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Q1 FY2019 Earnings Conference Call Transcript

MAIN SPEAKER:

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

Vipul Garg: Thank you, Margret. Good afternoon, everyone. And welcome to Tata Communications Earning Conference Call. We have been joined today by Vinod Kumar - MD and Group CEO; and Pratibha Advani - Chief Financial Officer.

The results for the quarter ended June 30, 2018 were announced yesterday, and the quarterly fact sheet is available on our website. I trust you would have the opportunity to look at the key highlights. We shall commence today's call with comments from Vinod, who will share his insights on the business dynamics and our strategic intent. He will be followed by Pratibha, who will lead the discussion on financials. At the end of managements' remarks, you will have an opportunity to get your queries addressed.

Before we get started, I would like to remind everyone that some of the statements made or discussed on the Conference Call today may be forward-looking in nature and must be viewed in conjunction with the risks and uncertainties we face. A detailed statement and explanation of these risks are included in our annual 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 to Vinod to share his views. Over to you, Vinod.

Vinod Kumar: Thanks, Vipul. 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 context of our industry then discuss our performance in Q1, and then close off with a few updates.

The telecommunications ecosystem remains as fascinating as ever, change has been a constant in the industry and FY19 will be no different. There are emerging trends, which will shape the telecom discourse in the future. We will be witnessing alliances between telecoms and content companies as we have started seeing in the US, smartphone users will increasingly adopt Augmented Reality while B2B Augmented Reality apps will considerably change the workforce processes. It is expected that pioneering players in the telecommunications industry will enable 5G between 2018 and 2020. It's not just consumers who are hungry for data; several industries including automotive, retail and utilities, home security, architecture, and even agriculture are embracing IoT which will necessitate networks to support broad range of applications. These trends are at different stages of development and realization in different geographies. And these will result in some impact on the degree global scale that's achieved in the near-term, but the trend is very evident.

Companies which embrace the change, and evolve around it, will continue to thrive. Tata Communications has dynamically kept pace with the changing technology landscape and transformed itself from a pure connectivity provider to a next-generation digital infrastructure provider. We continue to gain prominence in the large enterprise ecosystem with a clear focus on empowering customers with solutions that go well beyond product silos and we are continuing to innovate and scale both our products and our platforms.

Coming to this quarterly performance, as you are all well aware the industry is going through a tough phase and we have also been affected to a certain extent by operator consolidation in India. Despite these headwinds, we have been able to maintain our numbers this quarter. Consolidated revenue was down largely due to decline in Voice business. Despite the decline in the revenue, the operating profit was flat due to cost optimization and control. We continue to face challenges in Voice business but we were able to maintain our margins through cost efficiencies, which we are driving very closely. Q1 data revenue was flat on a quarter-to-quarter basis but grew 3.9% on a year-on-year basis, despite challenging industry landscape. The data EBITDA grew by 0.4% quarter-on-quarter and 3.1% on a year-to-year basis due to, again as I said, a strong focus on our operating costs. The change in treatment of one-time service revenue in accordance with IndAS 115 has impacted our data services portfolio, including the growth services. Traditional services EBITDA margin was strong at 30.8% while we were able to reduce the EBITDA loss in growth services significantly.

For Growth services, the market demand and relevance of our offerings remains very strong. The funnel for our growth services is strong, it is growing at faster rates than it did in the past. And we are confident to hit similar growth rates as we did in the last financial year. We will steadily shrink our EBITDA losses in Growth Services - for Q2 this should be roughly half of Q1 loss and we will be in positive territory after that. As I said, IndAS 115 has impacted the profitability a little but we are making all the efforts to stick to the timelines that we have as communicated earlier.

TCTS revenues were impacted due to operator consolidation in India and EBITDA was lower due to normalisation of certain one-off gains in in Q4. Overall we are very confident of the YOY growth for TCTS, on the basis of the orders which we already have under implementation.

Regarding working capital and the impact on debt, I want to assure you that this is a situation that will persist for couple of quarters, while the revenue mix stabilizes. It is not reflective however of any weakness in our underlying strategy or in the operational processes.

And finally, on ROCE, we stand firmly by the guidance we have provided for the 3 year horizon and are confident of achieving it.

Now, to provide you some updates on key developments in the past few months.

As you are all aware we got approval from NCLT on the surplus land demerger and we are now awaiting MCA approval. Post MCA approval this scheme will be effective. We hope to conclude the land demerger along with listing of Hemisphere properties within this calendar year.

