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Q3 FY2024 Earnings Call Transcript

MAIN Participants:

AS Lakshminarayanan, Managing Director and
Chief Executive Officer

Kabir Ahmed Shakir, Chief Financial Officer

Rajiv Sharma, Head, Investor Relations

Chirag Jain, Deputy General Manager, Investor
Relations

Chirag Jain

Good evening, everyone and welcome to the Tata Communications earnings conference call for Q3 FY24. We are joined today by our MD and CEO Mr. Amur Lakshminarayan and our CFO. Mr. Kabir Ahmed Shakir and our head for Investor Relations Mr. Rajiv Sharma. The results for the quarter ended 31st December 2023 have been announced today afternoon and the quarterly data back is available on our website.

I trust you would have had the chance to look through the key highlights. We will commence today's call with comments from Lakshmi, who will share his thoughts on the business and long-term outlook, followed by Kabir, who will share his views on the financial progress achieved. At the end of the management's 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 risk and uncertainties we face. A detailed statement and explanation of these risks are included in our annual filings, which you can locate 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 Lakshmi to share his views. Over to you, Lakshmi.

AS Lakshminarayanan

Welcome to all of you for the 3rd quarter FY24 earnings call. This being the 1st call for the year, want to wish you all a very Happy New Year. We are very pleased to share that our reported revenues grew by 24.4% Y-o-Y, our reported EBITDA is up 5.3% Y-o-Y and 11.7% Q-o-Q and our Adjusted PAT (excluding exceptionals) was up 13.9% Q-o-Q. Further, we are very happy to report that quarterly revenue crosses the INR 5,000 crore mark and our data revenues crossed the INR 4,000 crore mark, coming in at INR 4,618 crore and were up 15.6% Q-o-Q and 28.5% Y-o-Y. Digital services are now 45% of the total data business, in line with our aspiration of 50% and this positions us firmly as a leading CommTech Player. This is an important milestone from where we started 3 years back.

Our underlying data revenue growth at 6.6% Y-o-Y was affected by macro conditions. Our YTD reported revenue growth was at 15.1% on a consolidated basis. Our YTD reported data revenues were up 20.1% and up by 10.2% from an underlying perspective. As part of our financial disclosures, we are reporting both underlying and reported numbers as part of our commitment to the highest standards of financial disclosure and governance. That said it is important to recognize that Switch and Kaleyra are being run as integrated businesses. For example, Switch and our Media is led by one business leader. We have already moved to a structure for Kaleyra, DIGO and InstaCC where they are in one Customer Interaction Suite unit and led by one business leader. Customer opportunity will be looked at holistically as opposed to looking at it from an individual product lens.

Coming to Profitability, our efforts have enabled us to report 11.7% growth in Q-o-Q EBITDA this quarter, and I am encouraged to share that we have been able to fast track the cost synergies of our Kaleyra acquisition. For Switch the EBITDA losses have narrowed down further and we hope to accelerate our path to EBITDA breakeven. This quarter the EBITDA margins came at 20.1% versus 20.8% previous quarter. The drop in margins is primarily due to the change in revenue mix as the revenue share of digital portfolio keeps increasing. On the subsidiary review which I talked about last quarter, we are making good progress and we have mutually agreed to exit a large contract in TCTS which was not profitable, and we will share more on the review as we progress.

Now coming to our segmental performance. Our Core Connectivity business revenues grew by 4.3% Y-o-Y. To remain relevant and to be the partner of choice for our customers, we continue to enhance customer's experience by enabling our customers to consume our services digitally.

Our Digital Portfolio revenues stood at INR 2,099 crore, growing Strongly at 78.2% Y-o-Y and 44.1% Q-o-Q, aided by consolidation of the Kaleyra financials. Underlying Digital Revenues grew by 11.4% Y-o-Y this quarter, YTD underlying revenue growth is at 18.3%. From a YTD perspective except for Incubation, all segments have grown mostly above 20%. Next Gen in particular is up 43.6% YTD and Collab which was a drag until last financial year is up 10.2% on YTD basis. Our underlying Collaboration Portfolio grew by 4.4% Y-o-Y and by 3.1% Q-o-Q. The growth is on the back of robust traction in our Customer Interaction Suite which has offset a seasonal

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decline in the usage-based revenues this quarter. With the joint capabilities of both Kaleyra and DIGO it helps us to position as a formidable player. We remain committed to building an intelligent and contextual multichannel communications solution and creating a customer category of CIS to help us scale growth. We recently enabled Singapore Airlines transform the airlines communications and collaboration tools to enhance employee productivity and boost user experience. This new transformative initiative delivered on Tata Communications GlobalRapid™ platform will help the airline create new benchmarks in customer experiences.

Our Next-Gen connectivity offerings revenues declined by 1% Q-o-Q and up by 37.9% Y-o-Y. Our new offerings like Managed WIFI & IZO™ Multi Cloud Connect, Flex SDWAN and SASE continue to gain solid traction with enterprises. Case in point is JLR where we further strengthened our partnership by deploying our digital fabric comprising our agile infrastructure, platforms, and managed services, that will help integrate JLR's systems, workforce, suppliers, stakeholders, and customers across the globe, delivering a seamless flow of data to enrich key aspects of the business ecosystem. Our Cloud and Hosted ^{Security} revenues improved by 12.5% Y-o-Y. Our IZO™ Private Cloud, encompassing both IaaS and PaaS, grew well above the teens.

