

# Tata Communications (TCOM IN)

Data business gathering pace

INDIA | TELECOM | Quarterly Update

3 February 2016

## Top takeaways from Q3FY16

- ✗ Consolidated revenues lower than our estimates because of sluggish Neotel business
- ✗ EBITDA margins of voice services fell to an all-time low of 4.3% due to pressure on volume and pricing
- ✓ Data services revenue was in line, but EBITDA margins were higher than estimates. Data has continued to drive core business performance, with both network and managed services offerings showing enhanced traction
- ✗ Revenue from Neotel declined 17% yoy and was below estimates. Currency depreciation of ~16% added to the woes
- ✗ EBITDA was lower than our estimates due to both – the miss on voice services and lower revenue contribution from Neotel
- ⇒ Reported PAT was ahead of estimates on tax write-back

**Key highlights:** Operating performance of the core business continued to be steady with revenue/EBITDA growth of 6.1%/2.1% yoy. However, voice continued to be under stress due to structural headwinds and competitive pressure on volume and pricing – growing adoption of VoIP-based technologies over OTTs is causing the addressable market to shrink. Data services continued to grow with revenue/EBITDA growth of 17%/21% yoy. Data continued to drive core business performance, with both network and managed-services offerings showing enhanced traction.

## Conference call takeaways

- ✓ Improvement in data outpaced industry – both in terms of revenue and earnings; data has hit its near-term milestone of 20%+ EBITDA margin
- ✓ With data growing strongly, quality of growth is getting better as cash flow becomes more stable
- ✗ Voice is shrinking at a faster-than-anticipated rate as VoIP-based providers squeeze the market
- ✓ FCF remains a key priority – free cash flow from data for FY16 is set to be the highest ever and will compensate the weakness in voice
- ✓ Capex guidance lowered to US\$ 300mn from earlier US\$ 350mn
- ✓ Expects to sustain momentum in data segment – driven by sustained enterprise/next-gen-led growth momentum based on new services and recently won contracts, coupled with pick up in the carrier segment

**Outlook and valuation:** We have cut our estimates taking into account lower revenues from Neotel. However, this change does not have an impact on our target price and valuation, as Neotel is likely to be divested – and the sale price is already known. We maintain our Buy recommendation with a revised target price of Rs 475 (earlier Rs 490)

## BUY (Maintain)

CMP RS 379 / TARGET RS 475 (+25%)

### COMPANY DATA

O/S SHARES (MN) :	285
MARKET CAP (RSBN) :	117
MARKET CAP (USDBN) :	1.7
52 - WK HI/LO (RS) :	505 / 336
LIQUIDITY 3M (USDMN) :	2.8
PAR VALUE (RS) :	10

### SHARE HOLDING PATTERN, %

	Sep 15	Jun 15	Mar 15
PROMOTERS :	75.0	75.0	75.0
FII / NRI :	6.8	7.8	8.2
FI / MF :	11.5	11.0	10.7
NON PRO :	1.7	1.7	1.7
PUBLIC & OTHERS :	5.2	4.6	4.6

### Key Financials

Rs mn	FY15	FY16E	FY17E
Net Sales	1,99,133	2,10,530	2,23,195
EBIDTA	29,941	33,285	36,087
Net Profit	1,065	1,714	2,674
EPS, Rs	3.7	6.0	9.4
PER, x	101.4	63.0	40.4
EV/EBIDTA, x	5.6	5.3	4.6
PBV,x%	33.6	17.8	15.7
ROE, %	33.1	28.3	38.8
Debt/Equity (%)	2,366.2	1,358.7	1,120.6

### CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY16E	FY17E	FY16E	FY17E
Revenue	210.5	223.2	-0.7%	-0.6%
EBIDTA	33.3	36.1	-2.1%	-1.4%
Core PAT	1.7	2.7	-3.6%	-3.7%
EPS (Rs)	6.0	9.4	-3.0%	-3.3%

Naveen Kulkarni and Manoj Behera

(Rs mn)	Q2FY16	Q2FY15	yoY growth %	Q1FY16	qoq growth %	vs. expectations %	Comments
<b>Voice Solutions</b>							
Gross revenue	19,826	23,443	(15.4)	20,695	(4.2)	0.1	
EBIDTA	862	1,725	(50.0)	1,715	(49.7)		Pricing and volume pressure led to underperformance
<b>Data Services</b>							
Gross revenue	26,961	23,098	16.7	25,879	4.2	0.4	
EBIDTA	5,853	4,851	20.7	4,965	17.9		Robust growth continues
<b>Startup</b>							
Gross revenue	4,208	5,064	(16.9)	4,727	(11.0)	-18	Currency depreciation impacted reported revenue
EBIDTA	884	1,435	(38.4)	1,040	(15.0)		
<b>Total consol revenue</b>	<b>50,995</b>	<b>49,145</b>	<b>3.8</b>	<b>51,544</b>	<b>(1.1)</b>	<b>-1.3</b>	<b>Due to miss on Neotel business</b>
Adj. EBITDA	7,598	8,010	(5.1)	7,963	(4.6)	-5.1	Lower margin in voice solutions business led to the miss
<b>PBT</b>	<b>69</b>	<b>1,756</b>	<b>(96.1)</b>	<b>1,061</b>	<b>(93.5)</b>	<b>-93.4</b>	
<b>PAT</b>	<b>219</b>	<b>1,085</b>	<b>(79.8)</b>	<b>60</b>	<b>263.6</b>	<b>173.8</b>	

