
Rating Rationale for Tata Communications Limited's Long Term Debt Issue of INR 150 crore or INR 1.5 billion

Long Term Debt Issue: BWR AAA+

Outlook : Stable

Brickwork Ratings has assigned BWR AAA+ (Pronounced BWR Triple A Plus) for Tata Communications Ltd. ("TCom" or "the Company") proposed Long Term Debt Issue of INR 150 crore or INR 1.5 billion. Brickwork Ratings' 'BWR AAA+' stands for an instrument that is considered to offer BEST credit quality in terms of timely servicing of principal and interest obligations. The rating factored:

- Consistently good performance
- Dominant position of company in wholesale voice and enterprise data communication segment
- Highly experienced management with good execution capabilities
- Strong, committed promoter group
- Strategic moves being made by the company to accelerate growth

BWR has essentially relied upon audited financial results, projected financial figures, information and clarification provided by TCom.

The company is a leading global provider of a new world of communications, serving voice and data requirements of carriers and enterprises within the country as well as globally. It is a leader in Enterprise Data Services market in India and has a major share in Wholesale NLD and ILD voice traffic. With a leadership position in emerging markets, TCom leverages its advanced solutions capabilities and domain expertise across its global and pan-India network to deliver managed solutions to multi-national enterprises, service providers and Indian consumers.

TCom has posted strong growth in total business. On a standalone basis, income from operations increased 14.22% to INR 37.5 Billion in FY09 as compared to INR 32.83 Billion in FY08. Company's profit from operations increased 28.64% to INR 4.18 Billion in FY09 as compared to INR 3.25 Billion in FY08. The Net Profit totaled INR 5.16 Billion up from INR 3.05 Billion.

Background

TCom is a leading global provider of telecommunications solutions and is one of the top global wholesale voice operators, enterprise data and internet services in India. The company also provides broadband and content services to retail consumers. Formerly known as Videsh Sanchar Nigam Limited, it was established in April 1986 as a wholly owned government organization. In February 2002, under Government's plan for disinvestment, Tata Group acquired 45 % stake in VSNL in 2002 through its investment vehicle Panatone Finvest Ltd, and subsequently raised it to 50.1% becoming the majority shareholder in the company. In 2008, the

Company was renamed as Tata Communications Ltd. and thus integrated various brands of VSNL like VSNL, VSNL International, Teleglobe, Tata Indicom Enterprise Business Unit and CIPRIS.

TCom has operations in over 200 countries. TCom's portfolio of services covers:

- Value-added services such as international toll free calls and account calling in addition to domestic and international long distance calls to a customer base that includes over 1500 carriers, mobile operators and ISPs.
- Connectivity and data needs of global enterprises and service providers with solutions such as virtual private networks, global Ethernet, various managed services including services like TelePresence with high growth potential, leased lines, etc.

Business Operations

TCom operates in three main business segments viz. wholesale voice, enterprise & carrier data and other services. In 2008-09, Wholesale Voice segment generated around 46.4 per cent of the total revenues followed by Enterprise & Carrier Data which contributed 38.7 per cent and balance by other segment.

Wholesale Voice Services - cover international long distance (ILD) and national long distance (NLD). TCom provides one of the largest wholesale international voice services, internet services and also operates global submarine cable networks. Tata Communications handled over 24 billion minutes of voice traffic although it is facing competition with new players, some of who were TCom's customers earlier. TCom has maintained its leadership in wholesale voice segment with 44% share in ILD voice traffic and 53% share in NLD voice traffic.

Enterprise & Carrier Data Service - provides clients with international and national private leased circuits (IPLC and NPLC). Leased circuits, also called as leased lines, provide point-to-point private communication line over geographically dispersed area. Leased circuits can be used for internet access, business data exchange, video conferencing, and any other form of telecommunication. TCom offers a range of IP (Internet Protocol) services encompassing internet telephony, multi protocol label switching (MPLS), internet access, managed hosting and other data centre services, internet leased lines, mail and messaging services, video conferencing, website hosting services with security back-up and database management services & network management.