Media business revenues including revenues from Switch were sequentially up by 0.6% Q-o-Q and 110.3% Y-o-Y. Excluding Switch, media business revenues were up 6.5% Y-o-Y. With the combined capabilities of Switch and our MES business, we are very well positioned to capture incremental opportunities both in global and regional sports video market and with a key focus on increasing wallet share from the existing customer base.

Moving to our Incubation portfolio, we witnessed a flat quarter. Muted growth this quarter is on the back of a large customer implementation we delivered in the same period last year internationally. Our MOVE™ business continues to grow as we strengthen the segments we operate in while exploring newer avenues. We also continue to stabilize international opportunities and design wins in the IoT segment to propel this portfolio forward.

To summarize, we believe that our global digital fabric is a powerful concept which enterprises, especially in the international markets are beginning to realize. We are confident about the larger opportunity and with this strong conviction, we will continue to improve and derive value of these organic and inorganic investments and continuously augment our capabilities. With this, I will now request Kabir to share the financial highlights.

Kabir Ahmed Shakir

Thank you, Lakshmi. Good evening, everyone. I will take this opportunity to discuss the highlights of our financial performance for the quarter.

This has been a historic quarter for us as we surpassed the benchmark of INR 5,000 crore in our consolidated revenues for the first time ever. Our data revenues continued their healthy growth momentum, despite the macroeconomic uncertainties amid a challenging demand environment. Our reported revenue for the quarter stood at INR 5,633 crore, improving by 24.4% Y-o-Y and 15.6% on a sequential basis. Normalizing for Forex, our Consolidated revenues grew by 22.6% Y-o-Y and 15.1% Q-o-Q. Data revenue for the quarter stood at INR 4,618 crore, growing at 28.5% Y-o-Y and 15.6% on a sequential basis. The underlying data revenue growth stood at 6.6% Y-o-Y. Revenue growth for our digital portfolio stood at 78.2% Y-o-Y and 44.1% Q-o-Q, driven by the consolidation of the Kaleyra acquisition.

Moving to margins, our reported EBITDA margins for the quarter came in at 20.1% and underlying EBITDA margins were at 21.7%. Our core business margins excluding subsidiaries were at 23.6%. Our absolute EBITDA stood at INR 1,134 crore, improving by 11.7% Q-o-Q and 5.3% Y-o-Y, aided by a strong focus on driving profitable growth from our organic and inorganic investments. I am delighted to share we continue to succeed with our Fit to Grow strategy with Kaleyra turning EBITDA positive, ahead of our expectations in the first quarter of consolidation itself and Switch too making good progress towards EBITDA breakeven. We believe there is room to drive more value from both the organic and inorganic investments we have been making and we see multiple levers to achieve this.

Net debt stood at INR 9,310 crore and net debt to EBITDA at 2.21x, ROCE for the quarter at 21%. Our increased debt levels and

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sequential decline in ROCE is driven by Kaleyra acquisition. Cash capex for the quarter stood at INR 630 crore and the ramp-up is attributed to payments coming up for capex projects committed in the prior year as suggested previously. FCF for the quarter is at INR 77 crore. These financial KPIs are very much in line with our expectations. PAT for the quarter stood at INR 45 crore driven by one-off provision of INR 206.6 crore pertaining to the recent apex court judgement regarding the treatment of license fees being capital in nature and not revenue expenditure for the purpose of computation of taxable income. Though the Company is not a party to the above judgement, as a matter of prudence the Company has assessed and taken the aforesaid provision.

Moving to subsidiaries, our Payment business today has more than 95% of the current quarterly revenues coming from the Franchise model. We have 4600+ Franchise ATMs and only 128 Company owned ATMs, with this reversal being achieved in just 24 months resulting in the business turning EBITDA positive. TCTSL revenues improved by 10.7% Y-o-Y due to improving customer engagement and better pricing. We have mutually agreed to exit a large contract in TCTS which was not profitable, and this will improve overall business health. Secondly, we have reported revenues from The Campaign Registry – the information hub that allows us to register messaging campaigns as part of our subsidiaries as it is being separately managed as a subsidiary as well. This is a business which is part of our recent Kaleyra acquisition.

Over the last few years, we have focused on changing the texture of the business to significantly improve the customer relevance quotient and drive sustainable and profitable growth. Our finance strategy of Fit to Compete and Fit to Grow allowed us with the elbow room to invest in inorganic capabilities to improve strengthen our CommTech positioning. To sum up, we will continue to invest in building long-term capabilities which will help us cement our moats and our long-term ability to consistently create value for our shareholders.

I will now ask Chirag to open the forum for Q&A.

Chirag Jain

Thank you, Kabir. We will now open the queue for Q&A. Please raise your hand and ask your question. We will unmute you accordingly. We will wait for a minute for the queue to assemble.

Chirag Jain

The first question is from the line of Sanjesh Jain from ICICI Securities. Sanjesh, you have been requested to unmute. Please unmute yourself and go ahead and ask your question.

