



“Mastek Limited Q2 FY12 Results Conference Call”

January 19, 2012



**MODERATORS: MR. SUDHAKAR RAM – CHAIRMAN, MANAGING
DIRECTOR, CEO, MASTEK LIMITED.
MR. FARID KAZANI – GROUP CFO, MASTEK LIMITED.
MR. DIWAKAR PINGLE – ANALYST, CHRISTENSEN INDIA**



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Moderator

Ladies and gentlemen good day and welcome to the Q2 FY12 Earnings Conference Call of Mastek Limited. As a reminder for the duration of this conference all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time, I would now like to hand the conference over to Mr. Diwakar Pingle. Thank you and over to you sir.

Diwakar Pingle

Thanks Myron. Good evening friends and welcome to the Q2 FY12 earnings call of Mastek. I hope you've all got the release as well as the revenue analysis that we sent; in case there are people on this call that have not got the details please do write in to me, and I will be happy to put you on the mailing list and send the details over. On the call today, we have Mr. Sudhakar Ram – Founder and Chairman along with Mr. Farid Kazani who is the Group CFO and Finance Director. We will have a brief overview of the business by Sudhakar, followed by Farid who will kind of drill down deep into the financials, after which we will throw open the floor for question and answers. Sudhakar, over to you.

Sudhakar Ram

Thank you Diwakar and good afternoon, good evening to all of you. Like you have seen the performance in Q2 ending December has been quite good on various fronts, one is obviously from the perspective of revenue that we did see a constant currency growth of about 2.6% and rupee growth of 11%. More importantly the order book also, the 12 months order book backlog has also grown so we did add 4 customers and we have seen growth in order book, both in existing accounts as well as new accounts across all the geos, all the US, UK and the India Asia - Pacific market. We have seen growth in the insurance as well as in the government sector. The heartening part of this quarter is we did turn EBIDTA positive and we were at a marginal loss on a PBT and PAT level. So we did have a good operating margins swing from the previous quarter to this quarter, almost 10 percentage point. So the business outlook definitely looks better and we do expect to continue the growth momentum and even step it up over the next couple of quarters and that should lead to positive movement in the bottom line. I will now hand it over to Farid to take you to the actual numbers.

Farid Kazani

Thanks Sudhakar, and good evening friends. I'm happy to report that there has been a positive momentum in Mastek across various fronts and that has got reflected in the overall improved financial performance in this Q2 ended December. If we look at the revenues for the quarter we ended up at 173 crores as compared to 155 crores in the previous quarter. Rupee terms, growth is 11.3% and in constant currency we have had a growth of 2.6%. A good part of the growth is come in from all the geographies. So we had the UK and US both growing pretty decently.

We have also had improvement in the gross margins, our gross margins actually improved by 560 basis points in this quarter as compared to the previous quarter, and that has been on the



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back of various measures that we have taken in terms of improving the overall margins. Part of it has actually also been helped by the rupee dollar rate but the good part is that we had improvement in the billable utilization we have had savings in some of the projects; we did not have any transition cost that we had last quarter, so there has been no one-time impact there. Plus we have taken certain cost action at some project levels. The rest of the costs also in the organization which is the corporate cost and other sales and marketing cost has also been pretty much under control and that has helped to move to an EBIDTA positives in this quarter.

Last quarter we had a negative EBIDTA of 7.4%, which was 11.7 crore negative. This quarter we have ended up with +3.2%, which is 5.6 crores,. Out of this roughly 2% would be on account of the exchange gain that we have got on for a higher dollar and pound rate and the rest from operations. One of the noticeable changes in this financial results is the item on Fx gain and loss. Effective 1st October, 2011 which is from this quarter we have adopted AS-30 which is the hedge accounting where the mark to market on any forward contracts is reflected directly in the reserves under the Balance Sheet . So in this quarter there is no impact of M2M in the P&L, and what you see in the P&L is actually the impact for the hedges reflective for the quarter, At the end of December that hedging reserve account in the Balance Sheet stands at –Rs. 14.7 crore Removing the mark to market impact has helped reflect the real operating profit for the quarter . Effective October we will continue to use, adopt the AS 30 accounting as opposed to AS 11. Having said that the loss for the quarter has been significantly reduced to 1.5 crores as supposed to 27.3 crores.

