"Tejas Networks Q1 FY20 Earnings Conference Call"

July 25, 2019

MANAGEMENT: **MR. SANJAY NAYAK – CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR – TEJAS NETWORKS LIMITED**
MR. VENKATESH GADIYAR – CHIEF FINANCIAL OFFICER - TEJAS NETWORKS LIMITED
MR. KUMAR N. SIVARAJAN – CHIEF TECHNOLOGY OFFICER - TEJAS NETWORKS LIMITED
MR. ARNOB ROY – CHIEF OPERATING OFFICER - TEJAS NETWORKS LIMITED

MODERATOR: **MR. PRANAV KSHATRIYA – EDELWEISS SECURITIES LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Tejas Networks Q1 FY20 Earnings Conference Call, hosted by Edelweiss Securities Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Pranav Kshatriya from Edelweiss Securities. Thank you and over to you, Mr. Kshatriya.

Pranav Kshatriya: Thank you so much, Bharat. Good evening, everyone. On behalf of Edelweiss, let me welcome you to Tejas Networks Q1 FY20 Earnings Call. We have with us senior management of Tejas Networks, headed by Mr. Sanjay Nayak, along with senior member of management team. Without further ado, I will hand over the call to Mr. Sanjay Nayak to start the proceedings. Thank you and over to you, sir.

Sanjay Nayak: Thank you, Pranav. Good evening, everybody. Glad to see that you are all on the call at 6 o'clock in the evening. So, let me give you a quick update of the quarter. We had put the presentation on the website, so I hope you had a chance to look at it. So, I will actually be going slide by slide.

So, let us start with the slide which says, Q1FY20: Key Updates. So, the overall sense, clearly it was a weak quarter for us and the revenues are not necessarily what we would have liked them to be. But nonetheless, as we go through the call, we will give you an explanation in terms of what's happening, both in the revenues for Q1 and on the overall business as well. So, quickly to summarize, our net revenue for the quarter were Rs. 156.6 crores. The profit before taxes Rs. 10.2 crores and profit after tax was Rs. 5.9 crores. Pretty much as you know that since most of our operating costs are manpower related and quasi fixed, once the revenues are lower the PBT and PAT pretty much follow that. The working capital increased primarily because of higher DSOs. This, again, is one area which we had hoped to make some improvement during the quarter, we haven't been able to do as much improvement as we would have liked. On the contrary, there is a slight increase in the working capital at this point in time. And again, we will talk about when we expect it to normalize and how things are going to get back on track. Order book, as we start Q2 is at Rs. 426 crores, this is slightly higher than the order book that we had when we started Q1.

In terms of the business, we had a very strong growth in India private, both in terms of percentage of total as well as on an absolute basis, if you were to look at them on a year-on-year basis. The government business declined quite significantly, as in the entire FY19 government business was 55% of total, whereas in Q1 it is 15% of total. Within the government business, if you remember we have two segments, the BSNL/BBNL business and the critical infrastructure. So, the critical infrastructure business continues to be on a steady state run rate, and the BSNL/BBNL business was absolutely marginal during Q1. We do expect government business to pick up in second half of the year. I don't think too much action will happen in Q2. But definitely in the second half of the year we should see pick up in the government business.

On the international side, again, we are seeing a very strong momentum. So, first of all, we have lots of new customer engagements and we had three new customer wins as well. A very important win was that with a Tier-I pan African operator, with whom we have signed a multi-year rate contract for a wholesale bandwidth application. None of those revenues have come into the quarter. But as we start engaging with all the opcos, we should see significant revenues from this operator alone over the year. US is a very important market for us, especially given the investments and the things that we have been lining up. We are very happy to announce that for the US market we have hired a very, very solid leader. Paul Harrison, who has joined us from Infinera, which is one of the largest optical networking suppliers in US, was heading the Metro business of Infinera, which is the one that we too are going to be focusing on. So, Paul's already been on board, our team has already done a lot of work in terms of bringing things to a very good state. And again, we haven't had significant sales from US in Q1. But going forward for the rest of the three quarters we will actually start seeing interesting revenues coming out of the US market itself.

R&D is an important part of our company, this is something which we feel very proud about and something which we have continually been investing in. Total as on date we filed for 349 patents, and in addition we own 288 semiconductor IPs as well. We also had a patent grant during the quarter. And just to give you a sense of our products, we are getting global and international recognition for what we do. So, for example, we got the National Technology Award, which is among the highest technology awards in the country from the Government of India. And we were also the finalists for the Leading Lights award in the US for Most Innovative Products in the access category. We also got a UAE Business Award for the Best Global Networking provider in the Middle East Asia region.

So, overall, I would say, we have been doing well on the R&D, we have got good competitive products, and internationally we have started to ramp up. And India, of course, on the private side has done well, the government business has declined. And if I were to look at the India private and international as a total, it was 85% of the revenue, this is what we would count almost like a runrate revenue. Whereas the lumpy part of the revenue, which is the Indian Government, particularly the BBNL and BSNL business, declined quite significantly. And probably that was the main reason why our quarter revenues were not as high as we would have liked them to be.

I'm now on the next slide, which describes the revenues for the quarter. And again, I think as we have been communicating in the past, we do not really have a very strong quarter on quarter or a year-on-year trend, we look at our business on an annualized basis. But we did put the number up if you were to see from a YoY comparison basis. Really what is happening is that Q1 traditionally too is a slow quarter, but this year was lower than usual. And during the year as we go to Q2, Q3, Q4, we should be seeing improvement.

In terms of where, how the year will look like? We think it will be a second half heavy year. And we believe that Q2 will again be better than Q1, but definitely we will still have a lot of business that will come in the second half of the year. Primary reason for that is because the clarity on the government business, and if you recall, we had mentioned that we had about Rs. 350 crores worth of government orders that we won in the last fiscal year, they have to get converted into purchase orders. As on date they have not been converted and we expect that that should start happening during this quarter. And based on when and how those happen, we should see the pickup on revenues in the government part of the business in the rest of the year. But that's most likely going to be in the second half of the year.

