

# Tulip Telecom

		<b>CMP: INR115</b>	<b>TP: INR120</b>							<b>Neutral</b>		
BSE SENSEX	S&P CNX	Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
17,831	5,412	End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
Bloomberg	TTSL IN	3/11A	23,511	3,064	18.9	32.7	6.1	1.5	28.6	14.0	1.3	4.6
Equity Shares (m)	145.0	3/12E	27,467	3,172	19.5	3.5	5.9	1.2	23.4	11.7	1.4	5.0
52-Week Range (INR)	181/100	3/13E	31,899	2,681	18.5	-5.3	6.2	0.9	15.6	9.3	1.3	4.9
1,6,12 Rel. Perf. (%)	-10/-27/-28	3/14E	38,211	3,198	22.1	19.3	5.2	0.8	15.4	9.7	1.1	4.3
M.Cap. (INR b)	16.7											
M.Cap. (USD b)	0.3											

- 3QFY12 results below estimates:** Tulip Telecom (TTSL) posted a PAT of INR773m for 3QFY12, down 5% YoY and 11% QoQ. Revenue and EBITDA declined 2% QoQ v/s our expectation of 4% growth. EBITDA margin improved 50bp YoY but remained flat QoQ at 29%.
- Macro headwinds impacting enterprise spends, data center booking:** The management now expects FY12 revenue growth to be 14-16% (v/s 20% earlier), implying flattish QoQ growth in 4QFY12. While TTSL has been able to hold EBITDA margin at ~29%, slowdown in revenue growth can impact margins negatively. The data center business (capital employed: INR3.5b) has not yet begun contributing revenue. While the visible funnel for data center space has increased to 225,000sf, we note a reduction in target booking to 15-20% by the end of FY12 v/s the last quarter guidance of 25%.
- Leverage levels remain elevated:** During 9MFY12, TTSL added net debt of INR6.1b, including INR0.9b impact of adverse exchange fluctuations on forex debt. This was the seventh consecutive quarter of increase in net debt; reported net debt of INR21.4b does not include redemption premium of INR2.1b on FCCB due in August 2012. While the company has been considering various deleveraging options like monetization of stake in Qualcomm JV, equity raising at parent/subsidiary level, etc, timing of these events remains uncertain.
- Downgrade to Neutral:** 3QFY12 earnings were 20% lower than we had estimated and leverage concerns remain unaddressed. We cut our FY12/13/14 EBITDA estimates by 5/10/12% and EPS estimates by 12/18/23%. We downgrade our stock recommendation to **Neutral**, with a revised target price of INR120. The stock trades at 6.2x FY13E EPS and at an EV of 4.9x FY13E EBITDA. While valuations are supportive, re-rating would be contingent on key concerns getting addressed. We would await more clarity on re-financing of upcoming FCCB redemption, stake sale in Qualcomm BWA venture and revenue ramp-up of data center before taking a constructive view on the stock.

Quarterly Performance (Consolidated)										(INR Million)	
Y/E March	FY11				FY12				FY11	FY12E	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			
Gross Revenue	5,252	5,853	6,022	6,380	6,539	7,029	6,866	7,033	23,511	27,467	
YoY Growth (%)	18.6	19.2	20.2	20.2	24.5	20.1	14.0	10.2	19.6	16.8	
QoQ Growth (%)	-1.0	11.4	2.9	5.9	2.5	7.5	-2.3	2.4			
Total Operating Expenses	3,834	4,220	4,306	4,513	4,691	4,998	4,875	5,058	16,880	19,622	
EBITDA	1,417	1,633	1,716	1,867	1,848	2,032	1,991	1,975	6,631	7,845	
YoY Growth (%)	30.5	28.7	27.1	20.8	30.3	24.4	16.0	5.8	26.3	18.3	
QoQ Growth (%)	-8.3	15.2	5.1	8.8	-1.0	10.0	-2.0	-0.8			
Margin (%)	27.0	27.9	28.5	29.3	28.3	28.9	29.0	28.1	28.2	28.6	
Net Finance Costs	185	190	212	267	319	345	427	454	853	1,546	
Non-Operating Income	-13	14	11	-11	-11	-26	10	65	1	39	
Depreciation & Amortization	375	420	441	479	495	502	526	576	1,714	2,099	
Profit before Tax	844	1,038	1,075	1,111	1,023	1,159	1,048	1,010	4,065	4,239	
Income Tax Expense / (Income)	203	258	257	283	251	288	276	255	1,001	1,070	
Tax rate (%)	24	25	24	26	25	25	25	25	25	25	
Reported Net Profit / (Loss)	642	780	817	827	772	871	773	754	3,064	3,169	
YoY Growth (%)	8.6	59.6	42.5	25.8	20.3	11.6	-5.5	-8.8	32.6	3.4	
QoQ Growth (%)	-2.5	21.6	4.8	1.2	-6.7	12.8	-11.3	-2.4			
Margin (%)	12.2	13.3	13.6	13.0	11.8	12.4	11.3	10.7	13.0	11.5	

