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# Q3 & 9M FY2018 Earnings Conference Call Transcript

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## MAIN SPEAKER:

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

**Vipul Garg:** Thanks, Karna. Good Afternoon everyone and Welcome to the Tata Communications Limited conference call. We are joined today by Vinod Kumar - MD and Group CEO, and Pratibha K. Advani - Chief Financial Officer. Our results for the quarter and nine months ended December 31, 2017, were announced yesterday, and the quarterly factsheet is 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 the key thoughts from Vinod who will provide you an update on market environment and 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 conference call today maybe 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](http://www.tatacommunications.com). The company does not undertake to update those forward-looking statements publicly. With that, I would like to turn the call over to Vinod to share his views. Over to you, Vinod.

**Vinod Kumar:** Thank you, Vipul and Good Afternoon everyone and a very warm Welcome to all of you. I would start by giving you a perspective on our strategy within the industry context then discuss our performance in Q3, and then close off with a few updates.

Several trends have created disruption and opportunities in the telecom sector during the past few years including IOT, Artificial Intelligence, Big Data, Cloud Computing and so on. In the coming years, we will witness the impact of more technologies like Edge Computing, 5G, Blockchain, etc., very few telcos have been able to turn these technologies into business enablers for their core connectivity business and at the same time build services that leverage these disruptive technologies. I can confidently say that Tata Communication one of the rare Telcos globally that has been bold in terms of both innovation as well as in terms of execution, to make this shift from a pure connectivity provider to a next generation service provider. We defined our strategy to make the shift three years ago and have "put our money where our mouth is", sometimes even to your slight disapproval I must add.

As you will see from the increased disclosure we made this quarter on the operating metrics related to our growth in innovation services, we can confidently say that we have moved beyond just connectivity to being a Digital Infrastructure Provider. I underscore to being a digital infrastructure provider and not just a Telco. We have been bold to share these numbers with you because we are confident of the trend that we see building up. Most of what we have shared may look small in our overall context, but I urge you look at the nature of the services, the type of customer engagement that lies below them, and the stickiness of what we are offering. I hope that this also provides proof on our execution capability that our team has to translate concepts and trends in technology to products and services and then to operating results and then to revenues. The funnel for our growth and innovation services is getting stronger as our sales team gets better at positioning our services and the base of our customers who are willing to refer us is growing. You will also see how this is translating into a steady improvement in our product penetration rates.

Coming to the financial results that we just announced, despite industry headwinds, our data business has delivered healthy growth. Our data business revenues grew by 6.8% year-on-year and 3.6% quarter-on-quarter. Last quarter, I talked about churn affecting us and how we have been proactively tackling it. I am pleased that the growth trajectory in traditional services was back to usual level on the back of active churn management as well as new wins. Our traditional services revenues grew by 5.7% year-on-year. Products like VPN, Internet leased line, and Ethernet have been steadily growing in double digits which is industry leading growth levels. Our growth services witnessed another stellar quarter with year on year revenue growth of 38.5%. Growth services are scaling up as per plan and they remain on track to contribute positively to earnings in the coming quarters. The achievement of EBITDA neutral exit rate for growth services in March will be a function of the speed of our delivery and the customer usage, but we are getting closer.

Growth services contribution to our overall data will grow steadily from the 20% in Q3 to around 25% in the next one year. Innovation services will contribute additionally around 2% during this period of the next one year. We expect that the pace of growth in data business will pick up further as industry headwinds dissipate and the business attracts new customers. We expect the growth rates in traditional services and growth services to be maintained for the coming quarters. The voice business declined in line with industry trend. Q3 is generally a seasonally weak quarter and we have witnessed pressure on both volumes and pricing. The voice revenues declined by 26% year-on-year, but we could hold onto our EBITDA margins of 6% due to better cost management and operating efficiencies. The Transformation services grew by 12.5% year-on-year on account of new customer wins especially internationally and for higher value added services than in the past. The funnel of international opportunities for this business remains strong and we see growth being sustained for the coming year.

Last quarter, I talked about the importance of consistency of earnings delivery and how stronger EBITDA and return ratios will drive our value in the future. We believe we are on the right track and with stronger execution and operating leverage, we will elevate the growth and profitability further. Our transformation and digitization initiatives will bring in cost efficiencies in the future.

As part of our global growth strategy, we expanded to Latin America during the quarter. Brazil is the ninth largest IT market in the world and the largest in Latin America. IT investments in the country are expected to grow by 6.7% this year twice the rate of global growth by linking the new Seabras-1 cable system with the Tata Communications Global Network, Tata Communications has expanded to Brazil connecting Latin America's largest economy with the financial capital such as New York, London, Mumbai, and Singapore.

We entered into several strategic partnerships in the recent months working together with leading companies to push the boundaries of innovation and to help shape the future. Some of these are the partnership we did DRVR for international fleet management application for our MOVE platform. We partnered with the European PGA Tour for media services with Cloudera for our Big Data platform. MotoSport TV for Internet television platform and to deliver video content and with Ultracast for live 360° videos and virtual reality content. The endeavour of all these partnerships is to build a best-in-class global technology platform that will help to underpin the partner's digital transformation.

