



“Mastek Limited Earnings Conference Call”

October 19, 2011



**MODERATORS: MR. SUDHAKAR RAM – FOUNDER & MANAGING
DIRECTOR, MASTEK LIMITED.
MR. FARID KAZANI – GROUP CFO, MASTEK LIMITED.**



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Moderator: Ladies and gentlemen good day and welcome to the Q1FY12 earning conference call of Mastek Limited. As a reminder for the duration of this conference, all participant 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 like to hand the conference over to Mr. Diwakar Pingle. Thank you and over to you sir.

Diwakar Pingle: Thanks Myron. Good evening and good morning to everyone. Let me take the honor of welcoming you to the Q1FY12 earnings call for Mastek for the quarter ended September 30th. On the call with me are Mr. Sudhakar Ram, Founder and Managing Director and Farid Kazani, Chief Financial Officer. Sudhakar will start with a brief overview of the business followed by Farid who would possibly take you deep down with the numbers. So with this I will hand over the call to Sudhakar. Over to you sir.

Sudhakar Ram: Thank you Diwakar and good evening everyone. Thanks for joining the call. As you would have seen the numbers over the last two or three quarters, we have seen the improvement both in terms of new clients, improvement in pipeline, improvement in the order backlog, and I am pleased that after a long time, we have actually registered a quarter on quarter as well as a year on year revenue growth of almost 7% sequential quarter on quarter and year on year of about 4% and that's heartening after 12 quarters where after being impacted by the slowdown in the nature of business that we have, we can see that there is a gradual opening up of opportunities for the kind of work that Mastek does.

So the wins this quarter have happened both in insurance which is our focus as well as in the government and especially in the UK and we have seen improvement in performance across the geographies - India, Asia PAC, North America as well as the UK. So the performance has been in line with our own expectations. We did have a projected loss for this quarter as we started this year for a couple of reasons. One was the salary impact which could not be fully borne absorbed within one quarter and second we had to run huge transition cost at our own cost on major program that we were transitioning which we had talked about at the beginning of the quarter. So that cost has also hit us this specific quarter. What was unexpected was the mark to market losses on the sudden appreciation of the dollar and depreciation of the rupee. We also had some marginal overheads in terms of our product development expense, but overall apart from the mark to market loss, I think the quarter has been in line with our own expectation and we do expect that as we build our order book and revenue that we should be able to get back to profit over the next few quarters. So with that let me hand it over to Farid to take you through the details of the financials.

Farid Kazani: Thank you Sudhakar. Just to give you the headline numbers, the total income for the quarter ended September was 158.2 crores as compared to 147.7 crores in the previous quarter. It's a



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7% growth that we have had in rupee terms. At an operating revenue level, we have had 155.3 crores as compared to 144.2 crores, so that's a 7.7% growth in the overall revenue in rupee terms. The growth compared on dollar terms is 3.6%. So we have had a very good momentum on the topline both in terms of dollar and rupee. We have also had an improvement if you look at it as compared to the previous year our total income was 151 crores in the previous year quarter 1 and that also shows an improvement of almost around 5%. At a net loss we have had in this quarter 27.38 crores as compared to a loss of 7.7 crores. The previous quarter had two impacts; one was the write off of our vector goodwill of around 6.5 crores and we also had a positive tax of almost around 3.4 crores. Keeping that in mind and we also had an exchange gain last quarter of 2.3 crores. In this quarter, we have actually had an exchange loss of 7.3 crores. So if I compare like-to-like at an operating EBITDA level, this quarter we have had a negative 11.7 crores as compared to a breakeven in the previous quarter. So its negative 7.4% in this quarter as compared to a breakeven in the previous quarter.

I will give you the bridge of the 7.4% impact - roughly 5.5% has been the impact on the account of the salary increase. Salary increase has happened from the start of this year, our year starts from the quarter July to September. The increase in salary has been approximately 11% for the offshore employees and 3.5% for the onsite employees. So it's a 5.5% impact on account of salaries.

