Company In-Depth

2 January 2007 | 8 pages

# Tata Teleservices (TTML.BO)

## Buy: Laggard Catching Up Slowly

Rating change ☐
Target price change ☑
Estimate change ☑

- Earnings adjusted, new target price reflects higher dilution — We lower our FY07-08E EBITDA (by 22-25%) based on lower-than-expected performance in 1HFY07 even though sub adds have witnessed acceleration in the 2H. Coupled with higher-than-expected dilution in rights issue (at 19%), we cut our target price to Rs24 (from Rs31.44) based on March-08 DCF.

- Operational turnaround on course — TTML has been getting its act together operationally with its share of net adds at 12% for the past six months. However, in the context of its lowest-in-the-industry tariffs, the cumulative share of 7% in Mumbai/Maharashtra remains sub-optimal and appears constrained by its CDMA network.

- Returns could be back-ended though — Given TTML's likely net breakeven in FY09, returns could be back-ended, especially in relation to its peers. We expect financial milestones to drive stock performance. Demonstration of operating leverage, which we expect to improve by 10% during FY07-09E, would be critical.

- Corporate action could act as an external trigger — We expect Tata Group to consolidate its telecom holdings relative to VSNL, TTSL and TTML for the next 12-18 months. The process could begin with Tata's option to buy out the government's remaining stake in VSNL (the call option for which expires in Feb-07). We think TTML (along with VSNL) offers a route to gain exposure to the consolidated entity.

| | |
|---|---|
| **Buy/Medium Risk** | **1M** |
| Price (02 Jan 07) | Rs19.35 |
| Target price | Rs24.00 |
| *from Rs31.44* | |
| Expected share price return | 24.0% |
| Expected dividend yield | 0.0% |
| **Expected total return** | **24.0%** |
| Market Cap | Rs35,014M |
| | US$794M |

**Price Performance (RIC: TTML.BO, BB: TTLS IN)**


See page 6 for Analyst Certification and important disclosures.

**Figure 1. Statistical Abstract**

| Year end March 31 | Net Profit | EPS | Revenue | Revenue Growth | EBITDA | EV / EBITDA |
|---|---|---|---|---|---|---|
| (Rs m) | (Rs Mils.) | (Rs) | (Rs Mils.) | (%) | (Rs Mils.) | (x) |
| 2006 | (4,938) | (3.2) | 10,951 | 35.6% | 1,247 | 40.4 |
| 2007E | (2,830) | (1.6) | 14,861 | 35.7% | 3,044 | 18.3 |
| 2008E | (1,391) | (0.8) | 18,370 | 23.6% | 4,711 | 12.5 |
| 2009E | 1 | 0.0 | 22,011 | 19.8% | 6,741 | 9.0 |