I am happy to say that in the last quarter we have been positioned for the first time by Gartner in its 2017 Magic Quadrant for Managed Hybrid Cloud and Hosting in Asia-Pacific. Our inclusion for the first time in Managed Hybrid Cloud Hosting Magic Quadrant Asia-Pacific is a testament to our continued focus on making it easy for customers to accelerate the digital transformation strategy through a cloud-first strategy.

Another important milestone this quarter was the filing of the land demerger scheme. The filing of the scheme for demerger of surplus land is a welcome move and one that we have been all waiting for. I am sure that you are eager to know more about what we are doing with regard to the TTSL Enterprise business. All I can say at this time is that we are convinced about the industrial logic of an integrated enterprise play that spans all subsegments of the market that we find the network reach that TTSL has extremely interesting and we see clear operating synergies between our two businesses. We are carefully studying the opportunity and continue to maintain a strong interest in the asset.

To conclude, digital transformation is making waves across all sectors. Arguably, in most businesses, the focus has today been on looking digital, but now organizations across industries want to actually be digital. Cloud has become a strategic platform for businesses to expand into new geographies, introduce new products and services faster and to drive their growth. Collaboration, Mobility and IOT are now more than a buzz, and companies are looking for providers who have real solutions that can be delivered here and now. Through our product portfolio and platforms, we harness the unparalleled reach of our network and empower organizations to become truly digital and drive their growth on a global scale. This proposition, the Tata Communications offers is resounding with customers around the world and they do see us as a Digital Infrastructure company and we hope that you would do to. With that, I invite Pratibha to discuss the financials highlight of the last quarter. Thank you.

**Pratibha K. Advani:** Thank you, Vinod for sharing your thoughts on the evolving industry dynamics and our strategic roadmap. A very Good Afternoon to all of you and thank you for taking out the time this afternoon to be on our call. I would also like to thank you for the congratulatory messages that you have been sending to us since last evening on the strong set of numbers that we have delivered, and we are happy that we have not disappointed you and not only met but exceeded your expectations as well.

Consolidated revenues came in at 4115 crores, a decline of 2.4% quarter-on-quarter and 5.6% year-on-year, but you will agree this is not the true reflection of our intrinsic performance. The decline in voice was compensated by strong growth in data business. Consolidated EBITDA stood at 613 crores and witnessed a growth of 8.6% quarter-on-quarter and 11.9% YOY. We had healthy EBITDA margin expansion this quarter. Margins expanded by 150 basis points quarter-on-quarter and 230 basis points on a YOY basis. Margin expansion was on account of razor-sharp focus on costs coupled with strong growth in our high margin traditional services business. Other income was high this quarter due to interest received on the advanced paid to Tata Sons for Docomo settlement. This one-time interest income was 29.7 crores. Consolidated PAT stood at 10 crores against a loss of 250 crores last quarter. Tax amount looks high because of change in US tax rate due to which the value of deferred tax assets had to be brought down in our P&L. The one-time impact on this account was Rs. 16 crores.

Moving to our segment results, during Q3, data services reported a revenue of 2884 crores, an increase of 3.6% quarter-on-quarter and 6.8% YOY. This growth was achieved despite industry headwinds due to operator consolidation. Growth services witnessed another stellar quarter while traditional services bounced back to its usual growth trajectory. Revenue momentum in data services was healthy due to new client wins and better uptake of data bandwidth. Data EBITDA came in at 539 crores witnessing a strong growth of 16.7% quarter-on-quarter and 14.9% YOY. EBITDA margin expanded by 200 basis points quarter-on-quarter and 130 basis points on YOY basis and came in at 18.7%. Margin expansion was on account of higher revenue growth, productivity benefit, and yearly cyclical benefit on account of reconciliation with our international service providers. Data business now contributes to 88% of our overall EBITDA.

In traditional services, our revenue was USD 302 million and witnessed a growth of 1.6% QOQ and 5.7% YOY. EBITDA for the quarter came in at USD 95.3 million witnessing a strong growth of 16.4% quarter-on-quarter and 22.7% YOY. EBITDA margin for the quarter came in at an all-time high of 31.6%. As Vinod mentioned products like VPN ILL, Ethernet, and ILL are all growing ahead of industry growth rates.

Growth services delivered another quarter of strong growth and are scaling up as per our plans. Revenue for the quarter came in at USD 89.6 million a growth of 4.5% quarter-on-quarter and 38.5% year-on-year. We continue to invest in this business. As Vinod articulated earlier, we are on track and with each passing quarter, Growth services are becoming more meaningful and contribute to 20% of the overall data revenues and will contribute positively to earnings in coming quarters. Some products have already turned EBITDA positive and as we keep on growing scale, the overall portfolio should turn profitable. Our UCC portfolio contributes to 58% of growth services and this has grown YOY by 20% and is already EBITDA positive. Media services are growing by 28% year-on-year and are on track to break even.

We continue to invest for our growth in our innovation portfolio and our innovation portfolio presents an opportunity for us to participate in the emerging fields of IOT and cloud-based offerings. We expect innovation portfolio to start making healthy contribution to our overall revenue from FY '19 although I must reiterate we would continue to invest in this portfolio. Revenue for these services is still not meaningful, but we have added some operating metrics in our factsheet so as to give you a flavor on how these products are shaping and their potential growth opportunity. You would have noted that during the course of the year these metrics have grown multifold. For example, IOT India devices have grown by 10x while sims ordered on the MOVE platform have gone up by over 11x.

