

CMP: ₹ 560

Target: ₹ 540 (↑ -4%)

Target Period: 12 months

May 10, 2019

HOLD

Uninspiring show...

Tata Communications' (TCL) Q4FY19 performance was a mixed bag with a slight beat on topline, margins (owing to one time settlement benefit) and loss on bottomline due to impairment of goodwill and intangibles recognised by its subsidiary. Topline beat (₹ 4243.5 crore vs. our estimates of ₹ 4184 crore) was mainly the function of higher data segment growth (up 14.2% YoY at ₹ 3343 crore, primarily driven by growth services (up ~25% YoY in rupee terms). Margins at 16.1% (vs. 15.6% estimated) were higher due to one-time settlement in voice segment. The reported loss was ₹ 198.8 crore vs. expectation of ₹ 21 crore PAT, primarily due to impairment of goodwill and intangibles recognised by SIT Tai Seng Pte Ltd (its subsidiary – holds 26%) of ₹ 172.4 crore coupled with higher tax expenses.

Re-spells guidance; *Destination 21* seems uphill task

The company spelt out its guidance on the data business indicating that it expects the traditional business to witness 2% YoY growth in FY20E, as the impact of operator consolidation seemed to have normalised. On the transformation and growth services, expected growth is ~18-20% for FY20E. On the margins front, the company expects traditional and growth business to clock 29-30% and 5-7%, respectively. Transformation services is expected to witness profitability uptick as execution picks up, with historical high margins expected only over the next two years. The company also indicated that erstwhile Destination 21, ambition of achieving a topline of ~US\$150 million by FY21E, has now been pushed to FY22E.

Overall funnel/TCV at US\$2.3/1.4 billion

The company disclosed Total Contract Value (TCV) of gross data order book at ~ US\$ 1.4 billion (up 41% YoY) of which traditional and growth segment order TCV stood at ~US\$ 590 million and ~US\$ 790 million (up 40%) YoY. The overall funnel (order pipeline) stood at US\$ 2.3 billion. The company indicated that it is deeply engaging with its 672 customers (45% Indian, 55%international) to upsell other services and foresees an opportunity of ~US\$ 5 mn/~US\$ 10 mn/ customer per year, respectively for Indian and international customers, eventually. This translates into overall opportunity of ~US\$ 5 billion per annum, over the medium term.

Valuation & Outlook

We continue to believe that long term roadmap on the data segment is a tall ask. We would await traction and profitability in innovation services (a major chunk of the margin expansion guidance), before turning constructive. We continue to maintain our **HOLD** rating on the stock, valuing it at ₹ 540/share on an SoTP basis. The target price is inclusive of the value from the land bank. Furthermore, acquisition of TTSL is still awaited. If undertaken, it could result in increase in leverage, which is negative.

TATA COMMUNICATIONS

Particulars	Amount
Market Capitalization	₹ 15960 Crore
Total Debt (FY19)	₹ 10274.3 Crore
Cash (FY19)	₹ 852.1 Crore
EV	₹ 24786.2 Crore
52 week H/L	758/ 430
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Key Highlights

- Total contract value (TCV) of gross data order book was at ~US\$1.4 billion (up 41% YoY) of which traditional and growth segment order TCV was at ~US\$590 million and ~US\$790 million (up 40%) YoY. The overall funnel (order pipeline) was at US\$2.3 billion
- Guided for 18-20% revenues growth for transformation and growth services in FY20E
- Maintain our **HOLD** rating on the stock, valuing it at ₹ 540/share on SoTP basis

