Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

Tata Communications Ltd.

EQUITY REPORT

July 4, 2014

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Tata Communications Ltd. (TCOM) is a USD 3.2 billion 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. Its presence spans across developed markets to the world's fastest growing emerging economies. It is the number one international wholesale voice carrier and submarine cable owner by length. It 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 virtual private networks, the world's largest network of Telepresence services, the world's most extensive DDoS mitigation and detection service, content delivery networks, and cloud enablement solutions.

Investment Profile

Riding high on mobile data expansion- With mobile internet becoming the most popular medium for connectivity, strong growth is expected in Internet traffic on mobile devices. TCOM continued to focus on data-centric services to drive growth, with data centres, a high margin business, (EBITDA margins in FY14 at 30%) being one of the key focus areas. Additionally, management expects the white-labelled ATM business to achieve EBITDA breakeven in FY15.

Global leadership in Voice & Data bodes well for technological advancements- TCOM has more than 240,000 km of optic fibre network making it the world's largest submarine cable owner by length. It has more than 20% of the world's lit fiber capacity and is the No.1 international voice carrier by minutes with nearly 19% market share. Its clientele includes 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. This strong infrastructure will enable TCOM to adapt to new technologies rapidly and remain at the cutting edge of competition.

Eyes enhanced margins with increasing data businesses- The company's thrust on growing the data business continues to be strong with company reiterating its revenue growth and margin guidance of 20% for the data business. On the voice business, it expects a pricing pressure and hence continues to guide for a 7.5-8% margin 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.

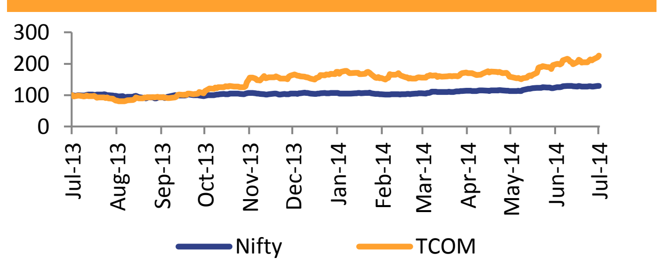
Market Data

Rating	**BUY**
CMP (₹)	408.6
Target (₹)	**478**
Potential Upside	~16.9%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	410.9/137.1
Adj. all time High (₹)	495.7
Decline from 52WH (%)	0.6
Rise from 52WL (%)	198.0
Beta	0.2
Mkt. Cap (₹bn)	116.5
Enterprise Value (₹bn)	235.7

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	172.1	196.7	212.7	237.2
EBITDA (₹bn)	20.6	30.9	33.0	37.2
Net Profit (₹bn)	(6.2)	1.0	3.6	6.5
EPS (₹)	(21.9)	3.6	12.6	22.7
P/E (x)	(18.7)	114.8	32.4	18.0
P/BV (x)	8.2	14.6	11.3	7.5
EV/EBITDA (x)	10.6	7.6	7.1	6.3
ROCE (%)	1.7	7.6	8.3	10.5
ROE (%)	(36.4)	4.4	35.0	42.0

One year Price Chart



Shareholding Pattern	Mar'14	Dec'13	Diff.
Promoters	75.0	75.0	-
FII	7.0	6.1	0.9
DII	12.1	13.3	(1.2)
Others	5.9	5.6	0.3

Tata Communications Ltd. - #1 enterprise data provider in India

TCOM operates in three major segments viz; Global Voice Solutions, Global Data & Management Services and South African Operations.

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 is the #1 global international wholesale voice operator and #1 provider of International "Long Distance Enterprise Data" and "Internet Services" across India. 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. The company's portfolio includes transmission, IP, converged voice, mobility, managed network connectivity, hosted data center, communications solutions and business transformation services to global and Indian enterprises & service providers as well as, broadband and content services to Indian consumers.

TCOM's Global Network encompasses one of the most advanced and largest submarine cable networks, a Tier-1 IP network, connectivity to more than 200 countries across 400 PoPs (Point of presence) and more than one mn square feet data center space. The company serves its customers from its offices in 80 cities in 40 countries worldwide. TCOM has a strategic investment in South African operator Neotel, providing the company with a strong anchor to build an African footprint. TCOM's depth and breadth of reach in emerging markets includes leadership in Indian enterprise data services, leadership in global international voice, and strategic investments in South Africa (Neotel), Sri Lanka (Tata Communications Lanka Limited) and Nepal (United Telecom Limited). The company operates through multiple segments.

