

BSE Code: 500483 NSE Code: TATACOMM Reuters Code: TATA.NS Bloomberg Code: TCOM:IN

Tata Communications Ltd. is a USD 3.2 bn global communications and enterprise IT service provider that owns and operates the world's most advanced subsea cable network, delivering first-class infrastructure, enterprise solutions and partnerships to carriers and businesses worldwide. The company's presence spans across developed markets to the world's fastest growing emerging economies. Tata Communications is the number one international wholesale voice carrier and submarine cable owner by length. The company has 20% of the world's internet routes directly connected to its network. On top of this robust backbone, sits Tata Communications' voice and data businesses and its comprehensive portfolio of managed enterprise services. These include high speed connections and global MPLS (multi-protocol Label Switching) virtual private networks, the world's largest network of Telepresence services, the world's most extensive DDoS (distributive denial-of service) mitigation and detection service, content delivery networks, and cloud enablement solutions.

Investment Rationale

Riding high on mobile data expansion: With mobile internet becoming the most popular medium for connectivity, Tata Communications recorded a 9.3% YoY growth in revenue from the Data and Managed services division to ₹23,326.5 mn in Q3FY15. The company continued to focus on data-centric services to drive growth, with data centres, a high margin business, being one of the key focus areas. The segment, which contributes ~74% to the company's EBITDA, is expected to perform better on hopes of strong growth in internet traffic on mobile devices.

Global leadership in Voice & Data bodes well for technological advancements: Tata Communications has more than 240,000 km of optic fibre network, making it the world's largest submarine cable owner by length. The company has more than 20% of the world's lit fiber capacity and is the leading international voice carrier by minutes with nearly 19% market share. Having a clientele of ~3,000 large corporate customers, including 260 of the Forbes 2,000 multi-nationals, the company also benefits from strong relationships with over 1,600 carriers and 700 mobile operators globally. We believe this strong infrastructure will enable Tata Communications to adapt to new technologies rapidly and to remain at the cutting edge of competition, going forward.

Eyeing enhanced margins with increasing data businesses: Tata Communications' thrust on growing the data business continues to be strong with company reiterating its margin guidance of 20% for the data business for FY15. On the voice business, it expects a pricing pressure and hence continues to guide for the margins to be in the range of 7.5-8.0% in FY15. On the new business, like data centre and ATM management, the company sounded very positive and expects the growth in the former to be strong, while the ATM management business is at the cusp of break-even with significant headroom for the revenue growth.

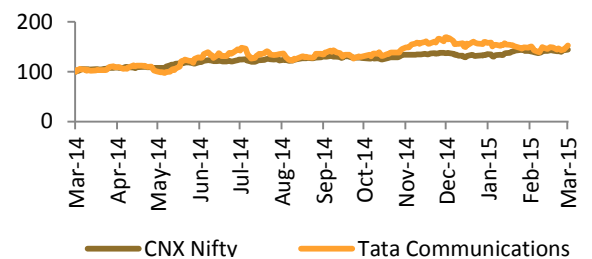
Market Data

Rating	BUY
CMP (₹)	415.8
Target (₹)	492
Potential Upside	~18.5%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	474.5/267.8
Adj. all time High (₹)	746.6
Decline from 52WH (%)	14.1
Rise from 52WL (%)	55.3
Beta	0.8
Mkt. Cap (₹bn)	118.5
EV (₹bn)	237.7

Fiscal Year Ended

Y/E	FY14A	FY15E	FY16E	FY17E
Revenue (₹bn)	196.7	212.7	237.2	264.5
EBITDA (₹bn)	30.9	33.7	39.4	45.6
Adj. Net Profit	0.4	1.3	3.1	5.9
Adj. EPS (₹)	1.2	4.6	10.7	20.7
Adj. P/E (x)	336.7	91.3	38.8	20.0
P/BV (x)	14.8	15.9	14.2	10.1
EV/EBITDA (x)	7.7	7.4	6.7	6.1
ROCE (%)	7.6	8.4	10.4	12.5
ROE (%)	4.4	17.4	36.6	50.3

One year Price Chart



Shareholding Pattern	Dec'14	Sep'14	Diff.
Promoters	75.0	75.0	-
FII	7.2	7.1	0.1
DII	11.3	11.6	(0.3)
Others	6.5	6.3	0.2

Tata Communications is the leading global international wholesale voice operator and provider of International “Long Distance Enterprise Data” and “Internet Services” across India.

Having a strong international presence, the company has offices in 80 cities in 40 countries across the globe.

