

Strong performance again...

Tata Communications reported a better-than-expected performance on the operating front led by superior margins in the data segment. The topline was at ₹ 4401 crore, up 3% YoY, flattish QoQ, with data revenues (forming ~83% of revenues) growing at 7.2% YoY, a tad lower than expectations. **EBITDA came in at ₹ 1158 crore, up 26.3% YoY, with margins at 26.3% (up 680 bps YoY) driven by strong data margins of 30.4% (up 830 bps YoY), aided by structural costs savings and continued Covid-19 led benefits such savings in travel costs, lower SG&A costs etc.** The company reported a PAT of ₹ 384.5 crore, up ~6.1x YoY.

Muted data revenues QoQ on forex, slow enterprise activity

The sequential muted data revenues were owing to delays in network transformation deal closure due to slower enterprise activity coupled with forex impact. Normalised for forex impact, data revenues would have grown 1.7% QoQ. Enterprise segment (64% of revenues) was down 1.1% YoY while service providers'/carriers revenues were up 12.4% YoY. The video connect business grew 74.2% QoQ, Security services grew 44.5% QoQ while hosting business grew 11.1% QoQ.

Upward shift of data segment margin continues

It is pertinent to note that data segment EBITDA expansion during the quarter was also aided by one-off Covid related benefit in operating costs, which continued in Q2. The company also got some timing benefit as some costs were pushed to H2. Interestingly, adjusted for these non-recurring benefits of ~₹ 100 crore, the adjusted data margin at 27.6%, still witnessed ~550 bps YoY improvement driven structural cost rationalisation, favourable mix of services, turnaround in transformation and lower losses in innovation services. The company has given a consolidated margin guidance of 23-25% on a steady state basis. We bake in 8.7% revenue CAGR in FY20-22E in the overall data segment, largely driven by traction in growth and innovation services. We expect data margins at 26.3% in FY22 vs. 22.1% in FY20, given the structural cost rationalisation benefits and improved profitability in transformation/innovation segments.

Valuation & Outlook

The consistent performance of the data segment is impressive with step up in margins led by scale & cost initiatives. Notwithstanding, some benefits which may wane off, we expect revenue growth traction (likely to step up by FY21 end) to keep the margins trajectory firm. The company's strategic growth plan, focused approach and consistent improvement in data segment continues to drive multiple re-rating, which is visible in the price run up. We believe continued performance and deleveraging possibilities bode well for the company. Thus, we maintain **BUY** with a revised SoTP target price of ₹ 1055/share. We raise our data segment EV/EBITDA multiple to 8.5x vs. 8x earlier.

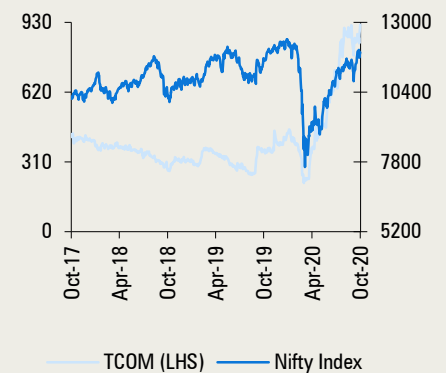
TATA COMMUNICATIONS

Particulars	Amount
Market Capitalization	₹ 26202.9 Crore
Total Debt (FY20)	₹ 10746 Crore
Cash (FY20)	₹ 909.1 Crore
EV	₹ 37732.4 Crore
52 week H/L	937/ 206
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Key Highlights

- EBITDA margin at 26.3% (up 680 bps YoY) driven by strong data margins of 30.4% (up 830 bps YoY), aided by structural costs savings and continued Covid-19 led benefits
- Maintain BUY rating, valuing at ₹ 1055/share on SoTP basis

Price Chart



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Key Financial Summary

(₹ Crore)	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY20-22E)
Net Sales	16,650.8	16,525.0	17,068.0	17,939.6	19,007.5	5.5
EBITDA	2,291.4	2,744.9	3,289.0	4,209.1	4,466.8	16.5
Adjusted PAT	46.9	(232.2)	283.9	1,155.5	1,244.2	109.3
Adjusted P/E (x)	558.7	NM	92.3	22.7	21.1	
Price / Book (x)	52.5	NM	NM	NM	NM	
Adjusted EPS (₹)	1.6	(8.1)	10.0	40.5	43.7	
EV/EBITDA (x)	14.7	12.8	11.5	8.5	7.5	
RoCE (%)	5.9	5.4	7.8	14.9	16.4	
RoE (%)	9.4	NM	NM	NM	NM	

