

Overhangs clouding the horizon Need to resolve pending issues for rerating

February 10, 2012

Rating Remains	Buy
Target price Reduced from 230	INR 150
Closing price February 9, 2012	INR 115
Potential upside	+30.4%

Action/valuation: Maintain Buy but TP reduced to INR150

Following recent 3Q results and Tulip's announcement on debt funding for the data center, we maintain our Buy rating with a reduced TP of INR150 but note that there are still some pending concerns which need to be resolved for a re-rating to occur. Tulip's core domestic trends have been resilient, but the stock has underperformed the market significantly by 22% since 2011, and 3% YTD. Tulip's current P/E of 5x is a 40-50% discount to its historical average now. Key overhangs include:

- Tulip's debt levels have been a concern to the market and continue to rise on account of rising working cap requirements and the investment in the DC. The timing of events such as monetising its stake in the QCOM JV remains uncertain and thus concern around leverage could remain, in our view. Tulip's FCCB are due for redemption in August (c.US\$140mn including yield) – it expects to have refinancing approvals by FY12, which when completed should alleviate some investors' concerns.
- Tulip's move to secure debt financing for the data center highlights some challenges in finding an equity partner on the right terms, which was the initial focus, and has been pursued for over six months now; we believe this could further stretch the balance sheet in the near term.
- Order 'visibility' on DC has improved to 225k sqft (175k sqft previously); however, it could still take 2-3 quarters for rev trajectory to become visible.
- Recent 3Q results for core business came in below expectations, and management expects some slowdown in 4Q as well.

Catalysts: Deleveraging, growth in fibre, progress on data centre, margin expansion

31 Mar	FY11	FY12F		FY13F		FY14F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	23,511	28,215	27,372	33,066	31,317	37,363	35,266
Reported net profit (mn)	3,065	3,551	3,215	4,398	3,589	4,939	4,175
Normalised net profit (mn)	3,065	3,551	3,215	4,398	3,589	4,939	4,175
Normalised EPS	21.13	24.49	22.17	30.33	24.75	34.06	28.79
Norm. EPS growth (%)	26.5	15.9	4.9	23.9	11.6	12.3	16.3
Norm. P/E (x)	5.8	N/A	5.6	N/A	5.0	N/A	4.3
EV/EBITDA (x)	4.5	4.3	4.3	3.4	3.7	2.9	3.2
Price/book (x)	1.3	N/A	1.1	N/A	0.9	N/A	0.8
Dividend yield (%)	1.5	N/A	1.5	N/A	3.4	N/A	3.9
ROE (%)	25.3	23.0	22.6	22.5	20.4	20.7	19.7
Net debt/equity (%)	128.9	92.7	138.7	63.7	108.7	41.6	84.1

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart.

Anchor themes

The ability to offer a range of services is key in the enterprise space in order to increase stickiness, in our view. Fibre ramp-up should allow for margins to improve and progress on data centres is key.

Nomura vs consensus

We are 8% below consensus on NPAT for FY12F.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

