

Transcript: Post Q1 FY2010 results conference call, Mastek Ltd
9th October 2009, 5pm IST

Presentation Session

Moderator:

Good evening ladies and gentlemen. I am Gopal, moderator for this conference. Welcome to the post results conference call of Mastek Limited. We have with us today the Mastek management team. At this moment all participants are in listen only mode. Later, we will conduct a question and answer session, at that time if you have a question, please press * and 1 on your telephone key pad. Please note this conference is recorded. I now would like to hand over the conference to Mr. Abhinandan Singh, Head of Investor Relations, Mastek. Please go ahead Mr. Singh.

Abhinandan Singh:

Thank you and welcome everyone to our post results conference call. Present along with me today at this call are Mr. Sudhakar Ram, our Chairman and Managing Director, Mr. John Dowd, our Group CEO and President, Mr. Farid Kazani, our Group CFO and Finance Director, and Mr. Jamshed Jussawalla, our CFO. We will begin today's forum with brief opening remarks by Mr. Sudhakar Ram and after that the floor will be open for your questions. After the call ends, within a few hours, we should have the audio replay of the call also available for you at the access numbers mentioned in the conference call invitation that was sent to you earlier. The transcript of the call should become available in a few days, which you can access at our website www.mastek.com. Now, I would like to request Mr. Sudhakar Ram, our Chairman and Managing Director, to initiate this call with his opening remarks. Over to Mr. Ram.

Sudhakar Ram:

Thank you Abhinandan and good afternoon, good morning to all of you. As you must have read, essentially this quarter as we had expected was what we see as the bottoming out of the impact of the slowdown and the results were a bit lower than what we thought it would be, partially because a couple of orders that we thought we had booked during the quarter got delayed. So the revenues were down from our guidance of 195 to 205 crores, we ended up with total income of about 191 and that had an impact on the profits at a PAT level. However, the efforts that we have taken in terms of maintaining the margins did pay off and at the EBITDA level we did improve margins this quarter from 15.3% last quarter to 15.5% this quarter. What I see is clearly the pipeline has built up and we are confident that the order book, which

has actually declined quarter-on-quarter over the last three quarters, will start strengthening and improving in the next quarter. So clearly the indicator this quarter, which is October, November, December, will be the strength of the order book. It will translate into uptake in terms of revenue; we have given a range of between 2% and 7% rupee terms in terms of the revenue growth and corresponding increase in profits. So, the profitability we have tried to maintain and marginally enhance, but clearly the focus seen in this quarter is to get the order book in place. The investments we have made in terms of enhancing the sales force, getting senior people in, in sales and marketing and in the executive leadership team, have actually translated to better pipelines, so as a company we think it will start generating results in terms of order book from this quarter onwards and we would like to get back on to a strong growth momentum within the next two to three quarters. So, that's pretty much where we are. The quarter has been in line with the fact that we thought we are going to have it impacted in term so the NHS ramp down, it was just that a couple of orders slipped, it has actually led to more of a slide in revenues than what we anticipated, but we do expect to get back on track from Q2 onwards. So those are high level comments, I will now leave the floor open to questions.

Question and Answer Session

Moderator:

Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone key pad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key. We request participants to ask one question in the initial round.

First question comes from Mr. Ruchit Mehta from HSBC.

Ruchit Mehta:

Hi good evening. Just on the delays in so many contracts that you mentioned in the opening remarks sir, could you give us a bit more understanding behind that, are these the same contracts, which we had seen delays earlier in Q3, Q4.

Sudhakar Ram:

Not really. These were some new orders from new customers as well as extensions from existing accounts, which got delayed.

Ruchit Mehta:

And as of now, you see them coming back on track in the current quarter, or you think they would...

