Tata Communications
Q2 & H1 FY2013 Earnings Conference Call
November 07, 2012 at 12.00 pm IST

Mahesh Pratap Singh: Good afternoon everyone, and welcome to the Tata Communications Limited conference call. We are joined today by Vinod Kumar, Group CEO and MD, Sanjay Baweja, Chief Financial Officer, and Srinivasa Addepalli, Chief Strategy Officer.

Our results for the quarter and half year ended September 30th 2012 were announced yesterday and the results presentation in available on our website. I hope you have had an opportunity to browse through the highlights of the performance. We shall commence today's call with key thoughts from Vinod Kumar, who will provide a strategic overview and update on the model. He will be followed by Sanjay Baweja, who will share the financial highlights during the review period. At the end of the management discussion, you will have an opportunity to get your queries addressed.

Before we get started, I would like to point out that some of the statements we may discuss on this conference call will be forward-looking in nature and must be viewed in conjunction with the risks and uncertainties we face. A detailed statement and explanation of these risks is included in our annual filings which can be found on our website, www.tatacommunications.com. The Company does not undertake to update these forward-looking statements publicly.

With that I would like to invite Vinod to share his view. Over to you, Vinod.

Vinod Kumar: Thanks, Mahesh. Good day, everyone, and a very warm welcome to our Q2 analyst call. For the next section, I will basically provide you a quick update on the strategic direction of the business, after which Sanjay will provide more details on the financials. If we look at our results in Q2 and in H1, you will find that Tata Communications is continuing to build significant momentum in the global telecom arena. We are consolidating our voice leadership and progressively strengthening our presence on the data side of the business as well.

I am pleased to share that TCL has delivered top-line growth on a yearly as well as sequential quarter basis in what actually continues to be a sluggish macroeconomic environment and an environment for business for both enterprises and carriers in India as well as elsewhere in the world. Our year-on-year revenue growth continues to be very healthy, as you can see, and is quite broad-based with all three of our segments (Global Voice, Global Data and the Start-up business) growing at encouraging rates, all of which are above what we see our industry peers doing, at least the comparable industry peers doing.

During the quarter, we have seen a temporary pause in the momentum we have shown in the profitability, especially given the trend over the last couple of quarters. This slowdown in momentum on profitability has largely been driven by some one-offs, exceptional items, and normalisation, coupled with the continued investments we have made, especially in product creation as well as in building our marketing and brand. Sanjay will talk about some of these in detail but I do want to emphasise here upfront that we are seeing no adverse change in the structural trends. We see no change in the direction of the business and we continue to make significant progress on multiple fronts and our long-term story and strategy remain intact. Having said that, we are cognisant of the work that we have ahead of us, in this quarter and subsequent quarters; the opportunity to grow to a global scale still beckons and we are building on the investments in capacity, infrastructure and technology, as well as the leadership team to deliver a global organisation that delivers value through partnerships with large global enterprises and helping them meet their communication needs.

If we look at segments, Global Voice Services or GVS delivered another quarter of growth; however, as you can see, pricing was a bit soft. The trend in ILD volumes is intact with total voice minutes at 13.2 billion minutes, which is where we have seen both quarter-on-quarter as well as year-on-year growth. The ILD part of that GVS business constitutes about 95% of the GVS gross revenues. The NLD component, which is quite marginal, lost some traction as some of our customers scaling back operationally due to the regulatory changes in India.

What continues to work for us in GVS is that we have maintained our mix of long-term contracts in the ILD business at 51%, helping us mitigate some of the volatility associated with traditional spot business. We have covered this in the previous call I believe, but happy to elaborate during the Q&A session. We are also making concerted efforts to improve the viability of our model by driving large strategic relationships and outsourcing partnerships. The market for wholesale voice is consolidating wherever large carriers are looking to outsource their ILD minutes and we stand to gain favourably when they do this, given that we are already the No.1 Wholesale International provider with nearly 1 out of 6 wholesale voice being carried by Tata Communications on our network, and we are the only telecom carrier, coupled with that, that has the full, wholly-owned subsea cable ring around the world in order to give the diversity that these large carriers are looking for when it comes to transport of their traffic. The quality of growth in GVS is also improving, as evidenced by a greater weightage of carriers who are routing their retail traffic directly to us. So instead of it coming through other intermediaries, we are able to get the retail traffic directly and this is happening both for the traditional carriers but also from the Cable Companies and the OTT players.

Moving to the GDS segment, we are continuing to make good progress and reporting healthy year-on-year growth, and if you compare this with what our global peers are showing in their results, we are definitely making headway. Within GDS, we are also making an impact with our Managed Services portfolio gaining more traction as well as the Network and VPN services delivering strong growth. I believe in the deck there is a chart that shows how our mix of services is evolving, which clearly shows how the Managed Services portfolio and the Network and VPN services are growing quite rapidly while the traditional services are seeing low growth, but growth nevertheless. While you will appreciate that we have a strong market presence domestically in India, we are very much in a development phase when it comes to international markets and what we are really doing is prioritising and focusing our marketing efforts and sales efforts on the Fortune 500, Forbes 2000 MNCs, and in India the ET 500 accounts, offering them bundled solutions that will help them transform their businesses and also helping them penetrate emerging markets since that is where they are seeing their growth. This strategy is playing out well. During the quarter, we gained significant MNC business with marquee wins, many of the largest customers that we target, and we have seen on a constant currency basis about 17% growth on a year-to-year basis, which is quite impressive given the macro environment that we are operating in.

To further supplement our focused growth in GDS and provide additional trust to some of our high-growth areas, we have recently created a Growth Ventures division within GDS. We have formed a division with its own leadership to drive the areas where we are seeing good opportunities for creating growth by incubating some of these businesses from an early stage and then helping them grow with a certain degree of autonomy within the overall Tata Communications framework. I will take this opportunity to inform you and also welcome Rangu Salgame to the team as the CEO of Growth Ventures. Rangu is quite a well known figure in the industry in India and around the world and has a track record working for many companies, both in developed as well as developing markets. Rangu joins the Global Management Committee (GMC) and will lead the Company's global high-growth businesses with an initial portfolio that includes our data centre business, our cloud activities, the security, media and entertainment portfolio.

