

25th July 2007**ACCUMULATE**

| | |
|--------------|--------------|
| Price | Target Price |
| Rs235 | Rs269 |
| Sensex | 15,795 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|----------------|-----|----|----|-----|
| Absolute | 5 | 34 | 59 | 100 |
| Rel. to Sensex | (4) | 19 | 41 | 30 |

Source: Capitaline

Stock Details

| | |
|------------------------------|---------|
| Sector | Telecom |
| Reuters | GTL.BO |
| Bloomberg | GTS@IN |
| Equity Capital | 974 |
| Face Value | 10 |
| 52 Week H/L | 245/113 |
| Market Cap | 22.9 |
| Daily Avg Vol (No of shares) | 2083596 |
| Daily Avg Turnover (US\$) | 10.5 |

Shareholding Pattern (%)

(31st June '07)

| | |
|---------------|------|
| Promoters | 33.4 |
| FII/NRI | 39.4 |
| Institutions | 3.2 |
| Private Corp. | 6.9 |
| Public | 17.1 |

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Result Update

Benefiting from the telecom spend

GTL reported Q1FY08 results much ahead of our expectations. The net sales for the quarter increased by 78% yoy to Rs4.1bn, EBIDTA increased by 107% yoy to Rs606mn, PAT decreased by 7% yoy to 321mn while APAT increased by 129% yoy to Rs408mn. The EBIDTA margins increased by 206bps yoy to 14.9%. GTL recently entered into an agreement with France Telecom to sell off its enterprise solutions and managed services business in an all cash deal valued at ~US\$40mn. The business sell off includes the transfer of the customer base of the business along with the relationships with technology providers such as Alcatel, Lucent, Nortel, Juniper, Verint, etc. along with 590 employees. The company has an order book of Rs16bn to be delivered over the next 12 months. Based on the strong growth, delivery and the opportunity available, we revise our estimates for FY08 upwards and introduce the estimates for FY09. The company also plans to hive off its BPO business and expects an additional cash inflow of US\$60mn from the sale. We have revised our price target for GTL from Rs192 to Rs269 based on SOTP approach. We recommend **ACCUMULATE** rating on the stock.

Result updates

GTL reported Q1FY08 results with a 78% increase in the net sales to Rs4.1bn. The EBITDA for the quarter improved by 107% to Rs606mn. The EBITDA margins increased by 206bps yoy to 14.9% primarily on account of the decreased cost of delivery (393bps) and SG&A (206bps) despite a 500bps increase in the cost of sales. The PAT for the quarter decreased by 7% yoy to Rs321mn because which was due to the other income component of 168mn in the same quarter last year. The APAT for the quarter increased by 129% yoy to Rs408mn.

Network services provides huge growth potential

The telecom industry in India is at a robust growth phase and the operators are in an aggressive expansion mode to provide connectivity to the growing subscriber base. The mobile operators in India alone are expected to spend US\$20bn on capex by FY10, which provides a significant opportunity for the company going forward. While the capex requirement of the industry would provide opportunities in the deployment space, the deployed networks would further have to be managed, operated and maintained which further provides opportunities for the company in the services side.

Outlook and Valuations

After the strong quarterly results and considering the huge growth opportunity in the telecom industry, we have revised our estimates for FY08 and introduced FY09 projections. We expect GTL to report revenues of Rs14.2bn and Rs17.7bn for FY08E and FY09E respectively. We expect the EBIDTA margins to improve from 12.7% in FY07 to 15% by FY09E. We expect the company's earnings to grow by CAGR 62% over FY07-09E with an EPS of Rs14.3 for FY08E and Rs18.7 for FY09E. We revise our price target from Rs192 to Rs269 based on SOTP approach (10x EPS of Rs18.7 for FY09E and value of holding in GTL Infra at Rs82 per share). The company is also aggressively scouting for a few acquisitions in the network services space, which would act as triggers for the stock and would provide upside to our estimates. We assign **ACCUMULATE** rating on the stock with a target of Rs269.

| YE-Mar | Net Sales | EBITDA (Core) | EBITDA (%) | APAT | RoCE (%) | EV/ EBITDA | P/BV | Div Yld (%) | AEPS (Rs) | P/E |
|---------|-----------|---------------|------------|-------|----------|------------|------|-------------|-----------|------|
| 15mFY06 | 9,805 | 1,713 | 17.5 | 1,053 | 6.3% | 12.5 | 2.3 | 8.5% | 8.9 | 26.5 |
| 9mFY07 | 9,254 | 1,172 | 12.7 | 674 | 5.9% | 12.9 | 2.0 | 1.1% | 9.2 | 25.5 |
| FY08E | 14,244 | 1,935 | 13.6 | 1,352 | 8.4% | 12.5 | 2.4 | 1.1% | 14.3 | 16.5 |
| FY09E | 17,663 | 2,649 | 15.0 | 1,770 | 11.4% | 8.9 | 2.1 | 1.1% | 18.7 | 12.6 |

The EPS and PE figures for 15mFY06, 9mFY07 are annualized.