On a like to like basis even if I knock off the 7 crores M2M loss last quarter I am comparing 20 crores loss last quarter as compared to 1.5 crores loss this quarter, so overall a good performance in various areas right from revenue and costs. 4 new clients added with 2 client additions that have come in from UK, one from the US and from one from India geography.

Order backlog also has increased quite appreciably in rupee terms from 326 crores to 369 crores and in dollar terms also, it has grown by over 5%. Our utilization ratios have been pretty good this quarter; we have ended up with an offshore utilization of close to 89% and the attrition number has been pretty much under control in line with the industry. In terms of cash and cash equivalents we have ended up with 113.7 crores as compared to 120 crores in the last quarter, but if you consider the debt reduction from 24.5 crores to around 19 crores we are even-stein level on cash and cash equivalent. We could have done better had we collected some of the amounts on receivables. We had the receivables going up with delay in collections at the end of December 2011 but the good point is that as I talk right now, we have been able to collect quite a bit of those receivables in early January.

In terms of headcount we have ended up at 2926 employees, compared to 2894; some increase but overall we have had a much better billable headcount in the quarter . In terms of revenue splits UK constituted 49% in this quarter, US was 45% and India - Asia Pacific was a little over 6%. In terms of verticals we have seen insurance at close to 40%, government is at 29%

and the rest of the vertical is at 31%. That is it from my side and I am happy to answer any question on the financials as I would like to throw the floor for questions right now.

Moderator Thank you very much sir. We will now begin with the question and answer session. The first question is from the line of Abhisekh Shindadkar from ICICI Securities, please go ahead.

Abhisekh Shindadkar Hi, good evening Farid. A good set of numbers. Congrats on a good set of numbers. Farid just a quick question. I am looking at the Excel which you sent; it seems that to be made a good profit unless I am in some looking at something wrong on the international revenue of around 9 crores, is that correct?

Farid Kazani Yeah, that is correct. There has been an improvement in the profitability both in the UK and the US with the gross margin shaping up in those projects and also in terms of the rupee exchange rate helping us at the bottom line level.

Abhisekh Shindadkar Okay, so if I exclude or if I look at the constant currency basis would we have been positive on the bottom line?

Farid Kazani For the company, the bottom line is -1.5 crores and I did mention that the impact on the exchange rate for the quarter has been 2%, roughly 4 crores to the margins as compared to Q1 rates.

Abhisekh Shindadkar No, I apologise. I am looking at the International revenues, so 164 crore is the revenue and the 9.5 crore is the bottom-line. So assuming if we take out the exchange gains out of this could we have been on a positive PAT number?

Farid Kazani We would have been on a positive PAT number

Abhisekh Shindadkar Okay, so what would have been the exchange gain in the international revenue on the bottom line?

Farid Kazani I said the gain would be 4 crores. We are at 9 crores so even after knocking off the 4 crores gain that we got on account of exchange will still be positive on international revenue.

Abhisekh Shindadkar So what is it that driving an 11 crores loss on the domestic business?

Farid Kazani Yes, there have been couple of projects that have taken a hit. Action has been taken to get them under control. plus in the government projects there has been an issue on collections so some bit of the collections have moved in the 180 day bucket and we had 1.5 crores of provision for receivables going over 180 days. Those government receivables will come in and some bit of that has already started trickling in in January.

Abhisekh Shindadkar So how many crores you have this set aside above the 11 crores for the collections?



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- Farid Kazani** In this quarter we have had 1.5 crores additional provision for the 180 day receivables.
- Abhisekh Shindadkar** So from that business perspective, it seems that it is not adding too much of revenue like 10 to 11 crores or probably 9 crores and it is making a 9 crores almost loss, so I understand that that you are saying that you are taking rationalization effects but then are these primary government projects. I mean, can we get them off from our P&L, I mean how quickly can we get them off from the P&L?
- Sudhakar Ram** I think you will see a much better performance in the next quarter, I think, one is the shaping of these projects and one specific insurance project itself that we had to take additional cost in this quarter so that itself will go off in the next quarter. There is going to be a improvement in overall Indian government revenues and also in one of the insurance projects we were not able to bill and account the revenues for some reasons, so to that extent the revenues looks lower in this quarter. Hopefully next quarter we will see a much better performance on the India business, including having collected some of the receivables that will add to the bottom-line.
- Abhisekh Shindadkar** So is that because some of your peers have stated that because of the rupee depreciation a lot of government contracts have resulted in being cost overruns. Have we seen any such issues in this or is that the reason that our government business or the India domestic business is a little weak?
- Sudhakar Ram** No, I don't think is there anything to do with the rupee depreciation because all our costs are in rupees; it is just the nature of some of these projects. We have not been able to take execution revenues, that milestones have not been reached, but the costs have been booked. Like Farid says we should be an improvement in Q3, in the government programs.
- Abhisekh Shindadkar** Okay, I was primarily referring to the import costs.
- Sudhakar Ram** We do not import anything for our Indian projects.
- Abhisekh Shindadkar** Farid, you normally give the dollar revenue in the Excel sheet, I apologise, I have been looking at this for the last half hour so but I did not figure out where exactly it is. So is there a change in the way you report
- Farid Kazani** No, we will have it sent across to you..
- Abhisekh Shindadkar** Okay so in terms of...now we have 89% offshore utilization and I assume this should be excluding trainees or unless we have too many trainees right?
- Sudhakar Ram** At this point of time, there are not many trainees in the headcount that is there. Our bench strength is quite optimized so there has been a very close control over the bench, including the requirement of trainees.



