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Q3 FY2025
Earnings Call Transcript

Main Participants:

AS Lakshminarayanan, Managing Director and Chief Executive Officer

Kabir Ahmed Shakir, Chief Financial Officer

Rajiv Sharma, Vice President, Head, Investor Relations

Sudeshna Patnaik, Deputy General Manager, Investor Relations

Sudeshna Patnaik

Good evening, everyone, and a warm welcome to you all. Thank you for participating in the Q3 FY2025 Earnings Call for Tata Communications. My name is Sudeshna Patnaik, and I'll be your host for the call. 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 31st December 2024 have been announced today and the quarterly data pack is available on our website. We will begin today's call with opening remarks from Lakshmi on the business performance and outlook, followed by Kabir on the company's financial performance. All participant lines will be muted for the duration of the call. There will be an opportunity for you to ask questions after the management remarks.

Some of the statements made in today's call may be forward-looking in nature and are subject to risks and uncertainties. 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.

AS Lakshminarayanan

Thank you, Sudeshna. We're pleased with our results for the third quarter, with continued growth in digital revenues coupled with improvement in EBITDA margins and free cash flows. Our strategic measures pertaining to the review of noncore assets and subsidiaries are yielding positive outcomes. We are on track with repositioning our assets to drive long-term value creation. In Q3, we entered into a share purchase agreement with TSI India for sale of our entire stake in TCPSL.

Similarly, Netfoundry, our fully owned subsidiary, requires additional investments to support its growth ambition and achieve its long-term potential. We are considering avenues to infuse external capital, which may result in us no longer being a controlling entity, while we continue to retain a stake in that business.

Coming to our financial performance, consolidated revenues came in at INR 5,798 crore and grew by 2.9% YoY, and 0.5% QoQ. Our EBITDA margins came in at 20.4%, improved QoQ by 100 bps. And our PAT came in at INR 256.6 crore, up 12.9% QoQ. FCF came in at INR 841 crore versus a negative FCF of INR 194 crore in Q2. Please note that Q3 numbers do not include TCPSL and Netfoundry.

Data revenues came in at INR 4,903 crore and were up 6.2% YoY and 1.4% Q-o-Q.

Core connectivity revenues came in at INR 2,590 crore, a growth of 2.8% YoY and lower by 0.9% QoQ.

Internationally, cable cuts were an issue in the previous quarters that we had called out. The repairs were completed in October. The later part of the quarter was about winning back the customers. In India, we continue to be market leaders in data center to data center connectivity and are investing further to sharpen our services with dedicated metro builds.

On the order book and funnel side, our funnel continues to be robust. Large deal funnel addition has increased by 50% YoY, giving us the confidence that we are delivering on our strategy and being relevant to our customers. Our order book in H1 had benefited from marquee large deals. The YTD order book growth is healthy double digit, and early signs suggest that 4Q is likely to be robust in revenue growth.

To throw some light on the deals in Q3, in India we are seeing increased traction in hosted SASE, internationally we continue to add new logos in the form of national champions. In UK and Ireland, we bagged orders from the top retail bank and a global retail chain to transform the digital landscape. In the Americas, we started working with the world's largest manufacturer of construction equipment to support their operations overseas. Additionally, we are seeing more wins from existing customers in line with our strategy of going “deeper with fewer” each year.

Coming to our digital portfolio performance, this quarter, our revenues came in at INR 2,313 crore at 10.2% YoY growth and 4.1% QoQ, this growth is broad-based.

Our collaboration and managed CPaaS portfolio, which is our interaction fabric, reported a robust growth of 11.7%

YoY and 5.7% QoQ. In Q3, we launched Kaleyra.AI to help enterprises uncomplicate their communications with their customers through workflows and templates powered by AI. We expect the adoption to start kicking in in a few quarters.

Next-gen connectivity, which is our network fabric, grew 9.2% YoY, and 14.4% QoQ. Customers shifting to cloud, shifting to Internet and adoption of AI are the key growth drivers for our network fabric, and we are capturing this opportunity through our IZO Hybrid WAN service, IZO multi-cloud connect service, both of which witnessed robust growth.

Cloud and security fabric grew by 12.5% YoY and 4.1% QoQ, driven primarily by our security portfolio. GPU-as-a-Service is already available in the market. Our AI Studio launch will come later this quarter.

Our incubation services, which is IoT Fabric, witnessed a growth of 23.1% YoY and a decline of 20.9% QoQ. In the top line, there is an impact on account of discontinued operations. In the previous quarter, our MOVE platform had seen an uptick driven by the SOTA campaigns by OEMs. These campaigns are periodic in nature. Having said that, we have extended our partnership with JLR, JLR's upcoming medium-sized SUV built on the new electric vehicle modular architecture will be leveraging Tata Communications' MOVE platform.

Our media portfolio witnessed 2% YoY decline, an increase of 6.7% QoQ. We signed a multimillion dollar deal with a LATAM-based media tech company. As a media cloud and edge technology partner, we will help them transform from a linear traditional channel format to a digital platform.

To sum up, in a not so conducive environment, we have delivered strong execution as reflected in our digital data growth, combined with expanded margins and increased cash flow. We will continue to invest in our products as we see our relevance with customers is growing.

With that, I now request Kabir to share the key financial highlights.

