

## Tata Telecom

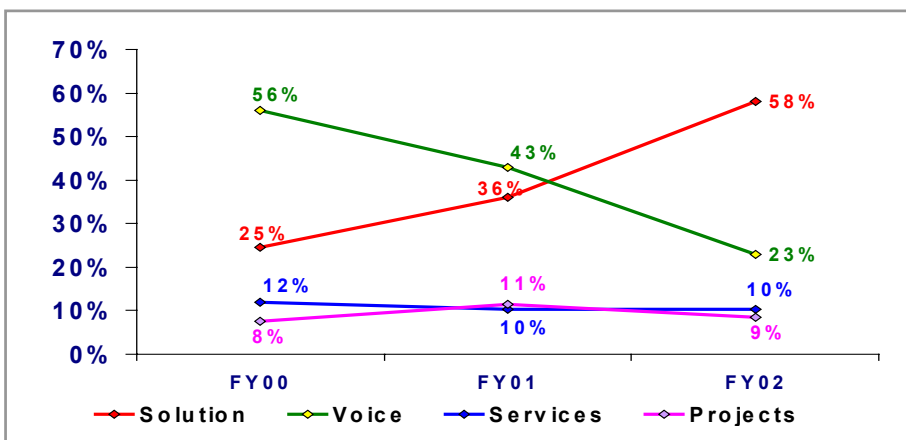
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Market Performer  
Rs125

### Key takeaways of the Analysts' Meet held by the company.

- Tata Telecom (TTL) spoke about its evolution and future plans. It reiterated that while the transition from pure voice to converged solutions has driven its revenues growth, a marketing solution instead of just selling boxes has helped it protect its profit margins (refer Exhibit 1). In FY04, the company would look at consolidating its current position, grow inorganically if possible and look at developing post-sales revenues.

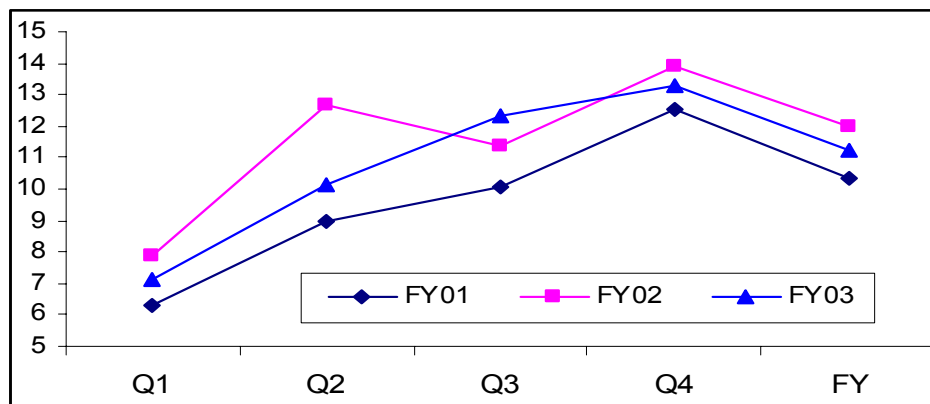
Exhibit 1: Changing Revenue Profile (as % of turnover)



Source: Company

- The management stated that despite the 22-25% revenue growth prospects between FY03-05 (with increased business in the contact centre/CRM arena), operating margins were unlikely to improve from current levels of 11.5-12%. Margins in the traditional PBX business were under squeeze and price-cutting was also evident in the emerging businesses despite their being on the higher end of the communications technology value-chain. The pressure on OPM was evident all along FY03 and we believe that the stock price more or less discounts it. FY03 OPM has been mostly below FY02 levels though still a notch above the levels recorded in FY01 (refer Exhibit 2).

