

TULIP TELECOM



In-line performance; valuations attractive

Q1FY11 results broadly in line with estimates

Tulip Telecom's (TTSL) Q1FY11 results were in line with our estimates, with revenues of INR 5.25 bn (up 18.6% Y-o-Y) and EBITDA of INR 1.4 bn (up 30.5% Y-o-Y). Given seasonal nature of the business, (Q3-Q4 being stronger quarters), Q-o-Q comparison is not meaningful. Management indicated that the fibre business continues to gain traction with Q1FY11 revenue contribution at 25% (versus 20% in Q4FY10). EBITDA margin expanded ~250bps Y-o-Y, to 27%, led by scale economies in the IP VPN business and higher revenue contribution from the more profitable fibre business. Despite healthy EBITDA growth, net profit grew only ~8.5% Y-o-Y owing to higher interest outgo (+17%) and higher tax rate at 24%. Net debt increased to INR 9.6 bn (from INR 8.4 bn in Q4FY10).

Key business updates

- TTSL recently won three contracts for providing **data connectivity services under the R-APDRP projects** in UP, Gujarat and Uttarkhand, totaling INR 1.7 bn. These projects are to be executed over the next 12-18 months with nominal capex requirements and will be maintained over a period of 3-5 years by TTSL. Management expects EBITDA margin for these projects to be higher than its current blended margin of ~27% and highlighted that the projects' infrastructure could be leveraged for other government projects as well in future.
- In July 2010, TTSL acquired **13% minority stake in a BWA JV with Qualcomm** for INR 1.4 bn. We view TTSL's investment in this JV as more of a financial investment given the size of its stake and the JV's focus on the retail segment versus TTSL's focus exclusively on enterprise connectivity. Given that there is no lock-in period for this investment for TTSL, we reckon that the company may monetise this investment in the future.
- TTSL has changed its accounting policy pertaining to forex gains/losses and has adopted **amended AS11** Q1FY11 onwards.

Outlook and valuations: Attractive; maintain 'BUY'

We have factored in TTSL's INR 1.4 bn investment in the BWA JV in our estimates, and our FY11-12 earnings are marginally lower by ~1%. We remain positive on TTSL's core business growth and believe that current stock valuations (P/E of 10.2x and 9.3x and EV/EBITDA of 5.7x and 5x FY11E and FY12E, respectively) likely reflect most of the investor concerns on rising competition (particularly with entry of BWA players) and potential price cuts. We maintain 'BUY' on the stock and rate it 'Sector Outperformer' on relative returns.

Financials

Year to March	Q1FY11	Q1FY10	% change	Q4FY10	% change	FY10	FY11E
Revenues (INR mn)	5,252	4,429	18.6	5,303	(1.0)	19,664	22,046
EBITDA (INR mn)	1,417	1,086	30.5	1,545	(8.3)	5,255	6,182
Adj. net profit (INR mn)	642	591	8.5	795	(19.3)	2,743	2,922
Diluted EPS (INR)	4.0	3.6	8.5	4.9	(19.3)	16.1	18.0
Diluted P/E (x)						11.4	10.2
EV/EBITDA (x)						6.7	5.7
ROAE (%)						29.0	25.9

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Reuters: TULP.BO Bloomberg: TTSL IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Underweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 184
52-week range (INR)	:	250 / 158
Share in issue (mn)	:	145.0
M cap (INR bn/USD mn)	:	26 / 553
Avg. Daily Vol. BSE/NSE ('000):	:	524.8

SHARE HOLDING PATTERN (%)

Promoters*	:	69.0
MFs, FIs & Banks	:	1.3
FIIIs	:	25.0
Others	:	4.7
* Promoters pledged shares (% of share in issue)	:	11.6

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecom Index
1 month	(3.3)	1.7	(0.7)
3 months	7.4	12.4	23.3
12 months	(13.3)	22.4	(24.5)