E: MOSL Estimates

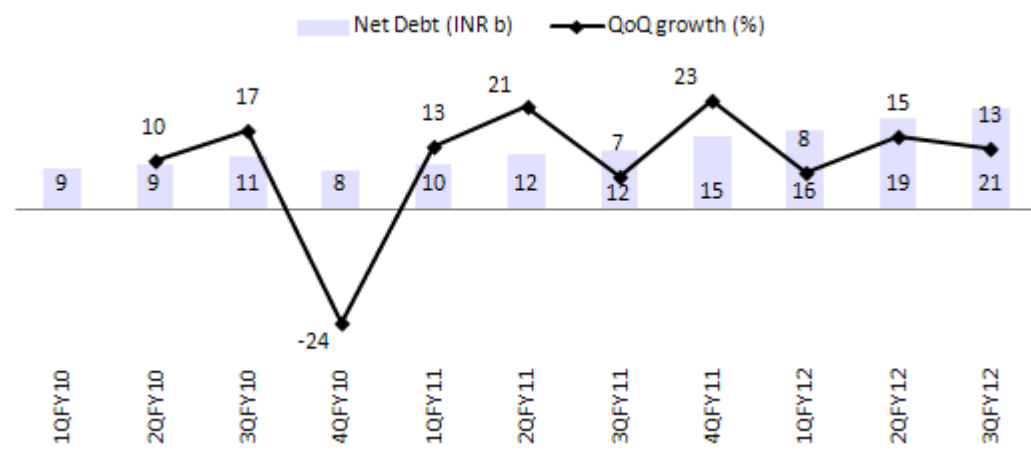
### 3QFY12 results below estimates

- Tulip's 3QFY12 PAT declined 5.5% YoY and 11.3% QoQ to INR773m (est of INR961m).
- Revenue increased 14% YoY but declined 2.3% QoQ to INR6.9b (est of INR7.3b)
- EBITDA grew 16% YoY but declined 2% QoQ to INR2b (6% below est).
- EBITDA margin was up 50bp YoY but remained flat QoQ at 29% (20bps above est).
- Capex incurred in 9MFY12 is INR4.04b on standalone basis and an additional INR1.37b for the Tulip data center business
- Effective tax rate was 26.3% during 3QFY12.
- Forex loss during the quarter was INR0.89b (v/s INR0.44b in 2QFY12)
- During 3QFY12 the data centre subsidiary reported EBITDA loss of INR16m taking the total EBITDA loss to INR46m in 9MFY12.

### 3QFY12 Concall highlights

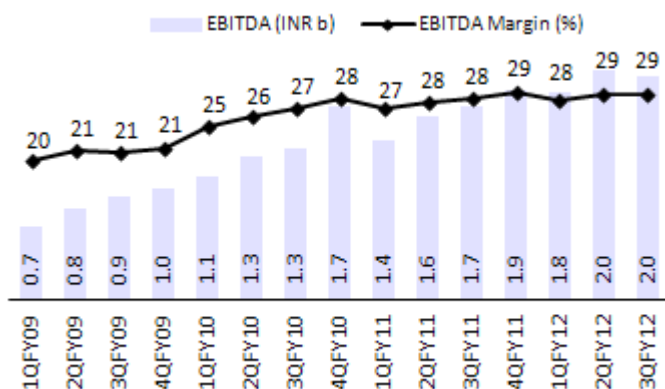
- Change in working capital for 9MFY12 has been ~INR3.5b.
- During the quarter, Tulip won an order for 200 racks from NTT Japan for which billing is expected to commence by March 2012.
- The company has raised mezzanine debt of INR2.5b. The cost of the mezzanine debt is higher than the average cost of debt for Tulip.
- In 9MFY12, gross block has increased INR6.3b.
- Capex guidance of INR4b for core business (excluding data center).

