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Q1 FY2025 Earnings Call Transcript

MAIN Participants:

AS Lakshminarayanan, Managing Director and Chief Executive Officer
Kabir Ahmed Shakir, Chief Financial Officer
Rajiv Sharma, Head, Investor Relations
Sudeshna Patnaik, Deputy General Manager, Investor Relations

Sudeshna Patnaik

Good afternoon, everyone, and a very warm welcome to you all. Thank you for participating in the Q1 FY'25 Earnings Call for Tata Communications. We are joined today by our MD and CEO, Mr. Amur Lakshminarayanan; our CFO. Mr. Kabir Ahmed Shakir; and our Head of Investor Relations, Mr. Rajiv Sharma.

The results for the quarter ended 30th June, 2024 have been announced yesterday and the quarterly data pack is available on our website for your reference. We will begin today's call with opening remarks from Lakshmi on the business performance and outlook, followed by remarks from Kabir on the company's financial performance. As a reminder, all participant lines will be in listen-only mode and there will be an opportunity for you to ask questions after the management remarks.

Before we begin, I would like to remind everyone that some of the statements made in today's call may be forward-looking in nature and are subject to risks and uncertainties. A detailed statement of these uncertainties is included in our annual filing on our company website. The company does not undertake to update these forward-looking statements publicly.

With that, I would like to invite Lakshmi to share his views. Thank you and over to you Lakshmi, for your opening remarks.

AS Lakshminarayanan

Thanks, Sudeshna. Good afternoon, all, and welcome to the Q1 FY25 earnings call. I'm happy to share that our consolidated revenues grew by 18.1% Y-o-Y and our EBITDA is up 9.8% Y-o-Y. Our PAT is higher by 3.6% Q-o-Q. This quarter, Switch completes 12 months of acquisition. And with DIGO and Kaleyra operating as a single unit, we are discontinuing providing financials as underlying and reported and moving back to only reported numbers.

Our EBITDA margins came in at 20%, an improvement of 140 bps Q-o-Q. Consolidated EBITDA is up 6.4% Q-o-Q and 9.8% Y-o-Y. Consolidated EBITDA margins improved by 140 bps Q-o-Q, largely driven by improvement in data EBITDA margins, which improved by 90 bps to 19.3%.The improvement of NR margins and early gains from strategic review of subsidiaries have helped us achieve margin improvements. Our core margins, excluding subsidiaries and Kaleyra, were at 23.3%, well within our ambition range of 23% to 25%. Our efforts will be to keep the EBITDA margins at 20% for rest of the year and improve from thereon.

Overall, data revenues grew at 20% Y-o-Y and 0.8% Q-o-Q. Core Connectivity accounts for 54% of data revenues and Digital Services account for rest at 46% and are very much in line with our stated ambition. Core Connectivity revenues this quarter were affected by cable cuts in Red Sea.

Before I deep dive into Digital Services, let me talk about order book and funnel. Our funnel continues to be robust. Our funnel comprises of 59% of digital platforms and services and 41% of core connectivity services. This quarter, our win rates have seen a healthy jump for India operations and improved marginally for International segment.

Our order book, which has been flattish for the past few quarters has seen a very good growth this quarter, largely driven by a couple of large deal wins. That said, macro challenges continue to exist. While opportunities exist in the market, decision making at enterprise level is slower resulting in longer lead times. Order book from OTT and SPs segments continued to be lumpy in the last couple of quarters. Separately, let me remind you that with the CIS becoming a large part of our digital portfolio, a good part of the revenues is usage revenues and they aren't reflected in the order book.

To sum up, we are very encouraged by our step up in the order book, win rates and our funnel looking good.

Coming to the digital portfolio performance, this quarter, our revenues came in at INR 2,144 crore, up by 51.5% Y-o-Y. Sequential revenue growth improved from a negative 0.8% in the previous quarter to 2.9% this quarter. Overall, the DPS portfolio growth has been broad based. There is a marginal decline in CIS, primarily driven by seasonality and muted growth in the global CPaaS market. We are pleased to report that our incubation business revenues were up 20.4% Q-o-Q. One specific highlight has been our MOVE platform which has grown 4x over the last years driven by good traction in the MVNO, MNO and auto OEM segments. Embedded Connectivity segment is in its early days.

