

VISIT UPDATE

MID CAP

Share Data

Reuters code	TATA.BO
Bloomberg code	TCOM IN
Market cap. (US\$ mn)	1,806
6M avg. daily turnover (US\$ mn)	2.9
Issued shares (mn)	285
Target price (Rs)	295

Performance (%) 1M 3M 12M

Absolute	(5)	(18)	(29)
Relative	(10)	(18)	(66)

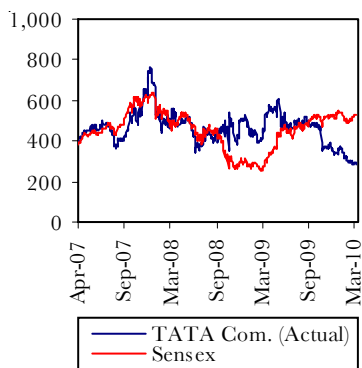
Valuation ratios (Consolidated)

Yr to 31 Mar	FY10E	FY11E
EPS (Rs)	(17.3)	(18.6)
+/- (%)	NA	NA
PER (x)	NA	NA
PBV (x)	1.8	2.2
Dividend/Yield (%)	1.6	1.6
EV/Sales (x)	1.4	1.2
EV/EBITDA (x)	10.6	8.6

Major shareholders (%)

Promoters	76
FII's	1
MF's	1
BFST's	11
Public & Others	11

Relative performance



Tata Communications Maintain Underperformer

Price: Rs 289

BSE Index: 17,168

12 March 2010

High capex to increase leverage

We met the management of Tata Communications (TCOM). Key highlights are:

- Wholesale voice segment (EBITDA margin of ~8%) will continue to report a revenue growth of lower single digits, as YoY volume growth of mid teens will be negated by a pricing decline of higher single digits.
- Enterprise segment should remain strong in FY11E; the management expects a YoY growth of ~20-25%.
- However, because of the pricing cuts taken at the time of global turmoil last year, EBITDA margin has come slightly down and 25% looks to be the steady state margin for the next two years.
- The company will take part in the WiMax auction, expected to take place in April 2010.
- US\$ 500 mn capex (excluding WiMax) each for FY10E and FY11E. TCOM has incurred a capex of US\$ 420 mn in the first nine months of FY10E.
- Debt remains the only possible funding option currently.
- Neotel is expected to achieve EBITDA breakeven in the next couple of quarters.
- Status quo maintained on the land demerger issue.

B&K's view

We have downward revised our numbers for the EBITDA and PAT, even though revenue estimates have slightly gone up. EBITDA is revised downward; as we do not think that pricing cuts taken by the company can be reversed. Downward revision in PAT is on account of lower EBITDA and high interest and depreciation charges, in line with high capex guidance. Our revised EBITDA estimate is 11% below the consensus, as we believe that pricing decline will more than offset the volume recovery. Raising equity seems to be difficult at the company level, as the Government of India might not want to dilute its holding below 26%, pending the settlement of the land demerger issue. We expect a combined capex of Rs 80 bn for FY11E and FY12E. Out of this, Rs 45 bn is on account of WiMax (auction outgo + roll out) and Rs 35 bn for undersea cables and other operations. Such a huge capex, without the support of equity raising option will excessively leverage TCOM's balance sheet. We see net debt-to-equity increasing to 2.7x in FY11E. We expect the company to raise equity at the subsidiary level. For example, TCOM, post obtaining the WiMax licence, can hive it off to a subsidiary and can look out for a strategic placement.

In terms of valuation (see Appendix I), fair value is further reduced to Rs 295 (from Rs 324 earlier), as value from core operations come down to Rs 50 (5.9x FY11E EV/EBITDA, 20% discount to average multiples for Bharti and RCOM), from Rs 74 earlier. Contribution from surplus land bank (3.1 mn square meter) is Rs 183 per share (at 30% discount to the market value). TCOM's 10.6% stake in Tata Teleservices (TTSL) is valued at Rs 62 per share. Maintain Underperformer.