On the focused path

During the restructuring exercise, GTL had decided to focus on the network services business and hive-off the other non-core businesses (IT services). The sell-off of the enterprise solutions and managed services businesses is in line with the managements focus to concentrate and scale up the network services business. The proceeds from the sale of the business would be utilized for the overseas acquisition for companies in the network services space. While the company has a huge opportunity for growth, the same is being tapped and reflects in the performance of the company.

BPO business hive off in the pipeline

GTL recently announced the hive off of its enterprise solutions and managed services businesses forming part of its IT services business to France Telecom in an all cash deal amounting to ~US\$40mn. The transaction with France Telecom includes the transfer of the customer base of the business along with the relationships with technology providers such as Alcatel, Lucent, Nortel, Juniper, Verint, etc. along with 590 employees. The Q1FY08 revenues include ~Rs400mn revenues from the hived off businesses. The annual employee costs pertaining to the hived off businesses amounted to Rs330mn for FY07. The company also plans to sell its BPO, KPO and application management businesses during the year FY08 and expects an additional inflow of US\$60mn from the sale of the remaining non-core businesses.

Significant opportunity available for growth

With the telecom industry growing rapidly, the mobile operators are spending aggressively on capex to expand their network capacities and geographical coverage. The emergence of tower companies is also seeing a large rollout of mobile infrastructure to provide growth opportunities for the company. While Bharti Airtel is planning to deploy 30,000 towers, RCOM's infrastructure subsidiary would deploy 23,000 towers in FY08 alone. The long awaited BSNL tender is also at the verge of getting finalized although with lesser size, but huge opportunity. Not just the operators, but also the third party service providers like GTL Infra, Quipo, Essar, X-cel, etc. are entering the tower sharing business with plans to deploy an aggregate of over 50,000 over the next two years. All this provides huge opportunity for the network services major, GTL.

Significant investment in the subsidiary GTL Infra

Post de-merger, the passive infrastructure provider, GTL Infrastructure, has got listed separately on the stock exchanges. By virtue of being the promoter, GTL has 41% stake in GTL Infrastructure Ltd. GTL infrastructure has also announced a 1:1 rights issue in which GTL would be investing Rs1.3bn. At CMP of Rs36 (ex rights) the value of GTL's holding in GTL Infrastructure amounts to Rs9.7bn or Rs102 per share of GTL. In our sum of parts valuation we have valued the holding in GTL Infrastructure at 20% discount to market price, which is Rs82 per share.

Acquisition on radar

GTL has raised US\$150mn as debt, which has been earmarked for acquisition. The company recently acquired Genesis Consultancy, a UK based network management and professional services company. Through this acquisition, GTL has acquired a pool of engineers having skill sets on the 3G platform. GTL, with a drive to become a leading network services provider globally, is actively scouting for acquisitions to increase its presence in the international markets. Recently, the company has also given non-binding offers to a few companies identified for acquisition.

Huge cash on books for acquisition

As on the year ending March 2007, GTL had cash and equivalents of Rs11.4bn on its balance sheet. The total debt outstanding on the balance sheet is Rs8.5bn. We expect the sale of enterprise solutions and managed services business to have resulted in a cash inflow of Rs1.75bn. Out of the total cash of Rs13.2bn available with the company, Rs2.6bn would be utilized for the share buyback and Rs1.3bn would be used to subscribe to the rights issue of GTL Infrastructure. This would still leave the company with a cash of Rs9.1bn, which would be utilized for acquisition.

Buy back at Rs300

GTL has cash of over Rs11bn on books, majority of which has been earmarked for acquisitions. From the excess cash available, the company has decided to buy back its shares at a fixed price of Rs300 per share through a tender offer aggregating to an amount of Rs2.6bn. Through the buy back the fully diluted equity of the company would be reduced from Rs1040mn to Rs954mn. The company is in the process of getting the shareholder approval through the postal ballot for the buy back. The management expects the buy back process to be completed by end Q2FY08.