### Net debt has increased for seven consecutive quarters

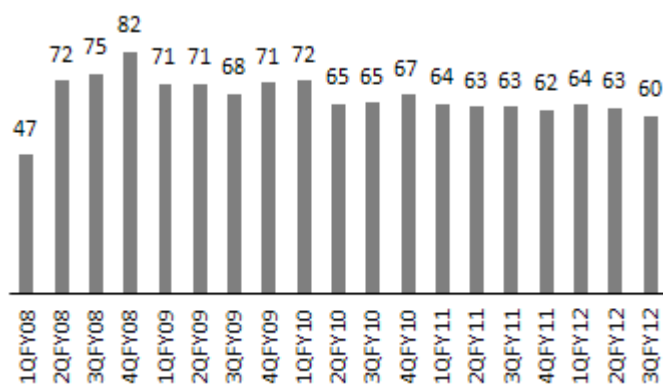


Source: Company/MOSL

### Tulip: Quarterly EBITDA and margin



### RM cost declined on QoQ basis (% of revenue)



Source: Company/MOSL

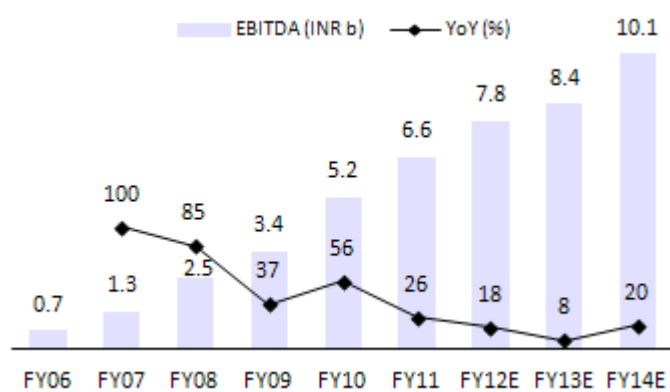
**Macro headwinds impacting enterprise spends, data center booking; leverage levels remain elevated**

- Over past one year net debt has increased from INR12.4b to INR21.4b. 3QFY12 was the seventh consecutive quarter of QoQ increase in debt for Tulip.
- The reported net debt of INR21.4b does not include redemption premium of INR2.1b on FCCB due in August 2012.
- While the company has been considering various de-leveraging options like monetization of stake in Qualcomm JV, equity raising at parent/subsidiary level etc, timing of these events remains uncertain.
- Revenue outlook for Tulip has weakened due to the economic slowdown. Management now expects FY12 revenue growth to be 14-16% (vs 20% earlier), implying flattish QoQ growth in 4QFY12.
- Data center business (capital employed of INR3.5b) has not yet started contributing revenue for the company.
- While visible funnel for data center space has increased to 225,000 sq ft, we note reduction in target booking to 15-20% by end FY12 v/s last quarter guidance of 25%.

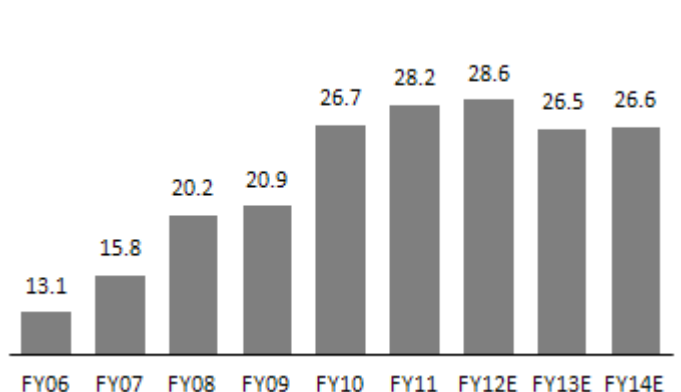
**Downgrade to Neutral with TP of INR120**

- We downgrade Tulip from Buy to **Neutral** with a revised TP of INR120.
- We cut FY12/13/14 EBITDA by 5/10/12% and EPS by 12/18/23%.
- We would await more clarity on re-financing of upcoming FCCB redemption, stake sale in Qualcomm BWA venture and revenue ramp-up of data center before taking a constructive view on the stock.
- At CMP of INR115, the stock trades at FY13 P/E of 6.2x and EV/EBITDA of 4.9x.