**Tata Communications Q3FY16 result update**

(Rs mn)	Q3FY16	Q3FY15	YoY (%)	Q2FY16	QoQ (%)
<b>Operating Income</b>	50,995	49,145	3.8	51,544	(1.1)
Personnel cost	7,602	6,661	14.1	8,312	(8.5)
Network Costs	25,771	25,191	2.3	25,317	1.8
Operating & other Expenses	10,023	9,282	8.0	9,951	0.7
Total expenses	43,397	41,135	5.5	43,580	(0.4)
<b>EBITDA</b>	<b>7,598</b>	<b>8,010</b>	<b>(5.1)</b>	<b>7,963</b>	<b>(4.6)</b>
EBITDA Margin	14.9	16.3	-140bps	15.4	-55bps
Depreciation	5,908	5,462	8.2	5,694	3.7
<b>EBIT</b>	<b>1,691</b>	<b>2,548</b>	<b>(33.6)</b>	<b>2,269</b>	<b>(25.5)</b>
EBIT Margin	3.3	5.2	-187bps	4.4	-109bps
Other Income	107	1,038	(89.7)	548	(80.4)
Interest	1,730	1,830	(5.5)	1,756	(1.5)
<b>PBT</b>	<b>69</b>	<b>1,756</b>		<b>1,061</b>	<b>(93.5)</b>
Exceptional Items:	-	-		-	
Tax	(154)	666	(123.1)	998	(115.4)
Tax rate	(224.1)	37.9		94.1	
Minority Interest	4	5		3	
Share of loss (in associates)	1	0		1	
<b>PAT(reported)</b>	<b>219</b>	<b>1,085</b>		<b>60</b>	

Source: Company, PhillipCapital India Research

**TCom's quarterly performance**

(Rs mn)	Q3FY16	Q3FY15	YoY (%)	Q2FY16	QoQ (%)
<b>Consol business</b>					
Revenue	50,995	49,145	3.8	51,544	(1.1)
EBITDA	7,598	8,010	(5.1)	7,963	(4.6)
EBITDA margin (%)	14.9	16.3	-140bps	15.4	-55bps
EBIT	1,691	2,548	(33.6)	2,269	(25.5)
<b>Core business</b>					
Revenue	46,787	44,081	6.1	46,574	0.5
EBITDA	6,714	6,575	2.1	6,680	0.5
EBITDA margin (%)	14.4	14.9	-57bps	14.3	1bps
EBIT	1,525	1,685	(9.5)	1,502	1.5
PBT	762	1,060	(28.1)	1,335	(42.9)
PAT	910	389	133.9	334	172.5
<b>GVS</b>					
Revenue	19,826	23,443	(15.4)	20,695	(4.2)
EBITDA	862	1,725	(50.0)	1,715	(49.7)
EBITDA margin (%)	4.3	7.4	-301bps	8.3	-394bps
EBIT	414	1,210	(65.8)	1,226	(66.2)
Minutes (bn)	10.4	11.7	(11.1)	11.1	(6.3)
<b>GDS</b>					
Revenue	26,961	23,098	16.7	25,879	4.2
EBITDA	5,853	4,851	20.7	4,965	17.9
EBITDA margin (%)	21.7	21.0	71bps	19.2	252bps
EBIT	1,111	(90)	NM	153	626.1
<b>Neotel &amp; Startup</b>					
Revenue	4,208	5,064	(16.9)	4,727	(11.0)
EBITDA	884	1,435	(38.4)	1,040	(15.0)
EBITDA margin (%)	21.0	28.3	-733bps	22.0	-99bps
EBIT	165	863	(80.9)	523	(68.5)

Source: Company, PhillipCapital India Research

**Implied valuation of TCom at our DCF target price (Rs 475/share)**

(Rs mn)	FY16E	FY17E	Comment
Neotel equity value (Rs/share)	25		
Land value (Rs/share)	52		
<b>Implied value of core business (Rs/sh)</b>	<b>398</b>		<b>Excluding Neotel</b>
EBITDA	27,288	29,493	
EV	2,00,455	2,00,455	
Net debt post-Neotel (FY15E)	(87,100)	(87,100)	
<b>EV/EBITDA (x)</b>	<b>7.3</b>	<b>6.8</b>	