Tata Communications - #1 enterprise data provider in India

Tata Communications, founded in 1986, is the leading global international wholesale voice operator and provider of International “Long Distance Enterprise Data” and “Internet Services” across India. The company provides its advanced solutions capabilities and domain expertise across its domestic and international network. With its wide portfolio of services including transmission, IP, converged voice, mobility, managed network connectivity, hosted data center, communications solutions and business transformation services to global and Indian enterprises & service providers, the company enjoys a leadership position among its peers.

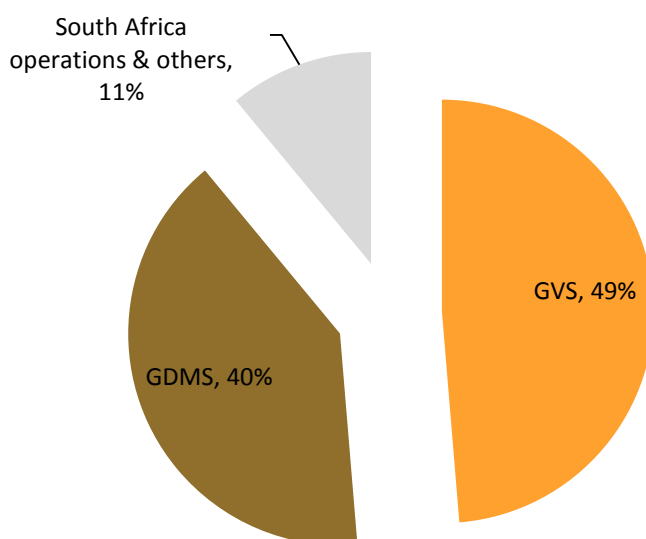
Having a strong international presence, Tata Communications has offices in 80 cities in 40 countries across the globe. The company has expended its footprints in the African market with strategic investment in South African operator, Neotel. The company operates through three major segments namely, Global Voice Solutions (GVS), Global Data and Managed Services (GDMS) and South African operations.

GVS - Tata Communications is the world’s largest carrier of international wholesale traffic, with the most advanced intelligent routing platform to provide quality voice services. It has over 1,600 direct and bilateral relationships with leading international voice telecommunication providers.

GDMS - The company is one of the world’s leading wholesale providers of data, Internet protocol (IP) and mobile signaling services. It carries 20% of the world's Internet traffic directly over its network and has over 15 terabits of international bandwidth lit capacity. Tata Communications owns and operates the world's only wholly-owned fibre optic sub-sea network ring named Tata Communications' Global Network (TGN), around the globe.

South African operations - In this segment, the company operates through its subsidiary “Neotel” and include other unallocated revenue. Neotel, which is still in its gestation period, continues to achieve growth.

Segment-wise revenue contribution (as in FY14)

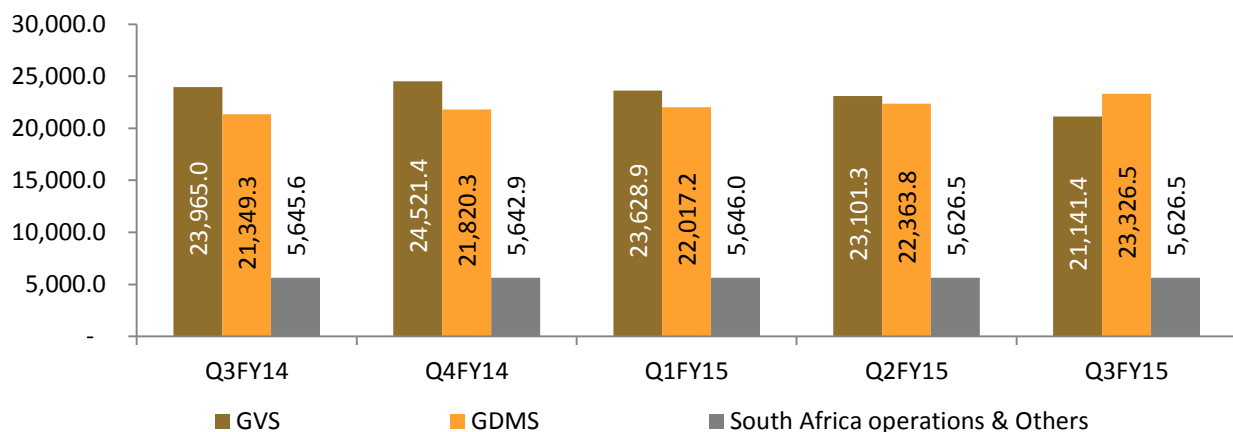


During Q3FY15, strong performance in the data segment (contributed ~48% to total revenue in Q3FY15) was offset by softness in the voice segment (contributed ~43% to total revenue in Q3FY15).

