

Seasonality/Deal closure delays impact performance

Tata Communication Q3FY21 revenues were weak sequentially largely due to seasonality and COVID related weakness in deal conversion impacting data revenues growth. Topline came in at ₹ 4223 crore, flattish YoY & down 4% QoQ with data revenues (forming ~84% of the revenues) up 3.8% YoY (down 2.6% QoQ). Consolidated EBITDA came in at ₹ 1046 crore, up 37.5% YoY with margin at 24.8% (up 678 bps YoY) but down 153 bps QoQ as Q2FY21 one-off gain of ₹ 43 crore and there was also an impact of ₹ 31 crore, due to timing difference of revenue & cost recognition in Voice segment. The company reported a PAT of ₹ 309 crore, (up 4.3x YoY, down 20% QoQ) with beat owing to lower depreciation and tax rate.

Growth segment revenues slows down...

The Growth segment was up 2.6% YoY and declined 10.8% QoQ. The company attributed the muted YoY growth to slower deal conversion in wake of business uncertainties due to COVID (especially media and mobility segment), while sequential decline was due to seasonality and lower usage-based revenue due to holidays. However, the company indicated that demand outlook is robust in the medium/long term and recovery is likely over the next couple of quarters. The company continues to target network transformation deals and called out Mobility and IOT as the future growth driver in the long term.

Data margins normalise as one-offs benefits wanes off

The company stated that it had benefited by ~₹ 50 crore per quarter due to covid-19 costs deferral. However, some of these have normalised as business cost now released which was held back. **Going into Q4FY21, more cost normalisation is likely. However, we highlight that the margins expansion YoY (~678 bps YoY) is largely aided by structural cost rationalisation (~₹ 100 crore quarterly), favourable mix of services, and lower losses in innovation services.** We bake in 8.5% revenue CAGR in FY20-23E in the overall data segment. We expect data margins at 27.3% in FY23 vs. 22.1% in FY20, given the structural cost rationalisation benefits and improved profitability in transformation/innovation segments.

Valuation & Outlook

The company's strategic growth plan, focused approach and structural improvement in data segment margins has driven multiple re-rating, which is visible in the price run up in last 3 quarters. While deal closures delays could have near term weakness in revenues, demand outlook is robust in the medium/long term. With stable performance and improved cash flow generation, deleveraging possibilities (already reduced net debt by ₹ 1204 crore over the last 3 quarters) bode well for the company. Thus, we maintain **BUY** with a revised SoTP target price of ₹ 1210/share, rolling over our valuations to FY23E.

TATA COMMUNICATIONS

Particulars	Amount
Market Capitalization	₹ 29963.5 Crore
Total Debt (FY20)	₹ 10746 Crore
Cash (FY20)	₹ 909.1 Crore
EV	₹ 41492.9 Crore
52 week H/L	937/ 206
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Key Highlights

- EBITDA margin was at 24.8% (up 678 bps YoY) but down 153 bps QoQ as Q2FY21 one-off gain of ₹ 43 crore and there was also an impact of ₹ 31 crore, due to timing difference of revenue & cost recognition in Voice segment.
- Maintain BUY rating, valuing at ₹ 1210/share on SoTP basis

Key risk to our call

- Delay in revenues growth recovery could impact operating leverage benefits and earnings growth estimates, going ahead.
- Turnaround in transformation and innovation will hold key for overall stepping up of margins in medium to long term. Non-fructification of the same could long term impact growth potential.

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	16,525.0	17,068.0	17,633.8	18,812.2	20,076.6	5.6
EBITDA	2,744.9	3,289.0	4,340.9	4,533.7	4,973.7	14.8
Adjusted PAT	(232.2)	283.9	1,330.1	1,312.3	1,570.2	76.8
Adjusted P/E (x)	NM	105.5	22.5	22.8	19.1	
Price / Book (x)	NM	NM	NM	NM	NM	
Adjusted EPS (₹)	(8.1)	10.0	46.7	46.0	55.1	
EV/EBITDA (x)	14.1	12.6	9.1	8.3	7.0	
RoCE (%)	5.4	7.8	16.0	16.6	18.5	
RoE (%)	NM	NM	NM	NM	NM	

