

July 25, 2017 at 04:00 pm IST

Q1 FY2018 Earnings Conference Call Transcript

MAIN SPEAKER:

Vinod Kumar, Managing Director and Group CEO
Pratibha K. Advani, Chief Financial Officer

Vipul Garg:

Thank you, Karuna. Good evening, everyone, and welcome to Tata Communications Limited conference call. We are joined today by Vinod Kumar - MD and Group CEO; and Pratibha Advani - Chief Financial Officer.

Our results for the quarter ended June 30, 2017, were announced yesterday, and the results presentation and the fact sheet are available on our website. I hope you had an opportunity to browse through the highlights of the performance. We shall commence today's call with key thoughts from Vinod who will provide you an update on the strategic direction of the company. He will be followed by Pratibha, who will share the financial highlights during the review period. At the end of the management 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 is included in our annual filings, which you can locate at our website, www.tatacommunications.com. The company does not undertake to update these forward-looking statements publicly.

With that, I would like to turn the call over to Vinod to share his views.

Vinod Kumar:

Thank you, Vipul. And a very good evening to everyone and a warm welcome to all of you. I will start by giving you an overview of our performance, and then share my perspective on industry developments and our strategic direction.

Firstly, I want to set the context and lead up to this financial year. The thrust of what we did last year was the business restructuring and successful divestment of noncore assets. As the year progressed we shifted our attention to strengthening our product portfolio. This happened in 2 ways - firstly, we strengthened our execution capability for services that fall under the growth services portfolio. And secondly, we started laying the foundation for our entry into cyber security, into IoT and cross-border mobility services. In FY17, we also significantly overhauled our sales organization under James Parker. In FY17, the reported results were adversely impacted especially the second half of the year by some exceptions and some regulatory changes. However, from our balance sheet, it is evident that our strategy of deleveraging systematically, along with business growth, is on target. The business is now generating healthy free cash flow.

Looking at FY18, in FY18 we expect the financial performance to be much more consistent and in line with the operating business performance. The data business continues to accelerate. Our data revenues grew by 4.6% year-on-year during the quarter. The reported numbers were affected by strengthening of INR during the quarter. In USD terms, the data revenues grew by a healthy 8.5% year-on-year. This is an industry-leading growth by any comparison. The data business has firmly established itself as a growth driver for the company, now constitutes just over 84% of the overall EBITDA.

The transformation services business has grown by a robust 11.5% year-on-year. But in our payment solutions business we continue to still be affected to a certain extent by the demonetization effect, and cash handling in particular is at 50% to 60% of the pre-demonetization levels. In other words, the cash available for us to dispense at the ATMs were 50% to 60% of where we were before demonetization.

The voice business continues to decline, but in line with industry trends and as we expected. Our data sales engine is picking up after the restructuring that we did in sales and we are seeing an improvement both in funnel ads as well as in closed sales. The good news is that the sales performance and revenue growth in the group services category have significantly improved over the past year.

As communicated earlier, we, at Tata Communications, have started our own digital transformation journey to revamp our systems, our internal processes with a focus on enhancing long-term productivity and to ensure that we had enriched our customer experience. This is a transformational journey that will take time, this could take as long as five years and there will be a cost of about \$90 million to \$100 million in CAPEX and OPEX over this period. We expect the productivity benefits beginning to start flowing into our P&L from FY19. We believe, however, that this is an important step that will build the foundation of the business and ensure the sustainability of the productivity growth that we require.

During this past quarter, we also announced a partnership, we had many things that happened, but we announced a partnership with Alibaba Cloud, the cloud computing arm of the Alibaba Group, to enable customers from over 150 countries, including India, to connect to Alibaba Cloud ExpressConnect via Tata Communications' IZO Private Connect Service. As you would have seen from previous announcements, we have nearly all the major cloud service providers connected now through our IZO Private offering. This allows us, I should say, to offer enterprise customers a single window of access into all their cloud service providers, regardless of where they may be located in the world. We look forward to strengthening and offering more global organizations connectivity to Alibaba Cloud and to strengthen our presence within the Chinese market in this process.