Segment-bifurcation

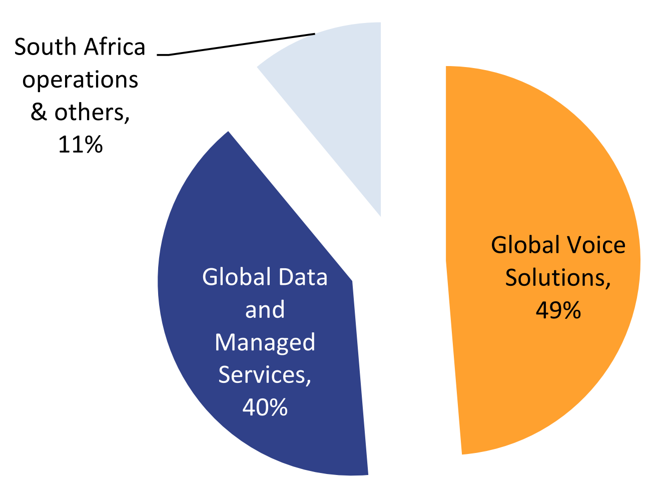
Global Voice Solutions (GVS)

TCOm 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.

Global Data and Managed Services (GD&MS)

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

Segment-wise Revenue



South African operations

In this segment, company operates through its subsidiary "Neotel" and includes other unallocated revenue. Neotel, which is still at a nascent stage, continues to achieve growth. Recently, this segment secured a ground breaking deal with the State Information Technology Agency (SITA) and the Western Cape provincial government to provide broadband services across the province over the next three years. The project is a first-of-its-kind in South Africa and has strict guidelines to deliver sites and service levels in a true public-private partnership, by leveraging the skills, resources and expertise of each party for the provision of broadband services across the Province.

Consolidated revenue grew by 14% YoY supported by strong momentum across all segments and favourable currency movement.

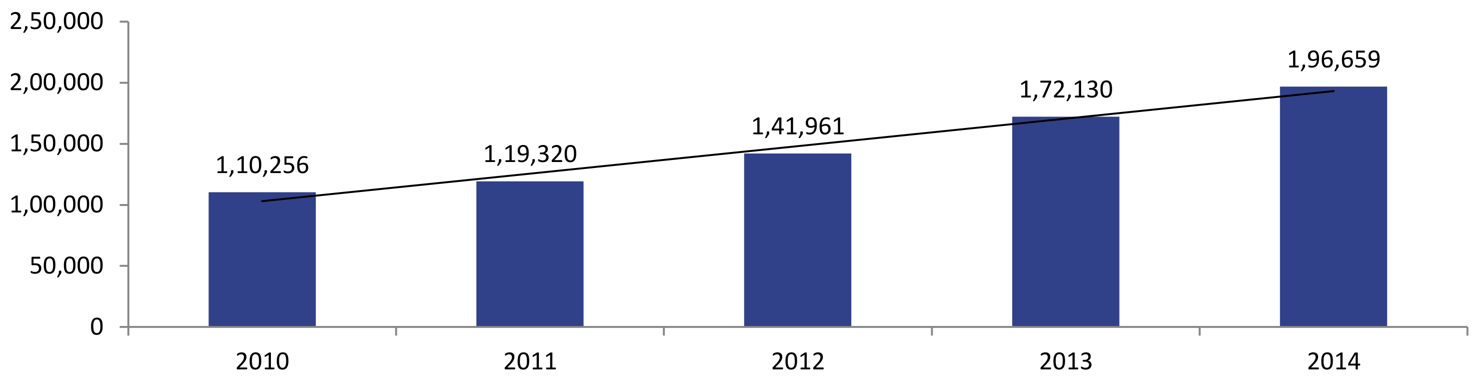
EBITDA margin increased by 374 bps led by significant improvement in underlying operational performance

Impressive operational performance drives the company's bottom-line growth

TCOM's consolidated revenue grew by 14% YoY to ₹196,659 mn in FY14 as compared to ₹172,130 mn in FY13. The growth in revenues was broadly supported by strong momentum across all segments and favourable currency movement. The core business's (excluding South African operations & other unallocable revenue) revenues from operations stood at ₹174,972 mn in FY14 as against ₹153,181 mn in FY14, posting a growth of 14% YoY. The company's continued focus on cost-management and progressive innovation in its product portfolio propelled a significant increase in its operational performance and net profit during the year. During FY14, the company's consolidated EBITDA stood at ₹30,880 mn as against ₹20,597 mn in FY13, recording a significant growth of around 50% YoY.