Moving to the performance of our subsidiaries, Transformation Services, revenue for the quarter came in at 294 crores, which is a growth of 10.5% quarter-on-quarter and 12.5% YOY. EBITDA came in at 40.4 crores witnessing a

growth of 19.6% QOQ and 10.6% YOY. EBITDA margins expanded by 100 basis points on a QOQ basis. We have added a few marquee international customers and continue to see a good funnel.

The challenges in payment solution business continues albeit it is bouncing back. We are focused on cost optimization by closing unprofitable ATMs. We have, however, seen an improvement in the number of transactions which have inched to 70 in December, but money supply continues to be at 50% of pre-demonetization levels. Our emphasis is on driving an efficient operation and grow the business.

Voice segment reported a decline in revenues of 14.2% quarter-on-quarter and 25.9% year-on-year. Q3 is a seasonally weak quarter and we have witnessed both volume and pricing pressure this quarter. EBITDA came in at 74 crores and degrew by 28.2% quarter-on-quarter and 6.2% YOY. You would recall that last quarter both EBITDA and margins were high due to one-time cost benefit. This quarter the margins have normalized to 6%, which is very much in line with our long-term guidance. This segment continues to be important for us from a free cash flow perspective generating year-to-date free cash flows 258 crores.

CAPEX for Q3 was USD 57 million, year-to-date we have incurred a CAPEX of 183 million. This is in line with the broad guidance given at the start of the year.

Net debt at the end of the quarter came in at USD 1.254 billion increase of USD 45 million over last quarter. The increase in debt is largely due to increase in working capital gap. The weighted average cost of debt was marginally higher than last quarter and it came in at 3.6%. This was due to one-time arrangement fee on refinancing of a long-term loans. Adjusted for this fee, the cost of debt would have been flat.

We are moving in the right direction, our product portfolio and solutions are geared towards the future and with a strong execution track record, we have created a niche for ourselves as a digital infrastructure provider. International transformation and productivity enhancement initiatives will continue the momentum in margins.

I would like to bring my commentary to a close and request the moderator to open the forum for Q&A.

**Moderator:** Thank you very much, Madam. Ladies and Gentlemen, we will now begin with the question and answer session. The first question is from the line of Amruta Pabalkar from Morgan Stanley. Please go ahead.

**Amruta Pabalkar:** I have three questions, firstly on the overall traditional basket, you mentioned that couple of products are growing ahead of industry, could you give us some more color as to how much have you been able to gain in terms of market share and have you benefited in gaining this share because of some other peers of yours being under pressure and is this funnel really accelerating in the near-term. Any indication on this would be helpful.

**Vinod Kumar:** We do not have the market share figures that I can share off immediately now, Amruta, but where we are definitely gaining share I would point out to is in our ILL services in India and in our VPN services in India and outside, so both of those cases we are gaining market share because of couple of reasons. One is the strength of our network and quality of our services as well as I think in our VPN services, the continuum of offerings we have from traditional VPNs all the way going through IZO SDWAN or Software Defined WAN services is quite compelling and in India nobody has that breadth of service and internationally we have comprehensiveness of offering which is fairly unique, so I would say in both of those cases, we actually are gaining market share and growing.

**Amruta Pabalkar:** What I can share with you Amruta, is some of the growth numbers in these services, VPN is growing by 11% year-on-year, ILL is growing by 15%, and Ethernet is growing by 16% year-on-year.

**Vinod Kumar:** If I can add to what Pratibha just said, the 11% and 16% on VPN and Ethernet is I would say multiples of where our international peers will be in terms of year-on-year growth and in ILL if you look at the figures for enterprise Internet access through our competitors, in India we will still be higher than them. I cannot sort of give a figure of the top of my head, how much faster we are growing but we are definitely growing by gaining market share.

**Pratibha K. Advani:** Actually, we are gaining market share in the international geographies, those are growing by 11% for us year-on-year versus India which is growing at 9%, so both are very healthy growth numbers that we are witnessing.

**Amruta Pabalkar:** Secondly, on the Tata Teleservices impact, we did get some flavor of it in the previous quarter as how could be the potential impact and exposure. Do we have any kind of a revised guidance based on how the negotiations are shaping up, what could be the potential impact that one can expect in the TCTSL and traditional segment in revenue and EBITDA?

**Pratibha K. Advani:** Amruta, we will go by the numbers that we had shared in our last conference call, but we have still not seen the impact coming in, and hopefully, Q4 will also be insulated and we should see the real impact happening in the next financial year.

**Amruta Pabalkar:** Is it fair to expect, say 50% of revenues potentially stand at risk just on back of TTSL wind up?

**Vinod Kumar:** Did you say 50%?

**Amruta Pabalkar:** Yes, 50% of the TTSL exposure at risk on back of the potential merger or you think that is an aggressive estimate?

**Vinod Kumar:** I am still not clear, 50% of the revenues we get from TTSL or 50% of TCTSL revenues?

**Amruta Pabalkar:** Now, 50% of the revenues you get from the TTSL?

**Vinod Kumar:** It is tough to say, I think there will be a gradual tapering off of services over a period of time, I do not think we have given estimate of 50%.

**Pratibha K. Advani:** Amruta, what we had not said was 50%, we had said that it could have an impact on our overall business of about \$50 to \$55 million, but the revenue share to overall TCTSL revenue is much smaller.

