

## Robust operating performance...

Tata Communication reported a better-than-expected Q4FY20 on the operating front led by superior revenues and margins in the data segment. Topline was at ₹ 4398 crore, up 3.6% YoY, 4% QoQ, led by superior data revenues (forming ~82% of revenues) that grew 7.5% YoY. EBITDA came in at ₹ 868.8 crore, up 26.8% YoY, with margins at 19.8% (up 360 bps YoY) driven superior data margins of 22.9% (up 530 bps YoY). The company reported a loss of ₹ 275 crore vs. expectation of ₹ 40 crore profit, due to exception charge of ₹ 378.1 crore (provision of ₹ 341.6 crore towards additional license fees liability, ₹ 36.5 crore towards staff cost optimisation).

## Data segment drives strong beat

Data business continued to witness healthy traction with strong margin turnaround in growth and stable trajectory in traditional services driving the profitability. The company witnessed strong 9.8% YoY, 9.1% QoQ revenue uptick in the growth segment driven by a surge in conferencing traffic. Margins expanded 510 bps QoQ to 11.6%, recording double digit margin for the first time. They also guided for double digit growth in data revenue and EBITDA growth in the medium term and would be sharing their strategic outlook later this month. We conservatively bake in 7.3% revenue CAGR over FY20-22E in the overall data segment, largely driven by traction in growth and innovation services. We expect data margins to expand to 23% in FY22 vs. 22.1% in FY19, driven by enhanced growth segment margin trajectory and scale/productivity benefits in innovation.

## Covid-19 to boost business

The company indicated that there has been a sharp increase in internet traffic while its UCC and IP traffic were up 20% QoQ, 23% YoY, respectively. It expects work from home (WFH) to be a key medium term trigger for organisations to upgrade their digitisation experience. However, some segments like media vertical may get impacted. Furthermore, there have been some delays in execution of new orders due to delay in procurement of equipment from OEMs.

## Valuation & Outlook

The consistent performance of the data segment is impressive but we await further clarity on strategic growth plans. The rising internet traffic and WFH are structurally positive for the company. We revised our EBITDA estimates upwards by 5%, 10% for FY21, FY22, respectively. However, post the sharp run up of ~130% in the last three months from lows, we believe valuations are full. Thus, we downgrade to **HOLD** (vs. BUY earlier). We assign EV/EBITDA multiple of 7.5x for data and 2x for voice FY22 EBITDA. We deduct ₹ 1541 crore (₹ 54/share) for AGR liability to arrive at our revised target price of ₹ 600/share.

### TATA COMMUNICATIONS

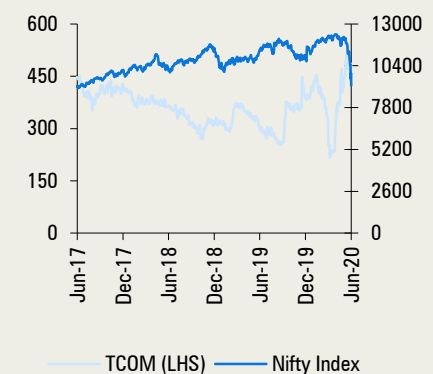
#### Particulars

Particulars	Amount
Market Capitalization	₹ 16488.7 Crore
Total Debt (FY20)	₹ 10746 Crore
Cash (FY20)	₹ 909.1 Crore
EV	₹ 25663.8 Crore
52 week H/L	533/ 206
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

#### Key Highlights

- Reports EBITDA margin at 19.8% (up 360 bps YoY) driven by superior data margins of 22.9% (up 530 bps YoY)
- Downgrade from BUY to HOLD rating, post a sharp run up, valuing it at ₹ 600/share on SoTP basis

