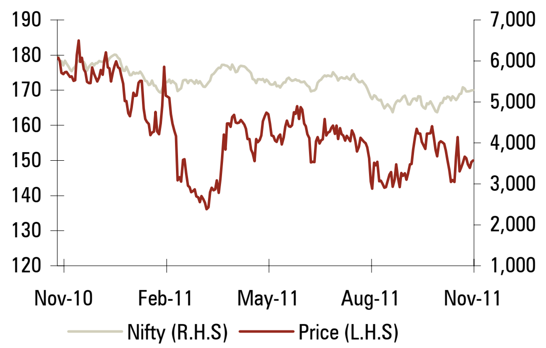
Valuation summary

	FY10	FY11E	FY12E	FY13E
PE (x)	8.2	6.2	6.0	5.7
Target PE (x)	10.0	7.6	7.4	7.0
EV/EBITDA (x)	3.6	3.8	4.4	4.0
P/BV (x)	1.9	1.4	1.3	1.1
RoNW (%)	26.2	25.3	21.5	18.8
RoCE (%)	27.3	20.1	15.6	16.0

Stock data

Market Capitalisation	₹ 1667.5 Crore
Debt-Cons.	₹ 1766.9 Crore
Cash & Invst.-Cons.	₹ 250.4 Crore
EV	₹ 2492 Crore
52 week H/L	181 / 100
Equity capital	₹ 29 Crore
Face value	₹ 2
MF Holding (%)	1.7
FII Holding (%)	18.5

Price movement



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Result analysis

Update on data centre

With a slight delay, the Bengaluru data centre got completed in February 2012. We expect the data centre to start booking significant revenue from Q1FY13 as against our earlier expectation of Q3FY12. However, it has already booked orders from HP, IBM and NTT amounting to a potential ₹ 600 crore for five years for 30,000 sq ft. With aggressive sales and marketing, the company is expecting the data centre to achieve booking of ~15-20% revenues by FY12.

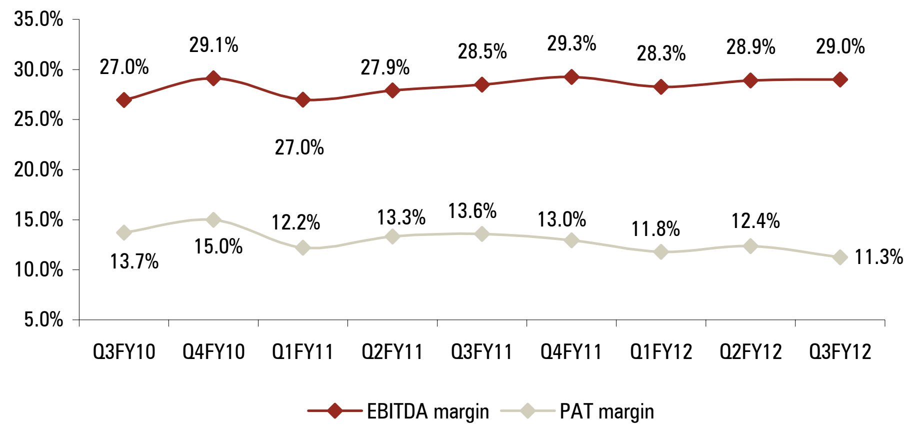
The data centre would require a total funding of ₹ 900 crore over three years, which would be funded through long term credit lines, mezzanine funding and internal accruals.

PAT margins hit by higher interest cost…

The EBITDA margin remained more or less stable QoQ but witnessed an expansion of 50 bps YoY to stand at 29.0% of revenues. Going forward, margins are expected to be slightly under pressure due to operating costs of the new data centre at Bengaluru.

The PAT margin fell QoQ to 11.3% from 12.4% in Q2FY12 primarily due to higher interest costs, which rose to ₹ 42.7 crore from ₹ 34.5 crore in Q2FY12. The average cost of debt also increased from 10.5% in Q2FY12 to 11.1% in Q3FY12.

Exhibit 2: EBITDA & PAT margin trend



Source: Company, ICICIdirect.com Research

Outlook & valuation

The company's venture into the fibre optic business has been showing good traction with 83% of new orders coming on the fibre network. The newly acquired data centre is complete and is all set to book revenues by the end of Q4FY12. We have estimated a utilisation level of ~30% in the data centre business in FY13.

The revenue has de-grown in Q3FY12 that is attributable to the slowing economy, which has caused a reduction in customer spending. The management has indicated that, going forward, revenue growth is expected to be under pressure for the next two quarters.