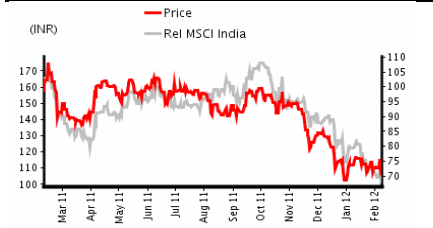
Key data on Tulip Telecom

Income statement (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	19,664	23,511	27,372	31,317	35,266
Cost of goods sold	-12,953	-15,188	-17,354	-19,730	-22,147
Gross profit	6,711	8,323	10,018	11,587	13,119
SG&A	-1,985	-2,459	-2,837	-3,340	-3,847
Employee share expense	-825	-946	-1,314	-1,503	-1,693
Operating profit	3,902	4,917	5,868	6,744	7,579
EBITDA	5,255	6,631	7,828	9,019	10,157
Depreciation	-1,353	-1,714	-1,961	-2,275	-2,578
Amortisation					
EBIT	3,902	4,917	5,868	6,744	7,579
Net interest expense	-687	-853	-1,523	-1,760	-1,615
Associates & JCEs					
Other income	439	1	0	0	0
Earnings before tax	3,654	4,065	4,345	4,984	5,964
Income tax	-899	-1,001	-1,130	-1,396	-1,789
Net profit after tax	2,755	3,065	3,215	3,589	4,175
Minority interests					
Other items	-331	0	0	0	0
Preferred dividends					
Normalised NPAT	2,423	3,065	3,215	3,589	4,175
Extraordinary items	331	0	0	0	0
Reported NPAT	2,755	3,065	3,215	3,589	4,175
Dividends	-232	-232	-243	-538	-626
Transfer to reserves	2,523	2,833	2,972	3,050	3,549
Valuation and ratio analysis					
FD normalised P/E (x)	7.4	5.8	5.6	5.0	4.3
FD normalised P/E at price target (x)	15.4	12.2	11.6	10.4	9.0
Reported P/E (x)	5.8	5.2	5.0	4.5	3.8
Dividend yield (%)	1.5	1.5	1.5	3.4	3.9
Price/cashflow (x)	15.4	6.7	7.2	3.5	3.1
Price/book (x)	1.7	1.3	1.1	0.9	0.8
EV/EBITDA (x)	4.9	4.5	4.3	3.7	3.2
EV/EBIT (x)	6.6	6.0	5.8	5.0	4.3
Gross margin (%)	34.1	35.4	36.6	37.0	37.2
EBITDA margin (%)	26.7	28.2	28.6	28.8	28.8
EBIT margin (%)	19.8	20.9	21.4	21.5	21.5
Net margin (%)	14.0	13.0	11.7	11.5	11.8
Effective tax rate (%)	24.6	24.6	26.0	28.0	30.0
Dividend payout (%)	8.4	7.6	7.6	15.0	15.0
Capex to sales (%)	12.7	26.2	20.1	13.4	11.3
Capex to depreciation (x)	1.8	3.6	2.8	1.8	1.6
ROE (%)	29.7	25.3	22.6	20.4	19.7
ROA (pretax %)	18.6	18.7	17.2	17.1	17.6
Growth (%)					
Revenue	21.8	19.6	16.4	14.4	12.6
EBITDA	56.1	26.2	18.1	15.2	12.6
EBIT					
Normalised EPS	1.8	26.5	4.9	11.6	16.3
Normalised FDEPS	1.8	26.5	4.9	11.6	16.3
Per share					
Reported EPS (INR)	19.00	21.13	22.17	24.75	28.79
Norm EPS (INR)	16.71	21.13	22.17	24.75	28.79
Fully diluted norm EPS (INR)	14.92	18.86	19.79	22.09	25.70
Book value per share (INR)	63.99	83.62	98.21	121.28	146.36
DPS (INR)	1.60	1.60	1.68	3.71	4.32

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	-1.5	-26.8	-31.0
Absolute (USD)	5.6	-26.3	-36.4
Relative to index	-14.7	-27.8	-30.4
Market cap (USDmn)	325.2		
Estimated free float (%)	31.0		
52-week range (INR)	181/93.8		
3-mth avg daily turnover (USDmn)	0.83		
Major shareholders (%)			
Bedi H S	32.0		
Cedar Infonet	24.6		