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Key Financial Summary

(₹ Crore)	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	17,619.7	16,650.8	16,525.0	17,193.4	17,979.5	4.3
EBITDA	2,405.9	2,291.4	2,744.9	2,808.4	3,141.7	7.0
Adjusted PAT	273.7	46.9	(232.2)	202.5	363.8	NA
Adjusted P/E (x)	57.6	336.0	NM	77.8	43.3	
Price / Book (x)	9.9	31.6	NM	NM	85.4	
Adjusted EPS (₹)	9.6	1.6	(8.1)	7.1	12.8	
EV/EBITDA (x)	9.7	10.2	9.0	8.7	7.6	
RoCE (%)	6.1	5.9	5.4	5.8	7.5	
RoE (%)	17.2	9.4	NM	NM	197.2	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q4FY19	Q4FY19E	Q4FY18	Q3FY19	YoY (%)	QoQ (%)	Comments
Revenue	4,243.5	4,184.2	4,008.6	4,269.5	5.9	-0.6	Topline beat was mainly the function of higher data segment growth (up 14.2% YoY at ₹ 3343 crore, primarily driven by growth services (up ~25% YoY in rupee terms). The voice revenues were down 19.1% YoY at ₹ 900.8 crore
Other Income	39.5	15.0	233.0	19.2	-83.1	-21.8	
Employee Expenses	768.8	753.2	754.7	757.1	1.9	-0.5	
Administrative Expenses	1,105.1	878.7	873.5	802.5	26.5	9.5	
Network costs	1,684.3	1,899.6	1,824.9	1,867.4	-7.7	1.7	
Raw Material Expenses	0.0	0.0	0.0	0.0	0.0	0.0	
EBITDA	685.3	652.7	555.4	842.6	23.4	-22.5	
EBITDA Margin (%)	16.1	15.6	13.9	19.7	229 bps	-359 bps	The margins were higher due to one-time settlement in voice segment
Depreciation	558.7	516.3	505.2	523.5	10.6	6.7	
Interest	103.9	103.1	91.0	104.0	14.1	-0.1	
Exceptional Items	-0.7	0.0	162.1	0.0	0.0	0.0	
Total Tax	100.7	29.0	145.1	66.7	-30.6	50.9	
PAT	-198.8	21.1	-121.0	173.3	64.3	-214.7	It reported a loss primarily due to impairment of goodwill and intangibles recognised by SIT Tai Seng Pte Ltd (its subsidiary – holds 26%) of ₹ 172.4 crore coupled with higher tax expenses
Total Minutes (in billion)	6.7	6.9	8.9	7.0	-24.7	-4.3	
GDS Revenues	3,342.7	3,298.8	2,895.4	3,325.9	15.4	0.5	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

₹ Crore	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	17,401.3	17,193.4	-1.2	18,627.7	17,979.5	-3.5	Realigned estimates based on management guidance
EBITDA	2,841.2	2,808.4	-1.2	3,255.1	3,141.7	-3.5	
EBITDA Margin (%)	16.3	16.3	1 bps	17.5	17.5	0 bps	
PAT	245.2	202.5	-17.4	402.8	363.8	-9.7	
EPS (₹)	8.6	7.1	-17.4	14.1	12.8	-9.5	

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

	Current			Earlier			
	FY17	FY18	FY19	FY20E	FY21E	FY20E	FY21E
Total Minutes (Bn)	43.0	39.4	30.1	28.6	27.2	29.7	28.2
ARPM (₹)	1.6	1.3	1.3	1.3	1.2	1.2	1.2
GVS Revenues	6,717.8	5,311.3	3,870.3	3,603.2	3,354.6	3,606.2	3,357.4

Source: Company, ICICI Direct Research

Business Highlights

Voice business:

- In US\$ term, voice business reported revenue a decline of 28.7% YoY. However, on account of rupee depreciation benefit, revenue decline stabilised at 19.1% YoY in rupee terms
- Volume slide continued for the quarter wherein overall volumes came in at 6.7 bn minutes, a decline of 24.7% YoY, mainly on account of ILD minutes decline of 18.2% YoY to 6.3 billion minutes. Realisations, on the other hand, improved 7.5% YoY to ₹ 1.34 per minute
- Voice margins for the quarter came in at 10.7%, an improvement of 430 bps on a YoY basis, also aided by one-time settlement benefit, which were not quantified

Data Business

- Revenue grew 14.2% YoY, aided by growth services, which grew 15.1%
- The growth on a QoQ basis was only 0.5% because in Q3FY19, the company recorded one-time revenue of ₹ 91 crore based on the favourable regulation on the access facilitation charges for cable landing stations

Traditional services:

- In US\$ term, traditional business revenue declined 0.1% YoY, impacted by operator consolidation
- EBITDA grew 6.7% YoY while margin expanded 280 bps YoY
- The management expects traditional business to witness 2% YoY growth in FY20E, as the impact of operator consolidation seems to have normalised. Margins are expected at ~29-30%

Growth services:

