

Tulip Telecom Limited

Another good quarter with positive indications for FY12; reiterate Overweight

- Business strength continues:** Tulip Telecom in 4Q delivered sustained revenue growth (+20% Y/Y) and expanding margins once again (+80bp Q/Q) as the contribution from fiber ramped up nicely to 80% of new orders. With incremental revenue streams (R-APDRP projects, International connectivity, data centre) expected to kick in, we expect these trends to continue, and we forecast 23% revenue growth and 1pp margin expansion to 29.2%. Management expects the 20% revenue growth rate of FY11 to continue in FY12, which we view as slightly conservative.
- Watching debt and leverage:** TTSL saw debt increase by Rs3.3B Q/Q and leverage (debt/EBITDA) increase to 2.7x (from 2.1x). While this was due to the well flagged data center investment the company made, we would be encouraged to see an indication of effort/steps taken to bring down leverage and debt, which will be a key focus in FY12, according to management.
- Forecast changes:** We reduce our FY12/FY13 revenue estimates by 2.9%/3.4% but increase our margin estimates by 0.9/1.0pp on account of the beat in 4Q, resulting in no change in our absolute EBITDA estimates of Rs8.4/Rs10.7B. However, higher interest costs drive a Rs2.5/Rs2.4 reduction in our FY12/13 EPS estimates to Rs20/28.
- New Mar-12 PT of Rs230 (40% upside):** As a result of our estimate changes and rolling forward our timeframe from Dec-11 to Mar-12, our PT falls slightly to Rs230. Announcements of clients or an investor for the data centre business should be key positive catalysts. The core business continues to show improvement in both revenue growth and margin expansion. TTSL trades at 8.2x FY12E P/E, a 12% discount to its three-year average, and at 5.1x FY12E EV/EBITDA, a 21% discount. Key risks: stiffer-than-expected price competition in TTSL's core business, and a slower-than-expected ramp-up of its data center business.

Overweight

TULP.BO, TTSL IN

Price: Rs164.25

▼ **Price Target: Rs230.00**
Previous: Rs244.00

India

Alternative Carriers/Emerging Wireline

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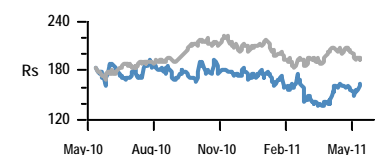
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Price Performance



	YTD	1m	3m	12m
Abs	-6.5%	0.7%	-6.2%	-10.0%
Rel	3.5%	6.9%	-10.6%	-17.1%

Tulip Telecom Limited (Reuters: TULP.BO, Bloomberg: TTSL IN)

Rs in mn, year-end Mar	FY10A	FY11A	FY12E	FY13E		
Revenue	19,655	23,510	28,966	34,980	52-wk range (Rs)	201.40 - 132.00
EBITDA	5,249	6,631	8,449	10,663	Mkt cap (Rs mn)	23,816
EBITDA margin	26.7%	28.2%	29.2%	30.5%	Mkt cap (\$ mn)	529
Net Profit	2,438	3,064	3,238	4,419	Shares O/S (mn)	145
Adjusted EPS (Rs)	15.3	18.8	19.9	27.8	Free float (%)	31.0%
Adjusted EPS growth (%)	(9.7%)	23.4%	5.7%	39.5%	3-mth avg trading volume (mn)	0
EV/EBITDA (x)	6.8	6.4	5.2	3.7	3m Average daily value (\$ mn)	1.14
Adjusted P/E	10.8	8.7	8.2	5.9	NIFTY	5,545
FCF to mkt cap (%)	-2.7%	-19.2%	-5.6%	3.8%	Exchange Rate	45.00
ROE	30.3%	28.6%	22.4%	21.0%	Price (Rs)	164.25
Net debt/EBITDA	1.7	2.2	2.0	1.2	Date Of Price	13 May 11

Source: Company data, Bloomberg, J.P. Morgan estimates.