In terms of profitability, while the Q1 profitability is clearly low, the reason for that is our costs, as I mentioned, are almost fixed. But by the time we end the year, we expect the profitability in terms of operating profit or EBIT in the same range that we had seen last year, which is 14% to 15% of net revenues. And we don't see any reason why we will be challenged on that.

Coming to these key financial indicators, which is the next slide. Our working capital increased by Rs. 144 crores on account of higher DSOs and higher inventory. And we expect that by the end of Q2 and soon thereafter, we should be able to you know normalize the same. The big one which hasn't happened was the last collection that we had overdue from be BSNL. And again, just to remind everybody, this is not a BSNL's own network, but this is the BSNL money that is on account of the Bharat Net project, for which BSNL was the executing agency. So, while BSNL has its own financial problems, we don't think that that has any direct implication on the receivable from them. We are working with the government, which means Department of Telecom included, to make sure that at least we should not be impacted by that. And we will keep you all posted as we make the progress. But I think we are making progress in the right direction. And that delay itself has caused the DSOs to go higher.

The other reason for the DSO to go higher was that in Q4 we had, again, in the last month of the quarter we had some government revenues, some of which are falling due in this quarter and we should be able to normalize those collections as well. But on an overall basis, it did increase the DSOs by a certain number of days.

In anticipation for some of the POs that we were planning to ship in the last quarter, we had built some inventory. For whatever reason some of the customer orders have got delayed. And that's why the inventory also increased from 64 days to 87 days. We had been maintaining a very tight inventory level over the last few quarters, but in this quarter again, due to the timing of the POs we have increased inventory levels. Going forward, by the end of Q2 again we think that inventory levels should be back to normal from what it was earlier. And from a cash perspective, we still have Rs. 231 crores of cash in the bank, we have no debt on our books, and we have adequate amount of money available for investments in terms of all the sales initiatives that we have.

Next slide is more on the medium-term strategies. This is just a recap of what we have been talking earlier and we are sticking to that strategy. And I must tell that it seems that we are heading in the right direction. So, India is of course going to be a large market. Data growth in India is happening and will continue to happen. This is a home market for us in terms of the government business, which we do have an advantage in terms of preference to Make in India. And we do have short term challenges in terms of the BSNL situation and the whole Bharat Net rejig because of the new government and freeze in terms of decision making over the past four to five months. But all of that seems to be clearing and when I talk about a little bit more commentary on the India, I will share that.

So, we will continue to gain from the India home advantage. But really the focus of the company in terms of where we are taking proactive steps is on the international side. Our target in the medium-term is to ensure that 50% of our total revenues are from international markets. Last year we had made some progress as we progressed from 19% the previous fiscal to around 22-23%. We are very confident that this year we will be much higher than 23% and on a trajectory to reach 50% in the medium-term.

R&D investments will continue. We make the R&D investment within our business model, and which is 12% to 13% on a fully expensed basis. That gives us adequate cushion to invest into the right product areas and create competitive differentiators. I will also talk about what are the competitive differentiators which we have in our products. But this is a strategy we will continue to maintain.

And last, and most important from many of our perspectives as well is that all of this we plan to do within a financial model, which we have been seeing to work in the last couple of years. And we think we will be able to maintain profitability as well as working capital efficiency. In the Q1 we have a bit of distortion on both of those. But as the year progresses, we should be able to make progress towards that goal as well.

The next slide is more of a recap again. If you think the base business that we are in, we are in the right business, the data growth is happening around the world with more use of internet, social networking, videos, cloud, everything that we all are connected with. So, fundamentally, as long as data keeps growing we are in the right business and there would be a need for higher amount of CAPEX in terms of the optical transmission equipment and all the other access equipment that we give.

Next slide talks about the business drivers for us in terms of the applications? So, one application which we are targeting, and we have got a lot of success, both in India and in international markets is the fixed broadband access. Basically, businesses and homes around the world need to connect on to a high speed internet. Wherever fiber can go, we will be using FTTX technology or fiber to the home technology based on GPON. And we have a product which we have shipped and we are getting very good success. We believe we have an extremely competitive product to compete with anybody in the world.

The second thing is that there will be lot of homes or enterprises where you will not be able to take fiber, either because of topology, because of sparse population and for that you need a fixed broadband on wireless. We have been investing in this area. And I am very happy and confident to say that this is the year where we will start seeing meaningful revenues coming from our fixed wireless access products as well. The good news from Tejas' perspective, which we will talk about later as well, is that all of these technologies are integrated on one single platform that makes it extremely easy for us to have this adopted by our customers.

The second area where we are continuing to see demand is the 4G backhaul, which is kind of happening in India and still a large part of other world. 5G has started to happen in certain geographies, it will really accelerate next year onwards or maybe even the year after. But realistically, all network decisions are being taken with 5G in mind, which basically means that operators are already believing that they have to have lot more network densification, which means you will have 10 times more cell sites than you have today. And each site would carry a lot more data than it is carrying today. And the best option again is if they can take fiber they would; if they cannot, they would actually use a fixed wireless technology to do the backhaul. And again, with the technology that we have developed, we should be able to address the demand for 4G, 5G and IoT, which of course will be on-boarded onto a 5G network.

The cloud and the datacenter market really means that the big fat pipes need to go into those datacenters, which will require multi-terabytes switching capacity. And again, we are not addressing all of it, but we are really picking up a few niche applications in that space. For example, alien wavelength which we have been very, very successful around the world to make sure that we have products which can compete with the best and can take advantage of that opportunity.

Coming to the next slide, which I think we shared last time at the end of Q4, is the segment wise revenues. So, if we really see what we have done, on the left hand side we have shown the pie chart in terms of how our business splits between four different segments. So, in FY19, India Government was 55% of the total, India private was 24%, the OEM has shrunk 2% and the international direct went to 19%. And if you recall, we pretty much transitioned all the OEM business into the international direct, and which has been a successful transition over the past two years.

If you look at our Q1FY20 revenues, India private was 68% of total, and international direct was 13%, OEM was 4%, and India government was 15%. Now, what it really meant is that between India private and international we have been contributing to around 85% of total in this quarter. And we believe, based on all the funnel that we have, and all the engagements we have, we expect international to show very, very strong growth during the financial year. If you recall, last year, international direct grew 70% year-on-year, and we have enough confidence that this year as well we should be able to sustain the momentum and hopefully even grow a little bit faster than that on the international direct side.