Returns improving

By the hive off of assets through the restructuring, payment of special dividend and now through the buyback, the company's net worth and the capital employed is on a decline while at the same time the higher earnings growth would lead to a significant improvement in the ROE and ROCE' of the company. While the ROE is expected to double from the current 8% to 16% by FY09E, the ROCE is expected to increase from the current 6% to 11% by FY09E.

| Y/E Mar (Rs mn) | Q5Jun06 | Q1Jun07 | %YoY | Q3Mar07 | %QoQ | 9mFY07 |
|----------------------------|---------|---------|----------------|---------|----------------|--------|
| Net Sales | 2,283.4 | 4,073.2 | 78% | 3,964.0 | 3% | 9254.3 |
| Cost of sales and services | 1,479.1 | 2,841.0 | 92% | 2,623.5 | 8% | 5965.0 |
| Cost of delivery | 241.5 | 270.8 | 12% | 373.1 | -27% | 1057.1 |
| Selling and admin exp | 269.9 | 354.9 | 31% | 410.9 | -14% | 1059.9 |
| EBITDA | 292.9 | 606.5 | 107% | 556.5 | 9% | 1172.3 |
| Depreciation | 96.3 | 114.4 | 19% | 108.7 | 5% | 308.5 |
| EBIT | 196.6 | 492.1 | 150% | 447.8 | 10% | 863.8 |
| Interest | 2.4 | 68.4 | 2750% | 72.9 | -6% | 153.7 |
| Other income | 168.2 | (82.2) | -149% | (65.0) | 26% | 20.3 |
| PBT | 362.4 | 341.5 | -6% | 309.9 | 10% | 730.3 |
| Tax | 18.1 | 20.1 | 11% | 26.0 | -23% | 56.1 |
| RPAT | 344.3 | 321.4 | -7% | 283.9 | 13% | 674.3 |
| EPS | 3.3 | 3.1 | -7% | 2.7 | 13% | 6.5 |
| APAT | 176.1 | 403.7 | 129% | 349.0 | 16% | 654.1 |
| % of Net sales | | | chg bps | | chg bps | |
| Cost of sales and services | 64.8% | 69.7% | (497) | 66.2% | (357) | 64.5% |
| Cost of delivery | 10.6% | 6.6% | 393 | 9.4% | 276 | 11.4% |
| Selling and admin exp | 11.8% | 8.7% | 311 | 10.4% | 165 | 11.5% |
| EBITDA | 12.8% | 14.9% | 206 | 14.0% | 85 | 12.7% |
| EBIT | 8.6% | 12.1% | 347 | 11.3% | 78 | 9.3% |
| APAT | 7.7% | 9.9% | 220 | 8.8% | 111 | 7.1% |

Source: Company, Emkay Research

Income Statement

| Y/E, Mar (Rs. mn) | 15mFY06 | 9mFY07 | FY08E | FY09E |
|----------------------------|---------|--------|--------|--------|
| Net Sales | 9,805 | 9,254 | 14,244 | 17,663 |
| Growth (%) annualised | 3.7 | 57.3 | 15.4 | 24.0 |
| Expenses | 8,092 | 8,082 | 12,309 | 15,014 |
| Cost of Sales and Services | 5,171 | 5,965 | 9,045 | 11,163 |
| % of sales | 52.7 | 64.5 | 63.5 | 63.2 |
| Employee Cost | 1,396 | 1,057 | 1,768 | 2,120 |
| % of sales | 14.2 | 11.4 | 12.4 | 12.0 |
| Selling/Admin Cost | 1,514 | 1,060 | 1,496 | 1,731 |
| % of sales | 15.4 | 11.5 | 10.5 | 9.8 |
| EBIDTA | 1,713 | 1,172 | 1,935 | 2,649 |
| Growth (%) annualised | (34.8) | 14.1 | 23.8 | 36.9 |
| EBIDTA % | 17.5 | 12.7 | 13.6 | 15.0 |
| Other income | 15 | 20 | 248 | 257 |
| Interest | - | 154 | 120 | 220 |
| Depreciation | 722 | 309 | 454 | 474 |
| PBT | 1,005 | 730 | 1,609 | 2,212 |
| Current tax | 48 | 74 | 258 | 442 |
| Deferred tax | (95) | (18) | | |
| PAT | 1,053 | 674 | 1,352 | 1,770 |
| Growth (%) annualised | (28.4) | 6.8 | 50.4 | 51.7 |
| Net Margin (%) | 10.7 | 7.3 | 9.5 | 10.0 |