Within the Data business I am very excited to share updates on the Managed Services side where I have mentioned we have seen growth, and in fact we have seen 26% year-on-year growth comparing Q2 of this fiscal year with Q2 of the prior year. The Managed Services portfolio, as you know, primarily includes our data centres, our cloud offerings, our ATM and payment services which is under the subsidiary company called Tata Communications Banking Infrastructure Limited (TCBIL). It also includes our Telepresence and Business Video services, our Audio and web conferencing services as well as our CDN offerings. These services are interesting to us and very important to us because they enable us to have longer partnerships with large enterprise customers. Typically the contract durations tend to be three to five years, against traditional network services, which are usually contracted on an annual basis, and the level of price erosion that these managed services are likely to be subject to tends to be lower than just the traditional network services. In our experience, we find that when the requirement is complex and the solutions give you an opportunity to engage with the clients in a way that is really about transforming their business, it is a multi-level relationship and then therefore the relationship becomes a stickier one and one that allows us to expand as the client's business evolves. And we are always on the lookout for these kinds of relationships and we track how we are doing in terms of how our sales are delivering these complex multi-product sales on a monthly basis.

We are also looking, as you know, at nurturing business verticals in media and entertainment as well as in the banking sector through our ATM management and outsourcing capabilities and therefore the definition of Managed Services keeps expanding. To give you an idea, in media and entertainment for example, we are moving beyond the broadcast sector, leveraging the relationships which we have with F1 and the experience we are getting in terms of technology and logistics to offer services for more sporting events and in more geographies. So these are examples of how we will continue to expand into adjacent areas, leveraging capabilities and assets that we have painstakingly put in place over the last several years.

Talking about TCBIL or the banking subsidiary, I am pleased with a lot of the progress they made in the last few quarters. During the last quarter, based on the ATM deployments, we have emerged as India's largest ATM services provider, after we won the contract for deploying and managing nearly 14,000 ATMs for public sector banks across three states (Tamil Nadu, West Bengal and Andhra Pradesh). So that business is showing good growth in terms of the market reach. Obviously there are investments that we have made and as the business scales, we will see TCBIL contributing more to our profitability.

Moving on and looking at other Managed Services, Business Video, which today includes the Telepresence services, which has been very well received by the market, is a segment or a product cluster that we are nurturing and we see considerable opportunity for us in the future. During the last quarter, we were recognised for being the Provider of the best Business Video service in the industry in the Asia Pacific region by Frost & Sullivan. And this is really something we are proud of because over the last two years we have grown our capability in the end-to-end managed video services, working with our network as well as with an extensive list of partners and competing with some of the largest telcos in the world and still holding our own and gaining share in this space. And the Frost & Sullivan award is a good indication and validation of the strategy that is being rolled out in this fast-moving but also much-desired service area for large enterprises.

Such industry-specific verticals also present additional growth opportunities for us and we continue to look for other verticals where we can leverage our network as well as our managed services capability and the client contacts we have. Beyond banking and financial services and media and entertainment, we are exploring opportunities currently in healthcare and education industries. Both of those are principally in India but once we create the model in India, we can take that elsewhere in the world as well.

Another aspect which pertains to both our service provider business as well as our enterprise business is what we are doing through partners, and we have a specific partnership initiative. A good example of what we are doing with partners is what we are doing for Nawras in Oman. Nawras is a subsidiary of QTel and they are the challenger to Oman Telecom, offering initially voice and mobile services, but we are helping them with on-the-ground resources to transform their business to offer enterprise services like MPLS, Ethernet, MVNO, but also helping them move from a consumer business to one that has a B2B orientation. And this kind of relationship is really a value exchange which is two-way because it helps the partner make the transformation using the expertise and experience, more importantly, that TCL brings to the table but at the same time, it includes them in our global network of partners, therefore when we terminate traffic into those countries from our MNC customers, we are assured of a more end-to-end service and a much better value proposition than many of our competitors can offer. Similarly, we are also working with SI partners in India as well as elsewhere to leverage their reach and by bundling our network services with their IT stack in order to offer more comprehensive solutions to customers. So partnerships are going to figure more and more prominently in our strategy and we are even creating specific groups that do this for a livelihood within the organisation.

One of the things which we have been contending with in the last several years as our service portfolio has grown and our capabilities have grown is getting our name recognised in the marketplace and getting customers to include Tata Communications in RFPs and finally choose us to provide service to them, especially outside India, and our brand recognition has been highlighted as something that we need to do more about. And as you know, we announced a deal with Formula1, largely to showcase our technology but equally to make sure our brand gets the prominence that is required on a global stage. The relationship with Formula1 has been progressing really well and both our talent and technology are getting great recognition from Formula1 management as well as the Formula1 ecosystem. There are many large players, not just the race teams but also other advertisers and sponsors who are involved and get to see what our technology is doing for the broadcast of Formula1, and in return we are also learning a lot about how to deploy technology in such a cutting edge environment where the requirements are extremely stringent. We are using it as a platform to showcase it to customers, to build relationship with customers, and it is definitely an increase in marketing spend which you can see in our cost profiles has gone up over the last year in terms of sales and marketing, but we believe that this is absolutely the right kind of spend for us in order to leverage what we have done in terms of building the network globally and creating the services.

Another showcase agreement, which we implemented over the last three to four months, which is a good example of how Tata Communications is penetrating a new set of MNC customers. We entered into an agreement and have delivered services, global MPLS services, to a company called Cargotec, which is a world-leading provider of cargo handling services, and we offer services to them providing connectivity on a turnkey basis to more than 150 sites globally. Cargotec is a company that has its headquarters in Finland, and I personally went to meet them and it was my first trip to the country there. And this is just one example of how we are getting recognised by MNCs, not only in the traditional markets but as we deploy services to the large banks and large IT companies and so on, we are getting recognised in other segments of the market and amongst the tier 2 MNCs also, who in turn are quite large. But this is just one example of many such things that are going on.

