

Funding concerns drag outlook



RESEARCH

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Stronger-than-expected cost savings lifts consol. earnings

Tata Communication's consolidated FY09 performance was better-than-our expectations due to stronger than expected cost savings, esp. in network costs during 4Q FY09. At its analyst meeting post results, the Co indicated that network costs will be in the range of ~50-55% going forward vs 57% in FY09. Factoring this, we have lifted consolidated FY10E EBITDA by ~18% and lifted PO by 11% to Rs450/sh implying an EV/EBITDA valuation of ~6x FY10E for the core business.

Funding issues are a concern given upcoming BWA auctions

We estimate TCom's consolidated FY09 net debt/EBITDA at ~3.1x and expect FY10E capex of ~US\$600mn to keep the balance sheet stretched. Given high likelihood of wireless-broadband (BWA) auctions in CY2009 and TCom's likely participation, we are worried about pot'l equity dilution and/or further debt burden.

Co's 2012 goals appear aggressive

TCom is aiming for at least 15% CAGR in revenues and at least 20% EBITDA margin by FY2012. Our impression is that these goals are aggressive. In FY09, TCom's consolidated revenue grew 20% YoY in rupee terms, aided partly by ~16% YoY depreciation of the rupee. EBITDA margin in FY09 was ~13.5%

Maintain Underperform on unattractive valuations

The stock appears to be trading close to its theoretical fair value at ~6x FY10E-EV/EBITDA after adjusting ~Rs344/sh for the value of non-core assets including real estate and the remaining Tata Tele stake. Risk of potential equity dilution and low earnings visibility drives our Underperform rating.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	3,156	2,649	3,252	3,834	4,684
EPS	11.07	9.29	11.41	13.45	16.44
EPS Change (YoY)	-30.6%	-16.1%	22.8%	17.9%	22.2%
Dividend / Share	4.50	4.50	4.50	4.50	6.48
Free Cash Flow / Share	(20.12)	(11.83)	14.73	27.78	32.99
ADR EPS (US\$)	0.550	0.404	0.479	0.565	0.690
ADR Dividend / Share (US\$)	0.223	0.196	0.189	0.189	0.272

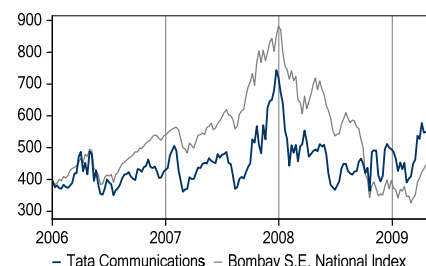
Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	42.66x	50.84x	41.40x	35.12x	28.75x
Dividend Yield	0.952%	0.952%	0.952%	0.952%	1.37%
EV / EBITDA*	19.72x	14.50x	12.72x	11.51x	10.46x
Free Cash Flow Yield*	-4.26%	-2.50%	3.12%	5.88%	6.98%

* For full definitions of *iQmethod*SM measures, see page 7.

Stock Data

Price (Common / ADR)	Rs472.45 / US\$19.32
Price Objective	Rs405.00 to Rs450.00 / US\$17.00 to US\$19.00
Date Established	29-May-2009 / 29-May-2009
Investment Opinion	C-3-8 / C-3-8
Volatility Risk	HIGH / HIGH
52-Week Range	Rs320.00-Rs660.00
Market Value (mn)	US\$2,828
Shares Outstanding (mn)	285.0 / 142.5
Average Daily Volume	352,552
ML Symbol / Exchange	VLSLF / BSE
ML Symbol / Exchange	TCL / NYS
Bloomberg / Reuters	TCOM IN / TATA.BO
ROE (2010E)	4.6%
Net Dbt to Eqty (Mar-2009A)	-3.4%
Est. 5-Yr EPS / DPS Growth	10.0% / 10.0%
Free Float	15.0%



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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5.

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iQprofileSM Tata Communications Ltd.