On the margin front, the consolidated EBITDA margins increased by 374 bps to 15.7% in FY14 as compared to 12.0% in the previous year. Net profit for FY14 was reported at ₹1,011 mn, marking the company's first consolidated annual net profit in the last five years - a result of significant improvement in underlying operational performance. Going forward, we expect the company's continuous focus on cost management and product innovation will further improve operational performance and thereby its profitability.

Revenue growth trend ₹mn



The management reiterated its stance and guided for an earnings before interest, tax, depreciation and amortisation (EBITDA) margin of 7.5-8% for the voice business and over 20% for the data business for FY15.

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

TCOM's global data centre business contributing around 40% to the top-line revenue grew by 17% to ₹79,256 mn in FY14 as against ₹67,534 mn in FY13. The data centre business is growing at nearly 18% for last two years with the EBIT margin 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 in to 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.

Launch of mobile VoIP platform to boost Average Revenue per User (ARPU)

Mobile VoIP offerings allow company to gain additional revenue from today's 'always connected' users, and create new market segments without the significant upfront capital investment.

TCOM recently launched a mobile VoIP platform for operators enabling the company to offer converged communication services across voice, chat, video and file sharing. The company claims that it will increase ARPU. Enhanced features include instant video conferencing, follow-me, private numbers, voicemail, identity numbers and local numbers in geographies where permissible. Mobile VoIP offerings allow company to gain additional revenue from today's 'always connected' users, and create new market segments without the significant upfront capital investment and lead time required for true native rich communication services, according to the company. "Mobile VoIP can be used by Mobile network operator) MNOs or indeed fixed-line or cable players to address specific target markets or develop new service bundles such as video conferencing."

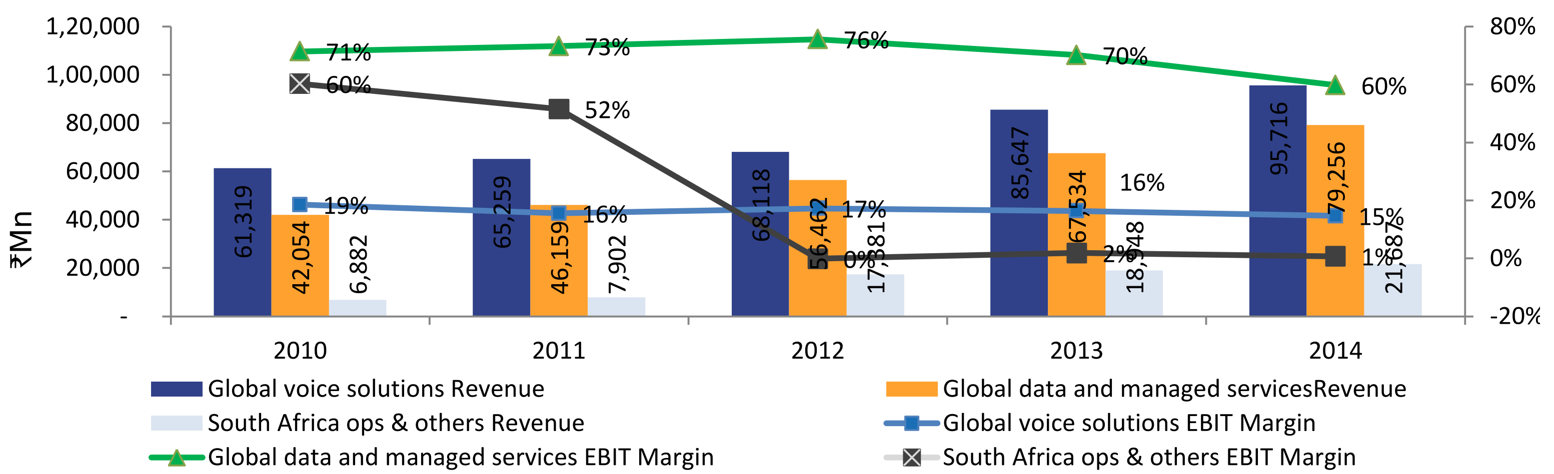
Volte offerings to garner huge revenue in coming years

VoLTE will allow mobile network operators to offer HD voice over their LTE / 4G networks and is seen as a key factor for the success of 4G customer uptake.

TCOM has recently 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 LTE / 4G networks and is seen as a key factor for the success of 4G customer uptake. 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 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 $16 billion business by 2017 and hence TCOM being an early entry player will be in a better position to reap benefits.

