## **TATA COMMUNICATIONS**



## **Q2 FY2017**

## **Earnings Conference Call Transcript**

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## **MAIN SPEAKER:**

**Vinod Kumar, Managing Director and Group CEO** 

Pratibha K. Advani, Chief Financial Officer

Vipul Garg: Thank you. Good afternoon, everyone, and welcome to the Tata Communications Limited Conference Call. We are joined today by Vinod Kumar, our MD and Group CEO and Pratibha Advani, Chief Financial Officer.

Our results for the guarter and half year ended September 30, 2016, were announced yesterday and the investor fact sheet is available on our website. I hope you had an opportunity to browse through the highlights of the performance.

We shall commence today's call with key thoughts from Vinod, who will provide you an update on the market environment and strategic direction of the company. He will be followed by Pratibha, who will share the financial highlights during the review period. At the end of the management remarks, you will have an opportunity to get your queries addressed.

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

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

Vinod Kumar Thank you, Vipul. Good afternoon, everyone, and a very warm welcome to all of you. I will start by sharing my perspective on our strategic direction and then also provide you an overview of our performance before Pratibha gives you more details.

Globally, we are seeing big opportunities in addressing the growing demand for solutions to support enterprises' digital transformation. Increasingly, we are seeing that enterprises want service providers to deliver rapidly expanding list of services such as cloud, managed securities, unified communications, collaboration, we speak about the UCC and so on. And the more integrated these solutions are and more seamlessly they are packaged together, the better from a customer's perspective.

The growth in new enterprise services is quite phenomenal. Between 2013 and 2018, Cisco expects that cloud IP traffic will grow by one-third, with many service providers seeing double-digit revenue growth from cloud services. Further, Infonet's research estimates the VOIP and UCC services will be an \$88 billion market by 2018. Looking at these numbers, it is very easy to say why this renewed emphasis in the telecom industry on serving enterprise customers. And it is just not from the telecom players alone, it is from both telecos as well as IT industry players and to fairly crowded market place given the size of the opportunities that is being pursued.

These services add complexity to the operations of enterprises, while also adding risk in terms of service development and on staying on top of enterprise demand when viewed from a telco perspective. Through innovation, collaboration and extensive partnering, we at Tata Communications have been able to and continue to co-create products critical to serve the fastemerging needs of both our customers and our partners. We are very mindful of also creating partnerships that keep us relevant as the industry line shifts and blurs. You would be seeing many announcements from us in the partnership space across many services and you can see how



active we are as we create the partnerships to co-create services but also create new channels to market.

We are seeing exciting opportunities in the cross-border mobility, in the IoT or Internet of Things, managed securities, cloud and artificial intelligence domain. We are quietly investing in new products and capabilities and our growth services portfolio is growing at a robust pace. And going forward it will be a meaningful part of the overall revenue mix of the company.

Over the next few months, I would say next six months you will also see us make some bold moves into the IoT and cross border mobility space, this is something I had hinted at on previous occasions and I am quite energized by the activities that is going on internally and with value propositions that we are creating and with the execution focus that my team is bringing to these new services that we would be announcing soon.

Moving on, capital intensity has become an issue in the global telecom industry. Most companies approach the capital intensity challenge solely through the lens efficiency by trying to squeeze as many projects as possible into a restrained or restricted capital envelope. We believe capital intensity should be viewed both through lens of efficiency but actually more importantly through lens of effectiveness. What we mean by that is we need to look at how you can surpass competition at the lowest possible cost. It is easier said than done, it requires several years of taking market share from competitors without excessive spending it. But at Tata Communications we are progressively getting there as you can see. Therefore, and thereby building an engine for improving shareholder returns.

The biggest initiative for us in this area are shifting towards a software base network architecture, a program that we are quite actively working on and you will see further announcements. And by revamping our IT systems and the processes that go around in the IT systems.

The next dimension I would like to talk about is on alliances and partnerships. Alliances and partnerships help bring a variety of requisite capabilities and reduce time to market. An example of this is how at Tata Communications we partnered with Sky Labs, a Singapore based technology solutions provider to unlock the potential of the Internet of Things capability for enterprise customers. As IoT starts to become reality, real-time assimilation and analytics of the data that comes from the sensors and devices requires a reliable network and it requires access to cloud platform that need to be highly secure, highly scalable and extremely flexible.

The IZO cloud enablement platform that has been a pioneer in Tata Communication harnesses our technology partnerships, leverages the core underlying network and our datacenter infrastructure, all of this has made us the perfect partner to help Sky Labs and their customers accelerate the organization wide digital transformation.