Exhibit 1: Variance Analysis

	Q3FY21	Q3FY21E	Q3FY20	Q2FY21	YoY (%)	QoQ (%)	Comments
Revenue	4,222.8	4,294.1	4,228.7	4,401.1	-0.1	-4.1	The data revenues (forming ~84% of the revenues) grew by 3.8% YoY (down 2.6% QoQ). Voice segment continued to remain weak with revenues down 16.6% YoY at ₹ 674 crore
Other Income	8.2	15.0	14.0	76.1	-41.2	-80.3	
Employee Expenses	770.0	742.9	746.2	761.9	3.2	-2.5	
Administrative Expenses	853.9	880.3	1,037.7	846.7	-17.7	4.0	
Network costs	1,552.9	1,606.0	1,684.0	1,634.9	-7.8	-1.8	
Raw Material Expenses	0.0	0.0	0.0	0.0	0.0	0.0	
EBITDA	1,046.1	1,064.9	760.8	1,157.5	37.5	-8.0	
EBITDA Margin (%)	24.8	24.8	18.0	26.3	678 bps	-153 bps	
Depreciation	557.0	573.0	560.5	571.9	-0.6	-2.6	
Interest	104.4	105.0	116.1	106.4	-10.1	-1.9	
Exceptional Items	11.4	0.0	0.0	54.0	0.0	0.0	
Total Tax	71.1	116.6	40.6	115.3	75.4	-38.3	
PAT	309.2	283.9	58.5	384.5	428.1	-19.6	PAT beat owing to lower depreciation and tax rate
Total Minutes (in billion)	4.6	4.7	6.0	5.2	-22.3	-10.1	
GDS Revenues	3,549	3,570	3,399	3,604	4.4	-1.5	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			FY23E	Introduced
	Old	New	% Change	Old	New	% Change		
Revenue	17,939.6	17,633.8	-1.7	19,007.5	18,812.2	-1.0	20,076.6	Realign after Q3 performance
EBITDA	4,209.1	4,340.9	3.1	4,466.8	4,533.7	1.5	4,973.7	
EBITDA Margin (%)	23.5	24.6	115 bps	23.5	24.1	60 bps	24.8	
PAT	1,107.5	1,271.5	14.8	1,244.2	1,312.3	5.5	1,570.2	
EPS (₹)	38.9	44.6	14.8	43.7	46.0	5.5	55.1	

Source: Company, ICICI Direct Research

Business Highlights

Voice business:

- Revenue for the quarter came in at ₹ 674 crore, down 16.6% YoY and 11.2% QoQ, on account of a decline overall voice volume which came in at 4.6 billion (bn) minutes, a decline of 15.6% YoY, 5% QoQ. Realisations were down 1.3 % YoY (down 6.4% QoQ) to ₹ 1.45/minute on account of better destination mix
- Voice margins for the quarter came in at 2.9%, down 290bps YoY, owing to one of the deals wherein revenue was booked in previous quarters while associated one-off cost was booked in this quarter due to timing difference. This led to an impact of ₹ 31 crore on the EBITDA.

Data business

- Revenue grew 3.8% YoY, down 2.6% QoQ at ₹ 3549 crore, driven by continued traction in traditional segment, while growth services witnessed muted growth. Sequential revenue was impacted by slower deal conversion due to COVID, seasonality and lower usage-based revenue in Growth Services. **Enterprise segment (63% of revenues) was up 1% YoY while service providers'/carriers revenues were up 5.4% YoY**
- EBITDA was at ₹ 1026 crore with a margin of 28.9%. EBITDA has grown 43.8% YoY, down 7.3% QoQ. EBITDA margins expanded 806 bps YoY but tapered by 150 bps QoQ, **as Q2FY21 had one-off gain of ₹ 43 crore and there was also an impact of ₹ 31 crore, due to timing difference of revenue & cost recognition in Voice segment.**

Traditional data services

- Revenue for the quarter was up 6% YoY, 0.8% QoQ at ₹ 2288 crore **with traction from Enterprise and OTT segments**. ILL grew by 15.7% YoY, while IP transit witnessed 11.8% growth YoY.
- Reported EBITDA came in at ₹ 981 crore, witnessing growth of 20.7% YoY and 3.4% sequential decline with a margin of 42.9%, up 530 bps YoY on the back of cost efficiency

Growth services:

- Revenue for the quarter came in at ₹ 806 crore, up 2.6% YoY and decline of 10.8% QoQ. Revenue growth has been slower than expected due to slower deal conversion in wake of business uncertainties due to COVID. Sequential decline was due to seasonality and lower usage-based revenue due to holidays. Within the segment, Video Connect business grew by 11% YoY.
- EBITDA for the quarter came in at ₹ 150 crore, witnessing 146% YoY and down 16.1% QoQ. EBITDA margins have expanded by 890 bps YoY to 15.6% (albeit down 100 bps QoQ), recording double-digit margins for a fourth consecutive quarter.