#### Price Chart



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#### Key Financial Summary

(₹ Crore)	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY19-22E)
Net Sales	16,650.8	16,525.0	17,068.0	17,726.7	18,668.1	4.6
EBITDA	2,291.4	2,744.9	3,289.0	3,326.0	3,808.3	7.6
Adjusted PAT	46.9	(232.2)	283.9	285.2	536.9	37.5
Adjusted P/E (x)	324.1	NM	53.5	53.3	28.3	
Price / Book (x)	30.4	NM	NM	NM	NM	
Adjusted EPS (₹)	1.6	(8.1)	10.0	10.0	18.8	
EV/EBITDA (x)	9.9	8.8	7.4	7.1	5.9	
RoCE (%)	5.9	5.4	7.8	7.9	12.3	
RoE (%)	9.4	NM	NM	NM	NM	

**Exhibit 1: Variance Analysis**

	Q4FY20	Q4FY20E	Q4FY19	Q3FY20	YoY (%)	QoQ (%)	Comments
Revenue	4,397.9	4,226.4	4,243.5	4,228.7	3.6	4.0	The beat at the topline level was led by superior data revenues (forming ~82% of revenues), which grew 7.5% YoY vs. our expectation of 3% growth
Other Income	37.3	15.0	39.5	14.0	-5.4	7.4	
Employee Expenses	792.2	755.7	768.8	746.2	3.1	1.3	
Administrative Expenses	1,048.2	1,035.5	1,105.1	1,037.7	-5.2	-0.2	
Network costs	1,688.6	1,715.9	1,684.3	1,684.0	0.3	1.9	
Raw Material Expenses	0.0	0.0	0.0	0.0	0.0	0.0	
EBITDA	868.8	719.3	685.3	760.8	26.8	-5.5	The beat at EBITDA level was on account of superior data margins of 22.9% (up 530 bps YoY) and much higher than
EBITDA Margin (%)	19.8	17.0	16.1	18.0	361 bps	176 bps	
Depreciation	686.7	550.9	558.7	560.5	22.9	22.5	Depreciation included ₹ 107 crore towards one-time due to impairment of certain assets and change in life of cable assets as per accounting policy
Interest	123.2	112.9	103.9	116.1	18.6	6.1	
Exceptional Items	378.1	0.0	-0.7	0.0	0.0	0.0	Exception charge included provision of ₹ 341.6 crore towards additional license fees liability and ₹ 36.5 crore
Total Tax	-9.8	31.7	100.7	40.6	-109.8	-124.3	
PAT	-275.0	39.6	-198.8	58.5	38.3	-569.8	
Total Minutes (in billion)	5.4	5.5	6.7	5.5	-19.4	-1.8	
GDS Revenues	3,595	3,446	3,343	3,420	7.5	5.1	

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

₹ Crore)	FY21E			FY22E		
	Old	New	% Change	Old	New	% Change
Revenue	17,295.5	17,878.6	3.4	18,030.7	18,862.2	4.6
EBITDA	3,239.3	3,390.3	4.7	3,505.4	3,866.7	10.3
EBITDA Margin (%)	18.7	19.0	23 bps	19.4	20.5	106 bps
PAT	346.9	369.3	6.5	452.0	616.7	36.4
EPS (₹)	12.2	13.0	6.5	15.9	21.6	36.4

Source: Company, ICICI Direct Research

## Business Highlights

### Voice business:

- Revenue for the quarter came in at ₹ 803 crore, down 10.9% YoY and 0.7% QoQ, on account of a continued slide in voice minutes despite firm realisations for the quarter. We note that a decline in revenue was lower on account of higher usage due to lockdown
- Voice overall volume came in at 5.4 billion (bn) minutes, a decline of 19.4% YoY, 1.8% QoQ. Realisations, on the other hand, were up 10.6% YoY (up 1.1% QoQ) to ₹ 1.49/minute
- Voice margins for the quarter came in at 5.7%, down 500 bps YoY as base quarter margins were aided by one-time settlement benefit

### Data business

- Revenue grew 7.5% YoY, 5.1% QoQ at ₹ 3595 crore, driven by strong growth across all segments. **Enterprise segment (62% of revenues) grew 11.1% in Q4 (~13.2% for FY20) while service providers/carriers revenues were up 2.2% in Q4 (~0.9% for FY20)**
- EBITDA was at ₹ 823 crore with a margin of 22.9%. EBITDA has grown 39.8% YoY, 15.3% QoQ. EBITDA margins expanded 530 bps YoY, driven by profitable growth and cost efficiencies