Another key element is the talent transformation that is taking place in Tata Communication. One, I would like to specifically call out and that was in the news, we recently roped in James Parker as our Global Sales Chief. James will be responsible for leading the Company's global sales organization across all customer segments. In the past, we had three different leaders managing each of the segment, we believe time has come for us to take a more holistic view and manage all segments under one leadership. James brings proven leadership and a wealth of industry knowledge and expertise from his 25 years in the industry. He has experience both in telecos as well as in the cloud infrastructure services as well as in the enterprise application space. He has



an impressive track record in driving business transformation in both the software and telecom industries and both in developed markets as well as in emerging markets.

From James' perspective, the priorities that he is working on; are to revamp our go-to-market model and to centralize our support resources. On one hand this will help us widen our market reach, because we would redeploy our resources to where we are seeing the most traction and the highest action in terms of opportunity. And on the other hand, by centralizing the support resources we expect to improve cost productivity. We believe we can create more headroom for growth using the organization that we have and minimize the headcount addition in the coming years.

We are hitting the right milestone at the right time and our strategic transactions, many of which you have visibility are materializing as per plan. To elaborate on that, in October we completed the India data center joint venture transaction with ST Telemedia. And by end of this year we expect to conclude the Singapore leg of that transaction. We have been working very closely with ST Telemedia to identify areas for business integration, to enhance customer service and to realize the full potential of the business partnership in the data center space as well as beyond. Both partners, STT and us are very committed to ensuring a smooth transition for existing customers and for the employees of Tata Communication in India and Singapore. This will have some optical impact at the EBITDA level, which Pratibha will explain. But you will clearly see the benefits at the operating PBT level and a reduction in net debt as a result of this transaction.

The Neotel hived off to Liquid Telecom is also moving on schedule. We just received some news over the last 24 hours from ICASA as the Telecom Regulator in South Africa that they will now not be requiring a tribunal hearing. This is good news for us, there were no objections from any of our competitors in the market. As you know, we already have the competition commission approval, now with this avoidance of the tribunal process we should be able to move forward the approval from the telecom regulator, ICASA as well at a faster pace.

Deleveraging continues to be a key focus area for us. And I do want to emphasize on this. And with this transition that I had called out, we are already moving towards the leaner balance sheet structure and we will continue to do more on this front. The business is generating healthy cash flows and they would definitely be further deleveraging in due course. We remain committed to growth and we will keep on investing into profitable opportunities to remain at the forefront of the technology curve. While we are deleveraging and looking at hiving off things which are non-core, it is critical that we keep the strength of our portfolio going and we create opportunities for us to create new ways of growth and create new inflections for our performance in the market.

Moving on, the demerger of the surplus land is on track. We are working with the shareholders in the scheme of demerger and we are hopeful that this process will be completed soon. I know there will be a question on your mind, I cannot put a specific date on it, but I can assure you that as a company and as a shareholder and the board, this is high on our agenda and we are working on it very hard and diligently.

Coming to performance. During H1 we advanced our financial towards the financial and strategic objectives. We are pleased with the continued momentum in our data services portfolio. H1 data revenues were up 13.5% year-on-year while H1 data EBITDA was up 34% year-on-year. We continue to generate healthy cash flows. H1 free cash flow for the core business, the business consolidated minus Neotel's was up by 67% year-on-year at Rs. 794 crore. Traditional services



continue to grow, outpacing the market while the share of growth services in the overall enterprise is growing based on the collaborative approach that we have outlined. This 12.5% in September 2015 and we have reached 13% in September 2016.

Our expectation, as your expectation also is that the growth services will grow even faster. I can tell you that the funnel here is strong. The response we are getting across the portfolio, across our UCC services, across hosting, security and so on from the market is extremely strong. We continue to invest and we will be bold in creating more capabilities and we are very confident that our growth services portfolio will actually start accelerating as the orders that we have converted into revenue and as the usage of services begins to ramp up and the customers who have already started availing of our services.

Moving on to the voice business. Our productivity initiatives coupled with stability in volumes is leading to the improvement in voice EBITDA with a quarter-on-quarter improvement of 10 bps in margin. The transmission services for TCTS margin was down on account of large rebadging deal that we did and a portfolio shift, a deliberate portfolio shift I should say towards domestic business in India. And this is more of a medium-term phenomenon and as we scale the main business with more international deals, the margin for TCTS will expand. I am pleased to add that we are seeing very strong funnel for TCTS and also we are creating greater depth in our practice areas by investing in this business because overtime we want this to be a business which is less head count based revenue and more IP or Intellectual Property based revenue model.

Looking ahead from our perspective, in terms of size and the countries that we play in. We are not actually seeing that much impact of economic volatility. And this is because we do really believe, and we are witnessing this on a daily basis that the digital revolution is real, that companies are embracing the change and we expect to continue seeing strong demand from our customers for services across the portfolio. Our focus remains to target enterprise in all our key markets. We will continue to move more resources to that state and towards partnerships. We want our enterprise customers and our partners to think of Tata Communications when they want world-class network compute and storage services. Our product strategy is really to combine network computer storage and security into a seamless offering so that our customers do not have to worry about adding these resources as and when their business moves. This is not a simple vision to execute and pull off, but this is really what is underlying all our actions and activities and enhancements that we make through our services and our underlying IT infrastructure.