- Q4 revenue had one-time gain of \$3.5 million on account of early termination penalty. The company reported EBITDA breakeven for the first time in growth (ex-Innovation) segment.
- EBITDA loss has come down from \$39.9 million (mn) in FY18 to \$7.4 mn in FY19
- IZO services grew 111.2%, media services grew 392.6% while mobility grew 59.8% YoY
- The management has guided for 18-20% revenue growth in 'Growth Services' and 5-7% EBITDA margins for FY20

Transformation services:

- Revenue grew 11.3% YoY in FY19 due to better execution of deals
- The management indicated that it is in discussions with three to four large international players while deal closure is expected in the next one or two quarters
- EBITDA was down 34.4% YoY in the year due to customer exit, timing mismatch between loss of revenue and cost realignment
- EBITDA margins were down as the management indicated that during H2FY19, the company picked up few low margin deals
- The management guided that the segment is likely to witness profitability uptick as execution picks up, with historical high margins expected only over the next two years

Payment solutions:

- The management indicated that they rationalise their ATM portfolio to focus on profitability. They closed down 3,395 ATMs during the year
- As a result of the same, EBITDA losses reduced to ₹ 5.2 crore vs. ₹ 19.8 crore in FY18
- As per management, average transaction per day per ATM has gone up from 70 in FY18 to 90 in FY19

Goodwill write-off:

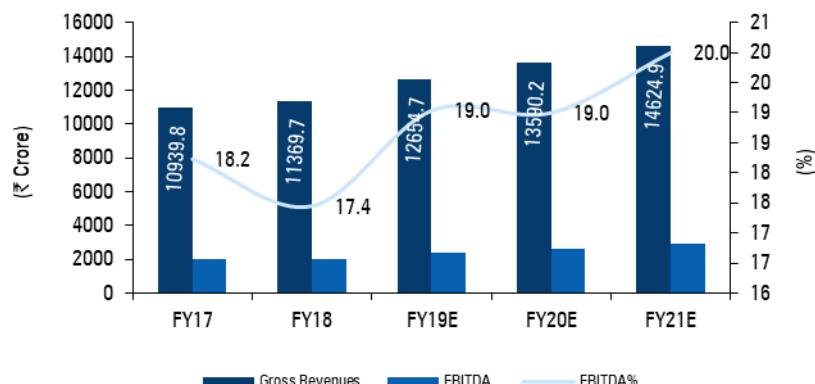
- The company absorbed losses of ₹ 172.35 crore during the quarter, proportionate to its 26% stake in Singapore data centre business namely 'STT Tai Seng Pte Ltd), primarily on impairment of goodwill and intangibles recognised by STT
- The management indicated that the valuation of their stake is now at \$110 mn and confirmed they do not foresee any further impairment
- As per the management, Singapore data centre market has become more competitive of late. That is the key reason for the impairment taken by STT

Order book and other guidance:

- The total order book is now at \$1.4 billion, growth of 41% YoY. Out of the total order book, traditional order book is at \$590 mn while order book for growth/innovation is at \$790 mn. The management indicated that the order book for traditional business has been flat for the year while order book for growth/innovation services grew 40% YoY. The funnel for FY20 is at \$2.3 billion
- The management indicated that capex for FY19 is at \$267 mn while it guided for capex of \$250 mn in FY20
- The guidance for overall data business EBITDA margins is at 25% in the medium to long term
- The company indicated that currently most orders in execution stage in Innovation services are undertaken as a market making for key services such as IoT, turnkey solutions, cross border mobility and Netfoundry EBITDA losses in innovation services was at ₹ 450 crore. The management indicated that losses in this business are expected to be at the same level in FY20. The management expects to be EBITDA positive in innovation services in FY22
- Net debt is at US\$ 1.2 billion, a reduction of US\$55 mn compared to Q3FY19 due to stronger working capital management
- **On the land demerger front**, the company indicated that MCA has called the final meeting on 17th May, 2019, the completion of which will pave way for surplus land demerger. **On the Tata Tele acquisition plans**, there was no further update.