I am very proud to say that in this quarter we had five wins at the 2017 Frost & Sullivan India Digital Transformation awards. This is a real testament to our innovation program and strategy of building a strong portfolio of services and applications on top of our global network. For the ninth year in a row, we won the Enterprise Data Service Provider of the Year. For the sixth year in a row, we won the Hosted Contact Center Service Provider of the Year. For the third year in a row, we won the Enterprise Telecom Service Provider of the Year for the Large Enterprise Segment. And second year in a row, we won Third Party Data Center Service Provider of the Year. And we won the award for IoT New Product and Service Innovation Award, which is a new award category.

More than the award spread itself, I think it is important to look at the texture of the awards. So, we continue to be recognized for our traditional services. We are being recognized for the growth portfolio, services like contact center as well as our data center services. And our move in areas like IoT, our platform in IoT India are also being recognized, and this is a reflection of the innovation pipeline that we have. These recognitions should be a clear validation that we have competitive services and that we are on target and we know where the market is going with our product development efforts.

Speaking of global reach, we expanded our IZO Private Cloud footprint in Europe, Middle East and Asia Pacific to address the data sovereignty concerns that large enterprises are beginning to have. We launched three new nodes for our IZO Private Cloud service in Germany, in the UAE and in Malaysia. The expansion of IZO Private Cloud in Europe, Middle East and Asia Pacific strengthens our ability to capitalize on the growth of private cloud services in these markets. It also enables to offer cross-border disaster recovery and business continuity solutions by having multiple instances of our private cloud deployed.

Looking ahead, I see exciting times for the company. We are celebrating our 15th Anniversary, and in these 15 years we have transformed from an Indian PSU to a global provider of communication and managed services, with exciting and innovative solutions across cloud computing, unified coms and Internet of Things, amongst many others. Our transformational journey will continue and should continue from being a traditional telco to being an OTT player and to being a digital enablement player. We continue to invest proactively and ahead of time and inflection creating services in the IoT domain, in security and mobility space. These areas are poised to grow exponentially in the coming years, but equally and very importantly, we also have a right to play in these domains.

As investments convert to revenue, the margins will expand as a result. The traditional services are growing at a healthy pace and give us good operating leverage and we will continue to drive this. We are seeing the economies of scale that will start seeing and then help us expand margins further in this area. In the growth services, services like UCC, hosting, security, are growing at a very healthy pace of between 20% to 25% and are an important part of our portfolio right now.

Just to give you an indication, we look at funnel adds very carefully. In Q1, the funnel adds that we got, looking at the overall funnels, were equally distributed between what we got from traditional services and growth services. This is the first time in the last several quarters that we have seen our growth services funnel expand at the same rate as our traditional services funnel, which is a positive sign and we see more opportunity there as our sales team gets comfortable with selling these services. Services like cross-border mobility, Internet of Things and some of the newer services that are being incubated will show their real revenue impact in the next financial year. We will start seeing some results as the year unfolds, but the real impact will start showing in FY18 and FY19.

Digitalization continues to create avenues for growth across the ecosystem, and our investment in digital competency holds us in good stead for the future. The ambit of the data business is expanding, and we are continuously building our growth services platform to broaden the addressable size of the market. Our strategy is to build leading edge solutions to enable borderless growth, to help our customers manage business risk, to enable them to enhance customer experience for their end users and to improve their productivity and efficiency.

Our sales strategy, our communication with customers and our product bundling are beginning to be centered around these four themes for borderless growth, managing business risk, enhancing customer experience and improving productivity and efficiency. And we believe that this shift will also help us move from being a product centric company, that we have been in the past, and moving to one which is more about a business solutions proposition that we believe will resonate well with our customers.

With that, I invite Pratibha to discuss the financial highlights for the last quarter, and I look forward to answering any questions you may have on our business strategy and direction during the Q&A. Over to you, Pratibha.

Pratibha K. Advani:

Thank you, Vinod. A very good evening to all of you. I will take you through the progress achieved during the quarter ended June 30th. We have shared a detailed fact sheet on our website, along with the announcement of our results. My focus today will be on sharing updates on the progress we have made during this quarter.