Source: Company, PhillipCapital India Research

## Financials

### Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	<b>1,96,659</b>	<b>1,99,133</b>	<b>2,10,530</b>	<b>2,23,195</b>
Growth, %	14	1	6	6
Total income	1,96,659	1,99,133	2,10,530	2,23,195
Raw material expenses	-1,07,457	-1,05,543	-1,10,069	-1,10,405
Employee expenses	-24,976	-27,948	-29,947	-33,541
Other Operating expenses	-33,346	-35,702	-37,229	-43,162
<b>EBITDA (Core)</b>	<b>30,880</b>	<b>29,941</b>	<b>33,285</b>	<b>36,087</b>
Growth, %	49.9	(3.0)	11.2	8.4
Margin, %	15.7	15.0	15.8	16.2
Depreciation	-20,914	-21,611	-22,550	-23,978
<b>EBIT</b>	<b>9,966</b>	<b>8,330</b>	<b>10,735</b>	<b>12,110</b>
Growth, %	2,951.4	(16.4)	28.9	12.8
Margin, %	5.1	4.2	5.1	5.4
Interest paid	-7,617	-7,508	-7,607	-7,305
Other Non-Operating Income	634	0	0	0
<b>Pre-tax profit</b>	<b>3,799</b>	<b>4,788</b>	<b>5,428</b>	<b>7,220</b>
Tax provided	-3,433	-3,705	-3,666	-4,250
<b>Profit after tax</b>	<b>366</b>	<b>1,083</b>	<b>1,762</b>	<b>2,970</b>
Others (Minorities, Associates)	-14	-18	-48	-295
<b>Net Profit</b>	<b>352</b>	<b>1,065</b>	<b>1,714</b>	<b>2,674</b>
Growth, %	(104.8)	202.6	60.9	56.0
<b>Net Profit (adjusted)</b>	<b>352</b>	<b>1,065</b>	<b>1,714</b>	<b>2,674</b>
Unadj. shares (m)	285	285	285	285
Wtd avg shares (m)	285	285	285	285

### Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	16,695	16,212	14,497	18,341
Debtors	27,339	24,870	29,240	29,759
Inventory	506	264	439	465
Loans & advances	6,777	3,667	4,018	4,440
Other current assets	10,211	9,262	2,975	7,380
Total current assets	61,527	54,274	51,168	60,385
Investments	7,538	8,790	8,790	8,790
Gross fixed assets	2,84,921	3,03,457	3,19,519	3,42,419
Less: Depreciation	-1,35,779	-1,56,419	-1,78,969	-2,02,946
Add: Capital WIP	6,530	6,383	7,031	4,218
Net fixed assets	1,55,672	1,53,422	1,47,581	1,43,690
Non-current assets	24,033	24,033	24,033	24,033
<b>Total assets</b>	<b>2,48,769</b>	<b>2,42,437</b>	<b>2,53,087</b>	<b>2,54,414</b>
Current liabilities	94,574	1,10,272	1,14,974	1,19,868
Provisions	4,045	6,577	6,954	7,373
Total current liabilities	98,619	1,16,849	1,21,929	1,27,241
Non-current liabilities	1,42,093	1,22,315	1,25,046	1,20,221
Total liabilities	2,40,712	2,39,163	2,46,975	2,47,461
Paid-up capital	2,850	2,850	2,850	2,850
Reserves & surplus	5,145	365	3,204	4,044
Shareholders' equity	8,057	3,273	6,113	6,953
<b>Total equity &amp; liabilities</b>	<b>2,48,769</b>	<b>2,42,437</b>	<b>2,53,087</b>	<b>2,54,414</b>

