

Tulip Telecom

Revenue in line; high interest cost dents PAT

Revenue up 49% YoY: Tulip Telecom's (Tulip) Q2FY09 results are in line with our expectations on the operational front. Revenues for the quarter grew 48.8% YoY driven by strong momentum in the IP/VPN business, which posted a growth of 98%. Revenues from Network Integration (NI) decreased 8% YoY due to the management's IP/VPN-focused strategy.

EBITDA margins expand: A higher revenue contribution from the IP/VPN business allowed the EBITDA and EBIT margins to expand by 116bps YoY to 21.1% and 326bps YoY to 19% respectively. The share of IP/VPN in overall revenues has increased from 51.3% in Q2FY08 to 68.4% in Q2FY09. Despite healthy revenue growth and margin expansion, net profit growth was 21% lower than our estimate at Rs 502mn owing to higher interest expenses and lower other income.

ARPU remain stable: Tulip added 20,085 connects during the quarter, taking the total number of connects to 152,364 at the end of September. Revenue per new installation remained unchanged at Rs 42,200. The average revenue per user (ARPU) from existing connects decreased 3.6% QoQ, whereas that from new connects increased 3.6% QoQ.

Revising estimates downwards: We have reduced our earnings estimates for FY09 and FY10 to build in lower connect additions in these years given the difficult macro environment and possible mark-to-market (MTM) forex losses that could arise out of unutilised FCCB proceeds. We have factored in MTM forex losses of Rs 508mn and Rs 680mn in FY09 and FY10 respectively. So far, the company has recorded Rs 160mn in MTM losses in H1FY09.

Revising target price to Rs 961, maintain Buy: Consequent to our earnings revision, we are lowering our target price to Rs 961 from Rs 1,287 earlier. Our target price is based on a DCF valuation and assumes a cost of capital of 16%, terminal growth rate of 3% and fully diluted equity shares of 34.4mn. At our target price, the stock would trade at 12.3x its FY10E fully diluted earnings of Rs 78. We maintain our Buy rating on the stock.

Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	3,846	4,017	(4.3)
EBITDA	811	816	(0.7)
EBITDA margin (%)	21.1	20.3	76bps
Adj net income	502	638	(21.3)
FDEPS (Rs)	14.8	18.5	(20.4)

Financial highlights

(Rs mn)	FY07	FY08	FY09E	FY10E
Revenue	8,426	12,190	17,398	20,748
Growth (%)	65.7	44.7	42.7	19.3
Adj net income	967	1,873	2,256	2,684
Growth (%)	95.4	93.7	20.4	19.0
FDEPS (Rs)	33.3	54.4	65.6	78.0
Growth (%)	80.1	63.2	20.4	19.0

Profitability and Return ratios

(%)	FY07	FY08	FY09E	FY10E
EBITDA margin	15.8	20.2	20.7	21.5
EBIT margin	13.9	16.7	18.0	17.4
Adj PAT margin	11.5	15.4	13.0	12.9
ROE	41.5	50.0	38.7	32.3
ROIC	30.3	28.6	28.5	27.2
ROCE	31.8	25.2	18.3	17.0

Results Review

31 October 2008

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 648	Rs 961	BUY	HIGH

BSE	NSE	BLOOMBERG
532691	TULIP	TTSL IN

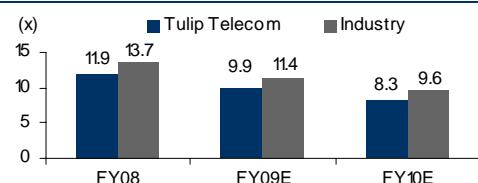
Company data

Market cap (Rs bn / US\$ mn)	19 / 377
Outstanding equity shares (mn)	29
Free float (%)	31.0
Dividend yield (%)	0.3
52-week high/low (Rs)	1,225 / 480
2-month average daily volume	39,942

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Tulip	648	(29.0)	(35.1)	(31.5)
BSE Teck	2,192	(13.9)	(27.7)	(36.9)
Sensex	9,758	(24.1)	(31.7)	(43.6)

