
Rating Rationale for Tulip Telecom Limited's Long Term Debt Issue of INR 100 crores or 1 billion

Long Term Debt Issue: BWR AA-

Outlook : Stable

Brickwork Ratings has assigned BWR AA- (Pronounced BWR Double A Minus) for Tulip Telecom Limited's ("TULIP" or "the Company") proposed Long Term Debt Issue of INR 100 Crores or 1 billion. Brickwork Ratings' 'BWR AA-' stands for an instrument that is considered to offer HIGH credit quality in terms of timely servicing of principal and interest obligations. The rating factored:

- Leading position of company in MPLS/VPN based enterprise data communication segment
- Strong growth in MPLS/VPN market
- Experienced management with good execution capabilities
- Strategic moves being made by the company to accelerate growth
- Pressure in network integration business from other players
- Threat to wireless business from bigger telecom players that are bidding for Wi-max spectrum which is expected to be auctioned by the government in near future

BWR has essentially relied upon audited financial results, projected financial figures, information and clarification provided by TULIP.

The company is a leading pan-India provider of communication solutions, serving data connectivity requirements of enterprises and government clients. It is a leader in multi-protocol label switching virtual private network (MPLS VPN) market in India and has a data network reaching 1,415 cities. Tulip Telecom also provides managed services such as Network Integration to support connectivity, data centers, and security and application management.

TULIP has posted good growth in total business. On a standalone basis, income from operations increased 32.2% to Rs 1608 crores in FY09 as compared to Rs 1,216 crores in FY08. The increase in revenues is due to increase in income from Corporate Network/Data services segment. Company's profit from operations increased by 44.2% to Rs 294 crores in FY09 as compared to Rs 204 crores in FY08. The Net Profit totaled Rs 249.5 crores in FY09, up 33.34% from Rs 187.11 crores in FY08. The Other Income has increased from Rs 23.04 crores in FY08 to Rs 34.45 crores.

Background

TULIP is a leading telecommunications solutions, mainly data communication infrastructure and connectivity, provider in India. The company provides intra-city and inter-city MPLS VPN connectivity mainly based on last-mile wireless network, Network Integration services i.e. designing, supplying & installation of networking equipments and management of client's data

communication networks which include State Wide Area Networks (SWANs). TULIP was incorporated in 1992 as Tulip software Pvt. Ltd that provided packaged software and PCs and subsequently became leading player in Enterprise Data Communication Service market.

TULIP's portfolio of services covers:

- Designing, Supply & Installation and maintenance of the Networking Equipments;
- Providing connectivity by way of MPLS / VPN services to various offices of the Enterprise;
- Managed services, like Data Centre, Remote Infrastructure Management Services and other value added services.

Business Operations

TULIP operates in two main business segments viz. network integration, enterprise network/data services while it has added a new business segment namely Managed Services. In FY09, Enterprise & Carrier Data segment generated around 70 per cent of the total revenues followed by Network Integration segment which contributed 28.26 per cent and balance by other segment.

Network Integration – TULIP provides services such as designing and developing the client network which includes assistance to clients by identifying and providing equipment for the network, integrating and implementing network rollouts as well as providing post-implementation network management and maintenance services. TULIP has been able to reduce significant cost and space requirements for its clients by implementing Remote Management services through its main network operation centers (NOCs) located in Delhi and Mumbai which are supported by 10 regional NOCs. Tulip Telecom also offers rural connectivity through Rural Connect targeted at state governments and agencies.

During the financial year FY09, the Network Integration segment generated revenues of Rs 464.3 crores as compared to Rs 558.93 crores in FY08, a decline of about 17%. The Company does not find this segment to be attractive due to low margin nature of this business and also possible exposure to currency fluctuation.

Enterprise Network/Data Service – TULIP provides clients with inter-city and intra-city data connectivity. Inter-city connectivity is provided through leased lines and fiber optic cables from other service providers while the intra-city connectivity is provided through its own wireless networks. TULIP offers a range of services such as multi protocol label switching virtual private network (MPLS VPN), internet access, IPLC and DLC through its network that covers 1,415 cities across India.