- Sudhakar Ram:** We do expect the order book to increase this quarter. As you are aware, it had come down to almost 250 crores, we need to get that back on track and that is the focus of the entire team in this quarter.
- Ruchit Mehta:** What would you say is the risk to not maintain the second quarter guidance, I mean, assuming these contracts remain delayed or deferred, how much of an impact do you foresee in the current quarter itself?
- Sudhakar Ram:** See, we don't expect, obviously what we have taken into account, the booking in any quarter only translates to a marginal amount of revenue. So I would say there is a 2% to 3% kind of a risk in terms of the revenue.
- Ruchit Mehta:** Okay. And in terms of your guidance are you factoring in that there will again going forward be a recovery in the margin from the current level of 15%, 15-1/2% to what we had anticipated of 17%-18%.
- Sudhakar Ram:** Yes, see, I think, a lot of our cost control initiatives have actually yielded dividend and that's how we have been able to maintain EBITDA margins. But right now, if you look at the investments we have made on the sales and marketing front, the actual uptake in margins will happen as our revenue base expands and our growth happens, which would translate to better bottom line, because the sales marketing costs would get amortized over the larger base.
- Ruchit Mehta:** Sure. I was just wondering, in terms of Elixir, if you could give us an update and more specifically as to the roll out with Zurich, as to where we are?
- Sudhakar Ram:** Yes, in fact the Elixir program, which is Elixir 4.2 for UK, has been pretty much on track and we do expect to start implementing Zurich in this financial year. So, the system that they need has gone into test with them, so they should be able to start implementing it within the next three to four months.
- Ruchit Mehta:** Okay. Essentially towards the end of Q3, Q4 you would have started the implementation work and revenue accretion should flow from that.
- Sudhakar Ram:** Yes.
- Ruchit Mehta:** Okay. And just finally, on your other income, you know it came in just about...even in your notes you have mentioned that it is lower than anticipated, just give us color as to what happened and...

- Farid Kazani:** If you look at the other income which was there in the last quarter, which was much higher, that was largely due to the FMPs, that got matured in the June-ending quarter, and there was some reversal in terms of the receivables that we were able to recover. That helped us in the other income area in preceding quarter. But if you look at this quarter, other income is largely the income which we have earned out of investments and therefore it is at the normal level that we would have per quarter. The aberration was last financial year's last quarter number.
- Ruchit Mehta:** Sure. And just finally, on the taxation, you have come negative, any reason for?
- Farid Kazani:** We had a deferred tax created this quarter, so that impacted this quarter and therefore you will see a negative taxation, which is why it is showing negative this quarter. Overall for the year we expect taxation to be around 10% to 11% and in the next quarter we would have some refund of tax, which will also probably help, but we have not quantified that completely.
- Ruchit Mehta:** Sure, thank you.
- Moderator:** Next question comes from Mr. Pratish Krishnan from DSP Merrill Lynch.
- Pratish Krishnan:** I just wanted to understand the guidance in terms of the average focus on growth rates, I mean, is it possible to split this into sort of, what is the kind of volume you are looking at?
- Sudhakar Ram:** The entire growth is volume-based because we have not seen any sort of price contraction or an expansion.
- Pratish Krishnan:** Okay. I am just wondering, because I believe, you probably have assumed a rupee appreciation in your numbers...
- Farid Kazani:** We have considered around 47.25 as the forward rate for quarter 2, which is down from 48.20, which has been in this quarter, that's the assumption that we have taken when we have given the guidance.
- Pratish Krishnan:** Yes. So in December kind of quarter would you be expecting around 6% to 7% kind of volume growth then?
- Farid Kazani:** Yes, around that, between 5 to 7%, you have to take somewhere where you will be within the band.