Posted mixed performance in Q3FY15; optimistic outlook for data segment bodes well for Tata Communications

Tata Communications registered a 1.6% YoY decline in consolidated revenue to ₹49,145.1 mn in Q3FY15 as against ₹49,960.0 mn in the corresponding period a year earlier, as the healthy performance by data segment (contributed ~48% to total revenue in Q3FY15) was offset by softness in the voice segment (contributed ~43% to total revenue in Q3FY15). While the Data and Managed services business showcased a 9.3% YoY growth in revenue to ₹23,326.5 mn, Voice solutions witnessed 11.8% YoY decline to ₹21,141.4 mn, during the quarter. Since the company continued to prioritize quality of traffic rather than chasing volumes, the performance from the voice segment remained sluggish. Besides, income from the South African operations fell by 3% YoY to ₹5,457.7 mn, during the quarter.

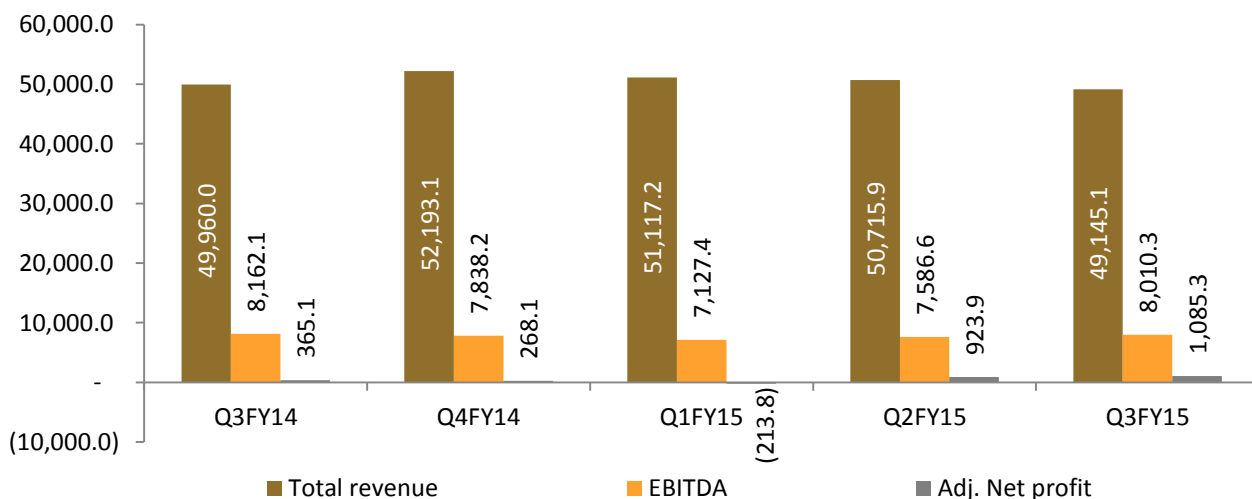
Data segment revenue grew decently; de-growth in voice segment dragged down the revenues (₹ mn)



De-growth in revenue coupled with higher operating expenses weighed on Tata Communications' operational performance.

De-growth in revenue coupled with higher operating expenses weighed on Tata Communications' operational performance. During Q3FY15, the company registered a 1.9% YoY decline in EBITDA to ₹8,010.3 mn as against ₹8,162.1 mn in Q3FY14 impacted by higher employee cost and other expenses. Employee cost and other expenses (as a % of revenue) grew by 121bps and 145bps YoY to 13.6% and 18.9% in Q3FY15 compared to 12.3% and 17.4% in Q3FY14.

Quarterly Performance trend (₹ mn)



With an investment of ~USD 115 mn in the data segment, out of the total capex of USD 185.2 mn in the 9M period ended December 2014, the company is betting big on the segment.

Tata Communications' global data centre business, contributing around 40% to the top-line, grew by 17% to ₹79,256 mn in FY14 as against ₹67,534 mn in FY13.

Mobile voice quality issues are an ongoing concern for network operators and investing in VoLTE is set to greatly reduce customer churn and improve the customer experience.

However, the company witnessed a strong growth in net profit driven by a triple-digit growth in other income, which rose by 322.0% YoY to ₹1,038.1 in Q3FY15 as against ₹246.0 mn in Q3FY14. The consolidated net profit surged by 197.3% YoY to ₹1,085.3 mn compared to ₹365.1 mn in Q3FY14. Decline in other financial expenses i.e. interest and taxation by 7.4% and 23.4% YoY to ₹1,829.8 mn and ₹666.0 mn, further supported the bottom-line growth.

