

Rating matrix	
Rating	: Hold
Target	: ₹ 540
Target Period	: 12 months
Potential Upside	: 10%

What's changed?	
Target	Changed from ₹ 610 to ₹ 540
EPS FY19E	Changed from ₹ 3.4 to ₹ 0.2
EPS FY20E	Changed from ₹ 15.1 to ₹ 8.6
Rating	Unchanged

Quarterly performance					
	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)
Revenue	4,068.2	4,217.6	-3.5	3,943.8	3.2
EBITDA	630.2	564.5	11.6	586.9	(1.2)
EBITDA (%)	15.5	13.4	211 bps	14.9	61 bps
PAT	1.7	(250.0)	NM	(58.5)	NM

Key financials				
₹ Crore	FY17	FY18	FY19E	FY20E
Net Sales	17620	16651	16286	17276
EBITDA	2406	2291	2491	2811
Adj. Net Profit	274	47	6	245
Adj EPS (₹)	9.6	1.6	0.2	8.6

Valuation summary				
	FY17	FY18	FY19E	FY20E
P/E	51.3	299.3	NA	57.2
Target P/E	56.2	328.0	NA	62.7
EV / EBITDA	8.9	9.4	8.9	7.9
P/BV	NA	28.1	52.1	50.3
RoNW	17.2	9.4	2.2	87.8
RoCE	6.1	5.9	4.3	6.4

Stock data	
Particulars	Amount
Market Capitalization	₹ 14039.1 Crore
Total Debt (FY18)	₹ 8987.2 Crore
Cash (FY18)	₹ 1295.6 Crore
EV	₹ 21544 Crore
52 week H/L	758/ 430
Equity capital (₹ crore)	285.0
Face value (₹)	10.0

Research Analyst

Bhupendra Tiwary
bhupendra.tiwary@icicisecurities.com

Sameer Pardikar
sameer.pardikar@icicisecurities.com

Tata Communications (TATCOM)

₹ 493

One-offs; realignment aids margins...

- Revenues for the quarter came in at ₹ 4068.2 crore vs. our estimate of ₹ 4010.1 crore. **We note that from now onwards, the company has re-aligned rental revenues (previously shown in other income) as part of data segment revenues. Therefore, our estimates are not comparable.** Data revenues reported growth of 9.1% YoY to ₹ 3069.1 crore. Data revenue growth more or less compensates for continued weak voice revenues, which declined 30.4% YoY
- EBITDA came in at ₹ 630.2 crore, which was better than our estimate on account of lower-than-expected network operating expenses and re-classified rental revenues flow through. EBITDA margins came in at 15.5%, better than our estimate of 14.5%. Both voice and data margins were better than estimates. Data margins came in at 17.5% (vs. expectation of 17.3%) while voice margins came in at 9.3% (vs. estimated 6.1%) for the quarter, aided by one-offs
- PAT was at ₹ 1.7 crore, lower than our estimate of ₹ 18.2 crore owing to higher depreciation at ₹ 500.6 crore (vs. our estimates ₹ 477 crore)

Growth services remain growth driver for data segment

Data revenues (including rentals) for the quarter witnessed healthy 9.2% YoY growth at ₹ 3069.1 crore. Among constituents, the traditional data segment (forming two-third of data revenues) declined 1.3% QoQ, 3.3% YoY to US\$287.3 mn, impacted by operator consolidation and pricing pressure. The growth segment (~22.3% of overall data revenues), was up 9.2% QoQ and 13.1% YoY US\$97 mn aided by good traction in IZO cloud enablement, media & entertainment, global hosted contact centre and mobility services. Data margins during the quarter were muted (down 20 bps QoQ) at 17.5%, on account of a decline of 240 bps in traditional data margin, which came in at 28.9% for the quarter. **The key highlight was growth services portfolio turning EBITDA neutral (loss of merely US\$0.3 mn) on the back of strong revenue growth and execution. Transformation services, however, reported a decline of 120 bps in EBITDA margin on a QoQ basis to 10% due to higher project costs while innovation services continued to bleed at operating levels.** We build in data revenue CAGR of 9.7% in FY18-20E to ₹ 13649 crore. We anticipate data margins of 19% by FY20E, up from 17.2% in FY18 driven by growth portfolio.