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Financials snapshot

(INR mn)

Year to March	Q1FY11	Q1FY10	% change	Q4FY10	% change	FY10	FY11E	FY12E
Total revenues	5,252	4,429	18.6	5,303	(1.0)	19,664	22,046	24,588
Raw materials	3,475	3,037	14.4	3,301	5.3	12,953	13,889	15,489
Staff costs	215	185	16.1	221	(2.6)	817	898	986
Other costs	145	121	19.6	236	(38.7)	639	1,077	1,159
Total expenses	3,834	3,343	14.7	3,758	2.0	14,409	15,864	17,634
EBITDA	1,417	1,086	30.5	1,545	(8.3)	5,255	6,182	6,954
Depreciation	375	353	6.3	155	141.5	1,353	1,649	2,112
PBIT	1,042	734	42.1	1,390	(25.0)	3,902	4,533	4,842
Interest	185	158	16.9	185	0.1	716	753	633
Other income	(13)	112	-	57	(123.6)	250	116	53
PBT	844	687	22.9	1,262	(33.1)	3,436	3,896	4,262
Tax	203	96	111.3	467	(56.6)	825	974	1,065
Extra-ordinary items	-	-	0.0	-	-	132	-	-
Reported net profit	642	591	8.5	795	(19.3)	2,743	2,922	3,196
Diluted EPS (INR)	4.0	3.6	8.5	4.9	(19.3)	16.1	18.0	19.7

as % of net revenues

Raw materials	66.2	68.6		62.2		65.9	63.0	63.0
Staff costs	4.1	4.2		4.2		4.2	4.1	4.0
Other costs	2.8	2.7		4.5		3.3	4.9	4.7
EBITDA	27.0	24.5		29.1		26.7	28.0	28.3
Adjusted net profit	12.2	13.3		15.0		14.0	13.3	13.0
Tax rate	24.0	14.0		37.0		24.0	25.0	25.0

- **Company Description**

TTSL's principle business entails providing enterprise connectivity services through wireless and fibre last mile network. It provides intercity and intra-city wireless IP VPN connectivity to enterprises in over 1500 locations. In the last 18 months, TTSL has also rolled out its own fibre network of ~6000 km spanning 50+ cities, with initial presence in CBDs of ~250 cities. TTSL has also entered the ILD segment and is setting up six international PoPs. It has also received the FCC 214 licence which will enable it to sell data connectivity services in the US. Besides enterprise connectivity, TTSL provides network integration and management services as well. In July 2010, TTSL acquired a 13% minority stake in a BWA JV with Qualcomm for INR 1.4 bn.

- **Investment Theme**

We are positive on TTSL's business prospects as an integrated provider of network equipment and connectivity for enterprises. With a wide network footprint covering urban & rural areas, we see continued traction in the IP VPN business driving revenue growth and profitability for TTSL. The rollout of fibre network is expected to materially enhance TTSL's addressable market and ability to compete for high bandwidth customers, thereby leading to higher realizations and better profitability.

- **Key Risks**

Competition from larger integrated telcos like Bharti Airtel, Reliance Communications, and BSNL is the key risk for TTSL. With the SME segment (currently the key market for TTSL) being considered as a lucrative opportunity by large players, added competitive pressure may increase the risk quotient for TTSL. Also, the emergence of new cost-effective and more efficient technologies may impact TTSL's business, as adopting new technologies or switching over to new service offerings may require significant capex that may not be viable for TTSL.