Segment-wise revenue and EBITDA trend



Diversifying GVS to improve revenue visibility

Leading global player with more than 20% of the world's lit fiber capacity. Over 240,000 km of optic fibre network and No.1 international voice carrier by minutes with ~19% market share.

TCOM 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, TCOM 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 GD&MS

Increasing mobile internet accessibility provides an avenue to capitalise on the market visibility and defend its market share.

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 TCOM 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.

Strategic easing of the leverage profile bodes well for TCOM

Tata communication plans to continue to monetise its real estate in prime locations in India to further strengthen its balance sheet.

As part of the company's strategy to focus on its core area of providing international telephony services, TCOM recently signed an agreement to pare its stake in Neotel, South Africa's second biggest fixed-line phone operator, to Vodacom SA for an enterprise value of 7 bn rand (about ₹39,500 mn). TCOM holds a 68% stake in Neotel. The company provides wholesale telecommunications and Internet services to companies in Africa. The deal will help TCOM pare its debt of ₹119,763 mn as on 31 March. It hasn't been able to raise funds to meet capital expenditure requirements because the Indian government, a stake holder in the company, has not allowed any share sale. It is in line with the company's financial objectives while paving the way for Neotel to improve its value proposition in the South African market.

This is a positive step for the company to focus on core business and to pave off non-core business or assets and moreover this will help company to pay off some of its consolidated debt, which stood at ₹119,763 mn (as on March 2014) and hence will strengthen the company's leverage profile and fundamentals. Decline in debt resulting in lower interest cost and thereby company will save after tax interest cost and hence improve profitability.

Payment solutions business attractively placed for robust growth

TCOM payment solutions Ltd (TCPSL) is a wholly owned subsidiary focused on payment solutions in India. TCPSL is one of the largest managed ATM service providers. TCPSL owns Indicash, India's first and largest white label ATM (WLA) network. Company sounded positive on its payment solutions business (the ATM business), which reported revenues of ₹4,700 mn with an EBITDA loss of ₹910 mn for FY14.

Tata Communications Payment Solutions aims to install 15,000 White label ATMs by 2016, which will boost the company's revenue.

The losses have reduced on an absolute basis owing to the company's effort towards exiting low margin or loss making sites and improving the revenue contribution from the mature ATMs. The company has guided for an EBITDA break-even from this segment for FY15. It also has outlined plans for a revenue monetisation from the white-label ATMS in tier-3 to tier-6 locations via third party advertisement, sales etc.

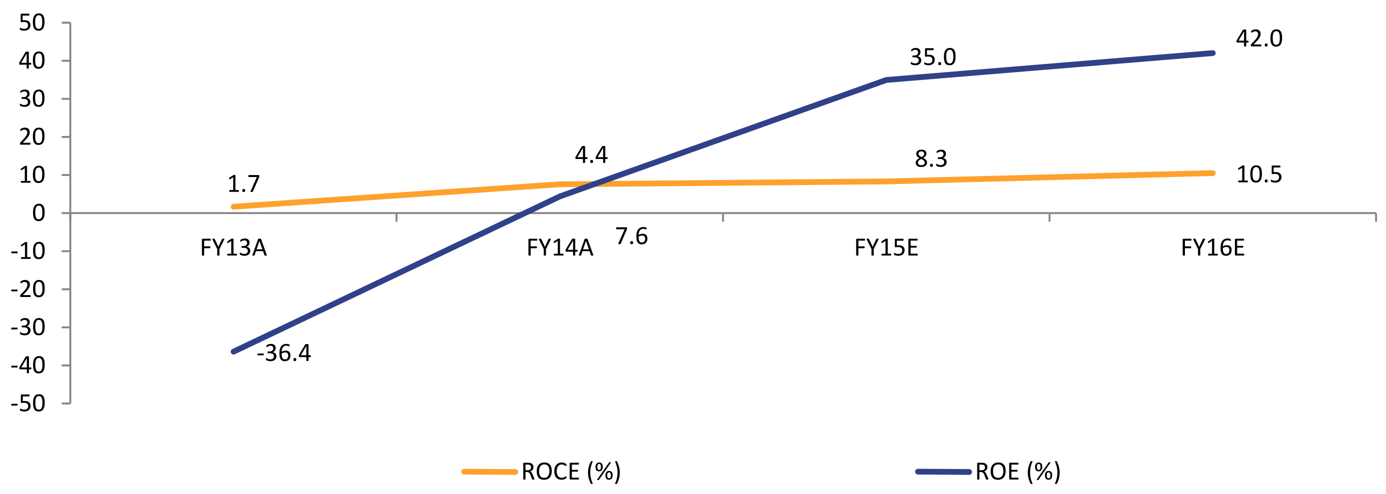
India's ATM infrastructure has doubled over the past three years to 127,000 ATMs. Despite this, growth is still remains deficient as the availability is only 125 ATMs per mn people in India, which is 1/10th of the ratio in the developed world. The white label ATM business has become attractive in India because the National Payment Corporation of India (NPCI) has allowed an ATM interchange fee of ₹15 for each cash withdrawal and ₹5 for non-cash transactions. This leaves immense scope for TCPSL to grow. It has invested ₹4.6 bn so far into this business and is garnering ₹5 bn in annualized revenue.

