Tulip Telecom TTSL IN

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COMPANY QUICK COMMENT

In our meeting with Tulip, the company notes that 1) its fibre coverage/reach and 2) "nimble" execution and service levels are key differentiators. Our checks with IT managers reinforce our view that non-price factors are more critical in vendor selection in enterprise –these could be harder to replicate. The company is also establishing international connectivity through its own points of presence (POPs) and carrier agreements – this should help it to address the ITES vertical as well as enterprises with a global presence.

Price target: 230.0 INR **Price (22 Dec 2010): 176.55 INR**

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A second look at Tulip's strategy (meeting take-aways)

We met with Tulip's Business head (West), to better understand Tulip's sales strategy. Tulip notes that 1) its fibre coverage/reach and 2) "nimble" execution and service levels are key differentiators. The company is expanding its international connectivity with its own points of presence as well as through agreements such as with Hutch. This should allow it to better tap into the ITES vertical, where bandwidth requirements are likely to be higher.

Our checks with IT managers indicate pricing appears to be one of the last factors for consideration and besides, all vendors are equally competitive, therefore cutting prices to win share doesn't seem like a reasonable competitive strategy for this market. We do not dismiss competition or pricing pressure, but for other vendors to become more aggressive in this segment we believe they need to further invest in: 1) coverage and reach of their last mile; and 2) service levels – both of which are likely to require time to implement.

Take-aways from Tulip meetings:

1) **Tulip believes that its wider fibre coverage better positions it over other vendors.**
   a. First, in enterprise networks, a majority of the network downtimes that occur can be attributed to last mile and therefore enterprises prefer vendors who own their last mile fibre versus leasing it from others. Thus, coverage is a key differentiator.
   b. Second, corporates with multiple offices in the country (banks for example) try to look for national footprint versus presence in top cities; Tulip's fibre presence in 300 cities is therefore an advantage.
   c. Lastly, Tulip also sees opportunities in many cases as a secondary vendor.

2) **Tier 1 city versus Tier 2:** Tulip notes that Tier 2 is an easy opportunity with limited competition and hence it continues to build presence here; however, the scope of the opportunity and returns are larger in Tier 1 cities (despite competition) therefore it continues to focus on both. Tulip also sees relatively lower competitive intensity in the government segment.

3) **Customer profile** – within Tulip, customers are categorized into 1) large enterprises – accounting for 65% of business; 2) commercial and channel – this consists of middle market accounts, and 3) a national segment consisting of carriers and alliances (ie, tie-ups with IT companies through whom they provide bandwidth indirectly).

4) **Focusing on IT/ITES** – Within the large enterprise group, Tulip has recently identified ITES as a new focus area. We understand that on average 20% of a corporate's IT capex is towards bandwidth. In the IT/ITES segment, the spend towards bandwidth could be larger. These companies have branches/offices internationally, and therefore prefer vendors with international bandwidth. Tulip recently established POPs in London, Singapore and US and also tied up with Hutch for use of its network, which allows it to target this opportunity. However, we also expect that these organizations are catered for by vendors such as TCOM, Bharti etc and therefore this could also be a more competitive area.

5) **Service levels and delivery lead times –** Tulip notes that it tries to be as "nimble" as possible with shorter lead times. Stated lead times are 3-6 weeks versus as long as two months from some other vendors.

Criteria for vendor selection based on our market checks

1) **Last mile fibre to the building -** typically, enterprises prefer vendors who have their own fibre versus leasing it, therefore coverage is key.

2) **Redundancy** (ie, to ensure if one line goes down, the vendor can offer alternate routing for traffic to avoid network downtimes)
3) **Service levels and relationship with the vendor** – how quickly can it react to bandwidth demand
4) **Availability of international connectivity** - this would be a criteria for multi-national companies with offices and locations outside India
5) **Price** – all operators appear equally competitive. Our market checks indicate that prices at which bandwidth is being leased by the end customer has fallen by as much as 30-50% y-y in some cases; Tulip notes that this price drop has occurred more in the NLD segment, which allows it to offer lower prices to customers.

Valuation Methodology and Investment Risks: We use a WACC of 12.3% driven off a cost of equity of 14% and a cost ofdebt of 8%. Our terminal growth rate is 3%.Risks to our investment view: 1) Increasing competitive headwinds in fibre, 2) slower than-anticipated expansion into fibre/government/international, and 3) a slowdown in macro environment/corporate spending.

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Tulip Telecom	TTSL IN	176.55 INR	22 Dec 2010	Buy	

Previous Ratings

Issuer	Previous Rating	Date of change
Tulip Telecom	N/A	N/A

Three-year stock price and rating history

Not Available for Tulip Telecom

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