Kabir Ahmed Shakir

Thank you, Lakshmi. The Q3 FY25 revenue growth driven by data came in at INR 5,798 crore, consolidated revenue growth of 2.9% YoY and 0.5% QoQ. The top line had certain Forex benefits accruing from its strengthening dollar. Normalizing for the same, the revenue growth is at 1.8% YoY and 0.2% QoQ. Data revenue for the quarter came in at INR 4,903 crore, a growth of 6.2% YoY and 1.4% QoQ. The digital revenues for the quarter came in at INR 2,313 crore, a growth of 10.2% YoY and 4.1% QoQ.

Last quarter, we emphasized multiple strategic measures, which will start benefiting us in the quarters to come. And I'm pleased to share that we are making good progress. We announced the monetization of land parcel in the previous quarter and necessary shareholder approvals are in place. Similarly, TSI purchase of entire stake in TCPSL will help us lower leverage, boost margin profile and PAT in the coming days. As Lakshmi highlighted earlier during the call, we are considering potential avenues of scaling Netfoundry by infusing external capital. This is another positive outcome of our strategic review of subsidiaries and will help strengthen and sharpen our focus on core and aid margins. Let me add that our strategic review of subsidiaries has not merely been restricted to monetization of assets. We've been working towards making TCTS more profitable and the impact on our profitability is already visible. TCTS EBITDA margins have improved by about 800 bps YoY. PAT for TCTS has significantly improved from negative INR 42 crore in FY24 to INR 40 crore till Q3 FY25. This has been outcome of our move to come out of a large loss-making contract.

Our measures towards simplifications continue as we undertake restructuring of the current layered corporate structure. TC Netherlands and TC UK have been identified as the preferred holding companies for potential acquisition overseas, and steps are being taken to realign them as direct subsidiaries of TC India. This simplification will help the company to be more efficient and opportunistic in pursuing any potential opportunities when they come by.

All the aforesaid measures are sharply improving the organization's ability to focus on the core and making us future ready, and at the same time freeing up resources to fuel our next phase of growth. With our land and noncore monetization stated above, we see our leverage ratios improving meaningfully over the next couple of quarters. Executing all the aforesaid measures was never easy as implementation required upfront costs and may have created a perception of inefficiency. These decisions position the company for long-term success and operational excellence.

Our EBITDA came in at INR 1,181 crore, up 4.1% YoY and 5.7% QoQ. Our EBITDA margins for the quarter were at 20.4%. Albeit negative, the EBITDA margin of our digital portfolio continues to witness an improving trend. PAT for the quarter came in at INR 256.6 crore, up 12.9% QoQ. FCF for the quarter was at INR 841 crore after being negative in the previous two quarters. This is the highest FCF we have reported in the last 10 quarters. We were able to address working capital concerns this quarter, even though collection in some pockets of SAARC region has been challenging in the recent past, driven by geopolitical factors. Cash CapEx for the quarter stood at INR 486 crore. ROCE came in at 16%, a decline of 40 bps QoQ. Net debt for the quarter stood at INR 10,468 crore, and net debt-to-EBITDA is 2.34x., Both net debt and ROCE are impacted by Forex . Net debt is higher by INR 200-odd crore and ROCE higher by 20 bps because of the Forex impact.

TCPSL and Netfoundry are part of discontinued operations and therefore they are not part of the reported financials. As such, the top line for Q3 is lower by INR 36 crore. EBITDA margins have been positively impacted by 40 bps and the improvement in PAT margin is seen at INR 20.7 crore. Net debt is higher by INR 267 crore due to non-inclusion of cash from TCPSL.

To sum up, our actions around repurposing our balance sheet combined with continuous investments in new capabilities position us well to participate in future growth opportunities.

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. Interested participants may click on raise hand icon at the bottom of the page on Webex application to join the Q&A.

The first question is from the line of Balaji Subramanian. Balaji, you have been requested to unmute yourself. Please unmute and proceed with your question.

Balaji Subramanian

Hi, good afternoon. Hi, Lakshmi, thanks for taking my question. My question would be on the demand environment. We have seen especially now with the Trump administration coming in, in some of the IT services companies at least are talking about an improvement in discretionary spending, from the next quarter or so. So are you also seeing some sort of a similar tailwind on the demand front? That would be my first question.

My second question would be on your FY27 revenue target, the data and the digital portfolio, revenue target. So now that we are just about a little over two years away from that time line. How do you see yourself achieving those targets? And then what is the visibility and how should one think about it?

Amur Lakshminarayanan

Yeah. So, thanks, Balaji. I think the first question on demand, I think, you referred to about the Trump administration coming in as well as the commentaries from the SIs. First of all, I think I had made the point before the demand cycles of what you hear and see from the SIs are not directly related to us as we are in a digital infrastructure business. And to make that point, even in both our quarter one and quarter two, we highlighted that our order booking has gone up both in Q1 and Q2, right? So even before that, I was saying that our funnel was robust. It was a matter of closing them and we are very pleased to have closed some of those in Q1 and Q2.

In Q3, our funnel additions have been robust, but closures is normal, I would say, like the previous years and not the increase that we had seen in Q1 and Q2. So our demand cycles are somewhat different to this, that's the first point I would make. Because in the biggest portfolio, both on the core connectivity as well as the next-gen connectivity portfolios, largely these are driven by the customers' adoption of cloud, they don't want to touch that infrastructure until something is broken. So the movements and the drivers of why customers go towards transforming are slightly different to what the SIs would say.

And I'm elaborating the point to just make sure that we can't directly correlate the two environments. Having said that, we are very pleased in this year's, particularly about our ACV performance. Q3 has come back to the normal. Our funnel is still pretty good in terms of additions. New deals into the funnel were good in Q3. And as we are looking at more larger and larger deals, our closure is taking time. I think that's more a function of us getting into a larger deal as opposed to necessarily the macro conditions, what I would say. So those are the main elements from what we see and how we see the demand environment to be.

