

Steady show...

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

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

Q2FY23 Results: TCOM reported a steady quarter.

- Topline at ₹ 4431 crore, was up 6.2% YoY & 2.8% QoQ, driven by data revenues up ~11.2% YoY & 4.6% QoQ) at ₹ 3493 crore
- EBITDA came in at ₹ 1130 crore, up 1.5% YoY, 4.9% QoQ. The consequent margin was at 25.5% (down 117 bps YoY, up 51 bps QoQ) led by voice margins, which were at 19.3%, up 890 bps due to India market shift (short term in nature). Core consolidated margins were 24%. Data EBITDA margin was at 28.8%, down 20 bps QoQ. The company reported a PAT of ₹ 532 crore, up 25% YoY, aided by one offs (profit on sale of properties - ₹ 46.7 crore & provision reversal - ₹ 29.7 crore) and lower taxes

What should investors do? TCOM's share price has grown at ~15% CAGR over the past five years.

- We change our rating from BUY to **HOLD** after a run up of ~22% in the stock price in the last three months and given the management's non-committal guidance on growth acceleration timelines

Target Price and Valuation: We value TCOM at a target price of ₹ 1270.

Key triggers for future price performance:

- Growth will be driven by platforms viz. a) cloud, edge & security, b) next generation connectivity, c) NetFoundry, **MOVE & IoT**, wherein each have robust market size growth potential of 15-25% CAGR in next four to five years
- We expect ~10% revenue CAGR in FY22-25E in the overall data segment and overall margins at 25.5% in FY25 vs. 25.3% in FY22, with weakness likely in H2FY23. Strong cash flows generation to aid deleveraging

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

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

TATA COMMUNICATIONS

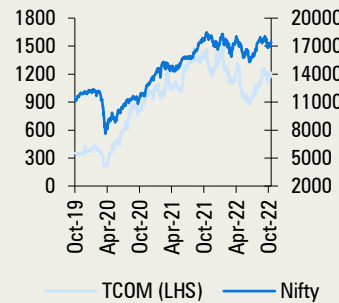
Particulars

Particulars	Amount
Market Capitalization	₹ 34503.5 Crore
Total Debt (FY22)	₹ 7921 Crore
Inv & Cash (FY22)	₹ 1176.2 Crore
EV	₹ 46033 Crore
52 week H/L	1592/ 856
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	58.9	58.9	58.9	58.9
DII	8.4	11.1	12.7	13.6
FII	21.6	19.4	17.9	17.0
Other	11.2	10.7	10.6	10.5

Price Chart



Key risks

Key Risk: (i) Delay in revenue growth recovery; (ii) Better than expected margins

Research Analyst

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Key Financial Summary

(₹ Crore)	FY20	FY21	FY22	5 yr CAGR (FY17-22)	FY23E	FY24E	FY25E	3 yr CAGR (FY22-25E)
Net Sales	17,068.0	17,100.1	16,724.7	(0.6)	17,818.7	19,444.5	21,355.0	8.5
EBITDA	3,289.0	4,260.6	4,226.7	12.1	4,448.7	4,861.1	5,445.5	8.8
PAT	(86.0)	1,250.6	1,481.8	0.3	1,834.3	1,807.4	2,158.3	13.4
P/E (x)	NM	27.6	23.3		18.8	19.1	16.0	
Price / Book (x)	NM	298.7	37.2		16.6	10.9	7.5	
EPS (₹)	(3.0)	43.9	52.0		64.4	63.4	75.7	
EV/EBITDA (x)	14.0	10.6	10.1		9.4	8.3	7.1	
RoCE (%)	10.6	20.7	26.5		27.7	29.1	32.2	
RoE (%)	NM	NM	NM		85.6	57.3	47.1	