We are constantly adapting and realigning to market changes and trends in line with the same, we have done a reclassification of our SASE business. Earlier, SD-WAN was part of Next Gen and Secured Service Edge (SSE) was part of the Cloud & Security in our reporting. With SD-WAN and SSE converging under SASE and SASE being an overlay security product, we are now including SASE under Cloud & Security. This aligns with our internal structure and review processes as well. We have provided re-casted numbers for the last 8 quarters. Cloud hosting and security revenues increased by 4.2% Q-o-Q and Next Gen revenues are flat due to the aforesaid reclassification and also some customer specific issues and delays. I expect this to pick up from the next quarter.

A significant win in this quarter that I want to highlight is in the BFSI space. This deal is the largest ever enterprise deal that we have won. To add some more colour on this deal size, the ACV is nearly 4x of our earlier largest enterprise deal. We are working with the customer for SOC modernisation. The SOC will be built on the pillars of maximum automation and minimum disruption. What helped us stand out in this deal was our deep understanding of the customer, a demonstrated skill set of automation capabilities using our in-house IPs, threat intelligence and other use cases, our operating model, that brought agility to meet the bank's business needs. This win reflects how being a B2B specialist is a deep moat for us and helps us differentiate ourselves from competition.

Media business revenues grew 9.2% Q-o-Q. The ICC T20 World Cup in Americas and Caribbean was a coming together of Tata Comm and Switch capabilities. Our global delivery integrated with Switch local operations support was a value proposition that resonated well with the team at Star and ICC and they could appreciate the combined strength that we could offer in comparison to other providers.

We remain confident about our data growth ambitions as it continues to be driven by our expanded portfolio of capabilities as well as our increasing customer relevance. Our strategy and focused execution towards increasing customer relevance and expanding to multiple buying centres within the organisation is boding well. Our acquisitions and organic capabilities have made our digital fabric more relevant to enterprises today and as we help them to solve challenges with their cloud strategies, helping them to deliver better customer experience and simplifying their network transformations.

We believe that our global digital fabric is a powerful concept with which our enterprises, particularly in the international markets, are beginning to realise. With our digital fabric, we are addressing numerous issues that businesses are facing. We are confident about the larger opportunity and with this strong conviction we will continue to improve and derive value from investments and continuously augment our capabilities.

With that, I'll request Kabir to share the financial highlights.

Kabir Ahmed Shakir

Lakshmi, thank you. Good afternoon, everyone. I'll discuss the highlights of our financial performance for the quarter. The first quarter of FY25 directionally offers a positive start to the new fiscal year with two aspects proving to be formidable. First is the sequential improvement in EBITDA margins and second is the improvement in data growth, particularly digital services. Getting both together, which is data growth and margins on the upward trajectory is exactly what we need to deliver on a consistent basis. With our investments in growth, we are well poised to grow despite a challenging macro and remain confident about doubling data revenues by FY27. I would like to bring to your attention that TCL standalone financials are not comparable with earlier quarters due to the creation of the new entity Novamesh.

Our consolidated revenues for the quarter stood at INR 5,633 crore, improving by 18.1% Y-o-Y and declining by 1% on a sequential basis. Data revenues for the quarter stood at INR 4,694 crore, improving by 20% Y-o-Y and by 0.8% on a quarterly basis. Digital services revenues improved 2.9% sequentially and were up 51.5% Y-o-Y. Almost each fabric has contributed to the growth of the digital services. Net revenue margins have been steady given our focus on operating leverage drivers.