Financial Statements

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Net revenues	12,163	16,144	19,664	22,046	24,588
Direct costs	8,981	11,511	12,953	13,889	15,489
Employee costs	396	712	817	898	986
Other expenses	330	554	639	1,077	1,159
Total operating expenses	9,708	12,777	14,409	15,864	17,634
EBITDA	2,455	3,367	5,255	6,182	6,954
Depreciation and amortisation	418	414	1,353	1,649	2,112
EBIT	2,037	2,953	3,902	4,533	4,842
Interest expenses	258	462	716	753	633
Other income	230	(386)	250	116	53
Profit before tax	2,009	2,105	3,436	3,896	4,262
Provision for tax	139	81	825	974	1,065
Core profit	1,870	2,023	2,611	2,922	3,196
Extraordinary items	0	475	132	-	-
Profit after tax	1,870	2,498	2,743	2,922	3,196
Equity shares outstanding (mn)	145.0	145.0	145.0	145.0	145.0
EPS (INR) basic	12.9	14.0	18.0	20.2	22.0
Diluted shares (mn)	162.2	162.2	162.2	162.2	162.2
EPS (INR) fully diluted	11.5	12.5	16.1	18.0	19.7
CEPS (INR)	13.5	14.9	25.4	29.6	34.7
Dividend per share	0.4	0.8	1.6	1.6	1.6
Dividend payout (%)	3.6	5.4	9.9	9.3	8.5

Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating expenses	79.8	79.1	73.3	72.0	71.7
Depreciation	3.4	2.6	6.9	7.5	8.6
Interest expenditure	2.1	2.9	3.6	3.4	2.6
EBITDA margins	20.2	20.9	26.7	28.0	28.3
Net profit margins	15.4	12.5	13.3	13.3	13.0

Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	44.7	32.7	21.8	12.1	11.5
EBITDA	83.3	37.2	56.1	17.6	12.5
PBT	93.0	4.8	63.3	13.4	9.4
Net profit	97.7	8.2	29.1	11.9	9.4
EPS	76.7	8.2	29.1	11.9	9.4

Balance sheet	(INR mn)				
As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	290	290	290	290	290
Reserves & surplus	4,164	6,529	8,989	10,794	13,437
Shareholders funds	4,454	6,819	9,279	11,084	13,727
Secured loans	1,943	5,141	5,476	6,743	5,746
Unsecured loans	6,996	6,083	6,715	4,647	4,929
Borrowings	8,938	11,224	12,191	11,390	10,675
Sources of funds	13,392	18,044	21,470	22,474	24,402
Gross block	4,447	9,437	14,502	20,207	24,254
Accumulated Depreciation	647	1,061	2,414	4,062	6,174
Net block	3,799	8,376	12,088	16,145	18,080
Capital work in progress	1,398	3,772	1,209	-	-
Total fixed assets	5,197	12,148	13,296	16,145	18,080
Investments	-	-	-	1,400	1,400
Inventories	702	916	688	738	823
Sundry debtors	2,006	3,242	5,320	5,436	6,063
Cash and equivalents	5,938	3,470	3,470	1,177	926
Loans and advances	287	1,093	1,559	1,747	1,949
Total current assets	8,932	8,722	11,037	9,099	9,761
Sundry creditors and others	532	2,363	2,117	2,570	2,867
Provisions	197	458	721	1,574	1,947
Total CL & provisions	729	2,821	2,838	4,144	4,813
Net current assets	8,203	5,901	8,199	4,955	4,947
Net deferred tax	(9)	(9)	(29)	(29)	(29)
Misc expenses not w/o	1	4	4	4	4
Uses of funds	13,392	18,044	21,470	22,474	24,402
Book value per share (BV) (INR)	31	47	64	76	95

Free cash flow	(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	1,870	2,498	2,743	2,922	3,196
Depreciation	418	414	1,353	1,649	2,112
Others	(68)	4	12	0	-
Gross cash flow	2,220	2,916	4,109	4,571	5,308
Less: Changes in W. C.	908	166	2,298	(387)	244
Operating cash flow	1,312	2,750	1,811	4,958	5,065
Less: Capex	3,118	7,365	4,786	4,497	4,047
Free cash flow	(1,806)	(4,615)	(2,975)	461	1,017

