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Q3 FY2022 Earnings Webinar Transcript

MAIN SPEAKER:

AS Lakshminarayanan, Managing Director and
Chief Executive Officer

Kabir Ahmed Shakir, Chief Financial Officer

Vipul Garg

Good afternoon, everyone, and welcome to the Tata Communications Earnings conference call. We are joined today by our MD and CEO, Mr. AS Lakshminarayanan; and our CFO, Mr. Kabir Ahmed Shakir. The results for the quarter ended 31st December 2021 have been announced yesterday, and the quarterly fact sheet is available on our website. I trust, you would have had the chance to look through the key highlights. We will commence today's call with comments from Lakshmi, who will share his thoughts on the business and our long-term outlook followed by Kabir, who will share his views on the financial progress achieved. At the end of the Management's remarks, you will have an opportunity to get your queries addressed.

Before we get started, I would like to remind everyone that some of the statements made or discussed on the conference call today may be forward-looking in nature and must be viewed in conjunction with the risks and uncertainties we face. A detailed statement and explanation of these risks are included in our annual filing, which you can locate on our website www.tatacommunications.com. The company does not undertake to update these forward-looking statements publicly. With that I would like to invite Lakshmi to share his views.

Over to Lakshmi.

A S Lakshminarayanan

Thanks, Vipul and good afternoon, everyone. And before we commence our call today, I would like to extend very warm New Year wishes to all of you on behalf of Tata Communications. I hope you and your family are safe and healthy.

With Omicron raging across the globe, there is some unevenness across the globe in terms of recovery, but we hope that all of this will be put to rest soon. But we remain watchful of the impact, it may have on our employees and the business. Our Data business continues to recover and for the second quarter in a row, Data business has grown sequentially. Data business revenue grew by 3% quarter on quarter, and this growth has been achieved, despite macro headwinds and Q3 being a seasonally weak quarter for us, as the year and holidays bring down the usage services. This growth is particularly encouraging as we have seen growth across all segments of the data business. Digital platforms and services, except the collaboration portfolio has grown between 7% to 20% sequentially and a double-digit year on year growth, which we see as a good sign. We also witnessed growth in all the regions, both in India and international markets, giving us the confidence that we are moving in the right direction. Revenue growth has been on the back of new wins, as well as more active account and churn management.

As part of our strategy, we are gradually changing our business model and focusing more on solutions. We are pushing out for the deals which give us more fixed committed recurring revenue, and this has started to show results, while usage-based services continue to remain soft, we have seen a steady growth in our fixed recurring revenue across all segments, giving us more predictability on the revenue.

We continue to be affected by macro challenges. Firstly, the large deal closure remains slow as the enterprises are resetting themselves from the COVID, and their expansion plans with respect to opening of new branches and global expansions seem to be put on hold. The second is supply chain challenges that continue to affect delivery. The chip shortage has affected the availability of equipment and the delivery timelines haven't improved materially in Q3. We continue to manage the situation through active engagement with our suppliers and investing ahead of time. Three, the talent attrition continues to be a challenge but hiring has now picked up and we rolled out more than 800 offers in Q3 and target to roll out, the same member in Q4. We have started picking up pace over the last few quarters. Though our business continues to be affected with short-term challenges, the steps are pointing towards

growth, and we are confident about the long-term opportunity. Investing in innovation and capability building has been a pillar of our strategy. Our product portfolio continues to evolve on 'What's new' and 'What's next' thought leadership, which enables us to meet our customer demands today as we prepare for the next phase of growth.

In the last two years, we've been focusing on our financial fitness, product strategy, capability building and of course immediate execution on all of these. Going forward, we will be investing in our growth engine, and we plan to further enhance our sales and technology capabilities. In FY '23, we are targeting to hire more than thousand people across geographies to strengthen our sales, solutioning and engineering capabilities. We also put in place additional retention and attraction measures to counter the talent war that's been going on in the market. We will continue to strengthen these even more in the coming quarters.

Our core connectivity business continues to show stable growth despite bandwidth rationalization and branch connectivity globally. This was triggered by the slow return to offices and hybrid mode of operations. Our core connectivity portfolio grew by 1.6% quarter-on-quarter and 1.3% year-on-year. The world is moving towards digital, and we, at Tata Communications, are leaving no stone unturned to partner with our customers in their digital journey. With a robust network infrastructure and digital offerings in collaboration, cloud and security space, we continue to support our customers by providing end-to-end solutions. A large part of our deals that we are signing now combines our network and other digital products, thus giving the customer a holistic digital experience.

Our digital platforms and solutions grew by 5.2% quarter-on-quarter and 6.7% year-on-year. Our Collaboration segment continues to be affected by decline in SIP usage-based services and seasonality impact of Q3. All other products in collaboration have witnessed robust growth. Our Microsoft Teams solution continues to grow at a rapid pace. We recently launched our Global Rapide Solution for Microsoft Teams deployment and management, and the response for this has been stellar. Our teams offering has clocked a consecutive quarter of over 100% year-on-year growth and is gaining traction. Overall, collaboration portfolio, declined by 1.4% quarter-on-quarter, and 8.9% year-on-year.

With businesses looking to secure their place in a hybrid world, we are providing the right tools through our cloud offerings and specialized security solutions, to ensure a seamless migration and digitally scale up infrastructure as opportunity landscape widens. Cloud business continues to gain traction. We continue to innovate our cloud and security offerings including our cloud SOC solution. Our cloud-based virtual desktop as a service or VDaaS infrastructure service in collaboration with VMware is one such example. It rapidly enables work from anywhere reality, helping to create a future for work that's highly adaptable, and secure. The solution empowers remote workers with industrial-grade security, massive scalability, and high performance wherever they are located, and it's hosted on Tata Communication's flagship IZO private cloud platform. Our cloud and security portfolio grew by 7.3% quarter-on-quarter and 19% year-on-year.