Sanjesh Jain

A couple of questions, first of all congratulations on successful integration and probably a much better performance from the acquisition. So, let me start with that. Can you help us understand what are the synergies benefit? Last quarter Kaleyra was a -5% EBITDA margin and this quarter we have achieved a positive PAT, which is a significant improvement in the performance of Kaleyra. So, what are the synergy benefits and number two, what is the underlying growth in Kaleyra for this quarter?

Kabir Ahmed Shakir

Let me take the first part and I will come to the second part in a bit. Let me just say on that integration is complete and we are far from it. We have just started that journey. So, there are 3 components to any acquisition, the most important part is integration. We have a project management team in place, which is tracking various milestones in the integration, that is on track. We have revenue synergies, and we have cost synergies, as Lakshmi mentioned, and I eluded further the cost synergies we have actually fast tracked it. We had enough window available for us even the Pre close itself to understand what the levers are. Just say, it was a SEC regulated and NYSE listed company. So, alongside came a lot of costs with that kind of a regulated structure. So obviously we were going to delist within 10 days of the closing of October 6th, on October 6th we delisted from NYSE and there were multiple other low hanging fruits from a cost perspective, which we were quick to take it out. So, I would say that's definitely one lever which we have fast tracked and therefore we have now seen that CIS portion of Kaleyra has turned EBITDA positive as a result. We continue to have the focus, on the business to drive the revenue synergies and of course the Synergy of growth, the combined portfolio of DIGO,

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InstaCC and Kaleyra forming part of the new category that we are working called CIS which is going to drive the entire thing and we are quite energized by that.

AS Lakshminarayanan

Sanjesh, let me add, one quarter would be too soon to call a success. I think, the teams are extremely focused. We are very excited about the talent that we have of the combined teams. As mentioned, we are going through this with a very disciplined execution. So, this whole integration will take time extracting all the cost synergies, driving all the revenue synergies, getting all the products and platforms together we will further invest in making the product more intelligent by adding AI and other capabilities. So, we have some ways to go. So, we are very pleased with the beginning that we have made.

Sanjesh Jain

Great and on the revenue growth in Kaleyra for this quarter?

AS Lakshminarayanan

Again, only one quarter, it is too soon to call out any quarterly trends and so on so forth.

Sanjesh Jain

How has been the Switch experience? Because there I can see there is a 25-crore reduction Q-o-Q on the losses last quarter was 37 odd crore and we have brought it down to 12 crores. Is it again, a combination of cost and revenue or it is just, cost as of now because revenue, tends to look like a flattish Q-o-Q where we had a cricket event also in India, I thought that should have benefited us.

AS Lakshminarayanan

I think the media on the Switch again, we are going to the execution on the cost and the revenue synergies. As you pointed out the losses are narrowing, and we will soon be breaking even that. From a revenue standpoint, there are multiple things that play for the media businesses and Switch, we have to invest more on the on the front end, which we will be doing. So, there were some one-off revenues what they call is occasional use revenue and that was a long tail. We are consciously looking at the long tail to see should we be having the long tail or focused on. Larger properties and larger contracts and the business is going through that transformation and aligning to what our Media business has been doing. On Y-o-Y business, overall media revenues, you would see, last year we had a World Cup, which gave us a boost. Otherwise, there is nothing on the revenue front.

Sanjesh Jain

One last question on the acquisition. We have earlier guided for a double digit in margins in Kaleyra is what we are targeting. With this initial start, do you think that is possible in the next 18 months to 24 months?

AS Lakshminarayanan

I think we mentioned that we want to break even in the short term, and we said in the medium term we want to achieve double digit and that's what we will be doing. I think we will execute, and we will let you know the progress. But again, I understand one quarter is too soon to call out many things. We did say that is our direction of travel, and that is what we would be doing.

Sanjesh Jain

My follow up question, on the core business or underlying business. We have seen this quarter of material deceleration in the revenue growth, 11% growth in digital Vs YTD 18%. If I remove this quarter, we were upwards of 20%. What has led to sudden deceleration in the growth and how does our order book look like for remainder of this year and next year.

AS Lakshminarayanan

Again, I will take more of a YTD perspective in this. We have been saying that there is a deceleration in digital. One, it is largely attribute to the macro, I think last quarter also you asked the same question in terms of deceleration, and I answered the same thing, the macro condition are still not very favourable. So, if you look at other companies in the same domain, I think they followed the slow down. The positive that I'm going to look at is with our expanded portfolio, our levels of participation in larger opportunities, the funnel is therefore healthy. On the decision making of customers, as I called out in last two quarters, I think it continues to be longer than normal, those are the conditions that we are in. Overall given the macro conditions, I think our growth is still very creditable and we are quite pleased with what we have delivered. Of course, we can be doing more as the conditions improve.

Sanjesh Jain

Any more colour on the order book, how do you see it growing? Because we were growing at double digit earlier. Are we still doing that? Because, we have invested significantly out on the foot on the street particularly on the international market, product expansion. So, this should have significantly expanded our reach as well as the wallet share. I thought it should help us right now.

AS Lakshminarayanan

It is improving. So, our international growth is quite good. I wouldn't say all the regions in international geographies are firing. I think certainly there are certain markets which are firing very well, and we are seeing a good double digit, one of the markets is delivered upwards of 20% and one of them is just shade below 20%. All regions are yet to fire. Those investments will pay dividends and as I called out, with our expanded portfolio, our levels of conversation and engagement with customers are definitely improving.