**We expect 14% EBITDA CAGR over FY12-14E**

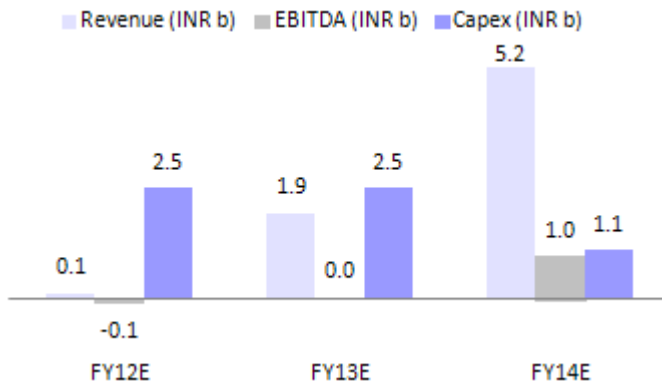


**FY12E EBITDA margin expected to reach ~29% (%)**

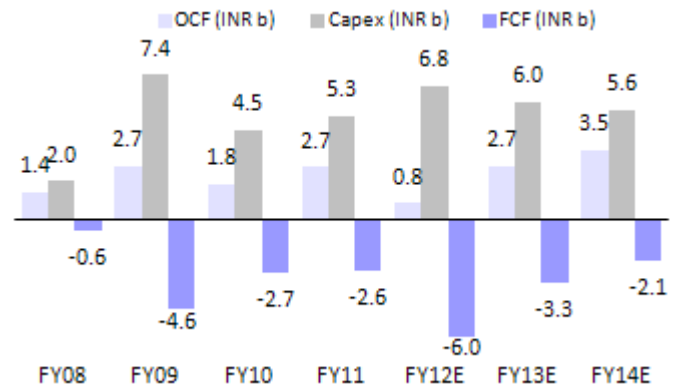


Source: Company/MOSL

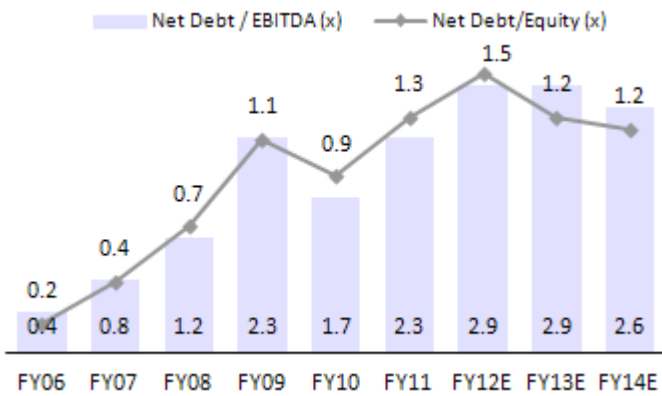
Data center operations ramp up



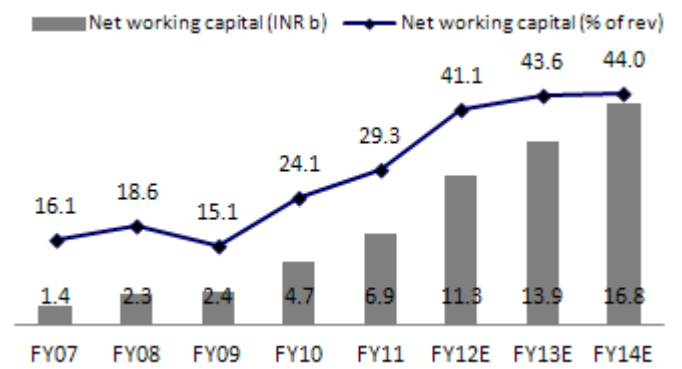
FCF continues to be negative



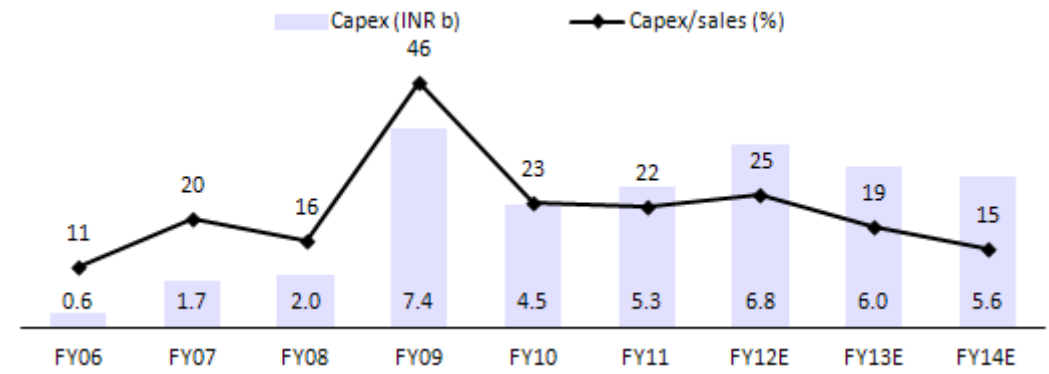
Leverage remains high



Net working capital continues to inch up (INR b)