**Amruta Pabalkar:** Just a small clarification there, so the total exposure to TTSL is about US\$50 million to the TCTSL segment and some exposure to the traditional segment, so is that correct?

**Pratibha K. Advani:** That is right.

**Amruta Pabalkar:** Lastly, on the potential acquisition of TTSL as Vinod mentioned that you see this as a strategic fit for your business, is it possible to kind of elaborate it a bit as to what exactly revenue and cost synergies do you see for TCOM, and how should we really thinking about this merger?

**Vinod Kumar:** At this point, I do not want to talk, I cannot talk about numbers, but I will just highlight qualitatively where we see the synergies from an operating perspective, one, shared services, you really do not need the same extent of shared services when you are merging two businesses that have certain similarities and we also have significant geographic presence and understanding in India. The functions like engineering, operations, field operations, there are synergy opportunities, and finally on the revenue side, which is where the really exciting possibilities are is we have a much broader product set than what TTSL currently has and their 51,000 customers will be quite interested in, actually many of them would be interested in the broad portfolio services that we bring that is already operational and live in TCL, so those are some of examples of where the synergies would come from, but I am not in a position to discuss numbers now.

**Moderator:** Thank you. The next question is from the line of Naval Seth from Emkay Global. Please go ahead.

**Naval Seth:** I have two questions, first on the cost control initiatives, can you highlight which are the cost heads where we have taken these initiatives and where results have been seen because as per your reported numbers, network OPEX have seen kind of savings on sequential basis, so if you can elaborate on the same?

**Vinod Kumar:** I will give you sort of the overall strategy on cost control, so we are doing several things in this area, but it began with activities earlier in the year to reduce our manpower costs and where we are now is we had a fairly major restructuring of the organization design itself in order to achieve two things. One is obviously to reduce our cost through de-layering of the organization as well as flattening the pyramid so to speak and we also are looking at where work gets done as organization and customers where revenue gets booked and so on evolves over a period of time, we think there is an opportunity to move cost to the right geographies closer to customers and revenues and those will result in some savings, so organization design and de-layering are one set of activities. The second really is part of our digital transformation project which is to look at our processes to streamline them and also to make them lighter touch and to see how we can automate it. We are in the early stages of that journey as you know, but this will be an ongoing exercise as far as technology and organisationstructure is concerned and this will result in manpower savings for us.

**Naval Seth:** Vinod, apart from manpower, I mean if you can quantitatively give some color on the savings what we have seen if at all you can will be helpful?

**Pratibha K. Advani:** On the network, we are doing actually a couple of things as Vinod mentioned, we are leading a large Transformation program across the organization and we are actually leading one specifically in finance where we are closely looking at all the costs and seeing opportunities on how we can negotiate better with our vendors. We are also looking at capacity consolidation and design and some of these have started to pay dividends and we are seeing the benefits. I also mentioned in the call, we also got a 50 basis points benefit because every year we do our reconciliation with our vendors, this is seasonal and cyclical and that benefit has also flown in to our network cost.

**Naval Seth:** Second question on the Transformational spend of \$90 to \$100 million, in last call it was mentioned that expenses towards \$5 million on quarterly basis, so was that part of in 3Q as well?

**Pratibha K. Advani:** That is right, but having said that we are also looking at our entire Transformation program and looking at what could be certain quick wins that we can attack and you are starting to see that benefit in the network cost, so the investments have got a little staggered and you are not seeing the full impact in this quarter.

**Naval Seth:** But, it was there in the last quarter?

**Pratibha K. Advani:** That is right.

**Vinod Kumar:** In terms of our Transformational program objectives they have not changed, if anything we will see if we can do more, but we are spending very wisely thanks to Pratibha's control of the purse strings.

**Naval Seth:** Last question is on EBITDA and data margin, so shall we assume that the EBITDA has been now bottomed out or margins have been now bottomed out at say 16.6%, which was reported last quarter and it will continue to improve from what we have seen in 3Q as well?

**Pratibha K. Advani:** You should see the momentum in our margins, but having said that I would like to add that we would see our traditional portfolio margins actually stabilize more at 29% to 30% range and the reason we are saying this is because we will see pricing or we are starting to see pricing pressure as the annual contracts come up for renewal and at 29% to 30% level, we would be comfortable.

**Naval Seth:** Despite your growth services, product mix changing, and losses increasing this quarter, so our target remains on track for the services to turn a bit, some of the services to turn a bit EBITDA positive in 4Q?

**Pratibha K. Advani:** That is right, actually in my commentary I had specially called out that our unified communication and portfolio had already turned EBITDA positive, and also Q3 even in growth services we see an impact of seasonality coming on account of the usage-based services because most of the international geographies are on two weeks of vacation, so that is why you are seeing some of the impact on the EBITDA where almost the losses are flat quarter-on-quarter.

**Moderator:** Thank you. The next question is from the line of Runit Dugar from IDFC Securities. Please go ahead.

**Runit Dugar:** Firstly, on the growth services side if I look at it on an aggregate basis, you run rating at about \$350 million, but still you're making losses. So, should we think of the cost structure more at a product level in the growth services because typically \$350 million is a pretty decent scale to start earning EBITDA? Thus, at what scale from product cost structure perspective do you think growth services can start delivering EBITDA on an aggregate basis?