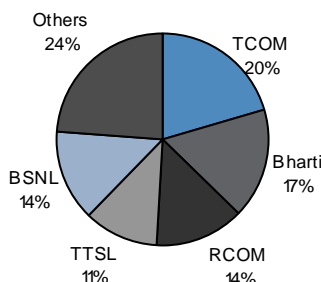
See page 9 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company description

Tulip Telecom (TTSL) is an enterprise communication service provider with operations in India, the US, the Middle East and Asia Pacific. Started in 1992 as a software reseller, it is now an enterprise solutions provider to over 2200 clients across banking, government, telecommunications and other sectors. TTSL is the #1 service provider in the MPLS VPN segment of enterprise data services with ~31% market share, and overall it has 12.7% share. The company has rolled out a last-mile fiber network to about 300 cities, opening up new addressable markets, and also has wireless last-mile connectivity in 2000 cities. The total value for R-APDRP projects can be valued at Rs2,300MM for Tulip.

Enterprise data service market share (FY10)



Source: Company reports.

J.P. Morgan vs. consensus

Sales

RsMM	J. P. Morgan	Consensus
FY12E	28,966	27,882
FY13E	34,980	32,858

EBITDA

RsMM	J. P. Morgan	Consensus
FY12E	8,449	7,959
FY13E	10,663	9,242

Adjusted EPS

Rs	J. P. Morgan	Consensus
FY12E	19.9	22.3
FY13E	27.8	28.1

Source: Bloomberg, J.P. Morgan.

P&L sensitivity metrics

	FY11E EBITDA impact (%)	FY11E EPS impact (%)
EDS revenue (RsMM)	25,592	
Impact of each 5%	4.4%	8.6%
Total Revenue (RsMM)	28,966	
Impact of each 5%	5.0%	9.8%
EBITDA margin (%)	29.2%	
Impact of each 1%	3.4%	6.7%
Capex (RsMM)	7,460	
Impact of each 5%	NA	0.4%

Source: J.P. Morgan estimates.

Price target and valuation analysis

Our Mar-12 DCF-based price target is Rs230. Our full DCF valuation of Tulip's core business is Rs220/share. To this, we add Rs10/share for its stake in the Qualcomm broadband wireless access (BWA) joint venture.

Risk free rate:	7.6%
Market risk premium:	6.0%
Beta:	1.20
Debt/capital	20.0%
Cost of debt:	8.8%
Terminal "g":	3.0%
WACC	13.0%

Source: J.P. Morgan estimates.

Key risks to our rating and price target are: (1) earlier- or deeper-than-expected competition from BWA winners such as Reliance Industries in last-mile enterprise connectivity and/or increasing competition from traditional players; (2) TTSL having to pay a license fee for using the 3.3GHz band (currently unlicensed); (3) continued caution on spending by enterprises (4) delays in the DC business.

Table 1: Valuation comparison

Company name	Ticker	Rating	Current Price	Target price	Upside / downside	P/E (x)			EV/EBITDA (x)		
						FY11	FY12E	FY13E	FY11	FY12E	FY13E
Bharti Airtel	BHARTI IN	OW	368	405	10%	22.7	18.6	13.0	10.0	7.8	6.0
Reliance Communications	RCOM IN	N	91	82	-10%	12.1	15.1	8.2	7.5	6.9	5.6
Idea Cellular	IDEA IN	UW	67	54	-20%	27.1	27.8	19.2	9.0	7.1	6.2
Tulip Telecom	TTSL IN	OW	164	230	40%	8.7	8.2	5.9	6.2	5.1	3.7
Tata Communications	TCOM IN	UW	223	207	-7%	4.0	4.2	3.1	11.0	9.1	7.1

Source: Bloomberg, J.P. Morgan estimates. Priced as of 13 May, 2011

Key takeaways from results and conf call

The good

Revenue growth rate maintained: 4Q revenue of Rs6,380MM represents +6% Q/Q, +20% Y/Y growth. The company delivered sustained Y/Y growth rates in 4Q and furthermore for the year, with revenue at Rs23.5B, Tulip delivered 19.6% Y/Y growth, in-line with expectations. Management highlighted that connectivity in the Enterprise Data Services segment drove growth.