As far as India private is concerned, that was another focus area for us. And our success in India private was predicated around us winning new customer applications, because we are suppliers to all the large customers any way. And we have been successfully doing that. While last year India private grew 28% on a year-on-year basis, by the time we finish this year, we believe that we should be able to sustain the momentum or maybe even accelerate a little bit in this segment.

As far as the India government is concerned, there are two pieces of India government, one was the critical infrastructure business which is the utility business, the smart city, the power grid, the railways and so on, which is a steady state business, and is not lumpy in nature. And we do believe that part of the India government business will continue in a sustainable steady state mode this year as well. The large part of India government business last year, around 35% or so out of 55%, was the BSNL and BBNL business, Bharat Net business, which are absolutely lumpy in nature, and that is what really did not happen in Q1. So, if you really see, out of 15% of India government revenues in Q1, probably about 8% of that was utility and maybe around 7% of that was the BSNL/BBNL, which was really marginal.

So, if you see the lumpy part of the business showed up in Q1, the run rate part of the business which is private as well as international and the utilities continued to show a healthy trend. And we expect that for the rest of the year the trend will continue. In terms of what is the likely scenario for the India government business for total year? The way we would like to show is that the BharatNet projects at a macro level, the new Government has clearly stated in the Parliament that they would like to wire up 250,000 villages on BharatNet, which is currently at 120,000 or so. So, the intent of the government is to continue with that project and wire up all the 250,000 villages at the earliest. Because of certain issues in BSNL, which we are all aware of, the execution of that project has got delayed to some extent right now. So, some of the state led BharatNet projects which had already gone through tender stages will get cleared is what our expectation is. Any new BharatNet projects will probably be thought through more carefully. And that is really where we believe that some amount of clarity will need to come before we can conclude exactly how India Government business will shape up for the rest of the year.

What is very clear is that in Q2 I don't see any significant trend difference for India Government, and hence most of the India Government revenues including the ones which will be converted from the tender that we won last year should get converted into orders in the next few months, are likely to happen in the second half of the year.

So, just to quickly summarize what you will see this year is the intent and the direction in which the company had started last year, which is to focus on international and India private, which is more sustainable and run rate business, will continue to see a positive sign during the year. The India Government part, we really have less control for the BSNL and BBNL projects which are large and lumpy. So, those we will be on a wait and watch mode and we will continue to communicate as and when we get more clarity.

Coming to the next slide in terms of the sub segment within the India thing. So, what are the telcos doing? So, when we looked at the commentary of most of the telcos, or at least ones which have come out publicly, it is very clear that the operator consolidation is almost completed now, everybody is clear that data growth is the way to go, prices seem to be stabilizing to some level. And it's very clear that to have better data experience you will need to increase the fiberization of towers. Still around 25% of the towers in the country are fiberized, and clearly around 50% to 60% have to get fiberized on an average to get good 4G coverage and good throughput of the network. So, we will see CAPEX going into optical transmission part of the network for sure.

The second mega trend which will happen, sooner than later now looks like, is the rollout of FTTH, fiber to the home. So, we do believe that a few operators will start rolling out commercial services in a reasonably large way in the next few months. And once that happens, it will trigger a growth in FTTH services, both to enterprises as well as homes. And how are we playing into that? Clearly, our strategy is that we want to get a larger wallet share of these new applications. And where we think we have a very good chance of succeeding is on the FTTX based on GPON. We are also working on metro capacity upgrade; we have seen some business in that segment and will continue to expand that. The full fruits of our wins for these applications have not yet shown up in numbers, so as the year progresses we should able to see more speed up in terms of the build outs of the application that we have won. And enterprise data services is continuing to be a good bread and butter business for us, which we have been serving through large data service providers in the country over many years.

Coming to the critical infrastructure part of the business, this is a business which is not really seasonal in the sense that power grid, railways, oil and gas, smart cities, security systems, defense, involve lots of small projects that are continually ongoing. And we have a very large market share within these segments. Really, at a fundamental level, all of these utilities are modernizing their legacy networks, and they require the kind of equipment that we have. And the preference to Make in India, the PMA policy is already applicable and it has been strengthened in the last couple of months by the new government. So, we expect that this part of the business will continue to be a steady run-rate business in this fiscal year as well. We don't see much impact of the government overhang on this part of the business.

The last part which is a telco in the USO business, is the one which we will see fluctuation as we saw in Q1. The good news is, USO fund, if you have been reading the newspapers, about Rs. 21,000 crores of USO fund has been released till date for Bharat Net Phase 1 and Phase 2 to BBNL. While some of it has been distributed, rest is still with them, so the money is available. And they feel that they want to wire up 250,000 villages in the country and complete a significant part of Bharat Net Phase 2 by March 2020. So, we will start seeing action happening in this direction.

In addition, there are other projects which the government is targeting, which is 5 million public Wi-Fi hotspots, railways is targeting a lot more Wi-Fi stations, and many, many other projects. So, we do believe that those projects will also result in business for us. And again, PMA policy and all related policies are still favorable. Another interesting thing that you might have been seeing in the news is about 5G and what is India going to do about 5G. And clearly, if you see all the statements which have been coming out from the government, they are very keen that when 5G happens in India, it should also help nurture and create a domestic ecosystem of product companies. There are a lot of thought processes and efforts happening to see if a few Indian companies can be created or stepped up to take advantage of certain parts of 5G ecosystem. Clearly, we have a play in to that, especially with the fixed wireless access program that we have been investing in the past few years. We do believe that there is an opportunity for us to upgrade our systems to 5G as and when it happens, and really take advantage of that. And once things happen, we should be able to benefit from that.

So, this part of the business, I would say would be the most lumpy and this is really where we would like to kind of give clarity only when we have clarity. And at this stage, it looks like it is in second half of the year when this business will pick up. When we again talk after a few months we will be able to kind of share more specific details. But barring this part of the business, the rest of the government and India private business is progressing nicely for us.

