HOLD Tata Communications

Scale and synergy to improve margin

Emkay
Your success is our success

Telecommunications › Company Update › **October 25, 2023**

TARGET PRICE (Rs): 1,840

TCom declined by 11%, following Q2FY24 results. Although Q2 results were broadly in-line, the steep correction following the result is largely due to moderation in underlying growth in Q2 with digital portfolio growth at 16.4% YoY (-1.2% QoQ) vs. 28% YoY (+8.6% QoQ) in Q1. Moreover, management's short-term margin guidance below 20% was also taken negatively. However, structurally, we remain positive on TCom. We like TCom's focus on digital services. Digital services (ex-Collaboration) has been delivering good performance. Kaleyra's acquisition will aid growth in collaboration. Focus on gaining scale and synergies can help improve margin faster. We see earnings improving at a fast pace from FY25 post peak investments in FY24, although the stock may consolidate in the interim. We retain our HOLD rating.

Tata Communications: Financial Snapshot (Consolidated)

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	1,67,247	1,78,383	2,11,813	2,45,015	2,67,084
EBITDA	42,267	43,182	43,233	52,185	60,925
Adj. PAT	14,758	16,546	10,142	18,984	25,273
Adj. EPS (Rs)	52.0	60.7	35.6	66.6	88.7
EBITDA margin (%)	25.3	24.2	20.4	21.3	22.8
EBITDA growth (%)	(0.8)	2.2	0.1	20.7	16.7
Adj. EPS growth (%)	18.5	16.8	(41.4)	87.2	33.1
RoE (%)	417.0	170.0	68.0	83.4	69.5
RoIC (%)	21.4	29.1	18.8	27.0	35.0
P/E (x)	31.1	27.7	45.2	24.2	18.1
EV/EBITDA (x)	12.5	11.9	12.4	10.0	8.3
P/B (x)	63.8	37.3	26.1	16.4	10.3
FCFF yield (%)	3.8	4.7	(2.5)	4.0	4.7

Source: Company, Emkay Research

We like improving order book and use of acquisition to enter new markets

We remain positive on TCom in the long term, as **(i)** Management's commentary on increased order book in the last few quarters is positive, despite the longer conversion cycle of the funnel; **(ii)** Acquisition of Switch and Kaleyra gives the company greater access to U.S./European markets; **(iii)** Early consolidation of Kaleyra from Q3FY24 will also aid faster realization of synergy benefits; **(iv)** TCom has also set a profitability glide path for each platform, which will aid in improving profitability. TCom's strength lies in operating in areas that include Network, Cloud, IoT, Mobility and Security. In our visit to TCom's experience center, the company has showcased its capability and credibility in stitching together platforms to solve customer problems. This can help TCom drive the next phase of growth. (***Link to report***).

Margin dilution in the interim; long-term story intact; HOLD

We see short-term margin dilution due to acquisitions (Switch and Kaleyra), with margin below 20% in Q3FY24 (vs. 24.2% in FY23). However, with synergy and operating leverage benefits, margin can recover to 23% by the end of FY26. We expect revenue/EBITDA to register a 14.2%/12% CAGR over FY23-26E. Revenue growth is expected to be led by the digital platform and services (40% CAGR over FY23-26E), which can also benefit from the Switch and Kaleyra's acquisitions as they gain scale. We see the share of digital platform and services revenue (ex-incubation) in data revenue increasing from 29% in FY23 to 48% in FY26, aided by acquisitions and improving scale. However, the stock may consolidate in the interim, before investors see actual signs of synergy benefits or TCom gaining scale in U.S./Europe markets. We retain our HOLD rating with a TP of Rs1,840/share (10.5x Sep-25E EBITDA).