Network transformation will be a huge opportunity in this hyper-connected digital world. Cloudification is driving the need for networks to become more intelligent, agile, secure and scalable. Our portfolio of cloud-based applications enabling enterprises across sectors to evolve into cloud first and internet first organizations. Our recent survey brought to light that 90% enterprises haven't still achieved their digital-first goals. It is heartening to see more organizations adopting new age technologies and solutions and shifting gears. Next Gen Connectivity portfolio grew by 9.6% QoQ and 24.3% YoY led by strong growth in IZO WAN and SDWAN.

We recently extended our partnership with one of the world's leading specialty chemical companies - With our IZO™ Internet WAN solution across 130 sites in 40 countries, we are helping the company evolve from Private MPLS network to Public Internet with guaranteed end-to-end Service level Agreements (SLAs). We are equipping their IT infrastructure with our innovative IZO™ Network Edge platform which provides customer increased visibility and control of their applications, and allows them to offer their employees, customers, and partners with faster and

more reliable & secure access to cloud-based applications. We also provide Direct Routing to Microsoft Teams, enabling the customer to deliver an enhanced collaboration.

We are enabling a secure network transformation of a European leading supplier of solutions and services for electrical installations, by delivering SD-WAN and Managed Security Services (MSS) across 80 sites around the world. An existing SD-WAN customer, we have now expanded our association by adding a layer of security in their network. Being their sole global network provider, we simplify their business operations by eliminating their need to engage with multiple vendors, enabling the customer to communicate seamlessly and securely across all their sites globally. The enhanced network also helps to improve efficiency of their processes as well as deliver their 18,000+ products and solutions to their customers with more agility, reliability, and security.

Our Media portfolio continues to grow aided by the resumption of sporting activities worldwide. We are supporting majority of flagship media customers cover sports events through Remote Production as broadcasters & federations have now moved firmly to the new workflow. This has created a very strong engagement in the industry with focus on significant upsell. Through our media cloud infrastructure on the edge, we are able to deliver content to all parties involved in production in a matter of seconds, with all editing and production done on the cloud, at an increased speed. During this quarter, our Media business grew by 18.4% QoQ and 21.8% YoY.

Our Incubation services portfolio is also making strides in the right direction as we are committed to seed these products and watch them scale rapidly into the future. Incubation services portfolio grew by 26.4% QoQ and 67.0% YoY. Our MOVE and IoT offerings are being recognized by the industry and the adoption is picking pace. During Q3, we have seen an uptick in usage of MOVE in the auto segment and we have also won some marquee deals in the IoT Segment. MOVE and IOT combined which we refer to as 'Connected Solutions' grew by 30.3% QoQ and 72.4% YoY.

Recently we won a deal to enable a local municipality in Saudi Arabia by bringing next-gen Smart City solutions. This is a milestone achievement as the IoT business expands its global footprint beyond India. We will serve as the one-stop-shop to provide the IoT hardware, platform, application, and insights for the customer. The solution will upgrade the city's existing streetlights with smart streetlight solution through automation of controls for energy and cost savings. The overlay of the smart streetlighting solutions based on our IoT fabric and platform will transform the city into an intelligent and energy efficient township and enable the city to significantly reduce its carbon footprint.

In terms of financial performance, our consolidated revenues for the quarter were at INR 4,185 Crore and witnessed a growth of 0.3% QoQ. EBITDA for the quarter was at INR 1,082 Crore with margin at 25.9%. The profitability and cash flow generation continues to be robust giving us the headroom to invest for the future. Profit for the quarter was at INR 395 crore. Our Data business grew by 3.0% QoQ and 3.4% YoY witnessing growth across all segments. We continue to reduce our Net debt on the back of strong cash flows and Net debt is now at USD 967 Mn witnessing a reduction of USD 78 Mn as compared to last quarter. This is the first time since 2014 that our Net debt has gone below USD 1Bn.

We will continue building and upgrading our capabilities, technical infrastructure and pursue business opportunities as they come up. Our end goal is to connect our customers through a robust, scalable and secure digital infrastructure and be the partners of choice in their digital transformation journey. We are excited for the coming year and remain focused on building a resilient organization as we move towards our long-term growth objectives.

I would now request Kabir to share an in-depth financial update with you all. Kabir, over to you.

Kabir Ahmed Shakir

Thank you, Lakshmi. Good afternoon, everyone and thank you once again, for joining us for our Q3 Earnings Call. Let me take the opportunity to go through our financial performance for the quarter in a bit more detail.

Tata communications has been constantly adapting to the changes in the industry and in the needs and demands of our customers since the pandemic hit us. We continue to expand our product portfolio, strengthen our execution capabilities and invest for future growth. We've started to witness the results and recovery in our Data business along with strong profitability, and it's the step in the right direction. For the quarter, consolidated revenue was at INR 4,185 crore witnessing a growth of 0.3% quarter-on-quarter and a decline of 0.9% year-on-year. The growth in overall revenue comes on the back of recovery in data business revenue. Profitability remains a key focus and EBITDA for quarter stood at INR 1,082 crore, witnessing a growth of 3.5% year-on-year and a decline of 2.7% quarter-on-quarter. You recall, last quarter that we had a one-off benefit of INR 50 crore during Q2, and if we normalize for that the EBITDA would have grown by 1.8% quarter-on-quarter. EBITDA margin came in at 25.9% expanding by 110 basis points as compared to the same quarter last year. Margins are higher than the stated range of 23-25 due to the benefit and staffing cost, which we will normalize as we hire more people as per our plan. PAT came in at INR 395 crores and grew by 27.8% year-on-year. This translates to an EPS of INR 13.8/share in Q3.

During last few quarters, revenue growth has been slow due to various reasons, but during that time, the financial health of the company has considerably improved due to our sustained efforts towards process improvements and efficiency. Our operating cash flow generation has improved significantly, and our net worth is steadily increasing, making our balance sheet much, much stronger.