On the international side, there are three geographies which we have been focusing on and the focus stays that way. Southeast Asia and South Asia we have made good progress last year. We have continued to make a lot more progress this year. We are clearly emerging as a very credible supplier to any operator who wants to diversify his vendor base, pick some non-Chinese suppliers, like some countries in this region are thinking of. And I think we fit the bill very well. We have a good amount of incumbency, customer success as well as feet on the ground in terms of sales presence in these countries. This is also the region where we think we will see the first few large deals for us on the fixed wireless application, which we have been developing. So, we are at an advanced stage of engagement with customers and we should see some success there as well. Malaysia, Bangladesh, Sri Lanka, Singapore and Vietnam are the countries where we have good traction. And we have a large opportunity funnel which we are confident will fructify during this financial year.

African and Middle East is another area where we have been continually investing. At the outset, we have added another operation in Algeria. Earlier we had operations in South Africa, we had one in East Africa, in Nairobi, we had one in West Africa, in Lagos; we have added North Africa office in Algeria. Algeria will be addressing all the francophone countries in the northern African region. We already have a couple of Tier-1 customer wins in Algeria, and using those as a success story we now want to expand in that region. So, the salesperson in Algeria is already on board.

Again, alien wavelength on the WDM side is something which we have done very well in the African region in addition to converged broadband access in terms of GPON, LTE and optical transport. Africa is the region where we won a multi-country RFP on a pan-African basis from a Tier-1 customer. So, overall Africa, I would say, is again progressing well and we expect it to expand quite significantly during the year.

In terms of US and Mexico, Mexico always, in fact, last year was a very strong performer. And we have Tier-1 customers in Mexico. Now we have a very large footprint in terms of the breadth of customers in Mexico. This is the year we are going to go deeper into those customers, and instead of selling into one application, we are now winning new applications into the same customers. And as a result, we expect Mexico to once again show strong growth this year. USA is a country that we have been investing over the last 15 to 18 months. We have done a lot of homework, a lot of groundwork lot of customer engagement and very strong sales funnel, especially in the Tier-2 and Tier-3 operators, and there are about 400 plus Tier-2, Tier-3 operators in the US. This is also a situation where the Chinese have not been allowed to sell in the US. So, there's a lowering of competitive intensity that we can take advantage of. While we have done on the work, we have not got large customer orders or generated significant revenues in US so far. We also have a seasoned head of sales for US who is known for closing deals and making things happen. And we are confident that for the remaining nine months for this year, although we didn't get much out of US in Q1, but the remaining nine months of the year we should see a good progress from the US as a geography. And this will basically set the foundation for next year and onwards.

The kind of applicant again we are seeing in the US where we are winning is network modernization, and we have talked about this earlier. We continue to believe that we do have a competitive edge in terms of technology in this area. We are also seeing traction for our GPON product. And with the most recent wireless auctions completed in the US, we will explore if there's an opportunity for fixed wireless in the rural areas for our wireless product. All of these look like exciting opportunities to go for in the US. So, in North America as a segment, we will continue to see good progress and growth. The OEM business pretty much flattened out to a minimum level last year. I think we will of course continue with that level, we might grow a little bit here and there. But it's unlikely that with the same OEMs we would have any significant increase in terms of the traction. So, that's kind of a quick summary of the various geographies.

Just to recap, again, in terms of the product areas and the addressable market in those product areas, the optical aggregation which is what has been a sweet spot for us for many years, is a $4 billion market going to about $5 billion. The fiber to the home, which is a GPON market which you got into the last couple of years is a $6 billion market, going to around $7.6 billion by 2023. The fixed wireless access, which is a new market we are now getting into, and one of the big killer apps for 5G is estimated to be a $1.8 billion market which would go to around $3.2 billion over the next few years. And this is where we think we have a good niche that we can go after with respect to 4G/5G based fixed wireless application.

Metro WDM and Access is where we are focusing on, we are not really focusing much on the long haul or ultra-long-haul WDM which some of our other competitors do. But in the Access and Metro WDMs it's a large market, $8.5 billion going to $11.4 billion. We do have, again, applications where we do extremely well. So, overall if you see, we have a large addressable market. And it's really for us to execute and get more traction in those segments.

Just a quick recap in terms of the product portfolio of the three segments of the business, which is the Access, Metro and core. So, Access and Metro is really where our sweet spot is currently, in terms of building a converged Access product, which is what we announced at Mobile World Congress earlier this year. This is the product that I talked about earlier, where you can be give GPON services, LTE services on fixed wireless as well as Ethernet services, all from the same hardware, same box, just by upgrading with new software, and new application features. In the Metro segment, capacities are going up from 100 gig wavelengths to 200 gig to 400 gig and 600 gig, and our products are all scalable to basically be able to address those capacities. We have products available in multiple form factors, so you have a smaller box that can be used at the edge of the network and a larger box for the metro core. And multi-terabit switching is realized using an innovative disaggregated architecture, which is a new trend happening in the industry especially for metro core deployments. And we believe that as the capacities increase, we will be able to launch this product and target to the right kind of customers. At this point in time, as I said earlier, Access and Metro is where most of our revenues are coming out.

Next. So, in terms of the key network applications where we win, clearly we talked about the converged mobile backhaul where you have 2G, 3G and 4G, 5G on the same box, we are starting to see a lot more RFPs where customers want to make sure that the hardware and software is 5G ready or upgradeable, and we are already addressing that. Wholesale services is an area where we have been doing quite well, especially with the alien wavelength solution where an operator can basically reuse other competitors' equipment and launch new services or new wavelength using our products at the end points. Enterprise services with guaranteed quality of services with support for low latency applications will become more and more important in 5G and is a sweet spot for us. Broadband access is an area where we believe the ultra-converged access product that we have, which integrates fiber to the home and wireless to the home technologies in one is a very unique product, especially in the emerging markets where people want to simplify network architecture, and we are seeing a lot of demand. And once we start getting initial success of the converged architecture in a few accounts, we should be able to replicate that success in a big way. Utility customers, again, are upgrading their older infrastructure to newer infrastructure and fit well in our sweet spot, and we are doing quite well in that segment in India. In fact, in the US market too we have had a few utility wins. Network modernization which, again, marries the legacy infrastructure to the new way of doing things in the packet architecture is another sweet spot for us. And we again have been doing very well in that segment as well.