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	32,833	37,494	41,387	45,216	49,501
Gross Profit	3,187	4,182	4,480	5,144	6,074
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	3,187	4,182	4,480	5,144	6,074
Net Interest & Other Income	1,424	442	406	616	963
Associates	NA	NA	NA	NA	NA
Pretax Income	4,611	4,624	4,886	5,760	7,037
Tax (expense) / Benefit	(1,455)	(1,975)	(1,634)	(1,926)	(2,353)
Net Income (Adjusted)	3,156	2,649	3,252	3,834	4,684
Average Fully Diluted Shares Outstanding	285	285	285	285	285

Key Cash Flow Statement Data

Net Income	3,045	5,160	3,252	3,834	4,684
Depreciation & Amortization	3,013	4,253	5,134	5,478	5,611
Change in Working Capital	(2,715)	1,668	1,393	1,371	1,534
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	112	(2,511)	0	0	0
Cash Flow from Operations	3,454	8,570	9,780	10,683	11,829
Capital Expenditure	(9,189)	(11,940)	(5,581)	(2,766)	(2,427)
(Acquisition) / Disposal of Investments	0	(409)	(1,208)	(1,232)	(1,257)
Other Cash Inflow / (Outflow)	(112)	2,511	0	0	0
Cash Flow from Investing	(9,301)	(9,838)	(6,790)	(3,999)	(3,684)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(1,443)	(1,443)	(1,443)	(1,443)	(2,078)
Cash Flow from Financing	(1,443)	(1,443)	(1,443)	(1,443)	(2,078)
Free Cash Flow	(5,735)	(3,370)	4,198	7,916	9,402
Net Debt	(5,083)	(2,372)	(3,920)	(9,161)	(15,228)
Change in Net Debt	7,289	2,711	(1,547)	(5,241)	(6,067)

Key Balance Sheet Data

Property, Plant & Equipment	44,742	52,429	52,877	50,165	46,980
Other Non-Current Assets	14,755	15,163	16,372	17,604	18,861
Trade Receivables	6,053	6,912	7,630	8,336	9,126
Cash & Equivalents	5,083	2,372	3,920	9,161	15,228
Other Current Assets	13,538	13,541	13,543	13,545	13,548
Total Assets	84,170	90,417	94,341	98,811	103,743
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	835	835	835	835	835
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	17,824	20,354	22,468	24,547	26,873
Total Liabilities	18,659	21,189	23,303	25,381	27,707
Total Equity	65,511	69,228	71,037	73,429	76,034
Total Equity & Liabilities	84,170	90,417	94,340	98,810	103,742

iQmethodSM - Bus Performance*

Return On Capital Employed	3.7%	3.9%	4.6%	5.3%	6.2%
Return On Equity	4.9%	3.9%	4.6%	5.3%	6.3%
Operating Margin	9.7%	11.2%	10.8%	11.4%	12.3%
EBITDA Margin	18.9%	22.5%	23.2%	23.5%	23.6%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.1x	3.2x	3.0x	2.8x	2.5x
Asset Replacement Ratio	3.0x	2.8x	1.1x	0.5x	0.4x
Tax Rate (Reported)	31.6%	42.7%	33.4%	33.4%	33.4%
Net Debt-to-Equity Ratio	-7.8%	-3.4%	-5.5%	-12.5%	-20.0%
Interest Cover	5.1x	2.4x	2.6x	2.7x	2.7x

Key Metrics

* For full definitions of iQmethodSM measures, see page 7.

Company Description

Tata Communications (earlier called VSNL) is India's incumbent provider of international telephony services. It was privatized in 2002 and the Tata Group is the major shareholder. Recently (in FY06) TCom enhanced its overseas presence through the acquisition of Tyco global undersea network (TGN) and Teleglobe.

Investment Thesis

Our Underperform rating on TCom is driven by demanding valuations for its core telecom business. We are also concerned that the recent global slowdown may hurt the growth of TCom's enterprise data business that contributes nearly 40% of its consolidated revenues. Better-than-forecast valuation of TCom's investment in Tata Tele (wireless major) presents potential upside

Stock Data

Shares / ADR	2.00
Price to Book Value	1.9x

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Table 1: 4Q FY09 results summary - standalone

Yr to March (Rs mn)	4Q FY08A	3Q FY09A	4Q FY09A	YoY chng	QoQ chng
Net Turnover	8555	9,902	8,869	4%	-10%
Network Costs	4624	4,715	3,726	-19%	-21%
<i>% of revenue</i>	<i>54%</i>	<i>48%</i>	<i>42%</i>		
Staff Costs	652	834	979	50%	17%
<i>% of revenue</i>	<i>8%</i>	<i>8%</i>	<i>11%</i>		
Other Operating Costs	1,768	2,048	2,385	35%	16%
<i>% of revenue</i>	<i>21%</i>	<i>21%</i>	<i>27%</i>		
Total Operating Costs	7,045	7,597	7,090	1%	-7%
<i>% of revenue</i>	<i>82%</i>	<i>77%</i>	<i>80%</i>		
EBITDA	1,511	2,305	1,780	18%	-23%
EBITDA margin (%)	17.7%	23.3%	20.1%		
Depreciation	902	1084	1305	45%	20%
Other Income	345	325	397	15%	22%
EBIT	954	1,547	871	-9%	-44%
Interest	120	344	442	269%	28%
Profit before tax	834	1,202	429	-49%	-64%
Taxes	264	393	871	231%	122%
Recurring Net Profit	571	810	-443	na	na
Exceptional income/(exps)	-11	0	3467		
Reported Net Profit	560	810	3024	440%	274%

