

Strong FCF; Positive surprise on margins ...

About the stock: Tata Communications (TCOM) is the leading global digital ecosystem enabler.

- It provides its clientele with state-of-the-art solutions, including a wide range of communication, collaboration, cloud, mobility, connected solutions, network and data center services

Q1FY23 Results: TCOM performance was marked by positive surprise on margins front and strong cash flow generation

- Topline came in at ₹ 4311 crore, up 5.1% YoY & up 1.1% QoQ, with data revenues up ~7.6% YoY (up 1.2% QoQ) at ₹ 3340 crore.
- EBITDA margin was at 25% (up 95 bps YoY and up 47 bps QoQ), possibly owing to some benefit of US\$ appreciation. Data EBITDA margin was at 29%, down 30 bps QoQ. The company reported a PAT of ₹ 544 crore, up 83.6% YoY, aided by higher other income (the majority of which included tax refunds and interest on the same) and lower depreciation and interest costs. There was also sequential decline in net debt by ~₹ 812 crore QoQ on the back of a healthy FCF.

What should investors do? TCOM share price has grown at ~12% CAGR over the past five years.

- We maintain **BUY** on the company

Target Price and Valuation: We value TCOM at a target price of ₹ 1260

Key triggers for future price performance:

- Growth will be driven by platforms viz. a) cloud, edge & security b) next generation connectivity c) NetFoundry d) *MOVE & IoT*, wherein each having robust market size growth potential of 15-25% CAGR over the next 4-5 years
- We expect ~9.4% revenue CAGR in FY22-24E in the overall data segment, driven by likely acceleration in growth from H2FY23 onwards. We expect overall margins to be at 25% in FY24 vs. 25.3% in FY22, with some weakness likely in FY23. Strong cash flows generation to aid deleveraging

Alternate Stock Idea: Besides TCOM, we like Bharti Airtel in telecom space

- A play on superior operating metric amid telecom sector consolidation
- BUY with a target price of ₹ 860

TATA COMMUNICATIONS

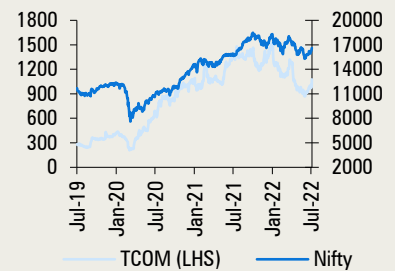
Particulars

Particulars	Amount
Market Capitalization	₹ 30697.4 Crore
Total Debt (FY22)	₹ 7921 Crore
Inv & Cash (FY22)	₹ 1176.2 Crore
EV	₹ 42226.8 Crore
52 week H/L	1592/ 856
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoters	58.9	58.9	58.9	58.9
DII	7.2	8.4	11.1	12.7
FII	23.5	21.6	19.4	17.9
Other	10.5	11.2	10.7	10.6

Price Chart



Key risks

Key Risk: (i) Delay in revenue growth recovery; (ii) Sustained margin weakness

Research Analyst

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	5 yr CAGR (FY17-22)	FY23E	FY24E	2 yr CAGR (FY22-24E)
Net Sales	16,525.0	17,068.0	17,100.1	16,724.7	(0.6)	17,787.4	19,426.2	7.8
EBITDA	2,744.9	3,289.0	4,260.6	4,226.7	12.1	4,325.0	4,856.6	7.2
PAT	(82.4)	(86.0)	1,250.6	1,481.8	0.3	1,580.3	1,794.5	10.0
P/E (x)	NM	NM	24.5	20.7		19.4	17.1	
Price / Book (x)	NM	NM	265.9	33.1		16.9	10.6	
EPS (₹)	(2.9)	(3.0)	43.9	52.0		55.5	63.0	
EV/EBITDA (x)	14.4	12.8	9.7	9.3		8.8	7.6	
RoCE (%)	7.3	10.6	20.7	26.5		27.7	30.8	
RoE (%)	NM	NM	NM	NM		86.9	62.2	