Sanjesh Jain

One last question probably on the balance sheet side, before I come back in the queue. The cash conversion appears to be quite weak for last two quarters, that is driving net debt higher than our acquisition cost. Is there anything change that we are seeing in the cash conversion along with the decision making getting slower in the deal? Are we also seeing a delayed payment from the customer side?

Kabir Ahmed Shakir

I am acutely aware of that. There is no cause for concern. We did have in the past a lot of tax refunds that team meticulously went ahead and then collected. So, after a point that indeed dries up. There is very little left to skim out there. Working capital there were indeed challenges in the in the previous quarter, not in this quarter. This quarter is better, although we could, we could have done little more than better than what we should have. Our capex is going up if you recall last year, when our approved capex was higher, the cash capex was actually lower because of delayed deliveries and better payment terms that the supply chain teams had negotiated. So, all of that catch up is happening in these quarters. Now, where the cash capex is actually higher than the approved capex. I would say a combination of all these things, which is why we are seeing the impact on the free cash flow.

Chirag Jain

The next question is from the line of Santosh Sinha from Emkay Global. Please go ahead and ask the question.

Santosh Sinha

My first question is regarding our trade receivables. What we have seen is that there has been a marked increase in the trade receivable to INR 2 billion from INR 1.7 billion in the last quarter from one of the customers. So, what is the plan of the company to actually recover this receivable and what is the way forward for this? Second question is regarding the slowdown in growth, in terms of incubation in particular. So, incubation was down 2% Y-o-Y basis, what is the key reason for that?

Kabir Ahmed Shakir

Let me take the receivable question first, there is nothing to worry, it is just a consolidation of Kaleyra, when we actually added the Kaleyra financials to us. We have obviously added all the P&L item and the balance sheet items as well. The addition of Kaleyra when you add together, sees the absolute increase in receivables, the days outstanding, which we track as a KPI is completely under control.

AS Lakshminarayanan

On the integration, I think I mentioned, there is one portfolio, which got affected because of a large contract that we had last year in the international region in IOT. That project was delivered and that's all bumped up in revenue. So, Q-o-Q basis, we are seeing that. Other than that, MOVE™, which is a major part of the integration on a YTD basis, we are seeing a good growth.

Santosh Sinha

Next question is regarding core connectivity, there also we have seen some moderation in this quarter, 4.3% Y-o-Y growth versus 7% last year, it is actually a decline of point 0.7% on Q-o-Q. So, what has led to this core connectivity and how we can see this in the long term.

AS Lakshminarayanan

Core connectivity has always been called out in the long term. You know, it will be in single digit, mid-single digits is what we called out. I think, last year and a couple of years, there was a lot of investment by the cloud providers, the major cloud providers and other CSP's which helped to drive the core connectivity. Within our enterprise segment, the core connectivity is still holding up. 4.3% is better than what for medium term what we had anticipated the core connectivity to grow at.

Santosh Sinha

One last question, regarding the margin outlook, in the long term. Since this quarter it is better than what we were expecting. How should we see that in the long term? Overall, the margins going forward, is there a lot of synergy benefit that will come through or going forward, the synergy benefit will not be as strong as we have seen in this quarter. How should we look at the margin in terms of long term.

Kabir Ahmed Shakir

Let me remind, our long-term ambition is to stay in the 23 to 25% EBITDA margin range. With the acquisitions that we have done in Switch and in Kaleyra, mathematically one can do what that impact was. We are slightly, just one quarter, better than what it would have been because we have accelerated some cost synergies. Having said that, our guidance that in the medium term we will get back to the 23-25 range not just EBITDA margin, ROCE, Net Debt and all the financial KPI ranges. We will get back to that steady state in the medium term and we are absolutely on course to get that. So, I have nothing further to add than reiterate that the only goalpost for us on a steady state long term basis is the 23-25 range.

Chirag Jain

The next question is from Gautam Rathi from Chanakya Investments. Gautam, you have been requested to unmute. Please unmute yourself and go ahead and ask your question.

Gautam Rathi

Wanted to understand a couple of things. Firstly, probing again, I know you've answered a lot on the growth. But if you just go back last quarter. One of the things you had said was, the slower growth that we saw last quarter was partially because of a slowdown in order booking that we had seen in the H2 of last year, and we have seen much better order booking in the first half. So, is it that some of these orders have been delayed because of the current environment, or how should we read it? Because if my understanding is right, the orders were in the bag. And it should have given us much better growth. Is it slower execution of those

orders? Or is it churn or what has caused this slow growth?

AS Lakshminarayanan

I think I mentioned related to last year, in H1 we had a good order booking, and H2 had slowed down in order booking, slowing down of the revenues, and subsequently related to H2, we were seeing good funnel and conversion, but it was not at the same level as of H1 last year, when it was improving. So, I think the conditions are still the same. Our funnel still looks healthy, our funnel additions and our participation levels are increasing. But I would say the overall order booking has not grown so much that we can call out specially. I think it got called out last time, and even this time in my commentary, is that our participation levels are increasing and improving but the decisions are slower.

