
Rating Rationale for Tata Teleservices Ltd's proposed unsecured Non Convertible Debenture (NCD) Issue of ₹ 500 Crores

NCD Issue Rating: BWR A+

Outlook : Stable

Brickwork Ratings (BWR) has assigned BWR A+ (Pronounced BWR Single A plus) to **Tata Teleservices Ltd's (TTSL)** proposed ₹500 crores unsecured NCD issue. 'BWR A+' stands for an instrument that is considered to offer adequate credit quality / safety in terms of timely servicing of principal and interest obligations. The rating factors, inter alia, TATA group's strong parentage, strategic partnership with NTT DoCoMo, growing market share after the launch of GSM last year, moderate presence in 8 circles where it has bagged 3G licenses, good distribution network across villages and India's potential in telecom sector. However, the rating is also constrained by a history of reported losses, negative cash flows and coverage ratios, and competition in telecom sector.

Background

Tata Teleservices Ltd. (TTSL) is a part of the giant Tata Group which has reported revenue earnings of USD 70.8 billion in FY09. It was incorporated in 1996 and is now the 5th largest telecom player by subscriber base. Company initially offered fixed line services and mobile services on the CDMA technology platform; since 2009 it has added GSM to its service portfolio. TTSL provides mobile services, wireless desktop phones, public booth telephony, wireline services and enterprise solutions. TATA operates in all 22 telecom Circles in India through two different companies; TTSL which is present in 20 circles and Tata Tele (Maharashtra) Limited (TTML) which is present in Maharashtra and Mumbai circles.

TTSL commenced operations in 1998 in Andhra Pradesh circle with over 600,000 subscribers. In 2002, with the acquisition of Hughes Telecom (India) Ltd. (which was renamed Tata Teleservices (Maharashtra) Ltd) the circles of Mumbai and Maharashtra were added to their repertoire. (Currently TTML has the largest wire-line base in Mumbai and Maharashtra among all private operators.) Until 2004 the company had limited operations with a presence in only 5 circles, and in 2005 it received a pan India license for CDMA. In 2008 with 2G auctions TTSL was allotted GSM spectrum and it won license for 2G in 19 circles due to its CDMA presence across India. In Nov 2008 Company also took a strategic decision to partner with Japan's NTT DoCoMo, which acquired 26% equity stake in TTSL. NTT DoCoMo was issued about 84.39

crore equity shares on a preferential basis for a subscription amount of approximately ₹9797 crore, representing 20% shareholding on a fully diluted basis. NTT DoCoMo also purchased about 25.32 crore equity shares from existing shareholders. TTSL has already rolled out GSM services in 17 telecom circles and plans to launch pan-India operations by the end of FY 2010-11

TTSL has 10 directors on board, with Mr. Ratan Tata as the Chairman. The Board includes 3 NTT DoCoMo executives, who have worked in Japan's Telecom industry for almost 30 years. Mr. Anil Kumar Sardana is the MD of Tata Teleservices; prior to this he was Executive Director of Tata Power Co. He has held senior positions at NTPC, BSES and Tata Power. Also on the Board is, Mr. N.S. Ramachandran, ex-Chairman and MD of MTNL. He has also worked with the International Telecom Union in Geneva, Maldives, Uganda and Zimbabwe. The Board also has many senior members of the Tata Group, namely, Mr. K. A. Chaukar, MD of Tata Industries Ltd; Mr. Ishaat Hussain, Finance Director, Tata Sons and Mr. N. Srinath, CEO & MD, Tata Communications. This ensures TTSL has adequate competencies on board.