Key performance highlight and outlook

Outlook

- The management maintained FY23 margins guidance range of 23-25% as they intend to reinvest incremental margins to drive growth. We, however, expect margins to bounce back once the revenues growth trajectory returns to double digits boosting operating leverage
- Growth funnel (pre stage of order book) deal win rate along with order book have remained stable QoQ and healthy. The company intends to drive growth by enhanced product offerings in next gen connectivity, IZO WAN, cloud etc. It also continues to put feet on street with new hiring and expanded regional presence through sales and marketing spends
- The company indicated that supply chain issues continue to remain but it is trying to tackle it through advance ordering. The supply chain issue and delayed deliveries have also led to lower capex in Q1 and Q2. However, TCOM is now treating supply chain issue as business as usual. We believe that full blown recovery in revenues growth will only be possible when the supply chain issues get sorted

Data business performance

- Revenue was up 4.6% QoQ, 11.2% YoY at ₹ 3493 crore, reflecting a gradual revenue recovery is under way. Incubation services and Digital Platforms segment of data business witnessed strong growth. Data EBITDA was at ₹ 1007 crore (up 3.9% QoQ, down 4% YoY) with a margin of 28%, down 20 bps QoQ and down 460 bps YoY

Core connectivity (erstwhile traditional services)

- Revenue for the quarter was up 2.7% QoQ, 4.2% YoY at ₹ 2374 crore. EBITDA margin was at 46.6% (up 410 bps QoQ, 70 bps 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. It expects to focus on network transformations to meet new markets needs to drive this segment**

Digital Platforms & Services (erstwhile Growth services)

- Revenue for the quarter came in at ₹ 998 crore, up 6.1% QoQ, 10.7% YoY. For Q2, collaboration revenue was 2.8% QoQ, 2.5% YoY with SIP trunking (usage based) revenues still soft while new CPAAS offerings such as **GlobalRapid**, **DIGO**, etc. have done well. Cloud, hosting and security was up 5.8% QoQ, 13.5% YoY led by broader and multi cloud offerings. Next gen connectivity (healthy growth due to IZO internet and SD WAN variant) and media revenue (led by global sports events and global edge opportunities) was up 15.3% QoQ, 19.9% YoY and 5.7% QoQ, 18.4% YoY, respectively. The company reported EBITDA loss of ~₹ 17 crore. **The management reiterated that underlying trends are positive for this business across the segments**

Incubation (erstwhile Innovation services)

- Revenue for the quarter were up 36.1% QoQ and 122.9% YoY to ₹ 120.8 crore, on the back of new deal wins and scale up of usage in existing accounts. EBITDA loss was at ₹ 82.5 crore. **The company has a three-pronged strategy with respect to connected solution – a) On campus – enterprise IOT solutions and smart cities; b) leveraging private network and c) Off campus - MOVE platform aiding solution and platforms like connected vehicles, smart manufacturing etc.**

Transformation services (TCTSL)

- Revenue (net of inter-segmental eliminations) for the quarter was up 1.4% QoQ and 2.8% YoY to ₹ 322 crore. The company reported EBITDA of ₹ 5.2 crore vs. losses in the base quarter

Payment solutions (TCPSL)

- Q2 revenue came in at ₹ 45.8 crore, up 4.1% QoQ and 5.2% YoY. The franchise model is making steady progress. EBITDA losses for the quarter was ₹ 1.7 crore

Voice business:

- Revenue for the quarter came in at ₹ 524 crore, down 13.5% YoY, on account of a decline in overall voice volume, which came in at 2.9 billion (bn) minutes, a decline of ~27% YoY. Realisations were up ~18.6% YoY to ₹ 1.8/minute. **Voice margins for the quarter came in at 19.3%, up 830 bps QoQ, aided by India market shift aiding realisations, which is short-term in nature, as per the company**

Capex and debt:

- Capex for the quarter was at ₹ 421 crore (cash capex 324 crore) vs. ₹ 346 crore in Q1. FCF was ₹ 617 crore (vs. 667 crore in Q2FY22). Going ahead, capex guidance is US\$300-325 mn in FY23 with most of the capex being growth led and for revamping and expanding the undersea cable. The actual capex continues to be lower than committed owing to supply chain issues. **There was a sequential increase in net debt by ~₹ 266 crore QoQ, to ₹ 6400 crore, owing to payment of dividends during the quarter (₹ 591 crore). The net debt to annualised EBITDA was at comfortable levels of 1.5x compared to 1.4x in Q1FY23**

Others:

- The company, during the quarter, completed monetisation of two small land assets, which resulted in profit on sale of properties of ₹ 46.7 crore

Outlook and valuations

The company's strategic growth plan, focused approach and structural improvement in data segment margins has driven multiple re-rating. While the demand outlook is robust in the medium/long term, deal closures delays and supply chain issues have led to a slower recovery in revenues.

We change our rating from BUY to HOLD after a run up of ~22% in the stock price in the last three months and given the management's non-committal guidance on growth acceleration timelines. We assign a target price of ₹ 1270/share, at 20x FY24 P/E.

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	Q1FY23	YoY (%)	QoQ (%)	Comments
Revenue	4,430.8	4,402.1	4,174.0	4,310.5	6.2	2.8	Revenue was up 4.6% QoQ, 11.2% YoY at ₹ 3493 crore, reflecting gradual revenue recovery is underway. Incubation services and Digital Platforms segment of Data business witnessed strong growth. Voice segment continued to remain weak with revenues at ₹ 524 crore, down 13.5% YoY, on account of a decline in overall voice volume which came in at 2.9 billion (bn) minutes, a decline of ~27% YoY. Realisations were up ~18.6% YoY to ₹1.8/minute.
Other Income	36.6	25.0	36.4	234.0	0.5	-84.3	
Employee Expenses	870.4	823.2	728.5	806.7	19.5	7.9	
Administrative Expenses	867.9	880.4	765.7	868.8	13.4	-0.1	
Network costs	1,562.9	1,606.8	1,567.0	1,558.0	-0.3	0.3	
EBITDA	1,129.7	1,091.7	1,112.9	1,077.0	1.5	4.9	
EBITDA Margin (%)	25.5	24.8	26.7	25.0	-117 bps	51 bps	
Depreciation	551.6	559.1	541.6	536.9	1.9	2.8	
Interest	97.8	90.1	90.8	79.9	7.7	22.4	
Exceptional Items	-76.4	0.0	-12.7	0.0	0.0	NM	
Total Tax	65.9	107.1	103.8	159.1	-36.5	-58.6	
PAT	532.3	363.4	425.4	543.8	25.1	-2.1	
Total Minutes (in billion)	2.9	3.8	4.0	3.3	-27.0	-12.4	
GDS Revenues	3,493	3,409	3,140	3,340	11.2	4.6	

Source: Company, ICICI Direct Research

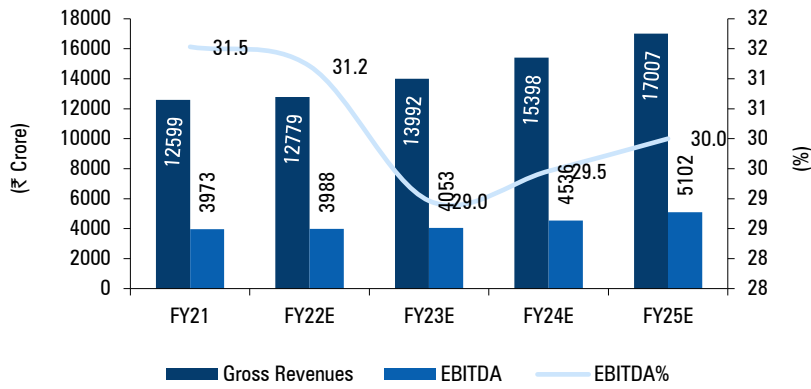
Exhibit 2: Change in estimates

(₹ Crore)	FY23E			FY24E			FY25E	Introduced
	Old	New	% Change	Old	New	% Change		
Revenue	17,787.4	17,818.7	0.2	19,426.2	19,444.5	0.1	21,355.0	Realign estimates
EBITDA	4,325.0	4,448.7	2.9	4,856.6	4,861.1	0.1	5,445.5	
EBITDA Margin (%)	24.3	25.0	65 bps	25.0	25.0	0 bps	25.5	
PAT	1,580.3	1,834.3	16.1	1,794.5	1,807.4	0.7	2,158.3	
EPS (₹)	55.5	64.4	16.1	63.0	63.4	0.7	75.7	

