

June 02, 2009

Key Data	(INR)
CMP	466
Target Price	457

Key Data	
Bloomberg Code	TCOM IN
Reuters Code	TATA.BO
BSE Code	500483
NSE Code	TATACOMM
Face Value (INR)	10
Market Cap. (INR bn.)	133
52 Week High (INR)	651
52 Week Low (INR)	320
Avg. Daily Volume (6m)	46846
F&O	
Market Lot	1050
Turnover (Rs Mn)	534

Shareholding	%
Promoters	76.2
Mutual Funds / Financial Institutions / Banks	0.5
Foreign Institutional Investors	1.5
Bodies Corporate	10.7
Individuals/NRI and Others	11.1
Total	100.0

	FY09	FY10E	FY11E
Net sales (Rs Mn)	99631.7	107251.7	125293.0
Op Profit (Rs.Mn)	13495.7	13996.3	18104.8
Net Profit (Rs Mn)	3158.0	1611.2	2356.9
OPM (%)	13.5	13.1	14.5
NPM (%)	3.2	1.5	1.9
EPS (Rs.)	11.1	5.7	8.3

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## Tata Communications Limited

Tata Communications Limited (TCom) announced consolidated results for the fourth quarter ended March 2009. Its consolidated total revenue for FY09 grew 20% YoY to INR99,631.7 million. The company's net profit grew robustly to INR3,158 million in FY09 from INR103 million in FY08. This included an extra-ordinary gain of INR3,621 million from the sale of shares in Tata Teleservices Ltd.

### Key highlights

#### WHOLESALE VOICE SEGMENT

- TCom's wholesale voice segment was the major contributor to total revenue in FY09, with a 58% share. This segment's revenue grew 12% to INR56,290 million in FY09 from INR50,410 million in FY08. During 4Q FY09, its revenue increased 9% to INR13,850 million from INR12,650 million in 4Q FY08.
- TCom has been able to maintain its leadership in the wholesale voice segment with 44% share in wholesale ILD voice traffic by revenue and 53% share in wholesale NLD voice traffic. The ILD segment recorded a volume of 24 billion minutes in FY09, as against 10 billion NLD minutes. The national long distance segment was the major volume growth driver, with a robust 43% YoY growth.
- We expect this segment to face pricing pressure with volume growth. We estimate TCom to register 16.8% volume growth over FY09-11. We estimate this segment's revenue to grow at a 6% CAGR from INR56,290 million in FY09 to INR62,640 million in FY11.

#### WHOLESALE AND ENTERPRISE DATA BUSINESS

- On a consolidated basis, the data business accounted for 40% of revenue. This segment's revenue registered a robust 25% growth from INR8,290 million in 4Q FY08 to INR10,370 million in 4Q FY09. For FY09, revenue grew 29% to INR38,720 million, from INR30,050 million in FY08, mainly driven by huge volumes.
- Global bandwidth demand is increasing at 60% with emerging markets growing at an even higher rate. To capture this market, TCom plans to have a submarine network covering the entire globe.
- The construction work on the TGN Eurasia cable system appears to be on track and the company expects this system to go live by end-3Q FY10.
- TCom continues to focus on emerging markets with the recent completion of its TGN Intra-Asia submarine cable system and strategic partnerships with key telecom players such as Etisalat for enterprise network services, including dedicated Ethernet services for connectivity to and from the UAE. Moreover, TCom and Tata Africa increased the Tata Group's shareholding in Neotel (South Africa's first converged services operator) to 56% earlier this year.
- TCom continues with its strategy of moving up the value chain and is looking at providing customized value-added services. In the past, it launched various managed services; revenue from this grew at a CAGR of 70% over FY07-09. Given its focus on delivering managed services, TCom has entered into several partnerships this year to develop innovative offerings. It has pioneered the public room model for Telepresence services through its partnership with Cisco, the Taj Group of Hotels, and the Confederation of Indian Industry. It launched global Content Delivery Network services in partnership with Bit Gravity.

