

Steady performance; one-offs aid EBITDA, PAT...

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 centre services

Q2FY22 Results: TCom reported stable core Q2FY22 results.

- Topline at ₹ 4174 crore was down 5.2% YoY, up 1.7% QoQ with data segment revenues declining 2.2% YoY (on high base) but showing modest 1.1% QoQ growth
- Consolidated EBITDA margin was at 26.7% (up 36 bps YoY, 263 bps QoQ) aided by one-off ₹ 50 crore for timing difference led employee cost benefit and reversal of provisions. PAT of ₹ 425 crore was up 10.6% YoY and 43.7% QoQ, owing to one-off benefits in margins and lower tax rate

What should investors do? TCom's share price has grown at ~18% CAGR over the past five years.

- We maintain **BUY** on the company

Target Price and Valuation: We value TCom at a target price of ₹ 1725

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 have robust market size growth potential of 15-25% CAGR in next four to five years
- We expect ~7% revenue CAGR in FY21-23E in the overall data segment, driven by likely acceleration in growth from H2FY22 onwards. We expect overall margins to at 25.5% in FY23 vs. 24.9% in FY21
- Strong cash flow generation to aid deleveraging

Alternate Stock Idea: Besides TCom, we like Jagran Prakashan in telecom & media

- A play on print sector recovery and superior dividend payout
- BUY with a target price of ₹ 70

TATA COMMUNICATIONS

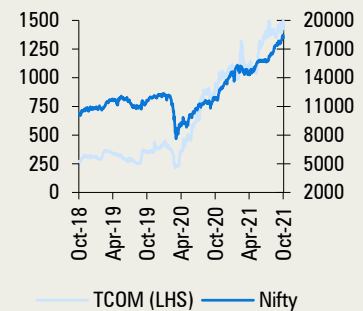
Particulars

Particulars	Amount
Market Capitalization	₹ 40659.5 Crore
Total Debt (FY21)	₹ 10001 Crore
Cash (FY21)	₹ 927.1 Crore
EV	₹ 52189 Crore
52 week H/L	1540/ 875
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Shareholding pattern

	Dec-20	Mar-21	Jun-21	Sep-21
Promoters	75.0	58.9	58.9	58.9
DII	1.4	7.0	6.9	7.2
FII	17.7	24.4	24.0	23.5
Other	6.0	9.7	10.2	10.5

Price Chart



Key risks

Key Risk: (i) Delay in revenue growth recovery; (ii) delay in turnaround of incubation segment

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 yr CAGR (FY16-21)	FY22E	FY23E	2 yr CAGR (FY21-23E)
Net Sales	16,525.0	17,068.0	17,100.1	(8.8)	17,098.8	18,631.1	4.4
EBITDA	2,744.9	3,289.0	4,260.6	17.5	4,375.1	4,750.9	5.6
PAT	(82.4)	(86.0)	1,250.6	LP	1,557.0	1,754.0	18.4
P/E (x)	NM	NM	32.5		26.1	23.2	
Price / Book (x)	NM	NM	352.2		25.9	12.6	
EPS (₹)	(2.9)	(3.0)	43.9		54.6	61.5	
EV/EBITDA (x)	18.0	15.9	12.0		11.3	10.0	
RoCE (%)	7.3	10.6	20.7		21.4	22.9	
RoE (%)	NM	NM	NM		NM	NM	

Key performance highlight and outlook

Revenues sees sequential growth after three quarters of decline

Data revenues (forming ~75% of revenues) declined 2.2% YoY (up 1.1% QoQ), primarily due to moderation of collaboration traffic, which was at its peak during Q1 and Q2 of last year. TCom indicated that revenue growth from here on would improve. Furthermore, usage-based revenue, which contributes 25% of data revenue that has moderated, is likely to pick up with economic reopening. **The management indicated that double digit growth in order book was seen both in India and overseas with 80% of orders from existing customers. The company indicated that barring UK and European region, recovery was seen everywhere. It however, expects them also to recover, going ahead, with global reopening and normalisation.** The company indicated that demand outlook is robust in the medium/long term and maintained the long term trend of double digit growth outlook along with overall EBITDA margins range of 23-25%.

TCom has informed that it would participate in growth of data centre through its 26% stake in STT, which it doesn't intend to dilute. STT is undertaking tripling of capacity from 130 Mhz to 400 Mhz over the next 5 years and would require overall capex outlay of ₹ 6000-9000 crore. The same will be funded through internal cash generation, Equity and Debt, for which TCom shall participate.

The company's strategic growth plan, focused approach and structural improvement in data segment margins has driven multiple re-rating. While deal closures delays have had near term weakness in revenues, the demand outlook is robust in the medium/long term and recovery is likely over the next couple of quarters. 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 ₹ 1725/share, at 28x FY23 P/E.