For FY12, management has indicated 20% revenue growth; however, we believe this is a cautious stance given that [1] fiber ramped up towards the end of FY11, [2] new revenue streams - government, international, wholesale - are expected to kick in during the year, and [3] pricing pressure appears to be stabilizing according to management. We forecast 22% core business growth and 23% consolidated revenue growth.

Fiber contribution ramps up: Fiber accounted for over 80% of new orders in revenue terms in 4Q FY11 up from 70% in 3Q. Of the total order book we believe the contribution increased from ~40% to over 50% in the quarter. The company appears well on its way to achieve management targets of 60-70% of its business from fiber by FY12.

Healthy margin expansion: Consolidated EBITDA margin was 29.3%, ahead of both our estimate of 28.8% and the consensus estimate of 28.5%. Margin expanded 80bp Q/Q after the 55bp in 3Q and 90bp in 2Q. Absolute EBITDA of Rs1.87B was 2%/3% ahead of JPME/consensus of Rs1.84/1.82B. Management highlighted improving contribution from fiber and the managed services business and also economies of scale as drivers of EBITDA improvement.

Data centre update: Management reiterated its indication that the data center, once operational, will have a revenue potential of Rs10B. The timing of the start of operations is indicated as August 2011 and the target booking is 75,000 sq ft, or a 17% take-up rate by year 1. Management commented that it was seeing strong demand for the DC space, although at this time this is from domestic customers. A strategic or financial investor is expected to be announced in the next 2-3 months.

The company has already announced IBM as its design partner and Schnabel as its consultancy partner (to oversee design, build and certification) for the data centre.

DC team appears to be in place with Mr. AS Rajgopal appointed as Chief Executive Officer, Mr. Kannan Venkat appointed as Chief Operating Officer (prior role was VP for DC operations at RCOM), Mr. Sujeet Deshpande assigned as Senior Vice President (prior role was Head, Global DC and Managed Services at TCOM) and Mr. Satyamoorthy D as President Sales (prior role: EVP and Head of Sales at Sify Technologies).

Another government power project: Tulip Telecom announced its 5th R-APDRP (Restructured-Accelerated Power Development and Reforms Project) win in Andhra Pradesh. The contract is for Rs320MM over five years, bringing the total R-APDRP

project value to Rs2.4B. Continued wins help Tulip solidify its position to win further such projects from the government.

We expect the early projects to start contributing revenue in 1H FY12 and estimate the annual run rate of revenue contribution to be ~Rs550MM, or 1.9%/1.6% of our FY12/FY13 revenue estimates.

Table 2: Summary of Tulip's R-APDRP wins

Project name	Project value (Rs MM)	Term	Annual revenue (Rs MM)
Uttar Pradesh and Gujarat (Power Corporation Ltd)	1,582	5 years	316
Uttarkhand Power Corporation Ltd	122	3 years	41
Punjab State Power corporation Ltd	380	3 years	127
<u>Andhra Pradesh Power corporation Ltd</u>	<u>320</u>	<u>5 years</u>	<u>64</u>
Total	2,404		548

Source: Company reports and J.P. Morgan

Market share increase: Tulip Telecom now has 12.7% share of the Enterprise Data Connectivity market, up from 11.3% last year. Its share of the MPLS/VPN market is now 30.6%.

The not-so-good

FY11 capex was Rs5.3B, which is above our Rs4-5B estimate: We believe Tulip invested in connectivity between two Indian cities, without which capex would have been within guidance. We see this as rational investment for future growth. In addition, Tulip spent Rs2.3B for the acquisition of the data centre facility.