We have also had transitioning cost for one large UK project that we have commenced and the transitioning cost has impacted in this quarter. We had already informed in our previous release that we will be impacted by this amount. That has impacted roughly 1.5%. Besides that we have had some provisioning that we made for receivables primarily in the India government side and that's roughly around 1.5 crores which is approximately 1% on the EBITDA margin this quarter. So that's the bridge for the 7.5%. In terms of realization, we have had a higher dollar realization, which is at 46.4 at an average as compared to 44.45 in the previous quarter. There has been a positive impact of the higher dollar accounted revenue. That has also come to the bottom-line. Compared to that we have had some other expense increases which have offset that. Our order backlog for the quarter ended September which is a 12-month order backlog was 326 crores in rupee terms as compared to 309 crores in the previous quarter. So it's a 5.5% increase. The improvement in the order backlog has happened in all the geographies which is in the UK, US, and in India - Asia Pacific, and in terms of client additions, we have had four client additions with 2 in the UK and 2 in North America.

We are working on various cost initiatives to improve our cost base both as an operating level and also reduce the areas under discretionary items and with improvement on the topline going forward and cost initiatives that has been kicked off, we should see a better margin scenario going forward.

In terms of our geographic split, we have had UK at 48% and that has been higher because of the business that has come in the UK. UK geography has actually grown 16% in rupee terms in



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this quarter. So the UK business stands at 48% at the end of this quarter as compared to 45%. Correspondingly the US revenue is lower at 44% as compared to 45% in the previous quarter. In terms of the vertical splits, we have the government business which has been higher in this quarter at around close to 31% as compared to 25% in the previous quarter. Insurance has been marginally low at 39% as compared to 40% in the previous quarter. On our cash and cash equivalent we have seen the number at 120 crores at the end of September as compared to 159 crores at the end of June. The drop has been primarily on account of two major reasons, one is the payout of the incentive that happened in the first quarter and there has been an increase in the receivables linked to some overflow of the receivable outstanding in the UK and some bit of in India. In terms of our utilization ratio, our utilization ratios in India have improved by 1% to 83.4 as compared to 82.4 and at an overall average level, it is now at 87 as compared to 86.3. In terms of our loan position, we have seen an increase in the loan figures from 18 crores to 24.54 crores. This is primarily the working capital that we have availed for doing our business in North America and it's a loan that we have taken for funding the working capital for our operations in North America. That's it from my side.

Sudhakar Ram: Thanks Farid and that is our own opening comment, so we will now open the floor for questions.

Moderator: Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Deepesh Mehta from SBI Cap Securities, please go ahead.

Deepesh Mehta: Can you highlight when we expect to return to operating level profit and operating level cash flow again?

Farid Kazani: Yeah we are expecting with the revenue growth momentum that has happened and also with the improvement in the order backlog, there is a positive movement on the topline. Once we see the revenue line growing in the next two quarters and with the cost improvement measures that we have put in place and some bit of the cost that was there in this quarter which will not happen in the going forward quarter, we should see a positive improvement on our margins. To your questions, when do we expect to come back to a breakeven level - it is definitely dependent upon how our revenue starts peaking up in the following quarter.

Deepesh Mehta: Now why I am stressing on this because we have given almost in line with industry salary hike. In terms of business prospects, we are still not in line with what other players are growing at or what they have delivered in terms of operating level. So just to understand first is what was our attrition rate for the quarter? Second is whether there is a kind of salary hike we have announced would be justifiable considering the problem what we are facing and operating cash loss if I see for last couple of quarters, now our cash would be closer to 70 crores odd numbers. So I just need to understand what the thinking process going on?



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- Farid Kazani:** I don't think it's way to look at just multiplying the current operating loss and assuming that for the next few quarters. You know we are seeing a good momentum on the top line. We have delivered a dollar growth also of around 3.6% at an operating level and with an improvement in the backlog and as Sudhakar mentioned we have seen good momentum on the pipeline. We expect business to grow on the following quarters. Once that happens, our costs are something which we are working to control and if the cost remains in line with the current level, we should see the margin improvements going forward and therefore definitely we will see the losses of the first quarter being recouped over the next few quarters in the year.
- Deepesh Mehta:** Okay now in terms of demand, in which geography we are seeing good demand traction and can you highlight the areas which are likely to support topline growth?
- Sudhakar Rao::** We are fortunate by this. The growth is expected across all geographies and on both the verticals that we focused on which is insurance as well as government. We did have wins in insurance in North America this quarter. We did have government wins in the UK. We have had some major wins here in India. So if I look at all those put together, the overall position seems to be good in terms of building a pipeline as well as a prospect base across different geographies. As you know our prime verticals are insurance and government and in insurance within North America we do both property casualty as well as life and annuity. So we do see improved demand across those verticals.
- Deepesh Mehta:** So because if I see the QoQ number, now insurance and government, we have seen improvement at least from a QoQ prospective, so I just need to understand which segment will drive growth or you expect both to be equally strong going forward?
- Sudhakar Rao:** It's difficult to say from a revenue perspective, but in terms of order book both we expect equal focus and response on both. Now some of these are related to individual deals - government deals seem tend to be larger, insurance deals have a better velocity. You get more deals in a quarter. So how exactly it will pan out in terms of actual revenue is difficult to give a segment wise split, but we do see both growing.
- Deepesh Mehta:** Understand, now considering recent macroeconomic uncertainty whether we think it will impact our right now expectation or it has already impacted some kind of demand or you have not seen that too in demand.
- Sudhakar Rao ::** See as of now we have not seen too much of our impact in terms of certainty, but there were certain deals that we expected in Q1, which have got deferred and we have seen them get in booked early in Q2, which is in the October timeframe. So there is a marginal lengthening of cycles, but it is not significant.
- Deepesh Mehta:** So clients are still spending what they have decided?
- Sudhakar Rao::** That's right.