This segment has been growing at a very healthy rate with enterprise data volumes growing almost 100% as companies are increasingly using networking and Information Technology. Additionally there is significant growth from both Indian and international clients in terms of connectivity and managed services in new markets to keep up with their global business expansion.

Other Services - encompasses broadband services, dial-up internet services, public access business (including Wi-Fi and cybercafés).

Although the broadband market is growing, it is not at par with that of mobile subscribers primarily due to insufficient last mile networks which limits the ability to serve retail customers. To cater to this problem, TCom is aggressively pushing for Wi-Max based wireless broadband network. In the existing wire line broadband service, TCom focuses on customers in high revenue generating plans which makes TCom one of the highest ARPU service providers. TCom also has a network of about 500 hotspots and has registered a growth rate of 200% in hotspot space. However, this business has been hived off to Tata Communications Internet Services Ltd in March, 2007.

Cable Consortiums and alliances:

Tata Communications has participated in consortium of cable systems which include SEA-ME-WE 4, C2C, SAFE, EAC, APCN-2, Americas 2, CANTAT 3, 121 etc. The Company has alliances with BT, C&W, France Telecom, T-System, Telecom Italia, AT&T, Verizon Business, Sprint, SingTel, NTT, Telstra, KDDI, Telecom Malaysia to name a few.

Acquisitions, Joint Ventures, Associates:

Tyco Global Network: Acquired in 2005, TGN consists mainly of an undersea fiber optic telecommunications network that connects northern Asia, America and Europe.

Teleglobe: Acquired in 2006, this global wholesale provider helped Tata Communications become the owner of a Tier-1 IP network. Teleglobe provides international voice, data, and value added services comprised mainly of mobile global roaming and signaling services. Teleglobe operates global telecommunication networks, has ownership interests in subsea and terrestrial cable systems and enables Internet connectivity through the use of satellites.

Neotel (Associate): The second largest service provider in South Africa. South Africa has issued license to Neotel to provide telecommunication services (except mobile services). The Company has effective 49% stake in Neotel.

Joint Venture with CEC: TCom has joint venture with China Enterprise Communications Limited (CEC). CEC is a value-added telecommunications services and integrated IT solutions provider headquartered in Beijing, China. CEC was recently awarded a nationwide IP VPN service license by PRC's Ministry of Information Industry (MII), the first telecom valued-added service license granted to a non-facilities based service provider. CEC has network reach throughout PRC, with no regional restrictions on its service capabilities. CEC provides VPN connectivity services to 347 cities in PRC. CEC's reach in PRC complements the Company's VPN presence in 120 Indian cities and 19 other major business capitals in North America, Europe and Asia. This joint venture is the first of its kind in the Chinese telecom sector, after PRC's entry into the WTO. It will leverage key synergies between the Company's high performance global IP

network with CEC's extensive IP VPN coverage in PRC, providing seamless connectivity to the world's most dynamically growing economic regions.

Other Initiatives:

- Incorporated a 100% subsidiary, Tata Communications Transformation Services Limited (TCTS) to help reduce cost of operations and take advantage of opportunities in outsourcing business.
- Implementing stringent service delivery standards adhering to global best practices.
- Created dedicated team to support its carrier partners and enterprise businesses.
- Implementing Tata Business Excellence Model that lays down best practices in areas like leadership, strategy, customer service, human resources and process management planning.

Management Profile:

Tata Group, founded by late Shri Jamsetji Tata in 1868, is one of the most prominent and respected business houses in India with aggregate revenue estimated at US \$62.5 billion (around Rs 2, 51,543 crore) in FY08 of which 61 per cent has come from business outside India. It pioneered several industries of national importance in India: steel, power, hospitality, and airlines. Currently, Tata Group has an aggregate holding of 50.1%, in TCom.

Mr. Subodh Bhargava, is the present chairman of TCom. Mr. Srinath Narasimhan is the Managing Director & CEO. TCom's Board of Directors comprises of eminent people from the industry and corporate world. Operations of the company are managed by professionals with vast industry and management experience.