Key performance highlight and outlook

Guidance & Outlook

- The management maintained FY23 margins guidance range of 23-25%. However, they also stated that higher travel and admin costs will accrue, going ahead with reopening of offices. We, however, expect margins to bounce back in FY24, driven by revenues growth recovery.
- Growth funnel (pre stage of Order Book) have increased, deal win rate has improved along with order book growth of healthy double digits. The company intends to drive growth by enhanced product offerings in next gen connectivity, IZO WAN, cloud etc. It has also put feet on street with new hiring and expanded regional presence through sales and marketing spends.
- It is currently facing challenges due to supply chain issues (also impacted by Russia Ukraine conflicts) which has worsened OEM lead time delay by ~5x from normal 12-16 weeks. Thus, it expects step up growth only once supply chain issues get sorted. The Supply chain issue and delayed deliveries has also led to lower capex in Q1.

Data business Performance

- Revenue was up 7.6% YoY, 1.2% QoQ at ₹ 3340 crore, reflecting gradual revenue recovery is underway. Incubation services and Digital Platforms segment of Data business witnessed healthy growth. EBITDA was at ₹ 969 crore (up 4% YoY and flattish QoQ) with a margin of 29%, down 100 bps YoY and down 30 bps QoQ.

Core Connectivity (erstwhile Traditional services)

- Revenue for the quarter was up 3.6% YoY and 1% QoQ at ₹ 2311 crore. EBITDA margin was at 42.5% (flattish QoQ and YoY). **We note that in the medium term, the company expects to grow in mid-single digits vs. flattish growth expected for the overall market in the segment.**

Digital Platforms & Services (erstwhile Growth services)

- Revenue for the quarter came in at ₹ 940 crore, up 0.9% QoQ and 12.3% YoY. For Q1, collaboration revenue was down 3.1% YoY/3.4% QoQ due to lower usage based revenues. Cloud, hosting and security was up 24.1%YoY/ up 9.4% QoQ. Next gen connectivity and media revenue was up 15.6% and 40.9% YoY, respectively. QoQ decline in Next gen connectivity was seen due to onetime revenue in Q4. EBITDA for the quarter came in at ₹ 66.7 crore, with margins at 7.1%, down 190 bps YoY. **The company expects SIP revenue (usage based) recovery only after couple of quarters. In the collaboration segment, CPAAS has been launched. The company is witnessing good conversation and funnel building up in the same. The management reiterated that underlying trends are positive for this business.**

Incubation (erstwhile Innovation services)

- Revenue for the quarter were up 140.7% YoY and 9.9% QoQ to ₹ 80.8 crore, on the back of new deal wins and scale up of usage in existing accounts. EBITDA loss was at ₹ 80 crore. **The company has historically indicated that potential in the incubation segment is huge. It has so far focused on limited use cases in IOT viz. worker safety, material, smart street lighting. Going ahead, with growth in Net Foundry, with more use case in MOVE/IOT and newer segments, it expects to scale up the overall presence.**

Transformation services (TCTSL)

- Revenue (net of inter-segmental eliminations) for the quarter was down 4% YoY and 5% QoQ to ₹ 317 crore. The company reported EBITDA of ₹ 15.6 crore vs. losses in base quarter.

Payment solutions (TCPSL)

- Q1 revenue came in at ₹ 42.5 crore, up 17.1% YoY and 3.4% QoQ. The business continues to be affected by COVID, though the franchise model is

making steady progress. Average daily transactions for Q1 FY23 were 49 as compared to 59 in Q1 FY22. EBITDA for the quarter was ₹ 1.2 crore, lower on account of higher CRA expenses.

Voice business:

- Revenue for the quarter came in at ₹ 561 crore, down 4.7% YoY, on account of a decline in overall voice volume which came in at 3.3 billion (bn) minutes, a decline of ~23% YoY, up ~4.2% QoQ. Realisations were up ~23.6% YoY to ₹1.69/minute. Voice margins for the quarter came in at 11%, up 400 bps QoQ.