Net debt as on 31st December stands at INR 7,189 crores, reduction in net debt during the quarter was INR 572 crores compared to Q2, and INR 783 crores compared to the same quarter last year. Net debt to EBITDA is now at 1.7x as compared to 1.9x a year earlier. As I mentioned, strong cash flow generation coupled with balance sheet strengths gives us the freedom to pursue future growth opportunities more aggressively.

While we plan for aggressive investment for future growth, we have clear sights on the returns for our shareholders. trailing 12 months ROCE is at 25.4% as compared to 21.1% during Q3 of last year. CapEx incurred during the quarter was INR 400 crores compared to INR 339 crores in same quarter last year. We've increased our approved CapEx in line with our growth plans, however, the spent CapEx is lower compared to the plan due to the slower execution of projects as Lakshmi explained. This will pick up hopefully in the coming quarters.

Data Business for the quarter came in at INR 3,233 crores, growing sequentially by 3% and 3.4% year-on-year. All the individual segments in data business grew sequentially year-on-year this quarter. We witnessed the consecutive quarter of sequential growth. We plan to build on this momentum and achieve our long-term growth objectives.

We continue to navigate through short-term macro headwinds and implement our strategy, that will help our business grow and deliver robust financial performance, going ahead. Data business EBITDA was at INR 1,041 crore, witnessing a growth of 3.6% year-on-year. Margins improved by 10 basis points year-on-year and came in at 32.2%. Profitable growth in core connectivity and reduction of losses in incubation services, is a primary driver of this strong margin.

To conclude my remarks, I would like to reiterate that with the improvement in the business environment, Tata Communications has started to see a recovery and it further bolsters our belief that we will grow at a faster pace as conditions further improve. We are implementing strategies to maximize our potential and continue to invest in the future of the company.

Before I end, I have an announcement to make. I would like to announce that Vipul Garg has decided to pursue opportunities outside of Tata Communications. Vipul has been with the company for more than five years, and he's

steered Investor Relations along with various other responsibilities. Most of you know him, on a first-name basis. During his tenure he has built a strong IR framework, helped onboard marquee investors and played an important role in communicating Tata Communications' strategy to the outside world. I'm sure Lakshmi joins me in thanking him for his contributions and we wish him well and all the best for his future endeavors. That brings us to the end of the management commentary. Let me hand over the baton back to Vipul to open the forum for any Q&A's.

Vipul Garg

Thank you, Kabir.

The first question is from the line of the Riddhesh Gandhi of Discovery Capital. Riddhesh, your line has been unmuted. You may ask your question now.

Riddhesh Gandhi

Sure. Hi sir. Just had a couple of questions. So, our revenue growth has obviously been slightly lower as you had indicated. Just wanted to understand; is this all due to effectively the exceptional items of say COVID and chip shortage, and then therefore, as the things normalize, do we see some amount of bunching where we will see higher growth happening in Q4 onwards? And just wanted to understand if these were already driven by actually external issues or if we also were slightly aggressive in the way we were thinking the revenue growth was going to play out?

A S Lakshminarayanan

No, I think, in terms of our reading of the industry and the way we participate in it, I think we are quite confident that we will participate in the industry's digital transformation. Our portfolio, we are continuing to strengthen and build to ensure that the participation will only yield the necessary results. In terms of the growth, and I think quarter-on-quarter, if you look at that 2% or 1.7% and 3%, it points all to the right direction, and as I called out in my commentary, a lot of this revenue uptick has come both from the wins as well as better management of churn and a tighter management of the accounts are yielding these. Now, COVID has had an element to play especially in the Usage Services and the broader chip shortage and the OEMs elongated delivery periods is slowing down the conversion of orders into revenues, that is also playing a part. And there is also a part of in terms of us, accelerating now our ability to have more feet on the ground in various geographies, and attrition hasn't helped, but we are hiring people to support that and increase our sales and solutioning capability. So, all of that. So, I would say a large part is external environment, and internally, we are strengthening the product and we will have to invest more on the sales and marketing and solutioning engine, which is what we are committing to do now in order to improve the growth scenario.

Riddhesh Gandhi

So and the other question was you just wanted to understand from a group level with perspective. Obviously, you've got a number of entities in the Tejas and effectively Tata Tele and you guys obviously also sort of focus on the digital outlays and growth, and there's also obviously a lot of cross-linked directorships between these entities. So, just wanted to understand, is there anything that you guys are looking at from a group level, how should we be thinking about how the Tata group is looking at Tata Communications in the entire picture I think?

A S Lakshminarayanan

No. I think, the group is very committed. I think the commitment was shown when the majority stake in Tata

Communications was taken and investing further in the sector. So Tejas is one such investment, which is an OEM, and they made that investment with a clear strategy to have a bigger role and play in the scheme of things as 5G comes into play.

So I think at the group level, yes, there is a design to see how we can exploit the synergies between various entities. So that would be the view from the group level. But as far as Tata Communications is concerned, I think we will keep our head down and make sure that we can deliver on our strategy, while exploiting any synergies available between the group companies, which we are doing.

Riddhesh Gandhi

Earlier we had similar discussion around potentially acquiring the SME business of Tata Tele. Is that still something which we are looking at? Or is that not right now on the cards?

A S Lakshminarayanan

I think it would not be right to comment, and all I would say is we are looking at all avenues for growth. Obviously, if there are synergies to be had, we will look at it more closely and we will let you know at an appropriate time. But from a growth perspective currently, we are investing in products, we are investing in our sales and marketing, and we will also look at other opportunities even if it is inorganic as we called out now- we have the strength to be able to do that. So all those options are available for us.

Vipul Garg

The next question is from the line of Sanjesh Jain of ICICI Securities. Sanjesh, you may please ask your question now.

Sanjesh Jain

Hi. Good afternoon and thanks for taking my question. A couple of them. First on the Core connectivity side, last two years I think our Core connectivity has done quite well even in the COVID year. Core connectivity has delivered a 6% to 7% growth and now we were in an unlocking stage. We were looking for more traffic growth as people go back to the office and the 1+% odd growth on a YoY basis, where cloudification is rising, where digital economy is rising. Can you just help us explain what's going on the Core connectivity side and why it suddenly underperforming on the growth?