Moving to the business, the emphasis on partnership has been quite significant. And through our partnership program, we joined forces with a number of marquee names with an aim to drive innovation, customer centricity and paving the way for truly borderless & seamless collaboration. Some examples of these are the following

- Tata Communications is one of the launch partners for the new Microsoft Teams Direct Routing capability. Calling In Microsoft Teams can be delivered over Tata Communications' Tier-1 global network, helping enterprises worldwide offer their employees a reliable, high-quality user experience.
- We are working with the Singaporean TelcoTech platform company MyRepublic as it looks to expand its offering from home broadband to mobile services. The cloud-based Tata Communications MOVE™ platform helps MyRepublic become a mobile virtual network operator (MVNO) without having to make any capital investments in its own mobile network infrastructure or service management.
- NEP and Tata Communications together completed the remote production of VIVO Indian Premier League 2018 for Star Sports. VIVO IPL is one of the most sought-after sporting spectacles in the world, which means that there is simply no room for error. In a high-pressure environment like this, remote production, enabled by an ultra-low-latency video network, that we provide is having a truly transformational impact.
- Tata Communications and Primestream®, have joined forces to launch an enterprise-grade Media Asset Management (MAM) solution in the cloud. The new platform enables broadcasters, content owners and enterprises to capture, produce, manage and deliver media content on a global scale. A joint offering with Primestream unifies and simplifies Media Asset Management from capture to distribution, and helps meet audiences' insatiable appetite for new video content, and more powerful viewing experiences.

These are just a few examples of where we are working with partners to create services and expand the impact we are having globally.

Tata Communication platform is now embedded in some of the biggest enterprise ecosystems and this is driving partner led growth for us. This has now gone beyond our traditional connectivity services, to also include mobility, IOT and some hosting services. Some examples of these are:

- W-Locate plans to expand its operations to other Asian countries enabled by our MOVE platform and by IZO private cloud.

- Tata Communications is working with BlaBla Connect to offer seamless connectivity to BlaBla Connect OTT subscribers
- We are working with Hong-Kong based start-up Doki Technologies to support the company's expansion in the US and Canada, Europe, and Southeast Asia.

Moving on to what matters the most, Human Capital has always been a key pillar of Tata Communications foundation, and I am happy to state that we have been awarded as one of the 'Best Companies to Work For®' in Hong Kong, 2018, as per the Great Place to Work® Trust Index© and Culture Audit© 2017 - 2018. The company scored 93% in the overall trust index, demonstrating strength as an equal opportunities employer with inclusive workplace policies, a positive work culture, robust new-joiner on-boarding processes and a strong learning and development strategy for its employees.

We continue to display clear thought leadership and are at the forefront of several key emerging trends in the enterprise ecosystem, strengthening our portfolio and infrastructure to meet the demands of the hybrid network and cloud future. I am happy to state Frost & Sullivan recognized Tata Communications for its remarkable contribution to Enterprise Services at its 2018 India ICT Awards. Tata Communications bagged six awards in the Enterprise Telecom Services and Infrastructure categories.

Last quarter, I presented the company's vision for the next 3 years. We have been laying the foundation to achieve this vision and we are satisfied with the progress and we are confident that we are moving in the right direction. Looking ahead, we expect a pick up in the pace of growth in data business as industry environment improves, customer portfolio beefs up and the newer services begin to contribute meaningfully. Our eyes are set on delivering consistency of earnings, stronger EBITDA and better return ratios.

The transformation that we are going through internally is beginning to give us enhanced agility and efficiency and will accelerate the deployment of solutions and services that can be scaled up. We have successfully managed and incentivized both our teams and vendors in ways that put customer outcomes at the center of everything we do. We have moved away from building assets and have a sharp focus on leveraging technology ecosystems and on making the internet fit for business. Our focus as we move forward will be on being digital, bundling our services, driving our product penetration, reskilling our employees and rightsizing of our operations.

With that, I would like to invite Pratibha to discuss the financial highlights of the last quarter. Thank you.

Pratibha Advani: Thank you, Vinod. Good afternoon to all of you and thank you for taking the time out to be on our earnings call today.

