

## Revenue growth, margin construct not in sync!

**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

**Q3FY23 Results:** TCom reported a weak quarter on the margins front.

- Topline came in at ₹ 4528 crore, up 8.2% YoY, 2.2% QoQ, driven by **data revenues (forming ~79% of revenues), which were up ~11.1% YoY (up 2.9% QoQ) at ₹ 3593 crore. Voice segment continued to remain weak with revenues down 8.7% YoY (down 3.6% QoQ) at ₹ 506 crore**
- Consolidated EBITDA came in at ₹ 1077 crore, down 0.5% YoY, 4.6% QoQ. Consequent **margin was at 23.8% (down 207 bps YoY, 170 bps QoQ), owing to lower data EBITDA margin, which was at 26.4%, down 246 bps QoQ.** PBT was down 9.4% YoY, given the muted operating performance and higher interest expenses

**What should investors do?** TCom's share price has grown at ~28% CAGR over the past five years.

- We maintain **HOLD** as the growth – margin construct is not in sync

**Target Price and Valuation:** We value TCom at a target price of ₹ 1290.

### Key triggers for future price performance:

- Growth will be driven by platforms viz. a) cloud, edge & security, b) next generation connectivity, c) NetFoundry, **MOVE** and **IoT**, wherein each have robust market size growth potential of 15-25% CAGR in next four to five years
- We expect ~10.6% revenue CAGR in FY22-25E in the overall data segment and overall margins at 25% in FY25 vs. 25.3% in FY22, with margin weakness likely over the next few quarters. 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 ₹ 960

## TATA COMMUNICATIONS

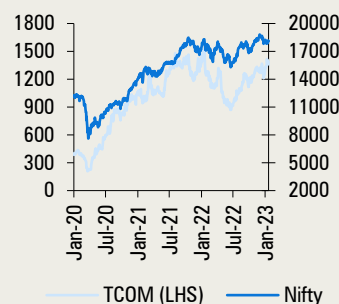
### Particulars

Particulars	Amount
Market Capitalization	₹ 36993 Crore
Total Debt (FY22)	₹ 7921 Crore
Inv & Cash (FY22)	₹ 1176.2 Crore
EV	₹ 48522.5 Crore
52 week H/L	1431/ 856
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

### Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoters	58.9	58.9	58.9	58.9
DII	11.1	12.7	13.6	13.7
FII	19.4	17.9	17.0	17.3
Other	10.7	10.6	10.5	10.2

### 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)	17,886.6	19,669.0	21,623.3	8.9
EBITDA	3,289.0	4,260.6	4,226.7	12.1	4,364.4	4,720.6	5,405.8	8.5
PAT	(86.0)	1,250.6	1,481.8	0.3	1,815.8	1,611.3	2,047.4	11.4
P/E (x)	NM	29.6	25.0		20.4	23.0	18.1	
Price / Book (x)	NM	320.4	39.9		18.0	12.6	8.7	
EPS (₹)	(3.0)	43.9	52.0		63.7	56.5	71.8	
EV/EBITDA (x)	14.8	11.1	10.7		10.1	9.1	7.6	
RoCE (%)	10.6	20.7	26.5		27.1	28.0	32.7	
RoE (%)	NM	NM	NM		85.3	54.8	48.1	

## Key performance highlight and outlook

### Outlook & New Developments

- The management **maintained FY23 margins guidance range of 23-25% as they intend to reinvest incremental margins to drive growth.** They aspire to attain double digit revenue growth along with RoCEs of 25-30%
- **Growth funnel (pre stage of order book), deal win rate and order book have improved** and are healthy. The company also indicated that **there is more conversation beyond connectivity and thus “relevance quotient” of company’s offerings are increasing.** 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 the street with new hiring and expanded regional presence through sales and marketing spends**
- **Acquisition:** TCom acquired **Switch Enterprise for US\$58.8 million. Switch is an American player and the leader in the sports media business (region-to-region player). It has annual revenues of ~US\$80 million.** This acquisition is in line with the company’s strategic vision to enter into an end-to-end media ecosystem and enable it to be the content provider. The management indicated that while it already has strength in the entertainment market as a global-to-global player, with the Switch acquisition, it could enter into a global-to-region player, enhance product offerings and tap global customers. It expects Switch to break even in the first year and become margin accretive from the second year, as a part of digital platforms and services business

ESG Disclosure Score*			
ESG Disclosure Score			
Score	FY20	FY21	FY22
Environmental	34.1	49.0	57.9
Social	37.3	52.2	54.6
Governance	96.1	96.1	96.1
<b>Overall ESG Score</b>	<b>55.9</b>	<b>65.8</b>	<b>69.6</b>

Source: Bloomberg, ICICI Direct Research, \*Score ranges from 0 - 100 with a higher score indicating