Tata Communications' data business is increasingly becoming a larger component of the company's EBITDA, accounting for ~74% in Q3FY15. In order to augment its capabilities and capitalize on the big data opportunity, the company has been investing majority of the capex in the data segment. With an investment of ~USD 115 mn in the data segment, out of the total capex of USD 185.2 mn in the nine months period ended December 2014, the company is betting big on the segment, which makes us quite optimistic about the prospects of the company going forward. Driven by the better outlook for data services, we believe, the company would post better performance in the coming quarters.

Global data centre business expansion: A lucrative move to boost the profitability

Tata Communications' global data centre business, contributing around 40% to the top-line, has witnessed 17% growth in revenue to ₹79,256 mn in FY14 as against ₹67,534 mn in FY13. The data centre business is growing at nearly 18% for the last two years with the EBIT margin growing at around 65%. The company is the largest player in the Indian market with 44 data centre sites covering a rack area of 1 mn square feet. The company's data centres are integrated into its global Tier-1 IP backbone to provide unparalleled reach and connectivity options. It is further looking to expand and would be investing in two more new sites. Data centre as a market is growing at 15-20% in emerging countries, while the growth is at around 10% in the developed nations. The company has further expanded its global data centre footprint by entering into strategic partnerships with NEXTDC in Australia, Interxion in Germany and Austria, as well as Pacific Link Telecom (PLT) in Malaysia.

As businesses go global, the addition of new geographies means customers can now have a single vendor operation and contract for a secure, robust and scalable data centre network. Thus, we believe the expansion to be accretive on the revenue as well as margin front.

VoLTE offerings to drive revenue growth in coming years

During FY14, the company announced its network readiness to supply Voice over LTE calling (VoLTE) to its growing global community of IPX-connected service providers. VoLTE will allow mobile network operators to offer HD voice over their 4G Long Term Evolution (LTE) networks and is seen as a key factor for the success of 4G customer uptake. Since, ~49% of Tata Communications total revenue comes from voice services, voice calls over VoLTE is expected to give an impetus to the company's overall revenue-base.

With this new service, customers will benefit from near-instant call setup, better sound quality and the ability to have HD Voice conversations with more users outside the mobile-only community. The company's VoLTE offering enables mobile operators to generate additional revenue through increased usage, especially in high-margin roaming scenarios and international calling. Adding VoLTE to the portfolio also provides mobile operators with a potential competitive advantage over OTT (over the top content) providers, who may not be able to match the quality of experience. This is especially true as video calling over LTE will be the natural evolution of VoLTE.

For mobile network operators, the improved quality leads to increased usage, and ultimately, better revenues. Mobile voice quality issues are an ongoing concern for network operators and

The company remains committed towards introducing more variants and products that will drive future volumes growth.

Tata communication is the only global Tier 1 service provider with a top five position in all continents, which strengthens its international backbone.

investing in VoLTE is set to greatly reduce customer churn and improve the customer experience. It is widely expected that VoLTE services combined with OTT VoIP are set to become a USD 16 bn business by 2017 and hence Tata Communications being an early entry player will be in a better position to reap benefits.

Diversifying GVS to improve revenue visibility

Tata Communications has 19% market share in international wholesale voice minutes. More than half of company's GVS business is contracted with other global carriers, which mitigates the volatility associated with the traditional spot business. Despite cannibalization of voice services by over-the-top (OTT) players such as Skype, Tata Communications is confident about growing the voice business due to increased mobile penetration across the globe. Its integrated capabilities allow it to capture this incremental business. Moreover, its innovations such as the Telepresence room, among others, have worked very well in the enterprise segment.

In order to de-risk Global Voice Services (GVS) business, the company is looking at ways to diversify the traffic. The company plans to diversify the traffic along two dimensions; one is to make sure it gets more retail traffic or traffic from the source, which it gets directly from a mobile operator and the other is to get traffic directly from a large telco, rather than picking it up in the wholesale market. Since more than 50% of the company's wholesale voice traffic currently is on long term contract basis, it provides long term revenue visibility.

Technological advancements: boon for the GDMS

With mobile Internet increasingly becoming the medium of connectivity, strong growth is expected in Internet traffic on mobile devices. Further, cloud computing is also expected to be the next wave of data storage over the next decade. These changes demand strong network coverage at the backend. We believe Tata Communications would have an edge over peers here underpinned by the fact that it is one of the few round-the-world sub-sea cable networks that carry nearly 10% of the global Internet traffic. Tata communication is the only global Tier 1 service provider with a top five position in all continents, which strengthens its international backbone.

