

Focus on topline growth over margins!

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

Q4FY23 Results: TCOM reported a weak quarter on the margins front.

- Topline came in at ₹ 4569 crore, up 7.2% YoY & up 0.9% QoQ, driven by data revenues (forming ~80% of revenues), which was up ~11.2% YoY (up 2.2% QoQ) at ₹ 3670 crore. Incubation services and Digital Platforms segment of data business grew ~65% and 16% YoY, respectively. Voice revenues were down 13.9% YoY (down 8.6% QoQ) at ₹ 462 crore
- Consolidated EBITDA at ₹ 1034 crore, was down 1.1% YoY and down 4% QoQ. The consequent margin was at 22.6% (down 190 bps YoY and down 115 bps QoQ) owing to lower data EBITDA margin, which was at 24%, down 240 bps QoQ. We highlight that it is the lowest margin in the last 12 quarters despite revenue growth picking up

What should investors do? TCOM's share price has grown at ~26% CAGR over the past five years.

- While topline growth focus is a positive stance, we would wait to see where margins settle over the medium term. We maintain our **HOLD** rating as the growth – margin construct remains out of sync

Target Price and Valuation: We value TCOM at a target price of ₹ 1250.

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 ~11.4% data segment revenue CAGR in FY23-25E and overall margins at 24.6% in FY25 vs. 24.2% in FY22, with margin weakness in FY24

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 ₹ 920

TATA COMMUNICATIONS

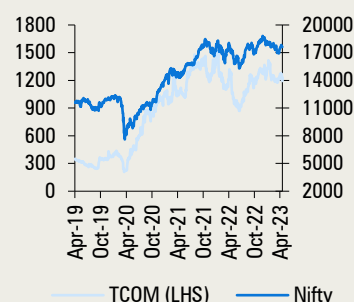
Particulars

Particulars	Amount
Market Capitalization	₹ 35208.9 Crore
Total Debt (FY23)	₹ 7554 Crore
Inv & Cash (FY23)	₹ 1822.1 Crore
EV	₹ 46738.4 Crore
52 week H/L	1431/ 856
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Shareholding pattern

	Jun-22	Sep-22	Dec-22	Mar-23
Promoters	58.9	58.9	58.9	58.9
DII	12.7	13.6	13.7	14.0
FII	17.9	17.0	17.3	17.0
Other	10.6	10.5	10.2	10.1

Price Chart



Key risks

Key Risk: (i) Any revenue growth challenges; (ii) Better-than-expected margins

Research Analyst

Bhupendra Tiwary, CFA
bhupendra.tiwary@icicisecurities.com

Key Financial Summary

(₹ Crоре)	FY20	FY21	FY22	FY23	5 yr CAGR (FY18-23)	FY24E	FY25E	3 yr CAGR (FY23-25E)
Net Sales	17,068.0	17,100.1	16,724.7	17,838.3	1.4	19,535.0	21,520.6	9.8
EBITDA	3,289.0	4,260.6	4,226.7	4,318.2	13.5	4,493.1	5,287.6	10.7
Adj. PAT	283.9	1,308.9	1,477.4	1,730.6	105.8	1,515.7	1,979.4	6.9
P/E (x)	NM	28.1	23.7	19.6		23.2	17.8	
Price / Book (x)	NM	304.6	37.9	23.2		13.9	8.9	
EPS (₹)	(3.0)	43.9	52.0	63.0		53.2	69.5	
EV/EBITDA (x)	14.2	10.7	10.3	9.9		9.2	7.5	
RoCE (%)	10.6	20.7	26.5	26.6		25.2	31.3	
RoE (%)	NM	1,133.6	159.3	114.0		59.8	50.4	

Source: Company, ICICI Direct Research;

