

Telecom

Target price: Rs1,665

Target price revision

Rs1,665 from Rs1,510

Shareholding pattern

	Sep '22	Dec '22	Mar '23
Promoters	58.9	58.9	58.9
Institutional investors	30.8	31.2	31.0
MFs and other	9.6	9.5	9.6
Banks/ FIs	0.0	0.3	0.3
Insurance Cos.	4.1	4.1	4.1
FIs	17.1	17.3	17.0
Others	10.3	9.9	10.1

Source: NSE

ESG disclosure score

Year	2021	2022	Chg
ESG score	65.8	69.6	3.8
Environment	49.0	57.9	8.8
Social	52.2	54.6	2.5
Governance	96.1	96.1	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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Tata Communications

BUY

Maintained

Aim – 2x data revenue by FY27 (18% CAGR)

Rs1,446

Tata Communications (TCom) has shared an upbeat revenue growth outlook for FY23-27E in its investor meet (on June 7, '23). The company expects its data revenue to grow by 2x to Rs280bn by FY27 at a revenue CAGR of 18%. This will be driven by >35% growth in its digital services revenue during the same period, and its mix will rise to >50%. This is a significant acceleration in digital services revenue growth vs 19% in the past three years, and data revenue growth which was under 10%. It expects international revenue to grow faster where it has good lead indicators. Despite the rise in low margin digital services, company anticipates EBITDA margin to be stable at 23-25%, with RoCE >25%. We believe acceleration in revenue may start showing in the next 12-18months as the company reaps benefits of the rise in execution of order wins, and international business starts firing. We are yet to factor The Switch acquisition in our estimates, and our data revenue growth forecast is conservative at 12% over FY23-25E. However, we have increased our target price to Rs1,665 (from Rs1,510) as we raise our FY25E PE multiple to 22x (from 20x). Maintain BUY. Risks: 1) Lower than expected revenue growth; and 2) higher-than-expected capex.

- **Inching-up expectation bar – 2x data revenue by FY27.** TCom, in the past 3-4 years, has significantly improved its margins from mid-teens to 23-25%; low single digit RoCE to >25% and net debt / EBITDA to <1.5x. Company is aiming to expand its revenue growth trajectory, and has set ambition to grow data revenue from Rs140bn in FY23 to Rs280bn in FY27 at a CAGR of 18%. Core connectivity is expected to grow in mid-single digit which means digital revenue has to grow at a CAGR of >35% over the next four years (vs 19% in the past three years). This will be driven by four key factors – 1) maintaining leadership position in India; 2) growing in international markets with rise to market challenger position from being peripheral player currently; 3) growing revenue contribution of million-dollar accounts from 35% to >50%; and 4) digital and platform services revenue contribution rise from 32% to >50%.

TCom is seeing increased traction in international markets, notwithstanding its historical performance, driven by strong next-gen connectivity services and solution-based approach. It expects to benefit from the rise in foot-on-the-street with increased manpower (where it has added >1,000 employee in the past one year), rise in analyst coverage and successful execution of complex projects / solutions. TCom has seen 50% growth in new international logos in the past two years and its alliance with SIs will also aid. It has also seen 50% growth in digital platform and services sales funnel in the past two years in international markets.

Market Cap	Rs412bn/US\$5.0bn
Reuters/Bloomberg	TATA.BO/TCOM IN
Shares Outstanding (mn)	285.0
52-week Range (Rs)	1452/856
Free Float (%)	41.1
FII (%)	17.0
Daily Volume (US\$/'000)	7,653
Absolute Return 3m (%)	19.4
Absolute Return 12m (%)	55.37
Sensex Return 3m (%)	5.4
Sensex Return 12m (%)	16.0

Year to Mar	FY22	FY23	FY24E	FY25E
Revenue (Rs bn)	165.3	176.4	192.2	210.2
Net Income (Rs bn)	14.8	17.2	16.5	21.5
EPS (Rs)	51.8	61.0	58.0	75.3
% Chg YoY	18.5	21.3	(8.1)	30.0
P/E (x)	27.9	23.7	24.9	19.2
CEPS (Rs)	117.1	130.2	127.4	147.2
EV/E (x)	11.9	11.4	10.6	9.1
Dividend Yield (%)	1.4	1.5	1.3	1.7
RoCE (%)	19.2	20.7	22.7	28.6
RoE (%)	284.1	117.7	61.7	54.4

TCom expects margins to remain stable at 23-25% despite rise in contribution from low margin digital services, and RoCEs to remain above 25%. It will not shy away from investing but expects net debt to EBITDA to be lower than 2x. Near-term capex is expected at US\$300mn, but it will rise with growth in revenue. The company believes margins in the near term may fall below 23% with the acquisition of The Switch, which is a loss-making business.