The combination of traditional services and growth services that we provide under one roof has given us a push for our growth and we believe we continue to be a key driver for our growth and a key element of our strategy. As we embark on the next leg of our growth, we will witness a corresponding expansion in the scale of our operations and data which will contribute to a continued improvement in earnings and in ROC performance. I can assure that the deleveraging activity and the ROC focus remains very strong and top of agenda for my entire leadership team and especially for Pratibha and myself.

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

Pratibha Advani: Thank you, Vinod. And a good evening to everyone participating in today's call. I will commence by highlighting the financial achievements during the guarter and the first half of the year. I trust you had an opportunity to look at our detailed earnings factsheet which we have



revamped. And hence, during my remarks I am going to talk more on key financial trends and reemphasize linkage to our growth strategy that Vinod has just articulated for all of us.

We are seeing a continuation of positive trends in the consolidated performance. Q2 FY17 revenues grew by 1.2% quarter-on-quarter on the back of growth in our data services portfolio which has witnessed sustained sequential growth over last six quarters. On a YonY basis revenues declined marginally due to slowdown in project revenue in Neotel.

Q2 FY17's consolidated EBITDA at Rs. 868 crore grew 0.6% seguentially. While margins were flat due to timing of some expenses and lower margins in our transformation services that Vinod just mentioned, and also payment solutions business on account of provision for bad debts. YonY EBITDA growth was 7.5% with 140 basis points improvement on the back of significant margin expansion in the data services portfolio.

In the first half of FY17, our consolidated EBITDA margins improved by 220 basis points on a year-on-year basis. Consolidated profit after tax for Q2 FY17 was Rs. 40 crore. This was after an impairment of Rs. 125 crore towards Neotel investment. If we adjust one-off items in both the quarters, since in the last quarter also we had an impairment, our consolidated profit after tax will be Rs. 165 crore, which is a growth of 23.3% quarter-on-quarter.

Coming to the core business performance, which as Vinod mentioned is consolidated minus Neotel, our revenues increased by 1.3% quarter-on-quarter sequentially and YonY our growth was 0.7%. In the first half of FY17, revenues grew by 1.3% year-on-year, growth in revenues was driven by strong performance of data business despite a year-on-year decline of 14.3% in our volumes business. Core EBITDA in first half of the year improved by 20.3% year-on-year at INR Rs. 1,565 crore with a margin improvement of Rs. 264 basis points during the same period. Similarly, core EBITDA in Q2 FY17 increased by 10.7% on a year-on-year basis at INR 779 crore, while on a quarter-on-quarter basis the EBITDA was marginally lower. PAT for the quarter came in at Rs. 28 crore after accounting for the Rs. 125 crore of Neotel impairment.

The operational momentum of the overall business is favorable. And as mentioned by Vinod, we generated healthy free cash flows of Rs. 794 crore for core business in H1, witnessing a 67% growth on a year-on-year basis. This number is derived by subtracting CAPEX from EBITDA. I would also like to add that we generated free cash flows of Rs. 257 crore in H2 after accounting for interest cost, tax and CAPEX, a growth of 49% over Q1. I am pleased to share that we are generating positive free cash flow after working capital changes. And for the first half of the year we have generated free cash flow of Rs. 125 crore after these adjustments.

The data business has witnessed strong momentum in the first half of the year wherein data revenues grew by 13.5% while the EBITDA growth was 34% on a year-on-year basis. But margin expansion by 350 basis points during the same period. Quarter two FY17 data revenue grew by 12.7% on a year-on-year basis and 2.6% on a quarter-on-quarter basis sequentially.

Q2 FY17 EBITDA grew 26.8% on a year-on-year basis and on a quarter-on-quarter basis the EBITDA declined marginally due to lower margins in the transformation services and payment solution services and timing of some of our expense, for example, marketing.

The traditional services portfolio continues to perform well and the growth services are beginning to get meaningful. Traditional services quarter two FY17 revenue grew by 7% and EBITDA grew



by 18% on a year-on-year basis. On a quarter-on-quarter basis, revenue grew by 2.6%. The margins in traditional business continue to be upwards of 30%.

In growth services, Q2 FY17 revenues grew by 13% on a YoY basis and 3.1% on a quarter-onquarter basis. Transformation services have witnessed some margin pressure on a count of scaling up of business and shift of revenue mix to domestic business from international that Vinod had alluded to earlier. This is temporary in nature. We are investing and building practice areas and also investing in technology for long-term value creation.

