



“Mastek Limited Q3 FY16 Earnings Conference Call”

January 14, 2016



MANAGEMENT: **MR. SUDHAKAR RAM – MANAGING DIRECTOR AND GROUP CEO, MASTEK LIMITED**
MR. JOE VENKATARAMAN – CHAIRMAN MASTEK UK LIMITED
MR. JAMSHED JUSSAWALLA – CFO, MASTEK LIMITED
MR. ANANT THAKRAR – SR. VICE PRESIDENT (FINANCE), MASTEK LIMITED

MODERATOR: **MR. DIWAKAR PINGLE – CHRISTENSEN**



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Moderator: Ladies and gentlemen good day and welcome to Mastek Limited Q3 FY16 Earnings Conference Call. 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 a '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Diwakar Pingle. Thank you and over to you sir.

Diwakar Pingle: Good evening, good morning to all of you depending on where you have logged in from. Welcome to the Q3 FY16 Earnings Conference Call of Mastek Limited. The results and the earnings presentation have been sent out and they have also been put up on the website. In case you do not have it please do write to us and we will send the same to you. Joining us today on the call we have with us Mr. Sudhakar Ram – Managing Director and Group CEO, Mr. Joe Venkataraman – Chairman of Mastek UK Limited, Jamshed Jussawalla – CFO of Mastek and Mr. Anant Thakrar – Sr. Vice President Finance of Mastek. To begin with, Sudhakar will give you a brief overview about the quarter gone past and this would be followed by a detailed financial analysis given by Anant. After that we will throw open the floor to Q&A. With that said, I am handing over the floor to Sudhakar. Over to you sir.

Sudhakar Ram: Thanks Diwakar and good evening to all of you. It has been a mixed quarter. We have had some strong momentum in terms of continuing to win business in retail, banking and government sectors

I am pleased that we have managed to reopen the US market for Mastek. As you know almost all our US business was transferred to Majesco when we did the demerger last year and so this is now opening our account back in the US having won a new project there. We also had a good break within a challenger bank within the UK, which we think is an exciting new area for our digital capabilities. Revenue did grow at about 4.5-5%, so there was decent growth in revenue.

However, there were a couple of disappointments. One was we announced in December that along with our partner The Law Society of the UK, we have decided to shut down the operations of the JV, Legal Process Technologies (LPT) because of certain changes in the market which has happened and some new competition which has come forth. It was disappointing because we did have high expectations out of this JV, and now we have to look at other revenues to make that up in the years ahead. We have also talked about continuing overruns on a project which have led to project losses. If you remember last quarter of 2015, same quarter last year, we had signaled that we have had overruns on some of the direct projects that we have because we have had more than the expected need for onsite security cleared resources. At that point there were three projects which were impacted.



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During the year, within the next two quarters we saw two of those projects turnaround and turned positive. We expected the same for this project but unfortunately it dragged on more and the scope has also enlarged because of which the cost hit has been much higher than what we anticipated. So we thought it was prudent to again reaffirm or re-convey the message that there is still one project which still suffers from the fact that we have more than expected onsite resources. While we have started the process of ramping it down and this program is expected to go live early in the next financial year, the impact will still continue though on a much smaller level over the next 3-4 quarters until we manage to stabilize this program. So this has cost us quite a bit in this quarter as well as in the earlier two quarters of this financial year. The focus of the company remains the same, in fact our brand in the US we have called ourselves Digility, is actually a combination of the words Digital and Agile that we are looking at delivering large complex transformation programs which help our customers leverage digital opportunities in an agile manner. So that remains the focus.

I think there is resonance in what we are doing, the government deals are taking a bit longer than what we expected but we do expect to get back into better revenue growth and profit as we go forward in the next few quarters. So with that let me hand you over to Anant to take you through the detailed numbers of this quarter.

Anant Thakrar:

Okay Sudhakar. Thank you very much for that and good morning and good evening to all the listeners.