Key performance highlight and outlook

Outlook & New Developments

- The management maintained its medium-term margins guidance range of 23-25% as they intend to reinvest incremental margins to drive growth. They also reiterated that FY24 margins would be at the lower end of the band as topline growth focus will take precedence over margins. They also stressed on driving double digit revenue growth (and possibly accelerate the revenue growth trajectory with "Product to Platform" shift) along with RoCEs of 25%+
- Growth funnel addition (pre stage of order book), in FY23** has been one of the best, with ~50% growth in large deal segment (US\$1+ mn average contract value). The company reiterated that **there is more conversation beyond connectivity and thus "relevance quotient" of company's offerings continue to improve.** The company intends to drive growth by enhanced product offerings in next gen connectivity, IZO WAN, cloud, etc. It also highlighted that ~40% of the order book is in the DPS segment currently, while it aspires achieve 50% of data revenue contribution from the Digital segment (versus ~32% currently). It has also put feet on street with new hiring and expanded front-end sales (especially internationally) and new capabilities
- Acquisition:** The company expects all necessary approvals to be in place soon and aims to attain Switch Enterprises integration in Q1FY24. Recall, TCOM acquired Switch Enterprise for US\$58.8 million in Q3FY23. 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. 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 part of Digital Platforms & Services business.

Data business performance

- Revenue was up 11.2% YoY & up 2.2% QoQ at ₹ 3670 crore, reflecting a revenue recovery is on track. Incubation services and Digital Platforms & Services (DPS) segment of data business witnessed strong growth. **Data EBITDA was at ₹ 882 crore (down 8.7% YoY, 6.9% QoQ) with a margin of 24%, down 233 bps QoQ and down 524 bps YoY.** As per our understanding, costs in Q4 were higher owing to a) employee expenses, b) higher growth in the DPS and innovation segment, which has lower margin profile than core connectivity, and c) investment in the international sales and capability teams' expansion for growth ahead. For FY23, data revenues grew 10.3% YoY at ₹ 14,095 crore. Data margins at 27%, were down 420 bps YoY as costs normalised post Covid led reopening, higher employee costs and overall expansion focus spends

Core connectivity (erstwhile traditional services)

- Revenue for the quarter was up 1.7% QoQ, 7.4% YoY at ₹ 2457 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 markets needs to drive this segment**

Digital Platforms & Services (erstwhile Growth services)

- Revenue for the quarter came in at ₹ 1080 crore, up 2.3% QoQ, 15.9% YoY. For Q4, collaboration revenue was down 3.5% QoQ, up 1.7% YoY. The SIP trunking (usage based) revenues have been stable, albeit there were some client level issues. 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 **GlobalRapid, DIGO, Insta CC** etc. continue to do well. Cloud,

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
Overall ESG Score	55.9	65.8	69.6

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

hosting and security was up 10% QoQ, 38.5% 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 4.8% QoQ, 10.3% YoY and – 2.3% QoQ, 19.4% YoY, respectively. **The management reiterated that underlying trends are positive for this business across segments**

Incubation (erstwhile Innovation services)

- Revenue for Q4 was up 9.4% QoQ and 65.3% YoY to ₹ 134 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 2.7% QoQ and 2.6% YoY to ₹ 342 crore. The company reported EBITDA of ₹ 13.1 crore with margins of 3.8% (up 160 bps YoY)

Payment solutions (TCPSEL)

- Q4 revenue was at ₹ 46 crore, down 7.4% QoQ, up 8% YoY. The franchise model is making steady progress and the company has added ~3300 ATMs on franchise model till date. EBITDA for the quarter was ₹ 21 crore

Voice business:

- Revenue for the quarter came in at ₹ 462 crore, down 13.9% YoY, due to a decline in overall voice volume, which came in at 2.5 billion (bn) minutes, a decline of ~21.6% YoY. Realisations were up ~9.8% YoY to ₹ 1.85/minute. **Voice margins for the quarter came in at 19.6%, up 1260 bps YoY, aided by India market shift aiding realisations, which is short-term in nature, as per the company and should gradually subside from FY24 onwards**

Capex and debt:

- Cash capex for the quarter was at ₹ 400 crore vs. ₹ 440 crore in Q3. **The committed capex at ₹ 531 crore in Q4 was one of the highest in last 20 quarters.** FCF was ₹ 631 crore (vs. 335 crore in Q3). Going ahead, capex guidance is US\$300-325 mn with most of the capex being growth led and US\$100 mn for revamping and expanding the undersea cable. The actual capex for FY23 has been lower than committed owing to supply chain issues and better terms with creditors. **There was a sequential decline in net debt by ~₹ 538 crore QoQ to ₹ 5732 crore, largely aided by cash flow generation. The Net Debt to EBITDA was at 1.3x (vs. 1.5x in Q3).**

Others

- The depreciation for the quarter was impacted by a ~₹ 41 crore one-off cost, related to the change in accounting for terminal value recognition of old cables

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. The topline growth focus is a positive stance but we would wait to see where margins settle over medium term.

We maintain HOLD given the growth – margin construct is not in sync. We assign a target price of ₹ 1250/share, at 18x FY25 P/E.

Exhibit 1: Variance Analysis

	Q4FY23	Q4FY23E	Q4FY22	Q3FY23	YoY (%)	QoQ (%)	Comments
Revenue	4,568.7	4,608.8	4,263.0	4,528.3	7.2	0.9	Revenue was driven by data revenues (forming ~80% of the revenues) which was up ~11.2% YoY (up 2.2% QoQ) at ₹ 3670 crore. Incubation services and Digital Platforms segment of Data business witnessed strong growth of ~65% and 16% YoY, respectively. Voice segment continued to remain weak with revenues down 13.9% YoY (down 8.6% QoQ) at ₹ 462 crore
Other Income	61.8	31.0	263.5	30.8	-76.6	100.9	
Employee Expenses	999.6	931.0	768.4	920.8	30.1	8.6	
Administrative Expenses	896.2	967.8	908.9	914.2	-1.4	-2.0	
Network costs	1,638.7	1,644.7	1,540.4	1,616.0	6.4	1.4	
EBITDA	1,034.2	1,065.3	1,045.3	1,077.4	-1.1	-4.0	Margin decline was owing to higher employee costs and spends to drive revenues growth
EBITDA Margin (%)	22.6	23.1	24.5	23.8	-188 bps	-115 bps	
Depreciation	618.5	555.7	588.7	554.8	5.1	11.5	The depreciation for the quarter was impacted by a ~₹ 41 crore one-off cost, related to the change in accounting for terminal value recognition of old cables
Interest	132.1	120.9	89.8	122.7	47.2	7.7	
Exceptional Items	0.0	0.0	20.9	0.0	0.0	NM	
Total Tax	28.1	96.1	243.3	43.6	-88.5	-35.6	
PAT	326.0	330.1	365.1	393.9	-10.7	-17.2	Weak operating performance percolated to bottomline

Source: Company, ICICI Direct Research

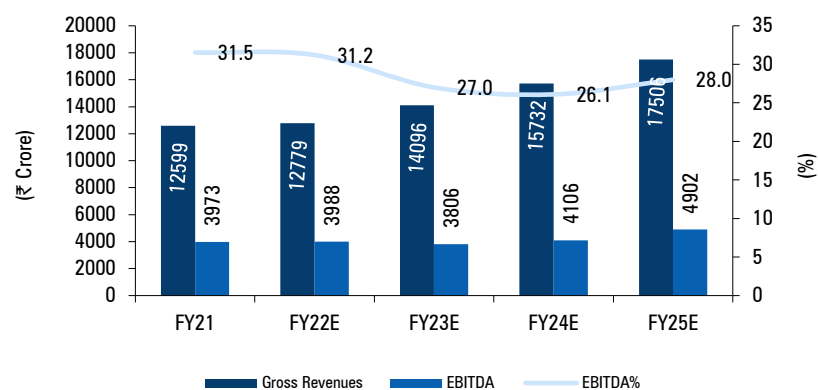
Exhibit 2: Change in estimates

	FY24E			FY25E			
(₹ Crore)	Old	New	% Change	Old	New	% Change	
Revenue	19,669.0	19,535.0	-0.7	21,623.3	21,520.6	-0.5	
EBITDA	4,720.6	4,493.1	-4.8	5,405.8	5,287.6	-2.2	
EBITDA Margin (%)	24.0	23.0	-100 bps	25.0	24.6	-43 bps	We lower the margin given the commentary and Q4 performance
PAT	1,611.3	1,515.7	-5.9	2,047.4	1,979.4	-3.3	
EPS (₹)	56.5	53.2	-5.9	71.8	69.5	-3.3	