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- Abhisekh Shindadkar** So from here on since I am assuming that your commentaries are little positive, would we be in going in for hiring or we should see things at the utilization might go up from these levels as well?
- Sudhakar Ram** No, I do not think that the utilization is will go up from here. In fact, it should remain in the band of 86% to 89%. There is some hiring that is being done for the revenues that we will be seeing in the next six months. So there will be little hiring that will be happening both at the trainee level as well as some lateral hiring.
- Abhisekh Shindadkar** So would you mind sharing any number of on how many people you plan to add in the next 6 to 9 months?
- Sudhakar Ram** No, we do not have numbers specific because it is linked to some of the projects and they are timed in such a manner so there is marginal hiring to that extent but I do not have exact numbers to give out.
- Abhisekh Shindadkar** And separately from a gross margin perspective out of the 560 basis points what would be the contribution of rupee and what would have been the other contributions if you can break that up, that 560 basis points?
- Farid Kazani** 200 basis points would have been the impact of the better exchange rate the rest would have been the improvement at overall projects. As I mentioned the last quarter we also had a transition cost, the transition cost was impacting roughly 1.5%, so that has gone up the rest has been overall cost improvement and higher billable headcount.
- Abhisekh Shindadkar** Okay in Q1 we had that 1.5%....
- Farid Kazani** Q1 1.5% was the impact on the transition costs and 200 basis point as I mentioned was the FX impact and the rest would have been the cost improvement and improvement in the billable ratio.
- Abhisekh Shindadkar** Okay and from that 14.7 crores balance in the OCI. I mean, how is our hedged position now at what rate and when I think how much of this will flow into the P&L?
- Farid Kazani** The hedges are close to USD35 million and our rate is roughly 48.6 on an average for the dollar and what would move into the P&L would be the hedges that get utilized during the quarter going forward and the impact would to the extent of rate differential between market rate and rate at which it has been transferred to reserves. So if the rupee depreciates further, there will be a loss taken on that and if the rupee appreciates then we will have a gain on that, so it will all depend on what the rupee will be at the end of the following quarters.
- Abhisekh Shindadkar** So this average rate includes the premium and we primarily have forwards?



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Farid Kazani Yes, we have forwards.

Abhisekh Shindadkar And it includes the premium right?

Farid Kazani Yeah..

Abhisekh Shindadkar Right and the hedges outstanding are for receivables?

Farid Kazani For net receivables only.

Abhisekh Shindadkar And from our debt prespective now we have 19 crores. I mean, can we just have repay the debt? What sort of debt.. primarily what are really utilizing this debt for?

Farid Kazani There is a line of credit for working capital requirements in the US so it is a kind of floating debt and there is another small debt that gets repaid on a six monthly basis. It does not make sense to repay because it is at a much lower rate; it will get repaid in the next one year.

Abhisekh Shindadkar The 19 crores?

Farid Kazani As mentioned, one is the floating working capital debt and the other is a small loan that we had taken in the US, right now, it is little over USD1 million that will get repaid in one year's time,

Abhisekh Shindadkar And what would have been the yield on our 114 crores of cash?

Farid Kazani Our yield is roughly around 6.7% net of tax.

Abhisekh Shindadkar Okay so how should we look at the tax rate for the next two quarters and for '13?