Financial Performance:

TCom has posted good growth in total business. Income from operations increased 14.22 % to INR 37.5 Billion in FY09 as compared to INR 32.83 Billion in FY08. Company's profit from operations increased 28.64% to INR 4.18 Billion in FY09 as compared to INR 3.25 Billion in FY08. The profit before tax for FY09 was INR 7.13 Billion as compared to INR 4.50 Billion during FY08. The net profit stood at INR 5.16 Billion in FY09 as compared to INR 3.05 Billion in FY08, reflects higher other income and the presence of profit on sale of long term investments. Segment performance is shown in Table 1.

Table 1			
Segment Revenues (Rs Crores)	2009	2008	2007
Wholesale Voice	1741	1695	1994
Enterprise & Carrier Data	1450	1226	1308
Others	558	362	444
Total	3749	3283	3746

Due to continued pricing pressure in the voice segment resulting in declining Average Revenue Per User (ARPU), the Company has made strategic decision of moving towards data business. The Enterprise & Carrier Data segment has therefore been major contributor to the gross profit accounting for almost 63% share in overall gross profits (Table 2).

Segment Gross Profit (Rs Crores)	2009	2008	2007
Wholesale Voice	331	199	487
Enterprise & Carrier Data	1131	1059	1070
Others	342	128	147
Total	1804	1386	1704

In FY08, due to competition, the company's PBITDA declined by about 33%. However, in the subsequent year, the company recouped and showed an increase of 36% in the PBITDA. Profitability margins improved from 9.27% in FY08 to 13.76% in FY09. On standalone basis in FY08, the total debt was INR 7.78 billion which increased to INR 23.28 Billion in FY09 (refer Annexure 2).

TCom has made substantial investments in other group companies, joint ventures, subsidiaries, and mutual funds. Investments in FY09 stood at INR 27.23 (21.03) Billion of which INR 6.31 Billion (3.49) was invested in mutual funds, the remaining invested in subsidiaries, group companies, and joint ventures.

In FY 08, TCom had settled a long pending case against Flag Telecom (now Reliance Globalcom) and has paid \$19 million (Rs 93.3 Crore) as per international tribunal's final award.

Brief overview of the company's performance, key ratios, and abridged balance sheet are as per Annexure 1 and 2.

TCom's performance vis-à-vis peers:

BWR has made a study of the performance (FY2008) of TCom vis-à-vis the peers. The peers have been chosen based on similar business activities such as ILD, NLD, and submarine cable. Table 3 gives the comparison of key parameters of TCom with its peers based on 2008 results.

Year: FY08	Tata Communications	Peers' Average
Total Debt- Equity Ratio	0.12	0.82
Interest Coverage Ratio	15.65	10.78
Debt Service Coverage Ratio	0.68	2.00
Profitability Margin	9.27%	20%
Return on Capital Employed	6.6%	17%
Net Cash Accruals to Total Debt	0.586	0.62
Current Ratio	0.79	0.86

Interest coverage is higher than that of the peers, which is at 15.65 as opposed to 10.78 of the peers.

Business Goals:

The company aims to achieve the following by FY2012:

- Number 1 or 2 in all focus markets
- Attaining 15% CAGR organic sales growth
- At least 20% EBITDA margin
- Positive EVA

Industry Scenario

Telecom Industry:

India's telecom market is growing rapidly and by 2010, telecom is expected to be Rs.1380 billion sector, contributing 5.4% to India's gross domestic product (GDP). According to the figures from the Telecom Regulatory Authority of India (TRAI), India's mobile subscriber base during 2007-08 increased approximately 58%, from 165.11 million to 261.09 million, while the fixed subscriber base declined from 40.9 million to 38 million. During the year, the broadband subscriber base grew by approximately 67%, from 2.34 million to 3.90 million but the growth has been constrained mainly due to lack of last-mile networks. In the voice business the Average Revenue Per User (ARPU) has been declining as a result of entry of new operators resulting in intense competition, however the demand for bandwidth connectivity is expected to grow as enterprises worldwide seek to utilize network and information technology to enhance productivity.