Debt, leverage and interest increase: Debt increased Rs3.3B to Rs17.7B, while net debt increased Rs1.9B to Rs14.3B. This is primarily driven by the debt taken on for the data centre business. Debt/equity has increased to 1.47x from 1.25x while debt/EBITDA increased to 2.68x from 2.10x. We note that overall cost of funds increased to 9.9% from “about 9%” sequentially, and net interest cost was Rs267MM vs. JPMe of Rs226MM and 3Q FY11 of Rs212MM. We have increased or FY12/FY13 net interest expense estimates to Rs1.57B/Rs1.49B from Rs1.17B/Rs1.19B. Long-term debt as a percent of total debt increased to 89% in FY11 from 76% in FY10.

We believe Tulip has a few options to reduce debt / leverage and would be encouraged on implementation of these: [1] internal cash generation post capex and working capital requirements; [2] sale of its 13% stake in BWA JV with Qualcomm which we value at Rs1.4B, especially if done at a premium; [3] a strategic/financial partner for its data center business which could address the capex here but also results in debt/equity levels improving.

Forecast changes

Table 3: Tulip: New vs. old estimates

Rs in millions, year-end March

	FY12E	FY13E
Revenue		
New	28,966	34,980
Old	29,816	36,199
% Change	-2.9%	-3.4%
Y/Y growth (%)	23.2%	20.8%
EBITDA		
New	8,449	10,663
Old	8,420	10,658
% Change	0.3%	0.0%
Y/Y growth (%)	27.4%	26.2%
EBITDA Margin (%)		
New	29.2%	30.5%
Old	28.2%	29.4%
% Change	0.9%	1.0%
Reported Profit		
New	3,238	4,419
Old	3,639	4,805
% Change	-11.0%	-8.0%
Y/Y growth (%)	5.7%	36.5%
EPS (INR)		
New	19.9	27.8
Old	22.4	30.2
% Change	-11.0%	-8.0%
Y/Y growth (%)	5.6%	39.5%
Capex		
New	7,460	6,418
Old	7,339	6,299
% Change	1.7%	1.9%
Y/Y growth (%)	-2.7%	-14.0%
Capex/sales		
New	26.0%	19.2%
Old	25.0%	18.6%
% point change	1.1%	0.7%

Source: J.P. Morgan estimates.

Valuation and rating analysis

Our Mar-12 price target is decreased to Rs230 from our prior Dec-11 price target of Rs244. We value Tulip's core business at Rs221 based on a full DCF analysis. We add Rs10/share for TTSL's 13% stake in the BWA JV with Qualcomm valued at Rs1,400.

Table 4: Tulip Telecom: SOTP

Rs in millions, year-end March

SOTP	Rs
Core valueA	221
Investment in BWA JV	10
Equity Value Per Share (Rs)	230

Source: Company reports and J.P. Morgan estimates.

We highlight the following downside risks to our ratings and price target: [1] Earlier- or deeper-than-expected competition from BWA winners such as Reliance Industries in last mile enterprise connectivity and/or increasing competition from traditional players like Tata Communications, BSNL, Bharti, Reliance Communications; [2] Tulip having to pay license fee for using the 3.3GHz band (currently unlicensed); [3] Continued caution on spend by enterprises; and [4] Delays in execution in Tulip's data center business.

JPM Q-Profile

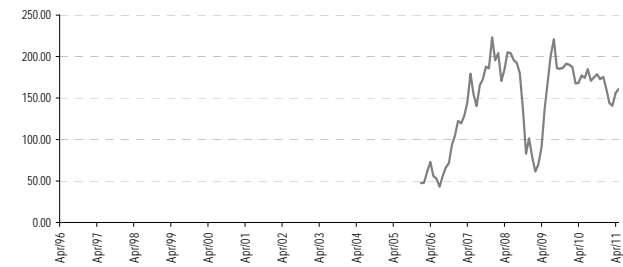
Tulip Telecom Ltd. (INDIA / Telecommunication Services)