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY21E	Q2FY20	Q1FY21	YoY (%)	QoQ (%)	Comments
Revenue	4,401.1	4,459.3	4,272.8	4,402.9	3.0	0.0	The data revenues (forming ~83% of the revenues) grew by 7.2% YoY vs. our expectations of 9% growth.
Other Income	76.1	15.0	9.6	14.7	693.5	1.8	
Employee Expenses	761.9	771.5	732.0	762.4	4.1	1.2	
Administrative Expenses	846.7	900.8	1,010.5	857.4	-16.2	5.1	
Network costs	1,634.9	1,762.3	1,696.6	1,741.3	-3.6	1.2	
Raw Material Expenses	0.0	0.0	0.0	0.0	0.0	0.0	
EBITDA	1,157.5	1,024.7	833.7	1,041.8	38.8	-1.6	The beat at EBITDA levels were on account of superior data margins of 30.4% (up 830 bps YoY), aided by structural costs savings and continued Covid-19 led benefits
EBITDA Margin (%)	26.3	23.0	19.5	23.7	679 bps	264 bps	
Depreciation	571.9	590.9	558.3	589.9	2.4	-3.1	
Interest	106.4	120.5	115.7	116.3	-8.0	-8.5	
Exceptional Items	54.0	0.0	6.0	10.5	0.0	0.0	
Total Tax	115.3	114.9	110.7	81.2	4.2	42.0	
PAT	384.5	212.4	53.9	257.8	613.2	49.1	The beat at operating levels percolated to PAT
Total Minutes (in billion)	4.9	5.4	6.0	5.2	-17.9	-5.8	
GDS Revenues	3,642	3,703	3,399	3,604	7.2	1.1	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			
	Old	New	% Change	Old	New	% Change	
Revenue	17,937.5	17,939.6	0.0	19,014.8	19,007.5	0.0	
EBITDA	3,978.5	4,209.1	5.8	4,335.4	4,466.8	3.0	
EBITDA Margin (%)	22.2	23.5	128 bps	22.8	23.5	70 bps	Realigned numbers after Q1 beat
PAT	793.3	1,107.4	39.6	1,006.5	1,244.2	23.6	Lower tax rate as per management guidance
EPS (₹)	27.8	38.9	39.6	35.3	43.7	23.6	

Source: Company, ICICI Direct Research

Business Highlights

Voice business:

- Revenue for the quarter came in at ₹ 759 crore, down 13.2% YoY and 5.1% QoQ, on account of a decline in voice minutes despite continued firm realisations. Overall voice volume came in at 4.9 billion (bn) minutes, a decline of 17.9% YoY, 5.8% QoQ. Realisations, on the other hand, were up 5.8% YoY (up 0.8% QoQ) to ₹ 1.55/minute on account of better destination mix
- Voice margins for the quarter came in at 6.6%, down 270 bps YoY

Data business

- Revenue grew 7.2% YoY, 1.1% QoQ at ₹ 3642 crore, driven by healthy growth segment and continued traction in traditional segment. Sequential revenue was impacted by slower deal conversion due to Covid, forex impact and moderation in Growth Services. **Enterprise segment (64% of revenues) was down 1.1% YoY while service providers/carriers revenues were up 12.4% YoY**
- EBITDA was at ₹ 1108 crore with a margin of 30.4%. EBITDA has grown 47.3% YoY, 13.6% QoQ. EBITDA margins expanded 830 bps YoY and 330 bps QoQ, **driven by cost efficiencies and lower costs due to lockdown. It should be noted that one-off Covid related benefit in operating costs continued in Q2 and the company also got some timing benefit as some costs were pushed to H2**

Traditional data services

- Revenue for the quarter was up 5.1% YoY, 1.9% QoQ at ₹ 2271 crore. Within this portfolio, continued robust bandwidth usage due to lockdown, aided the growth. NPL grew 30.9% YoY while IP transit witnessed 15.5% growth YoY
- Reported EBITDA came in at ₹ 1016 crore, witnessing growth of 24.3% YoY and 8% sequential growth with a margin of 44.7%, up 690 bps YoY on the back of cost efficiency costs due to lockdown