In the Data segment, I do want to point out though that enterprise CEOs are seeing the impact in their businesses of the macro environment and are adopting a cautious approach to their investment decisions. This slows down some of the decision making but our funnel has been growing quite well and we are really positioning our services to CIOs in the language of the times, which is really about cost optimisation, about rationalising their spend and, most importantly, about helping them transform their business. So we are seeing a silver lining in this opportunity – in the market, in spite of the market backdrop, that a lot of our propositions are now being viewed as attractive by customers who were not under the same pressures earlier.

In terms of profitability in the GDS segment, while we have had top-line growth and we are seeing the funnel growing and personally I see the value proposition getting more traction. In Q2 we had some impact on the profitability of our Data business. To put it in context, as we have discussed in the last quarter, we are investing heavily in marketing and building the front end, which is driving some costs up, but we believe that these are necessary investments, as I said, to leverage what we have already created. We have done the heavy lifting so far and we don't believe that this is the time for us to slow down in terms of leveraging what we have built. And the reason why we are making a slightly bold statement on this is we are seeing the traction with customers. Our sales funnel is up 86% on a year-to-year basis, and the conversion rate is beginning to pick up. The decision making is a bit slow now given the cautious nature of business people around the world, but we believe that this will turn. We are at a stage where most of our costs and investments are in and we should start seeing these sales convert into revenues and we should start growing our profitability back up to levels we have had in previous quarters and with time even increase beyond that.

Moving on to South Africa and to Neotel, Neotel continues to grow ahead of the industry. We believe, based on our estimates, we have gained about 1% share in the South African market in the first half of this year. In the last quarter, we talked about our focused efforts and investments in sales and marketing. These are continuing to be rolled out and our sales programmes are beginning to yield results in terms of some good wins recently, and Neotel has shown hefty revenue expansion in Q2, registering a strong sequential growth in what is otherwise a flat market in South Africa. What they have also done exceptionally well in Neotel is really cut back on operating costs. We have taken pretty much any fat that is in the cost structure out, and this has translated to growth in profitability with EBITDA now reaching 10.6% for the second quarter. This compares to, roughly 2% EBITDA for the same quarter in the last year. Cost optimisation has its limits obviously, we will continue to keep an eye on it but we believe that with the sales and marketing programmes that we have put in place, we will start seeing the top line also pick up more momentum in the coming quarters.

Neotel's value-promise to enterprise customers significantly leverages what we have in Tata Communications. We are the only provider in South Africa that has both strong international connectivity but also a very strong domestic fibre network which is truly state of the art, with extensive last-mile coverage, and Telkom South Africa is the only other player that has that. So in Neotel we see more opportunity and headroom to improve the performance and what we really need to do is focus on executing what we have built there. We have done a good job on the cost side; now we will ensure that what we have invested in terms of sales and marketing translates into results.

In conclusion, before I hand off to Sanjay, we have had strong top-line growth in the first half which I believe we can sustain in the second half; we will have an opportunity to improve our profitability profile during the second half of 2013. As I said, we believe we are making investments in the right areas. We are going to look at costs very carefully and keep squeezing out where it is possible and as quickly as we can do it. Net-net, the quarter was rough in terms of some of the numbers that you see but there were also many exceptions that we got hit with. We are in a good place as a business in terms of demand from both service providers as well as from enterprises. Our focus in enterprise is on emerging markets and managed services, it is the right thing. We are getting recognition, our funnel is growing and I believe that we have all the growth levers being exercised in order to make sure that the business keeps growing and progressing. And as I said earlier, our long-term growth outlook remains intact and we are optimistic for the Company.

So at this point I will hand off to Sanjay to give you a little bit more insight into the financials and then I will come back and take any questions along with Sanjay and Srini, to give you more clarity. Thank you.

Sanjay Baweja: Thank you, Vinod and a warm welcome to all of you. I will provide some color on the financial performance of the quarter under review and share the bigger picture that is shaping up.

Firstly, looking at H1, we have had a strong first half in revenue terms. Our consolidated H1 revenues stood at Rs 83,784 million, up 26% as compared to H1 revenues in previous fiscal, largely driven by strong growth momentum in core business. Core business has grown 28% compared to H1 in previous fiscal year while start-up business has grown 12%.On profitability, our consolidated H1 EBITDA stood at Rs 9,721 million, up 21% as compared to H1 in previous fiscal year. In EBITDA margin terms, H1 FY13 EBITDA margin are at 11.6%, 50 bps lower than H1 FY12 EBITDA margins. Core EBITDA is lower by 320 bps comparing H1 FY13 with H1 FY12, largely driven by investments we have been making in GDS in marketing and front end, especially in markets outside India. Compared to H1 in previous fiscal year, we have seen a strong profitability turn around in start-up. Last year in H1, start-up EBITDA was about -6% and this year H1, we are close to 12% EBITDA in start-up.

To list down Q2 financial highlights, our Gross Consolidated Revenues stood at Rs. 42,710 million, up 27% from the same quarter last year and up 4% from Q1 FY2013. Within that our Core Business Revenues were at Rs. 37,840 million, higher by 30% YoY and 4% QoQ. Contribution from both GVS and GDS supported this increase. The Start-Up business, which largely tracks the performance of Neotel, posted Revenues of Rs. 4,870 million, showing growth of 6% QoQ, fastest in last few quarters. Moving onto profitability, our Consolidated EBITDA was at Rs. 4,393 million compared to

Rs. 4,780 million in Q2 FY2012, and 5,328 million in Q1 FY2013. Talking about EBITDA margins, EBITDA margins during the quarter were 10.3%, dropping 270 bps sequentially.

Let me talk about some of the factors that have played out during the quarter, impacting profitability. There has been some upward revision in fees/charges from regulators in recent times and that is impacting our profitability. Specifically during the quarter, DoT increased ILD and NLD license fee rates w.e.f. 1st July, 2012 and that has had some impact. Other regulatory fee impact, when you look at year on year or H1 over previous H1 is that the Wireless Planning Commission (WPC) increased License fee and other fees for WiMax w.e.f. 1st April, 2012 and that is also a meaningful impact. We have also had one time actuarial loss on Canada pension fund, amounting to about Rs 185 million during the quarter. Further, In GVS, we have had unfavourable settlements during the quarter as compared to positive settlements we had seen in previous quarter. In addition to some of these one-offs and external factors our continued investments for future growth also impacts our profitability in near term. We are very confident that these investments will pay off in the coming quarters based on the pipeline build-up and underlying trends we are getting to see.