Voice segment revenues slide; margin aided by one-offs

Voice revenues were down 30.4% YoY. Voice margins came in higher at 9.3% (vs. estimated 6%) for the quarter, owing to one-offs. Going ahead, we expect voice revenues at ₹ 3627 crore in FY20E (decline of 17.2% CAGR over FY18-20) and 6% EBITDA margin.

Awaiting sustainable performance improvement; assign HOLD

We note that there remain unknowns as value of acquisition of TTSL enterprise business and its funding thereof, going ahead. We also note that company's long term roadmap of data segment by FY21 is a tall ask and we would, rather await traction/delivery in innovation services (a major chunk of the margin expansion guidance), which is at a nascent stage currently. We build in further weakness in voice segment into our estimates. Furthermore, there also remains risk of increased competitive on account of Reliance Jio Giga Fibre in the SME segment. We assign a **HOLD** rating on the stock, valuing it at ₹ 540/share on SoTP basis. The target price is inclusive of the value from the land bank.

Variance analysis

	Q2FY19	Q2FY19E	Q2FY18	Q1FY19	YoY (%)	QoQ (%)	Comments
Revenue	4,068.2	4,010.1	4,217.6	3,943.8	-3.5	3.2	Rental revenues inclusion in data segment aided revenue beat coupled with decent revenue growth
Other Income	8.6	45.0	29.2	-7.0	-70.4	-740.1	
Employee Expenses	744.8	705.8	742.6	689.0	0.3	2.4	
Administrative Expenses	875.7	882.2	873.1	875.2	0.3	0.8	
Network costs	1,817.6	1,842.2	2,037.4	1,792.7	-10.8	2.8	
Raw Material Expenses	0.0	0.0	0.0	0.0	0.0	0.0	
EBITDA	630.2	579.9	564.5	586.9	11.6	-1.2	Margins were aided by one-offs in voice segment and healthy data revenues
EBITDA Margin (%)	15.5	14.5	13.4	14.9	211 bps	61 bps	
Depreciation	500.6	477.2	483.7	484.9	3.5	3.2	
Interest	97.9	91.5	87.7	90.9	11.6	7.7	
Exceptional Items	-1.6	0.0	213.4	0.0	0.0	0.0	
Total Tax	41.8	39.3	58.8	64.1	-29.0	-34.9	
PAT	1.7	18.4	-250.0	-58.5	-100.7	-102.8	Lower PAT was owing to owing to higher depreciation
Total Minutes (in billion)	7.7	8.7	10.5	8.7	-26.7	-11.5	
GDS Revenues	3,069.1	3,006.7	2,783.2	2,917.0	10.3	5.2	

Source: Company, ICICI Direct Research

Change in estimates

(` Crore)	FY19E			FY20E			
	Old	New	% Change	Old	New	% Change	
Revenue	16,267.7	16,285.9	0.1	17,296.5	17,275.6	-0.1	While we lower our revenues estimates for voice business, we incorporate rental revenues as part of data segment
EBITDA	2,423.2	2,491.4	2.8	2,935.2	2,810.7	-4.2	
EBITDA Margin (%)	14.9	15.3	40 bps	17.0	16.3	-70 bps	
PAT	97.0	6.0	-93.8	431.6	245.2	-43.2	
EPS (`)	3.4	0.2	-93.8	15.1	8.6	-43.0	Earnings cut is reflective of higher depreciation, higher interest rate and lower other income estimates ahead