We model decline in capex going forward



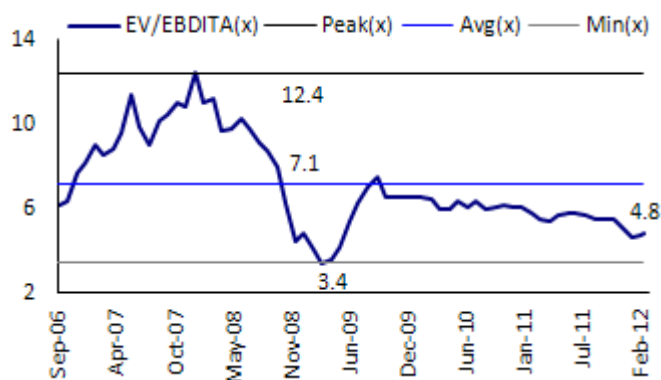
Source: Company/MOSL

## Tulip Telecom: Summary of estimate change

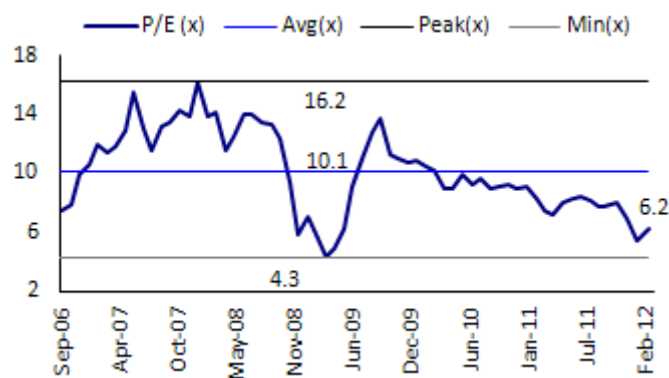
	FY12E	FY13E	FY14E
<b>Revenue (INR b)</b>			
Old	28.8	34.9	42.0
New/Actual	27.5	31.9	38.2
Change (%)	-4.5	-8.6	-9.0
<b>EBITDA (INR b)</b>			
Old	8.2	9.4	11.5
New/Actual	7.8	8.4	10.1
Change (%)	-4.7	-9.9	-11.8
<b>Net Profit (INR b)</b>			
Old	3.6	3.7	4.6
New/Actual	3.2	2.7	3.2
Change (%)	-12.0	-26.7	-31.2
<b>Diluted EPS (INR)</b>			
Old	22.2	22.5	28.6
New/Actual	19.5	18.5	22.1
Change (%)	-12.0	-17.8	-22.9
<b>Depreciation (INR b)</b>			
Old	2.1	2.8	3.4
New/Actual	2.1	2.7	3.2
Change (%)	-1.7	-3.8	-4.7
<b>Net Finance Cost (INR b)</b>			
Old	1.4	1.8	2.1
New/Actual	1.5	2.3	2.9
Change (%)	8.0	26.1	34.7
<b>EBITDA Margin (%)</b>			
Old	28.6	26.8	27.4
New/Actual	28.6	26.5	26.6
Change (bp)	-7	-37	-84
<b>Tax Rate (%)</b>			
Old	25.0	25.0	25.0
New/Actual	25.0	25.0	25.0
Change (bp)	0	0	0

Source: Company/MOSL

## Tulip Telecom: EV/EBITDA band



## Tulip Telecom: P/E band



Source: Company/MOSL

## Tulip Telecom: an investment profile

### Company description

Tulip is a leading player in the Indian enterprise data segment focused on providing connectivity to corporates, SMEs and government verticals. Tulip has an outstanding track record, having scaled up to a dominant ~31% market share in the largest and fastest growing VPN segment within five years. Tulip has network presence in ~2,000 cities and a client base of ~2,400.