Target Price – 12M	Sep-24
Change in TP (%)	-
Current Reco.	HOLD
Previous Reco.	HOLD
Upside/(Downside) (%)	14.4
CMP (23-Oct-23) (Rs)	1,609.0

Stock Data	Ticker
52-week High (Rs)	1,957
52-week Low (Rs)	1,157
Shares outstanding (mn)	285.0
Market-cap (Rs bn)	459
Market-cap (USD mn)	5,512
Net-debt, FY24E (Rs mn)	75,833
ADTV-3M (mn shares)	1
ADTV-3M (Rs mn)	1,865.1
ADTV-3M (USD mn)	22.4
Free float (%)	-
Nifty-50	19,282
INR/USD	83.2
Shareholding, Sep-23	
Promoters (%)	58.9
FPIs/MFs (%)	17.5/13.6

Price Performance

(%)	1M	3M	12M
Absolute	(14.2)	1.2	32.8
Rel. to Nifty	(12.5)	3.6	21.1

1-Year share price trend (Rs)

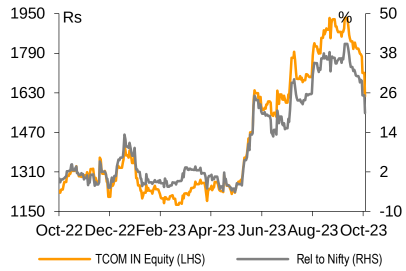

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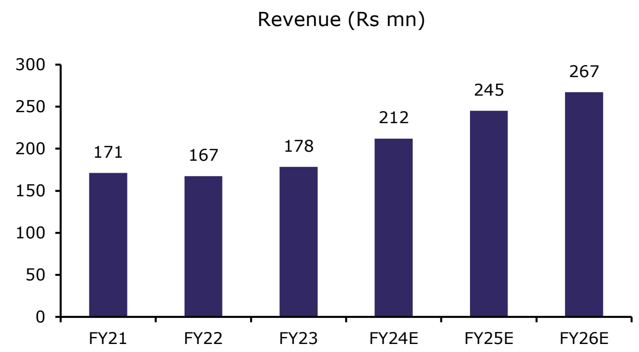
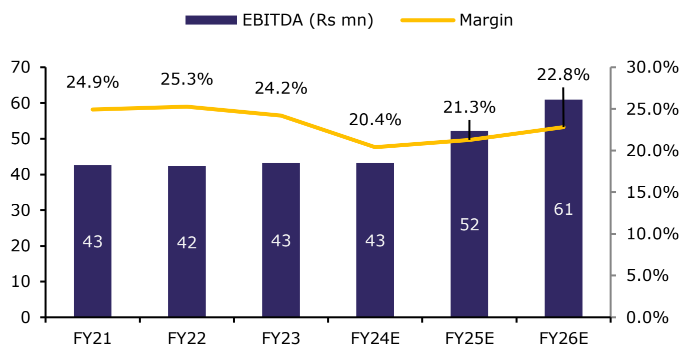
Exhibit 1: Revenue to register a 14.2% CAGR over FY23-26E