As Vinod articulated, FY17 has been an eventful year and we have been successful in deleveraging and restructuring the balance sheet through divestment of noncore assets. The FY17 performance was affected by exclusion of Neotel and data center. As Neotel is no longer part of the company, from now on, consolidated and core numbers are same. For like-to-like comparisons we have restated the previous quarter numbers in our investor fact sheet and excluded the data center numbers.

Starting this year, we have tweaked the definition of growth services. Conferencing services which were earlier a part of traditional portfolio, have now been grouped with UCC and included in growth portfolio. Accordingly, the numbers have been restated.

Core business had revenue of Rs. 4,310 crores, up 0.4% quarter-on-quarter, but lower by 3.3% year-on-year during Q1 FY18. The reported numbers have been affected by currency translation, the INR strengthened by 3.9% during the quarter from 67.09 to 64.48 in the current quarter. In dollar terms, the core revenue grew by 4.4% quarter-on-quarter and 0.3% YonY. This growth is largely coming from our data services portfolio. And in addition, we are also seeing stability in our voice services.

Despite our gross revenue being up 0.4% QoQ, net revenue is down 2% due to change in mix between data and voice services, with 1% favorable change towards voice services. Core business EBITDA during Q1 grew by 12.6% quarter-on-quarter at Rs. 559 crores with margins coming in at 13% for the quarter. Core PAT stood at Rs. 32 crores during the quarter as compared to a loss of Rs. 983 crores last quarter.

The core EBITDA margin was down 190 basis points YonY, primarily due to decline in voice business. Voice impacted our margins by 50 basis points. TCPSL, as Vinod articulated, due to the demonetization impact, had a 70-basis point

impact on the margins and investment in new growth services had a 90 basis point impact. Currency translation had a 70-basis point impact. Some of this impact was offset by growth in revenue.

The business is generating healthy free cash flows. We generated Rs. 107 crores of free cash flow after accounting for CAPEX, interest and tax costs, representing a growth of 45% year-on-year. The underlying business levers are in place and the free cash flow growth momentum will continue as we grow scale.

Other income saw a drop of Rs. 20 crores in this quarter YoY due to one-off profit on sale of fixed asset that had accrued in same quarter last year amounting to Rs. 13 crores. Drop in sale of mutual funds and impact of currency translation also reflected in the YoY drop in other income and also in the Q-on-Q. On a Q-on-Q basis, other income was lower by Rs. 16 crores due to reduction in fee and professional services that we had provided to ST Telemedia and also on account of currency translation.

Finance cost was lower as we got some benefit of currency translation. The dollar finance cost was \$11.65 million in Q1 FY18 as against \$11.8 million in Q4 FY17. Also, the MCLR came down this quarter, so we got some benefit on the INR debt.

This quarter, there was a loss in TCPSL of Rs. 60 crores on which we did not get any credit, due to which the tax rate is at 56%. Excluding TCPSL, the effective tax rate is at 33%, which is in line with our long-term guidance. In Q1 FY18, reported revenues of data business marginally declined by 0.3%, but EBITDA saw a healthy increase of 23.1% on a quarter-on-quarter basis. On a YoY basis data revenue was up by 4.6%, while EBITDA declined by 14.9%. The reported numbers were affected, as I mentioned earlier, due to currency translation. In US dollar terms, the data revenue grew by 3.8% and EBITDA grew by a healthy rate of 28.1% quarter-on-quarter. On a YoY basis data revenue was up by 8.5%, while EBITDA declined by 11.8%.

The EBITDA margin for the quarter was 17%, an expansion of 230 basis points over last quarter due to normalization of one-off cost. On a YoY basis, the EBITDA margin declined by 390 basis points, primarily due to impact of manpower costs, which had a 100 basis point impact; subdued performance of TCPSL business due to the demonetization impact, which was an impact of 100 basis points; and on account of higher backbone and cable repair costs, which, again, attributed 100 basis points. The transformation cost impacted the margins by 90 basis points.