A S Lakshminarayanan

No. I think, overall, from an industry perspective if you look at- the core connectivity is slated to be flat or even decline. And in that market, we are showing growth on the back of especially in India with more Data center connectivity coming and international also, we are growing.

So, I think that's the nature of the Core connectivity market, and we are performing in that segment quite above the market space. One thing, especially to look at is the OTT segment and the Cloud Player segment, who during the COVID times have invested with us- which is what led us to have a bigger growth last year in increased capacity, and those capacities are yet to be utilized fully, because nothing has changed in terms of further improved capacity to be utilized. So, those capacities are still under play. So, I think that's the overall environment of the Core connectivity and I think we are doing quite well in that environment of Core connectivity. Of course, the next-gen connectivity, which is all internet-based, and on demand based and so on, which is where we are seeing that

enterprises will grow in as they expand their footprint and open offices or look to see how to enable people from working from anywhere and that portfolio has grown quite well as I called out.

Sanjesh Jain

Got it. And last quarter, Lakshmi, you called upon a possibility of an ambition to see the pricing angle in Core connectivity to drive the growth. Any more color you want to add on that?

A S Lakshminarayanan

That is something we are still looking at, and I think I called out that the demand-supply economics doesn't support the pricing to be continuously declining and we are still looking at it. We hope to come back with a design and start acting on it, in the coming quarters.

Sanjesh Jain

But is there, because I think in the last year some of your comments you did mention that there could be higher growth in Core connectivity as well. Is there any change in the view for you on the Core connectivity side?

A S Lakshminarayanan

I think we called out the Core connectivity growth in single digits only. While the market of Core connectivity will be declining, which is what the market data we shared during our strategy presentation, with the market in Core connectivity is going to, globally, I'm speaking, is going to be that or declining and in that market, we said we will grow in the mid-single digits is what we called out in our strategy, and there is no change from that view.

Sanjesh Jain

We still hold that mid-single digit is possible in -this segment.

A S Lakshminarayanan

Yes. Yes.

Sanjesh Jain

Second on the collaboration side. Even on the low base, it's declining on a Y-O-Y basis. That takes care of seasonality. What's going on the SIP side, and how big is it? And we thought you were anticipating growth even in the SIP. Any view, change in the collaboration side on the SIP particularly?

A S Lakshminarayanan

No. I think on the SIP, as you know, is a large part of our collaboration. I think it's been impacted by a few things. One is the rationalization of the usage itself as people continue to work from home and it's been a see-saw from home to office kind of a situation, and even when people went to office, they continue to use the regular home working models rather than using the SIP. So, there's some rationalization happening on the usage, which costs SIP to... I think that is a structural shift. And also, we had company specific issues as a result of the IUC increase that we called out, and because of that rate increase that we have to do there have been specific issues with customers and therefore, a decline in the traffic. And the third is the seasonality. So, all three of them accounted for in Q3.

But the first two shifts have been playing out since almost one year, since Q3 of last year. We think that this will stabilize as the economies open, and people move to a more stable hybrid working environment- is what our outlook is.

Sanjesh Jain

I think, VoIP can actually keep putting pressure on SIP like what we saw in Voice. Can a significant portion of SIP move to VoIP

A S Lakshminarayanan

No, see, I think obviously the collaboration and cloud-based platforms as people move to using more of Teams and Cisco and Zoom a lot of revenues that we are calling out under SIP will get bundled under that.

Sanjesh Jain

It's better to look at it as a segment as a whole, which is underperforming, right?

A S Lakshminarayanan

Yeah. Yeah, that is right. And that is where I think we are hopeful with the Teams enablement has picked up, but even within Teams, and we called out in our strategy that we want to shift in the Teams more to a fixed recurring revenue for fully managed services as opposed to providing only the SIP underlay for the Teams right, which would have also been a purely only usage based and would have been impacted. Now, the growth in Teams shows that, our ability to then bundle and provide a more holistic solution of Teams, which is on a fixed recurring basis as opposed to just the usage basis is a good sign. So, majority of the Teams growth that we are seeing is largely on a fixed recurring basis, and it's not factored in the usage part to a great extent yet.

Sanjesh Jain

One question probably here to understand the shift. In the Teams, we are providing a lot more managed services and anything in SIP is just a connectivity. Do you think when a customer moves from purely taking a SIP to or more Teams, will it be revenue accretive, because that will speak of how the revenue eventually in the collaboration will move? So, only a SIP, from there if a customer transit to say pure play Teams kind of a platform, do you think, we will have a revenue accretion, or do you think we will lose out on a revenue in the transition?

A S Lakshminarayanan

We will not lose out on the transition. I think that the Teams will be largely focused on customers moving from people having on-site PBX, migrating that to the cloud, and as they move to the cloud, and as they activate their voice, it will be revenue accretive.

Sanjesh Jain

So that means once a customer moves, we will be revenue accretive on the Teams side rather than just selling SIP as a solution.

A S Lakshminarayanan

Yes, yes.

Sanjesh Jain

Next on the Transformation side, looks like the business is not stabilizing today and a year back, we saw that FY '22 would be the year of stabilization but I don't think that's happening. So what's the outlook on the transformation of business as a whole? Have you changed anything on the transformation business for us?

A S Lakshminarayanan

The TCTS is going through certain customer specific contract issues and this quarter specifically also had a provision for one of the customers, which took the margins down. But barring that, I think it is showing an improving trend. I think it will take a couple of quarters for it to fully turn around. But we remain quite confident that the capabilities that this company has, TCTS, is very niche with a great degree of domain knowledge, automation and process knowledge, which the Telco's world over require as they increase their CapEx in hybridization and 5G spend, the demands for them will grow. So, we remain committed to that business and transforming the business, but the recent run, in terms of both the revenue and margins, have been due to certain specific contracts, which we are working on to see how we recover and try and turn this company around.

