

Telecoms, Media & Technology
Diversified Telecoms
 Equity – India

Neutral

Target price (INR)	205.00
Share price (INR)	182.05
Potential return (%)	12.6

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-0.5	-8.6	-34.7
Relative ^A (%)	6.3	-6.2	-19.9

Index^A BOMBAY SE IDX

RIC TATA.BO
 Bloomberg TCOM IN

Market cap (USDm) 996
 Market cap (INRm) 51,884

Enterprise value (INRm) 123956
 Free float (%)

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Tata Communications

N: Revenue growth pressures may lead to margin-dilutive investments

- ▶ **Regulatory issues in India and pricing pressure in global markets may result in margin-dilutive investments**
- ▶ **Globally the fibre space is seeing consolidation; positive for TCOM but linked to surplus land monetisation**
- ▶ **Maintain Neutral rating; cut TP to INR205 (from INR241)**

Revenue growth may raise capex pressures: The draft national telecom policy, combined with the likely downward revision of termination charges, has raised concerns about the medium-term revenue growth prospects for TCOM, particularly from its Indian operations, which account for 30% of total revenues. Also, 20% of revenues come from Europe and the possibility of pricing and volumes pressures cannot be ruled out. The c400bps jump in EBITDA margins in the recent quarter was positive, although it was driven by cost-cutting and may limit longer-term scalability (particularly for Neotel, South Africa operations). We believe given the challenges on top-line growth, the company may be forced to invest in new, sub-scale products/segments that are marginal dilutive and result in capex pressure.

Global space seeing consolidation, real estate catalyst likely to be the key: Globally the fibre/wholesale space has seen some consolidation (Century Link-Saavis and Level3 –Global Crossing) and TCOM's ability to improve its balance sheet may allow it to benefit from this. However, this will depend to a large extent on the monetisation of surplus land, in our view, post which TCOM will have the capability to raise fresh/equity or participate in any meaningful strategic initiative. Early this year, the government announced a probe into the delay of the demerger of TCOM's surplus land and this raised some hope for investors of a resolution, however, progress since then has been slow. We believe monetisation will be delayed, with not much visibility in the next nine months.

Maintain Neutral, cut TP to INR205 (from INR241): We cut our target price to INR205, given the higher-than-previously estimated interest payments, and concerns over longer-term revenue/EBITDA growth. We cut our FY2013e earnings estimates by c32% on account of higher financing charges (given the rate hikes) and depreciation charges (higher capex). We have also cut the value of TCOM's c10% stake in Tata Teleservices by 8% to INR33 as we align our valuation to the active subscribers. We make no changes to our valuation for the surplus land and value it at INR97 (40% discount to the fair value). Upside risks for the stock include the ability to benefit from global consolidation and a quick monetisation of surplus land. Downside risks include lower-than-estimated volume growth and pricing pressure in global markets.

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	119,320	135,307	142,010	148,251
EBITDA	12,256	16,695	19,377	21,936
Depreciation & amortisation	-15,483	-17,293	-17,794	-19,454
Operating profit/EBIT	-3,227	-597	1,583	2,483
Net interest	-5,176	-8,450	-8,042	-7,841
PBT	-8,239	-8,701	-6,459	-5,358
HSBC PBT	-8,910	-8,701	-6,459	-5,358
Taxation	-688	-1,029	-858	-750
Net profit	-7,871	-7,312	-5,117	-6,422
HSBC net profit	-8,542	-7,312	-6,317	-6,422

Cash flow summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Cash flow from operations	10,463	18,870	15,133	15,778
Capex	-14,952	-21,899	-14,151	-13,608
Cash flow from investment	-14,952	-21,899	-14,151	-13,608
Dividends	0	0	0	0
Change in net debt	7,189	3,083	-982	-2,170
FCF equity	-7,556	-5,847	-1,218	2,484

Balance sheet summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Intangible fixed assets	786	786	786	786
Tangible fixed assets	123,155	127,761	124,117	118,271
Current assets	65,363	65,069	65,944	67,001
Cash & others	7,219	3,000	3,000	3,000
Total assets	197,749	202,061	199,292	194,503
Operating liabilities	71,028	83,789	87,120	90,923
Gross debt	84,654	83,517	82,535	80,365
Net debt	77,435	80,517	79,535	77,365
Shareholders funds	35,918	28,606	23,489	17,067
Invested capital	111,056	106,827	100,727	92,135