- Pratish Krishnan:** And what would drive this, because if I look at your order intake for this quarter, that still remains subdued, so what would really drive this kind of growth?
- Sudhakar Ram:** That is actually fresh order booking, which will be extensions from current contracts, as well as from new customers.
- Pratish Krishnan:** And secondly, in terms of margins, do you expect margins to expand even in second quarter?
- Farid Kazani:** We are expecting margins to kind of be stable to some kind of improvement in the quarter 2 and as Sudhakar just mentioned sometime back, we have made investments in sales and that will help in terms of further margin improvement once we have an uptake in the overall revenue going forward, which we clearly see that in the next few quarters, we will see some kind of overall improvement in the margins.
- Pratish Krishnan:** This is despite the rupee, like, rupee appreciation happening.
- Farid Kazani:** Yes, rupee kind of forecast, is what we have given for next quarter at 47.25, we have not forecasted the quarter after that, we will do that once we get into the third quarter.
- Pratish Krishnan:** Fine. And just one last one, does this tax rate freeze? You have just mentioned, 12%, that's for the full year, I mean, despite two quarters of negative tax rates, or...?
- Farid Kazani:** See, we would expect tax rate to be around 10% level, and there is some kind of refund that we are expecting in some of the element of tax in UK, which is likely to hit in quarter 2, which is what we have considered. Thereafter, obviously it will depend upon how the revenue and profit pans out, so it is a matter of conjecture. My assumption right now is 10% tax.
- Pratish Krishnan:** Okay, fine. Thanks a lot.
- Moderator:** Next question comes from Mr. Rishi Maheswari from Enam AMC.
- Rishi Maheswari:** Hi, my questions have been answered, just wanted a comment from Mr. John Dowd on his view of the company, what is his line of action from here on and how does he view Mastek from an outsider's perspective.
- John Dowd:** Thanks for the question. I am an insider, not an outsider, and my view of Mastek is, it has a great promise in future,

has some significant strengths as an enterprise, obviously with a genuine IT origin and the opportunities for competing globally on that basis, but importantly its IT foundation strictly in the insurance base is, in my view truly world-class. We are coming into an exciting time when that will be demonstrated versus developed, as we talk to you in the call, launch toward the Zurich implementation and in my view that will be a very exciting opportunity for the market to recognize the truly global world-class situation that brings. Sudhakar has also referenced in the call, we have restructured the organization on the front-end, we have brought in some very senior and very capable leaders that can guide our value proposition into large institutions, large partners, that we work with and come up with points of view and opportunities that are complex, but important within our client, and also great opportunities for us to unfold. So we invested in this past year of challenge and really put a transformational strategy in place that not only manages the cost efficiently, but frankly has got significant investments in R&D that will propel us to greater opportunities going forth in the future. My view of Mastek is that it is well positioned for a lift as the economic recovery emerges.

Rishi Maheswari:

Alright. Thanks so much.

Moderator:

Next question comes from Mr. Srivathsan from Spark Capital.

Srivathsan:

Yes, hi. Just wanted to know what's the head count at the end of this quarter in the virtual bench?

Farid Kazani:

The head count is roughly around 3500, and when I am referring to bench, the virtual bench has gone down to 230, which was in the last quarter it was around 320. The 3500 includes the virtual bench.

Srivathsan:

Okay, sure. With the kind of forex fluctuations, any change in hedging policies that you are contemplating at this point of time?

Farid Kazani:

Actually we have gone ahead and implemented a revised effect strategy and this was after taking views from a lot of bankers, where the consensus was that rupee would appreciate. We have gone ahead and partially covered our net exposures for the next three quarters and that will cover the starting of this quarter, so we have been able to get some favorable rates both on the pound and rupee.

Srivathsan:

Is it possible to share what's the exact amount of cover in the rates?