I will start with some colour on the Consolidated numbers, consolidated revenues came in at Rs. 3,912 crore, down 2.4% QoQ and 9.2% YoY primarily due to decline in Voice business and as Vinod mentioned earlier, due to operator consolidation in India. Despite decline in revenue, EBITDA margins expanded; Consolidated EBITDA for the quarter came in at INR 555.4 Cr which was flat sequentially and showed a decline of 0.6% on YoY basis. Reported margins expanded by 30 BPS sequentially and 120 BPS YoY. We have faced headwinds this quarter due to challenging industry landscape. Despite the headwinds we have maintained our margins due to productivity initiatives that we have been working on for the last few quarters.

Other income was lower this quarter as Q4 had one-time interest on income tax refund of Rs.189 Crores. Finance Cost was high on YoY basis due to increase in net debt and average Libor movement from 1.21% in Q1 FY18 to 2.34% in Q1 FY19. On a QoQ basis, financing cost was flat despite an increase in LIBOR. PAT loss narrowed to INR 58.5 Cr. as compared to a loss of INR 121 Cr. in Q4 FY18.

Moving to segmental performance. Data business was steady despite industry headwinds. Quarterly Data revenue grew by 3.9% YoY and declined by 0.3% QoQ, the growth was impacted due to as I mentioned earlier operator consolidation in India and IndAS 115 Impact which Vinod had touched upon earlier. Data EBITDA grew by 3.1% YoY

and 0.4% QoQ on the back of cost efficiencies. Data EBITDA margin expanded by 10 BPS on a QoQ basis. We did get some FX benefit to revenue which was Rs. 35 crore and to EBITDA Rs 70 lakhs on QoQ basis.

Traditional Services revenue for the quarter came in at USD 291 Mn and witnessed a decline of 1.8% QoQ and 4.6% YoY. Revenue was impacted by operator consolidation, but witnessed a strong EBITDA margin of 30.8% for the quarter and expanded by 210 BPS on a YoY basis and 40 BPS on a QoQ basis on the back of sustained productivity initiatives.

Growth services revenue witnessed a YoY growth of 20.8%. Within this portfolio; IZO services grew by 188% and Media services grew by 44% YoY. Revenue declined by 8.5% QoQ. Change in treatment of one-time service revenue in accordance with IndAS 115 has impacted our data services portfolio including Growth Services. Going forward one-time service revenue will be recognised over the life of contract which is in the range of 3-5 years in case of Growth Services. EBITDA loss for Growth Services declined to USD 9.4 Mn as compared to USD 13.7 Mn loss in Q4. We will continue to see this trend of narrowing losses in coming quarter.

Through our Innovation services portfolio; we are pursuing many exciting opportunities such as MOVE, IoT, and NetFoundry. We are confident that a larger and significant contribution to the overall revenues will be realized from innovation services in the future, but in the interim, we will continue to invest in these businesses. Our operating metrics for Innovation Services are moving in the right direction and we have started to see revenue trickle in.

Moving on to the performance of subsidiaries, Transformation services revenues came in at Rs. 275 crores witnessing a growth of 1.8% YoY and a decline of 7.0% on QoQ basis. The decline in revenue is on account of impact of Tata Tele business operations. EBITDA for the quarter was Rs. 30.8 crores witnessing a decline of 17.3% YoY and 36.7% on QoQ basis. The decline in EBITDA is due to higher Provision for doubtful debts and normalisation of one-time gain in Q4 because of corrective maintenance, which is a cyclical trend. We have seen some strong wins this quarter both from India and outside. You will see this business bounce back in Q2.

Payment solutions business was affected due to consolidation of our ATM portfolio as we closed some of the less profitable ATMs. This is what has impacted our revenue in this quarter. Over the year we have shut down over 2600 ATM's. Marginal EBITDA loss this quarter was on the back of provision for doubtful debts of Rs 4.9 crores. We are seeing an improvement in cash supply and the average daily transactions in our Indicash portfolio have increased to 96 this quarter as compared to 89 in Q4

Voice business continues to decline, and we saw pressure on both volumes and realisations this quarter. Revenue for Voice business declined 7.8% QoQ and a steep decline of 33.0% YoY and came in at Rs. 1,027 crores. EBITDA margin expanded by 40 BPS due to cost optimisation initiatives.

Capex for this quarter was at USD 72.3 Mn, increase in capex was due to spend on expansion of India access network and investment in Bay of Bengal cable. We maintain our annual capex guidance of USD 250-275 Mn.