Source: Company, ICICI Direct Research

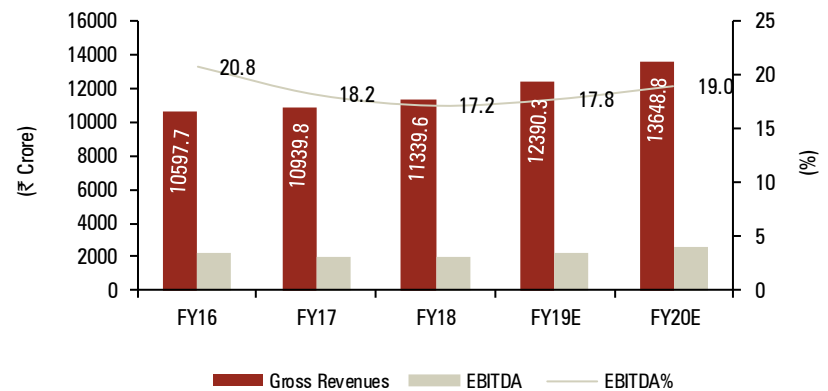
Assumptions

	FY16	FY17	Current		FY20E	Earlier	
			FY18E	FY19E		FY19E	FY20E
Total Minutes (Bn)	43.1	43.0	39.4	32.1	30.5	33.8	32.4
ARPM (`)	1.9	1.6	1.3	1.2	1.2	1.2	1.2
GVS Revenues	8,055.6	6,717.8	5,311.3	3,895.6	3,626.8	3,988.0	3,747.9