Sometimes in the funnel we shelve the opportunities because the customers are taking too long to make a decision. And we are flushing that out of the funnel and starting all over again, but despite that our funnel looks quite healthy. So that only tells me that our relevance to our customers is increasing, and our participation is increasing, but the conversion is taking time. Having said that compared to internationally, we have seen growth, which is a good indication for us and relative to 2 years ago when we saw what our digital portfolio overall was doing, I think last year we did well, and we continue to do well this year. So, this is only a reference point compared to what it was 2 years ago. But looking at our ambition, our ambition is much greater, and we have to do more, and we want to do more. And as in when the macro condition improves, we will be well positioned to do it.

Gautam Rathi

And this slightly better order booking in H1 versus muted order booking in H2. I'm just trying to understand are we on a trajectory where have we hit the bottom in terms of revenue growth, or we could see more pain if the environment remains the way we are today right? I'm just trying to understand more colour on how should we think of trajectory? Are we still in uncertain territories or are we passed the worst phase that is behind us in a way?

AS Lakshminarayanan

It's, difficult to say, Gautam. I would think I, if you're referring to QoQ growth narrative this quarter, that's why I added the YTD growth. If you look at YTD growth parameters, they are quite decent. So, I would read more into YTD growth and extrapolate, as opposed to looking at a QoQ or even a YoY because there are some aberrations in last Q3 to this. So, all those things I would ask you to look at. If I look at YTD numbers, while the growth is slower, it is still much better than what the market condition is, despite the market conditions, we are doing that is very creditable, is what I would say.

Gautam Rathi

Sorry to persist on this, but is it fair to estimate that, you know, going forward, expect YTD to continue to happen on a much more sustainable basis? Because there is a very sharp deceleration that has happened in the 3 quarters, right. 2 out of 4 growth services have reported negative QoQ quarter this time. And, and I can understand that this can happen sometimes. But is it the right way to think about it? YTD is the right way then we can, we can think of it that way going forward?

AS Lakshminarayanan

I would think, YTD is the right way to look at it. Portfolio of various things we have. Number of things are happening. From overall commentary point of view, you know, we are going to be doubling down on our efforts for marketing and sales and all of that. So, while at the same time, being prudent on cost and driving all cost synergies and even in our organic business, there's a lot of cost synergy activities that we've carried out, even this quarter. So, we will manage all of that prudently. But on sales and marketing, we will be doubling down because we see that we are participating in more opportunities. In fact, in international our presence is so small that we are not participating in all opportunities that we could be and should be participating, that's because the lack of footprint, so we have to do more.

Gautam Rathi

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And with this JLR deal, if you could, you know, give some colour that in our mind it looks like this is the 1st digital transformation deal that you really called out, right? Where you have a new-gen, network services, kind of a win kind of a deal where you are, you're doing it at a global scale. So, have we won similar deals or there are similar deals in the pipeline that you're looking at? And is our understanding right that it is 1 of those large transformational deals which could be a big growth driver for us going forward?

AS Lakshminarayanan

I think there are multiple, multiple large deals that we have, Gautam. Sometimes those deals are largely, I mean over the course of last year, in one of the major European customers, you know, we have displaced an incumbent, similarly, in APAC, one of the large banks we displaced an incumbent with our IZO™ internet. I think the reason why we called out the JLR, is you know, while being a large deal it encompasses a larger part of our additional infrastructure, because we already do connected vehicles for them, and this will entail all the network underlay plus the overlay and the security that goes with that. And therefore, we've called out at this deal. But there are, I mean, these are the type of deals that we are going to market within the international regions.

Gautam Rathi

And the campaign registry business, which has been a real stand out and a surprise for us. Is this, is it fair to assume that this is like a steady state revenue, which could only grow going forward, on a quarterly basis or is there any seasonality that we should be aware of?

Kabir Ahmed Shakir

I'll explain this is basically a business, which, I think Kaleyra has done; they're quite proud of building this business in the US. So currently, it's just a US centric business. They are looking at how they want to grow. After a point in time, it is all then led to the number of campaigns that are then run in that country and the growth is linked to that. But it's a robust business, which validates and ensures that it reduces spam for both the operators and the end users and the campaign owners, as well. So that they bring sanctity into the entire network. So, I would they are doing pretty well, and we are tracking them.

Gautam Rathi

We just wanted to understand, this is what we've clocked this quarter. It is more or less a steady state number right and it is not driven by any specific one offs. It's not like this Q3 is a very strong quarter for them, and you know seasonality and just wanted to get some colour. Because is it fair to assume that 120 x 4, is more like an annual revenue for them?

Kabir Ahmed Shakir

Again, one quarter, don't derive anything out of that. But, if I were to say, like any other business, it is driven by usage and the number of campaigns that are on in that particular quarter. So, I really do not have the underlying data of what were the historical campaigns that were actually run in this, in that country and how much share we have and therefore, so I would resist from giving you a very straight answer of x4, that you asked. So, because underlying nature of the business is dependent on the number of campaigns its runs. It has a fixed fee and then a variable fee linked into it. That's how the pricing model actually works.

Gautam Rathi

And is it fair to assume that right now it's a US centric business but you will try to take this business to multiple countries.