Our EBITDA margins for the quarter were at 20% and as Lakshmi said, our efforts will be to stay in that range of 20% for the rest of the year, delivering a consistent improvement over prior year. We benefited from an improvement in NR margins, cost savings from termination of loss-making contract in TCTS and one-off reversal in employee costs this quarter. Going forward, as we benefit from synergies from acquisitions and begin realising operating leverage from our organic investments, we see us meeting our EBITDA margin aspiration of 23% - 25%. Our focus continues to be on creating elbow room and capacity for multi-year growth as we ready to participate in new opportunities including AI cloud. PAT for the quarter stood at INR 333 crore and PAT margins were at 5.9%. Our PAT was up marginally by 3.6% Q-o-Q and lower by 12.8% Y-o-Y. PAT benefited positively from an exceptional gain worth INR 84 crore this year. Based on recent developments, there is a gain of INR 186 crore from the reversal of provision we took in 3rd quarter of FY24 towards interest on tax of variable license fee based on the Honourable Supreme Court of India's judgment. This is negated to the extent of INR 103 crore by a provision taken for impairment pertaining to investment in assets held for sale.

Free cash flow for the quarter was negative INR 385 crore, primarily driven by an increase in working capital. This increase in working capital is driven by our new entity Novamesh as it stabilises itself and an advance payment pertaining to a strategic deal in digital services. Net debt for the quarter stood at INR 9,611 crore and net debt to EBITDA is now at 2.2x. Cash CAPEX for the quarter stood at INR 541 crore though our approved CAPEX is close to INR 706 crore.

ROCE came in at 17.5%, a decline of 130 bps Q-o-Q as capital employed has increased due to nine months of Kaleyra acquisition. The ROCE numbers will witness a further dilution in the next quarter as the full impact of Kaleyra gets baked in before it starts to improve.

Moving to subsidiaries. TCTS revenues declined by 17.9% Y-o-Y due to the termination of a large loss making contract which we had called out earlier. The profitability of the business improved because of this termination. From a base of FY24, the current full-year impact of termination on consolidated financials would be 250 bps of negative impact on growth, but a 70 bps of positive impact on EBITDA. Our payment business is now completely on a franchisee model and we have been PBT positive for the last 7 consecutive months and the business has reported a healthy double-digit EBITDA margin of 10.4% this quarter.

Driving capital allocation across the organisation with an eye on return for every penny invested continues to be our focus area. With a robust capital governance framework, we are investing in the right opportunities to help us stay ahead of a disruptive technology curve. Our investments today are helping us participate in megatrends such as the AI, Cloud and enhanced collaboration experiences. At the same time, we are also optimising resources through our ongoing review, a strategic review of our businesses and subsidiaries. We are confident that these levers will enhance our moats and help us continue to improve our profitability and provide the best value to our shareholders.

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

Sudeshna Patnaik

Thanks Kabir. We'll wait for a minute for the question queue to assemble. The first question is from the line of Sanjesh Jain from ICICI Securities. Sanjesh, you have been requested to unmute yourselves. Please ask your question.

Sanjesh Jain

Hi, thanks for the opportunity and it's good to see a margin improvement to 20%. First question on the margin, can you help us with the bridge because operating leverage clearly was not there in this quarter. So it should have come from the synergy benefit from the Kaleyra, Switch, some one-off costs we booked related to acquisition in previous quarter, product mix and one-off in the employee costs.

Can you help us understand what all contribution did each of these elements had, and when you said 20% is sustainable for rest of the year despite ongoing investment, what is that makes you confident that these margins are sustainable? It's more operating leverage or you think there is more synergy benefit which is yet to come?

Kabir Ahmed Shakir

I'll start off with that, Sanjesh. Firstly, I mean as I explained in my commentary as well, there are a little bit of a one-off costs on employee costs which contributed in but let me take the easy ones out first. The impact on TCTS, the loss-making contract which I called out for the full-year is at 70 bps, for this quarter is only 10 bps. So the benefit we had was only small of 10 bps.

When I mentioned operating leverage drivers, I had also spoken about this in the previous quarters, that we have a glide path for every tower as to what their destination portfolio is and what are the drivers that will take them to the destination margin for each of them. I'm confident that a lot of those drivers are kicking in and this is getting reviewed by the business and we are very, very diligent about that.

So looking at the progress of that is what I had actually called out, that the operating leverage drivers are kicking in. And that gives us the confidence that we will be able to deliver the margins for the rest of the year, deliver a consistent improvement over last year. If we need to get to 23-25% EBITDA in the medium term, very clearly, it's not going to all come in in the final year. There is going to be an organic move towards this.