**Pratibha K Advani:** You are right, so we have gained scale in growth services. But this is a portfolio I have to point out where we also having to share commissions with our partners. So while at an EBITDA level its is not looking exciting but as it scales are you going to see the real benefit come at EBIT level because the CAPEX investments is not happening in this portfolio. The entire portfolio should turn EBITDA positive at about \$425-\$450 million. Having said that, the way we are defining growth services, what would also happen is as some of our other services in the innovation bucket mature, they will then come into the growth services. This is a portfolio that will continue to grow, but within this portfolio you will see most of the products turning EBITDA positive next year.

**Runit Dugar:** My second question is considering the kind of investments you have been making in new areas, new service products. It seems like there is a massive increase in your overall product and service offering, so effectively now you are straddling between legacy new tech and innovative new services and offerings. In this context, how do you structure your sales organization from structuring perspective, incentive perspective to maximize the sell through? So, if you can just give me some color on your sales.

**Vinod Kumar:** It is a very good question but requires a long answer for you to get an understanding. What I can say is that, over the last 2 years we have learnt a lot about how customers buy these growth services and the innovation services, and we have modified the sales organization to accommodate these buying behaviors. So, to just point out two of the many things that we have done, two salient ones, one as we have more product specialists now assigned to selling these growth services. So, we have people for security force, unified coms and IOTs, for example. In addition to that, we have created, and this is just beginning to, is being put into place and will start showing effect in a quarter or two, is dedicated desks that will be tasked with driving, adoption and usage. So, this again is a new requirement or new think that we have learned by selling services in the unified communication space and in the mobility space which our traditional salesperson will not be focused on. And the third is we have made quite a few changes to our sales compensation structure to get people to focus on these services: -one, to make sure that they get positioned in all our accounts, and secondly, we have also made changes in compensation structure time in order for them to drive usage once the customer has come on-board. So, there are quite a few things, but these are some examples of what we are doing. And in fact, in growth from last year we grew by 19.5% or 20% year-on-year and this year we are at 39%-40% year-on-year. A large part of it I would attribute it to the sales process getting more customized and sophisticated for growth services.

**Modeartor:** Thank you. The next question is from the line of Rajiv Sharma from HSBC. Please go ahead.

**Rajiv Sharma:** Just two questions from my side, the Tata Tele impact in the previous quarter on EBITDA was \$1 million. So, are we carrying that much impact means, have the EBITDA numbers been adjusted for \$1 million again this quarter or have we stopped taking the impact now and we will take it once the merger gets finalized?

**Pratibha K Advani:** No, that \$1 million impact has already been taken last quarter so that will continue.

**Rajiv Sharma:** So, we will not get any big spike or one-time adjustment in our numbers if that \$1 million impact and the \$55 million annualized revenue impact is getting adjusted, then there should not be any one-time big impact because you said a tapering down will happen in your earlier comments. So, I didn't really get that.

**Pratibha K Advani:** I just want to clarify that. We anticipated that the impact would flow in on the revenue. That hasn't started to happen here so that has got that deferred and most likely you would see that impact coming in Q1 of FY 19.

**Vinod Kumar:** And if it takes more time it is better for us because it allows us to replace that revenue with revenue from other customers, especially in TCTS.

**Rajiv Sharma:** But the impact will be at the revenue level, at the EBITDA level there will be no impact because you're already accounted for it?

**Pratibha K Advani:** No, \$1 million was just an initial ramp down of some services. But there would be an impact of \$55 million that would be close to \$8-\$10 million.

**Rajiv Sharma:** Okay so currently we are adjusting for the \$4 million annualized impact, but we are leaving out the rest \$4 million, given that we have some variables which are pending. Is that the way to look at it?

**Pratibha K Advani:** No, actually, the way I would say is that \$1 million was for services that we were doing, which has got discontinued. Those were 'one off' services that we were doing for them. You would still see on the \$50-\$55 million you would see the \$7-\$8 million impact next year.

**Rajiv Sharma:** So that will be incremental to what we have been adjusting in this quarter and the last one, it will be incremental to that?

**Pratibha K Advani:** That is right.

**Rajiv Sharma:** Second question was, I am just trying my luck but; new data margins at overall level currently, you were at 18.5% you have long-term suggestion of 27%-28%-30%. Do we see this going to at least 20% and above next fiscal?

**Pratibha K Advani:** I just want to clarify when Vinod did talk about data margins, that was really for our traditional portfolio of services where we said we would hit.

**Rajiv Sharma:** I am asking at consolidated level.

**Pratibha K Advani:** The consolidated margins, as I said they are on the right growth trajectory. We hope by the end of next fiscal, we will touch 20%-21% as the growth services portfolio turns profitable. Having said that I do want to highlight that we would continue to invest in our innovation services and you would have seen some of our operating matrices there. So some of the investment would come in terms of product engineering and the other piece will come from the customer win. So success based wins will also compel us to make those investments.

**Rajiv Sharma:** And lastly, Vinod mentioned something on the demerger of the lands so what is the progress in this quarter?

**Vinod Kumar:** I mentioned that the scheme is being filed and now we are waiting for SEBI approval that is the latest on that. We continue to maintain an August-September timeframe to conclude the process.