So, basically what I am trying to say is that in these six segments we clearly have differentiated customer successes and reference accounts, which we can use to basically replicate in other parts of the world.

Just to summarize, and after that we will take questions, I am on the last slide. So the fundamental drivers of the business continue to be strong, data growth is happening, broadband is happening and we seem to have the right products. Our focus as a business is really transforming the company from being a very heavy government kind of a business company to a more run rate business, which is a mix of private and international. The transition began last year, we have made some more progress in the first quarter of the year. And in the next three quarters we feel confident that we will head in the right direction. The lumpy part of the business which is the India Government tender business, it's something that will stay that way, we just have to make sure that the rest of the business grows healthily enough to take advantage of those big bumps that we get. So, India private and international, as we said, grew to 85% of total; new applications is what is driving the growth in India private right now, critical infrastructure is on a good steady state trend. And the Indian Government business is lumpy and the clarity in terms of business from this segment will only come in the second half of the year. So, this is the part of the business we will continue to have a little bit of uncertainty, till we actually win the tenders and get the orders in our hand.

International, we have been making consistent and focused effort on the sales side across all geographies, the three geographies that I mentioned. And we are starting to see positive results. This year I would say would be, again, a repeat of last year where the international direct will grow the fastest. And all the geographies will probably contribute equally, if not, or at least in the same range. And our medium-term target to have 50% of our total business on international is achievable. And we are of course building up leadership teams in the right areas and hiring more sales people on the ground as well. On the R&D side, as I said, we will continue to invest and make sure that we create applications where we have an edge. And essentially on the broadband access side, both on wireless and wireline, and Metro aggregation, we seem to have created a very good sweet spot which we would like to replicate across in terms of global success. And our products are clearly gaining more traction, more global recognition in terms of both industry as well as customer events.

That's really where I would pause. And I have with me Venkatesh Gadiyar, our CFO; Kumar, our CTO; and Arnob our COO to answer any questions that you may have.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Mukul Garg from Haitong Securities. Please go ahead

Mukul Garg: Sanjay, clearly it looks like business continues to remain quite challenging. If you look at the government business side, it has been a continued disappointing sector. We have had growth of traumas to H219 to H120, and now it has shifted to H220. Given the lack of visibility on the governmental or Bharat Net space, why should we assume any business from Bharat Net in FY20? You mentioned it's a H2 thing, but given the experience over the last few quarters, does it not make a case of kind of assuming that this business might not come this year, hence avoiding all this volatility which comes down on the revenue side in terms of expectations?

Sanjay Nayak: Now, that's a good question. So, this is what we tried to articulate, so clearly there are two things happening. So, one, we do have some backlog of orders which will get shipped out during this year, I am talking about the government as a whole, some of it may be BharatNet, some of it is of course the critical infrastructure. So, we have a backlog of orders which will clearly get executed during the next nine months from the government part of the business, so that's kind of the business which is secured. The critical infrastructure business, which is the utility business, as I commented, is a run rate business so I don't think that's going to have volatility. The BharatNet part you highlighted is exactly right that there will be volatility. So, the only reason for us to kind of call out as to why it could happen in Q2… By the way when I mention the government business, I mention the total government business, including the utilities. And as far as BharatNet part for Q2 is that at least the tenders which happened last year, and the results of which have been out, which have been submitted for final approval and are at the final stages of confirmations, if they happen during Q2 or even in early Q3, they will result into revenue this year, because the timelines of supplies will be there. But for whatever it's worth, if those orders don't convert, then you are right that new tenders coming in starting from now, getting closed and getting to revenue stage is unlikely. So, the short answer to your question is, if the Bharat Net tenders or the other tenders of government from last year get converted over the next three months, they will result in revenue this year; if they don't, they will not. And that's basically what we are articulating.

Mukul Garg: So, basically Sanjay what I was trying to kind of put across that, given what the experience has been over the last three quarters, shouldn't the base case be that these tenders might not get converted into purchase orders of this year? And if we just bake that into the commentary from private space and international market, this kind of a build and it suggests that there might be a worst case scenario for 7% to 15% YoY decline in a FY20. Is that something which we should be prepared for?

Sanjay Nayak: Again, it's very hard for us to call that out. I mean, what we are saying is one way to model, which is model the international, model the India private, model the critical infrastructure and any backlog, and anything above that is something may happen or may not happen and we really have no control on that. So, I think that's definitely one way to model.

Mukul Garg: The other question, for Venkatesh. Venkatesh, the inventory increases this quarter, and you guys have highlighted that it was because of expected customer order, was it in private space or in the public sector space?

Venkatesh Gadiyar: Yes. See, it's an equipment that can be used across multiple customer segment as well. But we had in anticipation of certain orders, which did not come and which we will execute and try to bring the inventory down in Q2.

Sanjay Nayak: Basically because the products are same for private or government, so we basically build the inventory, because the lead times are long, to kind of make sure that the same boxes could go to either a private or a government customers. So, we basically do a weighted average of different orders and some of those orders we have built in trade anticipation which should get unclogged in this quarter.

Mukul Garg: Understood. And on the cash flow from operation, is my understanding correct you guys have a decline of Rs. 122 crores in Q1 versus Q4?

Venkatesh Gadiyar: Yes.

Mukul Garg: So, I am just starting to reconcile this. If I look at the numbers from balance sheet, you guys have about Rs. 40 crores impact of inventory and about Rs. 60 crores impact of receivables. And if I build in, I am not able to come up to Rs. 122 crores, it is more like Rs. 70 crores, Rs. 80 crores decline in cash flow from operations. So, can you help me reconcile this Rs. 122 crores?