Sanjesh Jain

Got it. Last bit of question from my side. One of the order book. Lakshmi, you said that last quarter we saw double-digit growth in the large order deal wins. How has been the trend for this quarter on the other side? And the last question for Kabir. On the working capital days, it looks like we have improved significantly in last three-quarters. Do you think the working capital days, what has been achieved in the Q3, is sustainable over a longer period of time? Sir, these are my last questions.

A S Lakshminarayanan

On the order book, Q2, we had a good order book. I think some of the order booking has got pushed out to Q4. So, the Q3 is, is more a normal quarter rather than a standout that we had in Q2. So that's the color of the order book and more on the funnel side, I think the funnel side is stable. The quality of the funnel is good in terms of larger deals in the funnel. Our win rates are improving, but I think our immediate task is to see how to improve the funnel and thereby continue to improve the order book.

Kabir Ahmed Shakir

Let me just pick up on the working capital. Yes, Sanjesh our working capital progress has been really good and I'm quite delighted with what our collection teams are doing jointly with our sales support team. And we're bringing in quite an amount of I would say, process discipline inside the organization and that's started to show results, as we speak. My DSO days has come down from 56 days to 51, which is a healthy improvement and it's our endeavor to maintain these sustainable levels. In addition to that our PDD has come down quite a bit on the back of good collection efforts. So, I would say, these are a few of them and a couple more of process efficiencies and hygiene is underway in implementation and the intent is to maintain and improve from these levels.

Vipul Garg

The next question is from the line of Pavan Ahluwalia from Laburnum Capital. Pavan, you may please ask your question now.

Pavan Ahluwalia

Yes, thank you. Some of my questions have been addressed but two questions.

So when we look at the kind of sluggish growth in sort of communications- a part of it is due to the structural shift towards potentially more web-based usage. Has that basically played out? So are we done with that or are we likely to see that be a continuing headwind in the coming years as people use less and less dial-in and more and more web-based conferencing? That was one question. And the second was, we're seeing from various IT businesses as well that while the spend by enterprises on software has been pretty robust, the spend on network upgradation, network VAS, etc. has been sluggish and I'm guessing that is showing up in part in your growth numbers, order book numbers, etc. Any idea on why there is this gap and over what period of time do you expect this to reverse itself?

A S Lakshminarayanan

I think that the first one I'm collaboration, I think we discussed it extensively in the earlier questions as well. There is a structural shift in terms of people using more collaboration software to communicate, or collaboration applications to communicate, but underlying technologies will still be SIP and so on. So that is where our offering of Microsoft Teams and others will play, rather than being able to sell simply a vanilla SIP product to enterprises. So, that shift will continue to take place. I think, we should be seeing the plateauing out of that as I called out, our issue has been one, because of the industry structure. There has been a company specific issue with respect to the IUC charges that we had and so on. And the third is the COVID situation, people not going back to work and continuing to use from home. I think all three issues we think we should normalize in the coming quarters and should plateau it out is what I think. Once that happens and people start to shift to more of the collaboration applications, whether they use Teams or Zoom or Cisco, or any of these products. I think that Global Rapide, which we have now currently launched for Microsoft teams will come into play. People will shift because even if people implement Teams they are not necessarily shifting their PBX to the cloud. So as a next step that they will do. And as they do that, our collaboration portfolio should kick in. So we believe that once the SIP trunk sort of plateaus, and the decline plateaus, the other ones will start to kick in, in the collaboration space.

Now with respect second question on IT, I do see that where the enterprises when the focus on that transformation that immediate focus on transformation has been on the application side how to use the data for more analytics and so on. But as they move more and more to cloud the existing network infrastructure, especially if they want to leverage internet, will have to get transformed both from a network perspective as well as from a security perspective. The dollar spend might remain flat, but they have to go through a change and that is the change that we are looking to spot and make use of, and that is why, in our network transformation in our next-gen connectivity we are growing, but I think there is a bigger potential to grow even faster as the enterprises start to focus on the infrastructure transformation as they transform their applications and data analytics. So there is a lag, but I'm not able to really quantify it for you as to how much is the lag, because I think that would depend on various organizations and their strategy and their roadmap.

Pavan Ahluwalia

And when you say that dollar spend would remain flat, does that then mean that we are basically looking to take share from other network providers who may not be as or who may not have as compelling a VAS offering as us?

A S Lakshminarayanan

Yes. That is what we are - because in especially in the international markets, which is where a lot of these transformations will take place, we will be in a challenger position to challenge the incumbents to help enterprise

transform with Tata Communications rather than with the incumbents.

Pavan Ahluwalia

Are we truly different? because certainly even in a market like India, right, I mean Bharti is doing a lot of work in this space, Vodafone has a very strong offering, isn't it the case that most Telco's around the world have invested pretty well in this. So, are we really that much better than, Vodafone or Verizon or whoever the competitors are anywhere else in the world?

A S Lakshminarayanan

Yeah. I think especially when it comes to international footprint of customers, we truly can offer a differentiated offer. Our IZO product continues to be fairly unique in the market, where we are able to give service levels on internet. I think the that is still very unique. And on the IZO overlay, we are also, and as I called out one of the customers, the IZO Network Edge, which provides local breakouts through our network edge to connect to the cloud in a more agile fashion. So, we certainly have a differentiation when it comes to customers having multi geography footprint. And that is what we will have to push in the market and stake our claim in that space, and that's what we are doing.

Vipul Garg

The next question is from the line of Hitesh Arora of Unifi Capital. Hitesh, you may please ask your question now.

Hitesh Arora

Thanks for the opportunity. I just wanted to clarify- the Incubation Services. See, the top line, here, has largely been in the maybe INR 30 crore, INR 40 crore, and this quarter, it was around INR 50 crore odd. But we haven't really broken out in this segment, especially compared to the opportunity that we have here. Any comments there? I thought the opportunity set is huge, we should have already seen a much larger growth here but that's somehow seems to be elusive thus far.