- **Wholesale voice segment:** TCOM continues to post strong minutes' volume growth, especially in international voice market. In the national long distance (NLD) market, volume growth is stagnant and coupled with the decline in the realisation, NLD voice revenue is coming down. Incrementally, Indian NLD network (more than 100,000 route kms) will be used for enterprise services only. In the international long distance (ILD) services, the company continues to register strong volume growth of higher teens and the yearly pricing decline is of the order of higher single digits. We expect this segment to register a flat YoY growth next year.
- **Enterprise:** Based on new undersea cables and an improving outlook, the company expects to clock a 25% YoY growth. Following the economic turmoil last year, the company was forced to take price cuts, which the management believes, will now be difficult to reverse. Hence, some negative impact on the EBITDA margin is expected because of that. For the Data segment (Carriers + Enterprise), we concur with the management's view and see Data segment posting a YoY growth of 25% YoY in FY11E.
- **Stretched balance sheet:** The management has time and again confirmed TCOM's interest in the oncoming WiMax auction. For a pan-India spectrum allocation, reserve price is Rs 17.5 bn and two slots will be put for the auction process. For our calculation, we are assuming that TCOM will be interested in the WiMax auction on a pan-India basis and a capex of Rs 45 bn will be incurred for auction outgo as well as for roll out. Furthermore, the company would also incur a capex of Rs 35 bn for undersea cables (Gulf, Africa and Europe cables) and for other operations. Current net debt is at US\$ 1.2 bn and it will increase due to TCOM's inability to raise funds through equity (pending land demerger). We see net debt-to-equity increasing to 2.7x in FY11E, from 1.1x in FY09 and 1.4x in FY10E.

Change in estimates (assuming little contribution from WiMax)

(Rs mn)	FY11E			FY12E		
	Old	Revised	Change (%)	Old	Revised	Change (%)
Revenue	115,335	119,463	3.6	122,885	130,885	6.5
YoY (%)	7.0	10.2	–	6.5	9.6	–
EBITDA	20,991	16,964	(19.2)	23,348	23,559	0.9
YoY (%)	42.1	23.3	–	11.2	38.9	–
EBITDA margin (%)	18.2	14.2	(400)bps	19.0	18.0	(100)bps
Adjusted PAT	(2,687)	(5,291)	–	(676)	(3,533)	–

Appendix I: SOTP valuation

Core business Valuation				
Bharti Airtel FY11E EV/EBITDA (x)				7.6
RCOM FY11E EV/EBITDA (x)				7.1
Average FY11E EV/EBITDA (x)				7.4
Discount to average FY11E EV/EBITDA (%)				20
TCOM's FY11E EV/EBITDA (x)				5.9
TCOM's FY11E EBITDA (Rs mn)				16,964
TCOM's core business EV (Rs mn)				99,996
TCOM's net debt (Rs mn)				85,851
TCOM's equity value from core business (Rs mn)				14,145
O/s shares (mn)				285
a) Per share contribution (Rs)				50
TTSL's stake valuation				
Bharti Airtel EV/Subscriber (Rs/subs)				6,277
RCOM EV/Subscriber (Rs/subs)				3,079
Idea Cellular EV/Subscriber (Rs/subs)				4,188
TTML EV/Subscriber (Rs/subs)				5,264
EV/Subscriber, implied from NTT DoCoMo's 26% stake in TTSL (Rs/subs)				15,830
Average EV/Subs (Rs/subs)				6,928
Discount to average EV/Subs (%)				30
TTSL's EV/Subs (Rs/subs)				4,849
TTSL subscriber base (mn)				46.5
TTSL's core business valuation (Rs mn)				225,282
Value of TTSL's 37.65% stake in TTML (Rs mn)				13,413
TTSL's valuation (Rs mn)				238,695
TCOM's stake in TTSL (%)				10.60
TCOM's stake (Rs mn)				25,302
Holding company discount (%)				30.0
b) Per share contribution (Rs)				62
Land bank valuation				
Location	City	Acres	Rateperacre (Rs mn)	Value (Rs mn)
Dighi	Pune	524.0	8-10	4,716
Halisahar	Kolkata	35.2	25-40	1,144
Chattarpur	New Delhi	58.0	100-200	8,700
GK 1	New Delhi	70.0	700-1,000	59,500
Padianallur	Chennai	53.4	8-10	481
Total		741.0	133	74,541
Discount (%)				30
Value (Rs mn)				52,178
c) Per share contribution (Rs)				183
TCOM's per share value (a+b+c) (Rs)				295

Income Statement (Consolidated)

