

Telecoms, Media & Technology
Diversified Telecoms
 Equity – India

Underweight

Target price (INR)	70.00
Share price (INR)	86.15
Potential return (%)	-18.7

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-9.2	-22.8	-47.5
Relative^ (%)	-4.9	-13.9	-40.5

Index^ BOMBAY SE IDX

RIC TULP.BO
 Bloomberg TTSL IN

Market cap (USDm)	232
Market cap (INRm)	12,492
Enterprise value (INRm)	35236
Free float (%)	31

Note: (V) = volatile (please see disclosure appendix)

16 May 2012

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Tulip Telecom

Downgrade to UW: No respite

- ▶ **4Q results below estimates, margin decline by 300 bps**
- ▶ **Management suggests margins pressure, we build for c4% yoy decline in FY13e revenues**
- ▶ **Downgrade to UW from Neutral and cut target to INR70 (from INR125)**

4QFY12 results were below estimates with revenues c8% below our estimates and sequential margin decline by 350bps (EBITDA 18% below our estimates). PAT declined c6% and was 7% below our estimates. Management provided a capex guidance of INR6bn for next four quarters. Separately management suggested extension in accounting year by another six months to enable reporting in better alignment with the regulatory reporting requirements. We note over the last two quarters revenue has declined by 6% and EBITDA margins by 330 bps.

Weak outlook. In addition to the poor 4Q numbers, management suggested that poor macro environment continues to be a drag and that the company could be looking at a gradual reduction in margins over the next few quarters. In our view margin decline suggestion from the management is reflection of top-line pressures as well. We note the business model of the company is based on operating leverage and a slowdown in order book prevents the ability of the company to buy bandwidth in bulk and raises costs and results in margin decline. Despite this management sticking with its capex guidance of INR6bn may not go well with investors as it would only aggravate balance sheet concerns (we estimate 10% lower capex). While management suggested no impact on operations because of change in reporting requirements, this may raise investor concerns and possibility of one time adjustments cannot be ruled out.

FCCB redemption likely by debt. On the FCCB (Foreign Currency Convertible Bonds) issue management didn't provide any specific solutions, but maintained that it had several options at its disposal. We believe that FCCB is likely to be redeemed by assuming debt and this would adversely impact the profitability next fiscal because of increase in finance charges. We estimate total FCCB liability at USD135m (assuming a redemption premium of USD35m). Upside risk could stem from a possibility of unlocking value in Qualcomm venture and ability to rope in a strategic partner at the data centre level.

Valuation and risks: We are downgrading to UW and cutting our target price to INR70 (INR125) as we estimate FY13e revenue growth of -4% and margin decline of 350bps. We cut our FY13e revenues estimates by 18%, EBITDA estimates by 27% and PAT by 72%. We note we were earlier expecting c14% revenue growth, 8% EBITDA growth and a 15% decline in EPS. We continue to value Tulip on a mix of DCF and PE at 6x on FY13e earnings. Upside risks include the ability to gain market share via bundling data centre and core offerings, stake sale in the BWA venture and stake sale in the data centre business.

Financials & valuation

Financial statements

Year to	03/2012a	03/2013e	03/2014e	03/2015e
Profit & loss summary (INRm)				
Revenue	27,050	26,029	28,391	30,163
EBITDA	7,562	6,208	6,917	7,741
Depreciation & amortisation	-2,127	-2,877	-3,284	-3,589
Operating profit/EBIT	5,434	3,331	3,633	4,152
Net interest	-1,628	-2,318	-2,430	-2,473
PBT	3,847	1,013	1,203	1,679
HSBC PBT	3,847	1,013	1,203	1,679
Taxation	-761	-266	-325	-487
Net profit	3,086	748	878	1,192
HSBC net profit	3,086	748	878	1,192

Cash flow summary (INRm)

Cash flow from operations	6,701	6,101	6,768	7,179
Capex	-10,696	-5,700	-5,530	-5,379
Cash flow from investment	-12,386	-5,700	-5,530	-5,379
Dividends	0	0	0	0
Change in net debt	7,628	1,917	1,192	672
FCF equity	-5,664	-1,917	-1,192	-672

Balance sheet summary (INRm)

Intangible fixed assets	1,244	1,244	1,244	1,244
Tangible fixed assets	26,311	29,134	31,379	33,169
Current assets	16,444	16,236	15,922	16,054
Cash & others	5,000	5,000	5,000	5,000
Total assets	45,655	48,270	50,202	52,124
Operating liabilities	3,017	2,967	2,829	2,886
Gross debt	27,382	29,299	30,491	31,163
Net debt	22,382	24,299	25,491	26,163
Shareholders funds	15,223	15,970	16,848	18,040
Invested capital	35,982	38,647	40,717	42,581