**Rajiv Sharma:** So, when you say conclude the process, it will mean that the final monetization will happen?

**Vinod Kumar:** No, it means that the land will be demerged into HPIL.

**Rajiv Sharma:** So final monetization may still take a years time?

**Vinod Kumar:** I cannot comment on that because that is an HPIL decision right, because it is not ours to monetize.

**Moderator:** The next question is from the line of Senthil Kamaraj from Newbury Capital. Please go ahead.

**Senthil Kamaraj:** My question is with respect to the transformation from the 4G to 5G and with the automated calls and connected mobility coming into force, so how do you see 5G panning for the next 4 to 5 years?

**Vinod Kumar:** Well, we see 5G as an opportunity for two reasons; one is, we believe that the overall data consumption will significantly increased and the second is, with 5G. We believe that there will be last mile capillarity or last mile options which are based on 5G that will meet the needs of some of our enterprise customers and hence we look at it as one more access option that will be made available to us as and when the carriers roll it out. Since you are talking four to five-year time frame we can assume that but it is not going to be a near term thing. Globally as 5G rolls out again we see there is a positive thing, because it drives data consumption and gives us access options.

**Moderator:** Thank you. The next question is from the line of Himanshu Shah from HDFC Securities. Please go ahead.

**Himanshu Shah:** Just a couple of questions; you mentioned that the Tata Tele services having around 50,000 customers and we are reporting around 5000 customers, but I am presuming our data services, our enterprise business would be probably a much larger than that of Tata Tele services. So why there is so vast a difference in terms of customer count? Or is it that they serve to many small enterprises and we just focus on large companies, or something?

**Vinod Kumar:** You have answered your own question. You are right, we focus on large enterprises, whereas they focus on the medium and small end of the market. So that is why their customer count is high. Right now there is no overlap that is why they have 50,000 as compared to our 5000.

**Himanshu Shah:** Okay. So, is it possible to share the opportunity size and is there any specific reason we have not been entering into medium and small enterprises? Or is it due to some restriction or something? And once the Tata Tele business gets sold we would be able to venture in that segment?

**Vinod Kumar:** Well the reason is this, we have seen until now an opportunity to expand our presence by selling more services into the large enterprise market. However, the SMB market in India is a fast-growing segment and with TTSL opportunity on the back of their network we see the timing being right to get into that segment of the market. Additionally, we have now services such as hosting securities, unified communications, collaboration services that can be taken to the small and medium size enterprise customers who aren't will now be just buying pure bandwidth. Now they're looking to buy more services and the timing. We believe is right to include that segment in our addressable market.

**Himanshu Shah:** Sir just one last follow-up on that. Is possible to give some size of the market of large corporate and medium and small enterprise where we are not catering? It would help.

**Vinod Kumar:** I don't have it at top of my head, but we will give you that relative market size the next time we have a call.

**Himanshu Shah:** Sure sir, second question is when I just compare our enterprise business and that is primarily data services with that of Airtel, probably on revenue run rate we are at par with them but on consolidated margin fronts we are almost like half of Airtel. I understand that probably some of their cost, especially corporate cost, network cost may be sitting in some other business segment but still the difference is too high. So, what could be the potential reason and is it fair to assume means, 50% of our revenues are outside India I am presuming Airtel would have more

in India because that is their India segment business only or 100% in India. So they are much larger than us in enterprise business?

**Vinod Kumar:** It not apples to apples comparison due to multiple reasons. One is, as sure as I know they report, all enterprise, all segments small, medium and large whereas, what we focus is on the large. Second is, mobile data is included in their enterprise reporting as far as I know, and I have to say I'm only giving you my opinion. I do know these things for a fact whereas our business is really all data and cloud services and like you said yourself, we have both India and international and our International is a much bigger component than what they would have. In terms of like-for-like market share, we are bigger when it comes to large enterprise data services compared to any other player in the market in India.

**Himanshu Shah:** Okay. And in terms of margin profile the difference is quite large between us and Airtel.

**Vinod Kumar:** I cannot comment on their margins to be honest. I'm not sure how they allocate cost across various segment and as I said the customer segment in revenue itself is different then looking at margin and trying to compare may not provide any insights really.

**Moderator:** The next question is from the line of Ali Asgar Shakir from Motilal Oswal Securities. Please go ahead.

**Ali Asgar Shakir:** My first question was on your traditional segments, so this quarter the margin that we have seen I think is the peak margin. Even before we sold data center business we were not at this scale of margin. So I understand you mentioned about the cost optimization measures that we have taken. Just wanted to generally understand what is a further room for improvement on these margins would be over the next 2 to 3 years because I presume that majority of 70% to 80% of your revenues come from this segment in the data so overall margin improvement in the data segment will have a strong bearing from traditional services?

**Vinod Kumar:** As Pratibha said, the margins in the segment from the traditional data we should be looking at 29% to 30% because we have annual contract renewals that are coming up in Q4 and Q1, so that is one. We will continue to look at taking costs out, we have redeployed people to some of our growth and innovation services. But for this level of margin, we don't want to commit to obviously we are going to strive to maximize margins, but 29% to 30% is what we are more comfortable with for traditional data.

**Ali Asgar Shakir:** I think you just probably scale down by about a 150-200 basis points, given that in this quarter we have done about 31.6%.

**Vinod Kumar:** Yes, that is the math.

**Ali Asgar Shakir:** Okay. Second question is on your ATM business, the pre-demonetization level we were profitable. Just wanted to understand what is the probably it has taken too long, and I understand like you already mentioned that the money supply has been very weak. So just trying to understand the long-term focus in this business revenue, profitability, potential outlook and we were probably earlier looking for some strategic options so that is still on radar and all and how do we see this business going forward?