- Farid Kazani:** We have covered the net exposure to the extent of 40%-45% and the rates would be in the region of 49-50 on dollar and around close to 80 rupees on the pound.
- Srivathsan:** Just wanted to get some sense on business outside Elixir, what are the other focus areas, as we know that government and Wealth Management are two practices we have been investing. So, has there been any growth traction in both these verticals?
- Sudhakar Ram:** Sure, I think there are three aspects that you have to consider, one is the insurance that we keep talking about another is the government sector where the percentage of revenue from Government came down because of the NHS project completion, but we still have existing accounts, which we expect to grow and we are also looking at tying up new partnerships, the third is new verticals like health care and wealth management. Health care is in a very nascent stage and we are looking at what to do in the US, once the Obama Health Plan opens up. In wealth management we have made some forays and I think we would look at some interesting events this year in wealth management too. Apart from that we have had the geographic expansion in Canada and that has started to pay dividend that we would be signing up accounts in Canada in this financial year, so we should see some revenues coming in from Canada and we are also strengthening a horizontal competency base especially in the area of testing.
- Srivathsan:** Okay and if you have to look at Elixir per se we have launched two modules now in UK and one module in US and one model in Asia Pacific when do you see the complete roll out completed across all three geographies, all seven modules?
- Sudhakar Ram:** No, what we have done is we have launched two modules in the US. In the UK, it is an end-to-end platform which will implement -- so that is not one module, it will be all the modules, but for a set of product families, which Zurich needs, so that is the thing which will happen within this financial year, within the next three-four months. Similarly Elixir Asia that we have launched is an end-to-end platform which is unique for all the requirements of India and Asia Pacific countries that we operate in, that is again an end-to-end platform. So once we launch an end-to-end platform we may not necessarily get deals for all the modules together, sometimes we may get deals for some modules, some times it may be end-to-end, so that actually depends on the pipeline and the prospects there.

- Srivathsan:** And the incomes of the modules both in US and Asia are these SOA or the Elixir UK that is the old version that has been modified to these markets?
- Sudhakar Ram:** Both US and UK are SOA. The Asian version is actually a complete java component based version; actually we were looking at what is more appropriate technology for that region, so it is a java component based technology, J2EE technology.
- Srivathsan:** Okay sure, thanks a lot.
- Moderator:** Next question comes from Mr. Madhu Babu from Systematix Shares.
- Madhu Babu:** What are the areas where we are seeing the pipeline and demand outlook improving, you said that we have seen some improvement?
- Sudhakar Ram:** We see improvements in insurance, we see improvement in the existing accounts, we have seen some traction in new markets, which is things like wealth management in Canada and so on and new service lines, so those are the areas that we are focusing on. We are building up a pipeline in all those areas.
- Madhu Babu:** In Canada it would be government, Sir?
- Sudhakar Ram:** No, right now it is financial services, insurance, with the government in Canada, but we have potential future market once we have a base done.
- Madhu Babu:** Okay, when we say testing, is it like software testing?
- Sudhakar Ram:** That's right.
- Madhu Babu:** Okay and we have shown that we had one client in government vertical, so can I know regarding that, I mean?
- Sudhakar Ram:** Yes, we have added one client.
- Madhu Babu:** Okay, that is like BT any other partnership we have won or...
- Sudhakar Ram:** No, it is not a partnership, this is a direct customer.
- Madhu Babu:** Okay, sir and insurance has gone down by 14% this quarter, quarter-on-quarter, what was the reason for the weakness in insurance?

- Sudhakar Ram:** It is just a part of the project milestone, so some part of the license for capita got built last quarter, which was a lump sum, which was a huge amount and that was not there this quarter, but I think you should look at it over a period of three-four quarters rather than quarter at a time.
- Madhu Babu:** Okay and this Zurich implementation that is included in order book, sir, which we are going to start, Zurich Elixir?
- Sudhakar Ram:** No, it is not.
- Madhu Babu:** Okay sir, thanks.
- Sudhakar Ram:** Because as the delivery happens is when that order will get recognized, so we have to finish the Elixir for delivery for Zurich and then the implementation order will get booked.
- Madhu Babu:** Okay, so do we say that the order book has bottomed out from this quarter and we would see only uptake from here?
- Sudhakar Ram:** No, there are many things, which we know are there, but we don't have signed contracts in hand and we expect to start finalizing and signing up these contracts in this quarter, which is why we expect the order book to go up this quarter.
- Madhu Babu:** Okay sir, thanks.
- Moderator:** Next question comes from Ms. Sheetal Agarwal from DBS Cholamandalam.
- Sheetal Agarwal:** Elixir is basically insurance based and the dent in the revenues, which has come from the BT/NHS project, how are we going to fill it?
- Sudhakar Ram:** It will be through a set of things. So it will be increases in insurance, increases in existing accounts, increases in government, other new markets, it will be across the board.
- Sheetal Agarwal:** Will we see some decline in the government space, as in, in terms of the breakup of revenues?
- Sudhakar Ram:** Yes, in the short run, yes, but we do expect that to build back when some of our other accounts start opening up.
- Sheetal Agarwal:** Could you just give us some revenue expectation from this roll out of Elixir, like what kind of revenues you are expecting going forward?