So let me take you through the highlights of Q3FY16. So for the quarter our operating revenue stood at Rs. 137.8 crores as compared to Rs. 131.6 crores. This reflects an increase of about 4.7% in rupee terms and a growth of 6.4% in constant currency. The total income level we are at Rs. 140.7 crores compared to a Rs. 137 crores, which is 2.7% sequentially. So part of this increase, there was a final billing from the LPT joint venture which was included in this revenue here.

At the EBITDA level we stood at Rs. 3.6 crores compared to Rs. 8.9 crores in the last quarter. This was significantly down, predominantly due to the cost overruns on the project that Sudhakar has mentioned. So that has impacted the overall profitability in a significant way. In terms of overall net profit we are at Rs. 0.8 crores compared to Rs. 2.7 crores in the last quarter.

At 9-month level, our operating revenues are Rs. 402.7 crores and total income stood at Rs. 416.8 crores. The profit level for the 9-month period were at Rs. 7.9 crores.

In the quarter, we added 6 new clients and we are making good progress in opening accounts in all of our key verticals. There were 2 banking clients, one each in the UK and India. There was a Tier-I retailer and there is additional business within the public sector. As Sudhakar touched upon, we have also established our presence in the US and incorporated a company called Digility Inc. having won our first US client. This means our total client count is 82.



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From an order backlog perspective, we saw an impact from the LPT joint venture whereby we had orders that we had booked for the future periods which we needed to roll back. So in overall terms our 12-month order backlog stood at Rs. 210 crores compared to Rs. 224.2 crores last quarter.

During the quarter, cost overruns on account of onsite security cleared resources on a specific project amounting to Rs. 7.7 crore for Q3FY16 and Rs. 26.2 crore for the nine month period led to major losses impacting the profits. However, we have taken steps to reduce the onsite contractor staffing and with the first release going live in early FY17, the losses on the project should start tapering down in the coming quarters.

At the beginning of December, we had announced our decision to exit from the LPT JV. As far as the business is concerned this has been essentially wound down this quarter and we will complete the final aspects of it in the coming weeks. Due to the conservative nature of our accounting practices the overall results as on 31st December have not been materially impacted with this.

So just going a bit further down in terms of the metrics, our DSO stood at 54 days compared to 52 days last quarter. Our cash and cash equivalents are at Rs. 110.3 crores compared to Rs. 130 crores last quarter. Mastek hedges closed at 14 million pounds at a rupee rate of 108.1 to the pound. Our total head count was 1,302 people compared to 1,276 last quarter. And our billable utilization was steady at 81.7%. The Board have also announced a dividend of Rs. 1.5 per share.

With that let me hand over back to the operator for questions and we will go from there. Thank you very much.

Moderator: Thank you very much. We will now begin the question and answer session. Ladies and gentlemen we will wait for a moment while the question queue assembles. We have our first question from the line of Subhankar Ojha from SKS Capital. Please go ahead.

Subhankar Ojha: There are a couple of questions. One is with respect to these cost overruns of Rs 7.7 crores, are we done with this particular project or will there be similar losses from this in the coming quarters?

Sudhakar Ram: We are not done with it but we are expecting the losses to keep going down quarter on quarter.

Subhankar Ojha: Okay, and so how long it will continue like this?

Sudhakar Ram: I think it will be in the next financial year, the quantum of losses will be much lower than this financial year and to that extent I think we should be in a position to absorb them given profits from other projects that we make.