Considering some of the one-offs during the quarter, Q2 financial performance somewhat understates our operational performance and health of the business. H1 FY13 over H1 FY12 is a better reflection of steady state operational performance of the business where we have strong revenue growth and normalizing for some of one-offs and external environmental changes, stable to somewhat better margin profile.

Talking about segments, our global leadership in the wholesale voice market has sustained and we continue to build on that. We reported gross revenue growth of 34% YoY and 3% QoQ, while net revenues were up 20% y-o-y but down 11% q-o-q. During the quarter we have seen drop in NRPM, primarily driven by the unfavourable settlements I talked about earlier. We recorded total voice minutes, comprising of ILD & NLD of 15.3 bln mins in Q2 FY2013 as compared to 13.1 billion minutes we carried in Q2 FY2012 and 15.8 bn minutes that were seen in Q1 FY2013. Split of this quarter's volume between ILD and NLD was 13.2 bn minutes for ILD and 2.1 bn minutes for NLD. Our ILD volume has continued to grow as our network reaches more countries & carriers. Sequential drop in overall volume is entirely driven by NLD, which is a very small component in our GVS mix. NLD volumes were adversely impacted due to some of our customers scaling back operationally due to regulatory changes.

GVS profitability has been impacted due to unfavourable settlements during the quarter, along with one-off actuarial loss on Canadian pension fund. GVS delivered EBITDA margins at 6.1% in the quarter under review compared to growth that we had shown in the previous quarters. Q2 has seen a bit of normalization after last few strong quarters but there aren't any structural changes to the direction of the business. If you look at H1, GVS has registered 7.8% EBITDA, broadly in-line with steady state profitability we have been talking about for this business. If you take a fundamental look at the business we are looking at higher efficiencies on the trading aspect of the business which is still giving around 50% contribution, a greater share of longer time committed traffic contracts and our composition of our traffic mix, where the share of carriers routing retail traffic through our network is rising. So structurally we are seeing in fact a continuance of the trends we had seen in the previous quarters. We are quite confident that we will continue to manage GVS business for margin growth, returning to healthy and reasonably higher EBITDA margin number in the coming periods.

Moving onto Global Data, we showed Gross Revenues of Rs. 16,703 million, up 25% YoY and 5% QoQ. Global Data, EBITDA margins in Q2 FY2013 stood at 15.5% form 17.4% in the sequentially preceding quarter. This reflects incremental spends we have made towards leveraging the infrastructure we have built, higher spends on marketing and some one-offs such as Canada pension fund. As a Company we are looking at expanding into newer geographies, building new products & solutions and strengthening our business development efforts, particularly for building our enterprise customer base outside India and all of that has some impact on our immediate financial metrics. Like I said earlier, we are quite confident that these investments will pay off in the coming quarters based on the pipeline build-up and underlying trends we are witnessing. Our GDS sales funnel is up 86% compared to where we were a year back and we are hopeful that we will be able to translate this in revenues in coming quarters.

Our Start-up Business, chiefly Neotel, reported revenues of Rs. 4,870 million, showing an improvement of 6% on a sequential basis. You will recall we had talked about various sales programs and initiatives last quarter to accelerate growth in Neotel and we are quite pleased with the initial results. On profitability front, we have been able to sustain double digit EBITDA for second quarter in a row and this is the fifth consecutive quarter of Neotel's EBITDA level profitability. Our profitability turnaround is quite evident when you look at H1 FY12, where we had a negative start-up EBITDA of about Rs 500 million, to the current H1, H1 FY13, where we are at about Rs 1,100 million positive EBITDA. Speaking of Q2 FY13, on YoY basis, the Start-up Business has again had a significant upswing, from an EBITDA of Rs 93 million in Q2 FY2012 to Rs 516 million in Q2 FY2013.

Our Start-up business EBITDA margins stood at 10.6% in Q2 FY2013 as we are seeing graduated spends on building a stronger market present in an attractive marketplace. Over the past one year we have worked very hard to re-organise costs so that they are in line with our revenue growth. We have focused on productivity enhancements, rationalizing costs and realising value through greater outsourcing.

I would also briefly touch upon our capex program. As you will already know we are committing a limited amount of expenditure in the region of $250-300 million. For the first half, we have spent about $153 million in capex and are comfortable to close the year in the ball-park range we have talked about in past. As you may have heard us state, the majority of heavy-duty capex which was aimed at putting in place the fundamental pieces of our inter-connected & intelligent global network, is firmly behind us. The big-ticket investments which pertained to laying of undersea cables have been incurred and there will only be incremental spends on upgrading capacities on specific routes by making meagre investments in some components. The majority of these investments I have outlined are directed at our Data business. Our Voice business actually sees very meagre, maintenance capex by these standards. There is alignment of capex and demand and we make it a point to obtain maximal productivity from an existing asset before we invest in creating new ones. In Neotel the capex will be aimed at expanding our network and getting some last mile connectivity built in.

Coming to our key numbers in the balance sheet, our Core Net Debt for the period ended September 30, 2012 was at US$ 1,574 million from US$ 1,521 million on June 30, 2012 and our average cost of borrowing is about 5%. We are committed to bringing down our leverage and remain focused on free cash generation.

Looking ahead at the trends for the full-year we are pleased with the trajectory we are making with revenues. Profitability has seen a momentary pause during the quarter but like we highlighted we do not see any structural setbacks to our overall direction. We are seeing a very strong pipeline build up and continue to be confident about EBITDA expansion in coming quarters. This combined with our moderated capital spends should enable us to deliver free cash flows in the next few quarters. Tata Communications is on the path to full-profitability anchored by continued good business in Voice and growing scale in Data. Our technical capabilities rank amongst the best in the industry and we are beginning to see the benefits of the operating leverage on our infrastructure. Our sights are set on driving progressively better operating results going forth.

With that I conclude my opening remarks and I would request the operator on this call to open for questions and answers. Thank you.

Mahesh Pratap Singh: Operator, we can take the questions now.