Kabir Ahmed Shakir

Look it all has a lot of investment linked to that, so yes one can go and it's not that easy to replicate the same business in other geographies, because mobile network operators, their systems and process are different, regulation is different. So, it's really easy to say, otherwise a lot of people would have already done it by now, plus it comes with a huge investment as well. So, end of the day, they will stand in line like, many other projects in front of us, and the resource allocation will be done on the ROI that, that

particular business generates. So, I'm not going to slam dunk and say, yes, we want to expand to 5 countries because that decision has not been taken.

Gautam Rathi

That's very fair. And that's happy to hear that you are going to be looking at it that way. That's great. Just 2 more questions, the one off that was INR 185 crore, is that it, and have accounted for everything? Or is there something more to come in that?

I could not fully understand what exactly it was. So, you know, it just looks like there was some license fee that was, asked for and you paid for the entire thing along with interest, right? Is that fair?

Kabir Ahmed Shakir

That's not what it is. There was a recent Supreme Court judgment of a large telecom operator that came in October and although it doesn't pertain to us, we have been prudent to actually take provision. Basically, in a nutshell, the Supreme Court judgment says that the license fee payable is not revenue in nature for purpose of computation of taxable income and its actually capital in nature and should be amortised over the license period. So, what it basically does, is it just it's a timing difference. So, instead of, and we have done it for the past 10 years and prudently taken that provision. So, there's no shortfall of tax, and a small amount of taxes is because of the difference in the effective tax rate, in the various years that you actually see, but otherwise it's just the interest component of having, if at all that comes to us then that will be the impact. Going forward until there's a resolution to this, there will be true-up of the interest that will happen. So, to that extent, in subsequent quarters you will see a true-up of the interest.

Nishit Rathi

The last thing is, right is there any update on the AGR, anything that we should be aware of? Is there any chance of that liability coming up anytime soon for payment?

Kabir Ahmed Shakir

No, I mean if that comes up for payment, then we wouldn't have recorded into contingent liability. Whatever updates are there in the AGR we are reflecting that in our accounts. If you see in the last 4 to 6 quarters, there has been a lot of activity. The DoT has looked at our numbers. We have represented to them that they were errors on the face of it and that's the reason why you see numbers going a little down.

In fact, this quarter is because the department looked at the obvious errors and revised their showcase notices. We still maintain our standard. This is not applicable to us. This is sub-judice and therefore whenever it comes up, we will take it, but it is sub-judice at least we did not want to have wrong numbers into the show cause notices and demand notices. So that we've been working on I would say closely, with the DOT to ensure that they put in the right numbers, and we agree the principles they put so that we know what principles we want to contest when this comes up in court.

Nishit Rathi

It's very fair Kabir. Thank you so much. Thank you so much for patiently answering all our questions. Thank you so much.

Chirag Jain

Thank you. Thanks Gautam. Thanks Nishit. The next question from is from the line of Vinit Manek from Karma Capital. Vinit, you have been requested to unmute, please go ahead, and ask the question.

Vinit Manek

So, thank you. Most of my questions have already been answered but Lakshmi just 1 question to you, regarding AI. So, anything on that development are we doing. And do you expect any material business coming in for us in the next 6 to 12 months based on the

developments? Because we have been going through a few reports and news articles saying that a lot of activities happening on the telecom side of the business also. So, any, any material advantages that we see and are we building on such capabilities?

AS Lakshminarayanan

We are building on capabilities Vinit. I think this was part of our strategy 3 years ago. Starting from training people, where we trained over a 1,000 people in the company. We already are seeing AI deployed in some of our processes and products, which we have taken to market, and we also are examining because this whole AI, especially after the ChatGPT/Gen AI has become quite popular with enterprises so we anticipate that this is going to require a lot of computing power, and therefore we will enhance our cloud capabilities. The IZO™ cloud capability that we already have and enhance it with AI capabilities.

Vinit Manek

Okay, got it and this is a bookkeeping question to, Kabir, is that we have seen a significant QoQ increase of around absolute INR 50 crore in the interest cost. So, is this something like a peak that that we can expect? Or is it a steady state-run rate that we can expect going forward and is there any one-off forex component or something in the interest cost? Because versus the net debt increase the interest cost seems to be much higher.

Kabir Ahmed Shakir

Well, we have assumed the net debt of Kaleyra, as you all know, we paid about USD 100 Mn for the equity and whatever was the debt that we have assumed. And so therefore that impact will come through. At the moment the Kaleyra bond holders had a change of control clause. So, when the change of control happened, 30 days from that they could exercise and they exercised, and the entire USD 200 Mn of bond was repaid. We have therefore used our short-term facilities to cover that and hopefully we will recycle that with a more medium to long term instrument. So, what you see as of now, in this quarter is just that addition, and that interest costs as a result of that.

Associated with that, as well is the Fed rates that you actually see, that have been increasing. Even in the last quarter, also the increase has happened. So, therefore the benchmark rate has gone up. We have a certain portion of our debt, which is hedged but there's a certain portion that is actually open, and that's in line with our interest rate management and hedging policy. So, whatever you see is, there is a little bit of residual bit is as a result of that cost increase.