- We expect the enterprise data segment's revenue to grow from INR30049.6 million in FY08 to INR57359.2 million in FY11, a CAGR of 26%.

#### **RETAIL BROADBAND SEGMENT**

- TCom provides various other service offerings: Broadband for retail customers, dial-up Internet services and cyber cafes.
- TCom's broadband and Internet subscriber base increased to 350,000 as of March 2009, of which broadband subscribers accounted for around 220,000. These subscribers are generating an ARPU of INR800/month and the base has been expanding at 4,000-5,000 subscribers per month.
- Management is awaiting the WiMax spectrum auctions. It believes that WiMax spectrum auctions should help increase its broadband subscriber base, which in turn should lead to improved revenue visibility for the segment.

#### **FINANCIAL PERFORMANCE**

- **Revenue mix:** TCom's consolidated revenue grew 20% to INR99,631.7 million in FY09 from INR82,974.1 million in FY08. Given the continued pricing pressure for this the voice segment, the company adopted a cautious strategy of moving towards the data business. As expected, and in line with the company's strategy, the revenue mix is shifting towards the data business.
- During FY09, TCom's operating profit grew 60% to INR13,496 million, from INR8,452 million in FY08. The operating profit margin also improved from 10.2% to 13.5%, mainly driven by the reduction in network expenditure, which was a result of more on-net traffic. Further, shift in the revenue mix towards the high-margin data business also contributed to the improvement in TCom's margins.
- The company's net profit registered robust growth from INR103 million in FY08 to INR3,158 million in FY09. This included an extra-ordinary gain of INR3,621 million from the sale of shares in Tata Teleservices Ltd.
- Management has guided for a capex of \$600 million for FY10 excluding that for the upcoming WiMax auctions. The company will fund capex through borrowings and internal accruals. Management has also indicated that it would consider various alternatives for funding for the WiMax auctions.

#### **VALUATION AND RECOMMENDATION**

TCom indicated that, as a part of its long-term growth strategy, it plans to maintain leadership in all its focus markets. The company has set a target of 15% CAGR in organic sales over FY07-12. It is increasingly becoming global through its presence in the emerging markets. This is mainly to derisk itself from a highly competitive Indian market. TCom intends to increase the share of its retail business. It is already moving up the value chain and is looking at providing customized value-added and managed services.

Although management believes that it has created the right portfolio of products to cater to varied customers, the core wholesale voice business continues to face pricing pressure. Moreover, high debt along with funding concerns for WiMax auctions limit our growth outlook. Therefore, we maintain our "SELL" recommendation on TCom. At present, the stock is trading at a price of INR466.

## KEY RISK TO OUR PRICE TARGET

### A) Downside Risk

- **Lack of end-user relationship:** One of the most important factors, which restricts revenue growth for TCom is the lack of end-user relationship. Reliance and Bharti benefit from a significant subscriber base, which is absent for TCom. Tata Teleservices is the only telecom operator that continues to route its NLD and ILD traffic through TCom's network. Earlier, wireless service providers such as Idea, Vodafone, and Bharti used to route their traffic via TCom. However, lately, many service providers have acquired ILD and NLD licenses and are investing in building their own network, reducing their dependence on TCom. Thus, lack of a subscriber base is a major threat to TCom's growth.
- **Delay in WiMax auctions:** TCom has consciously decided to expand its WiMax services in the 2.3-2.5 Ghz post auctions and successful bidding for WiMax spectrum. However, with no clarity on spectrum allocations in the near future, growth in this segment will depend on getting spectrum in the 2.5GHz in the imminent BWA and 3G auctions.
- **High leverage:** TCom's debt level has been high over the past three years. Also, given its huge capex plans and the imminent WiMax auctions, we expect the company to raise further debt, which in turn would increase its debt burden.

### B) Upside Risk

- Expected revenue contribution from the TGN Intra Asia cable, which went live recently and the commencement of the TGN Eurasia cable in 3Q FY10.
- Any developments with respect to WiMax spectrum auctions.