Net Debt at the end of this quarter came in at USD 1.27 Bn, an increase of USD 117 Mn over last quarter. The increase in debt is on account higher working capital movement due to ongoing change in our portfolio mix in favor of data services which now contribute 74% to our revenues as compared to 64% a year earlier and also because of higher CAPEX spend this quarter. This change in mix is putting pressure on our working capital. Additionally, we are seeing a delay in voice settlements from countries like Libya and Cameroon putting short term pressure on our working capital. You would recall that Voice is a negative working capital business. However, for countries like Libya, all FX transactions are being routed through their central bank and we have got a confirmation that these will be released in due course.

To conclude, Our EBITDA margin has expanded this quarter on the back of sustained productivity initiatives despite battling industry headwinds. The change in portfolio mix in favor of data services and the continued focus on productivity and digital transformation initiatives will continue to drive an improvement in our margin profile.

This brings to an end of the management commentary. And I would like to request the moderator to open the floor into questions and answers. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. Our first question is from the line of Amruta Pabalkar from Morgan Stanley. Please go ahead.

Amruta Pabalkar: Firstly, as you mentioned, that the revenue for the data segment overall, as well as growth services, got impacted due to the change in the revenue recognition. Can you give us some sense that like-to-like, had this change not happened, what could be the QoQ revenue growth for Data as well as Growth Services?

Pratibha Advani: Amruta, the trend that we get, if you look at the last couple of quarters was in the range of \$10 million to \$13 million. And this has got spread over almost 36 to 48-month period.

Amruta Pabalkar: So, is it fair to say that that had this accounting change not happened, we would have been in the similar growth trajectory of 6% to 8% Q-on-Q, mainly for the growth basket?

Pratibha Advani: Yes, that is right.

Amruta Pabalkar: Secondly, with this change do we still maintain the 35% annual growth rate for the growth basket in fiscal 2019, or you see some down side to it?

Pratibha Advani: Vinod did mention earlier that we are expecting the same growth rate, but obviously we do some adjustment for this IndAS impact. But hopefully we should see the same growth momentum, going forward.

Vinod Kumar: The underlying business, leaving the accounting impact, we will maintain the same growth rate as before.

Amruta Pabalkar: And then, coming to the Innovation basket, your KPIs are impressive. The growth in MOVE and IoT QoQ looks interesting. Do you have kind of a broad picture framework that we can think of from, say, next 12-month perspective, how do this translate into revenue? You have \$150 million mark for fiscal 2021. But in the interim how can we think of revenue growth and the overall investment over next 12 months and 24 months?

Vinod Kumar: I do not want to throw a number out on that, we will come back to you maybe in the next meeting. But we see that beginning to pick up a steady pace as the trials we are doing, and you have seen the operating metrics, they will start translating into increasing revenue in this quarter and going on every quarter. But at this point I am not going to put a number out yet, but it is a fair ask, we will give you some view on that next quarter.

Amruta Pabalkar: Just for some sense, is it fair to say that the EBITDA losses that this basket is generating, probably the sequential run rate, this would be a fair number to look at over next two quarters or three quarters? I mean, \$1 million of a loss in EBITDA? Just this basket or you think there could be an upside to it in the near term?

Pratibha Advani: Are you talking about the Innovation Services?

Amruta Pabalkar: Yes, just the Innovation basket.

Pratibha Advani: No. Actually, we are still investing in this portfolio, Amruta. So, I do not know where have you picked up the \$1 million EBITDA loss number, because if you look at Innovation, then it was \$13 million. The net revenue number is \$1 million, that was because we are doing POCs for the customer. And so there is a higher

direct cost than the revenue that we are getting. And that is why Vinod mentioned that the success of incremental revenue comes at the end of these POCs. And that's why we don't want to cut out our revenue at this point in time. But we would be, on a quarter-on-quarter basis, be investing \$12 million to \$13 million every quarter in this basket.

Vinod Kumar: And that's not different from what we said before this, to clarify, because we believe that these services are still in a build mode, and so we do need to make sure that we both create the right service and create the right channels to market.

Amruta Pabalkar: If I may just chip in one last question, you mentioned that the TCTSL segment was impacted due to operator consolidation. Do you think that this impact is behind us, or TTSL impact could potentially come through over next couple of months based on whatever clarity you have as of now?

Pratibha Advani: As of now, Amruta, we think we would see the impact until Q3, early Q4.

Amruta Pabalkar: And we had a number between \$70 million to \$80 million. Has that number come down or we are still pretty much there in terms of TTSL?

Pratibha Advani: It has come down. It has kind of almost halved. But we would see the trickle-down effect happening over the next few quarters.

Moderator: Thank you. The next question is from the line of Girish Raj from Quest Investment. Please go ahead.