As Of: 13-May-2011

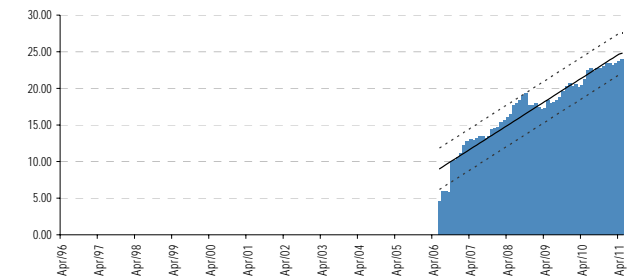
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

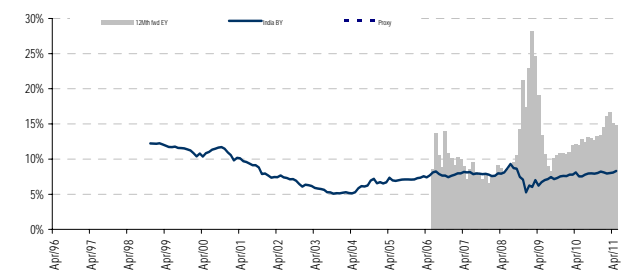
Local Share Price Current: **161.20**



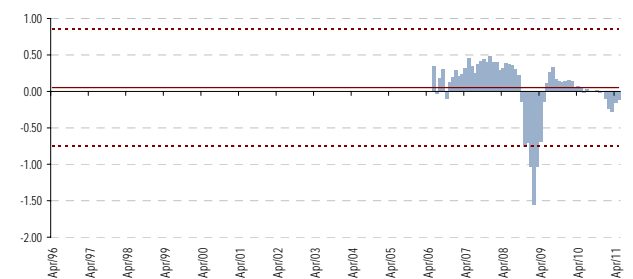
12 Mth Forward EPS Current: **23.95**



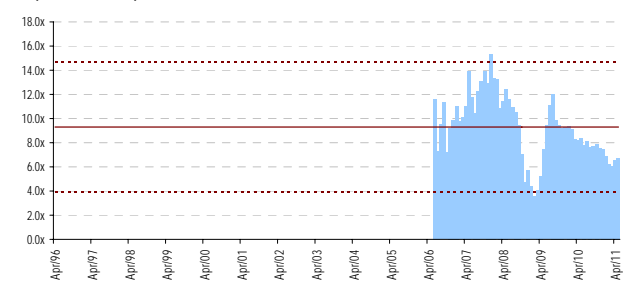
Earnings Yield (& local bond Yield) Current: **15%**



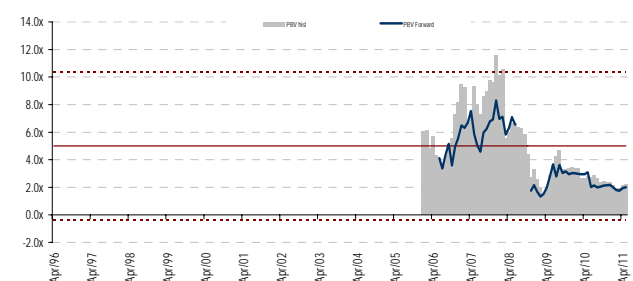
Implied Value Of Growth* Current: **-11.76%**