### Data business performance

- Revenue was up 8.2% YoY, 2.2% QoQ at ₹ 3528 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 ₹ 948 crore (down 9% YoY, 5.8% QoQ) with a margin of 26.4%, down 246 bps QoQ, 582 bps YoY.** Costs in Q3 were higher owing to a) employee expenses, b) higher growth in the DPS segment, which has lower margin profile than core connectivity and c) investment in the international sales team expansion

### Core connectivity (erstwhile traditional services)

- Revenue for the quarter was up 1.7% QoQ, 6% YoY at ₹ 2415 crore. **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 market needs to drive this segment**

### Digital platforms & services (erstwhile growth services)

- Revenue for the quarter came in at ₹ 1056 crore, up 5.8% QoQ, 17.2% YoY. For Q3, collaboration revenue was up 6.2% QoQ, 8.9% YoY. The SIP trunking (usage based) revenues have seen some stability. Furthermore, the company is pivoting from usage-based SIP to a mix of a fixed and usage-based model. The new CPAAS offerings such as **GlobalRapide, DIGO, Insta CC, etc.** have done well. Cloud, hosting and security was up 8.8% QoQ, 23.5% YoY led by broader and multi cloud offerings. Next gen connectivity (healthy growth due to IZO internet and SD WAN variant) and media revenue (driven by global sports events and global edge opportunities) was up 5.5% QoQ, 26.5% YoY and – 0.9% QoQ, 17.3% YoY, respectively. **The management reiterated that underlying trends are positive for this business across segments**

### Incubation (erstwhile innovation services)

- Revenue for Q3 was up 1.1% QoQ, 125.3% YoY to ₹ 122 crore, on the back of new deal wins and scale up of usage in existing accounts. **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 3.7% QoQ and 6.6% YoY to ₹ 333 crore. The company reported EBITDA of ₹ 14.9 crore vs. losses in the base quarter

### Payment solutions (TCPSL)

- Q3 revenue came in at ₹ 50 crore, up 8.4% QoQ and 14% YoY. The franchise model is making steady progress and the company has added ~2800 ATMs on franchise model till date. EBITDA for the quarter was at ₹ 1.9 crore

### Voice business:

- Revenue for the quarter came in at ₹ 506 crore, down 8.7% YoY, on account of a decline in overall voice volume, which came in at 2.8 billion (bn) minutes, a decline of ~23% YoY. Realisations were up ~19% YoY to ₹ 1.8/minute. **Voice margins for the quarter came in at 17.3%, up 950 bps YoY, 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 ₹ 391 crore (cash capex 440 crore) vs. ₹ 421 crore in Q2. FCF was ₹ 335 crore (vs. 617 crore in Q2). Going ahead, capex guidance is US\$300-325 mn with most of the capex being growth led and for revamping and expanding the undersea cable. The actual capex for FY23 has been lower than committed owing to supply chain issues. **There was a sequential decline in net debt by ~₹ 130 crore QoQ to ₹ 6270 crore, largely aided by cash flow generation. Net debt to annualised EBITDA was stable QoQ at 1.5x**

## 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, the margin softness will offset revenue recovery benefits.

We maintain HOLD given the growth – margin construct is not in sync. We assign a target price of ₹ 1290/share, at 18x FY25 P/E.

**Exhibit 1: Variance Analysis**

	Q3FY23	Q3FY23E	Q3FY22	Q2FY23	YoY (%)	QoQ (%)	Comments
Revenue	4,528.3	4,497.4	4,184.9	4,430.8	8.2	2.2	Revenue was driven by the data revenues (forming ~79% of the revenues) which was up ~11.1% YoY (up 2.9% QoQ) at ₹ 3593 crore. Voice segment continued to remain weak with revenues down 8.7% YoY (down 3.6% QoQ) at ₹ 506 crore.
Other Income	30.8	30.0	18.8	36.6	63.6	-16.0	
Employee Expenses	920.8	881.5	733.8	870.4	25.5	5.8	
Administrative Expenses	914.2	899.5	838.4	867.9	9.0	5.3	
Network costs	1,616.0	1,596.6	1,530.2	1,562.9	5.6	3.4	
EBITDA	1,077.4	1,119.9	1,082.5	1,129.7	-0.5	-4.6	
EBITDA Margin (%)	23.8	24.9	25.9	25.5	-207 bps	-170 bps	
Depreciation	554.8	562.2	542.5	551.6	2.3	0.6	
Interest	122.7	100.6	83.5	97.8	47.0	25.5	
Exceptional Items	0.0	0.0	-8.5	-76.4	0.0	NM	
Total Tax	43.6	111.5	95.8	65.9	-54.5	-33.8	
PAT	393.9	380.0	395.2	532.3	-0.3	-26.0	
Total Minutes (in billion)	2.9	2.9	4.0	3.3	-27.0	-12.4	
GDS Revenues	3,593	3,565	3,233	3,493	11.1	2.9	