Exhibit 2: Trend in OPM (%)



Source: Company and Karvy Estimates

- More solutions and lesser boxes also meant that the company improved revenues from its top-hundred customers from 50% in FY00 to 66% in FY02. It also improved the order size exceeding Rs10mn from 39% of revenues in FY00 to 57% in FY02.
- TTL had a significant market share in almost every category of the market for enterprise communications. It has a 36% market share in enterprise voice solutions, 60% in contact centre/CRM solutions, 42% share in IP telephony and a 20% share in tele-conferencing with Polycom.
- TTL's growth continues to be strongly linked to increased business process outsourcing from India. The domestic contact market centre is also growing and cumulative seats are currently put at 65,000, of which TTL has a market share of around 42,000 seats. TTL's revenues from contact centre/CRM have grown from Rs450mn in FY01 to Rs1140mn in FY03. Going ahead, TTL expects a 30% plus growth in this area. The enterprise voice solution revenues, which currently stand at Rs1590mn would most likely show a single digit growth in FY04.

We believe that TTL would deliver on the numbers. We estimate that gross revenues would hit Rs4bn mark in FY04 with net profits exceeding Rs235mn. Earning per share growth is likely to be heartening at 27% YoY to Rs16.58 in FY04 (*refer Exhibit 3*).

**Exhibit 3: Financials**

Year ending March 31	Rs Million				
	FY00	FY01	FY02	FY03	FY04(E)
Net Revenues	1,399.30	1,899.77	2,561.38	3,190.20	3,961.70
EBIDTA	141.76	233.62	321.31	371.75	457.03
Net Profit	40.36	83.69	156.82	185.58	235.97
Equity Capital	142.34	142.34	142.34	142.34	142.34
EPS (Rs) (fully diluted)	2.84	5.88	11.02	13.04	16.58
YoY % growth	NA	107.37	87.37	18.34	27.15
PE (x)	44.00	21.22	11.32	9.57	7.53
RoCE (%)	NA	13.95	25.03	24.91	25.79
RoNW (%)	NA	12.49	20.35	18.44	19.97

Source: Company and Karvy Estimates

However, a forward PE of 7.53x earnings is still not compelling enough to aggressively Buy the stock. We would be looking for clarification from the management on the following issues:

- TTL's main co-promoter Avaya (25.5% equity owner) continues to be under pressure to deliver profits. Though currently positive on cash, we believe Avaya would rather keep the profits with itself than show it in an associate company like TTL. We believe that given the extent of Avaya's problems in the US, TTL may not be able to bargain for better rates on products imported from Avaya. This may be already restricting growth in TTL's operating profits. Note here that TTL is Avaya's largest business partner in Asia Pacific. We reckon that TTL would be importing Rs2bn worth of communication equipment from Avaya in FY04. This would be close to 52% of its estimated gross revenue in FY04.
- Even if we were to assume that TTL faces no transfer pricing pressure from Avaya, a 12% OPM in a business that is technology driven would be a proof of how commoditised TTL's business is, at least in India. This is despite having made a successful transition from a box-pusher to an integrated solutions provider. Put differently, TTL commands



22 May 2003  
Analyst Meet

little or almost no pricing power though it is uniquely positioned and has a dominant market share in every category of the enterprise communication market.

**View and Valuation**

Without the pricing power we are not sure whether TTL would deserve a premium double-digit valuation. On a flat OPM between FY04-05, we expect TTL to rely on volume growth and tight working capital management to deliver profitability. TTL has a very strong balance sheet and little debt on its books (except for working capital) to worry about. Debtors have been contained at 115 days for FY03 while sales cycle has been brought down to an average 70-80 days.

We continue to be positive on the company's long-term potential and hold that a transition from solutions-provider to services beyond FY04 to protect or even improve margins is only logical. An acquisition is also on cards. However, these are the longer-term triggers. We would revisit our recommendation after our next meeting with the company's management.

We maintain a **Market Performer** rating on the stock, though a level of Rs100-105 would be attractive on the basis of valuations.

**Stock Ratings Absolute Returns**

Buy	:	> 25%
Out Performer	:	16 - 25%
Market Performer	:	0 - 15%
Under Performer	:	< 0%

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