Source: Citigroup Investment Research estimates and Company Reports

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| Fiscal year end 31-Mar | 2005 | 2006 | 2007E | 2008E | 2009E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | -5.5 | -6.0 | -12.4 | nm | nm |
| EV/EBITDA adjusted (x) | nm | 43.7 | 18.3 | 12.1 | 8.7 |
| P/BV (x) | 1.7 | 1.7 | 1.6 | 1.6 | 1.6 |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | -3.54 | -3.25 | -1.56 | -0.77 | 0.00 |
| EPS reported | -3.54 | -3.25 | -1.56 | -0.77 | 0.00 |
| BVPS | 11.06 | 11.42 | 12.31 | 12.31 | 12.31 |
| DPS | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Profit & Loss (RsM)** | | | | | |
| Net sales | 8,075 | 10,951 | 14,861 | 18,370 | 22,011 |
| Operating expenses | -11,906 | -14,423 | -16,329 | -18,143 | -20,287 |
| **EBIT** | **-3,831** | **-3,472** | **-1,468** | **227** | **1,724** |
| Net interest expense | -1,447 | -1,458 | -1,362 | -1,618 | -1,723 |
| Non-operating/exceptionals | 0 | 0 | 0 | 0 | 0 |
| **Pre-tax profit** | **-5,279** | **-4,930** | **-2,830** | **-1,391** | **1** |
| Tax | 0 | -9 | 0 | 0 | 0 |
| Extraord./Min.Int./Pref.div. | 0 | 0 | 0 | 0 | 0 |
| **Reported net income** | **-5,279** | **-4,938** | **-2,830** | **-1,391** | **1** |
| Adjusted earnings | -5,279 | -4,938 | -2,830 | -1,391 | 1 |
| Adjusted EBITDA | -661 | 1,247 | 3,044 | 4,711 | 6,741 |
| **Growth Rates (%)** | | | | | |
| Sales | 35.1 | 35.6 | 35.7 | 23.6 | 19.8 |
| EBIT adjusted | -159.1 | 9.4 | 57.7 | 115.5 | 658.5 |
| EBITDA adjusted | -220.9 | 288.6 | 144.1 | 54.8 | 43.1 |
| EPS adjusted | -84.7 | 8.3 | 51.8 | 50.9 | 100.1 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **5** | **926** | **724** | **2,803** | **4,275** |
| Depreciation/amortization | 3,170 | 4,719 | 4,512 | 4,484 | 5,017 |
| Net working capital | 666 | 1,145 | -957 | -290 | -743 |
| **Investing cash flow** | **-4,410** | **-3,481** | **-5,550** | **-5,660** | **-4,992** |
| Capital expenditure | -4,338 | -3,481 | -5,550 | -5,660 | -4,992 |
| Acquisitions/disposals | -72 | 0 | 0 | 0 | 0 |
| **Financing cash flow** | **4,611** | **3,162** | **5,123** | **2,000** | **1,000** |
| Borrowings | 5,616 | 2,290 | 1,000 | 2,000 | 1,000 |
| Dividends paid | 0 | 0 | 0 | 0 | 0 |
| **Change in cash** | **206** | **606** | **297** | **-857** | **282** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **45,513** | **49,998** | **56,262** | **58,996** | **60,315** |
| Cash & cash equivalent | 820 | 274 | 1,724 | 867 | 1,150 |
| Accounts receivable | 1,423 | 1,558 | 2,270 | 2,807 | 3,363 |
| Net fixed assets | 24,924 | 24,366 | 25,039 | 26,215 | 26,191 |
| **Total liabilities** | **29,027** | **32,640** | **33,993** | **36,726** | **38,045** |
| Accounts payable | 10,198 | 11,521 | 11,874 | 12,608 | 12,927 |
| Total Debt | 18,828 | 21,119 | 22,119 | 24,119 | 25,119 |
| **Shareholders' funds** | **16,487** | **17,358** | **22,270** | **22,270** | **22,270** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | -8.2 | 11.4 | 20.5 | 25.6 | 30.6 |
| ROE adjusted | -33.3 | -29.2 | -14.3 | -6.2 | 0.0 |
| ROIC adjusted | -12.1 | -9.6 | -3.6 | 0.5 | 3.8 |
| Net debt to equity | 109.2 | 120.1 | 91.6 | 104.4 | 107.6 |
| Total debt to capital | 53.3 | 54.9 | 49.8 | 52.0 | 53.0 |

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Figure 3. Change in EPS Estimates

| | 2007E | 2008E |
|---|---|---|
| Old | (1.64) | 0.03 |
| New | (1.56) | (0.77) |

Source: CIR Estimates

Figure 2. Key Assumptions – TTML

| | 2006 | 2007E | 2008E | 2009E |
|---|---|---|---|---|
| **Subscribers ('000)** | **1,840** | **3,125** | **4,502** | **5,784** |
| Mobile | 797 | 1,549 | 2,410 | 3,230 |
| FWT | 814 | 1,324 | 1,818 | 2,270 |
| Fixed | 229 | 252 | 274 | 285 |
| **ARPU (Rs)** | | | | |
| Mobile | 340 | 255 | 204 | 184 |
| FWT | 621 | 559 | 503 | 478 |
| Fixed | 1615 | 1,421 | 1,279 | 1,215 |
| **Costs** | | | | |
| Marketing Cost / revenue (%) | 16.8 | 13.6 | 11.6 | 10.2 |
| Interconnect Cost/Rev. (%) | 33.2 | 32.0 | 31.5 | 31.3 |
| **Balance Sheet** | | | | |
| Capex / Sales (%) | 37.7 | 37.3 | 30.8 | 22.7 |
| Net Debt | 20,845 | 20,394 | 23,251 | 23,969 |