Girish Raj: The first question is on the Traditional Services. The OPEX run rate has come down to \$143 million in first quarter. And the reason is productivity. Is this a sustainable number or is there anything else that we are not aware of?

Pratibha Advani: This should be a sustainable trend. As Vinod and I have been talking to all of you, we have put in productivity initiatives that are now starting to show. So, unless there is a one-off cable cart or an O&M cost, this really should be the trend, going forward.

Girish Raj: On the Growth front, with the new revenue run rate, because of the IndAS 115 impact, are we giving out any EBITDA target, as in when would we achieve this?

Pratibha Advani: Actually, Vinod mentioned in his commentary, we should start to see this loss coming down to half next quarter, and thereafter it should take a positive trajectory.

Girish Raj: On the OCI there is at Rs. 289 crore, and assuming remaining Rs. 30 crores to Rs. 40 crores is related to Sentient. What is the balance?

Pratibha Advani: Can I just come back to you on that answer?

Girish Raj: Okay, thank you.

Moderator: Thank you. The next question is from the line of Ritesh Gandhi from Discovery Capital. Please go ahead.

Ritesh Gandhi: It is a question on your growth in your innovative services. As per our estimates, you would have invested between OPEX, actually CAPEX, etc., over kind of at Rs. 2,000 crores - Rs. 2,500 crores in these two businesses. And this quarter we had losses at the EBITDA level of about Rs. 150 crores. So, what is giving us the confidence, sitting where you are, that this is a prudent allocation of capital, and that we will earn the required return ratios ultimately on this investment that we are making in these two areas?

Vinod Kumar: I said three things. One is, if we sat and only did traditional, we have become only marginally relevant to our customers in the future. So, to stay with what customers require and are buying, we have to make the shift. So, it is an existential point. And the second point is the addressable market size and the verification we have through both customer conversations and as well as with third-party review of our product portfolio strategy and so on the on the relevance and need that we are addressing in the market. So, we believe that there is considerable head room in the markets we have chosen for the Growth Services. So, that's the second point. And the third is the funnel that we have, the year-on-year growth in the funnel that we have seen, and on the closed order book which is under implementation. So, those are the three reasons that lead us to firmly believe that is the right place to allocate. It is not so much CAPEX as much as OPEX, because we are working hard to create a CAPEX asset-light portfolio around our Growth services. But we believe that, as these revenue picks up, we will start seeing the EBITDA improve, and then the return on the capital also show up.

Ritesh Gandhi: So, just take a follow-up on that, so is this an actually a defensive investment to actually protect our existing business? Or is it actually more of an offensive in terms of something that we are excited about the opportunity, and therefore are investing because we expect to earn adequately return on the capital we are kind of deploying here?

Vinod Kumar: I think it is both. It's probably more, if I had to chose one over the other to satisfy where you may be coming from, it is offensive where it is expanding. But if you look at a service like SDWAN, for example, over time, customers are going to require hybrid solutions, and that's where we have emphasized the theme on making the internet fit for business and leveraging the assets that we have created by building an overlay solution on top. And eventually even becoming access-agnostic and letting customers bring their own network. And hence, it is a migration from one service to the other that they need to also keep in mind in order to maintain the relevance. So, it is largely offensive and expansion of addressable market which we have shown you before on the market size doubling because of services like the compute and storage on the cloud, UC portfolio, our security services, and then SDWAN and the whole Internet-based VPN, I would say straddles both the defensive and offensive.

Ritesh Gandhi: The last question is that we heard extremely impressive plans for your business over the next few years. But what we have been observing over the last, because six to eight quarters is not really reflecting in your actual numbers or your financials. And so effectively how do we get comfort around the fact that your longer term projections and aspirations actually will get achieved, when will the near-term numbers will be achieved? And we are not really looking at this from a quarterly perspective, we are looking at it from an actually longer-term perspective, but still would like to see at least some degree of kind of confidence as we are seeing the contraption building. So, any idea on when we can actually just see this reflected in the actual financials?

Vinod Kumar: Yes, it's a very fair question. And to be frank, the reason why we came out and shared a three year view where we are going is, I think, if you look at the quarterly shifts or just look at the quarterly numbers, it is very difficult to call some of the transitions we are making from one service to another, one type of service to another, at the quarterly time blocks. Hence, we made the decision to actually say, this is where we are going, and we are confident we will get there, and we put a stake in the ground. So, yes, we look at it on a quarterly basis. You should look at it on a quarterly basis. But it's over a longer period that you would see the shift in the business mix. And historically we have proven that, right? We made the shift from voice to data, we made the shift from more traditional connect private-line data to VPN-based data. So, we believe we have the trend spotting ability and the execution ability to make the shift.