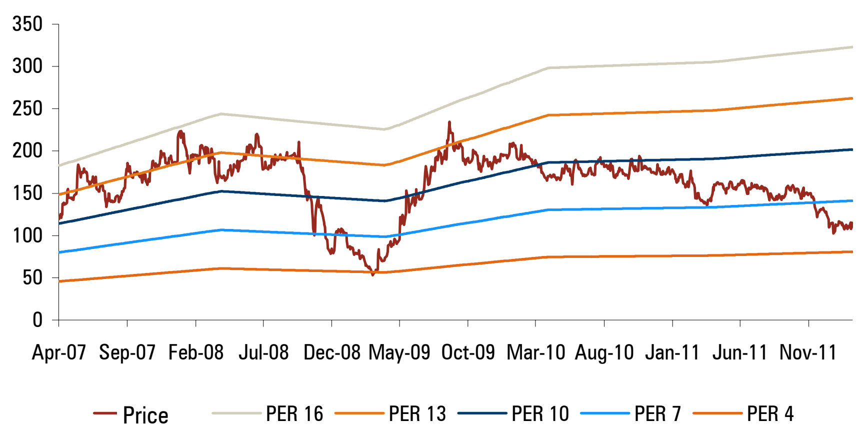
The debt in Q3FY12 increased from ₹ 2220.6 crore in Q2FY12 to ₹ 2415.9 crore. The rising debt level, currently at 1.7x debt to equity, remains a cause for concern. With the inclusion of high cost mezzanine funding, the cost of funds will also be a concern.

In light of the lower revenue growth forecast by the management and increasing finance charges, we have lowered our EPS estimates for FY12 by ₹ 21.9 to ₹ 19.1 and for FY13 from ₹ 22.9 to ₹ 20.2.

We estimate 16.7% CAGR (FY11-13E) in revenue to ₹ 3208.4 crore in FY13 from ₹ 2351.1 crore in FY11 while the PAT is expected to grow at 4.1% CAGR over the same period to ₹ 331.7 crore from ₹ 306.4 crore in FY11.

At the current market price of ₹ 115, the stock is trading at 6.0x FY12E diluted EPS of ₹ 19.1 and 5.7x FY13E diluted EPS of ₹ 20.2. We have valued the stock at 7x FY13E EPS and arrived at a target price of ₹ 141, which implies an upside of 23%. The high levels of debt can remain an overhang on the stock. We maintain our **BUY** rating on the stock.

Exhibit 3: One year forward P/E chart



Source: Company, ICICIdirect.com Research

Exhibit 4: Valuation Table

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY10	1966.4	21.8	14.1	10.0	8.2	3.6	26.2	27.3
FY11	2351.1	19.6	18.6	32.3	6.2	3.8	25.3	20.1
FY12E	2730.3	16.1	19.1	2.3	6.0	4.4	21.5	15.6
FY13E	3203.4	17.3	20.2	5.8	5.7	4.0	18.8	16.0

Source: Company, ICICIdirect.com Research

Financial summary

Profit and loss statement

(Year-end March)	FY10	FY11	FY12E	FY13E
(₹ Crore)				
Total operating Income	1,966.4	2,351.1	2,730.3	3,203.4
Growth (%)	21.8	19.6	16.1	17.3
COGS	1,295.3	1,488.4	1,706.5	2,093.6
Employee Expenses	82.5	94.6	131.8	144.2
Other Expenses	63.2	105.0	112.1	96.1
Total Operating Expenditure	1,440.9	1,688.0	1,950.5	2,333.8
EBITDA	525.5	663.1	779.8	869.6
Growth (%)	56.1	26.2	17.6	11.5
Depreciation	135.3	171.4	206.2	233.9
Interest	71.6	85.3	156.2	198.4
Other Income	3.0	0.1	1.4	5.0
PBT	321.6	406.5	418.8	442.3
MI/PAT from associates	(1.1)	4.9	8.6	14.7
Total Tax	89.9	100.1	105.4	110.6
PAT	231.6	306.4	313.4	331.7
Growth (%)	-7.5	32.3	2.3	5.8
EPS (₹)	14.1	18.6	19.1	20.2

Source: Company, ICICIdirect.com Research

Cash flow statement

(Year-end March)	FY10	FY11	FY12E	FY13E
Profit after Tax	231.6	306.4	313.4	331.7
Add: Depreciation	135.3	171.4	206.2	233.9
(Inc)/dec in Current Assets	-231.4	-231.5	95.4	-128.2
Inc/(dec) in CL and Provisions	1.7	15.2	-81.4	5.2
Others	0.9	-75.2	-43.9	0.0
CF from operating activities	138.1	186.3	489.7	442.7
(Inc)/dec in Investments	-250.2	-769.9	-940.6	-413.4
CF from investing activities	-250.2	-769.9	-940.6	-413.4
Interim Dividend paid	-27.1	-27.1	-27.1	-27.1
Bonus Issue	0.0	0.0	3.9	0.0
Secured Loans	33.4	682.0	977.2	0.0
Unsecured Loans	63.2	-124.2	-274.5	0.0
Foreign exchange fluctuation	-1.2	0.1	0.0	0.0
CF from financing activities	68.3	530.8	679.5	-27.1
Net Cash flow	-43.8	-52.8	228.6	2.2
Opening Cash	347.0	303.2	250.4	479.0
Closing Cash	303.2	250.4	479.0	481.2