To your question on FY27, I mean, as we said when we put out our ambition that we wanted to double our revenues, it is an ambition. That ambition was really underpinned by what we believe the enterprises were needing. And we still believe that those customers are, will have the need to transform the network, will need a fabric that seamlessly integrates across network, cloud, security and all of these. And therefore we are continuing to invest in that direction, and we are seeing good traction. Now whether we hit that number in two years is difficult to call out, it is, again, subject to many conditions in the macro. Even this year, for example, we anticipated a soft macro and demand environment. But I have confidence that we are moving in the right direction. We are investing in the right product set, and we are participating in opportunities to move us forward.

Balaji Subramanian

Thanks Lakshmi. That was useful. And what is the timeline by which you should be close to achieving your medium-term EBITDA margin target? If I do some rough math, it does appear that the annual loss that you are making in the digital portfolio piece, I do know that you have mentioned in the past that one can't kind of look at our digital portfolio and core connectivity in separation. But if I look at it, it does appear that the annual EBITDA loss there has stood a tune of INR 400 crore, INR 500 crore at least. So when can one expect these investments to normalize and make a decent maybe high single digits or early teens kind of EBITDA margins? I'm just talking about the digital portfolio piece.

Kabir Ahmed Shakir

Yeah. Balaji, let me take that question. I mentioned before, so I'll reiterate it. Every business within the digital portfolio has their destination margin. They are in the lines that you have already mentioned. So they may vary from one business to another. And the second bit is that they have a glide path of getting there. And there are drivers identified how we'll get. Some of them will be with volume and operating leverage kicking in. Some of them will be when they actually scale up and then we are able to get into multiple geographies. Some of them because of the cost-saving measures that we need to actually put, and some of them will be mix element.

So there are multiple drivers for each of the businesses that we are actually tracking. So that's what we have in the medium term, they should get to their destination portfolio. But having said that, I mean, in the digital portfolio, let's be open minded that we may have to pivot and repivot ourselves depending on how the environment and how the customer demands are unfolding in front of us. And we need to be agile enough to be relevant to our customers, especially in the digital portfolio. So therefore, I'd like to, yes, have my eye on what the destination margin is and what the glide part should be, but at the same time be flexible, that I stay relevant to the customers depending on the changing demand scenarios.

So with that, I would say, we are continuing in our overall margin ambition of getting back to the 23% to 25% range. As we said, we will get to the net debt-to-EBITDA ratio this year, ROCE next year and EBITDA the year after, that's what we had mentioned. We continue to maintain that except for net debt-to-EBITDA which may slip by a bit, especially because of the high Forex volatility that we have actually seen in the last four, six weeks, and we are all aware of what's happening to the dollar. As a result of that, the ratios do have changed.

Fundamentals of the business haven't changed anything, so it may slip by a quarter or so, both on the debt and on the ROCE line. Plus the corporate action that we have taken, for example payment solutions, on its own, that's the right thing to do for the business, but that means INR 267 crore of cash is gone, and therefore, net debt has gone up. Those are mathematics, Balaji. They don't change the fundamentals of the business or the value creating action that we are doing, each of them to get this business robust. So we are still committed to that and I'm really not worried if it changes by a quarter here or there because of macro conditions or external variables.

Balaji Subramanian

Thanks, Kabir, for the elaborate answer and all the best.

Kabir Ahmed Shakir

Yeah, thank you.

Sudeshna Patnaik

Thank you, Balaji. The next question is from Sanjesh Jain. Sanjesh, you have been requested to unmute. Please ask your question.

Sanjesh Jain

First, on the digital services, now that the Kaleyra is in the base, the growth of 10% appears to be significantly slower. What is really stopping us, because underlying driver really hasn't changed much, whether cloud adoption network transformation? I can understand slowdown in the CPaaS, but rest of the businesses, the fundamental really hasn't changed. So what is dragging us behind in the growth for the digital services? And what really will it take us for it to accelerate over 20%, 25%, which was the goal set for the organization?

Amur Lakshminarayanan

Yeah. So Sanjesh, firstly, you're right, the interaction business is a fairly substantial part of the digital portfolio now. And the interaction fabric on YoY basis has grown 11.7%, which we believe for that category of business is quite good because there has been a general slowdown on SMS and others. The drivers for that business to further grow will come when the adoption of other channels compared to SMS starts to acquire scale. So that is one driver. The second driver is essentially move it to a platform in terms of more AI-based orchestration and so on and that is what we are investing in. So that will happen in sequence. As the adoption of that happens, the interaction business growth and margins will begin to improve.

In the remainder of the digital portfolio, the next-gen connectivity has grown well. But for that, the order conversion takes much longer because when there is a large international network transformation, it does take time. Either because it's like customers say it's live wire, and we are touching the live wire for them, we have to be careful and they are ultra careful. And second is also they want to do that region by region, and it takes time to deliver, and therefore, recognize the revenue. So that is the kind of sequence that we have to go through.

So we see traction. The conversion to the revenue does take time. And I called out in the next-gen connectivity, we have grown well. And we are further investing in the new drivers, which are the cloud connectivity portfolio, which is very early stage in the market. The overall market is still only $1 billion globally. In that market, and that is seeing a very healthy growth, but that number growth, even if it is a 30%, 40% growth, is not going to shift the needle on the overall digital portfolio. So you're not able to really appreciate the growth in that portfolio.

