Result Update

June 1, 2010

Tulip Telecom (TULITS)

Rs 940

Rating matrix

Rating	:	**Buy**
Target	:	Rs 1077
Target Period	:	12 months
Potential Upside	:	15%

Key financials

(Rs Crore)	FY09	FY10E	FY11E	FY12E
Net Sales	1614.4	1966.4	2302.8	2656.1
EBITDA	336.7	525.5	594.4	732.5
Net Profit	250.5	275.4	269.1	354.0
EPS	76.2	83.8	81.9	107.7

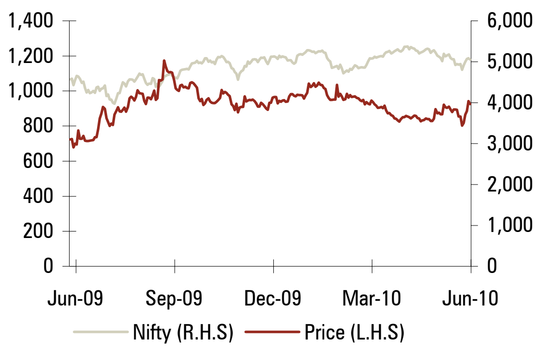
Valuation summary

	FY09	FY10E	FY11E	FY12E
PE (x)	12.3	11.2	11.5	8.7
Target PE (x)	14.1	12.9	13.2	10.0
EV/EBITDA (x)	8.6	5.9	5.2	4.4
P/BV (x)	4.0	3.3	2.6	2.0
RoNW (%)	36.7	29.1	22.4	23.0
RoCE (%)	24.7	26.7	23.6	23.7

Stock data

Market Capitalisation	Rs 2726 Crore
Debt-Cons. (FY09)	Rs 1122.4 Crore
Cash & Invst.-Cons. (FY09)	Rs 347 Crore
EV	Rs 2893.1 Crore
52 week H/L	1249 / 258
Equity capital	Rs 29 Crore
Face value	Rs 10
MF Holding (%)	2.0
FII Holding (%)	22.8

Price movement (Stock vs. Nifty)



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WHAT'S CHANGED...

PRICE TARGET .... Changed from Rs 1070 to Rs 1077

EPS (FY11E) .... Changed from Rs 80.6 to Rs 81.9

EPS (FY12E) .... Introduced at Rs 107.7

RATING.. Changed from Strong Buy to Buy

Going strong...

On a consolidated basis, Tulip Telecom reported its Q4FY10 results, which were below our expectations. The topline stood at Rs 530.7 crore against our expectation of Rs 557.4 crore. Revenues grew 13.0% and 5.9% YoY and QoQ, respectively. Revenue growth can be attributed to higher realisation from the optic fibre network. The EBITDA was up 54.1% YoY and 14.4% QoQ to Rs 154.4 crore as compared Rs 135.0 crore in Q4FY10. The EBITDA margin at 29.1% improved 768 bps YoY and 216 bps QoQ. PAT stood at Rs 79.5 crore (I-direct estimate of Rs 69.4 crore). PAT was aided by a change in the depreciation policy.

- **Highlights for the quarter**

  The company reported its best ever EBITDA margin of 29.1%. It was backed by the decrease in stock in trade by Rs 27.0 crore. The company has revised its depreciation policy considering the company's changing asset profile (ownership of a vast fibre infrastructure), which has aided the PAT during the quarter.

  The company won an order worth US$13 million for a three-year period from a partner in Saudi Arabia in the managed services segment. The revenue from the same has started accruing.

  The company has also proposed a final dividend, subject to approval of shareholders, of 80%, which is Rs 8 per share.
  Tulip announced a stock split of equity shares of Rs 10 each to five equity shares of Rs 2 each.

Valuation

At the current market price of Rs 940, the stock is trading at 11.5x FY11E diluted EPS of Rs 81.9 and 8.7x FY12E diluted EPS of Rs 107.7. We have valued the stock at 10x FY12E EPS and arrived at a target price of Rs 1077. Due to the recent run up in the stock, we are downgrading our rating on the stock from STRONG BUY to **BUY**.

Exhibit 1: Operating highlights

(Rs Crore)	Q4FY10	Q4FY10E	Q4FY09	Q3FY10	QoQ (Chg %)	YoY (Chg %)
Net Sales	530.7	557.4	467.7	500.9	5.9	13.5
EBITDA	154.5	140.2	100.2	135.0	14.4	54.1
EBITDA Margin (%)	29.1	25.1	21.4	27.0	216 bps	768 bps
Depreciation	15.5	39.7	13.6	40.9	-62.0	13.8
Interest	18.5	19.6	14.3	18.6	-0.9	28.8
Reported PAT	79.5	69.4	106.7	68.6	15.9	-25.5
EPS (Rs)	24.2	21.1	36.8	20.9	15.9	-34.3