We expect the growth momentum to continue in this segment driven by new ATM's and exit from or renegotiation of non-profitable brown label ATM contracts.

Key Risks

- TCOM has limited local support capabilities in developing markets, which are important for improving installation and repair times for customers with highly distributed networks.
- The companystill has low market share in the regional hubs where most MNCs are located, and its capabilities are not well understood in the broad market.
- TCOM 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.

Key ratios



Balance Sheet (Consolidated)

₹ million	FY13A	FY14A	FY15E	FY16E
Share Capital	2,850	2,850	2,850	2,850
Reserve and surplus	11,399	5,145	7,432	12,604
Net Worth	**14,249**	**7,995**	**10,282**	**15,454**
Minority Interest	79	62	62	62
Loans	102,750	119,763	118,519	117,103
Current liability	76,695	72,317	78,102	87,402
Other long term liability	39,330	41,591	41,591	41,591
Deferred tax liability	287	357	357	357
Provisions	3,974	6,684	7,286	8,116
Total Liabilities	**237,363**	**248,769**	**256,199**	**270,086**
Fixed Assets	146,091	149,487	152,477	157,051
Goodwill on consolidation	8,729	6,185	6,185	6,185
Long term loans & advances	21,193	22,825	23,509	23,980
Deferred tax assets	111	1,085	1,085	1,085
Non-Current Investments	7,532	7,538	7,538	7,538
Other non-current assets	81	123	123	123
Current Assets	53,626	61,527	65,282	74,125
Total Assets	**237,363**	**248,769**	**256,199**	**270,086**

Profit & Loss Account (Consolidated)

₹ million	FY13A	FY14A	FY15E	FY16E
Net Sales	**172,130**	**196,659**	**212,681**	**237,219**
Expenses	151,532	165,779	179,716	199,976
EBITDA	**20,597**	**30,880**	**32,966**	**37,243**
Depreciation	20,271	20,914	21,959	22,618
Other income	2,266	1,433	1,505	1,655
EBIT	**2,593**	**11,399**	**12,511**	**16,280**
Interest expense	7,941	7,617	7,395	7,043
Profit before tax	**(5,349)**	**3,782**	**5,116**	**9,237**
Exceptional item	1,042	662	-	-
Tax	2,202	3,433	1,535	2,771
Share of P&L in associate/MI	276	2.9	16.9	16.9
Net Profit	**(6,233)**	**1,014**	**3,598**	**6,483**

Key Ratios (Consolidated)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	12.0	15.7	15.5	15.7
EBIT Margin (%)	1.5	5.8	5.9	6.9
NPM (%)	(3.0)	0.2	1.7	2.7
ROCE (%)	1.7	7.6	8.3	10.5
ROE (%)	(36.4)	4.4	35.0	42.0
EPS (₹)	(21.9)	3.6	12.6	22.7
P/E (x)	(18.7)	114.8	32.4	18.0
BVPS (₹)	50.0	28.1	36.1	54.2
P/BVPS (x)	8.2	14.6	11.3	7.5
EV/Operating Income (x)	9.6	7.3	6.8	6.0
EV/EBITDA (x)	10.6	7.6	7.1	6.3

Valuation and view

The steadily improving core performance coupled with the management's initiative towards sharpening its focus and deleveraging its balance sheet via the Neotel stake sale and the 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.

We initiate 'BUY' rating on Tata communications. At a current CMP of ₹408.6, the stock is currently trading at P/E of ~18.0xFY16E. Considering the company's strong fundamentals, we expect the company to report an EPS of ₹22.7 in FY16E and we assigned a forward P/E multiple of ~21.0x FY16E resulting in a target price of ₹477.7, which provides a potential upside of ~16.9% to the stock price for the coming 12 months.

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