P/E comparison



Valuation matrix

(x)	FY07	FY08	FY09E	FY10E
P/E @ CMP	19.4	11.9	9.9	8.3
P/E @ Target	28.8	17.7	14.7	12.3
EV/EBITDA @ CMP	17.5	9.4	6.4	5.2





Result highlights

Quarterly performance

(Rs mn)	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Comments
Revenues	3,331	4,122	3,325	3,846	
<i>Growth YoY (%)</i>	<i>49.9</i>	<i>40.9</i>	<i>56.2</i>	<i>48.8</i>	• Revenue growth during Q2FY09 was boosted by strong momentum in the IP/VPN business. Revenues from this segment grew 98% YoY and 18.5% QoQ led by robust connect additions.
<i>Growth QoQ (%)</i>	<i>28.9</i>	<i>23.7</i>	<i>(19.3)</i>	<i>15.7</i>	
Cost of revenues	2,336	3,172	2,429	2,744	
Gross profit	995	950	896	1,102	
<i>Gross margin (%)</i>	<i>29.9</i>	<i>23.0</i>	<i>27.0</i>	<i>28.7</i>	
Other operating expenses	307	150	242	291	• Tulip witnessed margin expansion at all levels as the high-margin IP/VPN segment contributed a larger revenue share during the quarter.
EBITDA	688	800	654	811	
<i>EBITDA margin (%)</i>	<i>20.6</i>	<i>19.4</i>	<i>19.7</i>	<i>21.1</i>	
Depreciation	124	114	105	79	
EBIT	563	686	550	731	• Interest expenses increased 115% YoY and 46% QoQ due to a rise in interest rates and a higher level of debt. Excluding FCCBs, the outstanding debt at the end of the quarter stood at Rs 3.3bn against Rs 1.7bn in Q1FY09.
<i>EBIT margin (%)</i>	<i>16.9</i>	<i>16.7</i>	<i>16.5</i>	<i>19.0</i>	
Interest expenses	66	84	90	131	
Other income	84	81	21	(55)	
Profit before tax	581	683	481	545	
Income taxes	40	43	21	44	• Tulip booked an MTM loss of ~Rs 100mn on utilised FCCBs of ~US\$ 25mn due to sharp rupee depreciation.
Reported net income	541	640	460	502	
<i>Growth YoY (%)</i>	<i>96.8</i>	<i>93.4</i>	<i>61.6</i>	<i>35.2</i>	
<i>Growth QoQ (%)</i>	<i>45.8</i>	<i>18.4</i>	<i>(28.2)</i>	<i>9.1</i>	• The growth in net profit was lower than estimated due to higher interest expenses and lower other income during the quarter.
Adjustments	-	-	-	-	
Adjusted net income	541	640	460	502	
<i>Growth YoY (%)</i>	<i>96.8</i>	<i>93.4</i>	<i>61.6</i>	<i>35.2</i>	
<i>Growth QoQ (%)</i>	<i>45.8</i>	<i>18.4</i>	<i>(28.2)</i>	<i>9.1</i>	

Source: Company, RHH

Components influencing margin movement

Particulars	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Comments
Revenue contribution					• Contribution from the IP/VPN segment improved 161bps QoQ as the company added 20,085 connects during the quarter, while NI revenues dipped 8% YoY.
Network integration (%)	44.6	43.0	33.3	31.6	
IP/VPN (%)	55.4	57.0	66.7	68.4	
ARPU					• After witnessing a sharp decline in Q1FY09, ARPU from existing connects stabilised during the quarter as high-ARPU connects added in Q1FY09 contributed to revenues.
Installation ARPU (Rs/connect)	42,197	42,200	42,200	42,202	
<i>Change QoQ (%)</i>	<i>(0.0)</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	
Existing connect ARPU (Rs/mth)	4,281	4,323	3,907	3,766	
<i>Change QoQ (%)</i>	<i>23.7</i>	<i>1.0</i>	<i>(9.6)</i>	<i>(3.6)</i>	• ARPUs are expected to remain stable in H2FY09 with the continued addition of new high-revenue connects.
New connect ARPU (Rs/mth)	2,069	2,069	4,598	4,761	
<i>Change QoQ (%)</i>	<i>(14.2)</i>	<i>(0.0)</i>	<i>122.3</i>	<i>3.6</i>	