Balance Sheet

| Y/E, Oct (Rs. mn) | 15mFY06 | 9mFY07 | FY08E | FY09E |
|---------------------------|---------|--------|--------|--------|
| Equity share capital | 856 | 973 | 948 | 948 |
| Reserves & surplus | 8,790 | 10,129 | 8,239 | 9,742 |
| Networth | 9,645 | 11,102 | 9,187 | 10,691 |
| Deferred tax liability | (98) | (123) | (123) | (123) |
| Loan Funds | 3,044 | 8,492 | 8,492 | 8,492 |
| Minority interest | 9 | 3 | 5 | 5 |
| Total Liabilities | 12,600 | 19,474 | 17,563 | 19,066 |
| Gross Block | 3,116 | 3,758 | 4,374 | 4,574 |
| Less: Depreciation | 1,015 | 1,330 | 1,784 | 2,258 |
| Net block | 2,101 | 2,428 | 2,590 | 2,316 |
| Capital work in progress | 409 | 617 | 417 | 367 |
| Investment | 2,587 | 2,238 | 3,546 | 3,546 |
| Inventories | 772 | 1,696 | 1,171 | 1,452 |
| Sundry debtors | 2,925 | 3,958 | 3,512 | 4,355 |
| Cash & bank balance | 5,984 | 11,244 | 6,663 | 7,301 |
| Loans & advances | 2,715 | 4,388 | 3,903 | 4,355 |
| Current liabilities | 2,524 | 6,742 | 4,022 | 4,355 |
| Provisions | 2,369 | 353 | 216 | 270 |
| Net current assets | 7,503 | 14,192 | 11,010 | 12,837 |
| Miscellaneous expenditure | (0) | - | - | - |
| Total Assets | 12,600 | 19,474 | 17,563 | 19,066 |

Cash Flow

| Y/E, Mar (Rs. mn) | 15mFY06 | 9mFY07 | FY08E | FY09E |
|-----------------------------|---------|---------|---------|---------|
| Pre-tax profit | 1,028 | 730 | 1,609 | 2,212 |
| Depreciation | 722 | 309 | 454 | 474 |
| Interest & Fin charges | (424) | 154 | 120 | 220 |
| Chg in working cap | 616 | (1,429) | (1,399) | (1,190) |
| Tax paid | 309 | (74) | (258) | (442) |
| Others | (3,783) | - | - | - |
| Operating cash Inflow | (1,531) | (310) | 527 | 1,275 |
| (Inc)/Dec in fixed assetsP | 1,171 | (849) | (417) | (150) |
| (Inc)/Dec in investments | (544) | 349 | (1,308) | - |
| Others | 340 | (30) | - | - |
| Free Cash Flow | 967 | (531) | (1,725) | (150) |
| Inc/ (Dec) in Share Capital | 1,131 | 1,093 | (249) | (0) |
| Loans Taken / (Repaid) | (1,429) | 5,449 | - | - |
| Interest & Fin Charges | (401) | (154) | (120) | (220) |
| Dividend (incl tax) | (138) | (302) | (267) | (267) |
| Others | (115) | - | - | - |
| Net chg in cash | (951) | 6,086 | (635) | (487) |
| Total Cash Generated | (1,515) | 5,245 | (1,833) | 638 |
| Opening cash position | 7,499 | 5,984 | 11,244 | 9,411 |
| Closing cash position | 5,984 | 11,244 | 9,411 | 10,049 |

Ratios

| Y/E, Mar (Rs. mn) | 15mFY06 | 9mFY07 | FY08E | FY09E |
|------------------------|---------|--------|-------|-------|
| EPS (annualised) | 8.9 | 9.2 | 14.3 | 18.7 |
| Cash EPS (annualised) | 15.0 | 13.8 | 19.0 | 23.7 |
| Book Value (x) | 101.7 | 117.1 | 96.9 | 112.7 |
| PER (x) | 26.5 | 25.5 | 16.5 | 12.6 |
| Price / CEPS (x) | 15.7 | 17.0 | 12.3 | 9.9 |
| Price / BV (x) | 2.3 | 2.0 | 2.4 | 2.1 |
| EV / Sales (x) | 2.5 | 1.6 | 1.7 | 1.3 |
| EV / EBITDA (x) | 12.5 | 12.9 | 12.5 | 8.9 |
| DPS (Rs) | 20.0 | 2.5 | 2.5 | 2.5 |
| Dividend Yield (%) | 8.5% | 1.1% | 1.1% | 1.1% |
| RoCE | 6.3% | 5.9% | 8.4% | 11.4% |
| RoE | 8.7% | 8.1% | 14.7% | 16.6% |
| RoA | 6% | 4% | 7% | 9% |
| EBITDA Margins | 17% | 13% | 14% | 15% |
| Net Margin | 10% | 8% | 11% | 13% |
| Debtors T/O | 136 | 117 | 90 | 90 |
| Creditors T/O | 71 | 159 | 90 | 90 |
| W. Cap T/O (excl cash) | 71 | 87 | 111 | 114 |
| Total Debt/Equity (x) | 0.3 | 0.8 | 0.9 | 0.8 |

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