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- Deepesh Mehta:** Okay and can you tell me what was our attrition rate for the quarter?
- Sudhakar Rao:** Our attrition rate for the quarter was about 24% as a company, annualized.
- Deepesh Mehta:** And what was previous quarter that number to be?
- Sudhakar Rao:** Previous quarter was higher at about 28, if remember the figures.
- Deepesh Mehta:** Okay thank you.
- Moderator:** Thank you. The next question is from the line of Aishwariya K. from ICICI direct, please go ahead.
- Abhishek:** Hi, this is Abhishek, Farid can you just tell us what was the constant currency growth this quarter? You said 3.6% was the dollar growth. So I believe there would have been a negative impact because of the currency.
- Farid Kazani:** If you look at the dollar, we have realized 46.4 and as compared to 44.4 in the previous quarter. So in dollar terms, the growth is 3.6%. In constant currency also, it will be definitely positive. I don't have the number ready with me. I can share that with you after the call.
- Abhishek:** Okay so annualizing the current dollar growth, can you just help us understand to what level of growth would you be EBITDA positive; in terms of planning for current year, what is the level of growth that would make you EBIT positive?
- Farid Kazani:** I think the question of when do we turn positive will definitely depend upon how the revenue start picking up in the following quarters and the revenue coming in is definitely dependent upon some of the book and ship that will happen in this year . Another indicator that I can definitely help you with is the 12 month order backlog and based on historical numbers, whenever you look at the order backlog, we should end up at a order backlog which is almost around 43 to 45% of the next 12 months revenue. So if you take the current order backlog position of 326 crores and if you take that factor in mind, you will be able to project the 12 months revenue and you can conjecture what would be the growth
- Abhishek:** Okay that's helpful. Sudhakar at the start of the call, you made some interesting comments that you will get back to profits probably in the next couple of quarters, could you just help us at some of the levers that you are looking at to reach that target?
- Sudhakar Ram:** See the main lever is actually revenue growth like Farid said that if we keep up this momentum of about 3-4% dollar growth, then clearly the issue with the company is not on our cost base today. Over the last 12 quarters, we have seen our revenues decline and this is the first quarter after a long time that we have seen a growth and we just wanted to maintain the momentum. So if you look at our own strategy as a company while profit is definitely critical and we need to



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get back on to the black. The key driver is how do we get our revenue back up and get a momentum on revenue, get a momentum in terms of our new business within the market. Because the market opportunities are pretty large in each of the segments that we are working on. So prime driver is revenue, obviously there are some cost things that one can still use. We don't want to cut down on anything which is strategic to the company. So we have not cut down on product development; in fact if you see our note, the product development cost has gone up marginally this quarter as compared to the previous quarter.. We don't really want to cut down on the sales marketing investment because that's where our growth is linked to. But there are certain discretionary items, which we may tighten some more, but really the margin lever is revenue.

Abhishek: Okay and you know finally coming back to the same question on which my colleague asked I mean could you help us to understand what was the rationale of awarding industry level offshore and onsite wage hikes. I mean I understand that attrition is high, but would have been it possible to let off some of the excess and manage margins at these levels?