Source: Company, RHH



IP/VPN performance

Particulars (%)	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Comments	
Connect details						
Number of connects (No.)	93,811	117,177	132,279	152,364	<ul style="list-style-type: none"> Connect additions grew 45% YoY and 15% QoQ. Seasonally H2 is stronger than H1 for customer additions; we expect Tulip to add 95,000 connects in all during FY09. 	
QoQ Growth %	23.7%	24.9%	12.9%	15.2%		
Additions (No.)	17,974	23,366	15,102	20,085		
Customer details						
Total customers (No.)	744	856	984	1,132	<ul style="list-style-type: none"> Tulip added 148 new customers during the quarter including IRCTC, State Bank of Patiala, Future Group and WB Education Dept. 	
Connects per customer (No.)	126	137	134	135		
QoQ Growth %	7.6%	8.6%	(1.8%)	0.1%	<ul style="list-style-type: none"> Network coverage was expanded by 50 more cities and 165 points of presence. The company intends to take its network to almost all villages in the country over the next two years. Tulip is expanding its reach and services through optical fibre networks in central business districts. This would allow the company to offer end-to-end services to high bandwidth customers. 	
Network details						
Number of cities (No.)	1,100	1,200	1,250	1,300		
QoQ Growth %	10.0%	9.1%	4.2%	4.0%		
Points of Presence (No.)	3,081	3,206	3,281	3,446		
QoQ Growth %	4.2%	4.1%	2.3%	5.0%		
PoPs per city (No.)	2.8	2.7	2.6	2.7		
QoQ Growth %	(5.2%)	(4.6%)	(1.8%)	1.0%		
Capacity (mbps)	18,930	19,698	20,158	21,172		

Source: Company, RHH

Revision of estimates

We lower our connect addition estimates by 10% and 8% for FY09 and FY10 respectively

Estimates cut on potentially lower connect additions and MTM losses

We are revising our estimates for FY09 and FY10 to factor in potentially lower connect additions due to the difficult macroeconomic environment as well as MTM forex losses that could arise from unutilised FCCB proceeds. We expect Tulip to add 95,000 and 90,000 connects in FY09 and FY10 respectively as against 105,000 and 98,000 earlier.

Also, the company had raised US\$ 150mn through an FCCB issue, of which ~US\$ 25mn has been utilised to date. Tulip has booked MTM losses of Rs 160mn in H1FY09. We have assumed a gradual use of the FCCB proceeds in the coming quarters, resulting in MTM losses of Rs 508mn and Rs 680mn in FY09 and FY10 respectively at an exchange rate of Rs 49/US\$. Our earnings estimates factor in the fully diluted equity of 34.4mn shares on including the outstanding FCCBs.

Revised estimates

Key parameters	FY09E			FY10E		
	Old	New	% Chg	Old	New	% Chg
Revenue (Rs mn)	18,123	17,398	(4.0)	21,929	20,748	(5.4)
EBITDA (Rs mn)	3,813	3,607	(5.4)	4,908	4,460	(9.1)
EBITDA margin (%)	21.0	20.7	31bps	22.4	21.5	88bps
Net profit (Rs mn)	3,034	2,256	(25.7)	4,006	2,684	(33.0)
FDEPS (Rs)	88.2	65.6	(25.7)	116.4	78.0	(33.0)

Source: RHH

Valuation

Target revised to Rs 961; maintain Buy

We have valued Tulip using a three-stage DCF valuation approach, assuming a terminal growth rate of 3%. We have increased our cost of capital for DCF valuation from 14% to 16% to factor in the higher cost of debt. Consequent to our revision in earnings and cost of capital, we are revising our target price to Rs 961 from Rs 1,287 earlier. At our target price the stock would trade at 12.3x its expected diluted EPS of Rs 78 for FY10. We maintain our Buy rating on the stock.

Target price reduced to Rs 961 on revision in earnings and cost of capital



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY07	FY08	FY09E	FY10E
Revenues	8,426	12,190	17,398	20,748
<i>Growth (%)</i>	<i>65.7</i>	<i>44.7</i>	<i>42.7</i>	<i>19.3</i>
EBITDA	1,330	2,457	3,607	4,460
<i>Growth (%)</i>	<i>99.1</i>	<i>84.8</i>	<i>46.8</i>	<i>23.6</i>
Depreciation & amortisation	159	418	481	857
EBIT	1,171	2,039	3,126	3,603
<i>Growth (%)</i>	<i>87.5</i>	<i>74.1</i>	<i>53.3</i>	<i>15.3</i>
Interest	131	258	539	485
Other income	22	229	(173)	(210)
EBT	1,062	2,009	2,414	2,908
Income taxes	93	138	158	224
Effective tax rate (%)	<i>8.7</i>	<i>6.9</i>	<i>6.6</i>	<i>7.7</i>
Extraordinary items	-	-	-	-
Min int / inc from associates	-	-	-	-
Reported net income	970	1,871	2,256	2,684
Adjustments	3	(2)	-	-
Adjusted net income	967	1,873	2,256	2,684
<i>Growth (%)</i>	<i>95.4</i>	<i>93.7</i>	<i>20.4</i>	<i>19.0</i>
Shares outstanding (mn)	29.0	29.0	29.0	29.0
FDEPS (Rs) (adj)	33.3	54.4	65.6	78.0
<i>Growth (%)</i>	<i>80.1</i>	<i>63.2</i>	<i>20.4</i>	<i>19.0</i>
DPS (Rs)	2.0	2.0	2.0	2.0