Operator: Thank you. The question and answer session will be conducted electronically. If you would like to ask a question at this time, please press *1 on your telephone keypad. Please ensure the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has been answered, you may remove yourself from the queue by pressing *2. Again, please press *1 to ask a question. We will take our first question now today from Reena Verma Bhasin of Merrill Lynch. Please go ahead.

Reena Verma Bhasin: Yes, hi. Good afternoon and thank you very much for the call. I just have some fairly specific questions. Firstly, on the one-offs, we'd be very grateful if you can please quantify what the one-offs are and where in your cost line items do they rest. So if, Sanjay, you can please give me some colour on that, that would be very helpful, and I will follow up with more questions after that.

Sanjay Baweja: Basically, there are some things related to regulatory fee changes, which are included in our other costs. The build up of close to about $5 million, and I don't want to get into the specific elements of each one of them but that is…

Reena Verma Bhasin: Of regulatory impact?

Sanjay Baweja: Yes, that is the H1 impact, especially from a WPC perspective.

Reena Verma Bhasin: So the $5 million, all of it has been charged in Q2?

Sanjay Baweja: Q2 has about $3.5 million and the balance in Q1.

Reena Verma Bhasin: Okay, $3.5 million into 54; so about Rs. 190 million of regulatory hit?

Sanjay Baweja: Yes. Correct.

Reena Verma Bhasin: Okay, and the Canadian pension hit please?

Sanjay Baweja: That is 185 million rupees. We have mentioned that.

Reena Verma Bhasin: And that is again sitting only in the 2Q numbers?

Sanjay Baweja: Yes, that is specifically 2Q.

Reena Verma Bhasin: Okay, yes. And the other, you have two more of one-offs, you said you had four.

Sanjay Baweja: Yes, one is in the GVS which is the normal settlement which happens, and that settlement is an ongoing process. However, sometimes it gets positive and it was positive or favourable for us about $2.5 million in Q1, but in Q2 it became about $2.5 million negative. So the impact from a sequential perspective becomes close to $5 million.

Reena Verma Bhasin: Sorry, would you mind repeating that? I didn't get it.

Sanjay Baweja: Okay. So this is a normal settlement that you keep having with your vendors and customers on an ongoing basis quarter after quarter, month after month. It has so happened that the result of the settlement when we were accruing for revenue and costs, we had a positive $2.5 million in Q1 whereas when we were doing settlements and which we continue to do even now, we had a negative about $2.5 million based on the accruals that we were doing on a quarter-on-quarter basis. So the net impact on a sequential quarter basis became $5 million because $2.5 million positive in Q1, $2.5 million minus in Q2.

Reena Verma Bhasin: But if you're looking only at Q2 hit, it is 135 million rupee hit.

Sanjay Baweja: Yes, if you're looking only at the negative part, yes, but if you were to compare it with Q1 then you would face the double amount, yes.

Reena Verma Bhasin: Please pardon my persistence but you know, we just need to get these line items very clear. So settlement hits rests in which line item, in the network cost?

Sanjay Baweja: Some part will appear in the revenue and some part in the settlement in the network costs. It will get impacted at the gross margin level itself.

Reena Verma Bhasin: The WPC costs are in other operating costs?

Sanjay Baweja: Other operating costs, that is right.

Reena Verma Bhasin: Okay, so may I then ask you, if I make these adjustments in your 2Q numbers, you seem to have had a decline in cost line items almost across the board, indicating a very robust margin. Would that be a fair assessment?

Sanjay Baweja: The focus on cost has been there. The assessment that we will continue to focus is correct. To say that therefore this quarter our costs have been really low, I would not want to make that comment.

Reena Verma Bhasin: Okay, and just finally on this cost aspect, the other operating costs due to the charges, the regulatory charges, those are not really one-time, right? They are recurring because now they will remain at that level, or is there any element of one-off in those numbers?

Sanjay Baweja: This is recurring; however, we are taking steps to mitigate these costs and we believe that over the next 12 months, we will be able to reconstruct our network in a manner that we will let go off a lot of this, so these costs should not be a hit for us.

Reena Verma Bhasin: Sure. That is been incredibly helpful. Just on the net debt and interest side, please can you tell us what is the debt relating to the interest charge as reported in the P&L? You know, because the debt you give in your presentation is a core net debt number but the P&L interest doesn't reconcile with pure effective rate of 4.99% which you have shown in the presentation. So what is the base rate on which the interest is charged to the P&L?

Sanjay Baweja: Okay, so there is this Neotel debt and there is the core debt, $1.57 billion is my core debt, which is the debt in TCL; when I say 5% is my cost of debt that is what I am trying to say. So that is the core debt. The Neotel net debt is about ZAR 5.1 billion approximately, as we speak.

Reena Verma Bhasin: And the effective cost of that debt is?

Sanjay Baweja: They have a slightly higher cost and it is flexible, on their local market, but is close to about 11%.

Reena Verma Bhasin: Okay, and on the – just two more questions from me. One is on the TRAI recommendations on the cable landing stations, if Vinod can please help us understand what this means for the profit outlook for your Company please. The regulator, I believe has issued some recommendations or consultations they put on landing charges, cable landing charges.

Vinod Kumar: It is very early stages and I don't believe that there is any material cross connect charges at cable landing station these are such a small part of our revenues and you could argue that there may be international, there'll be more competition for the international capacity but frankly, the dependence on that part of the business is declining so it is not on my horizon or radar of major things that can affect our profitability.

Srinivasa Addepalli: Vinod, if I might add…

Vinod Kumar: Yes, Srini, go ahead. I was going to say Srini may have a comment on that.

Srinivasa Addepalli: Just to add to that, the process of consultation is still on, and many years ago the access facilitation charges were already determined to be cost-based, The access facilitation charges that we have provided and we charge are driven by our cost structure and not just our cost structure but the industry cost structure, each operator shares their cost details with the regulator and the charges are determined or the ceilings are determined. That is the process of consultation.

It doesn't have a material impact and since it is cost-based, it just reflects a basic return on the cost of operating that infrastructure. So we won't have any big loss of margin as a result of these changes.

Reena Verma Bhasin: Srini, thank you. It is nice to see someone having faith in the consistency of regulatory thought. But just finally, is there any thought at the overall Group level in terms of shifting businesses out of Tata Teleservices or into Tata Communications on the enterprise and fixed line side or have I missed the news here and something is already happened because I am not very sure whether I am updated on this aspect but if you could please offer some colour.