Cash flow metrics	(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	1,312	2,750	1,811	4,958	5,065
Financing cash flow	7,454	2,063	695	(1,354)	(1,269)
Investing cash flow	(3,118)	(7,365)	(4,786)	(5,897)	(4,047)
Net cash flow	5,648	(2,552)	(2,280)	(2,293)	(251)
Capex	(3,118)	(7,365)	(4,786)	(4,497)	(4,047)
Dividends paid	(68)	(136)	(271)	(271)	(271)

Profitability & liquidity ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%)	42.4	30.9	29.0	25.9	23.5
ROACE (%)	23.1	18.8	19.7	21.3	22.0
Current ratio	12.3	3.1	3.9	2.2	2.0
Debtors (days)	51	59	79	89	85
Fixed assets t/o (x)	3.2	1.9	1.5	1.5	1.4
Average working capital t/o (x)	2.5	2.3	2.8	3.4	5.0
Debt/Equity	2.0	1.6	1.3	1.0	0.8
Debt/EBITDA	3.6	3.3	2.3	1.8	1.5
Adjusted debt/Equity	2.0	1.6	1.3	1.0	0.8

Operating ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover	1.4	1.0	1.0	1.0	1.0
Fixed asset turnover	3.9	2.7	1.9	1.6	1.4
Equity turnover	3.4	2.9	2.4	2.2	2.0

Du pont analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin (%)	12.6	10.8	11.8	12.0	11.9
Total assets turnover	1.4	1.0	1.0	1.0	1.0
Leverage multiplier	2.4	2.8	2.5	2.2	1.9
ROAE (%)	42.4	30.9	29.0	25.9	23.5

Valuations parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	11.5	12.5	16.1	18.0	19.7
<i>Y-o-Y growth</i>	<i>76.7</i>	<i>8.2</i>	<i>29.1</i>	<i>11.9</i>	<i>9.4</i>
CEPS (INR)	13.5	14.9	25.4	29.6	34.7
Diluted P/E (x)	15.9	14.7	11.4	10.2	9.3
Price/BV(x)	6.0	3.9	2.9	2.4	1.9
EV/Sales (x)	2.4	2.1	1.8	1.6	1.4
EV/EBITDA (x)	12.1	10.2	6.7	5.7	5.0
Dividend yield (%)	0.2	0.4	0.9	0.9	0.9



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	BUY	SO	L	Idea Cellular	HOLD	SP	M
Mahanagar Telephone Nigam Ltd	HOLD	SU	M	Reliance Communication	HOLD	SP	M
Tulip IT services	BUY	SO	H				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss
Ideas create, values protect



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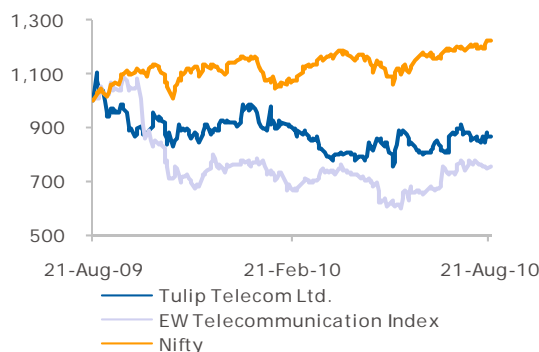
Coverage group(s) of stocks by primary analyst(s): Telecom

Bharti Airtel, Idea Cellular, Mahanagar Telephone Nigam Ltd , Reliance Communication, Tulip IT services

Tulip IT services



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	109	52	12	177
* 4 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	108	54	15	

Recent Research

Date	Company	Title	Price (INR)	Recos
13-Aug-10	Reliance Comm.	Poor volume growth; <i>Result Update</i>	168	Hold
11-Aug-10	Bharti Airtel	No surprises; <i>Result Update</i>	321	Buy
23-Jul-10	Idea Cellular	Realisations drop but relatively better ; <i>Result Update</i>	69	Hold

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