Source: Company, ICICI Direct Research

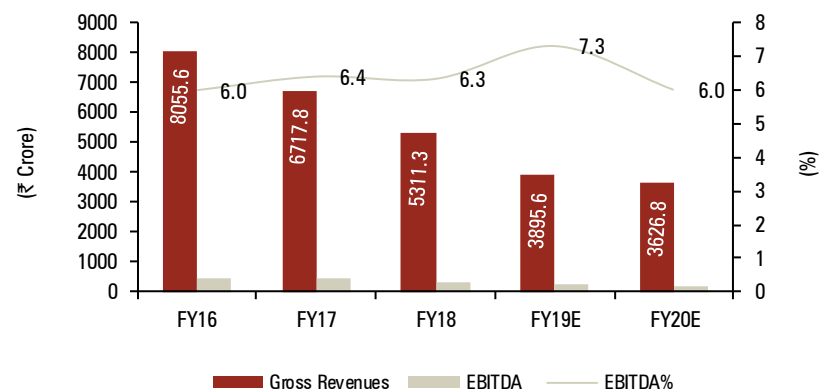
Company Analysis

Exhibit 1: GDS operating performance



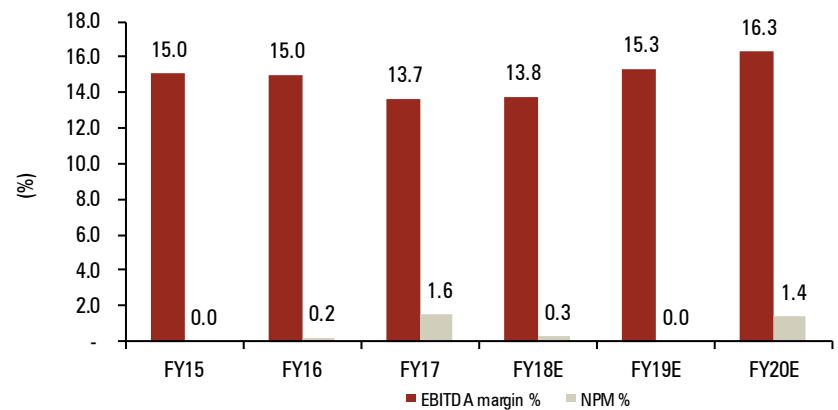
Source: Company, ICICI Direct Research

Exhibit 2: Global voice services operating performance



Source: Company, ICICI Direct Research

Exhibit 3: EBITDA and NPM margins trend



Source: Company, ICICI Direct Research

Other highlights

- **Guided for 6-6.5% voice business margin for FY19; reclassification of real estate income from other income:** The management indicated that voice business margin for the quarter were aided by one-off (unquantified) but maintained guidance of 6-6.5% for voice business in FY19. The company reclassified real estate rental income from other income to GDS and accordingly costs were charged to P&L for better representation
- **Wage hike, backhaul expenses drag traditional service EBITDA; Transformational services will pick up on better execution:** The company indicated that traditional service EBITDA for the quarter was impacted by i) US\$1.5 mn impact of wage hike ii) US\$1.5 mn impact on higher backhaul charges iii) US\$2.4 mn impact on cable cut and iv) US\$2.3 mn on unfavourable forex movement. The management indicated that traditional service revenue was also impacted to the tune of ₹ 35 crore due to consolidation of in Indian telecom market. The company expects revenue pick up in transformational services piece, going forward, as some of the projects that are under execution will start getting recognised in revenues
- **MCA approval awaited for land de-merger; planning of US facility for growth services:** The management indicated that as far as land de-merger is concerned, they have received NCLT approval and approval from MCA is awaited. The company opened a response centre in Chennai and Dubai during the quarter as a part of their growth services portfolio and indicated of opening of another facility in US in 2019. They indicated that such facilities have been planned on account of increasing traction of local cyber securities among enterprises
- **Rupee depreciation benefits revenue, EBITDA; investment of US\$12 mn in innovative services:** The management indicated that rupee depreciation had a positive impact of ₹ 110 crore on revenues. However, the benefit on EBITDA was only ₹ 11 crore. The company invested US\$12 mn in innovative services and indicated continued investments in this part of portfolio for meaningful contribution in the future earnings of the company
- **Other highlights:** i) The company maintained status-quo on potential acquisition of enterprise business of Tata Teleservices as it the deal is still being evaluated ii) Net debt declined by US\$17 mn to US\$1.2 bn irrespective of US\$22 mn dividend payout, iii) capex for Q2 was at US\$65 mn, iv) the company closed down 594 ATMs during the quarter, v) on account of Reliance Jio Giga Fibre, competitive intensity in SME segment could go up as per management, vi) average cost of borrowings marginally increased due to unfavourable Libor movement, which has also led to finance cost and vii) payment's solution business reported positive EBITDA due to closure of loss making 594 ATMs

Valuation

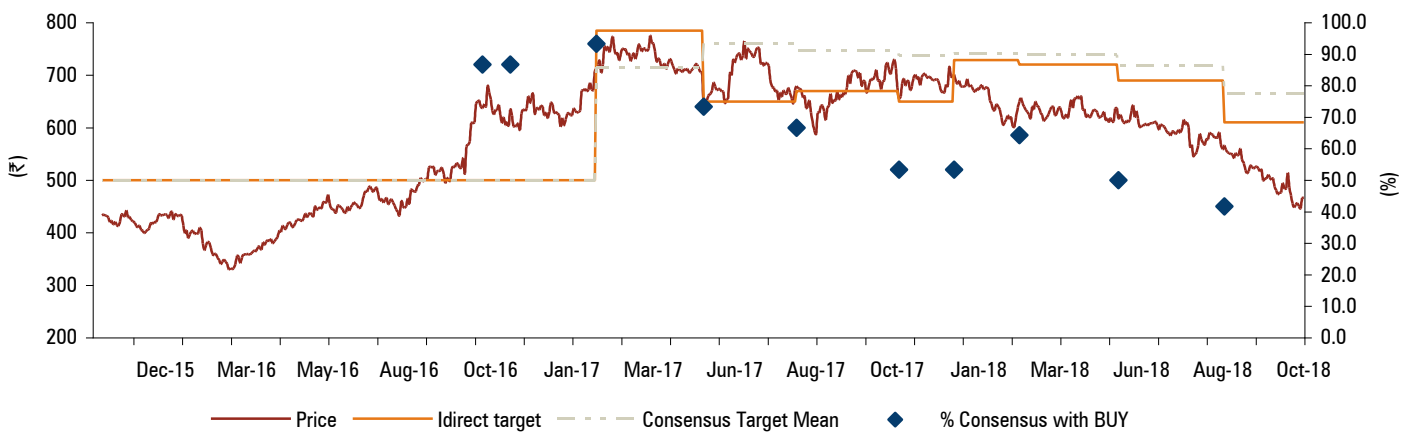
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Exhibit 4: Business valuation