And I do not know, other than repeating myself again, how else to explain it. And that is why we have also started sharing operating metrics, talking about the funnel. And we have even given you an indication of where we will end up next quarter on growth services, to give you comfort. But what I would say, when we are making these shifts the quarterly length is a bit restrictive, which is why we have given you a three-year view. And I think when you look back year-on-year view at the end of the year, you will see Growth Services, as I answered Amruta, we will maintain the same growth rate that we did last year. You will see it turning positive.

And, I mean, we will have to build on that and pick up, and the incubation services will move from operating metrics and proof-of-concepts to revenue, and then to EBITDA positive. But what we really do not want to do is to bind ourselves too closely to achieving a quarterly number at any cost and sacrifice the future, especially given the validation we have from customers and from independent industry analysts, it would be foolish to throw away these services that we have created by not adequately investing in taking them to the customers that need them the most.

Pratibha Advani: Girish, if I can answer your question on other comprehensive income, we have a Rs. 302 crores on account of foreign currency translation reserve on account of revaluation of our assets and liabilities.

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

Aliasgar Shakir: I have a few quick questions. One is, you mentioned that the funnel is strong and particularly in the Growth segment. So, just wanted to generally understand typically what is the time we require from receiving an order to probably seeing revenue recognition? I understand that we saw some impact this quarter, particularly because of the change in accounting, but for a couple of quarters our funnel has been really strong. So, just wanted to understand what kind of revenue growth outlook it could entail and the amount of time it will take.

Vinod Kumar: I think on revenue growth outlook, I have already stated that a couple of times, that we would maintain the growth rate that we did last year. In terms of understanding the business itself, the close time for Growth Services is roughly the same say as our VPN kind of services, so take around 90 to 180 days to close an opportunity that has been identified, services can be a bit faster, because in Growth Services we have many services that make it up. But typically, I would say 90 to 180 days to close, but we factor that in when giving you the revenue growth projection.

Aliasgar Shakir: And a few quarters back, I think maybe about six to eight quarters back we were spending what we called a transformation cost to create a leaner structure and improve our cost efficiency. So, just wanted to understand what is the investment for that requirement in that context, OPEX investment, and how much we have done? Should we see some reduction in cost towards that?

Vinod Kumar: So, are you referring to our digital transformation?

Aliasgar Shakir: Yes.

Vinod Kumar: Okay. So, I think we have the number for this year. We are not spending at the rate that we called out earlier, \$20 million over each year for the five-year period. But Pratibha, what is our latest view on that?

Pratibha Advani: Vinod, we would be spending in the range of about \$10 million to \$15 million this year. And to answer your question on productivity, some of the benefits that you are see on productivity, we have already started to see these kick in.

Aliasgar Shakir: So, I think we are already in the second or third year of that investment, correct me if I am wrong. So, just want to understand will this cost continue, or we should see this reducing going forward?

Vinod Kumar: We will start seeing the costs will continue this year and into the middle of next year. But you will start seeing, if you look at our non-manpower OPEX and manpower to net revenue that is beginning to stabilize, you will start seeing an improvement of those ratios next year. But the investments will continue this year and into middle of next year.

Aliasgar Shakir: I am just confirming, are there any liabilities of TTSL, probably towards spectrum payment or anything else around the consumer business that was not taken by Bharti which may come on us? Or it may be probably dealt by Tata Sons?

Vinod Kumar: We will not be taking on when the deal gets done anything related to the consumer business or spectrum and so on. Our interest is only in the enterprise business and the fixed-line assets. So, we will not be taking those obligations. But in terms of timing, we are going through the final steps of getting the Board to approve it. And hoping that in the next three to four weeks we will be able to conclude that.

Aliasgar Shakir: And just last question on our debt and working capital. So, you mentioned that, for a couple of more quarters we may see the working capital impact because of the change in revenue mix. I just want to understand what is the optimum debt level related to that? We are at \$1.3 billion and should this go up because of the change in working capital requirements? And what is the level that we are looking at either in terms of absolute amount or in terms of the leverage ratio? Or should this come down once we see improvement in EBITDA?