Ratio, growth and per share analysis

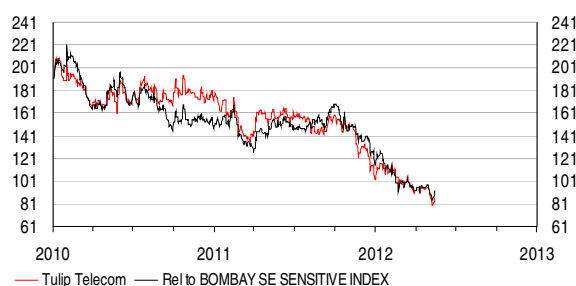
Year to	03/2012a	03/2013e	03/2014e	03/2015e
Y-o-y % change				
Revenue	15.1	-3.8	9.1	6.2
EBITDA	14.0	-17.9	11.4	11.9
Operating profit	10.5	-38.7	9.1	14.3
PBT	-5.4	-73.7	18.7	39.6
HSBC EPS	0.7	-75.8	17.5	35.7
Ratios (%)				
Revenue/IC (x)	0.9	0.7	0.7	0.7
ROIC	14.1	6.6	6.7	7.1
ROE	22.4	4.8	5.4	6.8
ROA	10.9	5.2	5.4	5.8
EBITDA margin	28.0	23.9	24.4	25.7
Operating profit margin	20.1	12.8	12.8	13.8
EBITDA/net interest (x)	4.6	2.7	2.8	3.1
Net debt/equity	147.0	152.1	151.3	145.0
Net debt/EBITDA (x)	3.0	3.9	3.7	3.4
CF from operations/net debt	29.9	25.1	26.5	27.4
Per share data (INR)				
EPS reported (fully diluted)	21.29	5.16	6.06	8.22
HSBC EPS (fully diluted)	21.29	5.16	6.06	8.22
DPS	0.00	0.00	0.00	0.00
Book value	104.98	110.14	116.20	124.42

Valuation data

Year to	03/2012a	03/2013e	03/2014e	03/2015e
EV/sales	1.2	1.4	1.3	1.2
EV/EBITDA	4.4	5.7	5.3	4.8
EV/IC	0.9	0.9	0.9	0.9
PE*	4.0	16.7	14.2	10.5
P/Book value	0.8	0.8	0.7	0.7
FCF yield (%)	-51.8	-17.5	-10.9	-6.1
Dividend yield (%)	0.0	0.0	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

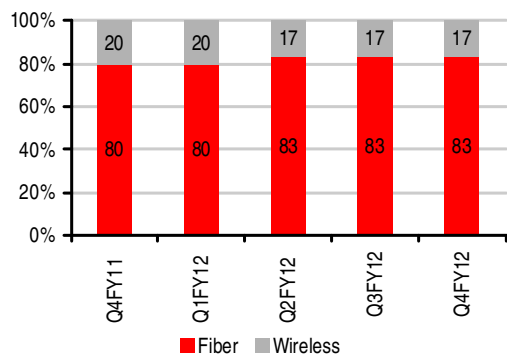
Note: price at close of 15 May 2012

Figure 1: Tulip 4QFY12 HSBC First Cut (Figs in INR m unless specified)

	Actuals	HSBC Estimates	Actual vs HSBC	3QFY12	4QFY11	QoQ	YoY	Consensus	Variance
Overall Business									
Revenue	6,617	7,175	-7.8%	6,866	5,853	-3.6%	13.1%	6,980	-5%
EBITDA	1,692	2,050	-17.5%	1,991	1,633	-15.0%	3.6%	1,978	-14%
EBITDA Margin (%)	25.6%	28.6%	-3.0%	29.0%	27.9%	-3.4%	-2.3%	28.3%	-3%
Net Profit	660	710	-7.0%	784	780	-15.7%	-15.3%	728	-9%
EPS (INR)	4.6	4.9	-7.0%	5.4	5.4	-15.7%	-15.3%	5.0	-9%

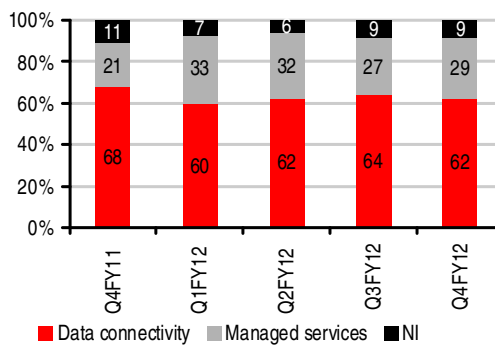
Source: HSBC, Company Data, Bloomberg

Figure 2: New Order Input split between Fiber & Wireless businesses (%)