Source: Company, ICICI Direct Research

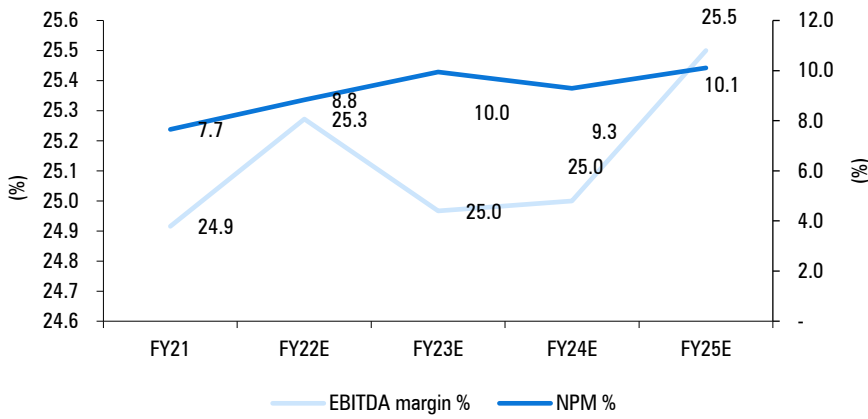
Financial story in charts

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)	FY22	FY23E	FY24E	FY25E
Total operating Income	16724.7	17818.7	19444.5	21355.0
Growth (%)	(2.2)	6.5	9.1	9.8
Employee Expenses	3040.3	3451.6	3597.2	3843.9
Network costs	6199.5	6366.2	7194.5	7901.3
Administrative Expenses	3258.2	3552.2	3791.7	4164.2
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	12498.0	13370.0	14583.4	15909.5
EBITDA	4226.7	4448.7	4861.1	5445.5
Growth (%)	-0.8	5.3	9.3	12.0
Depreciation	2204.5	2227.3	2294.5	2455.8
Interest	360.3	369.1	364.2	336.7
Other Income	332.1	330.6	144.0	150.0
Exceptional Items	-6.0	-76.4	0.0	0.0
PBT	2000.0	2259.2	2346.5	2803.0
Minority Interest	2.9	7.0	8.0	8.0
PAT from Associates	6.8	29.6	32.0	36.0
Total Tax	522.1	447.5	563.2	672.7
PAT	1481.8	1834.3	1807.4	2158.3
Growth (%)	18.5	23.8	-1.5	19.4
Adjusted PAT	1477.4	1773.1	1807.4	2158.3
Growth (%)	12.9	20.0	1.9	19.4
EPS (₹)	52.0	64.4	63.4	75.7

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement				
	₹ crore			
(Year-end March)	FY22E	FY23E	FY24E	FY25E
Profit after Tax	1481.8	1834.3	1807.4	2158.3
Add: Depreciation	2204.5	2227.3	2294.5	2455.8
Add: Interest Paid	360.3	369.1	364.2	336.7
(Inc)/dec in Current Assets	-65.2	-249.8	-371.3	-436.3
Inc/(dec) in CL and Provisions	-40.5	412.0	664.6	781.0
Others	0.0	0.0	0.0	0.0
CF from operating activities	3940.9	4592.9	4759.3	5295.5
(Inc)/dec in Investments	668.1	-50.0	-50.0	-50.0
(Inc)/dec in Fixed Assets	-2167.6	-2300.0	-2300.0	-2300.0
Others	484.9	-233.0	-232.0	-238.0
CF from investing activities	-1014.6	-2583.0	-2582.0	-2588.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-2080.1	-800.0	-1000.0	-1000.0
Less: Interest Paid	-360.3	-369.1	-364.2	-336.7
Less: Dividend and dividend tax	-399.0	-590.0	-627.0	-627.0
Others	-270.6	-100.0	-100.0	-100.0
CF from financing activities	-3109.9	-1859.0	-2091.2	-2063.7
Net Cash flow	-183.7	150.9	86.1	643.8
Opening Cash	927.1	743.4	894.3	980.4
Closing Cash	743.4	894.3	980.4	1624.2