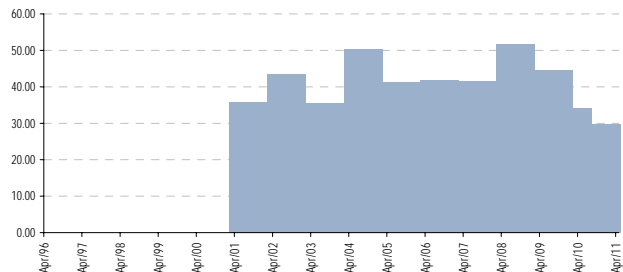
PE (1Yr Forward) Current: **6.7x**



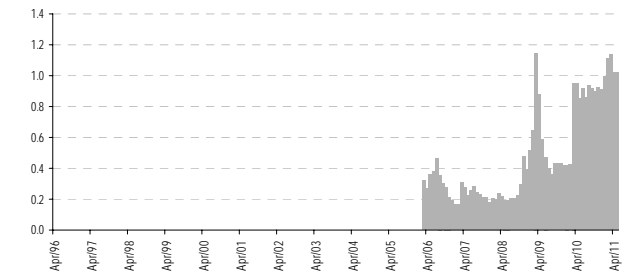
Price/Book Value Current: **2.2x**



ROE (Trailing) Current: **29.77**



Dividend Yield (Trailing) Current: **1.02**



Summary

Tulip Telecom Ltd.		SEDOL		B0T66S8		As Of:		13-May-11			
INDIA						Local Price:		161.20			
Telecommunication Services						EPS:		23.95			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	6.73x	3.54	15.35	9.40	9.30	14.64	3.95	-47%	128%	40%	38%
P/BV (Trailing)	2.18x	1.49	11.57	4.34	5.00	10.35	-0.34	-32%	430%	99%	129%
Dividend Yield (Trailing)	1.02	0.00	1.15	0.36	0.48	1.11	-0.16	-100%	12%	-65%	-54%
ROE (Trailing)	29.77	29.77	51.65	41.57	41.50	53.94	29.06	0%	73%	40%	39%
Implied Value of Growth	-11.8%	-1.56	0.49	0.14	0.05	0.85	-0.75	-1228%	517%	221%	143%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

Tulip Telecom Limited: Summary of Financials

Profit and Loss Statement					Balance Sheet statement				
Rs in millions, year end Mar	FY11	FY12E	FY13E	FY14E	Rs in millions, year end Mar	FY11	FY12E	FY13E	FY14E
Revenue	23,510	28,966	34,980	40,557	Cash and equivalents	2,504	3,044	1,964	773
EBITDA	6,631	8,449	10,663	13,052	Accounts receivable	6,344	7,539	9,104	10,556
D&A	-1,714	-2,563	-3,284	-3,915	Others	3,542	3,787	4,573	5,301
					Total Current assets	12,390	14,370	15,641	16,630
EBIT	4,917	5,886	7,379	9,136					
Interest income	-	-	-	-	Total current liabilities	2,990	3,519	4,249	4,927
Interest expense	-853	-1,568	-1,487	-1,277					
Net Interest expense	-	-	-	-	Net working capital	9,400	10,852	11,391	11,703
Profit before tax	4,065	4,318	5,892	7,860	Net fixed assets	20,526	25,729	28,864	31,168
Tax	-1,001	-1,079	-1,473	-2,672	Other long term assets	-	-	-	-
Net profit - reported	3,064	3,238	4,419	5,187	Total non-current assets	20,526	25,729	28,864	31,168
Net profit - adjusted	3,064	3,238	4,419	5,187					
					Total Assets	32,916	40,100	44,504	47,798
Shares Outstanding	163	163	159	159					
EPS (Rs) (Reported)	18.85	19.92	27.78	32.61	Long-term debt	15,769	17,725	13,024	10,973
EPS (Adjusted)	18.85	19.92	27.78	32.61	Other liabilities	5,022	5,550	6,281	6,959
					Total Liabilities	20,790	23,275	19,305	17,932
Revenue growth	19.6%	23.2%	20.8%	15.9%					
EBITDA growth	26.3%	27.4%	26.2%	22.4%	Shareholders' equity	12,125	16,824	25,199	29,866
Net profit growth	25.7%	5.7%	36.5%	17.4%					
EPS growth	23.4%	5.7%	39.5%	17.4%	Total liabilities and equity	32,916	40,100	44,504	47,798
EBITDA margin	28.2%	29.2%	30.5%	32.2%	Net debt/(cash)	15,265	16,680	13,060	12,201
EBIT Margin	20.9%	20.3%	21.1%	22.5%	Book value per share	75	103	158	188
Net margin	13.0%	11.2%	12.6%	12.8%					
Ratio Analysis					Cash flow statement				
%, year end Mar	FY11	FY12E	FY13E	FY14E	Rs in millions, year end Mar	FY11	FY12E	FY13E	FY14E
P/E (Adjusted)	8.7	8.2	5.9	5.0	Cash flow from operations	3,103	6,133	7,319	8,754
EV/EBITDA	6.4	5.2	3.7	3.0	Capex	-7,665	-7,460	-6,418	-6,220
P/B	2.2	1.6	1.0	0.9	Cash flow from other investing	-1,184	326	250	123
ROE	28.6%	22.4%	21.0%	18.8%	Cash flow from financing	3,440	49	-2,232	-3,848
ROCE	19.1%	17.7%	19.2%	22.0%					
ROA	10.7%	8.9%	10.4%	11.2%	Change in cash for year	-2,306	-953	-1,081	-1,191
FCF Yield	-19.2%	-5.6%	3.8%	10.6%	Beginning cash	3,470	1,164	211	-870
					Closing cash	1,164	211	-870	-2,061
Capex to sales	-32.6%	-25.8%	-18.3%	-15.3%					
Debt/Capital	59.4%	54.0%	37.4%	30.3%	FCF	-4,562	-1,327	901	2,534
Net debt/EBITDA	2.2	2.0	1.2	0.9					