This segment has been growing at a very healthy rate with enterprise network/data revenues growing almost 74% as companies are increasingly using networking and Information

Technology to keep up with their business expansion. Consequently, the share of this segment in overall revenues has gone up from 53% in FY08 to almost 70% in FY09. The segment revenues increased from Rs 657.5 crores in FY08 to Rs 1,144 crores in FY09.

It is however observed that, the Company provides inter-city connectivity for its wireless based IP/VPN business through lease arrangements as it does not have its own inter-city networks. Therefore, the Company's ability to offer high quality telecommunications services largely depends on the quality of the networks maintained by other operators, and their continued availability, neither of which is under its control. The lease rental agreements with other operators are subject to changes which may impact its capex plans.

Managed Services – provide IT outsourcing services like Data Centers, Remote Infrastructure Management services etc.

Management Profile

Col. H.S Bedi is the present Chairman and Managing Director of TULIP. The Board consists of well qualified and experienced people. However, four out of nine Directors of the Board belong to the Bedi family. Operations of the company are managed by professionals with vast industry and management experience supported by 2400 employees across India with over 70 per cent technical staff.

Financial Performance

TULIP has posted good growth in total business. On a standalone basis, Income from operations increased 32 % to Rs 1,608 crores in FY09 as compared to Rs 1,216 crores in FY08. Increase in revenues reflects an increase in income from Corporate Network/Data Services. Company's profit from operations increased 44% to Rs 294 crores in FY09 as compared to Rs 204 crores in FY08. The profit before tax for FY09 was Rs 282 crores as compared to Rs 201 crores during FY08 while the net profit stood at Rs 249.57 crores in FY09 as compared to Rs 187.27 crores in FY08. The increase in net profit reflects higher other income that includes saving on account of repurchase and cancellation of FCCBs. Segment performance is shown in Table 1.

Segment Revenue (Rs Crores)	2009	2008	2007
Network Integration	464.3	559	525.3
Corporate Network/Data Services	1144	657.5	315.53
Un-allocable	34.45	23	2.35
Total	1643	1239	843

The company's PBITDA stood at Rs 335.5 crores as on 31st March, 2009. PBITDA increased by 36.4% from FY08 figure of Rs 245.63 crores. The Interest Coverage ratio declined from 10.4 times in FY08 to 7.26 times in FY09. The Debt Service Coverage ratio for the year FY09 at 3.21 times was higher than previous year's figure of 0.82 times while Profitability margins improved marginally from 15.4% in FY08 to 15.52% in FY09. The Return on Capital Employed has also declined and stood at 21% in FY09 as compared to FY08 figure of 26%. On standalone basis in FY08, the total debt was Rs 893 crores which increased to Rs 1,122 crores in FY09 (refer Annexure 2). The increase in debt was largely due to the company's capital expenditure and optic fiber rollout plans in the major business districts of the country. A substantial portion of the debt consisted of Foreign Currency Convertible Bonds (FCCBs) that amounted to Rs 608.3 crores as on 31st March, 2009. The company had derivative contracts for hedging exposure to FCCBs. The losses on account of foreign currency fluctuation amounted to Rs. 61 crores for the year ended 31st March, 2009. At the same time, the Company had earned substantial benefits due to buyback of a portion of their FCCBs at a discount.

Brief overview of the company's performance, key ratios, and abridged balance sheet are as per Annexure 1 and 2.

TULIP's Performance vis-à-vis Peers:

Table 3 gives the comparison of key parameters of TULIP with its peers (with similar or closely similar business activities) based on 2009 results.

Year: FY09	Tulip Telecom	Peers' Average
Total Debt- Equity Ratio	1.65	0.74
Interest Coverage Ratio	7.26	5.07
Debt Service Coverage Ratio	3.21	1.6
Profitability Margin	15.52%	24%
Return on Capital Employed	21%	14.44%
Net Cash Accruals to Total Debt	25%	60%
Current Ratio	2.38	1.21

The Total Debt-Equity ratio of TULIP is much higher than that of the peers owing to funding requirements for the capital expenditure incurred during the past few years. Notably, the Profitability margins and Net cash accrual to total debt are significantly lower than those of the peers. The current ratio is higher than that of the peers. However, the company shows higher book debts/ accounts receivable outstanding in FY09 (Rs 297 crores) as compared to Rs 199 crores in FY08 due to increase in collection period from two months to about three months as a result of current economic slowdown.