Source: Company

Table 2: 4Q FY09 results summary - consolidated

Yr to March (Rs mn)	4Q08 (Implied)	3Q09A	4Q09 (implied)	YoY chng	QoQ chng
Revenues	21,708	26,135	25,939	19%	-1%
Network cost	11,749	14,102	12,845	9%	-9%
<i>% of revenue</i>	<i>54%</i>	<i>54%</i>	<i>50%</i>		
Operating & other expenses	5,452	5,232	5,305	-3%	1%
<i>% of revenue</i>	<i>25%</i>	<i>20%</i>	<i>20%</i>		
Salaries	2,061	3,026	3,527	71%	17%
<i>% of revenue</i>	<i>9%</i>	<i>12%</i>	<i>14%</i>		
Total Operating Costs	19,262	22,360	21,677	13%	-3%
EBITDA	2,447	3,775	4,262	74%	13%
EBITDA margin	11.3%	14.4%	16.4%		
Depreciation	2,071	2,776	3,628	75%	31%
Other income	719	565	233	-68%	-59%
EBIT	1,095	1,564	868	-21%	-45%
Interest	442	1,147	952	115%	-17%
PBT	653	418	(84)	na	na
Tax	820	412	995	21%	142%
Profit before minorities	(167)	6	(1,079)	548%	na
Minority interest	94	644	198	111%	-69%
Recurring net profit	(73)	650	(881)	na	na
Exceptional	(5)		(3,621)		
Reported net profit	(68)	650	2,740	na	321%

Source: Company

Table 3: Implied valuation of Tata Communications' core business

	Bull case	Bear case	FY10E
VSNL's share price (Rs)	468	468	468
Embedded value of investments (Rs/sh of VSNL)			
Equity stake in Tata Teleservices	140	100	120
Surplus Real Estate (@ 20% discount to estimated value)	188	104	177
Submarine Cable Network	63	32	48
Total embedded value (Rs/sh)	391	237	344
Implied equity value of core business (Rs/sh)			
Implied equity value of core business (Rs/sh)	77	231	124
Forecast FY10E net debt of the company (Rs/sh)	204	204	204
FY10E-consolidated EBITDA (Rs/sh)			
FY10E-consolidated EBITDA (Rs/sh)	55	55	55
Implied EV/EBITDA of core biz (x)			
Implied EV/EBITDA of core biz (x)	5.1	7.9	5.9

Source: Banc of America Securities-Merrill Lynch

Price objective basis & risk

Tata Communications Limited (VLSLF / TCL)

We have a price objective of Rs450 (ADR of US\$19) for Tata Communications. Our PO is based on sum-of-parts reflecting 1) TCom's core telecom business, 2) surplus real estate entitled to shareholders, 3) embedded value of TCom's stake in the wireless major - Tata Teleservices, and 4) asset value (at cost) of TCom's submarine cable network. We value the company's core telecom business at an implied EV/EBITDA of 6x FY10E versus the long-term trading range for wholesale carriers globally at 5-7x. Currently, there are few listed comparables of TCom as most of the large undersea cable providers are unlisted or bundled into last-mile providers. Greater visibility on the international operations of Tata Comm (not yet reported on a qtrly basis) could present upside to our PO. At this stage we do not have sufficient visibility to project long-term cashflows & use DCF. The risks to our price objective stem from: 1) sharper than expected slowdown in global bandwidth demand, 2) erosion of real estate upside due to poor visibility on monetisation, and 3) possible dilution of equity stake in Tata Teleservices.