- Sudhakar Ram:** See, our idea in Elixir is to be in the top two or three players worldwide in the next four-five years, which means that we have to be at, at least a 250 to 300 million revenue range just in insurance to be at that level and that remains our aspiration.
- Sheetal Agarwal:** You mean to say that it will be in a period of five years?
- Sudhakar Ram:** Four to five years, yes, it depends on how fast the recovery happens and when we can start actually capitalizing on the market opportunity.
- Sheetal Agarwal:** Okay and one last question, sir regarding when can we comfortably see ourselves going into the positive direction in terms of growth?
- Sudhakar Ram:** We will get positive from this quarter itself.
- Sheetal Agarwal:** Okay, thanks a lot.
- Moderator:** Next question comes from Mr. Sangam Iyer from Alfa Accurate.
- Sangam Iyer:** Yes, hi sir, just a clarification; when you said that your tax rate could be around 10 to 12% you were talking about the effective tax rate for the year?
- Farid Kazani:** Yes, that is the effective tax rate for the year.
- Sangam Iyer:** Okay and sir, on the current order book we have around 242 crores, right, and we were talking about a 5%-7% kind of a volume growth coming in, in this quarter and going forward an uptake, could you just give some more clarity on the pipeline that we have and the level of negotiations at which we are in, in terms of... etc?
- Sudhakar Ram:** See, basically it is the clarity, which is bringing that confidence that the order book will go up, so beyond that you need to know the entire list of the pipeline and so on, so what you have to see is that we have bottomed out in terms of the order backlog and it will start going up going forward.
- Sangam Iyer:** Okay sir, thank you.
- Moderator:** Ladies and gentlemen, to ask a question please press * and 1 on your telephone keypad. Next question comes from Ms. Shradha Agarwal from B&K Securities.
- Shradha Agarwal:** Hi sir, just on your guidance, I mean, if I look at your numbers, this is the fourth straight quarter wherein you

have underachieved your guidance, so at this point in time how confident are you of achieving the guidance for this quarter and if you are confident then why is there such a broad range in guidance, which you talked about at 2% to 7% kind of a jump in revenue growth rate?

Sudhakar Ram:

I think that is a fair comment, you have to recognize that we live in very turbulent times and especially in a solutions business where we are linked to major transformation programs getting initiated by the customer, you can be off on timing and these are not things, which are very predictable, so I completely agree that this last three quarters have been pretty bad overall for the industry and it has been bad even for Mastek from the ability to predict and solutions business is more difficult to predict than a constant outsourcing annuity revenue kind of a business, which all of us are aware of, so we are not trying to be pessimistic here in terms of our guidance, we are giving a realistic picture in terms of where we see we have to achieve and there is always an aspirational element built into any guidance that we give and as we stand today with a high confidence that we will achieve it. Why the range is high is, one, because of the timing and possible delays in timing and second is also the uncertainty about the currency, so that are the factors there that are built in into a range of figures that we have given.

Shradha Agarwal:

And, sir one thing more, I mean, if I could get the number of US dollar based revenue for this quarter?

Farid Kazani:

It is there in the analysis sheet.

Shradha Agarwal:

I mean, I wanted to get as to a percent, what was the impact of cross currency and what was the impact due to volume and pricing?