Industry Scenario

India's telecom market is growing rapidly and is expected to be Rs 1,380 billion sector contributing 5.4% to India's gross domestic product (GDP) by 2010. The demand for bandwidth connectivity is expected to grow as enterprises seek to utilize network and information technology to enhance productivity. There is a high demand for connectivity requirements in services sectors like Financial, BPOs, KPOs etc. Also, with increased usage of Voice over IP (VoIP) services, bandwidth requirements will increase in the coming years, which will further drive the demand for high end connectivity solutions. The data services market is estimated to be around Rs 5,155 crores and is expected to reach about Rs 15,400 crores with a CAGR of 25% driven by MPLS/VPN market which is expected to have a market share of nearly 50% in 2012-2013. On the other hand, the share of Digital Loop Carrier (DLC) market and ATM/Frame Relay market is expected to decline due to availability of cost-effective services such as MPLS network. The penetration level of broadband services in the SME sector is still very low in India which provides vast untapped market to the service providers. The wireless subscriber base has grown at a CAGR of 61% over the period FY04-FY09. Due to low tele-density levels in the rural areas there are significant opportunities to provide wireless services in this sector.

Major Challenges:

- Legal and regulatory framework yet to stabilize.
- Competition from existing private operators, new entrants and government controlled enterprises.
- Rapid technological changes may render the technologies, products or services obsolete.
- Telecommunications industry is capital intensive in nature and hence migration to new technology puts pressure on the performance.

Rating Outlook

Currently, the network integration business has been impacted by competition from other players. The enterprise network/data segment is also likely to face competition from bigger telecom companies that are bidding for Wi-max spectrum that is expected to be auctioned by the government in the near future.

However, TULIP's business mix is shifting towards enterprise network/data business which is expected to drive future growth of its operations. Indian wireless and enterprise data service market is poised for strong growth due to low penetration in rural and SME sector as well as increasing demand from services sectors. The Company is quite well positioned to take advantage of the same and with strategic initiatives being taken by the management to lead its growth, TULIP is expected to further improve upon its overall performance and margins. Keeping these in view, BWR has assigned "Stable" outlook to its rating.

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Annexure 1: Profit and Loss

Particulars (in Rs Crores)	2009	2008	2007
Income			
Sales / Income from Operations	1608	1216	841
Total Income	1608	1216	841
Expenditures			
Cost of Goods Sold	1151	898	655
Administrative Expenses	46	29	18
Payment & provisions for employees	71	39.6	30.7
Selling and Distribution expenses	4.2	3.9	3.55
Total Expenditures	1272.8	970.8	708
Profit before other income, finance expenses, depr. and amortization	335.5	245.63	132.8
Profit Before Taxes	282.3	201	106
Provision for Taxation	32.73	13.76	9.27
Profit After Taxes	249.57	187.3	96.9

Annexure 2:

Balance Sheet

	Particulars (Figures in Rs Crores)	2009	2008	2007
	Funds Employed:			
1	Share Capital	29	29	29
2	Reserves and Surplus	651.4	416	250.47
3	Total Shareholders' Funds	680.4	445	279.47
4	Secured Loans	514	194	141.6
5	Unsecured Loans	608	699	-
6	Deferred Tax Liability (Net)	0.92	0.92	0.8
7	Total Funds Employed	1802.4	1338	421.07
	Application Of Funds:			
8	Fixed Assets	1214	518	249.7
9	Investments	1.5	0.08	0.02
10	Net Current Assets*	588.35	820	172
11	Total Assets (Net)	1802.4	1338	421.07

Ratio Analysis

Particulars	2009	2008	2007
Debt - Equity Ratio	1.65	2.01	0.51
Interest Coverage Ratio	7.26	10.40	10.16
Debt-Service Coverage Ratio	3.21	0.82	2.06
Networth (Crores)	680	445	279
Profitability Margins	15.52%	15.4%	11.53%
Return on Capital Employed	21%	26%	35%
Net cash accruals to total debt	25%	25%	75%
Current Ratio	2.38	1.02	1.43