If you look at our cloud and security portfolio, cloud is largely in India. Yes, we've had somewhat of a lower growth there. I would put that both to market, as well as the customer specific churn that we had in that business, but the security business has grown quite well and we had called out winning some large deals in the first half of the year, and we will see some of it panning out as soon as next quarter. So I think the drivers are exactly the same. I think we are investing in the right areas and we expect that we would gain more traction as we go along.

Sanjesh Jain

Thanks, Lakshmi. That's fairly elaborate. But considering where we are today sitting on the order book and sales funnel, how does FY26 look for us? Do you see these challenges continuing and difficulty as an organization to accelerate the growth?

Amur Lakshminarayanan

As you know we don't give guidance. But the only indicators I would say there are certain tailwinds, which is our acceptance in the market of our products and platform, the growth in the funnel that I called out and the increased order booking that we did in the first half of the year. And we hope that it will pick up in Q4 again. Q3 came back to more normative levels. So these are the tailwinds we see.

And similarly, on the headwind side, we do have headwinds particularly when it comes to the connectivity business, there is price erosion. There are churns that happens. And this year, we suffered from cable cuts, which was a substantial pull-down in terms of the numbers that you would have had. So there are some headwinds and tailwinds. So it's difficult to call out what FY26 would be. And beyond these indicators, we don't want to give any guidance as such.

Sanjesh Jain

No, that's fair. That's fair. Just one follow-up question, we have done a lot of investment, whether it's product portfolio, foot on the street, putting up a huge investment on the employee cost and all, are we satisfied with the progress that we thought when we started these investments in terms of how we are moving today?

Amur Lakshminarayanan

Yes. I think the clear reflection is the increased the order book that we reported in first half would not have happened if we had not invested in expanding both our product portfolio as well as investing in the right type of sales resource in the markets. Now the question is in order for us to grow and further accelerate, we believe, despite our international business has grown quite well even this quarter and this year, year-to-date has grown, but in order for us to grow in the international markets, our footprint and coverage needs to substantially increase even more, right?

And that we are taking very measured steps rather than incurring all costs upfront because we are having to balance the costs incurred how long will a person take to become productive and the results that they deliver. So these are more measured steps to take. But clearly, our presence would have to increase even more in order to grow faster.

Sanjesh Jain

Fair enough. Lakshmi, just one on the cloud, we were very bullish on the cloud part of the business. We have announced certain new products as well, and that we are taking international unlike the existing cloud business, which is more India specific. When should we see acceleration in the order win on that part of the business?

Amur Lakshminarayanan

On the cloud, we did not say we are doing international, Sanjesh. Cloud has always been India. We do have some cloud presence internationally, but we have not really scaled that or invested further in the international side. We do have some customers that we support. What you perhaps are referring to is the CloudLyte, which is part of of our Edge portfolio? And the biggest proof point of the Edge, that it works is our media cloud business, right? So the media cloud, even the large LatAm deal that we announced, we will use our Edge portfolio, specifically tuned for media, for that transformation of that business. So it is seeing traction. Currently, the only major use case is media that we have. So we will look at other use cases for manufacturing and retail, and then we could scale that in those markets.

Sanjesh Jain

And then AI Cloud, there also we were started investing, right?

Amur Lakshminarayanan

Yeah, yeah. AI cloud is where we have been investing. I think we were very pleased. We said that we will have it ready this quarter. Earlier last week, we announced GPU-as-a-Service for general availability for customers. The AI Studio, which is the platform capability on top of the GPU, is something that we will launch later this quarter.

Sanjesh Jain

But traction in those will take some time before we see more order bookings coming in from these services, right?

Amur Lakshminarayanan

Yeah. Particularly on the enterprise side, people are still going to be in the experimental and learning mode, and then they have to graduate to adoption and scaling. So that will take time. There is a class of customers, who would want to invest in model building and so on. Those would be the first set of customers where we would expect more scale usage.

Sanjesh Jain

Got it. Does this rupee depreciation, a sharp rupee help depreciation become more competitive in the international market?

Kabir Ahmed Shakir

Let me take that. Not really because our price is always dollar-denominated. Our cost, our O&M are also dollar-denominated. So they do have a bit of time lag, and therefore, you see the reporting stuff. So on the top line, we this time had a bit of a benefit on Forex , but on the cost line, on the EBITDA line, it was very marginal. It had a little bit of a severe impact on the net debt line, right. But then the after a point in time, they normalized, Sanjesh.

Sanjesh Jain

Got it. Kabir, last question on the land sale, which we were trying to do worth INR 800 crore to INR 1,000 crore. When is that expected to close and cash flow to come in?

Kabir Ahmed Shakir

Yeah, it's INR 850 crore to be precise is the gross amount. The shareholder approval is in place. All others condition precedents that are required are already, everything is completed. So we hope to do that deal in this quarter, and the monies will come in this quarter. I mean, yeah, we have recognized the DTF for that in the current Q3 already. So you'll see the money is coming in, in Q4.

Sanjesh Jain

So just one follow-up squeezing in for on that. Now that there is a huge demand for data center in India, should we see more land sale coming up, say, in FY26?

Kabir Ahmed Shakir

Sorry, what is data center got to do with land sale? I didn't see the connection, Sanjesh. But anyway, I would say we have an asset monetization plan. And I said, it's small, small here and there which we have been selling for the last two years. This was the one big one, which had title issues associated with it. It took us almost literally 18 to 24 months to sort it out, and we were in a position to then sell it.