A S Lakshminarayanan

See, on the incubation, there are two or three parts to this. One is the connected solutions portfolio of MOVE and IoT and the other is the NetFoundry. I think as - the overall in the IoT space while people are talking about it, I don't think the full IoT benefit has been reaped or the enterprise has invested that much in IoT as yet. I think we are focused on a few use cases in IoT in worker safety, worker productivity and then expanding that to more asset in man, machine and material. On the MOVE side, and I know in the IoT and also the smart street lighting in India and we are expanding globally as well. So I think the use cases are gaining traction and we are focused on a set of niche use cases with our IoT fabric opportunities and that is beginning to gain some traction.

On the MOVE portfolio, I think, the breaking out as you call, we are quite confident will happen as we strengthen our story around the automotive space expanding our offering to beyond just the connectivity management to delivering other capabilities to Autos, right like, providing the over-the-air updates and so on. So those are still in the works. And thirdly the other segment is around the semiconductor, which we called out, and that is still work in progress. We have a couple of pilot customers that we have acquired and that also has a potential to scale. So all of these new use cases that we called out are on MOVE. We are building out the products and platforms around that, there are pilot customers that we have signed up, but the scaling will happen in due course, it is not in a stage of scale as yet.

Hitesh Arora

Understood. Just one last question on more of the financial side. Just to clarify, on the P&L items, there is an 'Other comprehensive income'. Kabir, if you could kindly clarify what is it? It is a loss of I think around INR 4.68 crore?

Kabir Ahmed Shakir

Normally a lot of investments that we don't take to the P&L actually goes through the OCI route. We take it either through the P&L or through the OCI. The INR 4.68 crore which is there is basically the foreign currency translation that is impact that you actually see in this quarter.

Hitesh Arora

Okay. And would you know that the previous number that is INR 23.15 crore corresponds to what?

Kabir Ahmed Shakir

Say again?

Hitesh Arora

I think in the previous quarter there is a number of INR 23.15 crore, the same head, 23.15 negative. So what is that? Again is that a translation loss, foreign currency translation loss?

Kabir Ahmed Shakir

There was an investment. Let me just look into my notes in a minute.

So last quarter was actually a translation loss and this quarter was on account of Canada Pension Plan, is that translation that we had. So, those are the two components for it. This quarter, our foreign currency translation was actually a gain this quarter, last quarter was a loss. But this quarter, we also had a Canada Pension gain as well. So that explains the FCTR in the OCI

Vipul Garg

The next question is from the line of Naval Seth of Emkay Global. Naval, you may please ask your question now.

Naval Seth

Thank you, Vipul. I have two questions.

First, as you had mentioned about increasing traction in MSMEs in your last Analyst day, so, can you throw some light, how has been last six, seven months since the time we have stated that. What is the level of traction we have achieved? Second again in the Analyst day, we had stated that they would be a level of debt, we would like to maintain. So have we reached that? Is that closer to our target? And as balance sheet now becomes very strong, what is the strategy on inorganic expansion? Does that take front seat now? Or it will be at its own pace as earlier kind of thought about?

Kabir Ahmed Shakir

Let me take the last two questions first Lakshmi, and maybe you can talk about the Prime section. So, on Net debt, we had stated as our long-term strategy to be under 2x. 2x to EBITDA is the range that we would like to be at. So, we were around 1.9x, 1.8x, this quarter we are at 1.7x and this quarter, we had the one-off benefit from various reasons, I mean a little unspent and therefore you see in the EBITDA line on our staffing cost benefit that we've got. I mean, I would not like to call it benefit because of lower number of people and higher attrition either. So, that was one of the drivers. We got some tax refund this quarter which is another driver. Plus, we also, I also alluded in my commentary that our cash CapEx. Although are approved CapEx in the outlay that we have approved is in line with plan, our cash CapEx is lower because of the delayed lead times and chip shortage and stuff like that Lakshmi also alluded to. So those are the reasons as to why we've got slightly better from a cash perspective. And I mean in the past I've said this to you guys as well. I'm a fan of a range and I would like to kind of operate in that range. We have a healthy balance sheet now even if you had to take our net debt coverage to 2.5x, we don't breach any of the covenants with our lenders and that gives us the healthy, room for investment for and therefore, we create that room on one side. On the other side, we are obviously pushing the business to bring value generating and value creating ideas and they go through with tooth comb in terms of the NPV and IRR each of the projects generate and that's how they are funded, and they are not funded just because there is room in the balance sheet. They are funded on the merits of value that they generate for us. So, that's how we would like to kind of, I would say manage the deadline. So you will probably find in some quarters, where are we need to take the right calls we will probably go a little over our range that we have said, but otherwise, we should operate at a healthy level.

Answering your question on inorganics, we had called out in our strategy a placeholder for tactical and bolt on acquisitions and we continuously monitor and scan the market for looking at opportunities that add value to our portfolio or to our go-to-market organization, either niche or generic. So that is a call that our M&A under Strategy team is continuously evaluating. In the past our affordability limited our ability. Today, I think that constraint is no longer there. Subject to of course the scrutiny of the hygiene and the value that that investment will bring to the table. But otherwise if I have to give directionally, yes, we are little more stepped up in our M&A scouting than what we were, maybe a year or two years ago. Lakshmi do you want to take the other one?

Amur Swaminathan Lakshminarayanan

I think we called out in our strategy, a Prime segment and we said we are going to call out a unit for addressing this prime segment. Just to clarify, we are not and did not say MSME segment because these are still medium-to-large-ish companies, which to serve in a new phygital model is what we said - a combination of physical presence in the region as well as a largely at digital motion through self-serve and everything. We are building out that model in terms of tools for self-serve and digital and bundled products and so on and so forth. We are seeing encouraging signs of adoption in the customers that we have approached in the early stage. It will play out once we pivot to the truly the physical model with fully digital self-service model and begin to offer more bundle services and bundle products in that customer base. So, it's progressing quite well, and it's too early to call out the results of that specifically.