So there were certain costs that were spent in the prior year. Hopefully, from where I sit today, I don't see those costs coming back in. I don't know, a new acquisition, spend on DD that might change, but as of now, I don't see any of them. So I'm confident that we will be able to maintain that at 20%. Likewise, all other growth that we are expecting and therefore, as a result of that, that operating leverage kicking in is also something which is actually factored in, which gives us the confidence that we will able to get to 20% for the rest of the year.

Sanjesh Jain

It appears, Kabir, that we can actually do more than 20%. Will that be a fair assumption if revenue growth kicks in as we are anticipating?

Kabir Ahmed Shakir

Well, if that happens, that's good, but let's be cautious with what we see on our forecast as of now. That's our endeavour as of now.

Sanjesh Jain

Got it. Great. Now switching to the revenue, where I think we are yet to see the kind of positive surprise. Lakshmi, you said in last quarter that there was a very healthy order book in the enterprise business. Well, this quarter had a decline of 5.6% Q-o-Q and again on Y-o-Y basis. If we adjust to the acquisition, the growth appears not so exciting. The same again goes for India, YoY growth of only 2.5%. While we were very confident on these two segments, while these two segments still doesn't look like are firing, like what we thought.

AS Lakshminarayanan

Sanjesh, I'm not sure if I said anything about the order book in the last quarter. I've been saying that last few quarters it has been flattish. In fact, in the investor’s day, I said we only had a marginal growth of 2% or something, is what I said.

Sanjesh Jain

Correct. Correct.

AS Lakshminarayanan

This quarter I called out that we had a healthy jump in our order books. This quarter did not see a decline. This quarter saw a very healthy jump on the order book, even though it's on the back of couple of large orders. One of the orders, we can start to realise revenues, some parts of it this year. But the other order, I think we actually published that it's World Athletics and World Athletics, the first event is in Tokyo next year, so it's an order booked this year.

There might be some revenues coming in, but the larger parts is from next year onwards. The order book, we are very pleased about the order booking that we have this quarter. I wouldn't call it momentum because again, as I said, is it back of two or three deals. But the funnel is looking good, our engagements are good. We just have to continue to execute regardless of what the macro conditions are.

Sanjesh Jain

Again, Lakshmi, touching upon even last year when in analyst meet you said that order book sales funnel growth was upwards of 100%, while order book was just 3% growth. You did try to explain in the call, but still that conversion is looking very painful for us, or much slower than probably what we had thought. Any discussion there which highlights that things can improve materially?

AS Lakshminarayanan

Sanjesh, I'm not sure if I ever said our funnel was 100% improvement.

Sanjesh Jain

No, you had that slide in the analyst meet.

AS Lakshminarayanan

100%?

Sanjesh Jain

Yeah. I think it's for digital services, if I'm right.

AS Lakshminarayanan

Yeah. Anyway, I think Rajiv and team will clarify this point. I continue to maintain that the funnel is looking good. I'm not sure, the conversion has been slow, Sanjesh, there's no doubt about it. This quarter, again, I repeat, what I said has been very good and very healthy. I think one of the other characteristics of the orders, particularly when it comes to the network, is the fact that largely enterprises have a cycle of three, four years before they touch it. It's not like applications and other things. If they have 100 applications, they can outsource 50 at any time and keep the rest or decide. So these comes in various cycles. That is one.

Second is in infrastructure, it is, I said in the investors meeting, it's like touching live wire and if it isn't broken, don't fix it is another attitude when it comes to these. There are multitudes of factors that go into why there are delays besides the macro conditions. But all I would say is that the funnel is healthy. We are increasing our engagement with our customers, particularly the G50 customers, which largely used to be India centric. Now we are expanding our relationships with them across the globe. So these are all good indicators of our engagement with the enterprise segment.

Sanjesh Jain

Great. Any comment on India, Lakshmi? That would be my last question.

AS Lakshminarayanan

No, again, India is healthy. I mean, this quarter is a blip due to the one-off we had in Q1 of last year, but I wouldn't read anything to, India is still quite strong funnel and we will end up strong.

Sanjesh Jain

Got it. Thanks for patiently answering all those questions and best of luck.