Transformation services:

- Revenue (net of inter-segmental eliminations) was down 1.8% YoY, and 3.3 QoQ to ₹ 322 crore.
- EBITDA loss for the quarter was at ₹ 9 crore (vs. ₹ 4 crore profit in Q2). Revenue and profitability continue to be affected for this business, while the transaction volume remained low due to COVID with transition costs also continuing. It had large deals in our order book, but the execution is taking longer due to COVID related restrictions affecting the scale up.

Innovation services:

- Revenue grew 25.2% YoY, down 10.2% QoQ to ₹ 32 crore.
- EBITDA loss for Q3FY21 was ₹ 103 crore as compared to a loss of ₹ 148 crore in Q3FY20.

Payment solutions:

- Revenue came in at ₹ 59 crore, down 32.4% YoY but up 1.9% 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 77 in Q3FY21 (vs. 64 in Q2) but average transactions count remains sharply below 89 in Q3FY20. As a result of the same, EBITDA was ₹ 5 crore (vs. losses in Q2) but much lower than ₹ 24 crore EBITDA in Q3FY20

Other highlights:

- Capex for the quarter was at ₹ 339 crore vs. ₹ 318 crore in Q2. FCF was ₹ 707 crore (vs. 840 crore in Q2). Net debt was at ₹ 7972 crore, decline of ₹ 659 crore QoQ, driven by healthy FCF during the quarter
Net debt to EBITDA on TTM basis was 1.9x vs. 2.9x in Q3FY20.

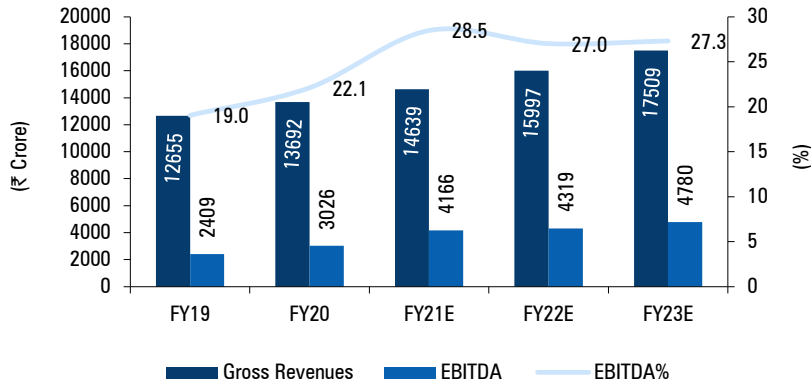
Valuations**Exhibit 3: Valuations**

Particulars	FY23 EBITDA (₹ Crore)	EV/EBITDA (x)	Amount (₹ Crore)
GVS Business Enterprise Value	192.6	3.0	587
GDS Business Enterprise Value (incl. Rent)	4,780.0	8.0	38,474
Data Centre - 26% stake (based on 20x EV/EBITDA)			1,820
Less: Net Debt (incl. Lease Liability)	-	-	4,882
Less:AGR liability	-	-	1,541
Equity Value of the business	-	-	34,458
No. of equity shares outstanding (Crore)	-	-	28.5
Target Price	-	-	1,209
Rounded off Target Price	-	-	1,210