### Key investment argument

- Tulip's owned and leased 'last mile' fiber network spans over 18,000 Kms; Fiber rollout allows tapping high bandwidth connects thereby capturing higher share of clients' requirement, increasing the addressable market by 5-6x and de-risking from competition; Fiber constitutes ~83% of the new order inputs in data connectivity business.
- Increased traction from fiber rollout and increased revenue contribution from data center should support 18/14% CAGR in revenue/EBITDA during FY12-14E.
- The government vertical, which contributes <5% of revenue, is likely to be an additional growth driver.

### Key investment risks

- High leverage levels with net debt/annualized EBITDA of 2.7x in 3QFY12.
- Net debt levels at INR21.4b (excluding redemption premium of INR2.1b on FCCB due in August 2012).

- Visibility on monetization of stake in Qualcomm JV and equity raising at parent/subsidiary level remains low.
- Potential technology disruption.

### Recent developments

- Tulip's Bangalore Data center has been commissioned. Orders amounting to a total value of INR6b for 5 years for 30,000sq ft have been booked.
- Tulip has won an order for INR0.5b from Sahara Para banking for connecting 3,000 locations across India.
- Tulip has won a government project worth INR0.5b from Rajasthan State Crime and Criminal Tracking Network and Systems.

### Valuation and view

- We downgrade Tulip from Buy to **Neutral** with a revised TP of INR120.
- We cut FY12/13/14 EBITDA by 5/10/12% and EPS by 12/18/23%.
- We would await more clarity on re-financing of upcoming FCCB redemption, stake sale in Qualcomm BWA venture and revenue ramp-up of data center before taking a constructive view on the stock.
- At CMP of INR115, the stock trades at FY13 P/E of 6.2x and EV/EBITDA of 4.9x.

### Comparative valuations

		Tulip	Bharti	Idea
P/E (x)	FY12E	5.9	28.8	41.5
	FY13E	6.2	17.3	19.0
EV/EBITDA (x)	FY12E	5.0	8.4	8.5
	FY13E	4.9	6.7	6.3
EV/Sales (x)	FY12E	1.4	2.8	2.2
	FY13E	1.3	2.3	1.8
P/BV (x)	FY12E	1.2	2.5	2.4
	FY13E	0.9	2.2	2.1

### Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	69.9	69.9	69.0
Domestic Inst	1.6	1.7	1.9
Foreign	18.7	18.8	19.6
Others	9.8	9.6	9.6

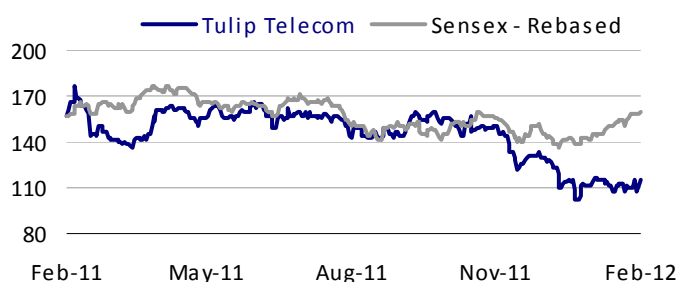
### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	19.5	22.4	-12.8
FY13	18.5	26.6	-30.4

