

Company Focus

18 July 2008 | 9 pages

Tata Teleservices (TTML.BO)

 Target price change
 Estimate change

Maintain Sell – Headwinds to Reappear in FY09-10E, GSM Effort Appears Half-hearted

- New TP at Rs23** — FY09/10E operating EBITDA is taken down 5-8% on lower ARPU's and higher cost pressures, in-line with Tata Tele's quarterly trends. Coupled with a higher WACC (10.8%), our new DCF-based target is Rs23/share (Rs31 earlier). The DCF value imputes FY10E EV/EBITDA of 8.8x, i.e., the middle of the larger peers' valuation range.
- Sell rating retained despite sharp correction in stock price** — We maintain our Sell (3M) rating on 1) consistently lower sequential revenue growth (3-6%) vs. peers, 2) challenges in TTML's cost structure, and 3) inherent risks in execution of a dual network strategy. Significant success of Virgin launch and consolidation of Tata's telecom holdings are, however, upside risks.
- GSM launch looks delayed beyond FY09** — TTML has yet to be allotted GSM spectrum and will take 6-9 months for launch post that, which means launch delayed beyond FY09E. Saturated penetration in Mumbai (76%) and simultaneous launch by other new entrants raises questions on NPV accretion. Funding for GSM is likely to come from tower sale (1,172 towers with book value of Rs2.5bn).
- 1QFY09 EBITDA beats forecast on lower operating costs** — While Q1 revenue at Rs4.8bn was in-line, operating EBITDA (Rs1,280m v/s our forecast Rs1,135m) surprised positively with flat costs qoq. As a result, even the net loss was lower than our forecast. We believe that net breakeven will happen in 2HFY09.

Sell/Medium Risk	3M
Price (17 Jul 08)	Rs22.85
Target price	Rs23.00
	<i>from Rs31.00</i>
Expected share price return	0.7%
Expected dividend yield	0.0%
Expected total return	0.7%
Market Cap	Rs43,351M
	US\$1,015M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	-3,155	-1.74	46.3	-13.1	1.9	-15.9	0.0
2008A	-1,257	-0.66	61.9	nm	1.9	-5.6	0.0
2009E	120	0.06	109.5	nm	1.9	0.5	0.0
2010E	866	0.44	604.8	51.4	1.9	3.7	0.0
2011E	1,800	0.92	107.9	24.7	1.9	7.6	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	-13.1	nm	nm	51.4	24.7
EV/EBITDA adjusted (x)	21.0	13.1	9.4	7.8	6.6
P/BV (x)	1.9	1.9	1.9	1.9	1.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	-1.74	-0.66	0.06	0.44	0.92
EPS reported	-1.74	-0.66	0.06	0.44	0.92
BVPS	12.29	12.19	12.18	12.13	12.13
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	14,070	17,072	20,828	24,743	27,446
Operating expenses	-15,506	-16,610	-18,320	-21,231	-23,269
EBIT	-1,436	462	2,508	3,512	4,177
Net interest expense	-1,718	-1,710	-2,388	-2,591	-2,263
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	-3,154	-1,248	120	921	1,914
Tax	-1	-9	0	-55	-115
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	-3,155	-1,257	120	866	1,800
Adjusted earnings	-3,155	-1,257	120	866	1,800
Adjusted EBITDA	3,026	4,856	6,994	8,679	9,886
Growth Rates (%)					
Sales	28.5	21.3	22.0	18.8	10.9
EBIT adjusted	58.6	132.2	442.8	40.0	19.0
EBITDA adjusted	142.6	60.5	44.1	24.1	13.9
EPS adjusted	46.3	61.9	109.5	604.8	107.9
Cash Flow (RsM)					
Operating cash flow	890	2,839	4,751	6,896	8,913
Depreciation/amortization	4,462	4,394	4,486	5,167	5,708
Net working capital	-417	-297	145	862	1,404
Investing cash flow	-4,354	-5,030	-8,563	-6,571	-5,448
Capital expenditure	-4,354	-5,030	-8,563	-6,572	-5,449
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	3,257	5,363	3,536	1,491	-2,000
Borrowings	-830	4,500	3,500	1,000	-2,000
Dividends paid	0	0	0	0	0
Change in cash	-207	3,171	-276	1,817	1,465
Balance Sheet (RsM)					
Total assets	54,019	60,179	64,144	67,522	66,823
Cash & cash equivalent	836	4,007	3,732	5,546	7,009
Accounts receivable	1,703	2,565	2,642	3,544	3,318
Net fixed assets	24,298	24,935	29,012	30,416	30,157
Total liabilities	31,786	37,105	41,034	43,922	43,223
Accounts payable	11,497	12,316	12,745	14,632	15,932
Total Debt	20,289	24,789	28,289	29,289	27,289
Shareholders' funds	22,234	23,074	23,111	23,602	23,602
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	21.5	28.4	33.6	35.1	36.0
ROE adjusted	-15.9	-5.6	0.5	3.7	7.6
ROIC adjusted	-3.6	1.1	5.5	7.3	8.9
Net debt to equity	87.5	90.1	106.3	100.6	85.9
Total debt to capital	47.7	51.8	55.0	55.4	53.6