While the macros are in place, we are focusing on pushing further the enterprise data services with the help of our partnership approach. One example of this is the Cisco powered UCC solution that showed more than 100% growth in revenue this quarter albeit it is still a small base.

Traditional services business revenue growth of 7% in Q1 with EBITDA decline of 1% on a YoY basis. Margins in traditional business were at 28.7% YoY. The traditional services margins have been impacted by access facilitation charges and salary hike. Traditional business continues to grow well, and as we grow further, we will enjoy benefits of economies of scale, which will help expand the margin over time.

Growth services business' robust growth. In Q1 FY18, revenues grew by a healthy 25.2% on a YoY basis. We are creating a pool of new growth services with the long-term objective of enhancing our product portfolio within the data services. This quarter, as mentioned to you earlier, some of the planned investments in new services like IoT, cross-border mobility and security services were made which led to drop in margins. As these offerings grow in scale, we will see commensurate growth in profitability.

Revenue from transformation services during the quarter saw a drop of 1% quarter-on-quarter and an increase of 11.5% YoY coming in at Rs. 271 crores. We witnessed a significant EBITDA margin expansion of 170 basis points YoY on the back of new deals and cost productivity initiatives that we had initiated last year. Q-on-Q performance looks subdued due to one-time gain of Rs. 10 crores that we had in last quarter of last year.

The Payment Solutions business continues to be impacted by demonetization and the cash handling is still at 50% - 60% of the pre-demonetization levels that Vinod mentioned earlier.

Let me discuss the trends in voice business. During Q1 FY18, we saw revenue increase of 1.6% Q-on-Q as IoT volumes increased this quarter due to temporary market shift in traffic. EBITDA declined by 22.7% on a Q-on-Q basis, because of a onetime benefit of Rs. 25 crores in Q4 last year. We are maintaining EBITDA margins in the range of 5% to 6% by driving cost optimization initiatives.

The core business net debt stood at \$1.2 billion as against \$1.15 billion in the previous quarter, an increase of \$54 million. This increase is largely due to dividend payment and increase in expenses. The core net debt-to-EBITDA was at 3.1x at end of Q1 FY18 with a corresponding weighted average cost of loan of 3.2%. This quarter, the cost of loan was impacted by upward LIBOR movement.

To sum up, the data business has witnessed robust growth and with enterprise segment witnessing a double-digit growth and the carrier business grew single digit. The share of international revenues and overall mix increased by 1% YonY on the back of strong growth in data business. EBITDA margins have normalized. Growth services continue with the upward trajectory growing at 25% year-on-year, while traditional services grew at a strong rate of 7% year-on-year. Generating free cash flows will be our priority while investing to grow revenue, investing in business transformation to enhance customer experience with an eye on driving productivity gains, which will further help improve margins.

In conclusion, all our financial parameters for our business are moving in the right direction. With these concluding remarks, I will request the moderator to open the lines for Q&A. Thank you.

Moderator: Thank you very much, ma'am. Ladies and Gentlemen, we will now begin the question-and-answer session. We have first question from the line of Runit Dugar from BOB Capital Markets.

Runit Dugar: I had three questions. Firstly, post the sales, Vinod, which I understand got completed last quarter, what kind of revenue run rates are you seeing? So maybe if you could give some qualitative color because sequential growth on a QoQ basis looks pretty strong in data. So is this ramping up through the quarter, month-on-month so that would be really helpful. That is my first question.

Vinod Kumar: I think the revenue run rates we do not give it at a monthly level, but the quarterly ones you have. But what I can say is that our gross MRC before any price erosion, right, which is a real reflection of the sales engine working, was up by 13% on a year-to-year basis, okay. And the sales organization still being ramped up and the sales motion, in other words, how we take the new teams to market are still being fine-tuned and perfected. So that is the number that may be a good reflection of sales activity. The other thing is funnel adds, and funnel adds, we have on a year-to-year basis close to 20% improvement on the funnel add for Q1 this year compared to Q1 of the last year. So that is again an indication of where, this is a full funnel with it's all probabilities, but gives you an idea that the sales engine is cranking.