**Vinod Kumar:** The strategic options remain on the radar but at the same time we have done a lot of heavy lifting and we are the only player in the market that has meaningful presence and by far we are the largest white label providers with our Indicash Brand getting traction across the country especially in Tier II and Tier III towns. I don't think this is in the data sheet also but our January count of transaction is 81 transactions per ATM which is higher than even pre-demonetization levels. Cash continues to be a challenge as we are operating at about 45% of the cash that we have but transactions have come back up infact in an article in the newspaper just yesterday on this as well, across banks. So that is positive. We have operationally tightened our belts quite a bit over the last year as a result of demonetization both in terms of OPEX and also redeploying our CAPEX very wisely and not spending incrementally to deploy ATM. The way I look at it is yes, strategically it is on the radar we look for options, but we are not in any

panic. We are the last man standing in this space and we have a great foot print and Indicash is gaining as a brand. We will see what we can do with it, but we understand underlying nature of the business and are aware of what the return possibilities are. So, it is back to EBITDA neutral level and we see that inching up over the coming quarters so it is at least I would say it is not in this troublesome state it was in 3-4 quarters ago immediately after demonetization.

**Ali Asgar Shakir:** Okay so a quick follow-up there, I may assume that the money supply doesn't improve significantly in another few quarters. Your run-rate that you mentioned for January. Should that allow you to turn profitable and sort of still generates a decent single-digit margin or it will continue to remain loss-making for some period. If that does happen, do you sort of also explore the option of closing down this business if you don't find a strategic partner soon?

**Vinod Kumar:** No, I'm not going to discuss those options on a call like this. I don't think it is a fair question. But we actually see it improving in terms of margin. And as I said, we already at a neutral level so it will not be a drain on our EBITDA.

**Ali Asgar Shakir:** Just one quick query on TTSL, Pratibha you did mention about the \$7-\$8 million EBITDA impact on \$50 million revenue impact. I just wanted to understand the bifurcations between voice and data, what proportion of this \$50 million would be probably voice component business with TTSL and data?

**Pratibha K Advani:** This is all data.

**Ali Asgar Shakir:** So that is about close to run 14%-15% margin that we were doing with them on the data business.

**Pratibha K Advani:** That is right. And I just want to clarify when we say margin a lot of costs also get allocated. Now in the business goes away my cost will not go away immediately, right. And that is why the impact is going to be there on the margins.

**Ali Asgar Shakir:** So then in that case, probably the margin impact could be higher because the cost...

**Pratibha K Advani:** So that is why I am saying when you said 14%-15%, although it would be a lower margin business, but because some of our overheads also get allocated now they don't immediately go away and hence the overall impact on the margins would be around that much.

**Ali Asgar Shakir:** Just a final question on your working capital. We have seen a continuous uptrend and I presume, like you mentioned previously, it could be because of the high proportion of working capital getting allocated towards your data business versus earlier, the voice business. So just share some thoughts on the outlook in terms of what sort of working capital requirement we would have over there and is it growing because of the enterprise requiring higher working capital. If you can just throw some light about why this is growing and how far it can grow and what is the implication it could have on our free cash flows?

**Pratibha K Advani:** Ali actually, you have answered some of that yourself. What we are now seeing is a very strategic shift in the data services portfolio, data contributing 70% to the top line and nearly 8% to EBITDA. While earlier voice was a negative working capital business, data what we are also finding is that the enterprise customer is demanding higher credit period. Having said that, the other impact that we have seen this quarter is also on account of GST in which our billings got delayed because customers were required to register based on the place of supplier rule and all the customers were not agreeable to registering themselves. So that kind of had a rippling effect which further compounded the working capital gap. In Q4, we hope to be able to collect some money and we should see the working capital gap stabilize.

**Moderator:** The next question is from the line of Shekhar Singh from Excelsior Advisors. Please go ahead.

**Shekhar Singh:** Just trying to understand this new breakup in terms of the growth services is it 20% of the revenue or is it 20% of data revenues?

**Pratibha K Advani:** 20% of data revenues.

**Shekhar Singh:** So of the total revenue it is actually 14%, if I'm not mistaken.

**Pratibha K Advani:** That is right.

**Shekhar Singh:** And secondly, like when you say voice services, voice services is your traditional services, basically what you are referring to as?

**Pratibha K Advani:** No within the data portfolio, we break that data into traditional which will be ILL, IPL, VPN and our traditional mobile services. We have then within data the growth services and the third bucket is the innovation services and even the two subsidiaries come under the entire data portfolio. Voice is an entirely separate segment and we report the segment results separately.

**Shekhar Singh:** And you mentioned that for data business and traditional services this quarter reported around 6% and 5.5% growth respectively and you're expecting data business growth to go up in future?

**Pratibha K Advani:** That is right. So while the traditional portfolio growth is going to stabilize at the 5% to 6% level, what we are seeing is a significant ramp up in the growth services and which is what Vinod alluded to earlier. That portfolio was growing by 19%-20% last year and now it is growing by 35% to 36%. So we are seeing a significant ramp up happening in the growth services portfolio. And given that ramp up the overall data services portfolio we should continue to see a double-digit growth.