There are a couple of other parcels which are on our radar now. And as and when the title and other regulatory issues and like classification and all those things are cleared, then we will get into the discovery mode. Some of them may be amenable for data centers, but some of them are probably very prime properties in the middle of cities, which may have better monetization, end use case. So that is left to the buyer who want to buy. We will do a discovery and try and get the best price for our shareholders.

Sanjesh Jain

Got it. Got it. And my only reason to connect it with the data center was that there was a classification issue on a significant part of the surplus land. And hence, the data center demand meets that classification issue and that was the reason.

Kabir Ahmed Shakir

We're going to put that up. And if there is a data center provider who is able to give us the value better than somebody who wants to build residences or malls, I'm completely independent of what it is. We will go for the highest value.

Sanjesh Jain

That's fair.

Sudeshna Patnaik

The next question is from Vibhor Singhal. Vibhor, you have been requested to unmute yourself. Please proceed with your question.

Vibhor Singhal

Yeah. Thanks for taking my questions and congrats on a descent performance. So Lakshmi, my question was mainly on the commentary by the IT services companies that have happened in this quarter. I mean starting from the TCS at the beginning of the quarter, I think almost all companies are talking about kind of a renewed environment, demand environment in the U.S. and the developer net discretionary spends coming back and green shoots in various basically domains.

So where are we in that entire scheme of things? I mean are we also seeing some of our clients or prospective clients talking positive about those things? Does any of that rub-off effect have on any of our segment verticals, which could help us take our growth to higher levels than what we are reporting today?

Amur Lakshminarayanan

Vibhor, I think, I sort of clarified that making that commentary to our business may not be relatable for various reasons because we are not in the application space. A large part of our portfolio is still network even if it is core connectivity and next-gen connectivity put together, is still a very large part of our group. And in this portfolio, the demand drivers clearly are as there are more migrations to the cloud as people want to move more to the Internet. And now with AI, the data is going to become even more important as to how they manage and store and utilize all of these. The demand for network transformation is definitely going to be there.

Having said that, how it translates is something that we have witnessed in the last two, three years is it's really like a live wire, people take very conservative approach in touching that and transforming that, and that will still continue. I think the only positivity I see is as people build more applications, there is going to be more data being transported and therefore the network would have to transform. When it would happen is not a direct correlation.

Second data point is even before others started making positive commentaries we said that our H1 order book, we said was much, much better than the previous years. So I'm just making that point to say that it's not directly co-relatable. The only area where we think the discretionary spend will benefit is one in our interaction business, because some of the marketing campaigns and others are discretionary, and that could go up and that could have a direct impact to our interaction business, and that is where we are further strengthening with our Kaleyra.AI product that we launched.

And the second area of the discretionary is more on the IoT Fabric, right. Again, that also depends on more discretionary budgets is what I would say. The rest of the fabrics are more fundamental and is not directly related to the environment that was described.

Vibhor Singhal

Got it. Got it. That was really helpful. So if I take it, let's say, I mean, the cloud business is predominantly India. Cloud adoption India is probably going to take place whenever it does with a lag, that's different. Well, next-gen you mentioned its network and will probably happens with a lag in some time. For the CPaaS business, I mean, to be honest, a very decent growth in this quarter. How do you see this growth playing out? I mean, what could be the triggers that could further up this number to, let's say, a mid-teen kind of a growth number on a YoY basis? Are we seeing more adoption of new technologies in which we have offerings for clients? I mean, some color on that would be really useful.

Amur Lakshminarayanan

Yeah. No, we have diversified the channels to voice, RCS, in some markets we have launched in the WhatsApp. So we would make more channel diversity available in many markets during the course of the year and that would be one of the triggers for growth. The second trigger is, of course, the platform that we are building on top of the channels, right, in terms of more intelligent orchestration and all of that. And that would be the second trigger.

And we are at the moment in very sort of early stages in terms of pushing that into the market. So we believe that, that will gain traction. And we will report on how that traction goes and how that growth we see because those will be the key drivers for the future growth. The SMS, they can take market share from other places, but it's still the overall SMS market is not growing as much as it used to. And also from a margin perspective, that is not a great driver of margins if you stay in SMS alone.

Vibhor Singhal

Got it. Got it. That's really helpful, Lakshmi. My last question is for Kabir. Well, Kabir, in terms of the margin profile, I mean, we are gradually expanding our margins on at the console level. But if I do the back calculation, I think, as I think one of the participants also asked, our digital margins still appear to be in the red. I know you don't give separate guidances for the separate divisions. But what will it take for our digital margins, let's say, to become profitable and get into that green territory? I mean the growth, to be honest, this quarter, we have grown almost 10% on a YoY basis in the digital portfolio. I mean do you need that growth to go up to a much higher level? Or do you think there is some base effect that will come into play or are we very close to that, and that irrespective of the growth numbers at some point in time, we should be able to reach that? Any color on that would be really helpful.

Kabir Ahmed Shakir

It's growth, growth, growth. I can't focus more on digital portfolio. Our biggest focus of the entire top management is driving growth. So we do not want to starve the business of the investments that it needs. So therefore, if we need to pivot and repivot, sometimes we challenge our business models and say, should we do it differently and we learn from it and adapt. We will continue to do that. Even in digital portfolio, just because you don't have the scale doesn't mean that you will not add feature sets. So you have to be relevant from your offering as well.