There has been rapid growth in investments in Telecommunications sector over the past few years. The share of Telecom industry in total FDI was 8% after Services sector (23%) and Computer & Hardware (11%). Investments are expected to accelerate further with entry of new players and auction of 3G spectrum.

Challenges for the Industry:

- Lack of clear regulatory roadmap on issues such as spectrum allocation, 3G auction and uncertainty when Defence Ministry will be vacating spectrum.
- Competition

Rating Outlook:

TCom's business mix is shifting towards enterprise data business which is expected to drive future growth to its overall operations. Various managed services are expected to contribute healthy EBITDA margins. Indian broadband market is poised for strong growth owing to very low penetration level. TCom is poised to take advantage of the same. Combined with the backing of TATA group, excellent management, and strategic initiatives being taken to lead its growth, TCom is expected to further improve upon its overall performance and margins.

The wholesale voice business may face some pricing pressures due to increased competition and lower tariffs. However, increasing demand for bandwidth and cable connectivity has compensated for declines in voice segment. It is noteworthy that TCom's net margin remained stable despite tariff decline because reduction on interconnect cost. An important risk factor is the uncertainty in Government policy on spectrum allocation, auction of 3G as well as the Defense vacating spectrum. Looking to the company's strengths, Brickwork Ratings expects TCom to maintain its healthy performance and profitability, going forward.

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Annexure 1: Profit and Loss

	Particulars (all figures (except EPS) in Rs Crores)	Mar'09 Year ended	Mar'08 Year ended
1	Revenues from Telecommunication Services	3749	3312
2	Expenditure incl. Depreciation and Amortisation	3331	2987
3	Profit from Operations before Other Income, Interest, and exceptional items	418	325
4	Other Income	173	166
5	Profit before interest and exceptional items	591	491
6	Interest (net)	129	29
7	Profit from Ordinary Activities before tax	713	451
8	Tax Expense	198	146
9	Net Profit from Ordinary Activities after tax	516	305
10	Paid up Equity Share Capital (Face value of Rs.10 per share)	285	285
11	Reserves excluding revaluation reserve	6305	6054
12	Earnings Per Share (EPS)	18.1	10.7

Annexure 2: Ratio Analysis

Particulars	2009	2008	2007
Debt - Equity Ratio	0.34	0.12	0.03
Interest Coverage Ratio	4.42	15.65	134.67
Debt-Service Coverage Ratio	1.41	0.68	4.23
Networth (in Rs Crores)	6798.05	6547.34	6359.5
Profitability Margins	13.8%	9.27%	12.5%
Return on Capital Employed	9.8%	6.6%	10.8%
Net cash accruals to total debt	0.34	0.586	3.59
Current Ratio	0.75	0.79	0.73

Balance Sheet

	Particulars (in Rs Crores)	2009	2008	2007
	FUNDS EMPLOYED:			
1	SHARE CAPITAL	285	285	285
2	RESERVES AND SURPLUS	6513	6262	6075
3	TOTAL SHAREHOLDERS' FUNDS	6798	6547	6360
4	SECURED LOANS	1289	-	-
5	UNSECURED LOANS	1039	778	198
6	DEFERRED TAX LIABILITY (NET)	133	84	72
7	TOTAL FUNDS EMPLOYED	9259	7409	6629
	APPLICATION OF FUNDS:			
8	FIXED ASSETS	4634	3533	3495
9	INVESTMENTS	2724	2104	2674
10	CURRENT ASSETS, LOANS AND ADVANCES	4797	4014	2317
A	Current Assets	1970	1586	1169
B	Loans and Advances	2827	2428	1147
11	CURRENT LIABILITIES AND PROVISIONS	2896	2241	1856
A	Current Liabilities	2607	1990	1586
B	Provisions	289	251	270
12	NET CURRENT ASSETS	1901	1773	461
13	TOTAL ASSETS (NET)	9259	7409	6629