Kabir Ahmed Shakir

Also, I'll just remind Sanjesh and all others as well, our TCL standalone numbers are not comparable because of the split we've done with some businesses into Novamesh. So we need to be a bit careful reading those numbers.

Sanjesh Jain

No, no. I am reading from our data pack sheet where we segregate between India and international.

Sudeshna Patnaik

Thank you, Sanjesh. The next question is from the line of Vibhor Singhal from Nuvama. Vibhor, please unmute your line and ask your question.

Vibhor Singhal

Thanks for taking my question. So, a couple of questions from my side. One is on the growth part. So Lakshmi, again any colour on the CPaaS business, which you mentioned that there was global headwinds and seasonality in the business in this quarter. But what is the outlook for this sector in the near future? I know, I mean, over the medium to long-term, I think they're excited about this space. But what would this be, let's say, in the near-term, in the next 2-3 quarters, given the global focus on profitability. And how do we see this going, let's say in FY25?

AS Lakshminarayanan

Short answer is we will grow. I think there are customers that we are acquiring and since it's a usage business, it depends on how the usage picks up. But we are winning deals in Kaleyra, which will help us to grow despite the overall CPaaS market being muted globally. So we will end up growing.

Vibhor Singhal

Right. Any specific domains where we are kind of targeting market share gain or anything that you could probably throw light upon?

AS Lakshminarayanan

Any specific regions or what was your question?

Vibhor Singhal

Let's say, I mean, in terms of WhatsApp or let's say any other domains. What I meant is that we are looking for?

AS Lakshminarayanan

Yeah, so, the Kaleyra platform, bulk of the revenues is in SMS. So that is what is in Stage 30 as we call it. And that is where we are actively going to market. The other channels of voice, WhatsApp, RCS and email, we have reached what we call a Stage 1. So the products are built out, the MVPs are used by now some anchor customers and it will take some time to move to Stage 3 and 30. So the large part of the revenues will come from the SMS channel even though we are acquiring channel customers on the other one. But the scale will happen through the SMS.

Vibhor Singhal

Got it. And just a small clarification now that we moved the SD-WAN part from Next Gen connectivity to the Cloud & Security bucket. If I remember correctly, the Cloud & Security bucket used to be predominantly India business. Would the same hold true also or a good amount of SD-WAN business was outside India and hence Cloud & Security would now be kind of more, I mean, would include more of global revenue than just being purely Indian?

AS Lakshminarayanan

Yeah. In Cloud & Security, all of the SD-WAN, SASE and largely the other aspects of security is all global. Our IZO private cloud is India focused. In security portfolio, we have a SOC and a cloud SOC offering that is largely for India. Even though in cloud SOC we have acquired now some international customers which again I would say is in Stage 1 and not rolled out to all the geographies yet.

Vibhor Singhal

Got it. Sure, that's helpful. Just one question for Kabir. Kabir, you mentioned that I mean, solid performance on the margins this quarter. So you mentioned that we are looking to remain at that 20% level margins for the remaining part of the year. Does that mean, I mean, the margins will stabilise at this level or you meant that probably there would still be some margin expansion through the remaining quarters?

Kabir Ahmed Shakir

Well, I mean, we are expecting to grow our margins towards 23%-25%. So you should see an organic inch up in that, but it will be in that range. I'm hoping that this will not go below 20%. So we were at 18.6%, if you remember last quarter. We increased it up because our ambition, as we said, is to get back there and the sooner we get is what is important. So there are multiple levers that we're going to do organically driving all the operating leverage drivers. I mentioned before, strategic review of subsidiaries that we are talking about, we have done one of them already and we will continue the review for the rest. Plus the cost synergies that we need to get. So there are a lot of levers and a lot of balls in the air, Vibhor, if I may, which gives me the confidence that we should not go below 20%.

Vibhor Singhal

Right. But if I were to just maybe probe a bit further. Don't want the number. But directionally, should we be able to improve margins from the 20% levels in the remaining 3 quarters of the year?

Kabir Ahmed Shakir

I would say yes.

Vibhor Singhal

Got it.