Source: Company Reports and Citigroup Investment Research estimates

Figure 4. Income Statement – TTML

| Rs m | 2006 | 2007E | 2008E | 2009E |
|---|---|---|---|---|
| Telecom Services | 10,951 | 14,861 | 18,370 | 22,011 |
| Interconnection/Access Costs | (3,639) | (4,756) | (5,787) | (6,889) |
| Network Operation Costs | (1,771) | (2,378) | (2,939) | (3,302) |
| Employee Costs | (486) | (573) | (630) | (681) |
| G&A expenses | (1,981) | (2,140) | (2,268) | (2,404) |
| Marketing and promotion | (1,844) | (2,028) | (2,130) | (2,236) |
| Total Expenditure | (9,721) | (11,874) | (13,754) | (15,512) |
| Operating Profit | 1,231 | 2,987 | 4,616 | 6,499 |
| Other Income | 17 | 57 | 95 | 242 |
| EBITDA | 1,247 | 3,044 | 4,711 | 6,741 |
| Financial Charges | (1,458) | (1,362) | (1,618) | (1,723) |
| Depreciation | (4,719) | (4,512) | (4,484) | (5,017) |
| PBT | (4,930) | (2,830) | (1,391) | 1 |
| Provision for Income Tax | (9) | - | - | - |
| PAT | (4,938) | (2,830) | (1,391) | 1 |

Source: Company Reports and Citigroup Investment Research estimates

Figure 5. Balance Sheet – TTML

| Rs m | 2006 | 2007E | 2008E | 2009E |
|---|---|---|---|---|
| Cash and Bank Balances | 274 | 1,724 | 867 | 1,150 |
| Sundry Debtors | 1,558 | 2,270 | 2,807 | 3,363 |
| Loans and Advances | 1,466 | 2,064 | 2,551 | 3,057 |
| Current Assets | 3,298 | 6,059 | 6,225 | 7,570 |
| Net Block | 22,615 | 23,289 | 24,464 | 24,440 |
| CWIP | 1,751 | 1,751 | 1,751 | 1,751 |
| Profit and Loss Account | 22,334 | 25,164 | 26,555 | 26,555 |
| **Total Assets** | **49,998** | **56,262** | **58,996** | **60,315** |
| Share Capital | 15,206 | 18,095 | 18,095 | 18,095 |
| Advance against Equity | - | - | - | - |
| Reserves and Surplus | 2,152 | 4,174 | 4,174 | 4,174 |
| Shareholder's Capital | 17,358 | 22,270 | 22,270 | 22,270 |
| Total Loans | 21,119 | 22,119 | 24,119 | 25,119 |
| Current Liabilities and Provisions | 11521.3 | 11874.39 | 12607.88 | 12926.79 |
| **Total Liabilities** | **49,998** | **56,262** | **58,996** | **60,315** |

Source: Company Reports and Citigroup Investment Research estimates

# Tata Teleservices

## Company description

Tata Tele (TTML) is part of Tata Group and provides telecommunication services in two of the most lucrative circles in India, Mumbai and Maharashtra. The company provides fixed line, CDMA-based mobile and fixed wireless services, and has 2.35m as on 30 September 2006. It was earlier called Hughes Tele, which was acquired by Tata Group in 2001-02. Tata Teleservices owns around 47% of the company, and provides similar services as TTML in 18 other circles.

## Investment thesis

We rate the stock as Buy/Medium Risk (1M) and believe that TTML has done a reasonable job in getting its act together in the intensely competitive markets of Mumbai and Maharashtra. It has increased its coverage significantly, stepped up marketing, introduced innovative mobile products and garnered about 12% of the net adds in the last 6 months. Fixed wireless offtake has been surprisingly strong as TTML has been able to churn subscribers away from incumbents MTNL and BSNL with a sleek product and better customer service.

We believe TTML will turn PAT positive in FY09 after turning cash profit positive in 1Q07. We believe that the company offers a good entry point to tap the turnaround in business fundamentals given the recent underperformance. Our target price of Rs24 is based on DCF and multiple discount to its larger listed peers.

## Valuation

We value Tata Tele using a DCF methodology given the back-end nature of its cash flow and profitability. Our March-08 DCF value comes to Rs24, which is our target price, on account of higher-than-expected dilution in the rights issue and near-term earnings adjustments (FY07-08E). For our calculations, we use explicit cash flow till FY16 and a terminal growth rate of 5%. We use a WACC of

12.0%, which factors in a risk-free rate of 8%, a risk premium of 6%, a beta of 0.9, a cost of debt of 7.5%, a debt / capital ratio of 15% and a marginal tax rate of 33.6%. We assume higher costs and equity for TTML than Bharti.

Alternatively, we value Tata Tele using a FY09E EV/EBITDA multiple of 10.1x, at a 10% discount to Bharti's imputed EV/EBITDA which translates into a fair value of Rs23. We believe that FY06 and FY07 multiples are not relevant as growth is at a nascent stage. We retain our Buy/Medium Risk (1M) rating on the stock.