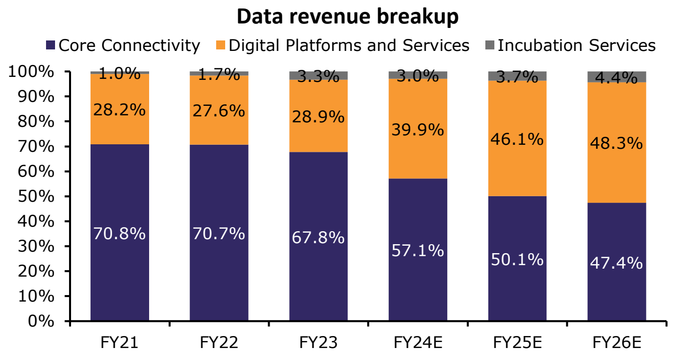
Source: Company, Emkay Research

Exhibit 2: Margin to improve gradually with synergy benefits



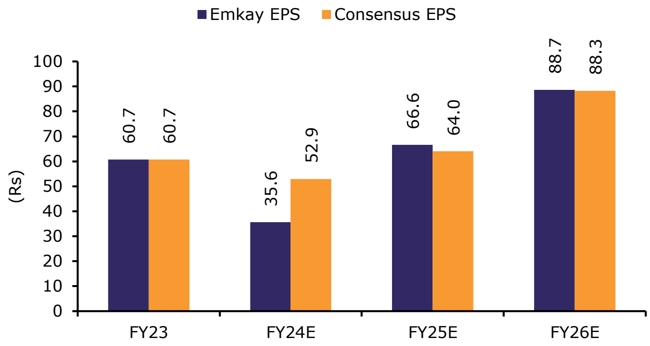
Source: Company, Emkay Research

Exhibit 3: Share of digital platform services in data revenue to increase to ~50% by FY26E



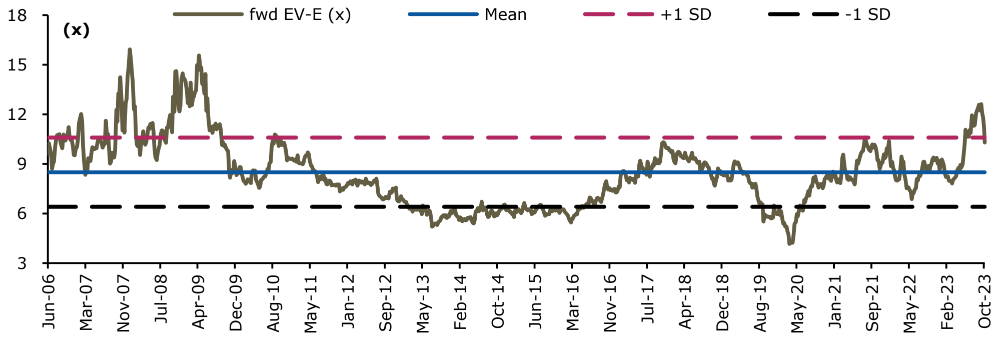
Source: Company, Emkay Research

Exhibit 4: EPS to improve at a fast pace post investment phase in FY24E



Source: Company, Emkay Research

Exhibit 5: EV/EBITDA (One-year forward)



Source: Bloomberg

Tata Communications: Consolidated Financials and Valuations

Profit and Loss

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	**1,67,247**	**1,78,383**	**2,11,813**	**2,45,015**	**2,67,084**
Revenue growth (%)	(2.2)	6.7	18.7	15.7	9.0
EBITDA	**42,267**	**43,182**	**43,233**	**52,185**	**60,925**
EBITDA growth (%)	(0.8)	2.2	0.1	20.7	16.7
Depreciation & Amortization	22,061	22,618	27,007	25,879	27,452
EBIT	**20,206**	**20,564**	**16,226**	**26,306**	**33,472**
EBIT growth (%)	3.8	1.8	(21.1)	62.1	27.2
Other operating income	0	0	0	0	0
Other income	3,321	3,632	3,000	3,000	3,000
Financial expense	3,603	4,974	6,292	5,985	5,425
PBT	**19,924**	**19,221**	**12,934**	**23,322**	**31,048**
Extraordinary items	60	764	0	0	0
Taxes	5,221	2,966	2,973	4,664	6,210
Minority interest	13	49	13	23	31
Income from JV/Associates	68	340	194	350	466
Reported PAT	**14,818**	**17,310**	**10,142**	**18,984**	**25,273**
PAT growth (%)	18.5	16.8	(41.4)	87.2	33.1
Adjusted PAT	**14,758**	**16,546**	**10,142**	**18,984**	**25,273**
Diluted EPS (Rs)	**52.0**	**60.7**	**35.6**	**66.6**	**88.7**
Diluted EPS growth (%)	18.5	16.8	(41.4)	87.2	33.1
DPS (Rs)	**20.7**	**21.0**	**25.0**	**30.0**	**30.0**
Dividend payout (%)	**39.8**	**34.6**	**70.3**	**45.0**	**33.8**
EBITDA margin (%)	25.3	24.2	20.4	21.3	22.8
EBIT margin (%)	12.1	11.5	7.7	10.7	12.5
Effective tax rate (%)	26.2	15.4	23.0	20.0	20.0
NOPLAT (pre-IndAS)	**14,911**	**17,391**	**12,496**	**21,045**	**26,778**
Shares outstanding (mn)	285.0	285.0	285.0	285.0	285.0