In the voice business, Q2 FY17 revenues declined by 0.9%, while EBITDA grew 0.9% on a quarter-on-quarter basis. While the volumes have stabilized, but we continue to see pricing pressure. Although, there is EBITDA improvement on account of our efforts on focusing on profitable minutes, as we have been doing in the past and driving cost efficiency. EBITDA margins came in at 6.6% in Q2, an improvement of 10 bps over Q1.

Neotel business has stabilized and there was also sequential margin growth in revenues of 0.2%. EBITDA grew by 16.3% on a quarter-on-quarter basis and the EBITDA margins for Q2 came in at

India data center deal was completed on 19th October. The enterprise value of the India leg was INR 31.3 billion and we retained a 26% stake in the business.

The net cash inflow to Tata Communication after tax and deal cost was USD 250 million. And the impact will be reflected in our Q3 financials. Part of the receipts will be used to pay debt and the balance will be used for investing in growth, as Vinod mentioned. We are seeing exciting opportunities in cross border mobility, IoT, managed security and cloud. As I had shared in my previous call, in the short-term we will see anywhere between 200 bps to 300 bps decline in the data EBITDA margins. But we will recoup approximately 40% to 50% of the EBITDA gap before PBT through rental income and other service fee that we will receive from ST Telemedia.

Under discontinued operations, you will see significantly higher margins which are not in line with our earlier stated position of approximately 30% margins for the datacenter business. As this excludes payments on account of rent and other service fee to TCL India which earlier was getting eliminated under our consolidated financials. The IndAS accounting principle mandates that the continuing operations reflect the current earnings and cost. And hence you will see these inflated margins appearing in discontinuing operations for both the datacenter business as well as Neotel. We may witness a marginal decline in ROC post India datacenter deal on account of revaluation of our 26% investment at fair market value and increase in the reserves and surplus on account of profit from the sale. I will like to reiterate that after adjustments of the above in the core reserves and surplus, and adding back rent income and other service fee, we will be at the right trajectory to hit 15% ROC in medium-term as articulated earlier.

In terms of consolidated balance sheet, there was a significant movement in other financial assets on account of payment of Rs. 1,058 crore towards Docomo obligation. I will also like to make a mention that our net worth was adversely impacted by rupee depreciation, we have seen a closing exchange rate move from Rs. 66.25 to Rs. 66.64 between March and September, hitting our FCTR by Rs. 97 crore. And consequently, reserves and surplus are getting impacted. The current net worth is definitely not a reflection of our operating performance, but is a result of uncontrollable external factors.



Core business net debt stood at USD 1.573 billion as compared to USD 1.439 billion in the earlier quarter. The net debt this quarter includes payment of USD 159 million to Tata Sons on account of the Docomo obligation. If we adjust this payment, the net debt would have improved to USD 1.414 billion, a reduction of USD 25 million over previous quarter.

While we continue to increase free cash generation, some of the increase is going towards meeting the working capital as we expand our data and enterprise business. Net debt-to-EBITDA stood at 3.5x at the end of Q2, while weighted average cost of loan was 3.02% in Q2. Adjusted for TTSL payment, the net debt-to-EBITDA would have been 3.1x. Our cost of funds continues to remain competitive.

Core business CAPEX in H1 FY17 was USD 115 million and we maintain the guidance for the financial year CAPEX of around USD 250 million, excluding data center.

With that, I will request the moderator to open the forum for Q&A.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin with the questionand-answer session. Our first question is from the line of Vinay Jaising from Morgan Stanley. Please proceed.

Vinay Jaising: My first question is, when I look at the incremental revenue coming in from the data business, not including the data center because that's partly been sold off. And I look at the incremental EBITDA coming in, what I am saying is that the incremental revenues have slowed down courtesy the subsidiary business slowing down. And in line, the incremental EBITDA has gone to negative levels if I look at it on a QoQ basis. I do hear the India concentration is a little bit more, but apart from the step function growth which we saw in the December quarter I am not seeing the revenue and the EBITDA growth coming in. So that is my first question, what are we missing or what are we doing to get the incremental revenue growth back in the data business and what is existing in the Tata Communication currently?

Vinod Kumar: Firstly, I think we have given the TCTS explanation already and if I can a little bit more color to it I would say that we have won a couple of meaningful contracts in India around the wireless space which is something we have been working for quite some time. And we picked those up even though there were relatively lower margins very deliberately because we believe that that is a capability that can then be showcased and is in much demand elsewhere in the world where similar work will fetch us much higher margins. I cannot specify names of customers and so on, but we have the conscious effort and it is already beginning to pan out well for us in terms of funnel built and further business we expect to get on top of that capability. So that is one. In TCTS we actually feel quite confident, it may take two quarters for it to show up in the way we are calling out, but I feel strong based on the funnel of activity there.

Vinay Jaisingh: It is regarding the margin right, so you are saying that the margin will come up but the revenue is already being shown on the numbers, right?