### Traditional data services

- Revenue for the quarter was up 5.3% YoY, 1.7% QoQ at ₹ 2196 crore. On a normalised basis, revenues grew 4.5% YoY. Within this portfolio, the company witnessed strong uptick in bandwidth usage due to lockdown, leading to IP traffic growth by 23% YoY
- Reported EBITDA came in at ₹ 812 crore, witnessing growth of 24.5% YoY and flat sequential decline with a margin of 37%, up 630 bps YoY on the back of focus on improving productivity and efficiency and Ind-AS benefits. Ex-Ind-AS basis, margin was at 35.6%, up 270 bps. **The company guided for margins at current levels of 37-38%, going ahead, in the traditional segment**

### Growth services:

- Revenue for the quarter came in at ₹ 856 crore, up 9.8% YoY, 9.1% QoQ. Driven by a surge in conferencing traffic in the last few days of the quarter due to lockdown; UCC revenues grew 20% QoQ
- EBITDA for the quarter came in at ₹ 91 crore, which was much higher than ₹ 51 EBITDA reported in Q3 as well as ₹ 42 crore in base quarter, on account of operating leverage. EBITDA margins have expanded by 510 bps QoQ to 11.6%, recording double-digit margins for the first time. **The company expects margins to remain robust in the long term with a slight dip in FY21 and back to double digits in FY22**
- Within growth portfolio, IZO grew 7%, SIP grew 7.8% and UCC grew 20% YoY

### Transformation services:

- Revenue (net of inter-segmental eliminations) grew 14.3% YoY, 10.2% QoQ to ₹ 361 crore
- EBITDA for the quarter came in at negative ₹ 16 crore (vs. negative ₹ 45.6 crore) as the company has been able to shed the onerous customer contract. **The company expects it to hit profitability in FY22**

### Payment solutions:

- Revenue came in at ₹ 82 crore, down 2.9% YoY, 6.2% QoQ, as the company focused on profitability. This business was affected by lockdown as the company witnessed a drop in average daily transactions to 84 in Q4FY20 from 89 in Q3FY20. As a result of the same, EBITDA declined 6.9% QoQ to ₹ 22 crore with EBITDA margin of 27%
- The company closed down net 38 unprofitable ATMs during the quarter

### AGR liability

- TCL had received a demand from Department of Telecommunication (DoT) for ₹ 6633 crore in Q2FY20, towards license fee on AGR. Out of this, ₹ 5434 crore is due to accounting difference on account of accrual basis vs. actual basis. **The contingent liability from AGR was ~₹ 1200 crore as on FY19 end, including interest & penalty**
- During this quarter, the company made a provision of ₹ 342 crore towards additional license fees liability on account of cost deductions as per actual payment
- The company's appeals relating to ILD & NLD licenses are sub-judice right now and pending at the Supreme Court, Madras High Court and are not included in the Supreme Court ruling of October 24, 2019 on AGR

### Other highlights:

- Capex for the quarter was ₹ 340 crore vs. ₹ 490 crore in Q3. For FY20, capex was at ₹ 1596 crore vs. ₹ 1864 crore in FY19. FCF was ₹ 995 crore for FY20 vs. ₹ 211 crore in FY19. **The company guided for similar capex levels for FY21**
- Net debt was US\$1.216 billion, a decline of US\$41 mn QoQ. In rupee terms, net debt was at ₹ 9176 crore, increase of ₹ 211 crore QoQ, which is largely a function of US\$/INR conversion impact as ₹ depreciated 5.8% QoQ. Net debt to EBITDA on TTM basis is 2.8x (vs. 3.1x in FY19). **TCL guided that medium term target is 2.5x**