I can't comment whether that will remain the same or not because of the refinancing that we will do hopefully at a lower cost on the USD 200 Mn plus any other financing requirement that we will have. The cash flow changes that we will do, which may mean we will reduce it. So, our ambition, as I said, is to operate under 2X and hopefully we should get the debt metric faster than the EBITDA and the ROCE metrics. So therefore, if debt comes faster down, then the interest cost also should reflect that. But these are all very dynamic things with a lot of moving parts. So, I can't give you a handle on that on interest cost per se, but those are drivers for the current quarter.

Chirag Jain

The next question is from Arvind Chetty from Dymon Asia Capital. Arvind, you have been requested to unmute, please unmute and you can go ahead and ask a question.

Arvind Chetty

This is more on Kaleyra. Assuming that you've reported Kaleyra revenues in the collaboration and CPaaS vertical, my calculations suggest Kaleyra revenues on a YoY basis for this quarter has sort of declined significantly from what they reported in December 22 quarter. Is that a fair calculation?

Kabir Ahmed Shakir

It is not the right way of calculating because what you see it publicly reported, including the Campaign Registry business which we have culled out and reported as part of our segmental performance. So, it would be difficult for you to do an apples-to-apples comparison that way. Our collaboration portfolio includes CIS, other aspects of DIGO and InstaCC as well. So let me assure you, it has not declined.

Arvind Chetty

Thanks, and on the reported basis, in terms of EBITDA margin, since a fair level of integration has been done, is it fair to assume that on reported basis the margins will see sequential improvement from here on.

Kabir Ahmed Shakir

I don't think neither Lakshmi nor I, said the integration is done. We just started on the integration, and we will keep laser focus on doing the integration well. I mean, for me, doing it well is more important and then doing on time and maybe ahead of time is the next thing that we look at. What we have highlighted in this particular quarter is one aspect of the integration, which is the cost synergies that have been fast tracked and therefore we have a line of sight and a trajectory on the EBITDA improvement, which we have said that in the near to short term, we will do break even. It just happened this the 1st quarter itself, so we are clear about that.

In the medium term is when we will actually get it to the double-digit EBITDA margin profile, and we will stay focused on that. And the reason why I'm reiterating that is there are investments that need to be made as we do the integration in the product organization, in the infrastructure, and in the platforms that combined portfolios bring. We don't want to rock them off and not achieve the revenue potential and the capability that the entire CIS platform has got. If we myopically get driven only by profitability, not to say that there's no focus there. But clearly, we need to balance both of them together.

Chirag Jain

Thanks Arvind the next question is from Vibhor Singhal from Nuvama. Request you to kindly un-mute. Please go ahead and ask the question.

Vibhor Singhal

Thanks for taking my questions. A couple of questions from my side. One question is for Lakshmi. Many of the IT services vendors that have reported results this quarter, they have talked about some green shoots appearing in the overall U.S. macro. Your sister concern mentioned about BFSI work being up. A larger corporate mentioned about green shoots in industry spending. So, I know there's a huge difference between the kind of clients and the work that we do but when you mentioned that we have growth in this quarter, and the overall macro environment has been tepid. Are we also seeing some kind of conversations with the clients, which are kind of hinting towards maybe things improving? Maybe if not in terms of the timeline, but directionally things are moving for higher tech spends going into CY24.

AS Lakshminarayanan

I think I would definitely say overall, as all macro parameters have shown the US market is definitely in an improved condition. From our customer and our perspective, we are seeing funnels developing there. And as I said in our case it is very different, right? In different markets we have to increase our footprint, in the U. S. we have to do more, and which is what we will be doing. But overall, the commentary that you heard, is accurate, and I would not want to pick out because our international presence in many markets is fairly small and anything is a big upside for us. So truly speaking, other than the slowness in decision, the macros shouldn't be affecting us too much.

Vibhor Singhal

So, apart from the delayed decision-making part, which continues to be at this point of time, may be same as it was a quarter ago.

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So other than that, the weak macros shouldn't be too much of a concern for us.

AS Lakshminarayanan

It shouldn't be.

Vibhor Singhal

Okay, just 1 last question for Kabir. I think you just mentioned about the interest expense going up because of the short-term loans that we have taken for the acquisitions. So, I think it's clearly visible in the numbers as well. So, I mean, at this point of time, I mean, the average cost of debt we see in the report is around 6.0%-6.3%. What is the target that you're looking at in terms of refinancing? Where do we eventually want the average cost of debt to hover around on a sustainable basis.

Kabir Ahmed Shakir

If you actually look at, we have a debt equity structure that is that is defined for us and an optimal WACC. And that's the reason why we talked about, our debt to EBITDA being under 2X. So that's the optimal WACC level which I would like to operate under. I'm trying to answer the question by giving you the contours of approach rather than pointing that because the context and the numbers, and this might change and therefore the number might change and that's the reason why it's important that we marry it to the principle.

So, we are committed to an optimal WACC. I want to stay committed to an investment grade kind of rating. Therefore, our coverage and service ratios need to fall within that ambit as well. We have a hedging policy which looks at giving certainty to near term P&L and therefore hedging a large portion of that. So, currently about, I would say, 60% of us of our current loan books is hedged. And finally, in terms of refinancing that you actually mentioned when we did the NCD issuance back in August although our requirement was in U. S dollars, we did borrow INR because there was an arbitrage that was available in the Indian markets, so we borrowed in Indian market and did a cross currency swap, and the landed cost of that was much cheaper than doing it directly in dollars.