So it is not about saying, okay, I have invested already in the past. So let me pause and not invest further in product capability. So therefore, like Lakshmi mentioned, we've launched Kaleyra.io this quarter. I mean that is essential. Just because I've launched Kaleyra.io, will I be able to take my price up? Suddenly, I don't know. Hopefully, we can. But that helps me stay relevant in the pace. So see our own ambition is that this part of the portfolio should grow significantly higher than what we have grown this quarter.

I mean obvious reasons, and I want to still feel happy about this growth, given the context and given the relative market situation and overall demand that we have seen in the last two quarters. But having said that, our ambition, whether it's from the FY27 that we talked about or even otherwise, that it needs has to be growth. And when that growth operates at that particular level, you can do the math yourself because a large element of the costs are fixed in nature. So automatically the EBITDA profile will improve. So therefore, for that to take short-term myopic decisions, it's very easy to cut investments, but I think we should purpose our energies as an organization in driving growth.

Vibhor Singhal

Just to dwell a bit on that more, Kabir. Does that also mean that in terms of, let's say, margin expansion for individual, let's say, CPaaS or media or the cloud vertical, the main and probably the only lever that we have for margin expansion is growth and the other operating levers in terms of cost optimization and all, they have largely been exhausted?

Kabir Ahmed Shakir

No, I'm not saying that.

Amur Lakshminarayanan

No, we still have the cost levers available in those businesses, Vibhor. I think we are going to work on some of those levers, especially some of the digital businesses, which operate more internationally, some of the businesses where we had done acquisitions. So if you go to the EBITDA, after we did the acquisition, we used to say that if you look at our core business, including what we defined as a core as including the digital portfolio pre-acquisition, right, Switch and Kaleyra, we said our margins were at around 23%, right.

We say that is still the case. Our margins of our core minus the acquired entities are still at the 23% despite the investments we made in business in cloud and security, in IoT and other areas. So we believe that even in those portfolios, we have levers available. So for example, in the cloud business, everybody knows that the whole market was hit by an increase of cost on VMware. So we are balancing. So there are levers available in each of those businesses for us to further optimize and we are working on those. On top of that, the revenue growth will truly bring the operating leverage on top of it. So we will be operating on both aspects of driving efficiencies in this business while securing and protecting the investments that we need to make, at the same time in order to drive growth.

Sudeshna Patnaik

The next question is from Hitesh. Hitesh, you have been requested to umute. Please proceed with your questions.

Hitesh

This cable cut thing, your other things being equal, should we see the impact, revenue increase impact in Q4? I assume this has been sorted by October. Other things being equal, should we see the revenue increase in Q4?

Amur Lakshminarayanan

Yeah. No, I think I mentioned in my commentary that we are in the process of winning back some of the customers from the cable cut. Then we have to get that traffic back and then the revenues would come. So we don't want to directly correlate to that. But having said that, overall, the core connectivity revenues this year is muted compared to the previous years, owing to the cuts that we suffered. And hopefully, that will come back to the previous levels.

Now the only caveat that I would add in this situation is, overall, the core connectivity internationally, the core connectivity as a market, is a declining market. And in that declining market, we have been growing and taking more market share. So while compared to the previous years where we had growth the core connectivity by 6%, it's come down to between 2% and 3%. We think it can go up, but it depends on how the markets will play out.

Hitesh

Just sort of trying to understand better. If I've understood correctly, our success rate or conversion run rate has come off in Q3 versus what was seen in the last two quarters or versus what was seen in H1. So is that correct? Is the understanding correct?

Amur Lakshminarayanan

Sorry, before you go to the second question, I just want to clarify, I didn’t get the first question. What did you mean by in Q3, something has come off? Can you explain it?

Hitesh

A conversion run rate or a success run rate.

Amur Lakshminarayanan

In the order book do you mean, yeah.

Hitesh

Yes, yes.

Amur Lakshminarayanan

Okay. Yeah.

Hitesh

The success ratio come off in Q3 versus H1?

Amur Lakshminarayanan

No, no, the win rates have not really come off. It doesn't mean that in Q3, we lost something and so on. There are some deals that are sort of overflowing into Q4, but our funnel continues to be quite good. I mean in terms of order booking, we cannot be that precise on a QoQ basis. So I don't see the quarter three order booking coming more to the FY24 levels is what I said is not indicative of our ability to win our conversion ratios or a win rate has come down. In fact, our win rates are still pretty good, has gone up. It's just some of the delays in some of the deals rolling over to the next quarter is what I would say.

Hitesh

So the cycle has elongated slightly.

Amur Lakshminarayanan

Yeah, cycle. I mean, it's marginally gone up. It's not very material compared to the last quarters from what we have on an average, when I look at the large deals, we used to be at seven months, now it's 7.4 months. So it is not as though it's elongated. But in some of these things, if a deal runs over rather than closing on December 15, they closed it on January 15th, I wouldn't read too much to into it.

Hitesh

And when we've got this, when you say we've got a double-digit order book growth versus last year, when does it show up in revenue?

Amur Lakshminarayanan

Yeah. That's a more complex question to answer, because many of these have different conversion time to revenues. But I did say some of the deals, which are more in the area of the cloud and security that we announced in Q1 and Q2, we should start seeing that in Q4. Some of the network deals will take longer to fructify. If it is in the core connectivity, for example, we're doing a dedicated build that might take almost 12 to 18 months to show up, right, as revenues.

Hitesh

Okay. Okay. And just for a better understanding, of the order wins that we have, what proportion would be in India and what proportion would be outside India?