Vinod Kumar: I would say that we are working more synergistically with TTSL and been working on multiple areas over the last six months to a year, on two areas in particular. One is in terms of network, we are trying to see how we can leverage each other's resources to reduce the cost of running our network, so looking for synergies in NOC and field operations and areas like that which can be still done with us being two separate companies which is the way it will be for the foreseeable future. And that is one area where a lot of work has gone into it and you will see the effect of that in our operating cost structure. The second is in terms of go to market synergies, we have decided to focus our direct sales effort more on large enterprise and TTSL will focus on small and medium enterprises in order to be better aligned with the DNAs of the two respective organisations. So this has been ongoing now for the sales; the sales synergy programme took effect in September. And then the operation's is an on-going activity, we continue to look for ways in which we can manage our networks more effectively.

Reena Verma Bhasin: Vinod, thank you. So is there any move to kind of acquire the small enterprise and retail fixed side of the business? Is there any thought at all at your end?

Vinod Kumar: No.

Reena Verma Bhasin: Okay, thank you. That is it from me, thank you very much for the call.

Operator: Our next question comes from H.R. Gala of Quest Investment Advisors. Please go ahead.

H.R. Gala: Hi, thank you for a very elaborate presentation on the strategic direction in which you expect Company to move. Just two observations from my side. If you look at the consolidated business segment information given in the published results, the almost equivalent amount is lying in the other unallocable expenses; you see quarter-on-quarter or half year or even full year almost identical amount. That makes the task of actually working out the margin for different businesses a bit difficult. So what would these other unallocable expenses include?

Sanjay Baweja: Yes, this is some of the opex which is related to network, depreciation, etc. which is very difficult for us to cut it out into various cost.

H.R. Gala: But depreciation I believe would have been charged off, in the segment result when we give the numbers separately for each segment, I think that would be after depreciation but before interest.

Sanjay Baweja: We leave it at the EBITDA level.

H.R. Gala: So you mean other unallocable expenses include depreciation also?

Sanjay Baweja: That is right.

H.R. Gala: Okay. That was one observation. The second observation was how much will be the total capital expenditure in FY '13 and next few years?

Vinod Kumar: We expect, as we have indicated earlier, to remain in the $250-300 million range for our capital expenditure as well as other investments we will make. We have proven over the course of last year and this year that we are able to sustain our volume growth and maintain our revenue growth with that level of capex expenditure, which goes both into volume growth as well as also into select strategic expansions.

H.R. Gala: Okay, so this much volume we should expect almost every year? $250-300 million.

Vinod Kumar: That is right. Sanjay, do you want to add any colour to our capex spend this year?

Sanjay Baweja: Yes, this year we will stay within the ballpark $250-300 million cash, but capitalisation could be slightly higher. The cash spent could be on the lower side than the capitalisation.

H.R. Gala: Okay. Yes, but no what I was saying that going ahead, will it remain in the same magnitude?

Sanjay Baweja: Generally we don't make forward statements, but we expect that we will continue to maintain the percentage capex intensity at the same level. We will not go beyond the current levels, above, closer to 9-10%.

H.R. Gala: Okay, last question from my side: when do you see company as a whole at the PAT level turning black. Because still we are bleeding every year, of course we are not making cash losses, that is a great thing which we have achieved over the last few years, but in terms of the final PAT number, when do you think in terms of the years, the company can become a cash – I mean in black?

Vinod Kumar: That is definitely one we won't be giving a specific answer on but I think you will have to look at the trends and how the business is evolving and extrapolate that yourself. But I can tell you that internally, that is our single focus across the whole organisation.

H.R. Gala: But can we achieve it over the next say three to five years? Will that be your objective?

Vinod Kumar: That is safe period.

Sanjay Baweja: Just to add to what Vinod said and what you also mentioned, for example our cash profit, if you were to compare last year H1 to this year H1, we have gone up to Rs. 643 crore versus Rs.474 crore last year. So from a cash profit perspective, we are making big strides into improving the cash profits for the Company.

H.R. Gala: Yes, absolutely, that is correct. Any move has been on disposal of these surplus assets which keeps on coming in the papers? Any action the Company has taken to separate these out or all that?

Vinod Kumar: There is a lot of activity around it in order to move things forward, but I can't report any tangible progress that is made, that has been made in the last quarter. But the dialogue and the number of people who are having the dialogue has been on the increase this year, as regards by the cabinet note and the approval that the cabinet gave for the demerger. But some of the steps associated with it still need to be worked out and there are some details that are yet unresolved, so we are working on that.

H.R. Gala: Okay. Thank you very much and wish you all the best.

Vinod Kumar: Thank you very much.

Operator: Our next question comes from Naveen Kulkarni of Phillip Capital. Please go ahead.

Naveen Kulkarni: Yes, thanks for taking my questions. My first question is on the Global Voice Services business. So just for the impact of Canadian pension fund of Rs. 185 million and Rs. 130 million for the settlement, still we work out EBITDA margins in the range of 7.5% for the Voice Services business. So are we seeing incremental pressure on realisations in this business or how is the trend now in the market? And my second question is on the Global Data Services business. I see the margins in this business have come down significantly on a sequential basis as well as a year-over-year basis. So it is because of the investments that we are taking in this business and is it possible, how discretionary are these investment or spending's in nature and are we seeing tangible results, and what is the plan there and what kind of margins should we be looking for this year, if you could give us some kind of indications on that, that will be good.

Vinod Kumar: Yes, Sanjay, do you want to take the Voice question? I will answer the Data one.

Sanjay Baweja: Yes. From a NRPM perspective, we are maintaining levels above 0.42 cents per minute, and we believe that we are continuing to see that trend. This quarter, like I said, because of the settlement etc. there has been a small blip compared to last quarter but otherwise we have been steadily for the last three or four quarters maintaining the margins that we are getting. Just because somewhere the termination goes up or down, it then does not necessarily impact our net margin. Our net margins have been steady at just about the 0.4 cents on an aggregate level.