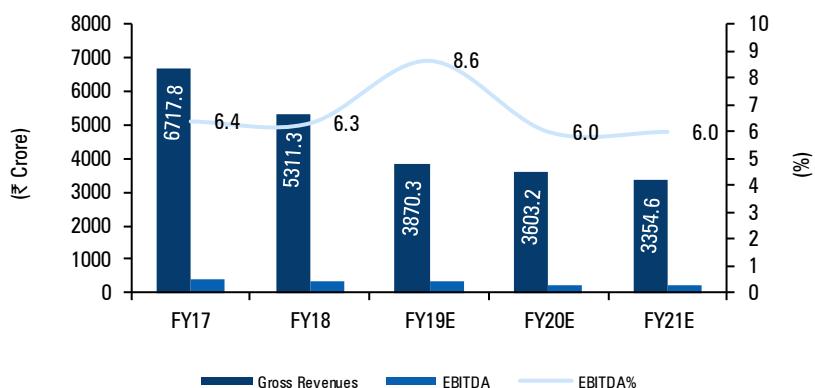
Financial story in charts

Exhibit 4: GDS operating performance



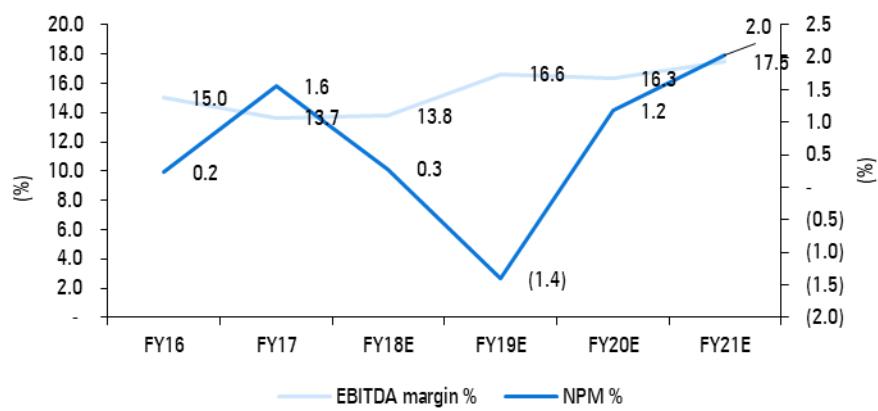
Source: Company, ICICI Direct Research

Exhibit 5: Global voice services operating performance



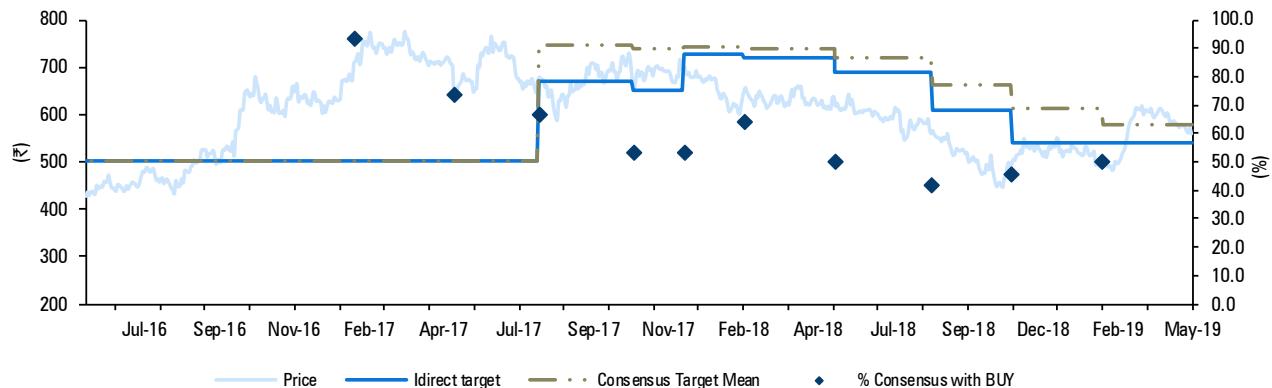
Source: Company, ICICI Direct Research

Exhibit 6: EBITDA and NPM margins trend



Source: Company, ICICI Direct Research

Exhibit 7: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 8: Top 10 Shareholders

Rank	Name	last Filing Date	% O/S	Position (m)	Change (m)
1	Tata Group of Companies	31-12-2018	0.5	139.26M	0.0
2	Government of India	31-12-2018	0.3	74.45M	0.0
3	East Bridge Capital Management L.P.	31-12-2018	0.1	14.32M	+2.21M
4	Amansa Capital Pte Ltd.	31-12-2018	0.0	5.27M	0.0
5	Fidelity Management & Research Company	28-02-2019	0.0	4.33M	+0.09M
6	Norges Bank Investment Management (NBIM)	31-12-2018	0.0	4.29M	+0.17M
7	FIL Investment Management (Singapore) Ltd.	31-12-2018	0.0	3.90M	-1.41M
8	Fidelity International	31-10-2017	0.0	3.34M	+3.34M
9	Life Insurance Corporation of India	31-12-2018	0.0	3.29M	0.0
10	Baron Capital Management, Inc.	31-12-2018	0.0	2.96M	0.0