Growth services:

- Revenue for the quarter came in at ₹ 903 crore, up 17% YoY with a marginal decline of 2.2% QoQ. The sequential decline was due to moderation in enterprise traffic during Q2, as the traffic is now closer to pre-Covid levels. The company is witnessing strong growth in services as sporting events have started. The video connect business grew 74.2% QoQ, security services grew 44.5% QoQ while hosting business grew 11.1% QoQ
- EBITDA for the quarter came in at ₹ 150 crore, witnessing 440% YoY and 30.6% QoQ growth, on account of operating leverage. EBITDA margins have expanded 420 bps QoQ to 16.6%, recording double-digit margins for a third consecutive quarter. **The company expects margins to remain robust in the long term given the scale and cost efficiencies**

Transformation services:

- Revenue (net of inter-segmental eliminations) grew 2.8% YoY, flattish QoQ to ₹ 333 crore
- EBITDA for the quarter was at ₹ 4 (vs. ₹ 3 crore loss in Q1) as the company has been able to shed the onerous customer contract and profitability has started to kick in. **The company expects it maintain the profitability momentum in FY22 and beyond**

Innovation services:

- Revenue grew 62.4% YoY, 57% QoQ to ₹ 36 crore. In this portfolio, MOVE grew 53%, IoT by 78.5% and NetFoundry by 11.4% QoQ
- EBITDA losses have started to come down while EBITDA loss for Q2FY21 was ₹ 80 crore compared to a loss of ₹ 150 crore in Q2FY20

Payment solutions:

- Revenue came in at ₹ 58 crore, down 31.7% YoY but up 11.1% QoQ. The business has been severely affected by lockdown but QoQ improvements have begun. The company witnessed a sequential improvement in average daily transactions to 64 in Q2FY21 (vs. 56 in Q1) but average transactions count remain sharply below 85 in Q2FY20. As a result of the same, EBITDA loss was ₹ 4 crore (similar to Q1)

Other highlights:

- Capex for the quarter was at ₹ 318 crore vs. ₹ 371 crore in Q1. FCF was ₹ 840 crore (vs. 670 crore in Q1). We note that company has guided for similar to FY20 capex levels (~1596 crore) capex levels for FY21. Net debt was at ₹ 8631 crore, decline of ₹ 377 crore QoQ, driven by healthy FCF and despite dividend payment of ₹ 114 crore and annual bonus pay-out to employees during the quarter **Net debt to EBITDA on TTM basis was 2.3x vs. 2.8x in Q2FY20.**

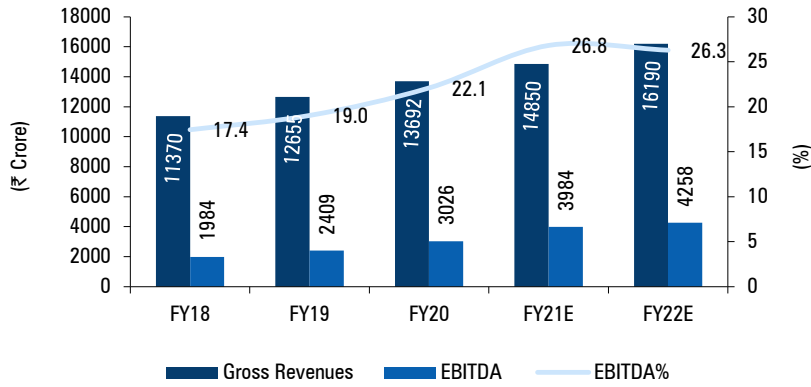
Valuations**Exhibit 3: Valuations**

Particulars	FY22 EBITDA (₹ Crore)	EV/EBITDA (x)	Amount (₹ Crore)
GVS Business Enterprise Value	211.3	3.0	644
GDS Business Enterprise Value (incl. Rent)	4,257.9	8.5	36,401
Data Centre - 26% stake (based on 20x EV/EBITDA)			1,820
Less: Net Debt (incl. Lease Liability)	-	-	7,250
Less: AGR liability	-	-	1,541
Equity Value of the business	-	-	30,074
No. of equity shares outstanding (Crore)	-	-	28.5
Target Price	-	-	1,055