Source: Company, ICICIdirect.com Research

Result analysis

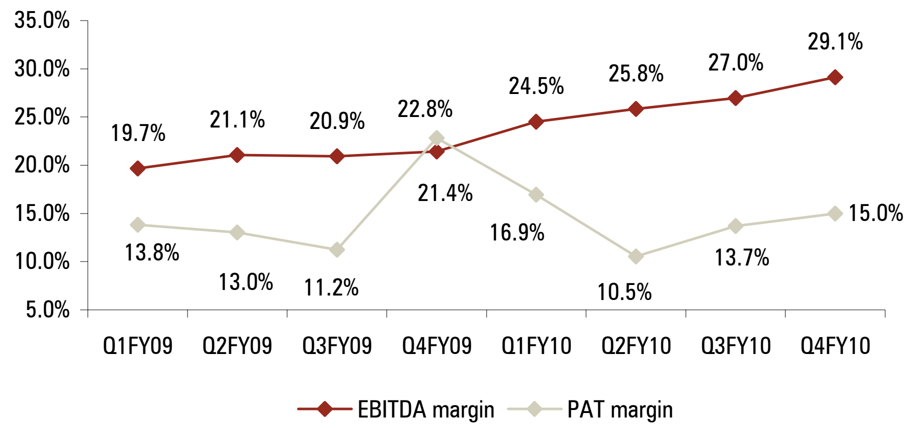
Economies of scale to support higher margin

The company recorded its highest ever EBITDA margin of 29.1%, improving 216 bps and 768 bps QoQ and YoY, respectively. Margins were up primarily due to the increasing mix of fibre optic network revenues (high margin business as compared to NI business) and partly due to decrease in stock by Rs 27.0 crore. On the back of better economies of scale and better realisation from the optic fibre network, we expect the company to report margins at 26.7% and 27.6% for FY11E and FY12E, respectively.

The PAT margin for the quarter stood at 15.0%, improving from 13.7% in Q3FY10 while it declined from 22.8% in Q4FY09. Margins improved primarily due to higher revenue realisation and lower depreciation during Q4FY10 due to a change in accounting policy for treatment of assets.

However, YoY the margin declined due to higher tax outgo as the tax exemption period of five years has now expired. We expect the company to register PAT margin of 12.3% and 13.5% for FY11E and FY12E, respectively.

Exhibit 2: EBITDA and PAT margin



Source: Company, ICICIdirect.com Research

Operational details

On the fibre network Tulip now operates in 46 cities and is expected to expand in 250 cities in the near future. The fibre client base of the company stands at 600 customers. It added several new customers like Adobe, Aditya Birla Group, All India Council for Technical Education (AICTE}, Eros International, Tata AIG, Verizon, Uninor, etc in this quarter. The management expects 70-72% of the new client base to come on the fibre network, going forward.

On the enterprise segment it signed on various existing and new customers during the quarter across various verticals including BFSI, utilities, manufacturing, telecom, logistics, etc.

The company is expected to expand its product and service offering through international long distance (ILD) services. It plans to set up a total of six POPs, one each on the west coast and East coast of the US, one in London, one in Singapore and two in India, which will act as gateways.

Outlook & valuation

Outlook

With the successful roll out of the fibre optic network and increasing reach with respect to its addressable markets, the company is currently operational in 46 cities and is targeting a commercial presence in 250 cities, going forward. On the back of higher client acquisition and better realisation from the fibre network, we expect it to report revenue growth of 17.1% and 15.3% for FY11E and FY12E, respectively. Increasing mix of revenue from the fibre optic network would aid the margin, going forward.

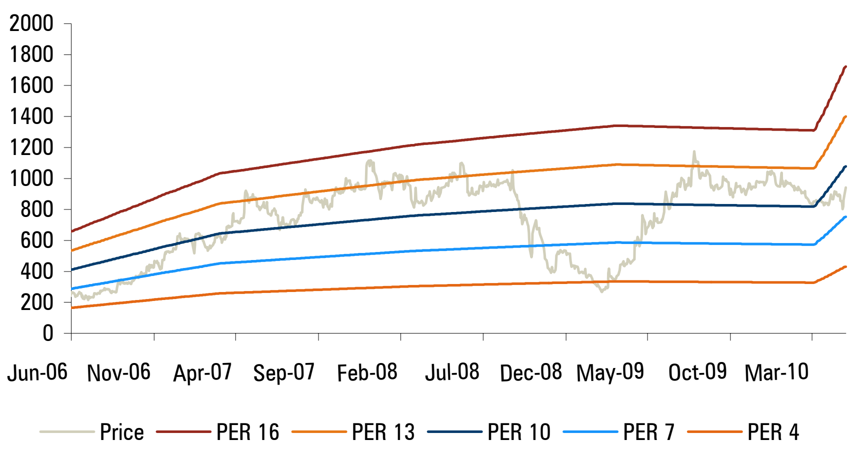
The fibre optic network would also increase the addressable market from 18% to 100%, thus providing the company with additional scope of growth.

The current growth can be attributed to strong demand from the BFSI, Insurance, manufacturing and logistics sector. The company's focus on the VPN segment has enabled it to deliver strong earnings growth.

Valuation

At the current market price of Rs 940 the stock is trading at 11.5x FY11E diluted EPS of Rs 81.9 and 8.7x FY12E diluted EPS of Rs 107.7. We have valued the stock at 10x FY12E EPS and arrived at a target price of Rs 1077. Due to the recent run up in the stock, we are downgrading our rating on the stock from STRONG BUY to **BUY**.

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
	(Rs cr)	(%)	(Rs)	(%)	(x)	(x)	(%)	(%)
FY09	1614.4	32.4	76.2	18.0	12.3	8.6	36.7	24.7
FY10E	1966.4	21.8	83.8	9.9	11.2	5.9	29.1	26.7
FY11E	2302.8	17.1	81.9	-2.3	11.5	5.2	22.4	23.6
FY12E	2656.1	15.3	107.7	31.5	8.7	4.4	23.0	23.7

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: 20% or more;
Buy: Between 10% and 20%;
Add: Up to 10%;
Reduce: Up to -10%
Sell: -10% or more;

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