- **Good lead indicators.** Though underlying data revenue growth in the past two years was much below expectations, TCom has shared some exciting lead indicators which provide comfort to achieve / accelerate revenue growth over the next few years. 1) TCom has seen large deal count grow by 84%; 2) product penetration ratio (PPR) has increased by 10%; 3) acceleration of million-dollar customer addition which has grown by 33 to reach a total 233 and has added >10 customers in US\$5-mn club. It has significantly changed its product portfolio, but was still able to maintain its NPS score which is in top quartile.

TCom is undergoing the phase of evolution where it is transforming from product-to-platform based services, evolution from platform to digital fabric and increasing customer relevance quotient. Its digital fabrics include connectivity services with extended portfolio offering under IZO services, platforms such as MOVE, IoT, private networks, etc that are wrapped with zero trust security and enabled by analytics and reporting.

- **Connected infrastructure market size is huge.** TCom remains excited about connected infrastructure services, which include IZO Internet WAN, IZO Multi-cloud connect, Managed Wi-Fi and LAN; and SD WAN + Network security. Its offerings in these services have seen an increased off-take while drop in legacy services is hitting incumbents. This is a large market with revenue size of >US\$115bn, growing at 1.4-17%. The company is benefiting from full spectrum of product and services, single policy ownership and transparency.
- **The Switch has a huge opportunity to unlock.** TCom has completed the acquisition of The Switch for US\$59mn for 100% stake. This will help TCom's media business, which has revenue base of Rs5.8bn, and has grown at a CAGR of 33% in the past three years. It is largely global-to-global video transport with market share of 25%. The Switch acquisition will help in growing in regional market, US is its largest market, with market size of US\$800mn (global) and US\$250mn in the US. The opportunity size in video production is US\$1bn. The Switch is strong incumbent with production penetration in a large number of stadiums. TCom's global reach will complement the regional strength of The Switch.

Chart 1: TCom expects to grow data revenue by 2x to Rs280bn by FY27



Source: Company

Chart 2: RoCE is likely to continue at >25%



Source: Company

Chart 3: Underlying capabilities that will help accelerate growth



Source: Company

Chart 4: Transition to digital fabric based solution helping in grabbing incremental market share, and differentiate helping TCom position as 'Commtech'



Source: Company

Chart 5: Strong digital portfolio to help grow revenue faster



Source: Company

Chart 6: Growing million-dollar club customer base



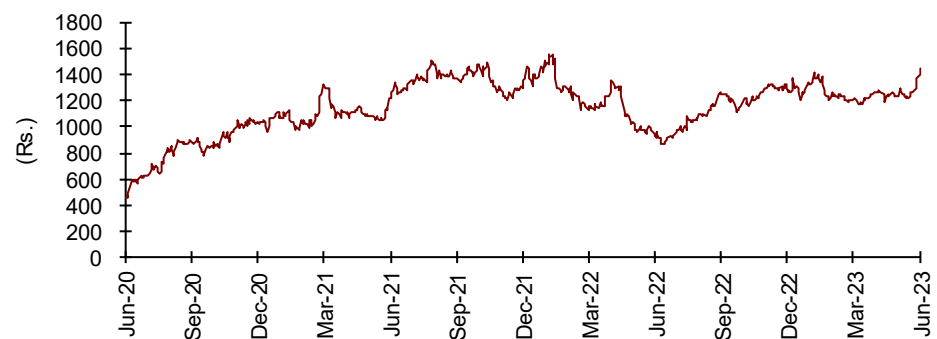
Source: Company

Chart 7: Healthy lead indicator for FY23



Source: Company

Price chart



Source: Bloomberg

Financial summary

Table 1: Profit and loss statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Operating Income (Sales)	1,65,318	1,76,374	1,92,210	2,10,182
Operating Expenses	1,24,980	1,35,200	1,48,331	1,59,636
EBITDA	40,338	41,174	43,879	50,546
% margins	24.4	23.3	22.8	24.0
Depreciation & Amortisation	22,045	22,618	23,260	23,970
Net Interest	3,603	4,325	4,474	3,613
Other Income	5,250	5,640	3,777	3,898
Recurring PBT	19,940	19,871	19,922	26,862
Add: Extraordinaries	60	764	-	-
Less: Taxes	5,221	2,966	3,571	5,621
- Current tax	4,313	4,328	-	-
- Deferred tax	908	(1,362)	-	-
Less: Minority Interest	(39)	(302)	(169)	(230)
Net Income (Reported)	14,818	17,970	16,520	21,471
Recurring Net Income	14,758	17,207	16,520	21,471