Source: Reuters, ICICI Direct Research

Exhibit 9: Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
East Bridge Capital Management L.P.	+16.65M	+2.21M	Aditya Birla Sun Life AMC Limited	-23.46M	-3.11M
Kotak Mahindra Asset Management Company Ltd.	+1.66M	+0.19M	FIL Investment Management (Singapore) Ltd.	-10.66M	-1.41M
Norges Bank Investment Management (NBIM)	+1.28M	+0.17M	Franklin Templeton Asset Management (India) Pvt. Ltd.	-1.35M	-0.15M
IDFC Asset Management Company Private Limited	+1.28M	+0.14M	Mellon Investments Corporation	-0.98M	-0.14M
DSP Investment Managers Pvt. Ltd.	+0.80M	+0.09M	ICICI Prudential Asset Management Co. Ltd.	-0.86M	-0.10M

Source: Reuters, ICICI Direct Research

Exhibit 10: Shareholding Pattern

(in %)	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Promoter	75.0	75.0	75.0	75.0	75.0
FII	14.1	14.9	16.3	16.9	18.2
DII	4.9	4.1	0.9	0.9	0.5
Others	6.1	6.1	7.8	7.2	6.4

Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: Profit and loss statement				
(Year-end March)	FY18	FY19	FY20E	₹ crore FY21E
Total operating Income	16650.8	16525.0	17193.4	17979.5
Growth (%)		(0.8)	4.0	4.6
Employee Expenses	2977.5	2959.7	2922.9	3056.5
Network costs	7903.2	7162.0	7851.6	8095.5
Administrative Expenses	3478.7	3658.4	3610.6	3685.8
Other Expenses	0.0	0.0	0.0	0.0
Total Operating Expenditure	14359.5	13780.1	14385.1	14837.8
EBITDA	2291.4	2744.9	2808.4	3141.7
Growth (%)		19.8	2.3	11.9
Depreciation	1906.3	2067.6	2114.8	2211.5
Interest	344.5	396.6	462.3	457.8
Other Income	380.5	60.3	100.0	100.0
Exceptional Items	375.5	-2.2	0.0	0.0
PBT	45.6	343.2	331.2	572.4
Minority Interest	3.0	1.9	4.8	4.8
PAT from Associates	-16.3	-150.3	25.2	25.2
Total Tax	354.9	273.3	149.0	229.0
PAT	-328.6	-82.4	202.5	363.8
Growth (%)	NM	-74.9	-345.9	79.6
Adjusted PAT	46.9	-232.2	202.5	363.8
Growth (%)		NM	NM	79.6
EPS (₹)	-11.5	-2.9	7.1	12.8

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
(Year-end March)	FY18	FY19	FY20E	₹ crore FY21E
Profit after Tax	-328.6	-82.4	202.5	363.8
Add: Depreciation	1906.3	2067.6	2114.8	2211.5
Add: Interest Paid	344.5	396.6	462.3	457.8
(Incl)/dec in Current Assets	339.5	-328.5	-338.7	-389.2
Inc/(dec) in CL and Provisions	290.6	-156.3	-46.3	79.8
Others	0.0	0.0	0.0	0.0
CF from operating activities	2552.3	1897.0	2394.7	2723.7
(Incl)/dec in Investments	1183.8	-241.1	-200.0	-200.0
(Incl)/dec in Fixed Assets	-1543.7	-2315.2	-1800.0	-1800.0
Others	-512.1	-76.0	0.2	0.5
CF from investing activities	-872.1	-2632.3	-1999.8	-1999.5
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-355.5	1287.1	0.0	-200.0
Less:Interest Paid	-344.5	-396.6	-462.3	-457.8
Less: Dividend and dividend tax	-135.7	-152.6	0.0	0.0
Others	-628.3	-446.1	-100.0	-100.0
CF from financing activities	-1463.9	291.8	-562.3	-757.8
Net Cash flow	216.3	-443.5	-167.4	-33.6
Opening Cash	1079.3	1295.6	852.1	684.7
Closing Cash	1295.6	852.1	684.7	651.1