**Shekhar Singh:** And in terms of margins, if I look at your traditional services, the data business, excluding the growth services and the growth services, so growth services right now we are making losses. What about the other two in terms of EBITDA margins?

**Pratibha K Advani:** So traditional services we are making 31.67% margin this quarter, innovation services we are still investing so that is EBITDA negative, growth services we are still investing so that is also EBITDA negative.

**Shekhar Singh:** And what about data business, excluding the growth service?

**Pratibha K Advani:** No, so I explained to you that data portfolio consists of traditional services, growth services, innovation services and the two subsidiaries. And the transformation services that subsidiary is EBITDA positive making 15%-odd margin, while the payment solutions services as an ATM business that is still EBITDA negative.

**Moderator:** The next question is from the line of Bharat Sheth from Quest Investments. Please go ahead.

**Bharat Sheth:** Just one question that, this year the kind of growth that we have seen in growth services, so what is your take on next year and going head because some of the innovation and how many products that you expect from innovation will migrate to growth next year?

**Vinod Kumar:** We believe that the momentum that we have in growth services will continue. Obviously, in the innovation bucket we have our global mobility which is our MOVE service portfolio, IoT in India, security services and NetFoundry are the four large ones and a few others that we have, but those are the four large ones. In terms of revenue contribution, we expect that they will contribute around 2% of the data numbers for next year and so that will be in terms of percentage jump fairly significant and so we will continue to report and show them as innovation rather than move them into growth. I think we're probably 6 to 8 quarters away before we do that.

**Bharath Seth:** And second, how with the help of these growth services and these innovation services, how does it help us to get a new customer and to get him to use our data services?

**Vinod Kumar:** Absolutely it works both ways we have equal number of examples for existing customers, adding our growth services and we have customers who are having their first experience with Tata Communications on the back of growth services and then very quickly buying our traditional services. So most of our network customers are buying security services or some form of SIP Trunking for the unified communication deployment within their enterprise. So that happens quite frequently. Equally, we will have customers in, for example our hosted contact center offering or security services and then buying traditional Internet connectivity service along with it. So, it works both way so it definitely helps us cross-sell our services into customers which is why you have seen our product penetration rates increase steadily quarter to quarter.

**Pratibha K Advani:** Our product penetration Vinod, was 4.5 last year, it has moved to 4.76 this year.

**Bharat Sheth:** In our security services where we are looking within the next couple of years, could we find ourselves. What is the opportunity?

**Vinod Kumar:** The opportunity in security is significant. So we see our business which is several hundreds of millions of dollars that is what I would say. We see significant growth opportunity in the security space. During the course of this year we have largely been building out our product portfolio to make a comprehensive managed security service provider offering and we are building out security operations centers in multiple geographies and we are actively in conversation with customers around the broader suite of security services.

**Bharat Sheth:** Okay. Pratibha on this with the cost optimization level we have seen a very good impact on current year in quarter number, EBITDA side. So what is the room further that we can bring down the cost?

**Pratibha K Advani:** Our efforts for cost optimization will continue and Vinod articulated some of the initiatives that we have taken which will continue to bear results. Having said that I had also mentioned that the maximum impact we saw was in our traditional services portfolio. But some of that benefit we expect to stabilize going forward because typically the customer contracts come up for renewal in Q4 and Q1 and we are seeing pricing pressure there. So, the benefits even though they will continue will get negated by the pricing pressure that we witness.

**Bharat Sheth:** And if my understanding is correct the data service which currently has EBITDA of around 18% that you said that next year would be a +20% or exit will be at 21%?

**Pratibha K Advani:** We would aim for an exit at 20%.

**Bharat Sheth:** And this tax impact that you say that is Rs. 16 crores is one time, correct?

**Pratibha K Advani:** That is right, that is because of the deferred tax asset impact.

**Bharat Sheth:** In US piece of business.

**Pratibha K Advani:** That is right.

**Moderator:** The next question is from the line of Nimit Tanna from CWC. Please go ahead.

**Nimit Tanna:** Just one clarification, so while our traditional margins you have given the range of between 29% and 30%, you have said in the previous calls also that the effort of the transformation whenever it kicks in may be second half of next year or later it will also help us structurally move and take that ahead of that. Is that fair just clarifying that point.

**Pratibha K Advani:** Nimit that is right. But I had also mentioned that some of the low hanging fruit stuff we have already captured that benefit and that is why you are seeing the upswing in the margin.

**Vinod Kumar:** Yes, Nimit your point is valid. On the second of the next year when we see a transformation program, the new systems in place and more streamlined processes, we will see more business velocity and some revenue acceleration possible, a faster revenue realization and we should see some associated cost take-out.

**Moderator:** Thank you. Ladies and gentlemen, with this I now hand the conference over to Mr. Vinod Kumar for his closing comments. Over to you Sir.

**Vinod Kumar:** Thank you very much for your participation and your questions. I hope that our increased level of disclosure this quarter will help you get a better understanding as to the operating metrics that are driving our growth services transformation and our innovation portfolio. As I said, we will continue providing this level of detail in the coming quarters. And we look forward to demonstrating very clearly through both the operating metrics and financial performance that will follow, that we are indeed positioning ourselves and being accepted in the market as a digital infrastructure provider. Thank you and look forward to speaking with you during our next call.

**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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