Runit Dugar: Right. The second question was on the growth services side. So obviously, you have seen a good improvement in the overall size and scale, so now it is still a \$73 million - \$74 million a quarter business and growing at 20%-plus. So at what level do you think that this business achieves scale then we start to see peaking of EBITDA losses really? So some color on that would be really helpful.

Vinod Kumar: Pratibha can give the exact number. But as I said before, our goal is to exit this year with EBITDA neutral situation in growth services. So we have, yes, may be Pratibha can add the number that what is the cutoff point, but that is what we expect to see and that is what I said in the last call or meeting.

Pratibha K. Advani: I think this growth momentum that you are seeing Runit, year-on-year of 25%, that should continue and only get better. And while we do not give formal guidance, but the fact that Vinod has mentioned that we should turn EBITDA neutral is itself a guidance.

Moderator: Thank you. Next question is from the line of Amruta Pabalkar from Morgan Stanley. Please go ahead.

Amruta Pabalkar: I had a question on growth services. So, we have classified UCC and conferencing solutions to the growth basket, now if we look at the revenue contribution of UCC, it is close to 45% and this product was historically a positive EBITDA contributor. Any rationale that the losses in the growth services have ballooned despite UCC moving to this basket, and how do you see the trajectory of this business by the end of fiscal 2018 and maybe 2019, if we could have some benchmarks there. And how far is IZO as a product far from being an EBITDA positive contributor?

Pratibha K. Advani: Vinod, are you taking that question?

Vinod Kumar: You take classification and I will come to IZO and UCC.

Pratibha K. Advani: Okay. We have reclassified that because a part of our UCC portfolio we were anyway showing as part of the growth business, and it has made a better sense to club that together. While yes, you are right, the revenue impact is Rs. 3.4 million, you are seeing a much higher EBITDA impact, this is on account of the investments that we are doing in some of our new innovation services like mobile network as a service, IoT and NetFoundry. These were earlier getting allocated to traditional services portfolio, we thought it is prudent that we need to break this out of the traditional services portfolio and put it together as part of the growth services, because these are the future new growth products in which we are investing. Over to you, Vinod.

Vinod Kumar: Yes. So, I think we have already answered the question on where we see growth services going, we expect that we will exit this year with EBITDA neutral situation. But at a product level we are not giving when each product is going to break even, we are not giving that guidance. However, as Pratibha made in her comments also, our SIP Trunking service in our UCC portfolio and our fiscal based solutions are growing very well on a year-to-year basis. And IZO, both IZO Private as well as the IZO WAN and SDWAN solutions are showing very strong growth on a year-to-year basis and quarter-to-quarter basis. Also, some of the recent wins we have had due to customer confidentiality, we cannot disclose it, but we have had some big wins with both US and European multinationals for large IZO, SDWAN deployment. These are multiyear contracts that will be implemented during the course of this year, and the sizes of each of those are fairly significant for a WAN network. So, the product is definitely gaining appeal in the market, I am talking about the IZO product now.

Pratibha K. Advani: Just one clarification that I want to add to what Vinod has mentioned, when we are talking about the growth services, we are talking about the UCC portfolio and our media services. Some of the new services that we are investing in currently, like cross-border mobility, IoT and security services, these will turn EBITDA positive, some of them next year and some the following year.

Vinod Kumar: Yes, you are right, Pratibha. Thanks for that clarification.

Amruta Pabalkar: Got it. Now coming to the traditional basket, this has been historically at about 30%. Now, how do we see this moving to 30% quickly or do you think that there would be some more costs yet to be absorbed on back of say data center or other overhead cost allocations?

Pratibha K. Advani: Amruta, if you are actually seeing, this portfolio is already at 28.7% and the margins have expanded. This quarter we had the impact of higher backbone and cable break cost, that was close to almost 100 basis points. There was also the FX impact and we gave salary hike to our employees. As the revenues start to increase quarter-on-quarter, that salary hike will get leveled out. So, we are optimistic that we should hit improved margins over a period of time.

Moderator: Thank you. Next question is from the line of Gaurav Malhotra from Citigroup. Please go ahead.