Cash flow statement

Y/E March (Rs mn)	FY07	FY08	FY09E	FY10E
Net income + Depreciation	1,128	2,289	2,737	3,541
Non-cash adjustments	148	(155)	36	(113)
Changes in working capital	52	(1,356)	(1,009)	(1,113)
Cash flow from operations	1,328	778	1,765	2,316
Capital expenditure	(1,930)	(3,104)	(1,827)	(819)
Change in investments	24	(300)	(200)	-
Other investing cash flow	-	-	-	-
Cash flow from investing	(1,906)	(3,404)	(2,027)	(819)
Issue of equity	-	-	-	-
Issue/repay debt	660	6,440	2,771	(1,067)
Dividends paid	(68)	(67)	(77)	(77)
Other financing cash flow	-	-	-	-
Change in cash & cash eq	15	3,748	2,432	353
Closing cash & cash eq	26	3,773	6,205	6,558

Economic Value Added (EVA) analysis

Y/E March	FY07	FY08	FY09E	FY10E
WACC (%)	13.0	14.6	16.0	16.0
ROIC (%)	30.3	28.6	28.5	27.2
Invested capital (Rs mn)	4,338	8,924	11,555	12,882
EVA (Rs mn)	753	1,257	1,452	1,450
EVA spread (%)	17.4	14.1	12.6	11.3

Balance sheet

Y/E March (Rs mn)	FY07	FY08	FY09E	FY10E
Cash and cash eq	26	3,773	6,205	6,558
Accounts receivable	1,399	1,980	2,596	2,861
Inventories	205	387	396	466
Other current assets	366	602	797	1,003
Investments	340	640	840	840
Gross fixed assets	2,500	5,480	7,557	8,476
Net fixed assets	2,271	5,480	7,557	8,476
CWIP	226	350	100	-
Intangible assets	-	-	-	-
Deferred tax assets, net	(8)	(9)	(14)	(19)
Other assets	1	1	0	0
Total assets	4,826	13,204	18,478	20,184
Accounts payable	348	368	552	546
Other current liabilities	115	138	166	199
Provisions	150	151	164	203
Debt funds	1,416	7,856	10,627	9,560
Other liabilities	-	-	-	-
Equity capital	290	290	290	290
Reserves & surplus	2,507	4,401	6,679	9,386
Shareholder's funds	2,797	4,691	6,969	9,676
Total liabilities	4,826	13,204	18,478	20,184
BVPS (Rs)	106.5	171.8	250.3	343.7

Financial ratios

Y/E March	FY07	FY08	FY09E	FY10E
Profitability & Return ratios (%)				
EBITDA margin	15.8	20.2	20.7	21.5
EBIT margin	13.9	16.7	18.0	17.4
Net profit margin	11.5	15.4	13.0	12.9
ROE	41.5	50.0	38.7	32.3
ROCE	31.8	25.2	18.3	17.0
Working Capital & Liquidity ratios				
Receivables (days)	62	51	48	48
Inventory (days)	13	12	12	11
Payables (days)	17	15	14	14
Current ratio (x)	4.3	13.3	13.9	14.6
Quick ratio (x)	3.1	3.9	3.6	3.8
Turnover & Leverage ratios (x)				
Gross asset turnover	5.1	3.1	2.7	2.6
Total asset turnover	2.1	1.4	1.1	1.1
Interest coverage ratio	9.0	7.9	5.8	7.4
Adjusted debt/equity	0.5	0.2	0.2	0.1
Valuation ratios (x)				
EV/Sales	2.8	1.9	1.3	1.1
EV/EBITDA	17.5	9.4	6.4	5.2
P/E	19.4	11.9	9.9	8.3
P/BV	6.1	3.8	2.6	1.9