Company's Operations

Tata Teleservices offers services under 6 different brands:

- Tata Indicom - CDMA services
- Tata DOCOMO - GSM services
- Tata Walky - Wireless phones
- Tata Photon - Wireless mobile broadband access
- Virgin Mobile - A branded mobile service targeted at the youth segment which arises out of an alliance between TTSL and the Virgin Mobile group. This is a master franchisee model
- T24 - A brand of Mobile telephony services being offered on the GSM platform by TTSL in partnership with the Future Group

Passive Tower Infrastructure: In December 2008, TTSL, along with Tata Sons and Wireless TT Info Services Ltd. (WTTIL – Tata Tele's telecom tower subsidiary) entered into a strategic agreement with Quippo Telecom Infrastructure Limited (QTIL). The transaction involved acquisition of WTTIL shares by QTIL from TTSL and TSL and demerger of QTIL's passive telecom infrastructure undertaking into WTTIL. The combined entity started operations with 18,000 towers, and today has a portfolio of nearly 35,000 towers.

Table 1: Tata Tele 3G license outflow

Circle	Outflow (in ₹ Cr)
Gujarat	1076.06
Karnataka	1579.91
Kerala	312.48
Punjab	322.01
Haryana	222.58
UP (W)	514.04
Rajasthan	321.03
MP	258.36
Total	4606.47

As at 30th July, 2010 TTSL, along with TTML serves nearly 76.06 million customers across the country. TTSL alone has 61.83 million subscribers as of 30th July 2010, compared to 37 million subscribers as of 30th June 2009.

In recent 3G auctions, TTSL has won spectrum in 8 circles and it has paid ₹ 4606.47 Crores as license fees for same. The spectrum is expected to be rolled out after Sept 2010. The state wise breakup of spectrum cost is as shown in Table 1.

Key Financial Information: Revenue from 2G has been increasing at 24.7% CAGR since FY06, while the current y-o-y growth is at 12.25%. Operating expenses grew 21% in FY10 due to GSM rollout in various circles. Looking at next five years we can see further increase in expenses on account of 3G rollout. TTSL expects to roll out 3G services by Sept 2010; however this is sensitive to government's timely allocation of 3G spectrum. The company is trying to reduce its losses by consistently increasing its subscriber base and revenues; and it expects to be in the profit zone in the medium term horizon.

In FY09 company restructured its balance sheet to write off part of its accumulated losses after approval from High Court wherein, the company carried out the following adjustments:

1. Paid-up equity share capital was reduced by ₹3,173.58 crores and adjusted against the debit balance of profit & loss account and unabsorbed depreciation.
2. Securities premium ₹1,967.72 crores, was adjusted against the debit balance of profit & loss account and unabsorbed depreciation.
3. Investment in Tata Teleservices (Maharashtra) Limited (TTML), was revalued to its market value of ₹28.50/- per share and the resultant revaluation amount of ₹1,648.75 crores was adjusted against the debit balance of profit and loss account and unabsorbed depreciation.

Due to huge capex plans and working capital requirements company has huge debt outstanding and it increased from 1.32x in FY09 to 2.57x in FY10. The company does not have any coverage for its financial costs and its current ratio indicates less than moderate liquidity. However, reduced losses and improving revenue is evident from reduced negative profit margins and Return On Capital Employed trend since FY07 as shown in Table 2 below:

Table 2: Key Financials

	2007	2008	2009	2010
Income from core operations (in ₹ Cr)	4319.3	5044.18	5534.28	6212.46
EBITDA (in ₹ Cr)	(166.85)	(160.6)	201.59	(433.07)
PAT (in ₹ Cr)	(2062.52)	(1826.51)	(1814.31)	(1333.68)
Depreciation (in ₹ Cr)	1217.51	1264.45	1353.49	1560.77
Amortization (in ₹ Cr)	161.38	164.26	203.2	168.49
Cash Profit	(683.63)	(397.80)	(257.62)	395.58
Capital Structure				
Net worth (in ₹ Cr)	1157.0	-39.7	10439.6	8090.0
Debt Funds (in ₹ Cr)	7095.3	9020.9	11577.6	12263.0
Debt/Equity	25.77	NM	1.36	2.57
Profitability				
EBITDA/Core Income	-11.5%	-3.4%	-2.8%	-10.9%
PAT/Core Income	-47.6%	-36.0%	-32.6%	-21.5%
ROCE	-24.4%	-17.9%	-6.2%	-7.0%
Coverage				
Interest Coverage Ratio	NM	0.24	0.23	NM
DSCR	NM	0.01	NM	0.14
Liquidity				
Current Ratio	0.22	0.22	0.81	0.57
Net Cash Accruals to total debt	-0.07	-0.05	-0.02	0.03