Capex and Debt:

- Capex for the quarter was at ₹ 346 crore (cash capex 329 crore) vs. ₹ 434 crore in Q4. FCF was ₹ 955 crore (vs. 611 crore in Q4). Going ahead, Capex guidance is US\$ 300-325 mn in FY23 with most of the capex is growth led and for revamping and expanding the undersea cable. The company indicated that it would not shy to increase capex, if the growth trajectory is higher. **Net Debt at the end of the quarter was ₹ 6134 crore, down by ₹ 812 crore QoQ, on the back of robust operating free cash flow generation and dividend pay-out scheduled for Q2. The Net Debt to EBITDA stood at comfortable levels of 1.4x vs. 1.6x in Q4.**

Others:

- As Assets held for sale, company has put on block - 10-11 real estate properties. Two of them have been sold and sales consideration is expected in Q2. The company did not quantify the expected value of assets to be sold.

Outlook and valuations

The company's strategic growth plan, focused approach and structural improvement in data segment margins has driven multiple re-rating. While deal closures delays and supply chain issues has led to slower recovery in revenues, demand outlook is robust in the medium/long term. Furthermore, stable performance and improved cash flow generation, deleveraging possibilities and improved return ratios bode well for the company.

With cash flow generation consistency and growth levers like cloud, edge & security, IOT etc., we remain constructive on the company. We maintain BUY with a target price of ₹ 1260/share, at 20x FY24 P/E.

Exhibit 1: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	Q4FY22	YoY (%)	QoQ (%)	Comments
Revenue	4,310.5	4,303.4	4,102.8	4,263.0	5.1	1.1	The data revenues was up ~7.6% YoY (up 1.2% QoQ) at ₹ 3340 crore. Voice segment continued to remain weak with revenues at ₹ 561 crore, down 4.7% YoY, on account of a decline in overall voice volume
Other Income	234.0	25.0	13.4	263.5	1,652.7	-11.2	Majorly included tax refunds and interest on the same
Employee Expenses	806.7	783.2	809.7	768.4	-0.4	5.0	
Administrative Expenses	868.8	903.7	745.2	908.9	16.6	-4.4	
Network costs	1,558.0	1,612.5	1,561.9	1,540.4	-0.2	1.1	
EBITDA	1,077.0	1,004.0	986.1	1,045.3	9.2	3.0	
EBITDA Margin (%)	25.0	23.3	24.0	24.5	95 bps	47 bps	
Depreciation	536.9	590.0	531.8	588.7	1.0	-8.8	
Interest	79.9	99.1	96.2	89.8	-17.0	-11.0	
Exceptional Items	0.0	0.0	-5.6	20.9	0.0	NM	
Total Tax	159.1	74.8	79.3	243.3	100.8	-34.6	
PAT	543.8	264.6	296.1	365.1	83.6	49.0	
Total Minutes (in billion)	3.3	3.5	4.3	3.2	-22.9	4.2	
GDS Revenues	3,340	3,350	3,104	3,301	7.6	1.2	

Source: Company, ICICI Direct Research

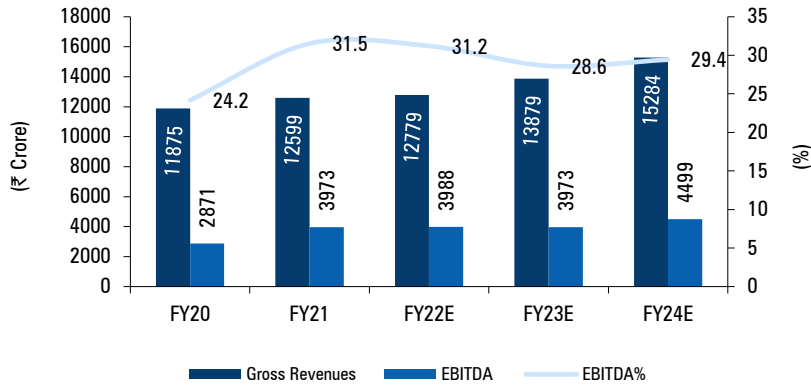
Exhibit 2: Change in estimates

₹ Crore)	FY23E			FY24E			
	Old	New	% Change	Old	New	% Change	
Revenue	17,912.1	17,787.4	-0.7	19,551.8	19,426.2	-0.6	Realign estimates
EBITDA	4,303.9	4,325.0	0.5	4,888.0	4,856.6	-0.6	
EBITDA Margin (%)	24.0	24.3	29 bps	25.0	25.0	0 bps	
PAT	1,367.8	1,580.3	15.5	1,782.1	1,794.5	0.7	
EPS (₹)	48.0	55.5	15.5	62.5	63.0	0.7	