Quarterly trend

Particulars	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09
Revenue (Rs mn)	2,585	3,331	4,122	3,325	3,846
YoY growth (%)	39.6	49.9	40.9	56.2	48.8
QoQ growth (%)	21.4	28.9	23.7	(19.3)	15.7
EBITDA (Rs mn)	515	688	800	654	811
EBITDA margin (%)	19.9	20.6	19.4	19.7	21.1
Adj net income (Rs mn)	371	541	640	460	502
YoY growth (%)	83.2	96.8	93.4	61.6	35.2
QoQ growth (%)	30.3	45.8	18.4	(28.2)	9.1

DuPont analysis

(%)	FY06	FY07	FY08	FY09E	FY10E
Tax burden (Net income/PBT)	87.1	91.0	93.2	93.4	92.3
Interest burden (PBT/EBIT)	90.9	90.7	98.5	77.2	80.7
EBIT margin (EBIT/Revenues)	12.3	13.9	16.7	18.0	17.4
Asset turnover (Revenues/Avg TA)	241.8	213.2	135.2	109.8	107.3
Leverage (Avg TA/Avg equity)	180.2	169.4	240.8	271.7	232.3
Return on equity	42.4	41.5	50.0	38.7	32.3

Company profile

Tulip Telecom (Tulip) is the market leader in India's fast growing IP/VPN connectivity market. Burgeoning use of information systems like ERP and CRM is resulting in a favourable industry scenario. The company has India's largest VPN network with points of presence in more than 3,446 locations spread across 1,300 cities in the country. Driven by an aggressive IP/VPN network expansion drive, Driven by aggressive IP/VPN network expansion drive, Tulip has witnessed a rapid growth in the number of connects, during past few year.

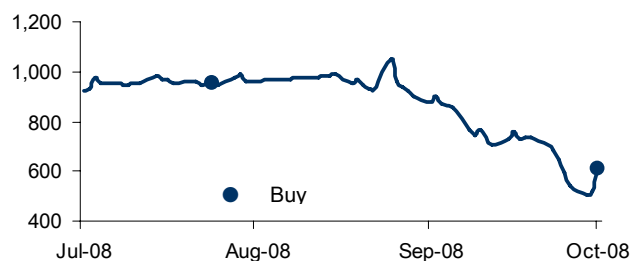
Shareholding pattern

(%)	Mar-08	June-08	Sep-08
Promoters	68.9	68.9	68.9
FIs	23.3	24.1	24.5
Banks & FIs	2.8	2.5	2.2
Public	5.0	4.5	4.4

Recommendation history

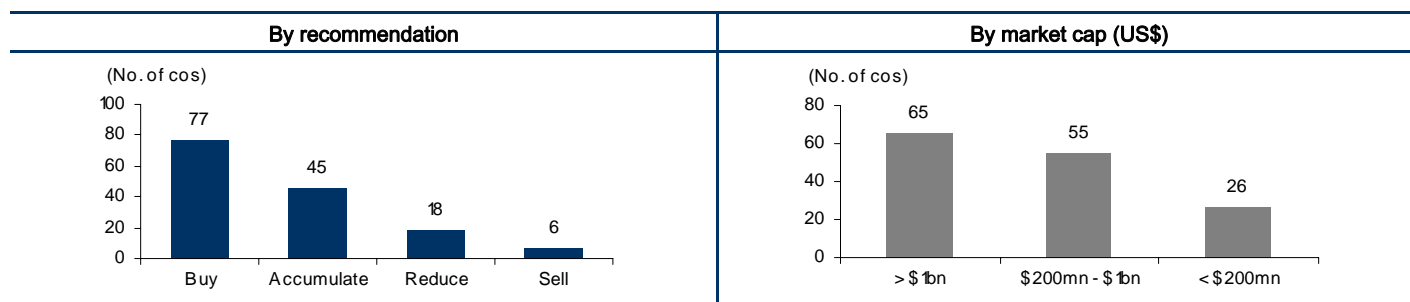
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	953	1,287	Buy
31-Oct-08	Results Review	648	961	Buy

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 20%
Accumulate	Between 10% and 20%
Reduce	Up to 10%
Sell	Less than 0%

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