Industry Analysis:

According to latest performance report by TRAI, the number of telephone subscribers in India increased from 562.16 million at the end of Dec-09 to 621.28 million at the end of Mar-10, registering a sequential growth of 10.52% over the previous quarter. This reflects Y-o-Y growth of 44.58% over the same quarter of last year. Overall teledensity in India has reached 52.74% as on 31st March 2010 vs. 36.98% in Mar-09. Urban teledensity is at 119.7% while rural teledensity is at 24.3%, which is growing at a much higher rate compared to urban India. The ARPU for industry has been falling for both GSM as well as CDMA category. For GSM it has fallen from ₹205 in FY09 to ₹131 in FY10, a YoY fall of 36%, while CDMA ARPU moved down from ₹99 to ₹76 in same period, representing fall of 23%.

According to Global Mobile Suppliers Association data BRIC nations are adding 327 million new subscribers every year and showing 25% YoY growth. India and China, are each adding 30 million subscribers every month; while China is currently at 750 million subscribers, India is at 620 million subscribers. However, in terms of subscriber addition India is growing twice as fast as China. India is ranked 2nd in terms of number of subscribers, 10th by service revenue and it does not feature in top 10 countries by data revenue. As overall ARPUs are falling, we believe, along with rural penetration, data revenue from higher ARPU customers is crucial for sustained growth of overall revenue level in Indian Telecom Industry. Globally data revenue contributes 26% to total mobile service revenue and remaining 74% comes from voice calls; India lags way behind in this space. China has data ARPU of USD 3.2 while India is at USD 0.5

The last few months have seen major activity in this sector in terms of 3G auctions and the total bidding amount for 22 circles was ₹67719 Crores compared to the government's expectation of ₹35000 Crores. This outflow will stretch the balance sheets of most of the players in short term. Globally 3G penetration as a percentage of total wireless subscribers has increased from 1.7% in FY04 to 10% in FY08; all developed countries are at 17-20% except Japan which is an outlier at 80% penetration. In China, where 3G auctions took place in 2009, penetration stands at 3.5%. We believe that in the long run, India can see moderate 3G penetration comparable to China due to falling costs of Smart phones and good support from Venture Capitalists to start mobile services companies which will develop high end applications to be used in 3G.

Rating Outlook

We believe parentage of Tata Group, its ability to extend support at all critical corners and good corporate governance will help TTSL in sailing through difficult phases in terms of financial performance. TTSL's strategic partner, NTT DoCoMo, which is a leader in the Japanese market can provide excellent technical support in rolling out 3G; this is evident from rollout of GSM last year where Tata DOCOMO was the pioneer of the 'per-second' tariff option. In less than one year of operations Tata DoCoMo gained 30 million subscribers and 7% of GSM market on a cumulative basis; it added 10 million subscribers in the first 4 months of operations and another 20 million in the next 4 months.

However, the company faces several challenges, some of which are due to industry dynamics. In normal conditions, the interest cost buildup and spectrum amortization could affect TTSL's net profit for the next few years. EBITDA could be under pressure for the next two years, due to high operating costs for spectrum rollout. Company currently does not have adequate operating profit to cover interest expenses and will suffer from this situation for the next few years, hence new borrowings for repayment cannot be ruled out. The ARPU for industry is also declining by ~5% per year due to price wars, and another challenge for all players is to grow their data subscriber bases which have higher ARPU compared to voice only subscribers.