Source: Thomson Reuters, Nomura research

Notes

We now expect FY12F revenue growth of 14-16%

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	5,255	6,631	7,828	9,019	10,157
Change in working capital	-2,297	-2,164	-3,486	-1,486	-1,487
Other operating cashflow	-1,796	-1,786	-1,862	-2,457	-2,867
Cashflow from operations	1,162	2,681	2,480	5,076	5,803
Capital expenditure	-2,501	-6,154	-5,500	-4,200	-4,000
Free cashflow	-1,340	-3,472	-3,020	876	1,803
Reduction in investments	1,459	-846	0	0	0
Net acquisitions					
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	20	2	791	698	537
Adjustments	-348	-1,254	-791	-698	-537
Cashflow after investing acts	-208	-5,570	-3,020	876	1,803
Cash dividends	-271	-271	-232	-243	-538
Equity issue	0	0	0	0	0
Debt issue	1,939	5,578	5,726	0	-2,000
Convertible debt issue					
Others	0	0	0	0	0
Cashflow from financial acts	1,668	5,307	5,494	-243	-2,538
Net cashflow	1,460	-263	2,474	633	-736
Beginning cash	946	2,405	2,142	4,617	5,249
Ending cash	2,405	2,142	4,617	5,249	4,513
Ending net debt	9,786	15,626	19,746	19,114	17,849

Notes

Capex of INR4bn for FY13F for core business

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	2,405	2,142	4,617	5,249	4,513
Marketable securities	1,065	362	362	362	362
Accounts receivable	5,320	6,344	7,874	9,009	10,145
Inventories	688	992	1,426	1,622	1,820
Other current assets	1,559	2,546	3,558	4,384	4,937
Total current assets	11,037	12,385	17,837	20,626	21,778
LT investments	0	1,549	1,549	1,549	1,549
Fixed assets	13,296	17,732	21,272	23,196	24,619
Goodwill	0	1,244	1,244	1,244	1,244
Other intangible assets					
Other LT assets	0	0	0	0	0
Total assets	24,334	32,911	41,902	46,616	49,190
Short-term debt					
Accounts payable	833	302	291	333	378
Other current liabilities	2,006	2,688	2,190	2,819	3,174
Total current liabilities	2,838	2,990	2,481	3,151	3,552
Long-term debt	12,191	17,769	24,363	24,363	22,363
Convertible debt					
Other LT liabilities	26	28	818	1,516	2,053
Total liabilities	15,055	20,786	27,662	29,030	27,968
Minority interest					
Preferred stock					
Common stock	290	290	290	290	290
Retained earnings	8,989	11,835	13,950	17,296	20,932
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	9,279	12,125	14,240	17,586	21,222
Total equity & liabilities	24,334	32,911	41,902	46,616	49,190
Liquidity (x)					
Current ratio	3.89	4.14	7.19	6.55	6.13
Interest cover	5.7	5.8	3.9	3.8	4.7
Leverage					
Net debt/EBITDA (x)	1.86	2.36	2.52	2.12	1.76
Net debt/equity (%)	105.46	128.87	138.66	108.69	84.11
Activity (days)					
Days receivable	79.5	90.5	95.1	98.4	99.1
Days inventory	22.6	20.2	25.5	28.2	28.4
Days payable	21.0	13.6	6.3	5.8	5.9
Cash cycle	81.0	97.1	114.3	120.8	121.6