## Valuations

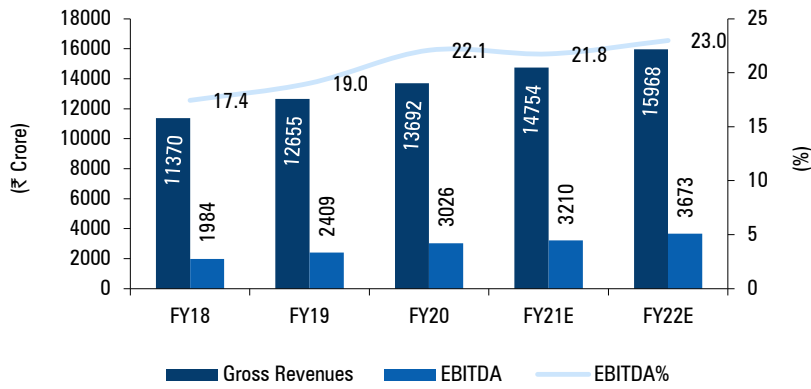
Exhibit 3: Valuations

Particulars	FY22 EBITDA (₹ Crore)	EV/EBITDA (x)	Amount (₹ Crore)
GVS Business Enterprise Value	173.7	2.0	347
GDS Business Enterprise Value	3,672.5	7.5	27,581
Total Enterprise Value			27,928
Less: Net Debt (incl. Lease Liability)			9,275
Less: AGR liability			1,541
Equity Value of the business			17,111
No. of equity shares outstanding (Crore)			28.5
Target Price			600