Analyst Certification

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APR - Telecommunications Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Advanced Info	XVDIF	ADVANC TB	Thititthep Nophaket
	Bharti	BHTIF	BHARTI IN	Reena Verma Bhasin, CFA
	China Unicom	CHUFF	762 HK	Cynthia J.H. Meng
	China Unicom -A	CHU	CHU US	Cynthia J.H. Meng
	Chunghwa Telecom	CHT	CHT US	John Kim
	Chunghwa Telecom	CHWAF	2412 TT	John Kim
	KT	KTCNF	030200 KS	John Kim
	KT -A	KTC	KTC US	John Kim
	LG Dacom Corp	DCMPF	015940 KS	John Kim
	LG TeleCom	LTCLF	032640 KS	John Kim
	SingTel	SNGNF	ST SP	Reena Verma Bhasin, CFA
	StarHub	SRHBF	STH SP	Chen Hsung Khoo, CFA
	Total Access	TACJF	DTAC SP	Thititthep Nophaket
	Total Access Communication	TACPF	DTAC TB	Thititthep Nophaket
NEUTRAL				
	China Mobile	CHLKF	941 HK	Cynthia J.H. Meng
	China Mobile - A	CHL	CHL US	Cynthia J.H. Meng
	DiGi.com Bhd	DIGBF	DIGI MK	Reena Verma Bhasin, CFA
	Idea Cellular	IDEAF	IDEA IN	Reena Verma Bhasin, CFA
	MobileOne	MBOFF	M1 SP	Chen Hsung Khoo, CFA
	RCVL	RLCMF	RCOM IN	Reena Verma Bhasin, CFA
	Taiwan Mobile	TWMBF	3045 TT	John Kim
	Telekom Malaysia	MYTEF	T MK	Reena Verma Bhasin, CFA
UNDERPERFORM				
	China Telecom	CHA	CHA US	Cynthia J.H. Meng
	China Telecom-H	CHJHF	728 HK	Cynthia J.H. Meng
	FarEasTone	FEOTF	4904 TT	John Kim
	MTNL	MTE	MTE US	Reena Verma Bhasin, CFA
	MTNL	XMTNF	MTNL IN	Reena Verma Bhasin, CFA
	SK Broadband	HANTF	033630 KS	John Kim
	SK Telecom	SKMTF	017670 KS	John Kim
	SK Telecom- A	SKM	SKM US	John Kim
	Tata Communications Limited	TCL	TCL US	Reena Verma Bhasin, CFA
	Tata Communications Limited	VLSLF	TCOM IN	Reena Verma Bhasin, CFA
	Telkom	TLKMF	TLKM IJ	Reena Verma Bhasin, CFA
	Telkom - A	TLK	TLK US	Reena Verma Bhasin, CFA
	TRUE Corp	TCPJF	TRUE TB	Thititthep Nophaket

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***iQmethod*SM Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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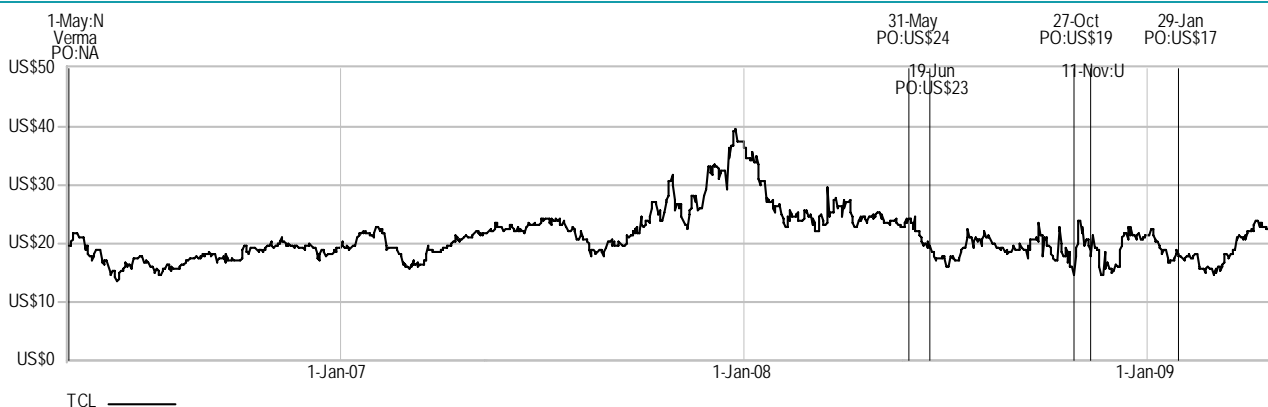
VLSLF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

"Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of April 30, 2009 or such later date as indicated. BAS-ML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of April 30, 2009 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

TCL Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

"Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of April 30, 2009 or such later date as indicated. BAS-ML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of April 30, 2009 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

Investment Rating Distribution: Telecommunications Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	85	45.70%	Buy	29	42.03%
Neutral	55	29.57%	Neutral	25	56.82%
Sell	46	24.73%	Sell	15	39.47%

Investment Rating Distribution: Global Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1243	38.21%	Buy	520	46.39%
Neutral	841	25.85%	Neutral	349	47.04%
Sell	1169	35.94%	Sell	388	36.30%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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