Gaurav A. Malhotra: Just two, three questions, one is on the voice segment. There has been pickup in the minutes this quarter, any particular reason for that? And despite the pickup in minutes, there has been a dip in the profitability, so just wanted to get some understanding on that.

Vinod Kumar: There is a marginal uptick on India minutes for a few weeks, which is reflected. But frankly, there is not enough data points there to project that forward in any different way from how we had in the past.

Gaurav A. Malhotra: Okay. On that data business side, just looking at overall data segment, the revenues have been sort of flattish, which you mentioned was on account of the currency. So, I am assuming that the costs are not entirely in dollars and that is one of the reasons why the margins have gone up?

Pratibha K. Advani: That is right, we have got some benefit in our cost. So, while revenue had an adverse benefit, costs had a marginal upside. But also the EBITDA margins have expanded because you would recall, we had one-off costs in Q4 last year, those costs have got normalized in the current quarter.

Gaurav A. Malhotra: And on the employee front, wouldn't this quarter be the quarter where you take wage hikes and despite that the salary has sort of declined quarter-on-quarter?

Pratibha K. Advani: So decline in the salary that you are seeing is primarily on account of the FX impact.

Moderator: Thank you. Next question is from the line of Aditya Karwa from JIPL Capital. Please go ahead.

Aditya Karwa: Just two questions, one was on the ATM business. Do you have any plans, let us say in the next one year that you might be considering selling that entire arm of? And if at all, what would be the current valuation? And second, how do you think the impact of Jio has been on the enterprise customers, if at all?

Vinod Kumar: Okay. So, I will take the ATM business first. I think that is something we won't be able to answer on the valuation. And as I have said before, Aditya, we continue to always keep the option of exiting that business as part of our strategic choices, it is a constant review. But at the same time we were finding that the impact for us is because we are not getting cash into our ATMs, we are getting transaction counts and people do want to transact in cash, they are just not able to get enough cash from the banks and Reserve Bank, from the public and private sector banks and Reserve Bank is not issuing it to them, that's a challenge. It has been improving a little bit, but not anywhere near the level that we used to have, where we were handling Rs. 100 crores of cash a day, we are at about Rs. 50 crores to Rs. 55 crores of cash a day right now, so that is where we are.

We do not want to panic and do anything, because many other players around us are folding and/or the banks are slowing down their ATM deployment. So, what we are doing is really cutting back our operating cost, getting much smarter at how we run the business, not adding ATMs and kind of make the business as healthy as possible, while continuing to evaluate strategic choices. But we do not want to panic and do anything, and this is not new, I have said this in the past also. But we constantly evaluate it is a comfort I can give you.

And on Jio and enterprise business, I would say, for now there has been very little activity or impact on the enterprise customers that we serve. They have a different requirement level of service availability, service quality, service predictability is much greater. Right now, the battle seems to be more in the consumer space. But I cannot speak for them, I can only speak based on what I see in the enterprise market.

Aditya Karwa: Sure. Just one more question, if there is time. Vinod, during your presentation you had mentioned an extra \$100 million on CAPEX, I just missed out on that bit, what was that on?

Vinod Kumar: So I said \$90 million to \$100 million combination of CAPEX and OPEX over five years for our digital transformation program. This is where we are revamping our IT systems and processes and workflows in order to improve internal business velocity and productivity and to improve our customer experience and to create new services faster.

Aditya Karwa: So, this would be inclusive of your original CAPEX plan or this is going to be an in addition to that?

Vinod Kumar: Over a five-year period, I said CAPEX and OPEX, we are still working the model out with various vendors, but it could come in CAPEX or OPEX. But over five years it is about \$100 million of gross CAPEX.

Moderator: Thank you. Next question is from the line of Sandeep Baid from Quest Investments. Please go ahead.

Sandeep Baid: Sir, the Chairman of Tata since recently talked about a cluster strategy and consolidation within the Group. So I just wanted to understand where does Tata Communications fit in and how it can benefit from group synergies?