Pratibha Advani: Vinay, if I can just add to what Vinod mentioned, if we were to actually exclude the subsidiaries then our revenues have actually grown 3.2% quarter-on-quarter and so has our margin increased by 3.3% and the margins have remained as a percentage, EBITDA margins have remained flat at 22.2%. So I just wanted to make that point while Vinod adds further. And this is excluding data center.



Vinod Kumar: Vinay, I was just saying that from a TCTS perspective you will see both continued growth in revenue but also improvement in margins because there are other deals that have been signed which are under implementation which will show us the revenue growth. But they are deals that have higher margins that will start showing up in a couple of quarters.

Vinay Jaising: The reason I asked this question is, obviously I did the calculation that Pratibha was suggesting. And my concern is, when we come back three months later for the next quarter's call, the jump up which we saw from the September to the December numbers of 2015 would not be there and then on a year-on-year basis the growth would not even look like 13% if I take out the data center growth, they would be looking much lower even if we grow at 3% to 4% both on a yearly basis and a quarterly basis. So, what I am trying to say is something good happened in the December quarter and we are sticking around to those revenue numbers and to those EBITDA numbers which are coming in from the subsidiary part of it. What you are suggesting, what I can understand is two quarters forward we will get margins come up for what we are doing, but what about the revenues then. Because I am seeing a bit of a slowdown for the next one, two quarters, maybe I am reading it wrongly.

Vinod Kumar: So, I would not comment on next one, two quarters, Vinay it is not fair for me to do that. But based on the overall activity, I am not talking TCTS right now, across our portfolio in our media business and in our enterprise business in some of the new services, we are staying as optimistic and as confident as we were before. How that translates from quarter-by-quarter I am not going to get into that, but directionally where we committed in terms of getting you certain margin threshold for data, in terms of getting ROC up to a certain level, all that we continue to maintain and there is nothing that I am seeing in the business that gives me any reason for my confidence to waver.

Vinay Jaising: So that was what we had historically spoken about, 10% plus in traditional business and 20% plus on the rest of the growth business. Is that what we were looking at till now?

**Vinod Kumar:** When you say 10% plus business, what are you referring to, EBITDA or...?

Vinay Jaising: Hopefully revenue, EBITDA should be better.

Vinod Kumar: I think 10% plus consistently on traditional business I do not think we have set that expectation. But on the growth services, what you stated is in the ballpark.

Moderator: Thank you. Our next question is from the line of Mehul Patel from MJ Patel & Company. Please proceed.

Mehul Patel: Can you throw some light on company called Level 3 in US which just got bought over, how are we competing with them, are we in the same line of business and where do we compete with them and where are we different? Thank you.

Vinod Kumar: The Level 3 is largely US and Europe focused operator. They have presence elsewhere also. And let me give you a little bit more color on Level 3. Level 3 tends to be more of a wholesale provider than enterprise, although they do have enterprise also through acquisitions they have done like Global Crossing. They are also very big believers in ownership of last mile in the US and hence have invested several billion of dollars on acquiring companies through heavy



leveraging of their balance sheet, they carry very high debt to EBITDA ratio to acquire last mile and have done that repeatedly. So, that is a little bit of profile on Level 3; if you knew that already, forgive me for repeating what you know. But for us Level 3 is not really a direct competitor, we do compete with them a little bit on the IP transit or wholesale IP space, but Level 3 is a supplier to us for local access in the US and that's largely the relationship. Now, I am glad you brought this up, because when you look at the multiples that some of the recent transactions in the US the consolidation moods have shown, Level 3 has won the sale of assets which is a wide area networking company. I think you will be quite pleased with the Tata Communication story and the headroom that we think our valuation can hold. If you just look at those international comparisons of people who do subsets of what we do.

Moderator: Thank you. Our next question is from the line of Aliasgar Shakir from Motilal Oswal. Please proceed.

Aliasgar Shakir: I have a couple of questions. First is on this reconciliation of your numbers as reported in IGAAP versus based in your investor fact sheet. So when I reconcile the EBITDA number in your IGAAP with your investor fact sheet, I believe there is about Rs. 52 crore - Rs. 53 crore of EBITDA which I am unable to reconcile. So, basically I have just deducted your Neotel Rs. 89 crore as well as about ballpark about Rs. 60 crore - Rs. 65 crore of your data center EBITDA. So that leaves you with about Rs. 52-odd crore. So I was just trying to understand how should this be accounted. And just a follow-up over there is that sir this discontinued operation that we have put in our IGAAP, does this include both India and Singapore or the next quarter we may see incremental revenue and EBITDA towards the Singapore operations? That is my first question.