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Net sales	82,630	99,632	108,360	119,463
<i>Growth (%)</i>	<i>(4.0)</i>	<i>20.6</i>	<i>8.8</i>	<i>10.2</i>
Operating expenses	(74,178)	(86,136)	(94,598)	(102,499)
Operating profit	8,452	13,496	13,762	16,964
EBITDA	8,452	13,496	13,762	16,964
<i>Growth (%)</i>	<i>(19.8)</i>	<i>59.7</i>	<i>2.0</i>	<i>23.3</i>
Depreciation	(7,844)	(11,023)	(14,325)	(17,537)
Other income	2,636	2,103	2,167	2,389
EBIT	3,243	4,576	1,604	1,816
Interest paid	(1,642)	(3,013)	(4,189)	(5,307)
Pre-tax profit (before non-recurring)	1,601	1,563	(2,586)	(3,491)
Non-recurring items	(112)	2,665	2,824	–
Pre-tax profit (after non-recurring)	1,489	4,228	238	(3,491)
Tax (current + deferred)	(1,769)	(2,307)	(1,840)	(1,800)
Net profit (before Minority Interest, Pref. Dividend, etc.)	(280)	1,920	(1,602)	(5,291)
Minority interests	383	1,238	(500)	–
Reported PAT	103	3,158	(2,102)	(5,291)
Adjusted net profit	215	493	(4,926)	(5,291)
<i>Growth (%)</i>	<i>(79.9)</i>	<i>129.4</i>	<i>NA</i>	<i>NA</i>

Balance Sheet (Consolidated)

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Cash & marketable sec.	2,941	8,759	2,310	2,896
Other current assets	43,687	56,802	58,661	65,562
Investments	12,044	16,760	12,658	10,510
Net fixed assets	82,963	116,059	129,733	169,696
Other non-current assets	1,674	575	575	575
Total assets	143,309	198,956	203,938	249,240
Current liabilities	56,870	79,192	88,655	97,159
Total debt	33,466	66,654	66,339	110,568
Other non-current liabilities	1,421	1,995	1,559	1,559
Total liabilities	91,757	147,842	156,553	209,286
Share capital	2,850	2,850	2,850	2,850
Reserves & surplus	48,147	48,727	44,485	37,053
Less: Misc. expenditure	522	(513)	–	–
Shareholders' funds	51,520	51,065	47,335	39,903
Minorities interests	32	50	50	50
Total equity & liab.	143,309	198,956	203,938	249,240
Capital employed	86,439	119,763	115,283	152,080

Cash Flow Statement (Consolidated)

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Pre-tax profit	1,489	4,228	238	(3,491)
Depreciation	7,844	11,023	14,325	17,537
Change in working capital	1,848	10,320	7,167	1,603
Total tax paid	(1,539)	(1,747)	(1,840)	(1,800)
Cash flow from oper. (a)	9,642	23,824	19,891	13,849
Capital expenditure	(21,291)	(46,054)	(28,000)	(57,500)
Change in investments	5,592	(4,717)	4,102	2,148
Others	(680)	900	513	–
Cash flow from inv. (b) (16,379)	(49,870)	(23,385)	(55,352)	
Free cash flow (a+b)	(6,737)	(26,047)	(3,494)	(41,503)
Equity raised/(repaid)	–	(1,099)	–	–
Debt raised/(repaid)	8,352	33,188	(315)	44,229
Dividend (incl. tax)	(1,501)	(1,501)	(1,501)	(1,501)
Others	373	1,276	(1,140)	(641)
Cash flow from fin. (c) 7,224	31,865	(2,955)	42,087	
Net chg in cash (a+b+c)	487	5,818	(6,449)	585

Key Ratios (Consolidated)

Yr end 31 Mar (%)	FY08	FY09	FY10E	FY11E
Adjusted EPS (Rs)	0.8	1.7	(17.3)	(18.6)
Growth	NA	129.4	NA	NA
Book NAV/share (Rs)	173.6	171.7	158.6	132.5
Dividend/share (Rs)	4.5	4.5	4.5	4.5
Dividend payout ratio	697.9	304.2	NA	NA
Tax	118.8	54.6	771.9	(51.6)
EBITDA margin	10.2	13.5	12.7	14.2
EBIT margin	3.9	4.6	1.5	1.5
RoCE	3.9	4.4	1.4	1.4
Net debt/Equity	59.2	113.3	135.1	269.5

Valuations (Consolidated)

Yr end 31 Mar (x)	FY08	FY09	FY10E	FY11E
PER	383.2	167.0	NA	NA
PCE	10.2	7.2	8.8	6.7
Price/Book	1.7	1.7	1.8	2.2
Yield (%)	1.6	1.6	1.6	1.6
EV/Net sales	1.8	1.5	1.4	1.2
EV/EBITDA	17.3	10.8	10.6	8.6

Du Pont Analysis – ROE (Consolidated)

Yr end 31 Mar (x)	FY08	FY09	FY10E	FY11E
Net margin (%)	0.3	0.5	(4.5)	(4.4)
Asset turnover	0.6	0.6	0.5	0.5
Leverage factor	2.5	3.3	4.1	5.2
Return on equity (%)	0.4	1.0	NA	NA

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 2. **OUTPERFORMER:** 0 to +25%
 3. **UNDERPERFORMER:** 0 to -25%
 4. **SELL:** Potential downside of < -25% (absolute returns)
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