Particulars	FY20EBITDA		Amount (₹ Crore)
	(₹ Crore)	EV/EBITDA(X)	
GVS Business Enterprise Value	217.6	2.0	435
GDS Business Enterprise Value	2,593.3	6.0	15,534
Total Enterprise Value			15,969
Less: Net Debt			8,090
Equity Value of the business			7,879
No. of equity shares outstanding (Crore)			28.5
Target Price (ex-land)			276
Land Valuation per share			263
Target Price			540

Source: ICICI Direct Research

Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Key events

Date	Event
2012	The government approves de-merger of land into a separate company. However, the de-merger process is still underway
2013	Successfully issues an inaugural SG\$250 million three-year bond and SG\$150 million tap at a coupon rate of 4.25%
2013	Delists ADR to satisfy minimum public shareholding norms by Sebi
2015	Modifies deal with Vodacom. Now, it would exclude the spectrum licenses of Neotel. The deal is subject to certain approvals at this point in time and the deal
Mar-16	Neotel deal between Tata Communications (TCL) and Vodacom terminated due to regulatory complexities surrounding the transaction and certain conditions being unfulfilled. In addition, the restructured transaction announced on December 10, cannot be processed
May-16	Tata Communications enters into definitive agreement with ST Telemedia through which the latter will acquire a 74% stake in TCL's data centre business in India and Singapore. The data centre business in India and Singapore have been assigned a 100% enterprise value of ₹ 3130 crore and ~₹ 1135 crore (SG\$232.4 million), respectively. Consequently, 74% stake sale is expected to result in cash inflow of ~₹ 3156 crore into the books of TCL, majority of which is expected to be used to reduce the debt
Jun-16	Enters into agreement with Liquid Telecom, owned by Econet Wireless Global, to sell its stake in African subsidiary Neotel at a consideration of ~ZAR 6.55 billion (~₹ 2900 crore). Liquid Telecom partners with Royal Bafokeng Holdings (RBH), a South African empowerment investment group, which has committed to take a 30% equity stake in Neotel. The deal value at ~ZAR 6.55 billion, though lower than the previous deal consideration with Vodacom of ~ZAR 7 billion, is on a higher EV/EBITDA multiple of ~8.3x
Oct-16	The Indian data centre deal gets concluded resulting in an inflow of US\$250 million post the debt, deal cost and tax expenses

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Tata Group of Companies	30-Jun-18	48.9	139.3	0.0
2	Government of India	30-Jun-18	26.1	74.4	0.0
3	East Bridge Capital Management L.P.	30-Jun-18	2.2	6.2	6.2
4	Amansa Capital Pte Ltd.	30-Jun-18	1.8	5.2	0.0
5	Fidelity Institutional Asset Management	30-Jun-18	1.7	4.9	0.0
6	Norges Bank Investment Management (NBIM)	30-Jun-18	1.4	4.1	0.0
7	Fidelity International	31-Oct-17	1.2	3.3	3.3
8	Life Insurance Corporation of India	30-Jun-18	1.2	3.3	0.0
9	Aditya Birla Sun Life AMC Limited	30-Jun-18	1.1	3.1	-0.7
10	FIL Investment Management (Singapore) Ltd.	30-Jun-18	1.0	3.0	0.0

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Promoter	75.0	75.0	75.0	75.0	75.0
FII	12.9	13.4	14.1	14.9	16.3
DII	5.7	5.0	4.9	4.1	0.9
Others	6.5	6.7	6.1	6.1	7.8

Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
East Bridge Capital Management L.P.	+40.76M	+5.91M	Aditya Birla Sun Life AMC Limited	-5.64M	-0.65M
Fidelity Institutional Asset Management	+2.71M	+0.39M	ICICI Prudential Asset Management Co. Ltd.	-2.79M	-0.40M
Kotak Mahindra Asset Management Company Ltd.	+1.73M	+0.23M	Axis Asset Management Company Limited	-1.74M	-0.19M
Amansa Capital Pte Ltd.	+0.63M	+0.09M	BNY Mellon Asset Management North America Corporation	-0.98M	-0.14M
The Vanguard Group, Inc.	+0.23M	+0.03M	UTI Asset Management Co. Ltd.	-1.21M	-0.13M