Pratibha Advani: Ali, while we can meet face to face and we can take you through the numbers, but just to explain the concept under IndAS and IGAAP. Discontinuing operation includes both India subsidiary of the datacenter and Singapore operations as well as Neotel. And I had explained a little earlier that the whole concept is that whatever you are earning in your continuing operations, that is what you show. But if there are any costs, etc that were getting eliminated in consolidation, those do not get reflected in the discontinuing operations. And that is why there would be the gap, but I am happy face to face to explain that to you.

Aliasgar Shakir: Just one more question on your CAPEX, so in this quarter we have seen about USD 50 million of CAPEX. You mentioned that you will be doing investments towards new practices. I just wanted you to, if you could throw a little bit color about what is this investment and what impact do we see of the same on both your revenue expectation as well as your CAPEX guidance?

Pratibha Advani: So, our CAPEX investments would be directed as both of us alluded to, some of the new opportunities that we are seeing in areas of cross border mobility, Internet of Things. You would have already heard that we are doing currently a POC with LORA technology. And some of these areas that we see would really be the future growth areas for Tata Communication and that is why we will be directing our investments.

Vinod Kumar: Let me add to that, the other area which is going to be quite important for us more than CAPEX its OPEX, but it is worth mentioning the whole side of security portfolio. Today, we have an offering which is relatively narrow, around network security. We are working on considerably expanding our security portfolio, largely through white labeling series of services



from partners, but building our intellectual property in terms of the service wrap around it. You will also see us investing more people on the ground for security audits, security operation center and so on around the world because this is a domain where we have considerable market permission to play, it is adjacent to the network and cloud services we offer, and it is an area which is making many Boards stay up at night because of the threat of cyber security to their core business. And hence, we are going to move aggressively into this.

Aliasgar Shakir: So does this add any new revenue line and subsequently increase our revenue growth expectations?

Vinod Kumar: Since you guys look at it take more from a medium-term perspective, I would say yes it will. But in the short-term there is a capability build up that we will have to do and hence our resources, CAPEX and OPEX allocation will go into this area along with IoT.

Aliasgar Shakir: And that also has upward risk to your CAPEX guidance of about \$250 million?

Vinod Kumar: \$250 million to \$300 million is being maintained, it is within that we will reallocate and there is no upward risk.

Moderator: Thank you very much. Our next question is from the line of Amruta Pabalkar from Morgan Stanley. Please proceed.

Amruta Pabalkar: I had three questions. Firstly, if you could give what would be the data center EBITDA for the quarter? And secondly, after the transition of the India and SG data center is complete, what could be the margin impact on your traditional segment? Thirdly, if you could give some sense on why the TCTSL margins compressed and overall what is your sense?

Pratibha Advani: So, let me answer the first two question, Amruta. The data center margins are in the range of 30% - 35% and I put that range only because TCX and TCDC India would fall within that range. Coming back to your next question, we really do not look at the impact on the traditional, but as I said on this total data portfolio there would be a 200 basis points to 300 basis points impact in margins. We have taken that range because this year it would be more 200 basis points since we did get some of the benefit during the year, but next year it will be closer to 300 basis points.

Amrita Pabalkar: So the way to look at it, if we had 22.7% EBITDA margins, the following quarter we could see around 200 bps of compression?

Pratibha Advani: That is right. But we would make up almost 50% of that through rental and other services income. So the way you should now start looking at our P&L is, on the top of EBITDA add this other revenue or income that we will get, 50% of that and that would become the adjusted EBITDA.

Amrita Pabalkar: And on the TCTSL margin compression and how do you see this profile shape up over the medium-term?

Pratibha Advani: We expect margins to be in the same level. This quarter there was a bit of a blip because we had to take a provision for bad debt. But again, given that today and tomorrow



ATMs are not going to be functional, there would be some impact. So if we leave aside one-off events or force majeure conditions, then the margins would be more or less stable.

Amrita Pabalkar: So 6% to 8% is kind of a margin profile that we should expect over next couple of quarters?

Pratibha Advani: That is right.

Amrita Pabalkar: Then, going back to your overall data margin profile with your expectation that it is reaching to around 30%, do we see any shift to this pieces or what is the timeframe that you are expecting for this to happen?

Vinod Kumar: We are still maintaining that, we think the growth services portfolio will pickup and while we see some improvement in TCTS in about two quarters, you will also start seeing a bigger contribution from TCTS in the period thereafter. So we are expecting that we will get to the 30% range by end of 2017 - 2018.

Pratibha Advani: And I think the confidence we get, Amrita, is from the fact that even today our traditional services margins are upwards of 30%. So there is that headroom for growth that is available for us.

Moderator: Thank you very much. Our next question is from the line of Sanjesh Jain from ICICI Securities. Please proceed.

Sanjesh Jain: I have got three questions. One is on employee cost, generally Q2 is when we take the annual wage hike, this guarter around the wage hike was little lower. Have we done some employee cost optimization here? And more, is it in GVS segment because I can see our employee in TCTSL have gone up, so that is one.