Venkatesh Gadiyar: Yes. Look at it in this way, total working capital has increased by Rs. 144 crores, which is nothing but it has increased by 77 days when compared to the March. March we had a working capital for 260 days, now it has went up to 283 days. It's primarily comprised of, DSO has increased by 48 days in this particular quarter. And, in fact, the DPO has come down that means; last year end was 132 days, now it has come down to 120 days, that means we have paid more to the vendor. Similarly, inventory has increased, which includes boost in transit, the value of about Rs. 24 crores. In fact, it has increased from 64 days to 87 days, there was an increase of 23 days. Net, net this has resulted in a cash outflow of nearby Rs. 122 crores. Basically the major component is DSOs has resulted in increase in the working capital.

Mukul Garg: Just to clarify, the receivables are up close to Rs. 60 crores and inventory up Rs. 40 crores, are these correct?

Venkatesh Gadiyar: Yes.

Mukul Garg: Okay, I will take it offline. The final questions which I had was, can you help us with the breakup of receivables, it continues to increase. And while we understand there's a lot of legacy impact from BSNL, is it possible to give a breakup of the Rs. 650 crores in terms of orders from private side, what is from public side, and more helpful will be what is greater than 180 days and what it is less than 180 days?

Sanjay Nayak: Yes, so essentially we don't have that level of detail, because it's the function of each customer's payment cycles, and all that. But at a broad level I can kind of give a clarity on where the DSOs have increased. So, the BSNL part of the DSO really, we have not collected much in Q1 at all, so we basically hardly collected a very small amount, so nothing really moved there. In Q4 of last year we had, if I am not mistaken, our government business was crores to 45% to 50%. And some of those things have also kind of become due in this quarter, they were not due last quarter, so that will get cleaned up. The international in India private, it is basically just a matter of timing. So, I would say that if I were to put where the DSOs have slipped, really the increase was on the BSNL stuff, the Bharat Net BSNL stuff which has slipped, plus some of the other government stuff which we shipped in Q4, which will basically get due in this quarter. So, the way we are looking at the business is that by the end of this quarter all receivables which are in our control, I would say primarily, which are non-BSNL ones should come back on track. The BSNL one, while we put every single effort and working with the Department of Telecom, that is the one which we will have to continue to see whether how soon we can collect it and what mechanisms can be done to secure that. So, I think those are the things which are coming down. But I would say other than that one of which has got delayed, the other receivables should come back on track by the end of this quarter itself.

Moderator: Thank you. The next question is from the line of Jayesh Gandhi from Birla Sunlife. Please go ahead.

Jayesh Gandhi: Further to what Mukul was asking, actually the fundamental point is, why do that business? We already have Rs. 350 crores, Rs. 400 crores of receivables from the government, government telecom company which is kind of bankrupt. If you execute more orders for them without receiving money, you will probably have Rs. 600 crores, Rs. 700 crores of receivables from them. And the entire cash balance that we have will get drained out. So, the point is that, why do that business at all? First insist on the payment and then only ship, I guess that's the only way you can do government business, you have many, many infrastructure companies which have gone to NCLT and become bankrupt because they done business with government and government is not paying them. So, I guess there does appear to be a real strong case of reconsidering whether we should be doing this business at all.

Sanjay Nayak: First of all, Jayesh, its a very good question. So, what we are doing is the following, so if you really see we have been ultra conservative in Q1, we have not even shipped out anything unless we are very sure of the payments. So, the non-BSNL part of the business, by which is power grid, railways, I don't think we have seen any issues with that. So, that part of the business we are continuing to do, and that's a good business for us, its good margins, the payment has never been a problem and we have fine. You are absolutely right that anything to do with BSNL, unless we get clarity on payments, there is no benefit of doing that business, because it's all on paper, to be honest. So, we will be essentially taking the same approach.

But on the second hand, what we are doing is, if we are not going to do that business we are putting extra effort from our side to really make sure that the international and the India private gets on more accelerated mode, because we really need to kind of "fill up the holes that that part of the business which was dominating for so many years has created". And that is really where the effort of the company is going. In fact, so if you really think of where the mindshare of all the senior management of the company currently is, it really is on focusing and growing the international and the India private, because that's really our long-term bet.

Jayesh Gandhi: We appreciate that, and that's been going very well. The point is that you already have a Rs. 250 crores - Rs. 400 crores receivable number, we don't want that to increase and use up the cash balance that we have just go looking at top line or delivering product without being paid.

Sanjay Nayak: Perfect. In fact, one more thing I must clarify, which I explicitly did not, remember earlier I was saying that for the second half of the year we may get some pickup of the tenders that we won last year, and we have not got the orders. So, your question, if I were to put it is, "Hey, why would you want to do any portion of that business, even if those orders come?" Now, the good news for us is that those orders are not directly from the government, those are from system integrators from whom we have a tight payment arrangement. So, for example, an earlier order that we executed last year, some of them for defense, some of them for certain other applications were through system integrators. We have already collected our money for those orders, just for your information. So, if we do any of this government business out of the backlog business that I have been talking about, that will only be under the condition that our customer is not government, our customer is a system integrator, and we have our own mechanisms of securing payments through appropriate instruments. And as far as we are concerned, we supply the equipment and we collect the money. So, we are very, very clear that even the orders that are supposed to convert… by the way, we loosely call it government business for second half, but because it is technically speaking a system integrator or a private company in between. But as far as we are concerned, we are very, very clear that we have enough momentum and enough opportunities to grow internationally that there is no reason for us to just do government business and lose money. So, that your line of thinking is exactly the line of thinking which the company has that unless our payment is secured we do not want to do government business, if a system integrator is in between and we are collecting our money, I mean, sure.

Jayesh Gandhi: Sure. So, my second question, Sanjay, is that what is the timeline or what efforts have we put in place to collect the money that is receivable? Rs. 680 crores, my sense is the dues from BSNL are Rs. 350 crores or Rs. 400 crores, if I'm not wrong?

Sanjay Nayak: No, no. So, the total dues from BSL is only Rs. 250 crores, and that is just the one which is the one which we have to put an effort, and I can tell you specific effort. So, we have been working... Because working with BSNL alone is not going to serve our purpose. We have been working with the parent department, the Department of Telecom and the UFO Administrator and all the other people. And I think they clearly see the need and the reason for Tejas to get paid, especially given that each country needs a few champions to really create the telecom infrastructure, and we clearly are one of those. So, I think enough effort is going on. And I have personally been tracking that activity, and as I said, I mean till it comes we cannot of course say anything, but all efforts are on and we are all confident that in the near-term we should be able to collect that Rs. 250 crores.