Source: Company, ICICI Direct Research

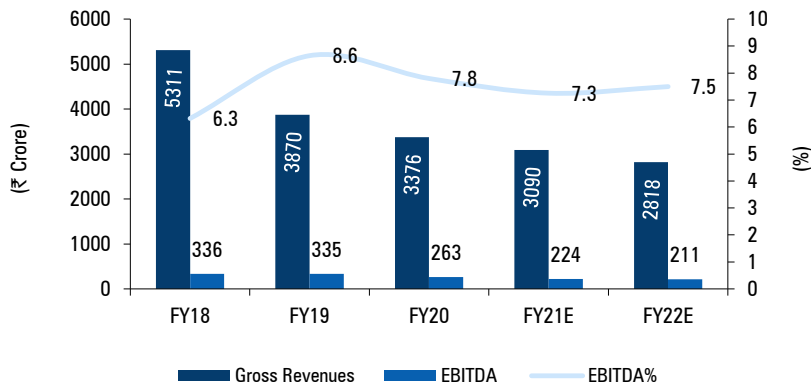
Financial story in charts

Exhibit 4: Global data services operating performance



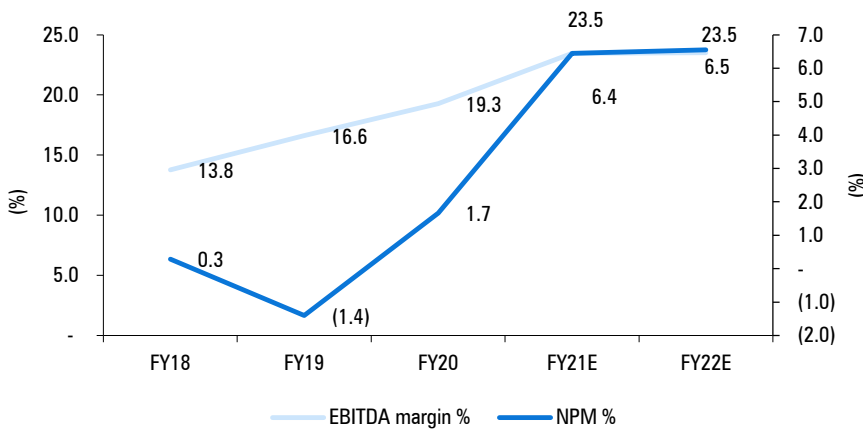
Source: Company, ICICI Direct Research

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
Total operating Income	16525.0	17068.0	17939.6	19007.5
Growth (%)	(0.8)	3.3	5.1	6.0
Employee Expenses	2959.7	3039.1	3114.2	3288.3
Network costs	7162.0	6777.6	7039.4	7412.9
Administrative Expenses	3658.4	3962.3	3576.9	3839.5
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	13780.1	13779.0	13730.5	14540.8
EBITDA	2744.9	3289.0	4209.1	4466.8
Growth (%)	19.8	19.8	28.0	6.1
Depreciation	2067.6	2357.7	2332.2	2375.9
Interest	396.6	470.7	442.1	434.5
Other Income	60.3	69.7	120.8	80.0
Exceptional Items	-2.2	390.6	64.4	0.0
PBT	343.2	139.7	1491.3	1736.3
Minority Interest	1.9	1.1	1.2	1.2
PAT from Associates	-150.3	2.2	-4.1	-4.8
Total Tax	273.3	226.7	378.6	486.2
PAT	-82.4	-86.0	1107.4	1244.2
Growth (%)	NM	4.4	-1388.3	12.3
Adjusted PAT	-232.2	283.9	1155.5	1244.2
Growth (%)	NM	NM	307.0	7.7
EPS (₹)	-2.9	-3.0	38.9	43.7