### Risk

Our quantitative risk-rating system, which tracks the share price volatility of the last 260 days, rates Tata Tele as Medium Risk. Disappointment on subscriber numbers and financials could be a negative trigger for the stock. Also, the company will require significant funds to expand and any plans that significantly dilute the share base would likely be received negatively by the market. Competition in Mumbai and Maharashtra is also likely to go up with BSNL setting up fresh capacity in these markets. If any of these factors has a greater impact than we expect, the stock could have difficulty achieving our target price.

## Bharti – (BRTI.BO, Rs629, Buy/Low Risk)

### Valuation

Our 12-month forward target price of Rs750 is based on DCF, which suggests a fair value of Rs749 as of March 2008 (rolled forward from March 2007). This is based on WACC of 10.8%, terminal growth rate of 3.5% and beta of 0.9 (implying a terminal EV/EBITDA multiple of 8.0x). We prefer DCF as our primary valuation methodology because the wireless market will likely continue to see robust growth requiring upfront capex but should generate significant free cash beyond 2009-10. Our target price represents a FY09E P/E of 20.0x, P/CEPS of 12.5x and EV/EBITDA of 11.2x.

The imputed target PER of 25.0x FY08E is at 25% premium to the broad market PER (20.0 FY08E at the higher end of Citigroup's Sensex target of 16,000). This we believe is justified by above-average earnings growth (FY06-09E EBITDA CAGR of 45.3% and EPS CAGR of 46.5%), improved earnings visibility and relative insulation from macro risks (interest rates and political risks).

### Risk

Our quantitative risk-rating system rates Bharti as Low Risk. We are comfortable attributing a Low Risk rating for the following reasons: (1) Bharti has a track record of profitability and execution; (2) the company's capex plans are fully funded; and (3) the strategic shareholding of SingTel and Vodafone leaves us comfortable with execution issues and initiatives. The risks that could prevent the stock from reaching our target price include competition-led tariff pressures, un-remunerative capex, overall market downside, and more telecom related paper entering the market.

# Analyst Certification Appendix A-1

We, Rahul Singh and Anand Ramachandran, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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### Tata Teleservices (Maharashtra) Ltd (TTML.BO)

**Ratings and Target Price History - Fundamental Research**

Analyst: Rahul Singh (covered since May 12 2006)

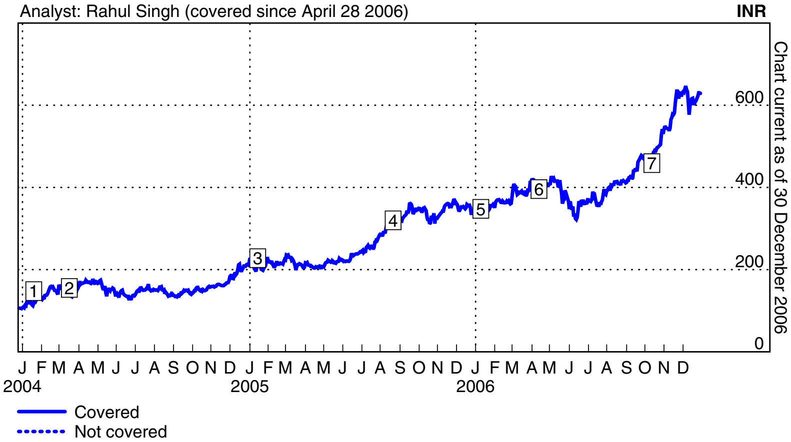

| # | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1: | 10 Jan 06 | 2M | 29.47 | 27.31 |
| 2: | 13 Apr 06 | *1M | *31.43 | 22.84 |

*Indicates change.

### Bharti Airtel Limited (BRTI.BO)

**Ratings and Target Price History - Fundamental Research**

Analyst: Rahul Singh (covered since April 28 2006)




| # | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1: | 20 Jan 04 | 1H | *160.00 | 118.40 |
| 2: | 17 Mar 04 | 1H | *220.00 | 146.15 |
| 3: | 14 Jan 05 | *1M | *260.00 | 210.30 |
| 4: | 22 Aug 05 | 1M | *400.00 | 306.10 |
| 5: | 10 Jan 06 | 1M | *450.00 | 339.25 |
| 6: | 13 Apr 06 | 1M | *500.00 | 395.95 |
| 7: | 12 Oct 06 | *1L | *600.00 | 475.65 |

*Indicates change.

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|---|---|---|---|
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