Source: Company, ICICI Direct Research

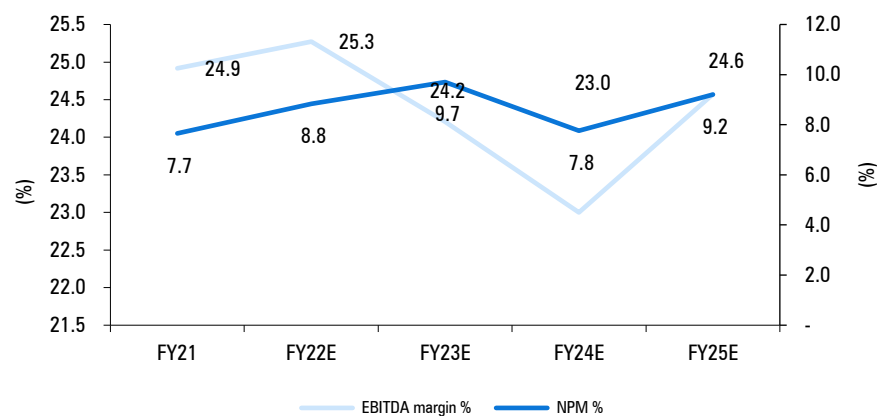
Financial story in charts

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	FY23	FY24E	FY25E	
Total operating Income	16724.7	17838.3	19535.0	21520.6	
Growth (%)	(2.2)	6.7	9.5	10.2	
Employee Expenses	3040.3	3597.5	4082.8	4261.1	
Network costs	6199.5	6375.5	7071.7	7710.8	
Administrative Expenses	3258.2	3547.1	3887.5	4261.1	
Other Expenses	0.0	0.0	0.0	0.0	
Total Operating Expenditure	12498.0	13520.0	15042.0	16233.0	
EBITDA	4226.7	4318.2	4493.1	5287.6	
Growth (%)	-0.8	2.2	4.0	17.7	
Depreciation	2204.5	2261.8	2344.2	2474.9	
Interest	360.3	432.5	493.8	423.8	
Other Income	332.1	363.2	152.0	170.0	
Exceptional Items	-6.0	-76.4	0.0	0.0	
PBT	2000.0	2063.5	1807.1	2559.0	
Minority Interest	2.9	4.9	4.1	5.4	
PAT from Associates	6.8	34.0	38.0	40.0	
Total Tax	522.1	296.6	325.3	614.2	
PAT	1481.8	1796.0	1515.7	1979.4	
Growth (%)	18.5	21.2	-15.6	30.6	
Adjusted PAT	1477.4	1730.6	1515.7	1979.4	
Growth (%)	12.9	17.1	-12.4	30.6	
EPS (₹)	52.0	63.0	53.2	69.5	

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement					₹ crore
(Year-end March)	FY22E	FY23E	FY24E	FY25E	
Profit after Tax	1481.8	1796.0	1515.7	1979.4	
Add: Depreciation	2204.5	2261.8	2344.2	2474.9	
Add: Interest Paid	360.3	432.5	493.8	423.8	
(Inc)/dec in Current Assets	-65.2	-316.1	-271.7	-448.0	
Inc/(dec) in CL and Provisions	-40.5	784.1	589.7	838.2	
Others	0.0	0.0	0.0	0.0	
CF from operating activities	3940.9	4958.3	4671.7	5268.2	
(Inc)/dec in Investments	668.1	-385.3	-50.0	-50.0	
(Inc)/dec in Fixed Assets	-2167.6	-2266.0	-2300.0	-2300.0	
Others	484.9	17.0	-235.9	-238.7	
CF from investing activities	-1014.6	-2634.3	-2585.9	-2588.7	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	-2080.1	-367.0	-1000.0	-1000.0	
Less: Interest Paid	-360.3	-432.5	-493.8	-423.8	
Less: Dividend and dividend tax	-399.0	-399.0	-399.0	-484.5	
Others	-270.6	-806.3	-100.0	-100.0	
CF from financing activities	-3109.9	-2004.7	-1992.8	-2008.3	
Net Cash flow	-183.7	319.2	93.0	671.2	
Opening Cash	927.1	743.4	1062.6	1155.6	
Closing Cash	743.4	1062.6	1155.6	1826.8	