Ratio, growth and per share analysis

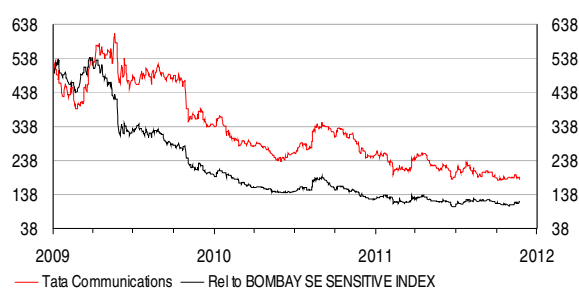
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	8.2	13.4	5.0	4.4
EBITDA	21.1	36.2	16.1	13.2
Operating profit				56.9
PBT				
HSBC EPS				
Ratios (%)				
Revenue/IC (x)	1.1	1.2	1.4	1.5
ROIC	-3.2	-0.6	1.7	2.9
ROE	-21.0	-22.7	-24.3	-31.7
ROA	-1.7	-0.1	0.9	1.4
EBITDA margin	10.3	12.3	13.6	14.8
Operating profit margin	-2.7	-0.4	1.1	1.7
EBITDA/net interest (x)	2.4	2.0	2.4	2.8
Net debt/equity	215.2	280.8	337.6	451.5
Net debt/EBITDA (x)	6.3	4.8	4.1	3.5
CF from operations/net debt	13.5	23.4	19.0	20.4
Per share data (INR)				
EPS reported (fully diluted)	-27.65	-25.69	-17.98	-22.56
HSBC EPS (fully diluted)	-30.01	-25.69	-22.19	-22.56
DPS	0.00	0.00	0.00	0.00
Book value	126.19	100.50	82.53	59.96

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	1.0	0.9	0.9	0.8
EV/EBITDA	9.9	7.4	6.3	5.5
EV/IC	1.1	1.2	1.2	1.3
PE*				
P/Book value	1.4	1.8	2.2	3.0
FCF yield (%)	-17.4	-13.5	-2.8	5.7
Dividend yield (%)	0.0	0.0	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 24 Nov 2011

Figure 1: Financial performance by region

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
India Voice	2,488	2,386	2,754	2,936	3,192
India Data	5,750	6,390	5,882	6,517	7,075
Total Revenues	8,238	8,776	8,636	9,453	10,266
q-o-q growth	-2%	7%	-2%	9%	9%
EBITDA margin	26%	23%	25%	25%	29%
International Voice	13,679	13,854	14,149	13,187	12,567
International data	5,645	5,487	5,896	6,123	6,246
International others	2,045	2,063	2,007	3,808	4,657
Total revenues	21,369	21,404	22,052	23,118	23,470
q-o-q growth	5%	0%	3%	5%	2%
EBITDA contribution	6%	8%	9%	8%	7%
Consolidated EBITDA margin	12%	12%	13%	13%	14%

Source: Company data

Figure 2 : Key events for the Tata Communications stock and likely timelines

Event	Expected time frame	Key factor to be watched	What is in the price?
New Telecom policy	Final policy may take 5-6 months before it gets finalised	One India pricing and Unified licence objectives stated in the draft policy are negative and could impact TCOM India NLD business margins. Key from TCOM perspective would be the migration path/incentives which the government offers to the NLD operators.	Market is not pricing in the possible negative aspects, given the complexity and hope that final policy will provide some kind of migration path. Significant investment in point of presence by TCOM should provide some downside support as most of the players have licences but not supported by adequate infrastructure
Surplus land monetisation	The issue is pending for several years and in our view monetization is unlikely before the next 12 months.	The process before this monetisation can commence is complex and any progress on resolving the various impediments will be a good sign for markets.	Markets providing c40-50% discount to the fair value of the surplus land, more visibility on monetisation will be a meaningful positive for the stock, in our view.
Global sector consolidation	Difficult to predict timelines	Surplus land disinvestment will be necessary before TCOM can pursue any meaningful strategic initiative.	Not priced-in by the market, in our view

Source: HSBC

Valuation and risks

Investment in Tata Teleservices

We value TCOM's investment in Tata Teleservices at INR33 (from INR36), c35% discount to the EV/subscriber of peer Idea Cellular (IDEA IN, INR94.75, N) applied to Tata Teleservices' active subscriber base. Our discount of c35% factors in the poor margin profile of Tata Teleservices.

Real estate valuations

Early this year, there was some progress on real estate valuations with the government announcing a probe into the delay in the demerger of surplus land from TCOM. Since then however, there has not been much progress and the visibility on any near-term monetisation remains subdued. We continue to value the surplus land at INR97 and, given the poor visibility, maintain our c40% discount to fair value.