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
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	642.6	1,787.0	2,867.3	4,298.6
Total Shareholders funds	927.6	2,072.0	3,152.3	4,583.6
Total Debt	7,921.0	7,121.0	6,121.0	5,121.0
Others	3,947.0	3,714.0	3,482.0	3,244.0
Total Liabilities	12,795.6	12,907.0	12,755.3	12,948.7
Assets				
Gross Block	40,104.7	42,404.7	44,704.7	47,004.7
Less: Acc Depreciation	30,351.8	32,579.1	34,873.6	37,329.4
Net Block	9,752.9	9,825.6	9,831.1	9,675.3
Capital WIP	778.7	778.7	778.7	778.7
Total Fixed Assets	10,531.6	10,604.3	10,609.8	10,454.0
Investments	1,565.2	1,615.2	1,665.2	1,715.2
Goodwill on Consolidation	108.3	108.3	108.3	108.3
Inventory	37.9	40.4	44.0	48.4
Debtors	2,582.1	2,751.0	3,002.0	3,297.0
Loans and Advances	232.0	247.2	269.7	296.2
Other Current Assets	967.6	1,030.9	1,125.0	1,235.5
Cash	743.4	894.3	980.4	1,624.2
Total Current Assets	4,563.0	4,963.7	5,421.2	6,501.3
Creditors	3,006.5	3,173.2	3,462.7	3,802.9
Provisions	766.6	809.2	883.0	969.7
Other current liabilities	3,099.3	3,302.0	3,603.3	3,957.3
Total Current Liabilities	6,872.4	7,284.4	7,949.0	8,730.0
Net Current Assets	-2,309.4	-2,320.6	-2,527.8	-2,228.7
Other non current assets	2,899.8	2,899.8	2,899.8	2,899.8
Application of Funds	12,795.6	12,907.0	12,755.3	12,948.7

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
EPS	52.0	64.4	63.4	75.7
Adj. EPS	51.8	62.2	63.4	75.7
BV	32.5	72.7	110.6	160.8
DPS	14.0	20.7	22.0	22.0
Cash Per Share	26.1	31.4	34.4	57.0
Operating Ratios (%)				
EBITDA Margin	25.3	25.0	25.0	25.5
PBT / Total Operating income	12.1	12.5	13.2	14.0
PAT Margin	8.8	10.0	9.3	10.1
Inventory days	0.8	0.8	0.8	0.8
Debtor days	56.4	56.4	56.4	56.4
Creditor days	65.6	65.0	65.0	65.0
Return Ratios (%)				
RoE	159.3	85.6	57.3	47.1
RoCE	26.5	27.7	29.1	32.2
RoIC	18.5	20.0	23.0	27.0
Valuation Ratios (x)				
P/E	23.3	18.8	19.1	16.0
EV / EBITDA	10.1	9.4	8.3	7.1
EV / Net Sales	2.6	2.3	2.1	1.8
Market Cap / Sales	2.1	1.9	1.8	1.6
Price to Book Value	37.2	16.6	10.9	7.5
Solvency Ratios				
Net Debt/EBITDA	1.6	1.3	1.0	0.6
Debt / Equity	8.5	3.4	1.9	1.1
Current Ratio	1.0	1.0	1.0	1.0
Quick Ratio	1.0	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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