Source: Company, ICICI Direct Research

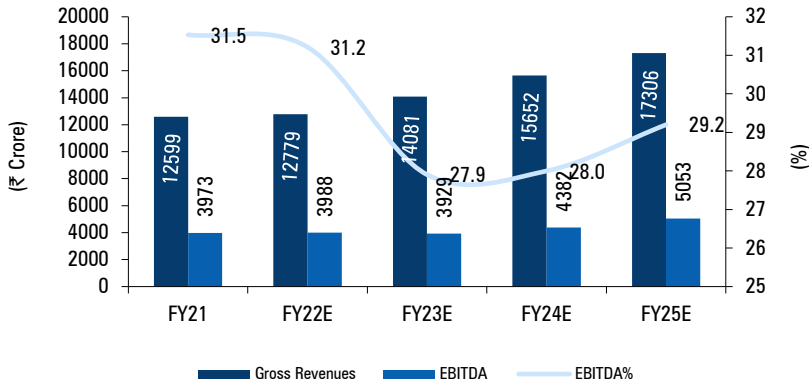
**Exhibit 2: Change in estimates**

₹ Crore)	FY24E			FY25E			
	Old	New	% Change	Old	New	% Change	
Revenue	19,444.5	19,669.0	1.2	21,355.0	21,623.3	1.3	Realign estimates
EBITDA	4,861.1	4,720.6	-2.9	5,445.5	5,405.8	-0.7	
EBITDA Margin (%)	25.0	24.0	-100 bps	25.5	25.0	-50 bps	
PAT	1,807.4	1,611.3	-10.8	2,158.3	2,047.4	-5.1	
EPS (₹)	63.4	56.5	-10.8	75.7	71.8	-5.1	

Source: Company, ICICI Direct Research

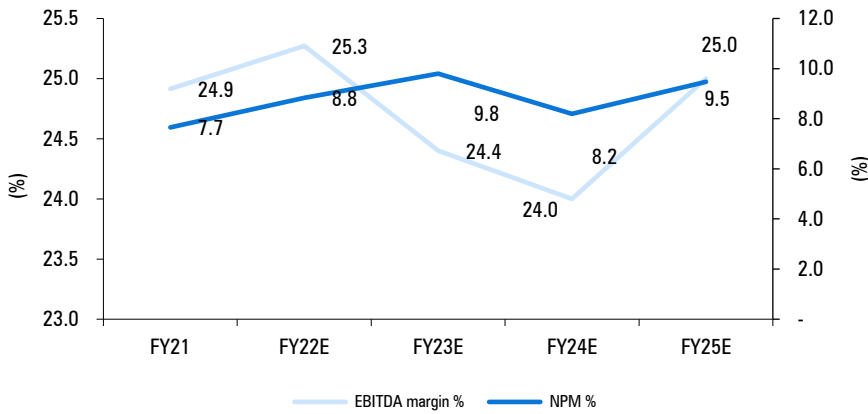
### Financial story in charts

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
<b>Total operating Income</b>	<b>16724.7</b>	<b>17886.6</b>	<b>19669.0</b>	<b>21623.3</b>
Growth (%)	(2.2)	6.9	10.0	9.9
Employee Expenses	3040.3	3521.2	3835.4	4000.3
Network costs	6199.5	6380.5	7179.2	7892.5
Administrative Expenses	3258.2	3620.5	3933.8	4324.7
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	12498.0	13522.2	14948.4	16217.5
<b>EBITDA</b>	<b>4226.7</b>	<b>4364.4</b>	<b>4720.6</b>	<b>5405.8</b>
Growth (%)	-0.8	3.3	8.2	14.5
Depreciation	2204.5	2200.1	2320.9	2486.7
Interest	360.3	413.2	463.5	428.5
Other Income	332.1	331.4	144.0	160.0
Exceptional Items	-6.0	-76.4	0.0	0.0
PBT	2000.0	2158.9	2080.1	2650.7
Minority Interest	2.9	6.3	5.6	7.1
PAT from Associates	6.8	32.7	36.0	40.0
Total Tax	522.1	369.5	499.2	636.2
<b>PAT</b>	<b>1481.8</b>	<b>1815.8</b>	<b>1611.3</b>	<b>2047.4</b>
Growth (%)	18.5	22.5	-11.3	27.1
<b>Adjusted PAT</b>	<b>1477.4</b>	<b>1752.5</b>	<b>1611.3</b>	<b>2047.4</b>
Growth (%)	12.9	18.6	-8.1	27.1
<b>EPS (₹)</b>	<b>52.0</b>	<b>63.7</b>	<b>56.5</b>	<b>71.8</b>