As far as the other Rs. 100 crores or Rs. 80 crores of the government money is concerned, that is not one customer, it is split between power grid, railways, Oil India Limited, some particular defense installation and so on. I don't think there's any risk to it, it is basically when it falls due we will collect during this quarter. So, I don't see that as a risk at all. As far as other receivables are concerned on international and India private, international and India private which I think I have mentioned earlier that initially when we sign up large deals, there would be some flexibility on payment terms that we have to give to the customers because we are potentially taking business away from potentially a Chinese competitor or someone else. So, in the first quarter we cannot put all the terms and conditions that are suitable to us. But once we make our mark, once we have got our engagements going, we are able to shrink down those payment cycles as well. So, a combination of all of this, I feel that barring that Rs. 250 crore uncertainty, all the other collections we have a well defined plan. And by the time we finish this quarter, we will actually see the progress of all the other collections, barring the Rs 250 crores that we talked about.

Jayesh Gandhi: So, if I put it slightly differently, excluding the Rs. 250 crores which we have receive from BSNL which is stuck, what is the normalized working capital cycle that you would have or the working capital days that you would have, if you can indicate that, I don't know whether you have a number right away, but would be happy to understand and know what is that normalized number. And would there be any operating cash flow, clearly that was done last year, but this year FY20 would we be seeing operating cash flows or a negative number there is what my question is? I don't know whether you have a answer for it, but happy to understand that.

Sanjay Nayak: Yes. I would give the broad answer and then we will get into the specifics maybe offline. The broad answer is very simple, our DSO target is around 140 to 150 days. And that's around the target that we had already achieved actually last year till we regressed because of BSNL tender business. Over the next few quarters and definitely before the end of this fiscal year we feel that we should be able to get back to that. And as a result of which, we should be able to generate free cash flow like we did in the past.

Jayesh Gandhi: So, 140 days is without the Rs. 250 crores?

Sanjay Nayak: Exactly, because Rs 250 crores is skewing everything right now. And one more thing I must mention is that in all our large deals, I am not talking about the small deals, there's a 5% to 10% retention amount. So, we collect the 90% or 95%. And the retention amount is paid typically one year after the last payment, because it's kept as performance security.

Jayesh Gandhi: What would be that number which is retained in the Rs. 650 crores?

Sanjay Nayak: Around Rs. 90 crores so probably would be retention amount. But it's not that, I mean, Rs. 90 crores of retention will also fall due at different points in time during the fiscal year. But if I were to take a snapshot of June 30th, around Rs. 90 crores is the retention amount that we have at this point in time. And this is accumulated over the year.

Jayesh Gandhi: Okay, I understand. Fair enough. So, I am getting some color on Rs. 650 crores as a breakup of that. And our target is to hit 140 days of DSO by end of the year is what you are saying?

Sanjay Nayak: Yes. And then the only one which could distort that is the BSNL. And which I think if I were to look at the end of the year situation, we are very, very confident that BSNL money should be collected, hopefully much before that.

Jayesh Gandhi: Yes, we will believe you when we see the money.

Sanjay Nayak: Absolutely. I am saying the same thing to my sales guys as well.

Jayesh Gandhi: Maybe you need a CEO for collection. So, the other quick question I have Sanjay and team is that, our R&D budget, and of course, rightfully so, is fairly high at 12%, 13%, 14% of the top line. If I look at the first quarter numbers we as shareholders are not making that much. Over the medium-terms, will the shareholders return, there is the PAT margin, be at least more or equal to the R&D spend that we are doing.

Sanjay Nayak: I don't know about the PAT, because this year we will have a little bit of a distortion of PAT, as we mentioned last time it was because of the accumulated tax credit and all that. But if I were to look at the operating profit level, we still believe that by the time we finish this year, and we have been reiterating that we have to look at our business on an annualized basis, we still believe we have all good reasons that 14% to 15% operating profit we will be able to get this year, based on the fact that international will be a significantly larger portion of our revenues compared to last year, by the time we finish the year. By the way, one thing which nobody asked and I also forgot to mention is that our gross margins for Q1 were about 4.5% lower than our average for last year. So, our material costs were a little bit higher, that was because of a particular product mix that we had during the quarter. But again, we believe that the gross margins will be at a normal level compared to last year by the time we finish this year, because of a business blend with higher international and lower government. Hopefully we again come back with operating margin in the same end that we had last year. And by the way, the R&D investment or something which we believe is the right thing for the company to do. And on a larger base, it will basically come down, even though it showed up is 12% or 13% right now, probably it might come down to around 11% by the time we finish the year. But it's I think investment worth making because we only win deals when people see a differentiated product or technology, otherwise the default customer can always buy from a Huawei or Alcatel or any product, but they buy from Tejas because we have something better than others. So, I think that's the area we will continue to focus in a right way, but it should still not be at the expense of not helping us generate the right operating profits. So, I think we will reach there by the time we finish the year.

Moderator: Thank you. The next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Sanjay, you mentioned that for international side you give a bit of any longer initial payment terms and then shrink that, 140, 150 days the initial setup term or is this more of a stable steady state? And if you can share initially what is the DSO which you guys have on new deals on international side?

Sanjay Nayak: So, I mean, unfortunately there is no single formula that we have, because we actually have three different international regions, which is US which by the way currently is, the business is not big, but the payment cycles are very short, it's less than 60 days for most cases, right. So, I don't think that's a problem there. But when you look at Africa, again, smaller customers' payment cycles are shorter, but once you get to a slightly larger customer payment cycles go higher. So, it's kind of a function of the specific situation. Similarly if you look at Southeast Asia, there are some customers with whom we have been doing business for many, many years, so we have a good control on the payment cycle, while some of the customers we are just signing onboard. So, I think it's a mixed bag. I would say the way we are looking at the entire business is because both on the margin side as well as DSO side is that as a blend between India, India government, private and international, we should be able to get to around 40% gross margins, which is kind of the industry average. And we believe that around 140 days of DSO is what we think we should be able to accomplish on a steady state. We will have quarterly fluctuation, like in this quarter we are pretty bad in terms of the DSOs and even the margins are about 4.5% lower. But I am sure as the year progresses and the quarter by quarter thing gets blended in over six months or a nine month basis, that we go away. I would say, clearly, we try not to give any long payment terms to the extent possible, but sometimes it's just the nature of the particular customer situation. And we have to be a little bit flexible on that.