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet					₹ crore
(Year-end March)	FY22	FY23	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	1,233.3	2,249.9	3,644.8	
Total Shareholders funds	927.6	1,518.3	2,534.9	3,929.8	
Total Debt	7,921.0	7,554.0	6,554.0	5,554.0	
Others	3,947.0	3,823.9	3,588.0	3,349.3	
Total Liabilities	12,795.6	12,896.2	12,676.9	12,833.1	
Assets					
Net Block	9,752.9	9,532.4	9,488.2	9,313.4	
Capital WIP	778.7	1,003.4	1,003.4	1,003.4	
Total Fixed Assets	10,531.6	10,535.8	10,491.6	10,316.7	
Investments	1,565.2	1,950.6	2,000.6	2,050.6	
Goodwill on Consolidation	108.3	115.1	115.1	115.1	
Inventory	37.9	160.0	53.5	59.0	
Debtors	2,582.1	2,735.0	2,995.1	3,299.6	
Loans and Advances	232.0	293.2	321.1	353.7	
Other Current Assets	967.6	947.5	1,037.6	1,143.1	
Cash	743.4	1,062.6	1,155.6	1,826.8	
Total Current Assets	4,563.0	5,198.2	5,562.9	6,682.2	
Creditors	3,006.5	3,277.2	3,478.8	3,832.4	
Provisions	766.6	847.2	899.3	990.7	
Other current liabilities	3,099.3	3,532.1	3,868.1	4,261.2	
Total Current Liabilities	6,872.4	7,656.5	8,246.2	9,084.3	
Net Current Assets	-2,309.4	-2,458.2	-2,683.2	-2,402.2	
Other non current assets	2,899.8	2,753.0	2,753.0	2,753.0	
Application of Funds	12,795.6	12,896.2	12,676.9	12,833.1	

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					
(Year-end March)	FY22	FY23	FY24E	FY25E	
Per share data (₹)					
EPS	52.0	63.0	53.2	69.5	
Adj. EPS	51.8	60.7	53.2	69.5	
BV	32.5	53.3	88.9	137.9	
DPS	14.0	14.0	14.0	17.0	
Cash Per Share	26.1	37.3	40.5	64.1	
Operating Ratios (%)					
EBITDA Margin	25.3	24.2	23.0	24.6	
PBT / Total Operating income	12.1	11.5	11.0	13.1	
PAT Margin	8.8	9.7	7.8	9.2	
Inventory days	0.8	3.3	1.0	1.0	
Debtor days	56.4	56.0	56.0	56.0	
Creditor days	65.6	67.1	65.0	65.0	
Return Ratios (%)					
RoE	159.3	114.0	59.8	50.4	
RoCE	26.5	26.6	25.2	31.3	
RoIC	18.5	19.2	20.0	26.4	
Valuation Ratios (x)					
P/E	23.7	19.6	23.2	17.8	
EV / EBITDA	10.3	9.9	9.2	7.5	
EV / Net Sales	2.6	2.4	2.1	1.8	
Market Cap / Sales	2.1	2.0	1.8	1.6	
Price to Book Value	37.9	23.2	13.9	8.9	
Solvency Ratios					
Net Debt/EBITDA	1.6	1.3	1.0	0.6	
Debt / Equity	8.5	5.0	2.6	1.4	
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%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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