Vipul Garg

The next question is from the line of Ali Asgar Shakir of Motilal Oswal Securities. Ali, you may please ask a question.

Ali Asgar Shakir

Yes, thanks for the opportunity. Couple of questions. First is on this Incubation segment. I hear your thoughts in terms of each of the categories and how we are trying to kind of strategize growth over here. This is about to INR 200 crore revenue run rate annually and we are doing nearly about INR 400 crore of EBITDA loss last year. So, I just wanted to hear your thoughts on probably three year out period, I mean given giving the kind of overall scale that

we have, where you think this particular business can reach, I mean across the three verticals you have which is MOVE, IoT the other one. If you can share thoughts about, I mean this INR 400 crore of loss, at what level do you think this will start delivering profit for us?

A S Lakshminarayanan

Let me first talk about the growth potential in the incubation services and as I called out in the MOVE and IoT, which combined we call it as a connected solution space. We think the potential is really huge., MOVE traditionally we had only addressed the auto segment with a limited connectivity management play. Now we are expanding to more use cases within the auto segment itself. And the second segment that we had called out is the semiconductors and born in the cloud, born connected kind of offerings as semiconductors come out and embed the semiconductors into the OEM devices. It will become connected. So that is another one which the product we are building out. So, each of these products are... we are working with pilot customers and building them out. But in terms of potential, we think there is a very large potential for them, and this can scale quite well. With respect to profitability, we are seeing a decrease in losses and as this business scales, we will return to profitability and that is what we have been saying and repeating the same thing again. And we haven't given a specific number at which we will sort of break even, but we are quite confident that we are now proceeding in the right direction with the reduction of losses.

Ali Asgar Shakir

Understood. The impression we get is, this is a business which is still much ahead of the curve. It's still in that exploration phase where we are trying to kind of explain the product to customers and see the reception. So, I mean, I'm just thinking from that point of view that the kind of investments we have done here, I mean, the kind of certainty we have in terms of, of course opportunity is there but given that this particular segment is so ever developing they could be a new category, new products, lot of changes that will bring upon. So the kind of confidence we have in terms of timelines in which this business can really deliver strong profitability?

A S Lakshminarayanan

No, I think the whole idea, when we talked about our strategy was all our products need to become profitable, right. So we did that scrutiny ourselves, and we are quite satisfied, Ali, that the area if you look at MOVE has very strong potential. It is not something that other MNOs are offering. There are other platform players perhaps like Jasper and others who do some of what they say we will do. But nobody is there who will do all of what we say, we will do. So I think like he called out, it will be a new category in a spanning the connectivity and bringing the data analytics relating to connectivity to OEMs and making a very strong play in their move to connected solutions. So, even the connected solutions by itself like people talk about connected car, connected devices, connected health care products- all of them are beginning to play out and we think that MOVE will have a very foundational play in that space. So, we are quite confident, and as it scales, it will definitely be, the pricing is improving as we shift to the platform and platform-based pricing and that is what is helping us with scale to decrease the losses. It will become profitable. So, I don't want to give out a number at what stage it will become profitable, but we will continue to invest because we are quite confident that this will turn around and yield the results that we are all looking for.

Ali Asgar Shakir

Sure. Thank you. This is very helpful. Second question is on our subsidiaries. You did comment on the transformation side of the business, where we are seeing some specific customer related issues. But if I combine both, let's say, transformation business as well as ATM business, both have been laggards for a while now. I mean, I think ATM business was under deliberation about it's a long-term strategy. So I'm just thinking from that point of view. Do

these businesses have any restructuring requirements. Are we contemplating anything over there in terms of... because of the management bandwidth that it would be taking and the losses that they have, it's nearly about combined 10% of our revenues? So, I mean, how are you looking at this business strategically?

A S Lakshminarayanan

See, both are very different businesses and I think we have to look at them on their individual merits. I think the transformation business, the core capability that we have in that business is about a very strong domain knowledge on the network side from a telecom, both on the wired and wireless side. And combined with their automation and process capabilities is what will make them attractive to international Telco's. So, therefore, from a long-term perspective we believe that this company can turn around and will turn around barring the current issues and it will take a couple of quarters for us to really turn this around and make it profitable- and growth will come, because we will make the right investments there to help other CSPs to manage their networks both fiber and cellular.

So things structurally and potential opportunity-wise there is good opportunity. I think we are, this business is going through the short term hiccups that I called out. Whereas on the ATM business again, I think we have commented on it. We are looking to again turn this around with a combination of looking at the business model in terms of the owned ATMs and operating, versus the franchise model, and we are seeing the turnaround happening from a changing the business model perspective. The early indicators, definitely tell us that is in the right path. This business has been hit by both repeated waves of COVID as well as more recently because of the flooding in in some of the states, where we are more prominently present in the Tier-3, Tier-4 regions serving through the Indicash brand, right. So we think that two things will shift this business towards better health. One is the business model shift that I talked about. And the second is the macro environment improving, which will enable us to shift the transaction volumes up. We have already seen the business has had one uptick from the RBI increasing the rates. So that is a positive direction for this business. So, the transaction volumes will pick up in the near future. That's our commentary on these two businesses, I think they will turn around. Structurally, they are managed independently with their own boards and so on. So we can re-examine once there the business turns around.

Ali Asgar Shakir

Just one question for Kabir, you did comment on acquisition. I just have a question on your investing - you mentioned in growth. Is this going to be more OpEx led, given that you did mention that we plan to hire about thousand odd people and what would be your CapEx guidance, and we have about INR 600 crore on an average CapEx that we've been doing. Now, the kind of cash flow that we throw is quite strong. So, given that we are comfortable with our leverage ratios, how we plan to use this cash apart from some of the acquisition that you would be exploring?