Source: Company, ICICI Direct Research

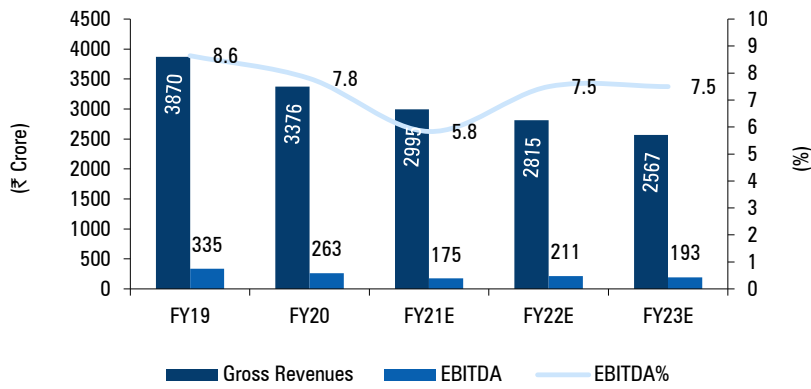
Financial story in charts

Exhibit 4: Global data services operating performance



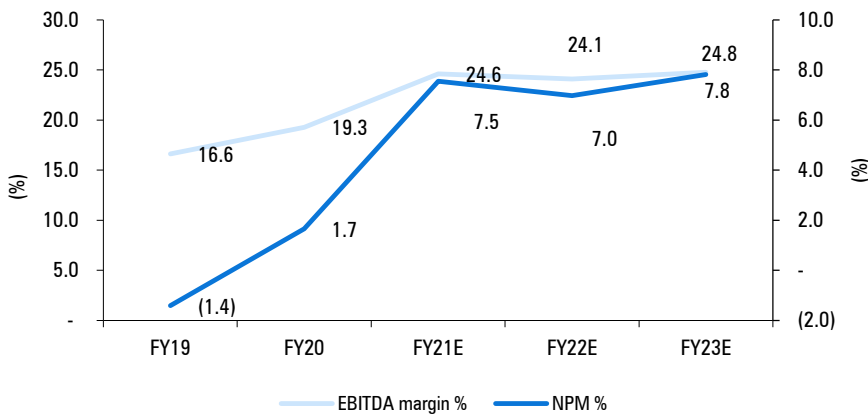
Source: Company, ICICI Direct Research

Exhibit 5: Global voice services operating performance



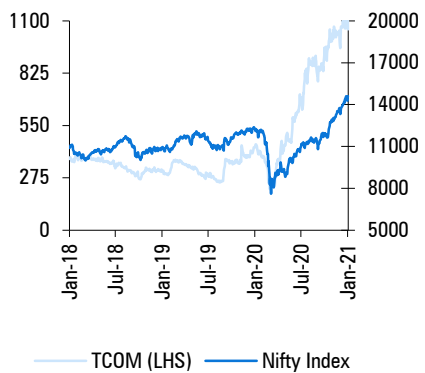
Source: Company, ICICI Direct Research

Exhibit 6: EBITDA and NPM margins trend



Source: Company, ICICI Direct Research

Exhibit 7: Price Chart



Source: Bloomberg, ICICI Direct Research

Financial summary

Exhibit 8: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Total operating Income	17068.0	17633.8	18812.2	20076.6
Growth (%)	3.3	3.3	6.7	6.7
Employee Expenses	3039.1	3100.6	3254.5	3473.3
Network costs	6777.6	6689.9	7223.9	7574.2
Administrative Expenses	3962.3	3502.4	3800.1	4055.5
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	13779.0	13292.9	14278.4	15102.9
EBITDA	3289.0	4340.9	4533.7	4973.7
Growth (%)	19.8	32.0	4.4	9.7
Depreciation	2357.7	2292.4	2351.5	2509.6
Interest	470.7	435.7	412.7	356.4
Other Income	69.7	114.1	60.0	80.0
Exceptional Items	390.6	75.9	0.0	0.0
PBT	139.7	1651.0	1829.5	2187.7
Minority Interest	1.1	1.2	1.2	1.2
PAT from Associates	2.2	-3.6	-3.8	-3.8
Total Tax	226.7	374.8	512.3	612.6
PAT	-86.0	1271.5	1312.3	1570.2
Growth (%)	NM	NM	3.2	19.7
Adjusted PAT	283.9	1330.1	1312.3	1570.2
Growth (%)	NM	368.5	-1.3	19.7
EPS (₹)	-3.0	44.6	46.0	55.1

Source: Company, ICICI Direct Research

Exhibit 10: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	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	-391.9	820.4	2,290.6
Total Shareholders funds	-1,278.4	-106.9	1,105.4	2,575.6
Total Debt	10,746.0	10,346.0	9,086.2	7,886.2
Others	4,996.6	4,757.1	4,520.0	4,280.6
Total Liabilities	14,464.2	14,996.2	14,711.7	14,742.4
Assets				
Gross Block	36,977.0	38,577.0	40,177.0	41,777.0
Less: Acc Depreciation	25,833.4	28,125.8	30,477.3	32,986.9
Net Block	11,143.6	10,451.2	9,699.7	8,790.1
Capital WIP	286.0	286.0	286.0	286.0
Total Fixed Assets	11,429.6	10,737.2	9,985.7	9,076.1
Investments	1,563.1	1,613.1	1,663.1	1,713.1
Goodwill on Consolidation	91.8	91.8	91.8	91.8
Inventory	73.0	75.4	80.4	85.8
Debtors	3,228.9	3,333.5	3,556.3	3,795.3
Loans and Advances	259.6	268.2	286.1	305.4
Other Current Assets	929.6	960.4	1,024.6	1,093.5
Cash	909.1	2,208.0	2,847.6	3,976.7
Total Current Assets	5,400.2	6,845.5	7,795.0	9,256.7
Creditors	3,845.0	3,985.7	4,252.1	4,537.9
Provisions	726.0	752.6	802.9	856.9
Other current liabilities	3,126.3	3,229.9	3,445.7	3,677.4
Total Current Liabilities	7,697.3	7,968.2	8,500.7	9,072.1
Net Current Assets	-2,297.1	-1,122.7	-705.7	184.7
Other non current assets	3,676.8	3,676.8	3,676.8	3,676.8
Application of Funds	14,464.2	14,996.2	14,711.7	14,742.4