Amur Lakshminarayanan

I don't have that handily with me. And that is not a data point that we also have given on before. So I don't want to start something new.

Sudeshna Patnaik

The next question is from Dayanand Mittal. Dayanand, you have been requested to unmute yourself. Please proceed with your questions.

Dayanand Mittal

Okay. Just one question. What are the key factors that's driving margin expansion? And where do you see margins over next few quarters? Thanks.

Kabir Ahmed Shakir

Yeah. I mean I don't want to give any specific guidance on margin per se. Our ambition is 23-25%, we were at 23 to 25%, and we came down as a result of acquisitions. So there are a combination of multiple things that we are doing. One, each of those acquisition assets need to deliver on their business cases, which have built in synergies and margin expansion on their own. Our own core business needs to also grow and we need to have mixed benefits there and operating leverage to kick in. So that is another driver. But there are also going to be BAU of inflation and headwinds that we will face, and we need to mitigate that and then continue to grow. So that I would say it's a mixed bag of multiple things that we are looking at on an ongoing basis. And our ambition is, in two years time, we get back to the 23 to 25% using a multitude of these levers that will play out.

Sudeshna Patnaik

The next question is from Riddhesh Gandhi. Riddhesh, you have been requested to unmute yourself. Please proceed with your question.

Riddhesh Gandhi

In the U.S. the Lumen’s technology will benefit a lot from just the overall positioning as a sort of provider backbone of AI. And I understand that we don't have as strong a network in the States. But do we see potentially this being an opportunity in India and some of our other markets actually where we are strong?

Amur Lakshminarayanan

Yeah. Riddhesh, I think even in today's commentary, I mentioned that we are a market leader in DC to DC connectivity in India, right? Internationally the core connectivity has been on the decline, and we have been growing. So we have been doing relatively well with focused investments and capabilities and delivering a network that is reliable for the DC to DC connectivity and for large enterprises who require large pipes, both nationally and internationally, right. So that is the business that has been growing for us 6%, 7%.

While we had initially said that it would be in mid-single digits or low single digits, based on how the overall market growth or degrowth was happening in the international markets. So that's just to give you a perspective. So definitely, AI and Lumen has seen that on the back of large investments by hyperscalers for AI cloud in the U.S., Lumen has benefited through the large order bookings there. And that is precisely what we have been doing in our core connectivity as well.

Riddhesh Gandhi

Got it. And then just to understand on your commentary on your FY27 aspirations, which you spoke about, is it that now it's sort of looking difficult or it is still on target, may slip by a quarter or two?

Amur Lakshminarayanan

No. I think I've been saying that, that is an aspiration that we set for ourselves based on which we were going to invest in products and increase our relevance. I think we are still continuing to do that. The traction and the feedback from the customers in the market is very positive on the digital fabric. So we'll have to continue to stay the course on that. Now when it will actually transpire, it depends on several factors that I've outlined and those need to play out.

Riddhesh Gandhi

Got it. And just to understand from the time in which we sort of set this aspiration and now, because I'm sure you guys would have done a lot of thinking into putting that aspiration out there as well. Actually, I mean, what has sort of, like, not played out as you had expected to for us to achieve the aspiration?

Amur Lakshminarayanan

One is clearly the macro condition. The geopolitical uncertainties and the demand environment has gone down all over the place, and that is something that we cannot anticipate for.

Riddhesh Gandhi

But which area of the macro uncertainty? I mean, which area has been impacted by the macro uncertainty per se?

Amur Lakshminarayanan

What do you mean by which area?

Riddhesh Gandhi

No. As in, you're saying that the reason why the things which have changed is the macro uncertainty. But how is the macro uncertainty going to materially move the needle with regards to us potentially achieving what we were looking at?

Amur Lakshminarayanan

That depends on the spend environment, right? So the customer spends more on applications, there's going to be more need for data. As customers spend more on applications there are going to be more data island, so the networks have to transform. So it has a bearing on how our customers would see us and would buy from people like us.

Riddhesh Gandhi

Got it. But the IT spending angle of the things stuff hasn't been reduced. Then in turn, the application would continue in turn sort of we would also continue, and we haven't seen that happening in IT services. So just wanted to understand the reason we're seeing this year.

Amur Lakshminarayanan

But even in the IT, there's been a slowdown overall, right. It's no longer in the big double digits that people we are talking about.

Riddhesh Gandhi

And so in the event that let's say, with regards to our aspiration, is it just ultimately a question of maybe a quarter or two? Or it could take an extra kind of a year or two to reach the aspirations? Or how recent will this aspiration be, given what we know today?

Amur Lakshminarayanan

Yeah, I'll come back to that. We'll come back. I think we have an investors meeting coming up later on during the year, and we will have a better sense by then. We have another quarter to go.

Riddhesh Gandhi

All right, thank you.

Amur Lakshminarayanan

Because it is too early to call it quits.

Riddhesh Gandhi

Got it. So we're still aiming for it and hoping for it? That's it. Okay.

Amur Lakshminarayanan

Absolutely, yeah.

Sudeshna Patnaik

The next question is from Nishit Rathi. Nishit, please unmute yourself and ask your question.

Nishit Rathi

How should we think about this quarter, right? Because it's after four quarters that we've seen very strong, broad-based QoQ growth in the digital portfolio. So I know almost 6% Q-o-Q growth and across the portfolio on the digital side, barring the incubation piece, right. So is that the right way to look at it? Or should we look at it more on a Y-o-Y basis? Because the last three quarters are in the base and this growth has come in a seasonally weak quarter, and you're saying the full benefit of the orders that you've won in H1, have not yet kind of transpired, right? So I'm just trying to understand what is the right way to think about it? And is it unfair on my part to kind of think that what you've delivered in Q3 should kind of sustain or kind of improve going forward on a sequential basis?