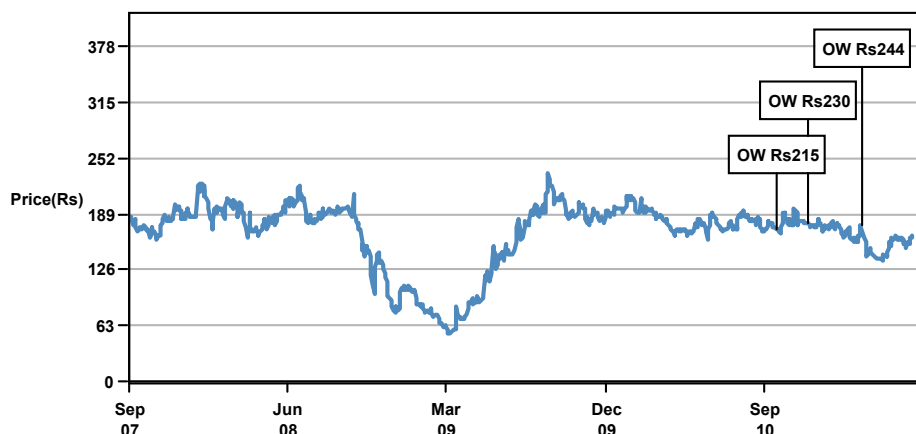
Source: Company reports and J.P. Morgan estimates.

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Important Disclosures

Tulip Telecom Limited (TULP.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
23-Sep-10	OW	172.30	215.00
16-Nov-10	OW	178.80	230.00
16-Feb-11	OW	175.20	244.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Sep 22, 2010. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
 J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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J.P. Morgan uses the following rating system: **Overweight** [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Neutral** [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Underweight** [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] J.P. Morgan Cazenove’s UK Small/Mid-Cap dedicated research analysts use the same rating categories; however, each stock’s expected total return is compared to the expected total return of the FTSE All Share Index, not to those analysts’ coverage universe. A list of these analysts is available on request. The analyst or analyst’s team’s coverage universe is the sector and/or country shown on the cover of each publication. See below for the specific stocks in the certifying analyst(s) coverage universe.

Coverage Universe: **Malvika Gupta:** Bharti Airtel Limited (BRTI.BO), Idea Cellular Limited (IDEA.BO), Reliance Communications Limited (RLCM.BO), Tata Communications Ltd (TATA.BO), Tulip Telecom Limited (TULP.BO)

J.P. Morgan Equity Research Ratings Distribution, as of March 31, 2011

	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	47%	42%	11%
IB clients*	50%	45%	33%
JPMS Equity Research Coverage	43%	49%	8%
IB clients*	70%	62%	56%

*Percentage of investment banking clients in each rating category.

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