Exhibit 1: Variance Analysis

	Q2FY22	Q1FY22E	Q2FY21	Q1FY22	YoY (%)	QoQ (%)	Comments
Revenue	4,174.0	4,202.2	4,401.1	4,102.8	-5.2	1.7	The data revenues (forming ~75% of the revenues) declined by 2.2% YoY (up 1.1% QoQ), primarily due to moderation of Collaboration traffic which was at peak during Q1 and Q2 of last year. Voice segment continued to remain weak with revenues down 20.1% YoY (up 2.9% QoQ) at ₹ 606 crore
Other Income	36.4	13.0	76.1	13.4	-52.1	172.8	
Employee Expenses	728.5	798.4	761.9	809.7	-4.4	-10.0	
Administrative Expenses	765.7	769.0	846.7	745.2	-9.6	2.8	
Network costs	1,567.0	1,613.2	1,634.9	1,561.9	-4.2	0.3	
EBITDA	1,112.9	1,021.5	1,157.5	986.1	-3.9	12.9	EBITDA has onetime benefits of ₹ 50 crore on account of 1) cost benefit from the timing difference in hiring new employees to fulfil open positions in the organization, and 2) reversal of provision of doubtful debts due to better collection efforts.
EBITDA Margin (%)	26.7	24.3	26.3	24.0	36 bps	263 bps	
Depreciation	541.6	531.8	571.9	531.8	-5.3	1.9	
Interest	90.8	96.2	106.4	96.2	-14.7	-5.6	
Exceptional Items	-12.7	0.0	54.0	-5.6	0.0	NM	
Total Tax	103.8	102.5	115.3	79.3	-10.0	30.9	
PAT	425.4	304.1	384.5	296.1	10.6	43.7	PAT beat owing to superior EBITDA and lower tax rate
Total Minutes (in billion)	4.0	4.2	4.9	4.3	-18.4	-7.5	
GDS Revenues	3,140	3,200	3,210	3,104	-2.2	1.1	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY22E			FY23E			
	Old	New	% Change	Old	New	% Change	
Revenue	17,358.4	17,098.8	-1.5	18,920.0	18,631.1	-1.5	Realigned estimates post Q2
EBITDA	4,282.5	4,375.1	2.2	4,824.6	4,750.9	-1.5	
EBITDA Margin (%)	24.7	25.6	92 bps	25.5	25.5	0 bps	
PAT	1,373.3	1,557.0	13.4	1,725.2	1,754.0	1.7	
EPS (₹)	48.2	54.6	13.4	60.5	61.5	1.7	

Source: Company, ICICI Direct Research

Business Highlights

Voice business:

- Revenue for the quarter came in at ₹ 606 crore, down ~20% YoY and up ~1.6% QoQ, on account of a decline in overall voice volume, which came in at 4 billion (bn) minutes, a decline of 18% YoY, down 7.5% QoQ. Realisations were down ~2% YoY to ₹1.52/minute. Voice margins for the quarter came in at 7.6%, up 100 bps YoY

Data business

- Revenue declined 2.2% YoY, up 1.1% QoQ at ₹ 3140 crore, impacted by moderation of collaboration traffic that was at its peak during Q1 and Q2 of last year. EBITDA was at ₹ 1049 crore (down 3.4% YoY, up 12.6% QoQ) with a margin of 33.4%, up 340 bps QoQ. **Margins were aided by onetime benefits of ₹ 50 crore on account of 1) cost benefit from the timing difference in hiring new employees to fulfil open positions in the organisation (it saw sharp attrition, the replacement of which lagged leading to lower employee costs) and 2) reversal of provision of doubtful debts due to better collection efforts**

Core connectivity (erstwhile traditional services)

- Revenue for the quarter was up 0.4% YoY and QoQ at ₹ 2241 crore. EBITDA margin was at 45.9% (up 330 bps QoQ), aided by one-offs

Digital platforms & services (erstwhile growth services)

- Revenue for the quarter came in at ₹ 856 crore, up 2.3% QoQ and down 8.9% YoY. Revenue declined YoY on account of moderation of collaboration traffic that peaked in Q1 and Q2 during the first wave of Covid. QoQ growth was on the back of an improved performance in all segments except collaboration portfolio. Within the segment. EBITDA for the quarter came in at ₹ 122 crore, with margins up 522 bps QoQ

Incubation (erstwhile innovation services)

- Revenue for the quarter was up 18.7% YoY and 16.2% QoQ to ₹ 43 crore. EBITDA loss was at ₹ 101 crore.