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
115	120	4.3	Neutral

### Stock performance (1 year)





## Financials and Valuation

Income Statement						Ratios					
(INR Million)											
Y/E March	2010	2011	2012E	2013E	2014E	Y/E March	2010	2011	2012E	2013E	2014E
<b>Revenues</b>	19,655	23,511	27,467	31,899	38,211	<b>Basic (INR)</b>					
Change (%)	21.7	19.6	16.8	16.1	19.8	EPS	14.2	18.9	19.5	18.5	22.1
<b>Total Expenses</b>	14,406	16,880	19,622	23,461	28,061	Cash EPS	22.5	29.4	32.2	36.9	44.2
<b>EBITDA</b>	5,248	6,631	7,845	8,438	10,150	Book Value	57.1	74.6	92.5	133.0	153.2
% of Gross Sales	26.7	28.2	28.6	26.5	26.6	DPS	1.7	1.7	1.7	1.9	1.9
Change (%)	55.9	26.3	18.3	7.6	20.3	Payout %(Incl.Div.Tax)	11.8	8.9	8.6	10.1	8.5
<b>Deprn. &amp; Amortization</b>	1,353	1,714	2,067	2,664	3,209	<b>Valuation (x)</b>					
<b>EBIT</b>	3,895	4,917	5,778	5,774	6,941	P/E		6.1	5.9	6.2	5.2
<b>Net Interest</b>	716	853	1,533	2,327	2,857	Cash P/E		3.9	3.6	3.1	2.6
<b>Other Income</b>	30	1	-16	128	180	EV/EBITDA		4.6	5.0	4.9	4.3
<b>PBT</b>	3,209	4,065	4,230	3,574	4,264	EV/Sales		1.3	1.4	1.3	1.1
<b>Tax</b>	899	1,001	1,057	894	1,066	Price/Book Value		1.5	1.2	0.9	0.8
Rate (%)	28.0	24.6	25.0	25.0	25.0	Dividend Yield (%)		1.5	1.5	1.6	1.6
<b>Adjusted PAT</b>	2,310	3,064	3,172	2,681	3,198	<b>Profitability Ratios (%)</b>					
Change (%)	-7.8	32.7	3.5	-15.5	19.3	RoE	28.7	28.6	23.4	15.6	15.4
<b>PAT after EO</b>	2,310	3,064	3,172	2,681	3,198	RoCE	14.0	14.0	11.7	9.3	9.7
<b>Balance Sheet</b>						<b>Turnover Ratios</b>					
(INR Million)											
Y/E March	2010	2011	2012E	2013E	2014E	Debtors (Days)	99	98	113	125	131
Share Capital	290	290	290	325	325	Asset Turnover (x)	1.21	1.07	0.89	0.82	0.86
Additional Paid up C	831	831	831	4,743	4,743	<b>Leverage Ratio</b>					
Reserves	8,157	11,004	13,905	14,214	17,141	Debt/Equity Ratio(x)	1.3	1.5	1.7	1.5	1.5
<b>Net Worth</b>	9,279	12,125	15,026	19,282	22,209	<b>Cash Flow Statement</b>					
Loans	12,191	17,769	25,901	29,094	33,453	(INR Million)					
Other Liabilities	29	32	32	32	32	Y/E March	2010	2011	2012E	2013E	2014E
<b>Capital Employed</b>	21,499	29,926	40,958	48,407	55,694	Op.Profit/(Loss) bef T	5,248	6,631	7,845	8,438	10,150
Gross Block	15,711	23,108	30,808	36,808	42,408	Other Income	30	1	-16	128	180
Less : Depreciation	2,414	4,132	6,199	8,862	12,071	Interest Paid	-716	-853	-1,533	-2,327	-2,857
<b>Net Block</b>	13,297	18,977	24,610	27,946	30,338	Direct Taxes Paid	-879	-998	-1,057	-894	-1,066
<b>Curr. Assets</b>	11,041	13,939	19,785	24,434	30,107	(Inc)/Dec in Wkg. Cap	-1,876	-2,111	-4,399	-2,616	-2,895
Inventories	688	992	1,159	1,347	1,613	<b>CF from Op.Activity</b>	1,807	2,669	840	2,728	3,512
Debtors	5,320	6,344	8,523	10,888	13,694	(inc)/Dec in FA + CWI	-2,502	-7,394	-7,700	-6,000	-5,600
Cash & Bank Balance	3,470	2,504	3,504	5,000	7,000	(Pur)/Sale of Investm	0	-1,549	0	0	0
Other Current Assets	1,562	4,099	6,599	7,199	7,799	<b>CF from Inv.Activity</b>	-2,502	-8,943	-7,700	-6,000	-5,600
<b>Curr. Liab. &amp; Prov.</b>	2,839	2,990	3,437	3,973	4,751	Issue of Shares	0	0	0	3,946	0
<b>Net Curr. Assets</b>	8,202	10,949	16,348	20,461	25,356	Inc/(Dec) in Debt	966	5,578	8,132	3,193	4,360
<b>Appl. of Funds</b>	21,499	29,925	40,958	48,407	55,694	Dividends Paid	2	2	2	2	2
E: MOSL Estimates						Other Financing Acti	-273	-272	-273	-2,373	-273
						<b>CF from Fin.Activity</b>	695	5,307	7,861	4,768	4,088
						Inc/(Dec) in Cash	0	-966	1,000	1,496	2,000
						Add: Opening Balanc	3,470	3,470	2,504	3,504	5,000
						<b>Closing Balance</b>	3,470	2,504	3,504	5,000	7,000

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- |   |    |
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