Source: Company, ICICI Direct Research

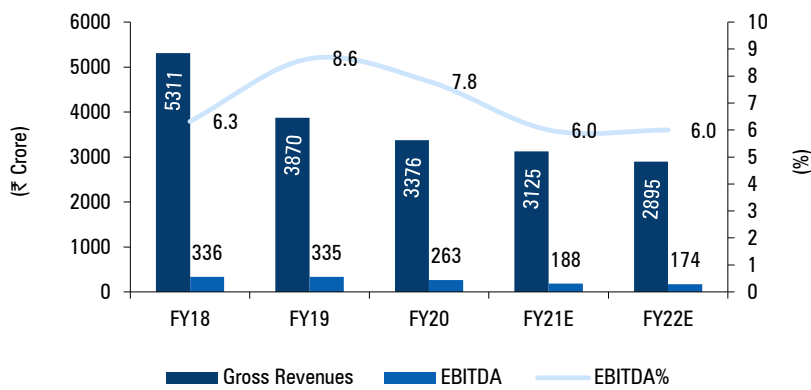
### Financial story in charts

Exhibit 4: Global Data Services operating performance



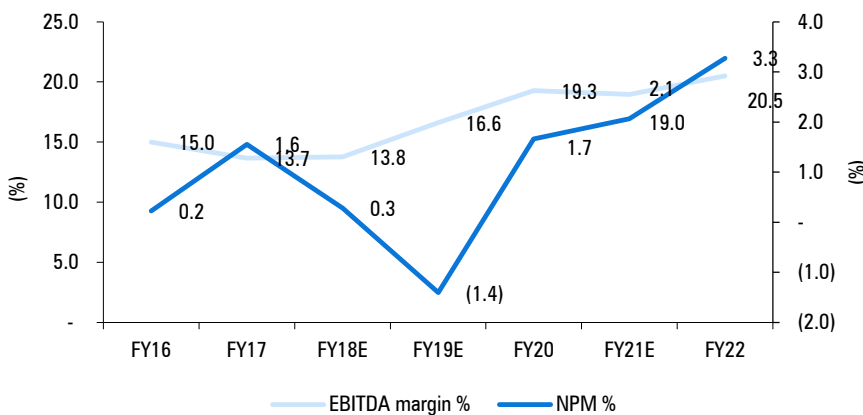
Source: Company, ICICI Direct Research

Exhibit 5: Global voice services operating performance



Source: Company, ICICI Direct Research

Exhibit 6: EBITDA and NPM margins trend



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 7: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Total operating income</b>	<b>16525.0</b>	<b>17068.0</b>	<b>17878.6</b>	<b>18862.2</b>
Growth (%)	(0.8)	3.3	4.7	5.5
Employee Expenses	2959.7	3039.1	3262.7	3395.2
Network costs	7162.0	6777.6	7024.1	7356.2
Administrative Expenses	3658.4	3962.3	4201.5	4244.0
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	13780.1	13779.0	14488.3	14995.4
<b>EBITDA</b>	<b>2744.9</b>	<b>3289.0</b>	<b>3390.3</b>	<b>3866.7</b>
Growth (%)	19.8	19.8	3.1	14.1
Depreciation	2067.6	2357.7	2360.0	2433.2
Interest	396.6	470.7	479.8	470.7
Other Income	60.3	69.7	60.0	60.0
Exceptional Items	-2.2	390.6	0.0	0.0
PBT	343.2	139.7	610.5	1022.8
Minority Interest	1.9	1.1	2.0	2.0
PAT from Associates	-150.3	2.2	5.0	5.0
Total Tax	273.3	226.7	244.2	409.1
<b>PAT</b>	<b>-82.4</b>	<b>-86.0</b>	<b>369.3</b>	<b>616.7</b>
Growth (%)	NM	4.4	-529.6	67.0
<b>Adjusted PAT</b>	<b>-232.2</b>	<b>283.9</b>	<b>369.3</b>	<b>616.7</b>
Growth (%)	NM	NM	30.1	67.0
<b>EPS (₹)</b>	<b>-2.9</b>	<b>-3.0</b>	<b>13.0</b>	<b>21.6</b>

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20E	FY21E	FY22E
Profit after Tax	-82.4	-86.0	369.3	616.7
Add: Depreciation	2067.6	2357.7	2360.0	2433.2
Add: Interest Paid	396.6	470.7	479.8	470.7
(Inc)/dec in Current Assets	-328.5	-516.6	-14.9	-247.9
Inc/(dec) in CL and Provisions	-156.3	1218.2	236.0	436.4
Others	0.0	0.0	0.0	0.0
<b>CF from operating activities</b>	<b>1897.0</b>	<b>3444.1</b>	<b>3430.2</b>	<b>3709.2</b>
(Inc)/dec in Investments	-241.1	-71.8	-50.0	-50.0
(Inc)/dec in Fixed Assets	-2315.2	-2222.9	-1600.0	-1600.0
Others	-76.0	-82.7	-239.5	-237.0
<b>CF from investing activities</b>	<b>-2632.3</b>	<b>-2377.4</b>	<b>-1889.5</b>	<b>-1887.0</b>
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	1287.1	471.7	-400.0	-1259.8
Less: Interest Paid	-396.6	-470.7	-479.8	-470.7
Less: Dividend and dividend tax	-152.6	-135.7	0.0	0.0
Others	-446.1	-874.9	-100.0	-100.0
<b>CF from financing activities</b>	<b>291.8</b>	<b>-1009.6</b>	<b>-979.8</b>	<b>-1830.5</b>
Net Cash flow	-443.5	57.0	560.8	-8.3
Opening Cash	1295.6	852.1	909.1	1470.0
<b>Closing Cash</b>	<b>852.1</b>	<b>909.1</b>	<b>1470.0</b>	<b>1461.6</b>