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement				
	₹ crore			
(Year-end March)	FY20E	FY21E	FY22E	FY23E
Profit after Tax	-86.0	1271.5	1312.3	1570.2
Add: Depreciation	2357.7	2292.4	2351.5	2509.6
Add: Interest Paid	470.7	435.7	412.7	356.4
(Inc)/dec in Current Assets	-516.6	-146.5	-309.9	-332.5
Inc/(dec) in CL and Provisions	1218.2	271.0	532.5	571.4
Others	0.0	0.0	0.0	0.0
CF from operating activities	3444.1	4124.1	4299.1	4675.0
(Inc)/dec in Investments	-71.8	-50.0	-50.0	-50.0
(Inc)/dec in Fixed Assets	-2222.9	-1600.0	-1600.0	-1600.0
Others	-82.7	-239.5	-237.0	-239.5
CF from investing activities	-2377.4	-1889.5	-1887.0	-1889.5
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	471.7	-400.0	-1259.8	-1200.0
Less: Interest Paid	-470.7	-435.7	-412.7	-356.4
Less: Dividend and dividend tax	-135.7	0.0	0.0	0.0
Others	-874.9	-100.0	-100.0	-100.0
CF from financing activities	-1009.6	-935.7	-1772.5	-1656.4
Net Cash flow	57.0	1298.8	639.6	1129.2
Opening Cash	852.1	909.1	2208.0	2847.6
Closing Cash	909.1	2208.0	2847.6	3976.7

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	-3.0	44.6	46.0	55.1
Adj. EPS	10.0	46.7	46.0	55.1
BV	-44.9	-3.8	38.8	90.4
DPS	4.8	0.0	0.0	0.0
Cash Per Share	31.9	77.5	99.9	139.5
Operating Ratios (%)				
EBITDA Margin	19.3	24.6	24.1	24.8
PBT / Total Operating income	5.5	11.6	11.6	12.3
PAT Margin	1.7	7.5	7.0	7.8
Inventory days	1.6	1.6	1.6	1.6
Debtor days	69.0	69.0	69.0	69.0
Creditor days	82.2	82.5	82.5	82.5
Return Ratios (%)				
RoE	NM	NM	118.7	61.0
RoCE	7.8	16.0	16.6	18.5
RoIC	7.8	18.1	20.6	25.3
Valuation Ratios (x)				
P/E	-348.6	23.6	22.8	19.1
EV / EBITDA	12.6	9.1	8.3	7.0
EV / Net Sales	2.4	2.2	2.0	1.7
Market Cap / Sales	1.8	1.7	1.6	1.5
Price to Book Value	-23.4	-280.4	27.1	11.6
Solvency Ratios				
Debt/EBITDA	3.3	2.4	2.0	1.6
Debt / Equity	-8.4	-96.8	8.2	3.1
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

Exhibit 12: 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	596	700	Buy	3,25,236	-59.0	-28.5	11.4	NM	NM	52.1	12.2	9.9	7.6	3.5	7.5	11.3	-4.7	-0.7	11.9
Indus Towers	254	220	Hold	47,026	17.8	16.4	17.6	14.3	15.5	14.5	5.8	5.6	5.2	18.1	19.7	22.2	24.4	23.4	25.9
Vodafone Idea	13	6	Sell	38,362	-25.7	-15.7	-8.5	NM	NM	NM	9.3	11.9	9.9	-5.7	-4.8	-4.2	NM	NM	NM
Sterlite Tech	193	200	Hold	7,647	10.8	7.3	11.7	17.9	26.6	16.5	9.0	11.5	8.1	27.8	20.9	14.6	33.0	25.0	15.1
Tata Comm	1,051	1,210	Buy	29,963	-3.0	44.6	46.0	NM	23.6	22.8	11.9	8.6	7.8	7.8	16.0	16.6	-22.2	NM	118.7

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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