Figure 3: Surplus real estate valuations

Land Details	Area (acres)	Developed Land (INRm)	Land value after developer margin of 25% (INRm)	Implied land value per acre (INRm)	Value per share (INR)
Dighi-Pune	524	4,646	3,716	7	13
Halishahar - Kolkata	35	233	187	5	1
Chattarpur - Delhi	58	7,304	5,843	101	21
Greater Kailash – Delhi	70	43,516	34,813	497	122
Padinallur - Chennai	86	2,164	1,731	20	6
Fair value of land/share (INR)					162
Value/share after adjusting for 40% discount (INR)					97

Source: HSBC estimates

Core business

We value the core business using DCF at INR75 (from INR108). For our DCF, we assume a cost of equity of 15%, a cost of debt of 11%, and WACC of 14%. We are concerned that weak global growth may hurt the growth of TCOM's enterprise data business, which contributes nearly 39% to its consolidated revenues. Our lower value in the core business is driven by a stretched balance sheet, higher-than-previously estimated finance charges (driven by the recent rate hikes), and a longer-term hike in our capex numbers by 7%.

In our view, revenue growth pressures may lead to the company investing in new products/segments, which may result in capex pressure. Furthermore investments in new products/segments are unlikely to have the scale benefits and may be margin dilutive, in our view. As such we cut our longer-term (FY2016) EBITDA forecasts by 7%. However, we have raised our near-term EBITDA margins to factor in the some impact of the recent cost-cutting pursued by the management.

Figure 4: Tata Communications – change in estimates of the core business (core accounts for 37% of our target price)

INRm	FY2012e	FY2013e
Sales		
New	135,307	142,010
Old	127,506	135,170
Change	6.1%	5.1%
EBITDA		
New	16,695	19,377
Old	14,655	17,874
Change	13.9%	8.4%
Net income		
New	-7,312	-5,117
Old	-5,747	-3,878
Change	-27.2%	-31.9%

Source: HSBC estimates

Figure 5: HSBC vs consensus

INRM	FY2012e	FY2013e
Sales		
HSBC	135,307	142,010
Consensus	131,344	141,111
Variance	3%	1%
EBITDA		
HSBC	16,695	19,377
Consensus	15,512	18,409
Variance	8%	5%
Net Income		
HSBC	-7,312	-5,117
Consensus	-6,307	-4,338
Variance	-16%	-18%

Source: HSBC estimates, IBES estimates

Target price and rating

Our DCF-based SOTP approach gives us a target price of INR205 (from INR241). Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%. Our target price implies a potential return of 12.6%, which is within the Neutral band; therefore, we are reiterating our Neutral rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks

Key downside risks include loss of market share in the domestic enterprise market given increased competitive intensity or lower-than-estimated volume growth in the data business, flat volumes in national long distance, and likely price erosion in international long distance business if the new telecom policy implements the one India pricing without adequately compensating the NLD players. Upside risks to our view include a rapid monetisation of the surplus land (markets then would lower the discounts to the fair value), ability to sustain the current cost structure and maintain present margins.

Figure 6: Sum-of-parts valuation

	New estimates (INR)	Old estimates (INR)
Core business	75	108
TTSL investments	33	36
Real estate	97	97
Target price	205	241

Source: HSBC estimates

Figure 7: Contribution to target price

	Contribution
Core business	37%
TTSL investments	16%
Real estate	47%
Target price	100%

Source: HSBC estimates

Disclosure appendix

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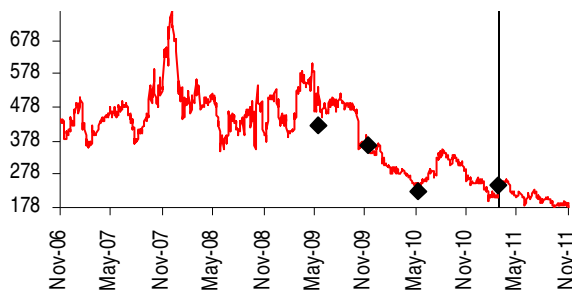
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Share price and rating changes for long-term investment opportunities

Tata Communications (TATA.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Neutral	22 March 2011
Target Price	Value	Date
Price 1	426.00	11 June 2009
Price 2	365.00	06 December 2009
Price 3	225.00	01 June 2010
Price 4	241.00	22 March 2011

Source: HSBC

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