### Cash Flow

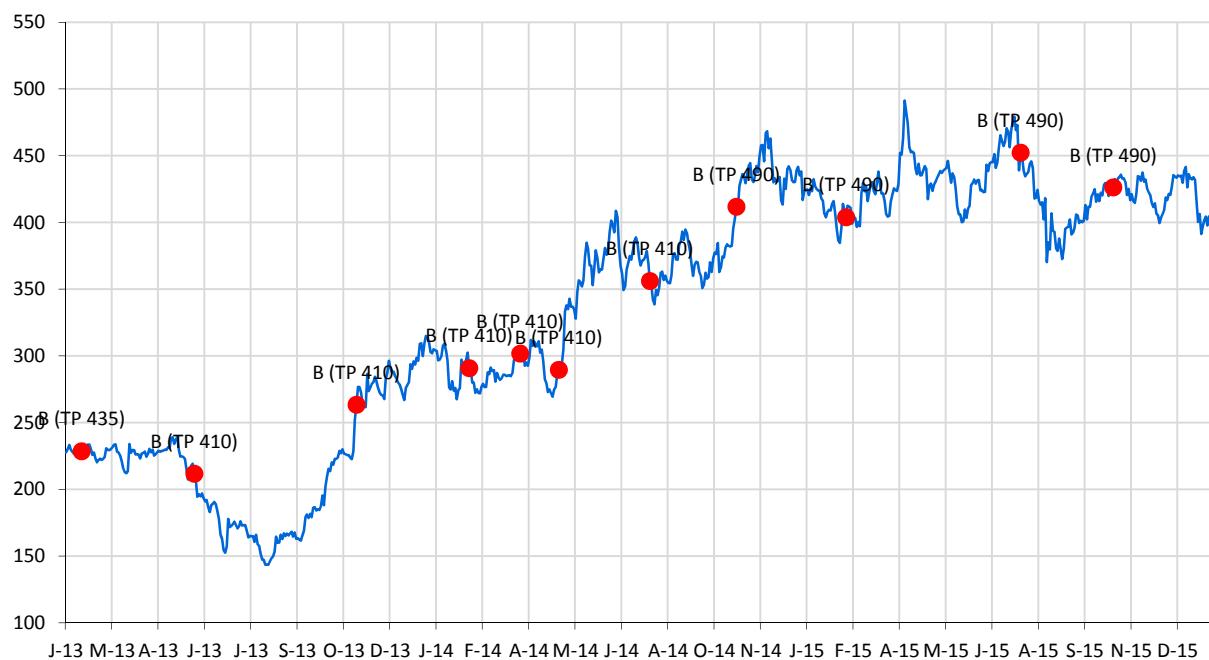
	FY14	FY15e	FY16e	FY17e
Pre-tax profit	3,799	4,788	5,428	7,220
Depreciation	20,914	21,611	22,550	23,978
Chg in working capital	9,029	26,659	3,012	114
Total tax paid	-3,433	-3,705	-3,666	-4,250
Other operating activities	0	0	0	0
<b>Cash flow from operating activities</b>	<b>30,309</b>	<b>49,353</b>	<b>27,324</b>	<b>27,062</b>
Capital expenditure	-21,765	-19,361	-16,709	-20,088
Chg in investments	-6	-1,252	0	0
<b>Cash flow from investing activities</b>	<b>-21,754</b>	<b>-20,612</b>	<b>-16,709</b>	<b>-20,088</b>
Free cash flow	8,555	28,741	10,615	6,974
Equity raised/(repaid)	-4,231	0	0	0
Debt raised/(repaid)	5,560	-15,000	-15,000	-15,000
<b>Cash flow from financing activities</b>	<b>1,298</b>	<b>42,482</b>	<b>6,230</b>	<b>-1,052</b>
Net chg in cash	9,853	7,282	16,757	1,679

### Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	1.2	3.7	6.0	9.4
Growth, %	(104.8)	202.6	60.9	56.0
Book NAV/share (INR)	28.1	11.3	21.2	24.2
FDEPS (INR)	1.2	3.7	6.0	9.4
CEPS (INR)	74.6	79.6	85.1	93.5
CFPS (INR)	107.3	173.2	95.9	95.0
Return ratios				
Return on assets (%)	2.2	2.4	2.8	3.2
Return on equity (%)	4.4	33.1	28.3	38.8
Return on capital employed (%)	3.4	4.1	4.9	5.6
Turnover ratios				
Asset turnover (x)	3.0	4.1	6.9	9.0
Sales/Total assets (x)	0.8	0.8	0.9	1.0
Sales/Net FA (x)	1.3	1.3	1.4	1.5
Working capital/Sales (x)	(0.3)	(0.4)	(0.4)	(0.3)
Working capital days	(92.3)	(132.4)	(135.8)	(127.3)
Liquidity ratios				
Current ratio (x)	0.7	0.5	0.4	0.5
Quick ratio (x)	0.6	0.5	0.4	0.5
Interest cover (x)	1.5	2.4	2.0	2.5
Total debt/Equity (%)	1,219.6	2,366.2	1,358.7	1,120.6
Net debt/Equity (%)	1,010.7	1,862.0	1,119.3	854.6
Valuation				
PER (x)	306.9	101.4	63.0	40.4
Price/Book (x)	13.5	33.6	17.8	15.7
EV/Net sales (x)	1.0	0.8	0.8	0.7
EV/EBITDA (x)	6.1	5.6	5.3	4.6
EV/EBIT (x)	18.9	20.2	16.4	13.8

Source: Company, PhillipCapital India Research Estimates

## Stock Price, Price Target and Rating History



## Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to } < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

**Management**

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