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet				
(Year-end March)	FY18	FY19	FY20E	₹ crore FY21E
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	214.3	-466.8	-364.3	-100.5
Total Shareholders funds	499.3	-181.8	-79.3	184.5
Total Debt	8,987.2	10,274.3	10,274.3	10,074.3
Others	3,480.9	3,441.2	3,441.4	3,441.9
Total Liabilities	12,967.5	13,533.7	13,636.5	13,700.8
Assets				
Gross Block	32,285.4	34,741.8	36,541.8	38,341.8
Less: Acc Depreciation	21,408.0	23,475.6	25,590.4	27,801.9
Net Block	10,877.3	11,266.1	10,951.3	10,539.9
Capital WIP	439.5	298.3	298.3	298.3
Total Fixed Assets	11,316.9	11,564.5	11,249.7	10,838.2
Investments	1,250.2	1,491.3	1,691.3	1,891.3
Goodwill on Consolidation	-	86.3	86.3	86.3
Inventory	27.0	76.6	79.7	83.3
Debtors	2,891.2	2,968.5	3,108.9	3,251.1
Loans and Advances	341.4	238.7	298.1	374.0
Other Current Assets	386.3	690.6	826.4	993.8
Cash	1,295.6	852.1	684.7	651.1
Total Current Assets	4,941.5	4,826.5	4,997.8	5,353.3
Creditors	3,471.6	3,688.5	3,768.4	3,940.7
Provisions	566.4	601.6	614.6	642.7
Other current liabilities	2,597.3	2,188.9	2,049.7	1,929.1
Total Current Liabilities	6,635.3	6,479.1	6,432.8	6,512.6
Net Current Assets	-1,693.8	-1,652.6	-1,435.0	-1,159.2
Other non current assets	2,094.2	2,044.3	2,044.3	2,044.3
Application of Funds	12,967.5	13,533.7	13,636.5	13,700.8

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY18	FY19	FY20E	₹ crore FY21E
Per share data (₹)				
EPS	-11.5	-2.9	7.1	12.8
Adj. EPS	1.6	-8.1	7.1	12.8
BV	17.5	-6.4	-2.8	6.5
DPS	4.8	5.4	0.0	0.0
Cash Per Share	45.5	29.9	24.0	22.8
Operating Ratios (%)				
EBITDA Margin	13.8	16.6	16.3	17.5
PBT / Total Operating income	2.3	4.1	4.0	5.2
PAT Margin	0.3	-1.4	1.2	2.0
Inventory days	0.6	1.7	1.7	1.7
Debtor days	63.4	65.6	66.0	66.0
Creditor days	76.1	81.5	80.0	80.0
Return Ratios (%)				
RoE	9.4	127.7	-255.5	197.2
RoCE	5.9	5.4	5.8	7.5
RoIC	3.3	5.7	5.9	8.0
Valuation Ratios (x)				
P/E	-48.0	-191.3	77.8	43.3
EV / EBITDA	10.2	9.0	8.8	7.7
EV / Net Sales	1.4	1.5	1.4	1.4
Market Cap / Sales	0.9	1.0	0.9	0.9
Price to Book Value	31.6	-86.7	-198.8	85.4
Solvency Ratios				
Debt/EBITDA	3.9	3.7	3.7	3.2
Debt / Equity	18.0	-56.5	-129.6	54.6
Current Ratio	0.9	0.9	1.0	1.0
Quick Ratio	0.9	0.9	1.0	1.0

Source: Company, ICICI Direct Research



Exhibit 15: ICICI direct Coverage (Telecom)

Sector / Company	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
					FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Vodafone Idea	14	30	Hold	12,185	-16.3	-23.3	-21.6	NM	NM	NM	38.5	14.4	11.7	-2.3	-4.9	-4.1	-15.3	-27.1	-31.4
Sterlite Tech	186	180	Reduce	7,475	14.0	14.7	15.0	13.2	12.7	12.4	8.2	7.4	6.4	29.7	27.8	26.9	28.7	33.1	27.5
Tata Comm	560	540	Hold	15,960	-2.9	7.1	12.8	NM	NM	43.9	9.0	8.8	7.8	5.9	5.4	5.8	9.4	127.7	-255.5

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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ANALYST CERTIFICATION

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