Analysts	Media
<p>Sameer Singhvi, Lead Analyst sameer.s@brickworkratings.com</p> <p>Mridula Chordia, Co-Analyst mridula.c@brickworkratings.com</p>	<p>Anitha G media@brickworkratings.com</p>
	<p>Relationship Contact</p>
<p>K N Suvarna Senior VP - Business Development kn.suvarna@brickworkratings.com</p>	
<p>Phone: 1-860-425-2742</p>	

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Annexure:

Statement of Financial Position

₹ Cr

	2010	2009	2008	2007	2006
Shareholders' funds					
Share capital	4144.40	4979.76	7182.51	6938.39	6738.39
Reserve and surplus	9480.80	9480.80	1967.72	1582.01	1582.01
Net Worth	13625.20	14460.56	9150.23	8520.40	8320.40
Loan funds					
Secured loans	10513.50	6357.23	5922.01	6910.28	6422.99
Unsecured loans	1750.00	5220.37	3098.85	185.00	0.00
Total Loan funds	12263.50	11577.60	9020.86	7095.28	6422.99
Total Sources of Funds	25888.70	26038.16	18171.09	15615.68	14743.39
Fixed assets					
Gross block	17677.33	11965.09	10610.65	10375.85	8210.58
Less: Accumulated depreciation	(6644.45)	(5221.14)	(4085.05)	(3197.87)	(2019.34)
Net block	11032.88	6743.95	6525.60	7177.98	6191.24
Capital work-in-progress	1958.21	1902.75	651.96	762.78	802.47
	12991.09	8646.70	7177.56	7940.76	6993.71
Intangible assets	2554.69	2560.26	2447.83	1237.17	1323.01
Investments	4006.30	4071.34	553.17	506.17	620.59
Current assets, loans and advances					
Inventories	36.67	23.36	22.48	16.91	0.00
Sundry Debtors	742.48	599.93	624.50	521.49	318.30
Cash and bank balances	4748.80	9091.58	205.48	158.50	1112.64
Loans and advances	2010.98	1482.13	1496.45	860.41	909.55
	7538.93	11197.00	2348.91	1557.31	2340.49
Less: Current liabilities and provisions					
Current liabilities	6082.48	4158.71	3288.26	2797.45	1906.47
Provisions	706.37	505.19	393.53	374.14	166.41
	6788.85	4663.90	3681.79	3171.59	2072.88
Net current assets / (liabilities)	750.08	6533.10	(1332.88)	(1614.28)	267.61
Miscellaneous expenditure not written off or adjusted	(3110.54)	25.32	135.49	182.45	240.22
Profit & loss account	8697.09	4201.44	9189.92	7363.41	5298.25
	5586.55	4226.76	9325.41	7545.86	5538.47
Total Uses of Funds	25888.70	26038.16	18171.09	15615.68	14743.39

Summary of Profit and Loss Statement

₹ Cr

	2010	2009	2008	2007	2006
Total Income	6458.96	5892.43	5377.90	4647.80	2599.29
Total Expenditure	6892.03	5690.84	5217.10	4814.66	2991.21
EBITDA	(433.07)	201.59	160.80	(166.85)	(391.93)
Profit before Tax	(1333.68)	(1804.51)	(1818.34)	(2054.31)	(1871.89)
Provision for Tax - FBT	0.00	9.80	8.17	8.21	6.32
Profit / (Loss) for the year	(1333.68)	(1814.31)	(1826.51)	(2062.52)	(1878.21)
Loss at the beginning of the year	(7363.41)	(9177.17)	(7363.41)	(5298.25)	(3420.04)
Restructuring adjustments as approved by the Honorable High Court of Delhi	0.00	6790.04	0.00	0.00	0.00
(Loss) at end of the year	(8697.09)	(4201.44)	(9189.92)	(7363.41)	(5298.24)