Vinod Kumar: Now on the Data business, yes, some of the spend you can argue is discretionary. Principally three areas we are investing in, one is around brand and marketing in order to create more awareness with the large MNC segment, especially outside India. And we are doing that through very focused customer engagement activities so we know that our marketing dollars are going to the customers with no spillage to those that we are not interested in.

Second area is in terms of increasing feet on the street and sales coverage and the supporting organisation like solution architects and sales engineers to design solutions in geographies; and in geographies, we have mainly done that in the US, Europe and Asia Pac. We may rebalance some of those within the regions but we still believe that is very necessary and as I said in my opening remarks, we have done the heavy lifting of building the network and creating the services. Now we need to get people to test it.

And then the third area is around building new services and we have identified again select areas around video collaboration, cloud and enablement of mobile broadband for mobile operators – as the areas where our investment needs to go. And in order to keep moving up the value stack and to move towards more margin-rich and longer-term contracts. So while yes, any of these can be throttled back if required, but that is not our current thinking and we will, our plan is to continue squeezing elsewhere in order to get operational efficiency but not back off on making these investments which we believe are important.

Naveen Kulkarni: I just have one more question on the Data Services. In the presentation we noted that the GDS sales funnel is up 86% on a YoY basis. So what is this indicating, as in how do we look at it in terms of visibility, in terms of revenues?

Vinod Kumar: We are not going to translate it into a number in terms of revenues because it is an overall funnel. I think the key thing, the main message in why we provided that data point this quarter and we will in subsequent quarters as well is to just demonstrate that the value proposition that we have for customers globally is the right one. If you look at our competitors on a global basis, people are posting flat quarter-on-quarter results; year-on-year growth even in data services of 1% or less, in some cases even a decline. And in spite of weakening demand, we have been able to gain customer attention which translates to growth in funnel, and then we should convert deals and sales and build revenue and so on. Hence when Sanjay made the remark, and I said it in my opening statement that based on this, we feel reasonably confident that the top-line growth in at least the second half of this year is sustainable.

Naveen Kulkarni: Just one query on this. How is the sales funnel measured, as in is it the number of contracts or is it in value terms?

Vinod Kumar: What we shared with you is total value.

Naveen Kulkarni: That answers my questions. Thanks.

Operator: Our final question comes from Srinivas Rao of Deutsche Bank.

Srinivas Rao: Thank you very much. I have a couple of questions. First can you throw some light as to Rangu has been appointed at the head of Growth Venture. What exactly is his brief? What is he going to do in the Company?

Vinod Kumar: Rangu is basically given a portfolio of businesses which we believe will be, one, are areas where we invest a fair bit for growth because we see us having a good platform to go into these new areas; and second is to keep on the lookout for opportunities where we can take our network and hosting and other cloud services and create industry-specific plays.

Today he is going to be looking at three things in particular. One is the data center business, we already have about 350,000 square feet of data center space in India, close to a million square feet of data center space globally, and we see a huge opportunity to scale in India. We are the number two player there now and we can see ourselves getting to the number one position if we act in a focused manner. So that'll be Rangu's major thrust as far as the data center business is concerned is to expand our footprint in India. At the same time, we have our cloud and hosting services that when looked at in the overall portfolio are relatively small and might not get the right level of senior management attention, so he will drive those themes to be sharper in their execution, especially in India and Asia Pac for cloud and hosting.

Our media and entertainment business has been getting good traction in the broadcast space, as I said, and with services like Video Connect that now many of the top sports broadcasters and event broadcasters are using. We want to expand that set of relationships or expand the services we offer to those customers and therefore we are taking those resources which are distributed across the organisation and putting it into one business unit under Rangu. And similarly on the drawing board, we have an initiative which we have been working on related to offering services to healthcare providers in the Indian market. That is another one which needs a little bit of handholding; it is still at a product and service conceptualisation stage. So these are three that are clearly identified and selectively we will add others as we move forward.

Srinivas Rao: Thanks Vinod. The second question is on your organisation structure. You mentioned about increasing the feet on the street. You put out a slide which gives out the headcount by function. The question is you have 60% in engineering and operations, another 20% in sales and marketing, so should we expect this pie to change, number one; and from our perspective, does it mean that employee cost as a percentage of sales would increase or decrease? And I am talking of a horizon of about a year plus, so not quarterly.

Vinod Kumar: A lot of people in operations and especially operations are customer-facing, you have service delivery people in the service operations centre, people in service management. It doesn't mean that if you are not showing up in sales, marketing and account management, you are not market-facing, right. So we should probably show it slightly differently because we don't want to rush to that conclusion because it is quite the opposite. We want to invest heavily in creating new services and in fact, in product management and many of our traditional areas, we are skimming down and moving resources into our big bets and into the new service areas, our innovation bucket. Similarly in operations, we are moving people, because of more automation and more process deployment, the people who are doing mundane activities or routine activities will decline and have been declining over a period of time but we are increasing the number of people who can serve customers through their entire lifecycle, who actually interact with customers. In fact you can argue that some parts of operations have more interaction with customers on a day-to-day basis than the account manager, but we need all of them to offer the full experience end to end.

To answer your question on costs going down, we are being extremely careful with employee costs. What I can say is probably next year our costs, our manpower costs will increase year-on-year basis less than this year's increase over last year.

Srinivas Rao: Fair enough. Third question is on your Data, and I refer to your Core business, Global Data. What we notice is EBITDA has been generally trending down over the last practically five quarters, starting second quarter of last year actually when it peaked. So where do we see this trending and what are the level of Data EBITDA we should think about, and just Data, I am assuming doesn't have a kind of seasonality so if you can throw some light on that. I mean, you were at a level of Rs. 340 crore on a quarterly basis and now it is about Rs. 260-270 crore. So that is what I am kind of trying to understand, what level of Data EBITDA should we think about.

Vinod Kumar: The Data EBITDA, we have had some pressure on it but as I have explained earlier, because of deliberate investments we are making. Some of these investments haven't quite produced the return yet and not that we are behind plan in terms of that; we would obviously like it to be faster. But it takes time, for example for the big step up we made in marketing and brand to translate into top line, and that doesn't mean we can stop now. Similarly, the feet on the street and the product services that we are creating have a little bit of runway before they can translate. I expect that the trend will reverse and we should be able to get back to the H1 FY12 levels. I am not going to give you a guidance on it but we are very much aware of what is driving the EBITDA down in Data. We are in some cases addressing it by trying to take some cost out but where we are investing, we will stick with it because they have been carefully chosen as the right areas to put money behind.