Kabir Ahmed Shakir

Ali, the investment is investment- to know whether it is OpEx, whether it is CapEx, I'm indifferent to it as long as they provide the right value and the right justification and go through the right hygiene. So there is no such constraint from that point of view and we will do that. We've given of course, there are contours, we have given contours of our profit guidance, contours of our ROCE guidance and so those are I would say the framework within, which we will play between OpEx and CapEx. We have given in the past a guidance of US\$250 million of CapEx in a year is what we said we will spend this year, as I mentioned. Our cash CapEx spend maybe lower because of various reasons. It's not that we don't want to spend our purchase orders are out, but we will just not get them back into the company on time to get them capitalized. So, there will be a timing and a phasing issue in this current year. But otherwise, there is going to be definitely focus on increasing that CapEx. So, every lever whether it is CapEx, whether it is acquisitions, whether it is innovation, whether this BAU in terms of resources, if to both from a product development point of view and feet on street, I think we are examining each and every one of them to try and

unconstraint from a resource perspective as long as they give us the right return.

Ali Asgar Shakir

Got it. And just asking from the point of view that we are throwing nearly US\$550 million worth of kind of operating cash flow. And so, I mean, that's a very solid number and even if I take your CapEx of \$250 million is still a very strong cash lying on the book. So, I mean, will this be used for deleveraging, or kind of increasing our dividend payouts or I mean how we are looking because it is like annually very strong number that, you'll keep throwing every year and hopefully keep growing this number.

Kabir Ahmed Shakir

Yeah. Well our subsea cables will in a couple of years' time will start coming to end of life, the ones which we invested earlier. So, it is not about one quarter whether I get to 1.7x or not. We take a slightly holistic and a more medium-term view on our capital spends. That's the nature of our business especially I would say on the Core connectivity space. Yeah, and we need to continue to invest and they will come in at certain spurts of investment that we need to make and we need to provide for that. That's what I would say. Yes in a quarter, it will be a higher here and there and therefore to that extent, it will become an auto deleveraging if we don't have investment choices, but long-term, I would stick to what I have said before as our guidance.

Vipul Garg

We're almost out of time. We will take the last question from Mihir Sheth of Segantii. Mihir, you may please ask your question now.

Mihir Sheth

Hi everyone. Thanks for the opportunity. So it is a quick actually question going back to, Lakshmi, your original comments on revenue, sort of delays and order flow. I understand and appreciate the macro challenges and I also appreciate that order flow cannot be even through the year. My question is a little bit more qualitative. Like if you were to ask your salespeople in terms of inbound inquiries in the level at which they are busy, is activity as intense as it was say, two or three quarters back? Can you just give us some color- how things are on the ground from a customer demand standpoint? Because all I'm trying to understand is the direction of where we would be 6 to 12 months from now rather than sort of obsessing about the last quarter or the quarter before that.

A S Lakshminarayanan

From an activity level, I think the activity levels are quite high and good. So even when there wasn't no regular customer demand, we are pushing ahead as you would expect in the enterprise business with more proactive proposals and so on. So, I think the activity levels are quite good, and I think- because of our more proactive approach and trying to engage with the customers with more holistic solutions, the nature of the total size of the funnel while it has not grown, the number of larger deals within that has grown. And secondly, I think it was good to see that our win rate there, even if it is marginal, has improved, which tells us that we can be competitive and we can compete effectively in those. I think two things need to happen for us. One is internally ramping up more feet on street and increasing our sales solutioning and marketing spend and activities there. The second is the customer side... not just the macro but the trickle-down effect of the digital transformation flowing from applications and analytics of data to the network infrastructure is something that we think will happen, and that is what we are targeting to see how we can participate in that space.

Mihir Sheth

So, I guess if I were to sort of put all this together, right, and think about what fiscal '23 and '24 will look like, the macro challenges seem to be transitory in nature. Who knows what future waves will hold for us, but as of now, they seem transitory in nature. You have put the feet on the street order or already on the ground and you're hiring more aggressively. And I would imagine that the customers network transformation projects will be further long than they were say three months back and definitely versus six months back. So, would it be fair to say that say that fiscal '23 and fiscal '24, you all would be gunning for a much higher revenue growth given what we're seeing right now in the funnel? Or do you need the funnel to itself to expand to start seeing good revenue growth?

A S Lakshminarayanan

I think the funnel needs to expand first and then we need to convert them into orders and then converting to revenue. So, that is the first step. In terms of increasing the feet on street, I called out that we are increasing our hiring and we are rolling out the offers. But all these sales and solutioning team will have to come on board, get familiar with the offerings in the company and then they will go through their own lag motions but they are quite confident. And that is why we are beginning to invest a bit early in the cycle to do that, right? The attrition hasn't helped but we are quite confident of tiding over that and increasing the hiring. So with all these, we are certainly looking to see how we can crank up the growth engine to the potential that we believe there is.

Mihir Sheth

Got it. Let me ask a question I should have asked in the first place or when trying to ask it around about. So fiscal '23, fiscal '24 is it reasonable to expect strong revenue growth, I mean, based on the visibility are seeing right now or are things still uncertain?

A S Lakshminarayanan

I don't want to give a forward-looking statement of that kind, I think, we are giving you a commentary around various factors of how we see the deal flow, how we see that we can participate in the transformation, how enterprises themselves are looking to prioritize from application down through the network infrastructure and all of that is the reality. Given that commentary and given those investments, given whatever we said, we are quite confident that we will do well, that is the extent to which I can say. I can't call out specifically about a quarter or the financial year.

Vipul Garg

This brings us to the end of the call, closing comments from you Lakshmi. Please.

A S Lakshminarayanan

No. I think I have said a lot of things. I only want to wish you a very Happy new year to all of you. I definitely see two consecutive quarters of sequential growth as a good positive sign, and we will stay committed to cranking up the growth engine. Thank you.

Vipul Garg

Thank you, Lakshmi. This brings us to the end of the call. You may please disconnect now. Thank you.

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