Sudhakar Ram: See, if you see the headcount itself from a peak of about 4000 people, we are now under 3000 people. So it's about 28, 29, 100 in terms of headcounts. So our company in terms of staff is size right for our kind of revenue. There is no issue there and the people are high caliber people. They have all been delivering programs. All our success so far has been based on the quality of deliverables. So compromising on salary increases would not really work out because you don't want to lose your best talent, that's what will actually fuel growth as a company. So we didn't go at the high end of the scale. We kept it at what we saw as the medium level within the industry in terms of salary scale. So you have not been exorbitant in terms of our increase. We have just given people an average increase and that is actually reflected in terms of lower attrition in this quarter. So it has been positive.

Abhishek: And lastly, could you help us understand some of the sales and marketing initiatives that you guys are taking to keep the revenue momentum strong for the next couple of quarters?

Sudhakar Ram: If you see a couple of quarters back, we have said that the PNC line has started building up and that was based on a technology refresh that we had done around the billing platform. Now we have kept a lot of sales marketing action around the billing platform over the last two quarters and that's yielding, like we had couple of wins this quarter. We do expect more wins in Q2, which is the October-November-December quarter. So in PNC there is a particular momentum which is achieved and we think that we are well set to grow in that line of business quite significantly in this year. In M&A, the Forrester has a program key in terms of delivery and the first part of Forrester will actually go into production towards end of Q2, which is in December. We also had the SEG acquisition which we did, which would have a ready product for the North American market and that prospect base is actually building up nicely and we do expect to close at least one deal in Q2 in terms of around the SEG platform, the Elixir-SEG integrated platform, which we said we launched in Q2 and we think we will be successful in turning it



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around in to a deal also. So that's something where there is marketing and sales traction around it and we do expect that to translate to business within this quarter itself. We have seen work around our existing accounts both in US and in UK and almost consistently every account has started delivering growth. So it may be marginal in one quarter term, but we do expect that to contribute to growth at the end of this year especially around the top 5 accounts, we do see a momentum in terms of building those accounts up over the period of this year. So partnership strategy, we did say we had signed one more partnership, so that part of the business we are growing. We do expect to sign another partnership in this quarter. We had the FSA shortlisting if you remember in January that we announced that we were one of the four suppliers shortlisted or actually selected by FSA to do application development work. Now there is a large program that FSA has bid out and we think our prospects are pretty good in terms of winning that this quarter. So in India, again there is momentum around our social justice system. There is definitely a momentum around the various other state level applications that we are doing. In insurance, we do expect to... we have a large base of insurers as our customers in India. We do expect to expand our footprint beyond the existing relationship to a broader base of services within these accounts. So there is activity happening across a different front which should actually contribute to the growth.

Abhishek: Okay that's helpful. I just wanted to understand that are we chasing a lot of contracts or will this revenue growth come at the cost of transition?

Sudhakar Ram: See one large deal that we signed last quarter involved us eating up the transition cost. Typically many of the deals that we do, we charge the transition to the customer. But this is too large and it had a significant revenue upside and so we decided to absorb the transition cost, given that it's a long term deal.

Abhishek: Okay but then, whatever contracts or whatever pipeline we have, do we see that you know this revenue growth might come at a cost which we might have to bear?

Sudhakar Ram: No we don't see that.

Abhishek: Okay and finally two questions for Farid, Farid can you just help us that do we have anymore one offs lined up in the next couple of quarters because it's very difficult to model them and second could you just tell us how the FX will, were the rupee to remain at these levels, how would the FX impact be to the next one or two quarters?

Farid Kazani: There are no one offs impact that are likely to come in the next quarter and in terms of FX, we have already taken a mark to market on our \$33 million at Rs. 49, so if the rupee remains at 49, then there is no further mark to market that we would anticipate. Just to let you know that in this quarter as I mentioned that there has been a provision for the receivables that we have had and that has been taken as an expense. Once we collect that amount that will actually come as a gain in the P&L in the next quarter.



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Abhishekh: Okay got that. Thanks and best of the luck for the rest of the year.

Farid Kazani: Thank you.

Moderator: Thank you. Currently there are no further questions.

Sudhakar Ram: Thanks everyone for your interest in Mastek. As you can see there has been a tough ride for us over the last couple of years and we are slowly seeing the light of day and we do expect to start showing consistently better performance quarter on quarter going forward and I do expect to report better results in the next quarter itself. So stay tuned and we'll connect back in January for our Q2 results. Thanks everyone.

Moderator: Thank you. On behalf of Mastek limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.