AS Lakshminarayanan

So just to elaborate on the CPaaS, even though I said that SMS is where we anticipate bulk of the growth this year, that is based on some of the, and I did mention that we are acquiring customers and we focused on some of the larger deals there. But also we are equally focused on margins. So it doesn't mean the SMS growth will come at a margin dilutive.

So in the Kaleyra, we're very happy about the integration efforts on platform engineering and the product roadmaps. Our focus will be to derive all the benefits of the synergies on cost and so on. But already the synergies on go-to market is playing out. We have acquired some large deals and that is what gives us the confidence that we can grow and grow profitably.

Sudeshna Patnaik

Thank you, Vibhor. I would like to remind that interested participants may click on the raise hand button to join the Q&A queue. The next question is from the line of Prateek Dugar. Prateek, I request you to please identify your firm name. Prateek, you have been unmuted. Please go ahead.

Prateek Dugar

I'm from Intelsense and first of all, I'd like to congratulate the management for the good set of numbers. And I had two questions. First question is a bit contextual. I just wanted to understand our total addressable market for the SASE based offerings because with some large companies in the U.S. like Palo Alto had signed 8 figure deals in the past. And we also had a partnership with Fortinet wherein Fortinet has in its PPT, given projections about the entire security, networking and the unified SASE market, they are expecting it to be a $208 billion kind of a market by 2027. Are we actually working anything in this domain? I mean, do we have any offerings in this domain?

AS Lakshminarayanan

Yeah, Prateek, we have 2 offerings in this domain. One is what we call as a hybrid SASE. Even today, very large enterprises are looking to see how to bring together a best-of-breed solution, which means that they might take an SD-WAN from a Versa or a Cisco and bring the SSE and other security solutions from players like Palo Alto or Zscaler and so on. And that is what we call as the best-of-breed solution. And that is an offering that we have already reached Stage 30. We have implemented fairly large-scale solutions globally for customers.

The new offering that we have launched is what we call as a Unified SASE, which is a single vendor and a single pass SASE as they call. And that we have launched in partnership with Versa. And that's a global launch that we did. And we've already got a couple of customers signed up and that in our opinion would be large towards the mid-tier customers in the international markets. So that is where these two will fit. We have created a special team that has a GTM responsibility for this. So we are very actively focused on this market.

Prateek Dugar

Okay, thank you. And the other question was like in our last concall we had mentioned about replacing incumbents and some certain challenges that you were facing regards to the awareness levels about our solutions. If you could just give any progress on that front and share some of the name of the incumbents or give a flavour about the total addressable market in that area?

AS Lakshminarayanan

Yeah, I have to give you a very detailed answer for that. I think the incumbents are dependent on the geographies that we compete in, but largely the global players when it comes to the network modernisation of underlay as well as the overlay implementing either hybrid or unified SASEs, we see the major players being NTT, Orange, Verizon and the usual suspects in that space. So those are the big competitors globally.

As I said, we have a challenger position in the international markets and relatively a small presence compared to them. But we are very confident because we have something very unique in our underlay called our IZO WAN proposition where we are able to offer very high performing network with SLAs on Internet and so on.

And similarly on the overlay part of SD-WAN and SASE, we have a great experience and being a very B2B focused company, we bring the best of both the network, we bring the best of tooling and technologies and some of the IPs we have created there and bring some of the service capabilities that these large organisations require. And that is what we think will be a winning mix in the market.

Sudeshna Patnaik

Thank you, ladies and gentlemen. This brings us to the end of the Q&A session. I would request Lakshmi to please share his closing remarks.

AS Lakshminarayanan

Thank you, Sudeshna. I think I would sum up the quarter as a very robust execution. We have seen an uptick in EBITDA from 18.6% to 20%. We have seen, from a decelerating Q4 in digital and data revenues to an uptick again. Y-o-Y, it's been an excellent acceleration. Across the digital portfolios, most portfolios have kicked in, be it MOVE or in the Cloud & Security portfolio. And of course, with CIS aided through the inorganic route.

The other portfolio of Next Gen connectivity, as I said was a blip and will pick up in the coming quarters. So overall, we feel very confident about the products in the portfolio and our engagement in the market, and we'll continue to execute on the strategy. Thank you.

Sudeshna Patnaik

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

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