Notes

Rising debt levels

Source: Company data, Nomura estimates

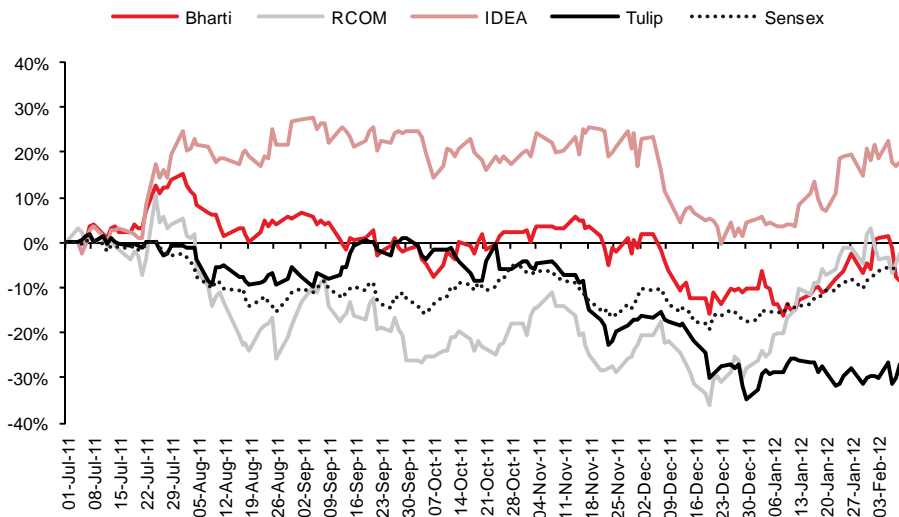
3Q results

ABOVE OR BELOW EXPECTATIONS? Revenue and EBITDA are 5-6% below our expectations.

WHAT DO THE RESULTS MEAN?

- Both revenue and EBITDA saw a 2% q-q decline this quarter and hence are below our and the market's expectations. Management has alluded to headwinds from the macro-economic environment for this sequential decline in the core business. Management expects these could continue into 4Q, and we expect they could even persist into FY13F, in our view, and keep a lid on operational surprises.
- The stock has underperformed on account of other concerns – and we believe resolution of these issues is key for the shares to re-rate.
 - Tulip's leverage has been a key concern for the market, and net debt has risen from INR15bn in 4Q11 to INR21bn 3Q12. This is driven by higher capex requirements (given investment in the data center) and working capital needs (net working capital outflow in 9M12 was INR3.5bn vs INR2.2bn in FY11). Timing of liquidity events and subsequently, deleveraging appear uncertain at the moment.
 - Moreover, redemption of FCCBs is due in August 2012 (c.US\$140mn, including yield) and with the rupee depreciating, has been a key overhang for the stock. Tulip expects to have approvals in place to refinance the same by FY12 – this should alleviate investors' concerns.

Fig. 1: Price performance in last 6M



Source: Bloomberg

ANY CHANGE TO GUIDANCE?

- Slight change in order book target on the new data center from 25% of usable space by FY12 to 15-20% of usable space by FY12.
- Capex of INR4bn for core business in FY13 and INR2.25bn for the data center.
- Growth for FY13 for core business could be in the 15-20% range, but dependant on macro.

KEY NUMBERS

- On a y-y basis, revenues grew 14% to INR6.9bn, although slowing down from previous quarters. YTD, revenue growth of 20% is still in line with our full-year growth estimates.

- EBITDA rose 16% y-y to INR2bn. Margins improved modestly by 10bps q-q to 29%. YTD, margins of 28.7% is tracking broadly in line with our estimates.
- On the data center, management notes order visibility to the tune of 225k sqft (vs 175k sqft). Nevertheless, it needs to lock in these orders and see revenue contribution filtering through for investors to feel more comfortable around this project.

EARNINGS REVISIONS

We lower our earnings estimates for the core business by 9-18%, to account for slower revenue growth in FY12-14F, higher D&A and higher interest expense to account for cost of debt post refinancing of FCCBs. We also increase the working capital needs for this business based on current trends – in 9M12 working capital outflow was INR3.5bn. *(These estimates are for the core business and do not include contribution from the data center.)*

We value the data center on a stand-alone basis and factor 50% of our preliminary valuation estimate into our target price. Our TP for Tulip following revisions moves downwards to INR150.