Source: Company, Emkay Research

Balance Sheet

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	2,850	2,850	2,850	2,850	2,850
Reserves & Surplus	5,810	10,981	14,705	25,139	41,862
Net worth	**8,660**	**13,831**	**17,555**	**27,989**	**44,712**
Minority interests	285	303	290	267	236
Deferred tax liability (net)	(1,868)	(2,798)	(2,798)	(2,798)	(2,798)
Total debt	**91,215**	**85,766**	**1,04,866**	**1,06,866**	**96,866**
Total liabilities & equity	**98,292**	**97,103**	**1,19,914**	**1,32,325**	**1,39,016**
Net tangible fixed assets	81,451	78,568	89,869	91,591	72,578
Net intangible assets	16,225	16,460	18,369	18,762	18,811
Net ROU assets	11,488	9,968	9,085	7,089	22,602
Capital WIP	8,723	11,481	11,481	11,481	11,481
Goodwill	0	0	18,000	18,000	18,000
Investments [JV/Associates]	15,652	19,506	14,506	14,506	14,506
Cash & equivalents	**6,820**	**10,782**	**14,528**	**29,938**	**36,567**
Current assets (ex-cash)	52,011	52,803	61,183	66,478	72,280
Current Liab. & Prov.	95,557	1,04,014	1,17,105	1,25,519	1,27,806
NWC (ex-cash)	**(43,545)**	**(51,210)**	**(55,922)**	**(59,042)**	**(55,526)**
Total assets	**98,292**	**97,103**	**1,19,914**	**1,32,325**	**1,39,016**
Net debt	68,743	55,479	75,833	62,423	45,794
Capital employed	96,814	95,554	1,19,914	1,32,325	1,39,016
Invested capital	**65,618**	**53,786**	**79,400**	**76,401**	**76,464**
BVPS (Rs)	25.2	43.1	61.6	98.2	156.9
Net Debt/Equity (x)	9.6	4.5	4.3	2.2	1.0
Net Debt/EBITDA (x)	1.6	1.3	1.8	1.2	0.8
Interest coverage (x)	0.2	0.2	0.3	0.2	0.1
RoCE (%)	**22.6**	**25.2**	**17.8**	**23.2**	**26.9**

Source: Company, Emkay Research

Cash Flows

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	19,924	19,221	12,934	23,322	31,048
Others (non-cash items)	0	0	0	0	0
Taxes paid	(5,221)	(2,966)	(2,973)	(4,664)	(6,210)
Change in NWC	4,062	6,735	4,712	3,120	(3,515)
Operating cash flow	**40,724**	**46,610**	**43,397**	**47,959**	**49,179**
Capital expenditure	(19,823)	(21,208)	(57,333)	(26,000)	(24,000)
Acquisition of business	6,681	(3,853)	5,000	0	0
Interest & dividend income	71	71	71	71	71
Investing cash flow	**(9,820)**	**(21,430)**	**(49,333)**	**(23,000)**	**(21,000)**
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	(22,721)	(5,449)	19,100	2,000	(10,000)
Payment of lease liabilities	(2,104)	(1,816)	0	0	10,432
Interest paid	(3,603)	(4,974)	(6,292)	(5,985)	(5,425)
Dividend paid (incl tax)	(5,900)	(5,985)	(7,125)	(8,550)	(8,550)
Others	(2,425)	11,566	2,571	2,034	2,034
Financing cash flow	**(34,647)**	**(4,842)**	**8,254**	**(10,500)**	**(21,940)**
Net chg in Cash	(3,744)	20,338	2,318	14,459	6,239
OCF	40,724	46,610	43,397	47,959	49,179
Adj. OCF (w/o NWC chg.)	44,786	53,345	48,109	51,079	45,664
FCFF	20,901	25,402	(13,936)	21,959	25,179
FCFE	17,370	20,499	(20,157)	16,046	19,826
OCF/EBITDA (%)	96.3	107.9	100.4	91.9	80.7
FCFE/PAT (%)	117.2	118.4	(198.7)	84.5	78.4
FCFF/NOPLAT (%)	**140.2**	**146.1**	**(111.5)**	**104.3**	**94.0**