Source: Reuters, ICICI Direct Research

Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Total operating Income	17619.7	16650.8	16285.9	17275.6	
Growth (%)	(14.3)	(5.5)	(2.2)	6.1	
Employee Expenses	2839.4	2977.5	2900.4	2936.9	
Network costs	8811.9	7903.2	7381.0	7900.1	
Administrative Expenses	3562.5	3478.7	3513.1	3627.9	
Other Expenses	0.0	0.0	0.0	0.0	
Total Operating Expenditure	15213.8	14359.5	13794.5	14464.9	
EBITDA	2405.9	2291.4	2491.4	2810.7	
Growth (%)	-1.6	-4.8	8.7	12.8	
Depreciation	1865.8	1906.3	1986.9	2073.1	
Interest	367.2	344.5	379.1	377.5	
Other Income	360.3	380.5	41.6	80.0	
Exceptional Items	-933.5	375.5	-1.6	0.0	
PBT	1466.8	45.6	168.7	440.2	
Minority Interest	2.6	3.0	3.4	4.8	
PAT from Associates	5.1	-16.3	8.0	7.9	
Total Tax	236.4	354.9	167.2	198.1	
PAT	1232.9	-328.6	6.0	245.2	
Growth (%)	217.4	NM	-101.8	3964.7	
Adjusted PAT	273.7	46.9	6.0	245.2	
Growth (%)		-82.9	-87.2	3973.8	
EPS (₹)	43.3	-11.5	0.2	8.6	

Source: Company, ICICI Direct Research

Balance sheet		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
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	1,306.9	214.3	-15.3	-5.7	
Total Shareholders funds	1,591.9	499.3	269.7	279.3	
Total Debt	9,342.7	8,987.2	8,987.2	8,987.2	
Others	3,823.0	3,480.9	3,482.5	3,482.7	
Total Liabilities	14,757.6	12,967.5	12,739.4	12,749.2	
Assets					
Gross Block	30,551.9	32,285.4	34,285.4	36,285.4	
Less: Acc Depreciation	19,501.7	21,408.0	23,394.9	25,468.0	
Net Block	11,050.1	10,877.3	10,890.4	10,817.4	
Capital WIP	629.3	439.5	439.5	439.5	
Total Fixed Assets	11,679.4	11,316.9	11,330.0	11,256.9	
Investments	2,434.0	1,250.2	1,300.2	1,500.2	
Goodwill on Consolidation	-	-	-	-	
Inventory	19.2	27.0	26.4	28.0	
Debtors	2,590.0	2,891.2	3,034.1	3,100.1	
Loans and Advances	811.2	341.4	334.0	425.1	
Other Current Assets	565.1	386.3	453.4	553.1	
Cash	1,079.3	1,295.6	600.0	560.2	
Total Current Assets	5,064.7	4,941.5	4,447.8	4,666.6	
Creditors	3,581.4	3,471.6	3,346.4	3,502.5	
Provisions	568.7	566.4	546.0	571.4	
Other current liabilities	2,194.7	2,597.3	2,540.4	2,694.8	
Total Current Liabilities	6,344.7	6,635.3	6,432.8	6,768.7	
Net Current Assets	-1,280.0	-1,693.8	-1,985.0	-2,102.1	
Other non current assets	1,924.2	2,094.2	2,094.2	2,094.2	
Application of Funds	14,757.6	12,967.5	12,739.4	12,749.2	