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1QFY09 operating EBITDA surprises positively with flat costs qoq

Figure 1. Quarterly performance

Rs m	1QFY08	2QFY08	3QFY08	4QFY08	Q1FY09	QoQ Growth (%)	YoY growth (%)
Gross revenues	3,933	4,184	4,398	4,557	4,780	4.9%	21.5%
Interconnect costs	(1,038)	(1,065)	(1,098)	(1,164)	(1,200)	3.1%	15.6%
Network opex	(601)	(678)	(752)	(825)	(823)	-0.3%	36.9%
Employee Cost	(227)	(232)	(235)	(242)	(273)	12.7%	19.9%
Admin cost	(484)	(416)	(466)	(476)	(496)	4.2%	2.4%
Selling	(732)	(823)	(761)	(702)	(709)	1.0%	-3.1%
Operating EBITDA	852	969	1,086	1,149	1,280	11.4%	50.3%
<i>Margins (%)</i>	<i>21.6%</i>	<i>23.2%</i>	<i>24.7%</i>	<i>25.2%</i>	<i>26.8%</i>	<i>NM</i>	<i>NM</i>
EBITDA	1,004	1,065	1,283	1,503	1,549	3.0%	54.3%
<i>Margins (%)</i>	<i>25.5%</i>	<i>25.5%</i>	<i>29.2%</i>	<i>33.0%</i>	<i>32.4%</i>	<i>NM</i>	<i>NM</i>
Net profit	(284)	(493)	(274)	(206)	(347)	NM	NM

Source: Company, Citi Investment Research

Subscriber estimates revised marginally due to higher competition

Figure 2. Subscriber estimates revised

	FY09E			FY10E			FY16E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Total	7,220,851	7,032,871	-2.6%	8,670,022	8,501,667	-1.9%	11,817,500	11,717,619	-0.8%

Source: Citi Investment Research estimates

KPI trends are in-line with the quarterlies

Figure 3. Wireless KPI details

	FY08	FY09E	FY10E	FY11E	Comments
MoU (min)	338	321	334	347	
Change (%)		-5.0%	4.0%	4.0%	FY09 to see continued rationalisation of free minutes, MoU to again rise from FY10 onwards
Rev/Min (Rs)	0.79	0.70	0.63	0.58	Industry leading rev/min
Change (%)		-12.0%	-10.0%	-8.0%	In-line with the industry trend
ARPU (Rs)	268	224	210	201	
Change (%)		-16.4%	-6.4%	-4.3%	

Source: Company, Citi Investment Research

Earnings revised down on lower ARPUs and higher cost pressures

Figure 4. Earnings Revisions

	FY09E	FY10E	FY11E
Operating EBITDA (Rs m)			
Old	6,533	8,178	
New	6,027	7,751	8,944
Change (%)	-7.8%	-5.2%	NM
EPS (Rs m)			
Old	(0.14)	0.41	
New	0.06	0.44	0.92
Change (%)	NM	NM	NM