Interim Results	INR Mn					
	4Q FY09	4Q FY08	YoY chg%	FY09	FY08	YoY chg%
<b>Net Sales</b>	<b>25939.4</b>	<b>8502.4</b>	<b>205.1</b>	<b>99631.7</b>	<b>82629.8</b>	<b>20.6</b>
Total Expenditure	21677.3	7027.9	208.4	86136.0	74178.2	16.1
<b>Operating Profits</b>	<b>4262.1</b>	<b>1474.5</b>	<b>189.1</b>	<b>13495.7</b>	<b>8451.6</b>	<b>59.7</b>
Other Income	233.1	352.1		2102.8	2635.50	
EBDIT	4495.2	1826.6	146.1	15598.5	11087.14	40.7
Depreciation	3627.5	858.4		11022.7	7844.1	
EBIT	867.7	968.2		4575.8	3243.04	
Interest	952.0	105.3		3013.0	1641.8	
PBT	-84.3	862.9		1562.8	1601.24	
Exceptional item	3620.8	-10.5		2664.8	-112.0	
Profit from Ordinary Activities	3536.5	852.4		4227.6	1489.2	
Taxes	994.8	263.8		2307.3	1768.9	
Profit before Minority Interest	2541.7	588.6		1920.3	-279.7	
Less: Minority Interest	-278.1	0.0		-1317.8	-382.7	
Add: Share of profit/loss of associate	-80.1	0.0		-80.1	0.0	
<b>Net Profit</b>	<b>2739.7</b>	<b>588.6</b>	<b>365.5</b>	<b>3158.0</b>	<b>103.0</b>	<b>2964.8</b>
Equity Share Capital	2850	2850		2850	2850	
EPS (Rs)	9.6	2.1		11.1	0.4	
CEPS	22.3	5.1		41.8	27.9	
<b>Profitability Ratios</b>						
Operating Profit Margin (%)	16.4	17.3		13.5	10.2	
PAT Margin (%)	10.6	6.9		3.2	0.1	

Source: Company

Earnings Summary				(INR Mn)
Particulars	2008	2009	2010E	2011E
<b>Net Sales</b>	<b>82629.8</b>	<b>99631.7</b>	<b>107251.7</b>	<b>125293.0</b>
Total Expenditure	74178.2	86136.0	93255.4	107188.2
<b>Operating Profits</b>	<b>8451.6</b>	<b>13495.7</b>	<b>13996.3</b>	<b>18104.8</b>
EBDIT	2635.5	2102.8	3217.6	3758.8
Depreciation	11087.1	15598.5	17213.9	21863.6
Amortization	7844.1	11022.7	11832.1	14373.1
EBIT	3243.0	4575.8	5381.8	7490.6
Interest	1641.8	3013.0	3012.1	3314.6
PBT	1601.2	1562.8	2369.7	4175.9
Exceptional item	-112.0	2664.8	0.0	0.0
Profit from ordinary activities	1489.2	4227.6	2369.7	4175.9
Taxes	1768.9	2307.3	1798.1	2558.7
Profit before Minority Interest	-279.7	1920.3	571.6	1617.2
Less: Minority Interest	-382.7	-1317.8	-1119.7	-819.8
Add: Share of Profit/Loss of associate	0.0	-80.1	-80.1	-80.1
<b>Net Profits</b>	<b>103.0</b>	<b>3158.0</b>	<b>1611.2</b>	<b>2356.9</b>
Growth in sales (%)	-4.0%	20.6%	7.6%	16.8%
Operating Profits Growth (%)	-19.8%	59.7%	3.7%	29.4%
PAT Growth (%)	-33.1%	2964.8%	-49.0%	46.3%
Operating Profit Margin (%)	10.2%	13.5%	13.1%	14.5%
Net Profit Margin (%)	0.1%	3.2%	1.5%	1.9%

Source: Company reports and ACMIL estimates.

## Notes:

### **Institutional Sales:**

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