Amur Lakshminarayanan

I think the way to look at this quarter is the overall digital growth as you mentioned in the current environment is quite good, the YoY growth as well as the QoQ growth. I've also called out the individual portfolios, and we've had good growth on the next-gen connectivity, on the cloud and security as said, albeit more on the security side rather than the cloud side. Our interaction fabric has grown double digit on a Y-o-Y basis.

Even our IoT fabric, while there's a QoQ decrease, YoY there has been a good increase in that business as well. So I think on the digital side, definitely, it's been a good quarter. Some of the orders that we won in H1 and H2 would have got reflected in this quarter itself. But next quarter, some of the larger deals that we booked, the translation of that, we would start seeing in the next quarter is what I mentioned.

Nishit Rathi

Yes. So in that context, because the YoY numbers have a very big bearing of the last three quarters, which were subdued. And if I annualize the growth that you have delivered in this quarter and annulizartion wrong is the question I'm asking you? Is there anything abnormal in this quarter, which you believe may not continue going forward? Because the order books are there, our relevance is increasing, the market is there. What should lead to that not happening going forward?

Amur Lakshminarayanan

So, I think see, the annualizing doesn't really work, the reason being, I think I mentioned the tailwinds I've been talking about, right, the order booking, the funnel being good and so on and so forth. The headwind really, especially on the network, including the next-gen connectivity, is still a very large part of our business, close to about 60% is on the core and the next-gen connectivity put together. That business particularly is subject to price erosions and churn, and customers, especially if you take an IT customer or a BPO customer of ours in India, if they lose a customer, then that network connectivity goes, right? So there are network terminations that happen. But a large factor is also the network price erosions that happen. Those are the headwinds that we have to worry about, and that's the headwind that we constantly battle. So the reason why I'm giving you that explanation is in this business, annualizing the quarterly revenue and extrapolating on that is not the right way to look at.

Nishit Rathi

No, no, I fully agree with you. It may not be the right way. I'm just saying in context that we lost a month with cable cut, the currency is in our favor and the fact that we booked very strong orders in H1. So I'm just trying to understand the caution, where is that caution coming from.

Amur Lakshminarayanan

There is no caution. I mean I'm just giving you both plus and the minus side. The plus side is clearly the orders booked. Last year, we saw a lot of DC-DC growth in India. We are the market leaders. As and when more comes, we will capitalize on those in all other portfolio, I think we are investing in the right places to be able to grow. The caution, along with that positive, I'm also saying what the headwinds normally are. That's what I'm bringing both the pluses and minuses, to be clear.

Nishit Rathi

No, absolutely. Got it. Okay. And can you just also help me understand how should we think about, if data localization were to happen, what are the parts of the businesses that could be positively impacted? Or what are the possible impacts that could be there on our business?

Amur Lakshminarayanan

No. Clearly, the cloud business will benefit. If there is more of a mandate to localize.

Nishit Rathi

Okay. And the connectivity side?

Amur Lakshminarayanan

Yeah, there is a cloud growth and there is more data centers in India, then the connectivity also will benefit from that.

Nishit Rathi

Understood. And last quarter, you called out that your international order book was at all time 5-year high, right, order booking, I think, if I'm not mistaken. Has that trend continued because you called out some very interesting deals that you won the international bank, the international retailer and some very interesting customers, so has that momentum continued? Are you seeing increased traction in that piece out there?

Amur Lakshminarayanan

Yeah. I think the international funnel is quite healthy. And year-to-date, the order booking also has been healthy. I think the thing is in the international regions, those regions are still relatively small for us. So even if those regions grow at 25%, or year-to-date, I've seen most of the regions have grown at a very healthy double digit, in terms of how it shifts the needle for us overall, is still a question. But in terms of the traction that we see, we surely see traction in all the markets.

Nishit Rathi

So are there some international regions? Because if you are seeing 25%, international is, if I'm not mistaken, around 40% of our business, right? So if that is growing at a very healthy pace, are there some international markets which are seeing headwinds?

Amur Lakshminarayanan

The international is also in two parts, one is the enterprise and also we have in international, we had the service providers and we have the OTT business as we call, right? So all of that is international. So the international enterprise is doing well. The OTT, after a lull, has picked up. So that would be the broad commentary on the international side.

Nishit Rathi

And lastly, are there any plans to invest in cables again because a lot of cables are starting to near end of life, are there any plans to kind of invest in cables?

Amur Lakshminarayanan

Yeah. We have been investing regularly on the cable side, right? Whether we may not invest directly as a consortium partner or build by ourselves, but we are investing through IRUs. So we are continuously investing and monitoring the capacity requirements of our business. And in fact, in the last few four, five years, our capacity has gone up quite high. So there is a constant investment that we are doing on cable systems.

Sudeshna Patnaik

Given the constraint on time, we will end the question-and-answer session now. With that, I will request Lakshmi to please share his closing comments.

Amur Lakshminarayanan

Yeah. Thank you all. I think we are very, very pleased with the digital growth. The overall international growth has been a good all round performance. Our performance on EBITDA has been quite good. And also the EBITDA to cash flow conversion is also very good. So we're very pleased with the overall in the quarter. 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 please disconnect now. Thank you.

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