Vinod Kumar: You'll see it come down with the improvement in EBITDA. But rather than pick a number, I would just say that, compared to Telecom industry norms, we are in very safe levels. We have never had any challenges whatsoever in raising debt or renewing debt or serving our debt. But that's not what we take comfort in we like it to reduce and we are seeing a slight hump right now, but it is not because of any recklessness, it is just a change in mix that we have to manage through, and we will overcome it.

Aliasgar Shakir: So, two quarters later, once the revenue mix is stabilized, we should start seeing this coming down?

Vinod Kumar: I would say two to three quarters, yes.

Moderator: Thank you. The next question is from the line of Sanjesh Jain from ICICI Securities. Please go ahead.

Sanjesh Jain: A couple of questions from my side first on the Enterprise segment, particularly from India perspective, have we seen any competitive intensity increasing as of now?

Vinod Kumar: Our answer is, no. It is the same players which are pretty much in the market. Even the consolidation, the players who exited are not ones that we typically would compete with in the large enterprise space. Maybe there is a little bit of pressure on pricing when it comes to our Wholesale services, but I do not think it is anything unusual that we have seen in the last two quarters.

Sanjesh Jain: I was referring to our Enterprise segment, because I can understand consolidation would have hit our service provider segment. But our Enterprise segment is also seeing decline in the growth, so we were growing in teens, now it has come down to 7.9% YoY basis. So, I was wondering there was a currency tailwind also built into it. So, what has like to the decline in our Enterprise revenue, any particular thing which is happening?

Vinod Kumar: No, nothing particular to call out. But on competition, there is nothing particular.

Pratibha Advani: Yes. The impact is because of IndAS.

Sanjesh Jain: Okay, so that is more from the enterprise perspective?

Pratibha Advani: That is right, because of the one-time Service revenue now gets amortized over the life of the contract.

Sanjesh Jain: Okay, to that extent, so your enterprise has hit but your Service provider had negligible service revenue?

Pratibha Advani: That is right.

Sanjesh Jain: Second, on the VPN services, our VPN services have also declined 1% YoY. Is our IZO cannibalizing our VPN, is that happening?

Vinod Kumar: No. That is not the main reason I would assign to it. As I said, there is a hybrid trend which we are seeing, but there is no cannibalization at this point.

Sanjesh Jain: These are complementary services, right?

Vinod Kumar: They're complementary. Otherwise, we may go into a new customer and go purely with IZO and cannibalize somebody else's traditional VPN solution. But we are not seeing that effect on our base yet.

Pratibha Advani: And again, the VPN services get impacted by IndAS.

Sanjesh Jain: The last one. On the CAPEX side, because we have seen the consolidation in Telecom, and I can understand your Tata Tele acquisition is three to four weeks away. And it may take some time to even consummate that. Do you see risk to your CAPEX guidance, assuming you need to roll out some more access network?

Vinod Kumar: No. We are maintaining our CAPEX guidance.

Sanjesh Jain: So, we are maintaining, so we are comfortable in that range that we should be able to meet our network requirement, as well?

Vinod Kumar: We will make sure we do.

Moderator: Thank you. The next question is from the line of Keshav Harlalka from BHA Securities. Please go ahead.

Keshav Harlalka: Sir, just wanting to know about the timeline for the de-merger of Hemisphere Property? From what we got from the AGM is that the certified copy of the NCLT approval for the de-merger was obtained on August 6th. If you could give us some sense on the timeline where we could get MCA approval, and finally we could see a record date for the de-merger of Hemisphere?

Vinod Kumar: I can't call exactly what MCA date, to be honest.

Keshav Harlalka: What is your estimate sir, approximately?

Vinod Kumar: Yes, MCA, I do not know, but I think by September, October, we should be able to conclude the de-merger is my prediction.

Keshav Harlalka: And I also want to know is there any impact because of RCOM, TTML and TTSL are no longer Telecom. Did we get any revenues corresponding quarter last year, why has there been such a steep decline in revenue vis-à-vis corresponding quarter last year? Can you comment on that, please?

Pratibha Advani: Year-on-year there has been close to a Rs. 40 crores - Rs. 45 crores impact in revenue.

Keshav Harlalka: Okay. So, is there a way we are going to make that up in some other way, or this is going to be the case for the rest of the year?

Pratibha Advani: I mean, we are going to see growth in our portfolio, so that's going to cover up some of the gap. But specifically any plans to bridge this gap, that is not possible since those businesses have shut down. So, I don't think we can.

Vinod Kumar: Yes. We are forecasting growth, and that will come from other accounts, not from these accounts.