Number two is on other income, other income QoQ has come down, so just wanted to understand, are we recognizing Rs. 1,058 crore which has been deposited to TTSL towards DoCoMo obligation, has the interest cost been reflected in other income?

And third question more on TCTSL and what has happened yesterday, the demonetization of Rs. 500 and Rs. 1,000 note and we can expect more bank transactions happening, are we really looking at our ATM rollout now given that the usage in the ATM can go up substantially from here?

Pratibha Advani: Sanjesh, to answer your first question on employee cost, last year you would recall in our March financials we had shared that on an exceptional cost line we look at staff cost optimization. And some of that benefit is now flowing through into our P&L in the current year. So while we have given a wage hike, that has got neutralized with this initiative that we took last year. Other income is lower because we had to liquidate some of our investments to pay for the DoCoMo obligation. And so there were two arms to that, liquidation of our investment and picking up additional debt to pay the Rs. 1,058 crore.

On the TCTSL, our comments. We are currently adding 400 to 500 ATMs every quarter, our white label ATMs. So we would continue to make that investment. We are still assessing the impact of



what happened yesterday and maybe we will be able to provide you with more color in the next quarter.

Sanjesh Jain: Just one follow-up question, is the interest income on the TTSL amount is being reflected in other income?

Pratibha Advani: No, it is not reflected in the other income.

Moderator: Thank you very much. Our next question is from the line of Rajeev Sharma from HSBC. Please proceed.

Rajeev Sharma: I had just three questions. First is on the IoT, I do not see the Indian telcos getting into IoT anytime soon, so if Vinod you can explain where the demand will be coming from? And what is the medium-term impact you could see in those services? Second is on the cost inflation, last quarter we talked about possible increase in cost for some time, maybe a couple of quarters. But this quarter we are talking about local sales head and consolidation of shared resources so that the headcount can be minimized. So just a little confused as to how do I add them up. And lastly, you did mention about this data center transaction, if you could state what is your after tax, what comes into the business, what comes into your balance sheet from the data center. Thank you.

Vinod Kumar: I will answer the first two and let Pratibha answer the question on datacenter balance sheet. Firstly on cost, I think we are going to spend more in Q3 and Q4 on ramping up some of our sales headcount and in terms of there is a marketing program that we have to drive demand for our new services. And the third area will be to create our capability for product engineering, people operation, people for IoT and IoT security and for our software defined wide area network. So, all those are built into our plan and we will see an increase. What I meant is that from a share restructuring standpoint, we think we can get more efficiency with the new structure. And so for example, our Product team or solution teams, by centralizing these we think we can get more efficiency. So going forward we can actually increase our revenues without having to increase cost in the same proportion as we would have done in the past, so that is how we need to take a look at it. It does not mean that we would not see any cost increase in the required areas in the second half of the year. And that would not be something that just shows initial jumps but we feel the need to do it and we will do it very prudently.

On the IoT side, our customers set is really not the telcos, we are looking at B2B IoT offering that will target large enterprise customers, both in India and outside. And we plan to offer turnkey IoT solutions that will target industries like manufacturing, retail, logistics and transport, automobile sector, these are the kind of industries we are targeting and we are coming across many business requirement for use cases for a turnkey IoT solution where you provide the sensor, network, platform as well as the application service.

Now, this is a vision. You are not going to start seeing IoT show up meaningfully in our numbers for the next three, four quarters. It is a big area, it is a huge market, we want to move early, capture customers and improve our capability. But it is not going to come in the next quarter or the year, the quarter after that in any sizable way that you would notice. You will probably read about it more in terms of press releases talking about our service strategy in terms of customer awareness, that is what we are going to start seeing. And I just want to emphasize that we see



this as a big opportunity that will unfold and hence we will invest in it. The guestion of where we are investing as we disinvest in other areas, this was one that we will look to direct our resources.

Pratibha Advani: To answer your last question, our profit from the India leg of the datacenter transaction deal is around \$329 million.

Moderator: Thank you. Our next question is from the line of Nimit Tanna from CWC Advisors. Please proceed.

Nimit Tanna: Just one clarification and one question. So the clarification was on the margins, I just want to clarify, there are three impacts to the margins, the first impact is the 200 basis points to 300 basis points because of the way your data center operations moved out. The second is that close to half of this gets recouped through other income. And then the third impact is just as revenue grows through operating leverage we would kind of see some kind of margin traction because we kind of take shared cost. So these are the three moving parts, right?

Pratibha Advani: Absolutely, Nimit you have got it right.

Nimit Tanna: So when you are saying the decline in the recoup, obviously whatever addition we do is the function of the revenue growth for the quarter?

**Pratibha Advani:** That is right.

Nimit Tanna: And the question is, just a very quick one Vinod. If you could just share some update on how IZO is picking up? Because conceptually it is very powerful, but how is the end market response, especially for the internet hybrid product?