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Liabilities</b>				
Equity Capital	285.0	285.0	285.0	285.0
Preference Share Capital	0.0	0.0	0.0	0.0
Reserve and Surplus	-466.8	-1,563.4	-1,294.1	-777.4
Total Shareholders funds	-181.8	-1,278.4	-1,009.1	-492.4
Total Debt	10,274.3	10,746.0	10,346.0	9,086.2
Others	3,441.2	4,996.6	4,757.1	4,520.0
<b>Total Liabilities</b>	<b>13,533.7</b>	<b>14,464.2</b>	<b>14,094.0</b>	<b>13,113.9</b>
<b>Assets</b>				
Gross Block	34,741.8	36,977.0	38,577.0	40,177.0
Less: Acc Depreciation	23,475.6	25,833.4	28,193.3	30,626.6
Net Block	11,266.1	11,143.6	10,383.7	9,550.4
Capital WIP	298.3	286.0	286.0	286.0
Total Fixed Assets	11,564.5	11,429.6	10,669.6	9,836.4
Investments	1,491.3	1,563.1	1,613.1	1,663.1
Goodwill on Consolidation	86.3	91.8	91.8	91.8
Inventory	76.6	73.0	76.4	80.6
Debtors	2,968.5	3,228.9	3,183.9	3,359.0
Loans and Advances	238.7	259.6	271.9	286.9
Other Current Assets	690.6	929.6	973.7	1,027.3
Cash	852.1	909.1	1,470.0	1,461.6
Total Current Assets	4,826.5	5,400.2	5,975.9	6,215.5
Creditors	3,688.5	3,845.0	3,918.6	4,134.2
Provisions	601.6	726.0	739.9	780.6
Other current liabilities	2,188.9	3,126.3	3,274.7	3,454.9
Total Current Liabilities	6,479.1	7,697.3	7,933.3	8,369.7
Net Current Assets	-1,652.6	-2,297.1	-1,957.3	-2,154.2
Other non current assets	2,044.3	3,676.8	3,676.8	3,676.8
<b>Application of Funds</b>	<b>13,533.7</b>	<b>14,464.2</b>	<b>14,094.0</b>	<b>13,113.9</b>

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Per share data (₹)</b>				
EPS	-2.9	-3.0	13.0	21.6
Adj. EPS	-8.1	10.0	13.0	21.6
BV	-6.4	-44.9	-35.4	-17.3
DPS	5.4	4.8	0.0	0.0
Cash Per Share	29.9	31.9	51.6	51.3
<b>Operating Ratios (%)</b>				
EBITDA Margin	16.6	19.3	19.0	20.5
PBT / Total Operating income	4.1	5.5	5.8	7.6
PAT Margin	-1.4	1.7	2.1	3.3
Inventory days	1.7	1.6	1.6	1.6
Debtor days	65.6	69.0	65.0	65.0
Creditor days	81.5	82.2	80.0	80.0
<b>Return Ratios (%)</b>				
RoE	127.7	-22.2	-36.6	-125.2
RoCE	5.4	7.8	8.6	12.5
RoIC	5.7	7.8	9.2	13.8
<b>Valuation Ratios (x)</b>				
P/E	-200.2	-191.8	44.6	26.7
EV / EBITDA	9.2	7.8	7.3	6.1
EV / Net Sales	1.5	1.5	1.4	1.2
Market Cap / Sales	1.0	1.0	0.9	0.9
Price to Book Value	-90.7	-12.9	-16.3	-33.5
<b>Solvency Ratios</b>				
Debt/EBITDA	3.7	3.3	3.1	2.3
Debt / Equity	-56.5	-8.4	-10.3	-18.5
Current Ratio	0.9	1.0	1.0	1.0
Quick Ratio	0.9	1.0	1.0	1.0

Source: Company, ICICI Direct Research

**Exhibit 11: ICICI Direct Coverage ( Telecom)**

Sector / Company	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
					FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Bharti Airtel	551	700	Buy	300,604	1.0	-59.0	7.3	537.9	NM	75.0	16.1	11.5	8.6	2.1	3.5	7.1	-3.5	-4.7	5.2
Bharti Infratel	221	175	Hold	40,913	13.5	17.8	16.3	16.4	12.4	13.6	4.6	4.7	4.5	21.2	18.1	19.4	17.2	24.4	23.3
Vodafone Idea	10	UR	UR	28,937	-5.1	-23.7	-5.4	NM	NM	NM	31.7	8.4	6.3	-5.0	-5.1	-3.3	-25.9	-120.8	-108.6
Sterlite Tech	105	95	Hold	4,211	14.0	10.8	8.5	7.5	9.7	12.2	5.3	5.8	6.2	29.7	27.8	20.9	28.7	33.0	25.1
Tata Comm	579	600	Hold	16,489	-2.9	-3.0	13.0	NM	NM	44.6	9.2	7.8	7.3	5.9	5.4	7.8	9.4	127.7	-22.2

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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