Source: Company, ICICI Direct Research

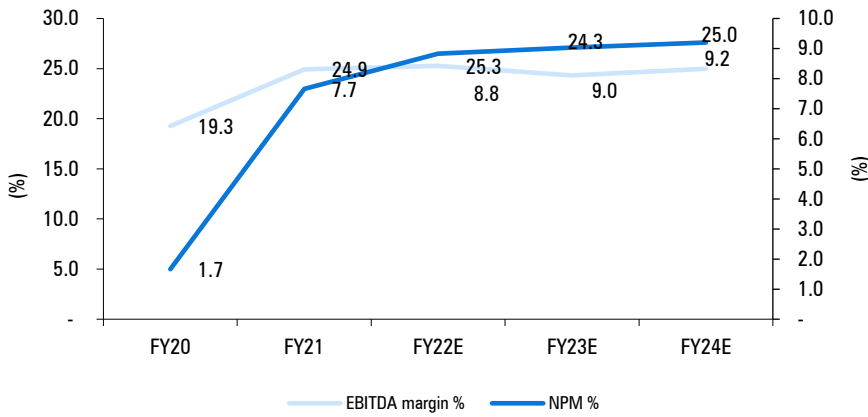
Financial story in charts

Exhibit 3: Global data services operating performance



Source: Company, ICICI Direct Research

Exhibit 4: EBITDA and NPM margins trend



Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Total operating Income	17100.1	16724.7	17787.4	19426.2
Growth (%)	0.2	(2.2)	6.4	9.2
Employee Expenses	3049.1	3040.3	3259.5	3438.4
Network costs	6333.3	6199.5	6638.8	7304.3
Administrative Expenses	3457.2	3258.2	3564.2	3827.0
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	12839.5	12498.0	13462.4	14569.7
EBITDA	4260.6	4226.7	4325.0	4856.6
Growth (%)	29.5	-0.8	2.3	12.3
Depreciation	2313.9	2204.5	2259.0	2331.1
Interest	420.2	360.3	347.5	326.6
Other Income	156.8	332.1	309.0	140.0
Exceptional Items	74.7	-6.0	0.0	0.0
PBT	1608.6	2000.0	2027.4	2338.8
Minority Interest	0.9	2.9	4.4	5.0
PAT from Associates	-2.1	6.8	21.7	22.0
Total Tax	354.9	522.1	464.4	561.3
PAT	1250.6	1481.8	1580.3	1794.5
Growth (%)	NM	18.5	6.7	13.6
Adjusted PAT	1308.9	1477.4	1580.3	1794.5
Growth (%)	361.0	12.9	7.0	13.6
EPS (₹)	43.9	52.0	55.5	63.0

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit after Tax	1250.6	1481.8	1580.3	1794.5
Add: Depreciation	2313.9	2204.5	2259.0	2331.1
Add: Interest Paid	420.2	360.3	347.5	326.6
(Inc)/dec in Current Assets	736.7	-65.2	-242.7	-374.3
Inc/(dec) in CL and Provisions	-784.4	-40.5	399.2	670.0
Others	0.0	0.0	0.0	0.0
CF from operating activities	3937.0	3940.9	4343.3	4747.9
(Inc)/dec in Investments	-670.3	668.1	-50.0	-50.0
(Inc)/dec in Fixed Assets	-1452.8	-2167.6	-2300.0	-2300.0
Others	-773.9	484.9	-235.6	-235.0
CF from investing activities	-2897.0	-1014.6	-2585.6	-2585.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-745.0	-2080.1	-1200.0	-1000.0
Less: Interest Paid	-420.2	-360.3	-347.5	-326.6
Less: Dividend and dividend tax	-135.7	-399.0	-590.0	-627.0
Others	278.9	-270.6	-100.0	-100.0
CF from financing activities	-1022.0	-3109.9	-2237.5	-2053.6
Net Cash flow	18.0	-183.7	-479.8	109.3
Opening Cash	909.1	927.1	743.4	263.6
Closing Cash	927.1	743.4	263.6	372.9