Farid Kazani:

We will come back to you on that, but just to give you an idea, last quarter we had the dollar rate, which was at around 48.12 and this quarter we had the dollar at 48.28, so there is not much shift in the dollar rate, there has been a marginal shift in the pound rate which is around 76.30 vis-à-vis 79 in this quarter.

Shradha Agarwal:

Right, because for companies which get close to 30% of revenues from Europe they had an impact of close to 1-1/2% due to cross currency, so for a company like Mastek, which does get a good amount of revenue from Europe I guess the cross currency impact would have been upwards of 2, 2-1/2%?

Farid Kazani:

Well, we can come back to you on the exact workings.

- Shradha Agarwal:** Sure sir thanks.
- Moderator:** Next question comes from Mr. Akhil Dhawan from Locus Investments.
- Akhil Dhawan:** Hi, guys, just a couple of quick things, one, could you quantify how much was the NHS revenue that came off this quarter?
- Farid Kazani:** It could be less than a million pounds that would have been there in this quarter, so that is the residual part of the revenue from NHS on the project front.
- Akhil Dhawan:** And about that same number has been in the previous quarter?
- Farid Kazani:** It will be close to around 1-1/2 to 1.6 million pounds.
- Akhil Dhawan:** I see, and then just two other quick things if you could comment on, one, is obviously just the client matrix if you could kind of comment on this in kind of a continuous sequential downtrend in overall number of clients as well as million dollar plus clients and the second is just on the wage front if you can talk about the wage hikes, if any you are thinking of and if so quantify them?
- Sudhakar Ram:** See, we are not looking at wage hike except some corrections, but there is a variable component which will kick in if the targets of the company are achieved. So wages, pretty much, we have not had any increases this quarter. In terms of total number of clients we have not lost any of the top 10 clients, so there is no significant change in the client base at the top lateral, but there will be some projects getting over especially in the STG business kind of a thing and some product implementations getting over. So, overall there is not much of a change in the client in terms of any significant impact on the business.
- Farid Kazani:** In fact if you look at the top five clients, they constitute more or less the same percentage, which was there in the last quarter, almost close to 58% and the top 10 clients constituting 71%.
- Akhil Dhawan:** Right and one last thing can you tell us how many of the 27 million dollar plus clients are insurance clients?
- Sudhakar Ram:** We will have to get back on that. It is not a ready number available.
- Akhil Dhawan:** That's it I am done, thanks.

Moderator: Ladies and gentlemen, to ask a question please press * and 1 on your telephone key pad. There are no further questions. Now I hand over the floor to Mr. Sudhakar Ram, Chairman and Managing Director of Mastek for closing comments.

Sudhakar Ram: Thank you all for attending this quarter's call and your continued support to Mastek. Last quarter we did say that we do see this quarter as bad and we see this as the bottom, I think pretty much our view of the world remains the same as we stand now that we do see both the order book initially improving and the revenues improving through the rest of this year. The rate of improvement still remains not quite determinable and predictable especially because of the solutions component and the link that we have to people's optimism, not necessarily the economic revival, but the fact that people will open up purses for major transformation programs when they see the economic outlook improving in their own businesses. So we see early signs of that in the pipeline, the teams that we have put in place are particularly adept at capitalizing on this uptake as and when it happens. So overall we remain very confident about the business prospects, about the segments that we operate in, as well as the caliber and the quality of the intellectual properties, the intellectual capital and resource talent base that we have as a company. So as a third wave company we definitely see that the market opportunities remain huge and Mastek will be in a position to capitalize on these market opportunities going forward, so thanks once again for your participation and see you next quarter.

Moderator: Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you, have a pleasant evening.

-
- Note:**
- 1. This is a transcription and may contain transcription errors. The Company takes no responsibility of such errors, although an effort has been made to ensure high level of accuracy.*
 - 2. Any of the statements made above may be construed as opinions only and as of the date. We expressly disclaim any obligation or undertaking to release any update or revision to any of the views contained herein to reflect any changes in our expectations with regard to any change in events, conditions or circumstances on which any of the above opinions might have been based upon.*