

Company

18 June 2010 | 6 pages

Tulip Telecom Ltd (TULP.BO)

 Equity

Mgmt Meeting: Focus on Fiber with an Eye on Competition

- Business mix geared towards fiber** — Fiber uptake has been strong and currently contributes ~20% to revenues, which management expects to rise to 70% by FY12E. The company has signed up ~600 customers within 8 months of launch with the bulk of the sign-ups being new contracts and only ~30% replacement contracts (from wireless). While Tulip will benefit from 1) reduced focus on network integration (<10% of revs) and 2) scale with bulk bandwidth purchase, EBITDA margins are unlikely to improve significantly from current levels given pricing pressure.
- Fiber vs. 4G** — While the 2.3GHz BWA spectrum can be used to deploy either of the 4G wireless broadband technologies (WiMax/LTE) to offer high data speeds, the company claimed that these cannot match the speed and capacity available in fiber. Besides, any wide-scale adoption of LTE (the likely choice of winners) is at least 2-3 years away.
- Pricing likely to come under pressure but should be manageable** — While management acknowledged risk of price re-negotiation by customers post BWA, we believe its wide footprint (1400 cities) provides the requisite head-start, especially in areas covered only by wireless (30% of overall revenues). Besides, on-ground fiber in 46 cities should help it compete effectively, especially for the high bandwidth/high profit customers.
- Maintain Buy** — Benefits of fiber from scale economies and higher profitability are now being seen in the financials, especially with rising corporate IT spend as the economy rebounds. In addition, the stock is trading at 9.0x FY11E PER, relatively cheap given medium-term growth potential. Disruptive pricing from new competition and any value destructive acquisition are key downside risks.

Buy/Medium Risk	1M
Price (18 Jun 10)	Rs893.20
Target price	Rs1,120.00
Expected share price return	25.4%
Expected dividend yield	0.9%
Expected total return	26.3%
Market Cap	Rs25,903M US\$560M

Price Performance (RIC: TULP.BO, BB: TTSL IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	2,505	86.39	33.9	10.3	3.8	44.4	0.4
2010A	2,432	83.86	-2.9	10.7	2.8	30.5	0.4
2011E	2,974	102.56	22.3	8.7	2.2	28.4	0.9
2012E	3,565	122.94	19.9	7.3	1.7	26.5	0.9
2013E	3,916	135.05	9.9	6.6	1.4	23.1	0.9

Source: Powered by dataCentral

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Tulip Telecom Ltd

Company description

Tulip Telecom Ltd. (Tulip) is a telecom data service provider that started as a software products vendor in 1992 and entered system integration as a partner of Compaq, IBM etc in the mid-90s. Tulip in its present form began in 2001 when it entered Network Integration followed by its entry in VPN business in FY05. It listed in Jan 2006.

Investment strategy

We rate Tulip Buy/Medium Risk (1M). Fiber uptake has been strong and contributes ~20% to VPN revenues. Management expects the contribution to rise to 40% in FY11E and 70% in FY12E. In addition, the bulk of the sign-ups have been new contracts rather than replacement demand (from wireless). The improving business mix with from fiber benefits from 1) scale economies & 2) access to higher bandwidth customers especially with rising corporate IT spend. Meanwhile its headstart in the semi-urban where it has a wide network will help it compete effectively against larger operators especially if BWA spectrum is fragmented (similar to 3G). We forecast EBITDA CAGR of 18% over FY10-13E.

Valuation

We set our 12-month target price at Rs1,120 based on 10x Sep-11E P/E, in line with the stock's historical discount to the market. We prefer P/E over discounted cash flow (DCF) as: 1) the nature of the business (both VPN and NI) results in low revenue visibility beyond 1-2 years; and 2) it plans to expand into new services like Managed services and to start supplying bandwidth to state electricity boards as part of the APDRP scheme; the size of these opportunities is a difficult variable to estimate over a longer time frame. The target P/E is at a discount to P/Es of other capex-leverage companies that are comparable in terms of EPS CAGR and ROE despite medium-term growth potential. The target multiple is also at a discount to the broader market.

Risks

Our quantitative risk-rating system, which tracks 260-day share price volatility, assigns a High Risk rating to Tulip. We, however, believe that a Medium risk rating is more appropriate given Tulip's presence in the high-growth segment of data connectivity (IP VPN) with increasing IT budgets of corporates /Government, its strong market position and headstart over larger telcos in the rural areas, notwithstanding risks of adverse regulatory changes, technology obsolescence and growing competitive intensity as it starts to compete with larger operators. Other company-specific risks include management's ability to augment bandwidth and make necessary changes in the organization structure to effectively handle rapid growth in scale and scope of operations and any value destructive acquisition. These risk factors could impede the stock from reaching our target price.

Appendix A-1

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Tulip Telecom Ltd (TULP.BO)

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Fundamental Research

Analyst: Gaurav Malhotra, CFA

Covered since May 6 2008

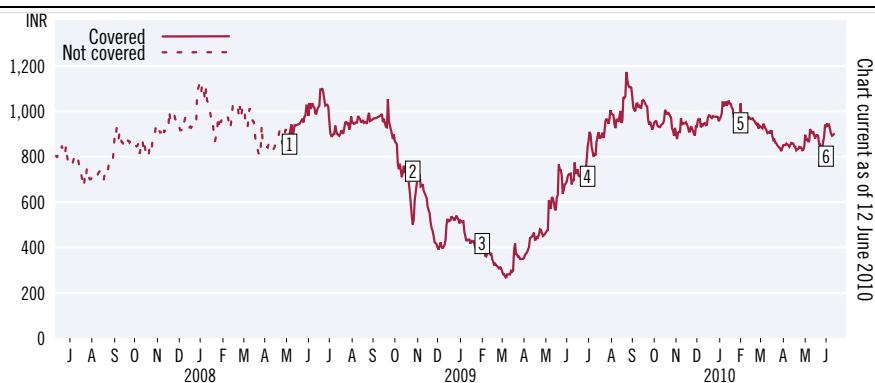


Chart current as of 12 June 2010

	Date	Rating	Target Price	Closing Price
1	6-May-08	*1M	*1,220.00	898.85
2	26-Oct-08	1M	*730.00	542.40

	Date	Rating	Target Price	Closing Price
3	2-Feb-09	1M	*625.00	388.90
4	30-Jun-09	1M	*990.00	843.85

	Date	Rating	Target Price	Closing Price
5	1-Feb-10	1M	*1,150.00	1,035.15
6	1-Jun-10	1M	*1,120.00	930.50

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Mar 2010

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