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Liabilities				
Equity Capital	285.0	285.0	285.0	285.0
Preference Share Capital	0.0	0.0	0.0	0.0
Reserve and Surplus	-169.5	642.6	1,533.0	2,600.5
Total Shareholders funds	115.5	927.6	1,818.0	2,885.5
Total Debt	10,001.0	7,921.0	6,721.0	5,721.0
Others	4,304.0	3,947.0	3,711.4	3,476.4
Total Liabilities	14,420.5	12,795.6	12,250.3	12,082.8
Assets				
Gross Block	38,321.3	40,104.7	42,404.7	44,704.7
Less: Acc Depreciation	28,147.2	30,351.8	32,610.8	34,941.9
Net Block	10,174.1	9,752.9	9,793.9	9,762.8
Capital WIP	394.5	778.7	778.7	778.7
Total Fixed Assets	10,568.5	10,531.6	10,572.6	10,541.5
Investments	2,233.4	1,565.2	1,615.2	1,665.2
Goodwill on Consolidation	110.3	108.3	108.3	108.3
Inventory	34.4	37.9	40.3	44.0
Debtors	2,607.7	2,582.1	2,746.2	2,999.2
Loans and Advances	235.8	232.0	246.7	269.5
Other Current Assets	876.5	967.6	1,029.1	1,123.9
Cash	927.1	743.4	263.6	372.9
Total Current Assets	4,681.5	4,563.0	4,325.9	4,809.5
Creditors	3,239.5	3,006.5	3,167.6	3,459.5
Provisions	688.1	766.6	807.7	882.2
Other current liabilities	2,985.3	3,099.3	3,296.2	3,599.9
Total Current Liabilities	6,912.9	6,872.4	7,271.6	7,941.5
Net Current Assets	-2,231.4	-2,309.4	-2,945.6	-3,132.0
Other non current assets	3,739.7	2,899.8	2,899.8	2,899.8
Application of Funds	14,420.5	12,795.6	12,250.3	12,082.8

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios				
(Year-end March)	FY21	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	43.9	52.0	55.5	63.0
Adj. EPS	45.9	51.8	55.5	63.0
BV	4.1	32.5	63.8	101.2
DPS	4.8	14.0	20.7	22.0
Cash Per Share	32.5	26.1	9.2	13.1
Operating Ratios (%)				
EBITDA Margin	24.9	25.3	24.3	25.0
PBT / Total Operating income	11.4	12.1	11.6	13.0
PAT Margin	7.7	8.8	8.9	9.2
Inventory days	0.7	0.8	0.8	0.8
Debtor days	55.7	56.4	56.4	56.4
Creditor days	69.1	65.6	65.0	65.0
Return Ratios (%)				
RoE	NM	159.3	86.9	62.2
RoCE	20.7	26.5	27.7	30.8
RoIC	17.8	18.5	18.7	22.8
Valuation Ratios (x)				
P/E	24.5	20.7	19.4	17.1
EV / EBITDA	9.7	9.3	8.8	7.6
EV / Net Sales	2.4	2.3	2.1	1.9
Market Cap / Sales	1.8	1.8	1.7	1.6
Price to Book Value	265.9	33.1	16.9	10.6
Solvency Ratios				
Net Debt/EBITDA	1.8	1.6	1.4	1.0
Debt / Equity	86.6	8.5	3.7	2.0
Current Ratio	1.0	1.0	1.0	1.0
Quick Ratio	0.9	1.0	1.0	1.0

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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