Mukul Garg: Got it. The other question was, if we look at the gross margin side, you have highlighted that generally gross margin you guys are expecting it to be stable YoY. But given that the Bharat Net portion of the business will, as a portion of revenues will come down very meaningfully going forward, shouldn't the gross margin be higher given that those products generally carry a better margin profile?

Sanjay Nayak: Again, it's a bit hard to say. For example, if you think about the Bharat Net Phase 1 versus Phase 2, because the same product we got add-on orders, we probably did much better gross margins in the second order, because the price was pretty much what was 24 months back, but we got the orders recently. So, I would say, I mean, the only broad thinking is that the international margins are higher than the India margins. Within India, by the way, I mean, we all know that the private operators are not going to give you high margins either. So, we have to fight for every penny of margins there as well. So, net, net India margins will be at a certain level and international margins will be higher. Within international, of course the US is the highest followed by depending on which country you are in, Africa or Southeast Asia. India margins will clearly on a blended basis be the lowest. And that is why when I was responding to Jayesh's question, I said this year we will see a higher percentage of international revenues compared to the 22% last year. We have a natural tendency to improve some margins. But on the other side we will have some drag on margins because of deals in India. And like Q1, even though we did higher in India private, the margins are down by a few points because of the nature of that specific situation. So, I think those things will happen. But on a blended basis is what we really try to manage the company, because still at the base of the company we have, it's very hard to kind of do too much of a fine tuning on an individual customer or a geography basis. But on a blended basis we feel comfortable on both the margin and the DSO that we should be able to maintain the last year's level and improve.

Mukul Garg: Got it. One quick question on the order book, and thanks for providing that on a quarterly basis. What portion of that is from Bharat Net?

Sanjay Nayak: So, first of all, at a high level the Rs. 426-odd crores we have, about 40% of that is what we will be revenuing this year. And ballpark I think about 50% of that would be BSNL and Bharat Net, and the remaining 50% is the India private and international. So, that’s a rough split on the revenues for this year by the way, not on the overall order pipeline. So, let's say out of the Rs. 426 crores, about Rs. 170-odd crores is the revenues that we will do this year. Out of Rs. 170 crores, about 50:50 would be between those two. And the revenues for the Bharat Net or BSNL are more like service revenues, so that would be basically not any supply but more service related then supply related.

Mukul Garg: And the remaining, if you look at this Rs. 426 crores, does that include L1s or that is confirmed orders?

Sanjay Nayak: No, this is not L1, this is orders in hand.

Mukul Garg: Okay. And on Tier 1 customer win in Africa, can you help us with the potential opportunity or value?

Sanjay Nayak: Hopefully, it's a pretty large potential, so we just signed the rate contract, we got the license to go to all the OpCos and start pitching our solution. The way it works is the selection is central, which means they do a global RFP and the centralized procurement team selects their vendors, they issue you the rate contact and then say, "okay, you can go to any OpCo and these are the the names of the OpCos, you can pitch your solution and you can basically win business". So, that's the good part. So, they had given us a number when the RFP happened, but I would really discount that number at this stage, because we have not done our own first assessment into every Opco. So, my sense is that during the year we will actually start to see, and my thinking again is that Q2 will not be the quarter where we will get significant revenues, because we just got the clearance to go. And by the time it takes to prime up all the OpCos, our second half of the year when we will start to see meaningful revenue. So, I don't have a magic number right now, but it looks like a fairly large opportunity. And more importantly, the best part which we talked to a few OpCos is that, which is by the way the value of our product architecture that once they select product of stages, say for application A, the same product can also do application B, C, and D. So, I don't actually have to win a new application in that Tier 1 because they have actually done the rate contract for our particular box. And but if the same box can do two, three different functions, so the OpCos are excited that, okay, now that I can induct this box in my network, but in addition to the original application for which it has been selected, I can also deploy it for some other application. So, I think that's an exciting potential which is emerging for us.

Mukul Garg: But is that something which we should look at more of a three digit opportunity size over the next few years?

Sanjay Nayak: I really have no basis to give you a number at this stage. But once we do get a sense of how it's shaping up, we will at least try to give a direction on that. But at this stage, it's a bit early for us to precisely put a number to it. But it's a large OpCo, many, many operations, they have a huge CAPEX every year. So, opportunity is good. But it would be a bit premature for us to actually put any number two it.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. And due to time constraints, we won't be able to take the further questions. I now hand the conference over to Mr. Pranav Kshatriya for closing comments.

Pranav Kshatriya: On behalf of Edelweiss, I thank you for attending the call. I will hand over the call to Mr. Sanjay Nayak for his final remarks.

Sanjay Nayak: Thank you, Pranav. Thank you, everybody. I think the questions were very insightful. I hope we were able to answer them in the way that we know. And just to quickly summarize, I think it was clearly a challenging quarter, both on the revenue front as well as the DSO front. But the company is doing everything that we can to do two fundamental things to the business, reduce our dependency on government business and increase international and private business. And secondly, really get the DSO problem under control so that the cash comes back to the company rather than staying with the customers. And we are making good efforts on both things, and will continue to report progress as the year goes by.

And then the last thing again I want to mention is that, our business really is not a quarter-on-quarter or year-on-year, we should look at it on an integrated basis for the whole year. And we tried our best to give as much information as we could to give you a sense of the progress we are making. And clearly this is one year where based on all the commentary that I made, we would have a heavier second half of the year compared to first half, unlike last year where the first half and second half had not that much of a difference in revenue profile. So, that's more or less what I would say. And again, thank you for your patient hearing on the whole call.

Moderator: Thank you. On behalf of Edelweiss Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.