Moderator: Thank you. The next question is from the line of Bharat Seth from Quest Investments. Please go ahead.

Bharat Seth: I would like to, I mean, on Traditional business what growth estimate that we are putting for the current year?

Pratibha Advani: We do not specifically give guidance.

Bharat Seth: Yes, but normally we used to say that it should grow around in 6% to 7%. So, any change in that number, or still we will stick to that number?

Pratibha Advani: No. I mean, given the challenge that we are seeing in the India landscape, that number will come marginally down. We anticipate the growth will more be in the range of 4% to 5%.

Bharat Seth: And since we have said the impact of this digital transformation, as we are seeing in our Traditional business, where would we like to put EBITDA, I mean for the full year?

Pratibha Advani: We would be comfortable with EBITDA margins in the range of 29% to 30%.

Bharat Seth: Vinod, on this Enterprise business we have been really a successful in India. So, what are the now initiatives that we have taken and what kind of results that we are seeing in the international market? And which are the international market that we are targeting for these Enterprise businesses?

Vinod Kumar: Firstly, we are focused on the US, UK, France, and Germany, Singapore, Hong Kong as the principal markets for our enterprise services. We are getting some traction through services like MOVE in markets, including Taiwan and Korea. So, we have some customers outside that, but those would be the principal areas of focus and where we are applying more resources. Another way to look at it is we now have a fairly good idea of where we get the most returns for our sales investment, and that is in customers that are between \$15 billion and \$35 billion in revenue. And we are therefore adopting what we call a “deeper with fewer strategy”, which is to focus on a smaller set of customers but be intensely committed to the service level we provide them. And through that increase the product penetration ratio, or cross-sell more services into the same account. And for our other customers, continue to maintain the relationship but manage it more through digital sales process, which is a big shift in our sales go-to-market model, which we have been implementing since the beginning of this year. And it will unfold and conclude in the next three to four quarters.

Bharat Seth: And second on these innovation, the direct cost sales gone up substantially because we are building up the business. So, can you give some kind of, what could be the direct cost run-rate going ahead for this current year, next three quarters?

Vinod Kumar: We will be maintaining and slightly increasing the spend we make on our Innovation Services, just like we did in the past with our Growth Services. They are still at the stage where they need investment, and we will continue to do that, again, because we have very good market validation that we are getting, as you can see from the operating metrics that we share.

Bharat Seth: And would like to share TCTSL growth and EBITDA for the full year?

Vinod Kumar: I would just say that TCTS has a strong order book which is under implementation. And it is an international order book. And therefore, we expect to see revenue growth, very respectable revenue growth, if I can call it that, and also margin expansion as the year unfolds.

Bharat Seth: And how confident we are taking this TCTSL growth for longer term in the coming years?

Vinod Kumar: TCTS?

Bharat Seth: Yes.

Vinod Kumar: We believe that the growth in TCTS can be quite strong based on the run rate what we have right now, and the run rate which we will exit this year. We believe that we can have strong growth. TCTS has strong growth prospects.

Bharat Seth: Basically, help us when improving the networking of the Telco? Is that correct, efficiency of the Telco network?

Vinod Kumar: Yes. I would not just say efficiency, we basically offer a range of managed services and operational improvement and engineering services for Telcos and other communication service providers, both traditional as well as some of the newer CSPs.

Bharat Seth: And how do we see the opportunity with rollout of 5G in TCTSL?

Vinod Kumar: As and when the 5G rollout begins to pick up speed, so would the opportunities for TCTS, because there will be two things that are required. One is more engineering services which are complex in the case of 5G, as well as migration of customers from one service platform to another, or one technology platform to another.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for closing comments.

Vinod Kumar: Thank you very much for your participation, and also the questions. I know that, from a quarterly perspective, the expectations can be a bit more than what we have delivered. But I can tell you, based on the underlying business and the focus of the entire Tata Communications team, and the review of our strategy, both by external experts and customer validation, we feel confident that we are allocating our capital and our OPEX to the right areas. And hence, we are maintaining some of the projections that we have made for the trend in terms of growth services, the EBITDA loss declining and then turning positive in the near term, in terms of the overall growth services momentum that we expect to demonstrate for this year over last year; and finally, in terms of return on capital employed from a medium to longer-term perspective. So, we seek your understanding at the granular level of our strategy, and your support and your comments and advice is always sought for and most welcome. Thank you, and I look forward to speaking with you in a few months with the next quarter's results.

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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