Vinod Kumar: Okay, two things. So, IZO Private which is the connect that we provide to both our internet access customers and our VPN or VAN customers to the big cloud providers like AWS, Microsoft and so on is picking up at a very good clip. We have some joint marketing programs with the big cloud providers that is generating leads for us. And also we are quite well positioned as a preferred channel partner for the company, so they are also sending leads to us. So IZO Private is working well. IZO WAN, we have proof of concepts, many which are in play and in two weeks, November 28th we would be announcing our IZO Intelligent WAN which significantly increases the feature set of our hybrid Van service set. And the market response from that has been quite strong. So we continue to remain bullish that the IZO Hybrid WAN strategy will keep us winning in the enterprise WAN space. We remain as optimistic as we were before on IZO WAN.

Nimit Tanna: And just a follow-up, so there is obviously a longer-term opportunity on growth services for the VAN product and IoT, but in the near-term the biggest drivers for growth services will be UCC and IZO Connect, is that correct?

**Vinod Kumar:** One more thing where we think the interaction is on hosting and security.

Pratibha Advani: Nimit, just to add to what Vinod mentioned, already the numbers are still small so I am not going to call out the revenue numbers. But YoY we have seen a 300% growth in IZO.



Moderator: Thank you. We have the next question from the line of Dikshit Mittal from Subhkam Ventures. Please proceed.

Dikshit Mittal: This Neotel impairment of Rs. 125 crore, have we taken full impairment or there is more to come in next quarter?

Pratibha Advani: No, we have taken the full impairment. And if there is any change in FX impact, that we will have to take, but otherwise pretty much we have picked up.

Dikshit Mittal: And secondly, in the investor fact sheet you have given the core business profitability, so have you taken this Rs. 125 crore impairment in that?

Vinod Kumar: That is right, and I had also called out in my transcript earlier that we did include this and that is why we have the PAT of Rs. 28 crore.

Dikshit Mittal: Last question from my side, if I look at some of your peers, like the case of this Level 3, and other peers as well like Cogen Communication or Equinix, everyone seems to be getting EBITDA margin in excess of 35%. So as you mentioned earlier that they are basically into the wholesale and not into enterprise, so why our margins are substantially lower than these peers, is there any differential in the services offered or we can also reach that level of margins?

Vinod Kumar: A couple of things. One is, they do not have as much voice, and then I would urge you to look beyond EBITDA and also look at their debt levels to see the big picture.

Moderator: Thank you. Our next question is from the line of Neerav Dalal from May Bank. Please proceed.

Neerav Dalal: Most of my questions have been answered, expect for a couple. One is on the depreciation, it is quite lower this quarter, so your comments on that? And the absolute numbers in terms of employee cost for the quarter?

Pratibha Advani: The depreciation is lower because for discontinuing operations we stop to charge depreciation as accounting standards. So there is no depreciation that is charged on assets for data center as well as for Neotel. The employee cost for the quarter is.... You wanted for the quarter or do you want it for half year?

Niray Dalal: Either will do.

Pratibha Advani: So it is Rs. 700 crore.

Moderator: Thank you. We have the next question from the line of Pranav Kshatriya from Edelweiss. Please proceed.

Pranav Kshatriya: Most of my questions have been answered, I just want to check on the voice side. There have been quite a few new offers for offering international voice at a cheaper price, so are you seeing a pressure on voice outgoing realization from India? That is my first question. And do you see any chance of inbound termination charge being reset by TRAI in the recent consultation paper? Thank you.



Vinod Kumar: The answer to both the question is, no, we do not expect any big shift. We have factored what is going to happen with the voice business going forward also. We think about \$16 million of free cash flow, something that the business can still generate. And we have both revenue and cost initiatives that we are driving to say that with some confidence.

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

Vinod Kumar: I would like to just say that from a quarterly basis there may be something that you are not seeing in-line exactly with the trends you may have expected. But as I responded to Vinay earlier and Nimit, from the activity level that we see internally, the customer funnel that is building, the nature of the customer conversations and generally lower growth positioning in the market, we remain confident with both our strategy as well as our execution ability. And therefore maintain the outlook that we provided earlier in terms of margins as well as ROCE.

The last point that I want to mention, again to reiterate here is that focus we have on capital efficiency, on making sure that ROCE thresholds that we have communicated are met and experience in terms of generating free cash flow for the business remains unchanged. And there is not a single person on my team who does not believe that and is working towards that. So we look forward to communicating more with you both in terms of strategy as well as more details on our products and service rollouts as well as deliver continued growth results quarter-on-quarter. Thank you very much.

Moderator: Thank you very much, members of management. Ladies and Gentlemen, on behalf of Tata Communication Limited, that concludes today's conference call. Thank you all for joining us. And you may now disconnect your lines.

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