Source: Company, Emkay Research

Valuations and Key Ratios

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	31.1	27.7	45.2	24.2	18.1
P/CE(x)	13.2	12.4	13.1	10.9	9.2
P/B (x)	63.8	37.3	26.1	16.4	10.3
EV/Sales (x)	3.2	2.9	2.5	2.1	1.9
EV/EBITDA (x)	12.5	11.9	12.4	10.0	8.3
EV/EBIT(x)	27.5	26.4	34.7	20.9	15.9
EV/IC (x)	8.5	10.1	7.1	7.2	7.0
FCFF yield (%)	3.8	4.7	(2.5)	4.0	4.7
FCFE yield (%)	3.6	4.2	(4.1)	3.3	4.1
Dividend yield (%)	1.3	1.3	1.6	1.9	1.9
DuPont-RoE split					
Net profit margin (%)	8.8	9.3	4.8	7.7	9.5
Total asset turnover (x)	1.6	1.9	2.0	1.9	2.0
Assets/Equity (x)	29.4	9.9	7.2	5.5	3.7
RoE (%)	**417.0**	**170.0**	**68.0**	**83.4**	**69.5**
DuPont-RoIC					
NOPLAT margin (%)	8.9	9.7	5.9	8.6	10.0
IC turnover (x)	0.0	0.0	0.0	0.0	0.0
RoIC (%)	**21.4**	**29.1**	**18.8**	**27.0**	**35.0**
Operating metrics					
Core NWC days	(95.0)	(104.8)	(96.4)	(88.0)	(75.9)
Total NWC days	**(95.0)**	**(104.8)**	**(96.4)**	**(88.0)**	**(75.9)**
Fixed asset turnover	0.5	0.5	0.5	0.6	0.6
Opex-to-revenue (%)	37.7	40.1	42.3	41.3	40.8

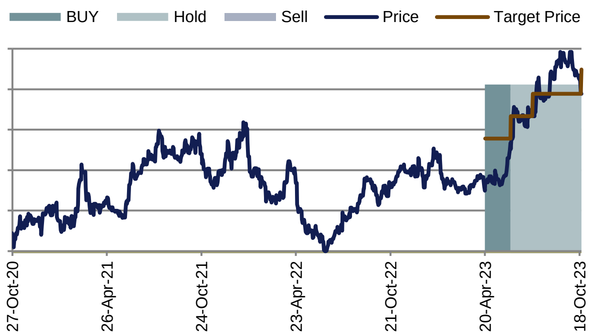
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	CMP (INR)	TP (INR)	Rating	Analyst
21-Oct-23	1,710	1,840	Hold	Santosh Sinha
03-Sep-23	1,852	1,710	Hold	Santosh Sinha
20-Jul-23	1,604	1,710	Hold	Santosh Sinha
29-Jun-23	1,583	1,590	Hold	Santosh Sinha
08-Jun-23	1,414	1,590	Hold	Santosh Sinha
20-Apr-23	1,232	1,470	Buy	Santosh Sinha

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

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