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Assets				
Total Current Assets	60,968	68,431	68,987	72,780
of which cash & cash eqv.	7,434	11,317	6,218	3,565
Total Current Liabilities & Provisions	1,07,846	1,09,968	1,15,287	1,21,142
Net Current Assets	(46,878)	(41,537)	(46,299)	(48,362)
Investments	15,652	15,824	15,824	15,824
of which				
Strategic/Group	11,324	15,824	15,824	15,824
Other Marketable	4,328	-	-	-
Net Fixed Assets	1,16,804	1,13,276	1,19,056	1,25,439
Goodwill	1,083	1,083	1,083	1,083
Deferred Tax Assets	2,173	2,173	2,173	2,173
Total Assets	88,833	90,818	91,836	96,156
Liabilities				
Borrowings	78,968	68,968	58,968	48,968
Deferred tax liability	305	305	305	305
Minority Interest	285	285	285	285
Equity Share Capital	2,850	2,850	2,850	2,850
Face Value per share (Rs)	10.0	10.0	10.0	10.0
Reserves & Surplus	6,426	18,411	29,429	43,749
Net Worth	9,276	21,261	32,279	46,599
Total Liabilities	88,833	90,818	91,836	96,156

Source: Company data, I-Sec research

Table 3: Quarterly trend

(Rs mn, year ending March 31)

	Jun-22	Sep-22	Dec-22	Mar-23
Net sales	42,593	43,815	44,787	45,179
% growth (YoY)	4.9	6.4	8.2	7.3
EBITDA	10,258	10,804	10,277	9,835
Margin (%)	24.1	24.7	22.9	21.8
Other income	2,852	859	804	1,125
Add: Extra ordinaries	-	764	-	-
Net profit	5,448	5,323	3,939	3,260

Source: Company data

Table 4: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Operating Cashflow	46,090	39,273	40,476	45,155
Working Capital Changes	(4,052)	(1,458)	(336)	(589)
Capital Commitments	(18,260)	(20,800)	(26,250)	(27,563)
Free Cashflow	23,778	17,014	13,890	17,003
Cashflow from Investing Activities	9,311	9,968	3,777	3,898
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	(24,179)	(10,000)	(10,000)	(10,000)
Dividend paid & Others	(10,133)	(13,100)	(12,766)	(13,554)
Chg. in Cash & Bank balance	(1,224)	3,883	(5,099)	(2,653)

Source: Company data, I-Sec research

Table 5: Key ratios

(Year ending March 31)

	FY22	FY23	FY24E	FY25E
Per Share Data (in Rs.)				
Recurring EPS	51.8	61.0	58.0	75.3
Reported EPS	52.0	63.1	58.0	75.3
Recurring Cash EPS	117.1	130.2	127.4	147.2
Dividend per share (DPS)	20.7	21.0	19.3	25.1
Book Value per share (BV)	32.5	74.6	113.3	163.5
Growth Ratios (%)				
Operating Income	(2.4)	6.7	9.0	9.4
EBITDA	(1.5)	2.1	6.6	15.2
Recurring Net Income	11.4	16.6	(4.0)	30.0
Diluted Recurring EPS	18.5	21.3	(8.1)	30.0
Diluted Recurring CEPS	13.1	17.8	(5.0)	30.0
Valuation Ratios (x)				
P/E	27.9	23.7	24.9	19.2
P/CEPS	12.3	11.1	11.4	9.8
P/BV	44.4	19.4	12.8	8.8
EV / EBITDA	11.9	11.4	10.6	9.1
EV / Operating Income	2.9	2.7	2.4	2.2
EV / Operating FCF	11.4	12.4	11.6	10.3
Operating Ratios				
Other Income / PBT (%)	26.3	28.4	19.0	14.5
Effective Tax Rate (%)	26.2	14.9	17.9	20.9
NWC / Total Assets (%)	(52.8)	(45.7)	(50.4)	(50.3)
Inventory Turnover (days)	0.8	0.8	0.8	0.8
Receivables (days)	57.0	57.0	58.0	59.0
Payables (days)	66.4	64.4	62.4	60.4
Net Debt/EBITDA Ratio (x)	1.7	1.4	1.2	0.9
Capex % of sales	10.0	9.2	13.7	13.1
Profitability Ratios (%)				
Rec.Net Income Margins	8.9	9.8	8.6	10.2
RoCE	19.2	20.7	22.7	28.6
RoIC	23.6	23.9	25.2	30.2
RoNW	284.1	117.7	61.7	54.4
Dividend Yield	1.4	1.5	1.3	1.7
EBITDA Margins	24.4	23.3	22.8	24.0

Source: Company data, I-Sec research

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