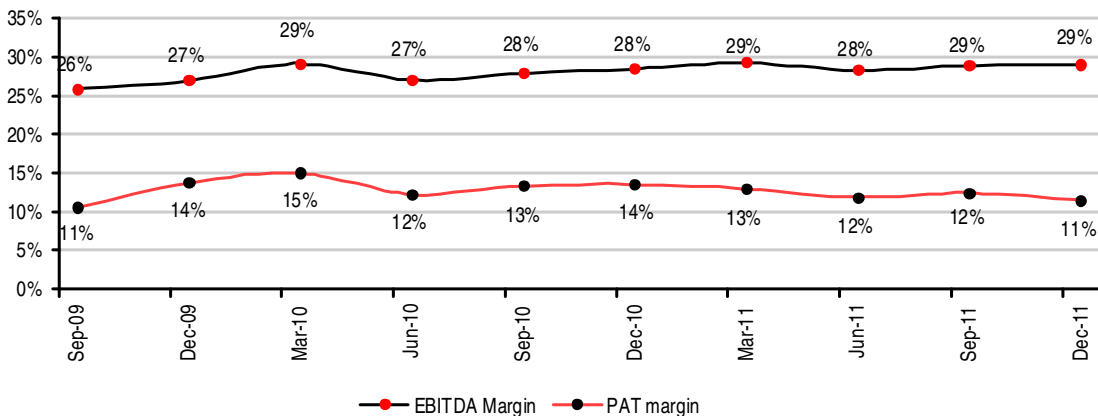
Source: Company data

Figure 3: Breakup of order intake (%)



Source: Company data

Figure 4: Financial Performance



Source: Company data

Figure 5: Key events for the Tulip stock and likely timelines

Event	Expected time frame	Key factor to be watched	What is in the price?
PE induction at the data centre level	Uncertain	Company now looking to debt financing, suggesting that an equity/PE partner is unlikely currently.	Not in the price as there has been considerable delay.
Ability to unlock investments in Qualcomm venture	Visibility has improved	With likelihood of RIL launch by end of this calendar year, there will be demand for the Qualcomm spectrum in our view	FCCB concerns, weak outlook prevent investors to get excited by non core issues. Any sale would imply some support to the stock price.
FCCB repayment	Needs to be done by August	Management suggested that it expects to have refinancing approvals by FY12e	Timely repayment will address investor concerns, but repayment via assumption of debt will impact profitability

Source: HSBC

Valuation and risks

We value Tulip Telecom's business using the average of PE and discounted cash flow methodologies at INR70 (from INR125), attaching equal weightings to each. For our DCF analysis, we assume a cost of equity of 15% and a cost of debt of c11%; we assume a target debt-to-total capital ratio of 30% and Weighted average cost of capital (WACC) at 13% to arrive at a fair value of INR102 per share (previously INR132).

Our DCF valuations have been cut as we cut our EBITDA by c30% for the next three years given our assumptions that the DC business will take time to get scale and put pressure on consolidated margins and suggestion by management for margin decline. EBITDA margins of c24% in FY13 are 170 bps lower than Q4FY12 EBITDA margins. For our PE methodology, we use a PE multiple of 6x (using the 12-month average of one-year forward PER) on FY13e earnings to arrive at a fair value of INR31 per share (from INR 112, now lower as we have cut our FY2013e estimates by 72%). Separately, we value Tulip's investment in the Qualcomm venture at c50% discount to book value or at INR3 (no change) reflecting the uncertainty over the ability to monetize investments in the Qualcomm BWA venture in the near to medium term. Using our blended approach, we arrive at a 12-month target price of INR125.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%. Our target price implies a potential return of -18%, which is below the Neutral band; therefore, we are downgrading the stock to Underweight. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated. Upside risks include the ability to gain market share via bundling data centre and core offerings, stake sale in the BWA venture and stake sale in the data centre business.

Figure 6: New vs old estimates (Figures in INRmn)

	FY13e	FY14e
Sales		
New	26,029	28,391
Old	31,913	36,008
Change	-18%	-21%
EBITDA		
New	6,208	6,917
Old	8,512	10,113
Change	-27%	-32%
Net profit		
New	748	878
Old	2,715	2,932
Change	-72%	-70%

Source: HSBC

Figure 7: Target price computation (Figures in INR per share)

Particulars	New Value per share	Previous value per share
DCF value @13% WACC	102	132
PE at 6X FY13 EPS	31	112
Assigning 50% weight to each	67	122
BWA investment	3	3
Target Price	70	125

Source: HSBC

Disclosure appendix

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Share price and rating changes for long-term investment opportunities

Tulip Telecom (TULP.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	20 October 2010
Overweight	Neutral	06 December 2011
Target Price	Value	Date
Price 1	235.00	20 October 2010
Price 2	146.00	06 December 2011
Price 3	125.00	10 February 2012

Source: HSBC

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