So, the Treasury team constantly scans the market, is in constant conversation with our banking partners, to look at the right opportunities where we will actually do. So, that's the reason why, when we did not have certainty, whether the Kaleyra bondholders were indeed end up, all their bonds. So, we just established a line of credit in early December, when the bonds came up for the payment. And now we will examine what is the right structure, right market, right currency for us to be able to do the funding to replace this short term in line with our Treasury policies which I just explained about.

So those are other contours with which we will operate, not just this but I would say there are several other BAU that we have in terms of funding BAU capex, monetization activities that we do, or getting cash flow generated by the business, and everything put together. So that's the whole cash projection and cash analysis with which we review this. Almost I would say on a weekly basis with the dynamic market situation that we have. All of the other things are reviewed almost on a monthly basis.

Vibhor Singhal

Got it, thanks a lot for that very comprehensive answer. Just one small a book-keeping thing. I'm sorry if I missed that, I think you mentioned that all the debt related to the Kaleyra acquisition is in our books already or there is some still pending amount that might come in the next couple of next quarter or so.

Kabir Ahmed Shakir

The entire thing is in our books, so full balance sheet has been consolidated and its balance sheet has been taken. So, the full thing is already reflected in our results.

Vibhor Singhal

Thank You so much. And thanks for taking my questions and wish you all the best. Thank you.

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Chirag Jain

In the interest of time, we will have 1 more question as the last question from Sanjesh. Sanjesh, you have been requested to unmute. Please go ahead and ask your question. We limit this to one question.

Sanjesh Jain

Thanks for taking my question again. One, on the employees' side, I wanted to understand, you did allude Lakshmi in your initial comment that you want to repurpose the employees from both Switch as well as the Kaleyra to cross sell the Tata Communications product. So is that agreed by the employees and what are the areas of focus for us through those employees to target in the U.S. market. What are the key areas of focus that will they drive that. And will they work along with the TCom team. How will that organization structure work?

AS Lakshminarayanan

It's probably too early to announce externally the new structure that we put in place. But as I mentioned in my commentary, they are all working under one business leader. So, Switch, for example, is the sales teams are completely integrated. They take the offerings in a joint way; both the teams are working together to bring the power of both companies. Similarly, in Kaleyra, we are looking at the sales teams to operate as one, as opposed to two different teams.

And as we speak the training for the teams have started on the various offerings within the CIS portfolio, for example, InstaCC is a portfolio that Kaleyra does not have. So, the sales teams are being trained on that. And that's what they will take to market. Whether the Kaleyra teams will take the overall Tata Comm offerings; they are not capable of doing that. But they will work in an integrated fashion with our regional teams, to look at what are the common accounts, which of the accounts where Tata Comm is present and vice versa, which is what we called out as sales synergies which we will start looking at and that activity has already started.

Sanjesh Jain

So, we will have both vertical and horizontal structure because this appears to be more vertical, while I thought we were moving out of vertical to a more horizontal solution. Let's say a kind of an organization structure where there is a change in that, right?

AS Lakshminarayanan

Not really so, even within the Tata Comm portfolio, if you look at, we had what we call as the products-sales specialist. So, if you look at InstaCC and DIGO, in the markets where we were operating, both in India and APAC, for example, we had a sales specialist team, focused only InstaCC and DIGO for instance, right they will work hand in hand with the account teams. Some of these regional teams because they are the specialists in that portfolio. Now, the account teams are charged with understanding the customer context and they will position the digital fabric, whether it's the network, whether it's security, with all the portfolio that we have. But once the opportunities are qualified the sales specialist will go in to support the account teams to take the opportunities forward and close it. So, in terms of Kaleyra, Kaleyra would be the sales specialist for the CIS portfolio. This is not any different from the philosophy that we are operating in.

Sanjesh Jain

So that, that that two layers of structure will continue and that's what we are implementing for the new coming companies?

AS Lakshminarayanan

Yes.

Sanjesh Jain

This also means that in an upcoming year, our employee inflation will be lower than what we had historically. Right? Because, uh,

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we are getting the very talented foot on street, through these two acquisitions. Will that be a fair assumption?

AS Lakshminarayanan

If you look at Kaleyra as existing business that has to grow. So, they come with that talent to sell that portfolio of CIS. So, they will support. Whereas the sales team which covers a larger set of accounts and keeps hunting for new logos, we need to continue to invest as we grow. So, I don't think this would make up for the future growth.

Sanjesh Jain

Fair thanks Lakshmi for answering all those questions. And again, best of luck for the company for the coming quarters. Thank you.

Chirag Jain

I'll now request Lakshmi to share this closing comments.

AS Lakshminarayanan

My top of mind is crossing the INR 5,000 crore mark and crossing the INR 4,000 crore mark on the data business is truly a milestone that we are all very proud of. I think we're very proud of the activities of integration that are going on, and we will execute all of this in a very disciplined manner to deliver on our ambitions of doubling our revenues and achieving all the other financial KPIs. I think this sets us up very well.

Chirag Jain

Thank you, Lakshmi. This brings us to the end of the investor call in case of any queries. Please write to investor.relations@tatacommunications.com in case of any queries. The recording will be available on the website in the next 24 hours. You may please disconnect now, Thank you.

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