Source: Citi Investment Research estimates

WACC revised up

Figure 5. Cost of capital calculation

Risk-free rate (%) - (Rf)	9.0%
Equity risk premium (%) (Rp)	6.0%
Subjective Premium	0.00%
Beta (B)	1.0
Cost of equity	15.0%
Cost of debt	10.0%
Marginal tax rate (%)	33.6%
Target Debt to total capital (%)	50.0%
Long Run Nominal Growth rate (g) (%)	4.0%
WACC	10.8%

Source: Citi Investment Research

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 had 5.08m subscribers as of Mar 2008. It was earlier called Hughes Tele, which was acquired by Tata Group in 2001-02. Tata Teleservices owns around 39.5% of the company, and provides similar services as TTML in 18 other circles.

Investment strategy

We rate the Tata Tele stock as Sell/Medium Risk. Though TTML has done a reasonable job in getting its act together in the intensely competitive markets of Mumbai and Maharashtra with a steady rise in market share, its cost structure remains challenging and sequential revenue growth (3-6%) is consistently lower than peers. Moreover GSM launch looks delayed beyond FY09 with GSM spectrum yet to be allotted. Saturated penetration in Mumbai (76%) and simultaneous launch by other new entrants also raises questions on NPV accretion.

Valuation

We value Tata Tele using a DCF methodology given the backend nature of its cash flow and profitability. Our Mar-09E DCF value sets our target price at Rs23. For our calculations, we use explicit cash flows till FY16 and a terminal growth rate of 4%. We use a WACC of 10.8%, which factors in a risk-free rate of 9%, a risk premium of 6%, a beta of 1.0, a cost of debt of 10.0% and a debt / capital ratio of 50.0%. The imputed FY09E EV/EBITDA multiple at 8.8x is in the middle of the larger peers' valuation range (Bharti, RCOM, Idea).

Risks

Our quantitative risk-rating system, which tracks the share price volatility of the last 260 days, rates Tata Tele as Medium Risk. Further acceleration in subscriber additions and market share gains, significant success of Virgin launch, higher-than-expected NPV creation from the GSM network and consolidation of Tata's telecom holdings may act as positive catalysts for the stock and could prevent our target price being achieved.

Appendix A-1

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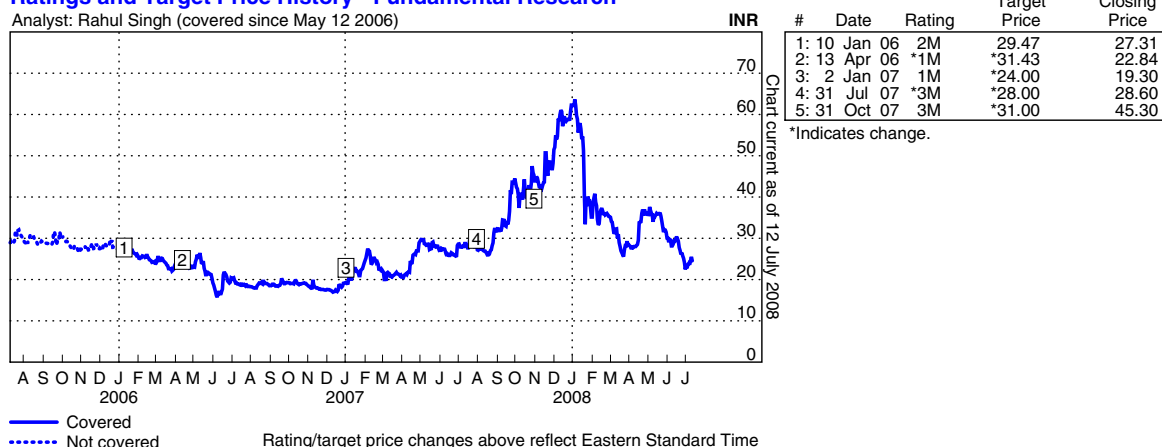
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Analyst: Rahul Singh (covered since May 12 2006)



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