Fig. 2: Earnings revisions

	2012E	2013E	2014E
NEW ESTIMATES			
Revenue	27,372	31,317	35,266
EBITDA	7,828	9,019	10,157
NPAT (reported)	3,215	3,589	4,175
NPAT (adj)	3,215	3,589	4,175
OLD			
Revenue	28,215	33,066	37,363
EBITDA	8,127	9,723	10,912
NPAT (reported)	3,551	4,398	4,939
NPAT (adj)	3,551	4,398	4,939
%Difference			
Revenue	-3%	-5%	-6%
EBITDA	-4%	-7%	-7%
NPAT (reported)	-9%	-18%	-15%
NPAT (adj)	-9%	-18%	-15%

Source: Nomura estimates

Appendix A-1

Analyst Certification

We, Neeraja Natarajan and Sachin Gupta, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Tulip Telecom	TTSL IN	INR 115	09-Feb-2012	Buy	Not rated	12,49,50

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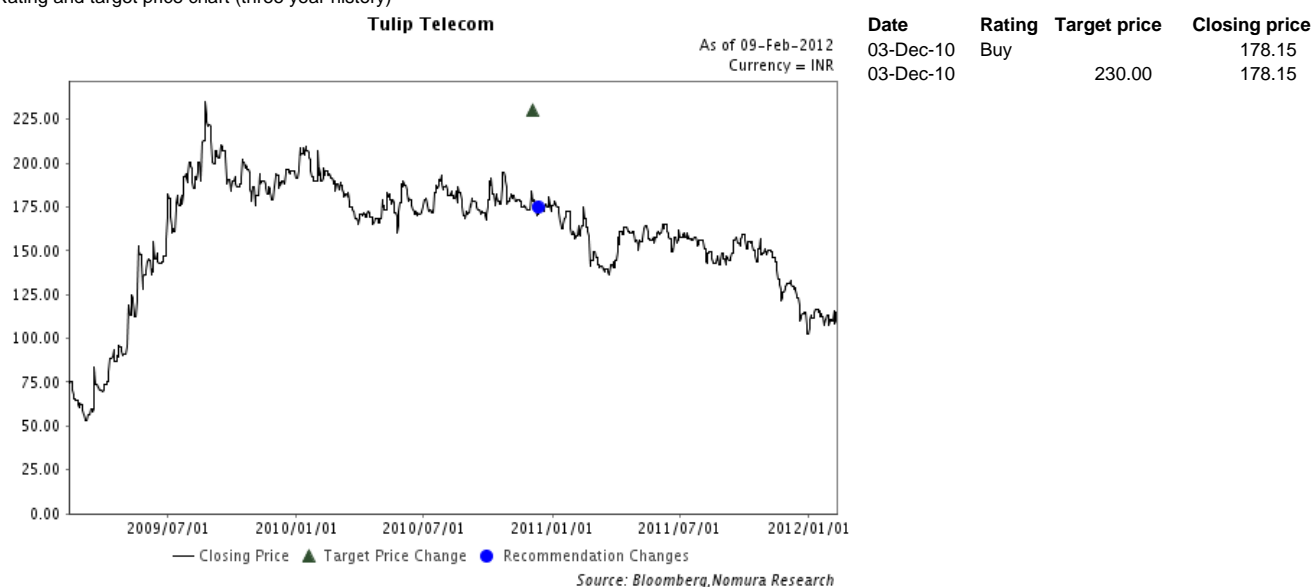
Previous Rating

Issuer name	Previous Rating	Date of change
Tulip Telecom	Not Rated	03-Dec-2010

Tulip Telecom (TTSL IN)

INR 115 (09-Feb-2012) Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of INR150 is based on DCF valuation for the core business using a WACC of 12.3% and terminal growth of 2%, and it includes 50% of the implied value for the DC business based on preliminary estimates. The cashflows are discounted back to 2017.

Risks that may impede the achievement of the target price Downside risks include: slower-than-anticipated demand and profitability on the data centre side, increasing competition and macro slowdown.

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STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended**', indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including, but not limited to, when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company. Benchmarks are as follows: **United States/Europe**: Please see valuation methodologies for explanations of relevant benchmarks for stocks (accessible through the left hand side of the Nomura Disclosure web page: <http://go.nomuranow.com/research/globalresearchportal>); **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology.

SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

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