Srinivas Rao: So on the same note, what we notice again on a five-quarter basis, while your gross revenues in Data have continued to move up in kind of a higher plane, the net revenue number is at the largely flattish Rs. 1200 crore per quarter. It is more than 1,280 crore. And basically your interconnect has essentially, which is what I think is the difference between gross and net, has dramatically increased, so your interconnect payouts. So is this because of a change in your product mix or any change in your customer mix? Why has the interconnect gone up so dramatically?

Vinod Kumar: The core Data business still hasn't changed that much. There is some increase in licence fees, they have gone up from 6% to 7%, that has a small impact. But the biggest factor contributing to the direct costs which is keeping net revenue flat right now is our banking business. As we deploy more ATMs, there is a fixed cost that we incur per ATM, whereas the transactions, which are on the basis which we get paid, ramp up over time. So our TCBIL business and the number of ATMs we have deployed have significant growth on a year-to-year basis, but the ATMs take about six months before the transaction volumes get to the desired or expected level where we start seeing the return. Depending on the contract, we expect 150-200 transactions per ATM but it doesn't happen on day one when you deploy it, but the costs of putting that ATM there hit you from day one. That is the biggest difference between last year and this year as far as Data is concerned.

Srinivas Rao: Okay, so that difference, would it show up as a difference between gross and net revenues?

Vinod Kumar: That is where it will show up, yes.

Sanjay Baweja: Just to elaborate a little more, what happens in an ATM is firstly we take most of our ATMs on operating lease. The entire lease amount gets into that mode as direct costs, and therefore it starts from the day we start deploying an ATM. If you have noticed and we have been saying this over the two to three quarters, we have really deployed a lot more ATMs and the transactions, like Vinod said, are going to take some time whereas the full operating cost in terms of a full lease value, the per months lease value has started coming into it. So that goes into the direct costs. So that is the big factor as far as the net revenue going downward or being a straight line.

Srinivas Rao: Okay, just to clarify, you get paid in that business as a function of the number of transactions of an ATM?

Sanjay Baweja: Correct.

Srinivas Rao: So the revenue model is based on the number of transactions per ATM?

Sanjay Baweja: That is right.

Srinivas Rao: In your capex guidance, you mentioned you have spent about $153 million for first half so you reaffirm your capex for the full year, which I think is about, $220-230 million. Is that right?

Sanjay Baweja: We have given the ballpark number of $250-300 million, we reaffirm that we will be within that.

Srinivas Rao: DoCoMo, we have news reports indicate that DoCoMo has not exercised the call option it had to increase its stake in Tata Teleservices. Do you have any formal communication from DoCoMo on that count? I mean you were one of the selling shareholders when the initial transfer was brought by them.

Vinod Kumar: No, the communication will not be to us. It will be to TTSL and frankly, we can't comment on that.

Srinivas Rao: So I mean, so you don't have any formal communication from DoCoMo on that count. You as in Tata Communications.

Vinod Kumar: No.

Srinivas Rao: Okay, one final question then. Neotel, maybe I missed it but what is your current level of debt in Neotel, which I think Reena also asked that. It obviously doesn't show up in your presentation.

Sanjay Baweja: Yes, it is about ZAR 5.1 billion.

Srinivas Rao: ZAR 5.1 billion in Neotel? But that is fully consolidated, right?

Sanjay Baweja: Yes. ZAR to dollar is about 8.9 so it comes to about $500 million.

Srinivas Rao: And this debt has recourse to Tata Communications, right?

Sanjay Baweja: No.

Srinivas Rao: Okay, so there's no recourse with respect to Tata Communications, the Company has not guaranteed any interest payments or debt repayments on this debt.

Sanjay Baweja: That is right.

Srinivas Rao: One final question. I recollect that there were some debt covenants which you had disclosed in last year's annual report obviously, and there are a couple of covenants and you were closer to some of the debt covenants at that point of time. Are you closer to any of the debt covenants with respect to net debt to EBITDA or interest coverage ratio or so on and so forth at the current stage? And a related question is you mentioned that you would like to be FCF positive. I mean, at least based on your current capex guidance, FY13 definitely looks unlikely. So when you say FCF positive, are you indicating more in the FY14 timeframe?

Sanjay Baweja: So let me confirm that as far as the covenants are concerned, we will be okay at the end of this year for our covenants. And FCF positive, if you noticed, we have increased our cash profits and as far as our numbers go, we are likely to be FCF positive this year also.

Srinivas Rao: Not after capex, right?

Sanjay Baweja: FCF will need to be after capex.

Srinivas Rao: Yes, okay. Fair enough. Just one final question, on the land issue I know you mentioned that there has been no progress this quarter, so would that mean that the talk of an SPV being formed, so has that been formed or it has not yet been formed or legally registered? If you could throw some light on where the process is at this stage.

Sanjay Baweja: The SPV has always been there. The public notification or the media reports suggested that the government wanted to have part of the shares of that, and that is where it is.

Srinivas Rao: Vinod, you wanted to add something to that?

Vinod Kumar: No, I think that is where it is. There are some modalities which are being worked on but it is not the entity formation which is the challenge.

Srinivas Rao: Okay, it is more the taxation impact is what we have been told up until now.

Sanjay Baweja: Yes.

Srinivas Rao: Okay. Fair enough. That is all from my side, thanks.

Operator: Thank you, ladies and gentlemen, that was the last question. I would like to hand the floor to Mr. Vinod Kumar for closing comments.

Vinod Kumar: Thank you very much for your questions. It is been a pleasure to interact with you over this call. On behalf of Sanjay, Srini and the rest of my team, we thank you for taking the time out and engaging with us today. We sincerely value your interest and support for Tata Communications. If there are any questions or doubts or clarifications that you need addressed, please do not hesitate to reach our Investor Relations desk and we will promptly get those answers to you. Thank you very much and look forward to speaking to you at our next call next quarter. Thank you.

Operator: Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.