Farid Kazani For the 2 quarters, there will normal tax on the profit that we make and the profits is linked to how the revenues shape up, and in '13 we will end we should end up with the tax rate of anywhere up to 22% to 25% of the PBT.

Abhisekh Shindadkar So primarily out of the 100% what percentage of the revenue are from SEZs now?

Sudhakar Ram The SEZ is in Chennai. We are working on building some revenues going forward.

Abhisekh Shindadkar But I guess as you move on more towards profitability, I think moving revenues to SEZ would be worthwhile right, if my understanding is correct?

Sudhakar Ram SEZ is in Chennai, and we have to take projects to Chennai and we have to have resource available to manage those projects, so it will take time, but we are moving in that direction.



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- Abhisekh Shindadkar** Okay what are our current DSO's, I think you said that but I missed it?
- Farid Kazani** Yeah our receivables is to 220 crores, in terms of DSO it is little over 70 days and it has gone up as I mentioned because of December end delayed collection, but we see collections trickling in January and to that extent, there will be a better position in this quarter.
- Abhisekh Shindadkar** So what was it the last quarter, right from 70 days was it like...?
- Farid Kazani** It was 67 days it has gone a little over 70 days here.
- Abhisekh Shindadkar** Okay from a business perspective. I mean, how are we... I apologize; I did not see your Excel sheet in detail. So from a business standpoint, how are things coming up in Europe and in the US, especially in the UK, are you seeing anything which kind of makes you feel cautious?
- Sudhakar Ram** Generally business has been looking up for us both in UK and US, but given the general issues in Europe, we are just going to say that it could impact us. As of now, we do not see anything which we can point towards the fact which will impact us, but this is something that we are watchful about it. Abhisekh, I think we the need the other people also, they are queuing up for questions. If you could come back later.
- Abhisekh Shindadkar** I apologize I'll come back for, thanks a lot.
- Sudhakar Ram** Thanks a lot.
- Moderator** Thank you. We have the next question from the line of Mohit Aneja from CRISIL, please go ahead.
- Mohit Aneja** The numbers appear pretty good this time; I have just one question for you. We have again have product development expenses of around 11.5 crores in this quarter. Would like to understand what contribution was from products this time and how much over time would we be seeing product development expenses in the P&L account?
- Sudhakar Ram** See the product development right now is largely focused on two things. Technology refresh on our P&C product in North America as well as a large part is the Elixir in North America. P&C I think has started yielding results. And we have seen better performance this quarter and we see good pipelines. In L&A, it is largely oriented around delivering the Foresters program and we also had another win the last quarter which is Wawanesa. So I think calendar year 2012 will see implementation of just these two mainly, because till we get the product up and running in these sites, it is unlikely that more customers will come on.
- Mohit Aneja** When are we actually going to see contribution from product development expenses?



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- Sudhakar Ram** It is a difficult question to answer. We are already seeing contribution from product development expenses in P&C. In L&A we are seeing some contributions based on the wins that we have in Forester and Wawanesa, but it is not fully. I mean, those projects will not take into account the full product investment, obviously it is meant for a larger base.
- Mohit Aneja** And how much more of these expenses can you expect going forward?
- Sudhakar Ram** We will cut down on the product expenses marginally, so from 11 crores level it may come down, but further next 12 to 18 months there will be that order of magnitude of product development expenses, it is just that the revenue base will increase.
- Mohit Aneja** Thank you very much.
- Moderator** Thank you. We have the next question from the line of Kavita Vampalli from Nirmal Bang Securities, please go ahead.
- Kavita Vampalli** Good evening gentlemen and congrats for a good set of numbers. So, just one question out of this 11.74% QoQ growth on revenues, what is the volume growth and what is the benefit on rupee?
- Farid Kazani** I already mentioned that the growth in terms of the constant currency is 2.6% and the rupee growth reflected is 11.3%.
- Kavita Vampalli** Okay, I missed on that. Thank you so much.
- Moderator** Thank you. Currently there are no further questions.
- Farid Kazani** Thank you gentlemen for attending this call and it has been a much more encouraging quarter in Q2 and we hope to keep the momentum up and our endeavor is to come back to the black as soon as possible. So we will see you the next time and please feel free if you have any questions unanswered or if you have any further questions, please write to me or to Diwakar. Thank you very much.
- Moderator** Thank you. On behalf of Mastek Ltd. that concludes this conference. Thank you for joining us and you may now disconnect your lines.