Vinod Kumar: I think this cluster strategy is more in the media than in actual implementation within the group at this stage, so you will have to direct that question to Chandra to clarify that. But there is plenty of opportunity for us to derive group synergy, and one area where we are seeing that is the number of joint projects we are doing in the IoT space with multiple group companies to test out value propositions. And that is something that IoT is enabling us to do more so than we could ever do in the past. We have tapped into domain expertise before but now we have quite a few very concrete cases of us working across the group companies to build a compelling propositions and to prove them out in live environments. But, frankly, this has nothing to do with clusters, it is just leveraging the reach of the group which is available to us, but now with IoT we have a platform to do that with.

Sandeep Baid: Sir, can you give an example of what exactly you are doing on the IoT strategy front with the group companies?

Vinod Kumar: I will give you an example. One of my colleagues who heads the IoT business spoke about it, and I think also Gopi, who is our group CTO, spoke about it. The industrial safety is a very big application for IoT in India, and so we worked across multiple group companies in order to build the prototype of an industrial device and that was tested in some of our manufacturing plants. We used elements of the design and value engineering capabilities from another group company, and we worked with another company within the group again to build the software. It is all done on arm's length basis, but the fact that we are able to have these conversations and test it out quickly was possible because of the breadth of the group.

Sandeep Baid: Right. And lastly sir, are you seeing synergies in terms of marketing, say TCS clients, are there areas where you're working together with TCS on that?

Vinod Kumar: So, we have been working with TCS on a sell-to and sell-through strategy for a long time. Equally, we work with other Indian enterprise, we are not exclusive with TCS, and we continue to work on those programs to see how we can do more with TCS. Now again, it is nothing to do with the leadership change in the group or any announcement. The fact that today Tata Communications has a broad portfolio of services to create digital infrastructure is what is permitting these conversations more so than before. In the past, we just had our connectivity offering, now we have connectivity, we have our IZO hosting in services, we have IoT offering, security offering. These are enabling more conversations and clearly being part of the large group is very beneficial to us to accelerate some of these go-to-market initiatives.

Moderator: Thank you. Next question is from the line of Aliasgar Shakir from Motilal Oswal Securities. Please go ahead.

Aliasgar Shakir: I had a question for Pratibha. So, this is just a follow-up on the clarification regarding the growth services margin that you mentioned. Does the margin profitability that we are expecting, end of FY18, does not include the cross border connectivity IoT and cyber security. While I understand that we do not provide product wise margin in profitability, but I am just trying to understand if we include them, then what is the sort of margin impact it could have on the growth services, could it imply that the growth services margin or other absolute or EBITDA loss could remain at this level, or what is the sort of extent of impact that can have on the growth services margin?

Pratibha K. Advani: It could have a slightly higher impact in the growth services margin because we are continuing to invest in this portfolio right now. It is still at a very nascent stage and it will take some time to scale up, so we should expect higher investment in these three services.

Aliasgar Shakir: Okay. So would you be able to sort of quantify and say whether this current quarter's EBITDA loss, will it come down from year even if we include them or, I mean, if we include them then it should sort of stagnate at this level by FY18?

Pratibha K. Advani: It actually depends on how some of the other growth services grow. We are seeing good traction there and if they scale up then we should be able to absorb some of this investment that we will be doing in the innovation services.

Aliasgar Shakir: Okay, that is very helpful. And another question, I just wanted to understand scalability of margins in our traditional business. So, we are already close to 30%, 28%, 29% margins over there, what sort of scalability potential you see in the traditional services margin over a two to three-year period?

Pratibha K. Advani: Ali, all that I can say is that the traditional services are growing at 6% to 7%. That is industry-leading growth. And if you look at some of our services there like VPN, ethernet, they are growing at 18% - 19% year-on-year. So, as we gain economies of scale we should see margin expansion, but obviously it is after a point that you also have to continue to invest back. I cannot predict situations like cable breaks, etc. So we are comfortable with margins at this level with some amount of expansion.