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement				
	₹ crore			
(Year-end March)	FY22E	FY23E	FY24E	FY25E
Profit after Tax	1481.8	1815.8	1611.3	2047.4
Add: Depreciation	2204.5	2200.1	2320.9	2486.7
Add: Interest Paid	360.3	413.2	463.5	428.5
(Inc)/dec in Current Assets	-65.2	-265.3	-407.1	-446.3
Inc/(dec) in CL and Provisions	-40.5	439.7	728.6	798.9
Others	0.0	0.0	0.0	0.0
<b>CF from operating activities</b>	<b>3940.9</b>	<b>4603.5</b>	<b>4717.3</b>	<b>5315.2</b>
(Inc)/dec in Investments	668.1	-50.0	-50.0	-50.0
(Inc)/dec in Fixed Assets	-2167.6	-2000.0	-2300.0	-2300.0
Others	484.9	-233.7	-234.4	-238.3
<b>CF from investing activities</b>	<b>-1014.6</b>	<b>-2283.7</b>	<b>-2584.4</b>	<b>-2588.3</b>
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	-413.2	-463.5	-428.5
Less: Dividend and dividend tax	-399.0	-590.0	-627.0	-627.0
Others	-270.6	-100.0	-100.0	-100.0
<b>CF from financing activities</b>	<b>-3109.9</b>	<b>-1903.1</b>	<b>-2190.5</b>	<b>-2155.5</b>
Net Cash flow	-183.7	416.6	-57.6	571.4
Opening Cash	927.1	743.4	1160.0	1102.4
<b>Closing Cash</b>	<b>743.4</b>	<b>1160.0</b>	<b>1102.4</b>	<b>1673.9</b>

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
<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	642.6	1,768.5	2,652.8	3,973.2
Total Shareholders funds	927.6	2,053.5	2,937.8	4,258.2
Total Debt	7,921.0	7,121.0	6,121.0	5,121.0
Others	3,947.0	3,713.3	3,478.9	3,240.6
<b>Total Liabilities</b>	<b>12,795.6</b>	<b>12,887.8</b>	<b>12,537.7</b>	<b>12,619.8</b>
<b>Assets</b>				
Gross Block	40,104.7	42,104.7	44,404.7	46,704.7
Less: Acc Depreciation	30,351.8	32,551.8	34,872.8	37,359.4
Net Block	9,752.9	9,552.9	9,532.0	9,345.3
Capital WIP	778.7	778.7	778.7	778.7
Total Fixed Assets	10,531.6	10,331.6	10,310.6	10,124.0
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	40.5	44.5	49.0
Debtors	2,582.1	2,761.5	3,036.7	3,338.4
Loans and Advances	232.0	248.1	272.8	300.0
Other Current Assets	967.6	1,034.8	1,137.9	1,251.0
Cash	743.4	1,160.0	1,102.4	1,673.9
Total Current Assets	4,563.0	5,245.0	5,594.5	6,612.2
Creditors	3,006.5	3,185.3	3,502.7	3,850.7
Provisions	766.6	812.2	893.2	981.9
Other current liabilities	3,099.3	3,314.6	3,644.9	4,007.1
Total Current Liabilities	6,872.4	7,312.1	8,040.8	8,839.7
Net Current Assets	-2,309.4	-2,067.1	-2,446.3	-2,227.5
Other non current assets	2,899.8	2,899.8	2,899.8	2,899.8
<b>Application of Funds</b>	<b>12,795.6</b>	<b>12,887.8</b>	<b>12,537.7</b>	<b>12,619.8</b>

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
<b>Per share data (₹)</b>				
EPS	52.0	63.7	56.5	71.8
Adj. EPS	51.8	61.5	56.5	71.8
BV	32.5	72.1	103.1	149.4
DPS	14.0	20.7	22.0	22.0
Cash Per Share	26.1	40.7	38.7	58.7
<b>Operating Ratios (%)</b>				
EBITDA Margin	25.3	24.4	24.0	25.0
PBT / Total Operating income	12.1	12.1	12.2	13.5
PAT Margin	8.8	9.8	8.2	9.5
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
<b>Return Ratios (%)</b>				
RoE	159.3	85.3	54.8	48.1
RoCE	26.5	27.1	28.0	32.7
RoIC	18.5	20.0	22.1	27.2
<b>Valuation Ratios (x)</b>				
P/E	25.0	20.4	23.0	18.1
EV / EBITDA	10.7	10.1	9.1	7.6
EV / Net Sales	2.7	2.5	2.2	1.9
Market Cap / Sales	2.2	2.1	1.9	1.7
Price to Book Value	39.9	18.0	12.6	8.7
<b>Solvency Ratios</b>				
Net Debt/EBITDA	1.6	1.3	1.0	0.6
Debt / Equity	8.5	3.5	2.1	1.2
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

## RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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