Key Risks

- Tata Communications has limited local support capabilities in developing markets, which are important for improving installation and repair times for customers with highly distributed networks.
- The company still has low market share in the regional hubs where most MNCs are located and its capabilities are not well understood in the broad market.
- Tata Communication does not currently offer managed LAN and WLAN services.
- The company's strategy of diverting mobile traffic on the wholesale basis might pose a problem to collect minutes of traffic as the telecom market growth is slow.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY14A	FY15E	FY16E	FY17E
Share Capital	2,850.0	2,850.0	2,850.0	2,850.0
Reserve & surplus	5,145.2	4,609.8	5,493.5	8,904.5
Net Worth	7,995.2	7,459.8	8,343.5	11,754.5
MI	62.1	62.1	62.1	62.1
Total debt	119,762.7	131,739.0	144,912.9	159,404.2
Provisions	6,684.3	7,352.7	8,088.0	8,896.8
Deferred tax liability	357.3	357.3	357.3	357.3
Other non-current liabilities	41,591.1	45,750.2	50,325.2	55,357.8
Other current liabilities	72,316.6	69,019.9	65,875.3	62,875.6
Capital Employed	248,769.3	261,741.0	277,964.3	298,708.2
Fixed Assets	149,486.9	152,476.6	157,050.9	161,762.5
Goodwill	6,184.6	6,184.6	6,184.6	6,184.6
Investments	17,582.2	18,586.6	19,691.5	20,906.8
Loans & advances	29,601.5	31,284.9	33,215.1	35,278.4
Deferred tax assets	1,084.7	1,084.7	1,084.7	1,084.7
Other non-current assets	123.2	123.2	123.2	123.2
Other current Assets	44,706.2	52,000.4	60,614.3	73,368.1
Capital Deployed	248,769.3	261,741.0	277,964.3	298,708.2

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY14A	FY15E	FY16E	FY17E
Net Sales	196,659.0	212,681.4	237,219.1	264,499.3
Expenses	165,779.4	178,959.4	197,865.2	218,874.5
EBITDA	30,879.6	33,722.0	39,354.0	45,624.9
Other Income	1,433.0	1,576.3	1,655.1	1,737.9
Depreciation	20,913.7	21,541.1	22,187.3	22,187.3
EBIT	11,398.9	13,757.2	18,821.7	25,175.4
Interest	7,617.0	7,312.3	7,019.8	3,509.9
PBT	3,781.9	6,444.8	11,801.9	21,665.5
Exceptional Item	662.2	-	-	-
Tax	3,432.8	5,149.2	8,753.6	15,756.6
PAT	1,011.3	1,295.6	3,048.3	5,908.9
MI	(14.0)	(14.0)	(14.0)	(14.0)
Share of profit/loss of asso.	16.9	16.9	16.9	16.9
Net Profit	1,014.2	1,298.5	3,051.2	5,911.8
Adj. Net Profit	352.0	1,298.5	3,051.2	5,911.8

Key Ratios (Consolidated)

Y/E	FY14A	FY15E	FY16E	FY17E
EBITDA Margin (%)	15.7	15.9	16.6	17.2
EBIT Margin (%)	5.8	6.5	7.9	9.5
NPM (%)	0.5	0.6	1.3	2.2
Adj. NPM (%)	0.2	0.6	1.3	2.2
ROCE (%)	7.6	8.4	10.4	12.5
ROE (%)	4.4	17.4	36.6	50.3
EPS (₹)	3.6	4.6	10.7	20.7
Adj. EPS (₹)	1.2	4.6	10.7	20.7
P/E (x)	116.8	91.2	38.8	20.0
Adj. P/E (x)	336.6	91.2	38.8	20.0
BVPS(₹)	28.1	26.2	29.3	41.2
P/BVPS (x)	14.8	15.9	14.2	10.1
EV/Net Sales (x)	1.2	1.2	1.1	1.0
EV/EBITDA (x)	7.7	7.4	6.7	6.1

Valuation and view

The steadily improving core performance coupled with the management's initiative towards sharpening its focus and deleveraging its balance sheet via non-core asset monetisation seems positive for the company as this will further strengthen the company's fundamentals. With the company's continuous efforts to improve operational efficiency and asset allocation, increasing contribution of data business in its product portfolio with various initiatives in the ATM business, which will attain breakeven in the coming years, will give the company a new growth story.

At a current market price (CMP) of ₹415.8, the stock trades at an adj. P/E of 38.8x FY16E and 20.0x FY17E. We recommend 'BUY' on the stock with a target price of ₹492, which implies a potential upside of ~18.5% to the CMP from the long term perspective.

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