Transformation services (TCTSL)

- Revenue (net of inter-segmental eliminations) for the quarter was up 0.7% YoY and 1.5% QoQ to ₹ 335 crore. It was impacted due to the second Covid wave while costs remained elevated. EBITDA loss for the quarter was at ₹ 21.5 crore

Payment solutions (TCPSL)

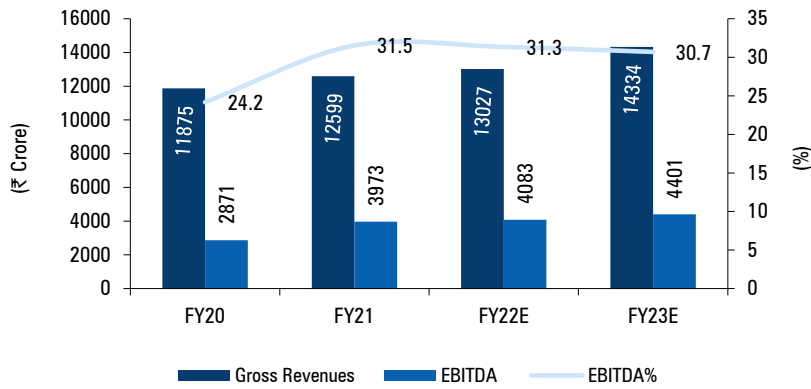
- Revenue came in at ₹ 40.9 crore, down 29% YoY and up 8.8% QoQ. The company had discontinued third party ATM contract in December, 2020 which has impacted quarterly revenues by ~₹ 10 crore. It has been hard hit by the second Covid wave and subsequent lockdowns. Average daily transactions for Q2 were 56 compared to 64 in Q2FY21. EBITDA for the quarter was at ₹ 3 crore

Other highlights:

- Capex for the quarter was at ₹ 392 crore vs. ₹ 381 crore in Q4. FCF was ₹ 721 crore (vs. ₹ 605 crore in Q1). **There was a sequential decline in net debt by ~₹ 240 crore QoQ on the back of a better working capital mix and improvement in operating profit. Net debt to EBITDA was at comfortable levels of 1.9x**

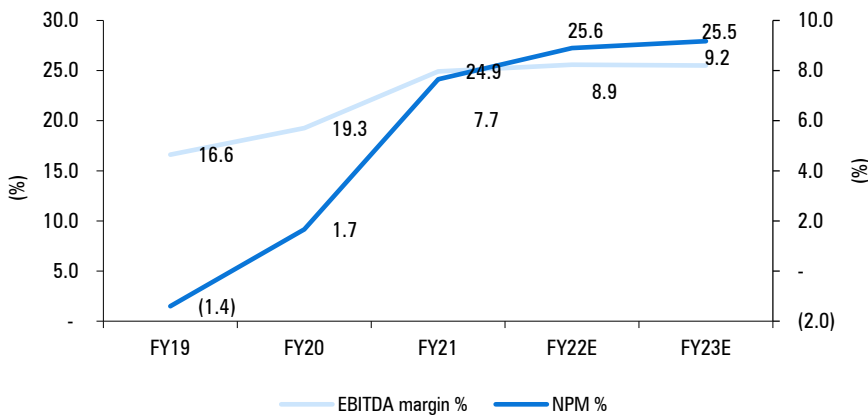
Financial story in charts

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)	FY20	FY21	FY22E	FY23E	
Total operating Income	17068.0	17100.1	17098.8	18631.1	
Growth (%)	3.3	0.2	(0.0)	9.0	
Employee Expenses	3039.1	3049.1	3082.0	3260.4	
Network costs	6777.6	6333.3	6432.7	7079.8	
Administrative Expenses	3962.3	3457.2	3209.0	3539.9	
Other Expenses	0.0	0.0	0.0	0.0	
Total Operating Expenditure	13779.0	12839.5	12723.8	13880.2	
EBITDA	3289.0	4260.6	4375.1	4750.9	
Growth (%)	19.8	29.5	2.7	8.6	
Depreciation	2357.7	2313.9	2171.6	2310.3	
Interest	470.7	420.2	365.7	326.8	
Other Income	69.7	156.8	109.8	140.0	
Exceptional Items	390.6	74.7	-18.4	0.0	
PBT	139.7	1608.6	1966.0	2253.8	
Minority Interest	1.1	0.9	4.3	6.0	
PAT from Associates	2.2	-2.1	0.8	2.0	
Total Tax	226.7	354.9	405.5	495.8	
PAT	-86.0	1250.6	1557.0	1754.0	
Growth (%)	NM	NM	24.5	12.7	
Adjusted PAT	283.9	1308.9	1542.4	1754.0	
Growth (%)	NM	361.0	17.8	13.7	
EPS (₹)	-3.0	43.9	54.6	61.5	