Source: Company, ICICIdirect.com Research

Balance sheet

(Year-end March)	FY10	FY11	FY12E	FY13E
(₹ Crore)				
Liabilities				
Equity Capital	29.0	29.0	32.9	32.9
Reserve and Surplus	855.0	1,183.5	1,426.1	1,730.8
Total Shareholders funds	884.0	1,212.5	1,458.9	1,763.6
Total Debt	1,219.1	1,776.9	2,479.6	2,479.6
Others	2.9	3.2	3.2	3.2
Total Liabilities	2,106.1	2,992.6	3,941.7	4,246.4
Assets				
Gross Block	1,450.2	1,863.6	3,077.0	3,490.4
Less: Acc Depreciation	241.4	413.2	619.4	853.3
Net Block	1,208.8	1,450.4	2,457.7	2,637.2
Capital WIP	120.9	322.8	50.0	50.0
Total Fixed Assets	1,329.6	1,773.2	2,507.7	2,687.2
Goodwill	0.0	124.4	124.4	124.4
Investments	0.0	154.9	154.9	154.9
Inventories	68.8	99.2	88.7	92.9
Debtors	532.0	634.4	606.7	711.9
Loans and Advances	155.9	254.6	197.4	216.2
Cash	303.2	250.4	479.0	481.2
Total Current Assets	1,059.9	1,238.5	1,371.8	1,502.2
Total Current Liabilities	283.8	299.0	217.6	222.8
Net Current Assets	776.0	939.5	1,154.3	1,279.4
Misc. Expenses	0.4	0.4	0.4	0.4
Application of Funds	2,106.1	2,992.6	3,941.7	4,246.4

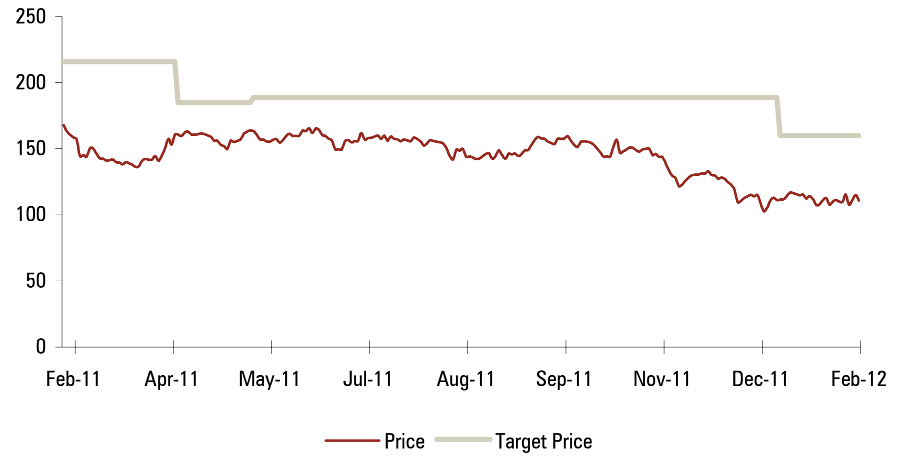
Source: Company, ICICIdirect.com Research

Key ratios

(Year-end March)	FY10	FY11	FY12E	FY13E
Per share data (₹)				
EPS	14.1	18.6	19.1	20.2
Cash EPS	22.3	29.1	31.6	34.4
BV	61.0	83.6	88.8	107.3
DPS	4.0	4.0	4.0	4.0
Cash Per Share	18.4	15.2	29.1	29.3
Operating Ratios (%)				
EBITDA Margin	26.7	28.2	28.6	27.1
PBT / Total Operating income	16.4	17.3	15.3	13.8
PAT Margin	11.8	13.0	11.5	10.4
Inventory days	19.4	24.3	19.0	16.2
Debtor days	98.8	98.5	81.1	81.1
Creditor days	52.7	46.4	29.1	25.4
Return Ratios (%)				
RoE	26.2	25.3	21.5	18.8
RoCE	27.3	20.1	15.6	16.0
RoIC	34.6	22.4	18.0	18.2
Valuation Ratios (x)				
P/E	8.2	6.2	6.0	5.7
EV / EBITDA	3.6	3.8	4.4	4.0
EV / Net Sales	1.0	1.1	1.3	1.1
Market Cap / Sales	0.8	0.7	0.7	0.6
Price to Book Value	1.9	1.4	1.3	1.1
Solvency Ratios				
Debt/EBITDA	2.3	2.7	3.2	2.9
Debt / Equity	0.6	1.0	1.5	1.3
Current Ratio	3.7	4.1	6.3	6.7
Quick Ratio	2.7	3.3	4.1	4.6

Source: Company, ICICIdirect.com Research

Exhibit 5: Recommendation History



Source: Company, ICICIdirect.com Research

Exhibit 6: Recent Releases

Date	Event	CMP	Target Price	Rating
16-Feb-11	Q3FY11 Result Update	168	208	STRONG BUY
8-Apr-11	Q4FY11 Preview	161	185	BUY
16-May-11	Q4FY11 Result Update	164	189	BUY
5-Jul-11	Q1FY12 Result Preview	158	189	BUY
1-Aug-11	Q1FY12 Result Update	157	189	BUY
5-Oct-11	Q2FY12 Result Preview	153	189	BUY
8-Nov-11	Q2FY12 Result Update	151	189	BUY
6-Jan-12	Q3FY12 Result Preview	111	160	BUY

Source: Company, ICICIdirect.com Research

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