Source: Company, ICICI Direct Research

Cash flow statement		₹ Crore			
(Year-end March)	FY19E	FY19E	FY19E	FY20E	
Profit after Tax	1232.9	-328.6	6.0	245.2	
Add: Depreciation	1865.8	1906.3	1986.9	2073.1	
Add: Interest Paid	367.2	344.5	379.1	377.5	
(Inc)/dec in Current Assets	-17.8	339.5	-202.0	-258.5	
Inc/(dec) in CL and Provisions	1302.5	290.6	-202.5	335.9	
Others	0.0	0.0	0.0	0.0	
CF from operating activities	4750.5	2552.3	1967.5	2773.1	
(Inc)/dec in Investments	-603.4	1183.8	-50.0	-200.0	
(Inc)/dec in Fixed Assets	1705.1	-1543.7	-2000.0	-2000.0	
Others	-378.7	-512.1	1.6	0.2	
CF from investing activities	723.0	-872.1	-2048.4	-2199.8	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	-6725.7	-355.5	0.0	0.0	
Less: Interest Paid	-367.2	-344.5	-379.1	-377.5	
Less: Dividend and dividend tax	-135.7	-135.7	-135.7	-135.7	
Others	858.0	-628.3	-100.0	-100.0	
CF from financing activities	-6370.5	-1463.9	-614.7	-613.1	
Net Cash flow	-897.0	216.3	-695.6	-39.8	
Opening Cash	1976.3	1079.3	1295.6	600.0	
Closing Cash	1079.3	1295.6	600.0	560.2	

Source: Company, ICICI Direct Research

Key ratios					
(Year-end March)	FY17	FY18	FY19E	FY20E	
Per share data (₹)					
EPS	43.3	-11.5	0.2	8.6	
Adj. EPS	9.6	1.6	0.2	8.6	
BV	55.9	17.5	9.5	9.8	
DPS	4.8	4.8	4.8	4.8	
Cash Per Share	37.9	45.5	21.1	19.7	
Operating Ratios (%)					
EBITDA Margin	13.7	13.8	15.3	16.3	
PBT / Total Operating income	3.1	2.3	3.1	4.3	
PAT Margin	1.6	0.3	0.0	1.4	
Inventory days	0.4	0.6	0.6	0.6	
Debtor days	53.7	63.4	68.0	65.5	
Creditor days	74.2	76.1	75.0	74.0	
Return Ratios (%)					
RoE	17.2	9.4	2.2	87.8	
RoCE	6.1	5.9	4.3	6.4	
RoIC	4.3	3.3	4.2	6.1	
Valuation Ratios (x)					
P/E	NA	-42.7	NA	57.2	
EV / EBITDA	8.9	9.4	8.9	7.9	
EV / Net Sales	1.2	1.3	1.4	1.3	
Market Cap / Sales	0.8	0.8	0.9	0.8	
Price to Book Value	NA	28.1	52.1	50.3	
Solvency Ratios					
Debt/EBITDA	3.9	3.9	3.6	3.2	
Debt / Equity	NA	18.0	33.3	32.2	
Current Ratio	1.0	0.9	1.0	1.0	
Quick Ratio	1.0	0.9	1.0	1.0	

Source: Company, ICICI Direct Research

ICICI Direct Research coverage universe (Telecom)

Sector / Company	CMP		Rating	M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)			FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Bharti Airtel (BHAAIR)	300	380	Buy	119,922	2.3	-2.8	-4.8	132.3	NM	NM	7.3	9.2	7.9	5.6	2.2	3.7	2.4	-1.0	-3.2
Bharti Infratel (BHAINF)	263	285	Hold	48,644	13.5	12.0	12.5	19.5	22.0	21.1	6.8	6.7	7.8	21.1	19.1	19.6	14.7	14.1	15.7
Idea Cellular (IDECEL)	42	50	Hold	40,574	-9.6	-9.6	-11.9	NM	NM	NM	11.6	12.5	27.1	-2.3	-5.7	-3.7	-15.3	-39.5	-37.1
Sterlite Tech. (STETEC)	365	400	Buy	14,632	8.3	13.3	16.0	43.8	27.4	22.9	20.7	22.1	14.4	29.7	27.0	27.0	28.7	33.1	29.5
Tata Comm. (TATCOM)	493	540	Hold	14,051	-11.5	0.2	8.6	NM	###	57.3	9.4	9.7	8.9	5.9	4.3	6.4	9.4	2.2	87.8

Source: Company, ICICI Direct Research

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Sell: -10% or more;



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

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

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