Tulip Telecom TULP.NS TTSL IN

TELECOMS

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Some recovery, not clear if out of woods yet

Quick Note

August 15, 2012

Rating Remains	Neutral
Target price Remains	INR 90
Closing price August 14, 2012	INR 104

Recovery in revenue growth to 8% q-q and margins to 27% (vs 26% in the previous quarter) in this June quarter is a positive surprise, given macro/competition headwinds the company has been facing in the past 2 quarters. Despite which, management notes that the near-term outlook remains “mixed” suggesting that challenges could persist in the core connectivity business. Moreover, take-up in the data center continues to be slow (only 10%) while Tulip continues to make investments (INR2bn for this year), which is a concern. Hence, we maintain Neutral. Tulip recently announced that it is making progress on its FCCB redemption (total amount of USD145mn). It has recently tied up USD80mn in debt, while we believe the issue of fresh FCCBs for the remainder could still be underway. The redemption date is only weeks away, and this is still a concern and the stock could remain volatile ahead of this.

Above or below expectations

Tulip’s June quarter revenue/EBITDA came in 8-18% above our/consensus expectations.

What does the result mean?

- **Operational trends improved in this quarter with revenue growing 8% q-q to INR7bn and EBITDA by 13% q-q to INR1.9bn.** In past 2 quarters, revenue and EBITDA have declined sequentially due to the slowing macro environment as well as competition which resulted in downward pricing pressure. While this quarter’s result is a positive, we believe challenges may not be at an end as yet. On a y-y basis, revenues rose 10%, while EBITDA grew by 4%.
- **Tulip announced another data center order for INR870mn over 3 years and for 10k sqft. Nevertheless, order inflow for the data center is progressing well below expectations and Tulip has locked in only 10% (or ~40k sqft) as of now.** Moreover, revenues for the data center were supposed to have begun to kick in, but it is not clear if this is the case.
- **FCCB refinancing/redemption appears to be under progress**, but isn’t completed yet. Tulip is now close to its redemption date in August and the stock could remain volatile until fully completed. Current gearing levels remain at 3x net debt to EBITDA.

Key numbers

- Sequentially, revenue grew 8% to INR 7.2bn while EBITDA grew 13% to INR 1.9bn with 26.8% margins.
- Underlying NPAT was down 19% q-q to INR 547mn largely on account of tax benefits in the previous quarter. It had a INR616mn one time gain from the sale of its stake in the BWA venture with Qualcomm.
- 81% of the new connectivity orders received were for fibre. Data connectivity accounts for 59% of its total order input while managed services accounts for 31%. It received a new DC order from the Indian government for INR870mn for 10K sqft of space in this quarter.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 1: Tulip quarterly trends

INR mn	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Revenue	4,429	4,910	5,009	5,307	5,252	5,850	6,026	6,379	6,539	7,029	6,866	6,617	7,165
- % Chg QoQ	*-5%*	*11%*	*2%*	*6%*	*-1%*	*11%*	*3%*	*6%*	*3%*	*8%*	*-2%*	*-4%*	*8%*
- % Chg YoY	*33%*	*28%*	*13%*	*13%*	*19%*	*19%*	*20%*	*20%*	*25%*	*20%*	*14%*	*4%*	*10%*
EBITDA	1,086	1,269	1,350	1,545	1,417	1,630	1,715	1,866	1,848	2,032	1,991	1,692	1,920
- % Chg QoQ	*8%*	*17%*	*6%*	*14%*	*-8%*	*15%*	*5%*	*9%*	*-1%*	*10%*	*-2%*	*-15%*	*13%*
- % Chg YoY	*66%*	*56%*	*46%*	*54%*	*31%*	*29%*	*27%*	*21%*	*30%*	*25%*	*16%*	*-9%*	*4%*
EBITDA Margin	*25%*	*26%*	*27%*	*29%*	*27%*	*28%*	*28%*	*29%*	*28%*	*29%*	*29%*	*26%*	*27%*
NPAT	452	518	574	795	642	778	816	826	772	871	773	671	547
- % Chg YoY	*-2%*	*3%*	*16%*	*-25%*	*42%*	*50%*	*42%*	*4%*	*20%*	*12%*	*-5%*	*-19%*	*-29%*

Source: Company reports, Nomura estimates

Appendix A-1

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Tulip Telecom	TTSL IN	INR 104	14-Aug-2012	Neutral	Not rated	A11

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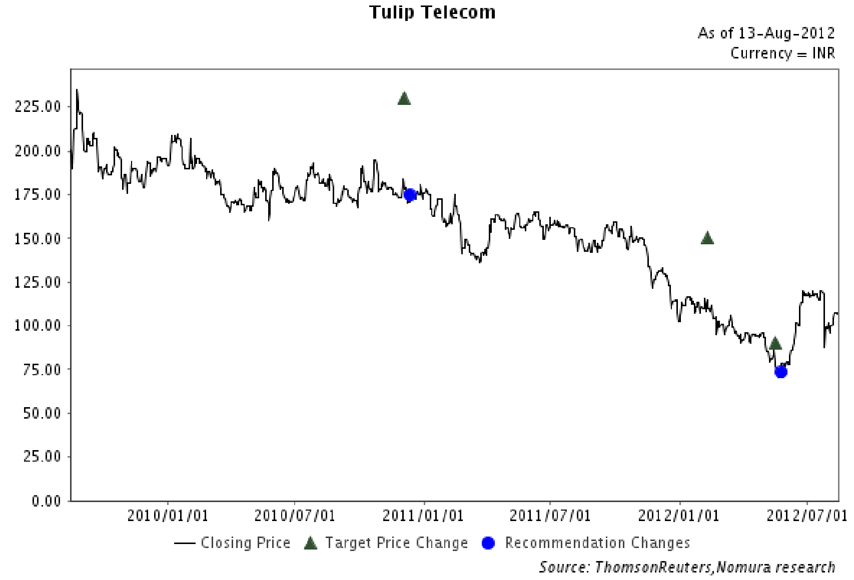
Previous Rating

Issuer name	Previous Rating	Date of change
Tulip Telecom	Buy	17-May-2012

Tulip Telecom (TTSL IN) **INR 104 (14-Aug-2012)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
17-May-12	Neutral		76.70
17-May-12		90.00	76.70
10-Feb-12		150.00	110.30
03-Dec-10	Buy		178.15
03-Dec-10		230.00	178.15

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of INR90 is based on DCF valuation for the core business using a WACC of 12.3% and terminal growth of 2%, and it includes 50% of the implied value for the DC business based on preliminary estimates. The cashflows are discounted back to 2017F. This leads our DCF valuation to INR129. To account for the uncertain timings of various events such as FCCB redemption, timing of data centre ramp-up we apply a 30% discount to arrive at our final TP of INR90.

Risks that may impede the achievement of the target price Downside risks include: slower-than-anticipated demand and profitability on the data centre side, increasing competition and macro slowdown. Upside risks include – faster pickup in firm orders in DC, recovery in macro economic scenario

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STOCKS

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