Aliasgar Shakir: Okay, that is very helpful. Just last question on the payment bank business. So, Vinod, you mentioned that we are running at close to 55% - 60% in terms of the total cash management. I mean, what is it that we hear from the RBI, is this situation looking to improve given the fact that like you are mentioning that the transactions are only getting impacted because of the shortage of cash and if we have cash then there could be a possibility that we may turn EBITDA breakeven sooner than expected?

Vinod Kumar: I cannot give you a very clear answer on that. We have seen the cash volumes go up slowly, but when it will get restored is anybody's guess. I think across the industry there is a lot of effort to put pressure on the RBI and regulators to get more cash because the demand is there in the market for cash. We will have to see how long they are going to hold up and expect behavioral change to drive more digital. But at some point, they have to react and respond to how people want to transact on a personal basis. So, we will have to watch this space is all I can say, in 3 months we will get to Rs. 80 crores per day. I wish I could give that answer, but I cannot as of now.

Moderator: Thank you. Next question is from the line of Girish Raj from Quest Investments. Please go ahead.

Girish Raj: So, the innovative services related investments will be shown outside growth services or will it be part of growth services?

Pratibha K. Advani: This will be part of growth services.

Girish Raj: So when Vinod says the exit EBITDA margin would be neutral, so that will include the innovative services investment?

Pratibha K. Advani: No, actually I clarified, if you have heard me earlier, specifically that when we talk about growth services and what Vinod alluded to was our unified communication and collaboration services and the media services, those two should turn EBITDA positive by or EBITDA neutral by this year end, but we will continue to invest in new services. Today, we are talking about cross-border mobility, IoT, managed-security services, but obviously we would look at enhancing our portfolio, we are not going to throttle or stop investing in new products and services. So this is going to be a continuous cycle.

Girish Raj: Okay. So any indication as to if we include all these investments how will the EBITDA margin look for growth services?

Pratibha K. Advani: We really do not split our EBITDA margins across various services. So, as we mentioned, you will start to see the EBITDA losses decline as some of these services grow and absorb the cost that we will incur towards innovation.

Girish Raj: Okay. The second question is on transformation services. So, any commentary on the growth outlook and margin going forward, qualitative comment?

Vinod Kumar: Sorry, could you repeat the last bit of what you said on transformation services?

Girish Raj: Any qualitative commentary on the growth and margin outlook?

Vinod Kumar: Okay. So, I expect that based on the funnel that we see and orders that we are closing that the international contracts will grow faster than the India business, that should lead to some margin expansion. And we expect to be able to maintain the same or slightly greater revenue growth compared to what we have shown in Q1.

Moderator: Thank you. Ladies and Gentlemen, with this I now hand over the floor back to the management for their closing comments. Over to you.

Vinod Kumar: Okay. I think we have made our comments and I think Pratibha said it very emphatically. When we look at our business of the traditional, the growth and the innovation and transformation portfolio, we are really running each of these as an integrated portfolio but at the same time with very clear and different expectations, which are aligned with your expectations on margin, internally as well. And last year, we were allocating management bandwidth to doing much needed balance sheet cleanup activities and restructuring of the portfolio principally around Neotel and data center, and we have those behind us. And it is enabling the leadership of the organization to really focus on the execution of our core services. We feel confident that we have chosen the right products to focus on. We are confident that the portfolio breadth is the right one that ensures both the near-term growth in revenue and profitability but also securing our future.

The investments we are making in transformation, the digital transformation I spoke about, are much needed and important, and will also begin to show up in the numbers. And we are being extremely careful with focusing on things that will make a difference, either to our top-line or to our productivity. And we are reviewing the business cases for each of these very carefully. So, the critical activity and focus for us is execution right now, it is not about thinking of what the strategy should be, we are confident about our strategy, it is making sure that we execute well and also execute with keeping the future in mind. We do not want to be in a start-stop mode when it comes to innovation and transformation. So, that is something that we will do, but we think trajectory and the trend is positive and we will continue to grow quarter-on-quarter.

Thank you. We look forward to the next call with all of you to share updates and to demonstrate the continued progress.

Moderator: Thank you very much, sir. Ladies and Gentlemen, on behalf of Tata Communications Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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