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet		₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E	
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	-1,563.4	-169.5	1,287.4	2,941.4	
Total Shareholders funds	-1,278.4	115.5	1,572.4	3,226.4	
Total Debt	10,746.0	10,001.0	9,201.1	8,001.1	
Others	4,996.6	4,304.0	4,067.0	3,827.6	
Total Liabilities	14,464.2	14,420.5	14,840.6	15,055.1	
Assets					
Gross Block	36,977.0	36,790.4	38,640.4	40,490.4	
Less: Acc Depreciation	25,833.4	26,616.4	28,787.9	31,098.2	
Net Block	11,143.6	10,174.1	9,852.5	9,392.3	
Capital WIP	286.0	394.5	394.5	394.5	
Total Fixed Assets	11,429.6	10,568.5	10,247.0	9,786.7	
Investments	1,563.1	2,233.4	2,283.4	2,333.4	
Goodwill on Consolidation	91.8	110.3	110.3	110.3	
Inventory	73.0	34.4	34.4	37.5	
Debtors	3,228.9	2,607.7	2,810.8	3,062.7	
Loans and Advances	259.6	235.8	235.8	256.9	
Other Current Assets	929.6	876.5	876.4	954.9	
Cash	909.1	927.1	1,406.9	2,295.7	
Total Current Assets	5,400.2	4,681.5	5,364.3	6,607.8	
Creditors	3,845.0	3,239.5	3,232.4	3,522.0	
Provisions	726.0	688.1	686.6	748.1	
Other current liabilities	3,126.3	2,985.3	2,985.1	3,252.6	
Total Current Liabilities	7,697.3	6,912.9	6,904.1	7,522.8	
Net Current Assets	-2,297.1	-2,231.4	-1,539.8	-915.0	
Other non current assets	3,676.8	3,739.7	3,739.7	3,739.7	
Application of Funds	14,464.2	14,420.5	14,840.6	15,055.1	

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement		₹ crore			
(Year-end March)	FY20E	FY21	FY22E	FY23E	
Profit after Tax	-86.0	1250.6	1557.0	1754.0	
Add: Depreciation	2357.7	2313.9	2171.6	2310.3	
Add: Interest Paid	470.7	420.2	365.7	326.8	
(Inc)/dec in Current Assets	-516.6	736.7	-203.0	-354.6	
Inc/(dec) in CL and Provisions	1218.2	-784.4	-8.8	618.7	
Others	0.0	0.0	0.0	0.0	
CF from operating activities	3444.1	3937.0	3882.4	4655.2	
(Inc)/dec in Investments	-71.8	-670.3	-50.0	-50.0	
(Inc)/dec in Fixed Assets	-2222.9	-1452.8	-1850.0	-1850.0	
Others	-82.7	-773.9	-237.0	-239.5	
CF from investing activities	-2377.4	-2897.0	-2137.0	-2139.5	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	471.7	-745.0	-799.9	-1200.0	
Less: Interest Paid	-470.7	-420.2	-365.7	-326.8	
Less: Dividend and dividend tax	-135.7	0.0	0.0	0.0	
Others	-874.9	143.2	-100.0	-100.0	
CF from financing activities	-1009.6	-1022.0	-1265.6	-1626.8	
Net Cash flow	57.0	18.0	479.8	888.9	
Opening Cash	852.1	909.1	927.1	1406.9	
Closing Cash	909.1	927.1	1406.9	2295.7	

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					
(Year-end March)	FY20	FY21	FY22E	FY23E	
Per share data (₹)					
EPS	-3.0	43.9	54.6	61.5	
Adj. EPS	10.0	45.9	54.1	61.5	
BV	-44.9	4.1	55.2	113.2	
DPS	4.8	0.0	0.0	0.0	
Cash Per Share	31.9	32.5	49.4	80.6	
Operating Ratios (%)					
EBITDA Margin	19.3	24.9	25.6	25.5	
PBT / Total Operating income	5.5	11.4	12.9	13.1	
PAT Margin	1.7	7.7	9.0	9.4	
Inventory days	1.6	0.7	0.7	0.7	
Debtor days	69.0	55.7	60.0	60.0	
Creditor days	82.2	69.1	69.0	69.0	
Return Ratios (%)					
RoE	NM	NM	98.1	54.4	
RoCE	10.6	20.7	21.4	22.9	
RoIC	7.8	17.8	20.2	23.3	
Valuation Ratios (x)					
P/E	-473.0	32.5	26.1	23.2	
EV / EBITDA	15.9	12.0	11.3	10.0	
EV / Net Sales	3.1	3.0	2.9	2.5	
Market Cap / Sales	2.4	2.4	2.4	2.2	
Price to Book Value	-31.8	352.2	25.9	12.6	
Solvency Ratios					
Net Debt/EBITDA	2.8	1.8	1.5	0.9	
Debt / Equity	-8.4	86.6	5.9	2.5	
Current Ratio	1.0	1.0	1.0	1.0	
Quick Ratio	1.0	0.9	1.0	1.0	

Source: Company, ICICI Direct Research

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