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
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	-466.8	-1,563.4	-555.9	588.2
Total Shareholders funds	-181.8	-1,278.4	-270.9	873.2
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
Total Liabilities	13,533.7	14,464.2	14,832.1	14,479.5
Assets				
Gross Block	34,741.8	36,977.0	38,577.0	40,177.0
Less: Acc Depreciation	23,475.6	25,833.4	28,165.5	30,541.5
Net Block	11,266.1	11,143.6	10,411.5	9,635.5
Capital WIP	298.3	286.0	286.0	286.0
Total Fixed Assets	11,564.5	11,429.6	10,697.4	9,921.5
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	76.7	77.2
Debtors	2,968.5	3,228.9	3,342.2	3,541.1
Loans and Advances	238.7	259.6	264.7	266.4
Other Current Assets	690.6	929.6	977.1	1,004.2
Cash	852.1	909.1	2,198.8	3,049.1
Total Current Assets	4,826.5	5,400.2	6,859.4	7,938.1
Creditors	3,688.5	3,845.0	4,054.9	4,296.2
Provisions	601.6	726.0	765.6	859.9
Other current liabilities	2,188.9	3,126.3	3,285.9	3,655.6
Total Current Liabilities	6,479.1	7,697.3	8,106.4	8,811.7
Net Current Assets	-1,652.6	-2,297.1	-1,247.0	-873.7
Other non current assets	2,044.3	3,676.8	3,676.8	3,676.8
Application of Funds	13,533.7	14,464.2	14,832.1	14,479.5

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	1107.4	1244.2
Add: Depreciation	2067.6	2357.7	2332.2	2375.9
Add: Interest Paid	396.6	470.7	442.1	434.5
(Inc)/dec in Current Assets	-328.5	-516.6	-169.6	-228.3
Inc/(dec) in CL and Provisions	-156.3	1218.2	409.1	705.3
Others	0.0	0.0	0.0	0.0
CF from operating activities	1897.0	3444.1	4121.2	4531.7
(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
CF from investing activities	-2632.3	-2377.4	-1889.5	-1887.0
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	-442.1	-434.5
Less: Dividend and dividend tax	-152.6	-135.7	0.0	0.0
Others	-446.1	-874.9	-100.0	-100.0
CF from financing activities	291.8	-1009.6	-942.1	-1794.3
Net Cash flow	-443.5	57.0	1289.6	850.4
Opening Cash	1295.6	852.1	909.1	2198.8
Closing Cash	852.1	909.1	2198.8	3049.1

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS	-2.9	-3.0	38.9	43.7
Adj. EPS	-8.1	10.0	40.5	43.7
BV	-6.4	-44.9	-9.5	30.6
DPS	5.4	4.8	0.0	0.0
Cash Per Share	29.9	31.9	77.1	107.0
Operating Ratios (%)				
EBITDA Margin	16.6	19.3	23.5	23.5
PBT / Total Operating income	4.1	5.5	10.5	11.0
PAT Margin	-1.4	1.7	6.4	6.5
Inventory days	1.7	1.6	1.6	1.5
Debtor days	65.6	69.0	68.0	68.0
Creditor days	81.5	82.2	82.5	82.5
Return Ratios (%)				
RoE	127.7	-22.2	-426.5	142.5
RoCE	5.4	7.8	14.9	16.4
RoIC	5.7	7.8	16.8	20.2
Valuation Ratios (x)				
P/E	-318.1	-304.8	23.7	21.1
EV / EBITDA	12.8	11.5	8.5	7.5
EV / Net Sales	2.1	2.2	2.0	1.8
Market Cap / Sales	1.6	1.5	1.5	1.4
Price to Book Value	-144.1	-20.5	-96.7	30.0
Solvency Ratios				
Debt/EBITDA	3.7	3.3	2.5	2.0
Debt / Equity	-56.5	-8.4	-38.2	10.4
Current Ratio	0.9	1.0	1.0	0.9
Quick Ratio	0.9	1.0	1.0	0.9

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 (%)		
					FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Bharti Airtel	398	700	Buy	2,16,969	-59.0	-24.7	11.2	NM	NM	35.5	9.2	8.0	6.2	3.5	6.9	9.2	-4.7	4.2	11.3
Bharti Infratel	181	180	Reduce	33,496	17.8	16.7	17.4	10.2	10.9	10.4	5.7	5.6	5.3	18.1	19.8	21.7	24.4	23.7	25.5
Vodafone Idea	8	6	Sell	22,844	-25.7	-14.5	-6.8	NM	NM	NM	9.3	11.3	8.7	-5.7	-4.4	-3.4	NM	NM	NM
Sterlite Tech	152	125	Reduce	6,131	10.8	8.1	11.4	14.1	18.7	13.3	7.6	9.0	6.9	27.8	20.9	15.8	33.0	25.1	15.8
Tata Comm	919	1,055	Buy	26,203	-3.0	38.9	43.7	NM	23.7	21.1	10.8	8.0	7.1	7.8	14.9	16.4	-22.2	-426.5	142.5

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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