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- Subhankar Ojha:** Secondly with respect to LPT, so Rs. 5.9 crores of loss that we have had in the last quarter, so that is behind us in terms of entire losses we have absorbed already.
- Sudhakar Ram:** Yes, so whatever was related to LPT we have completely written down in our book this quarter.
- Subhankar Ojha:** And the cash at the end of the quarter was Rs. 110.3 crores versus Rs. 130 crores, so why has the cash balance come down?
- Sudhakar Ram:** There were just some outstanding sums which are due and we expect those to come through over the next 30 days or so..
- Subhankar Ojha:** Okay, so you mean to say Rs. 130 crores, I mean you expect the cash level to go up, that is what you are saying?
- Sudhakar Ram:** Yes.
- Subhankar Ojha:** Okay. And finally, I have shared last quarter also with you, is there any plan that we have with respect to the Majesco stake? I mean do you want to sell that stake because that is a financial investment for us.
- Sudhakar Ram:** No, not at the moment. If we do it will be against a proper deployment of that money e.g. we are in the lookout for acquisitions in the US.
- Subhankar Ojha:** So you will sell that stake before you do the acquisitions. So is that the thing?
- Sudhakar Ram:** It could be a possibility.
- Moderator:** We have our next question from the line of Krishnan VR. Please go ahead.
- Krishnan VR:** LPT, I think we made some losses. What is the total amount of losses what we have made in this quarter?
- Sudhakar Ram:** There are no significant losses that we have made. We have mentioned Rs. 5.9 crores but that does not include any revenues for services that we provided to the LPT joint venture. So at a net-net level there has been no significant impact in the overall quarter's results. And I think we mentioned that when we announced in the market in early December 2015 the closure of the business we said that we did not believe there was going to be any material impact in the quarter and to a greater or lesser extent that has proved the position as at 31st of December 2015.
- Krishnan VR:** So this quarter how much did we account for that? We did not account any losses from LPT this quarter?



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Sudhakar Ram: We did not account for any significant losses. We have taken all of the cost of the LPT joint venture but we also provide services to the joint venture and so therefore that is balanced out.

Krishnan VR: I am trying to find out because we did a turnover of Rs. 137 crores and if we made some Rs. 5 - 7 crores loss on the LPT and if you add that Rs. 7.7 crores cost overrun, so the EBITDA is coming to around may be Rs. 16 - 17 crores and plus other things. So what kind of EBITDA margin we are in? Is it somewhere close to the 10% EBITDA margin?

Sudhakar Ram: If we take the 9-month picture then whatever we have just made on the LPT I think we are pretty much at a breakeven level, so there is no plus or minus. If I take project overruns at Rs. 26.2 crores. We have an EBITDA of Rs. 29.1 crores for the first 9 months.

Krishnan VR: And I have to add Rs 28 - 29 crores on that loss

Sudhakar Ram: Yes, so Rs. 55 crores will be the adjusted EBITDA for the nine months. It will be around 13% EBITDA.

Krishnan VR: So the total for that cost overrun project till 9 months we have made a loss of around Rs. 27-28 crores.

Sudhakar Ram: Rs. 26.2 crores.

Krishnan VR: Thanks. This is a UK project?

Sudhakar Ram: Yes.

Moderator: We have a question from the line of Ganesh Shetty. Please go ahead.

Ganesh Shetty: I just want to have some clarification regarding Indigo Blue Operations and revenue during the quarter and whether the revenue growth is as we have anticipated before the acquisition.

Joe Venkataraman: It is more or less in line with expectations. We expected their order book to go up and in the last quarter we announced that they won a framework arrangement for very close to £3.2 million with one of the government organizations. So the ramp up of this framework is happening in the current quarter and in the following quarter, so at this point of time we are a bit short but I think we have won a couple of deals in this quarter as well jointly and that is going to improve the revenue position going forward from Indigo Blue.

Ganesh Shetty: Sir, our revenue is more or less concentrated on UK government and there is a one big customer we are relying upon for our revenue and future growth. Was there any other revenue from other customers? Can you please give some highlights?



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Joe Venkataraman: If you are talking about Indigo Blue, there is a definite distribution, it is coming from quite a few customers. But from the government as a business and from a Mastek UK perspective we have opened up a few more accounts in different verticals and we expect that the concentration to be less so going forwards.

Ganesh Shetty: Can you please guide us regarding business going forward maybe after 6 months or so and/or acquisition initiatives which would suit our present capability going forward to increase our revenue all over the world excluding the present UK business? Can you please give some highlight on this?

Joe Venkataraman: Acquisition is part of our growth strategy. So we are continuing to look at companies both in the UK and the US. We have to look for the right company to acquire, we are looking at companies in the range of revenue of 10 million pounds or 20 million pounds of that order of magnitude. There are some in the pipeline but as you know that we cannot give a quarterly view on when this is going to happen and as and when it happens we will absolutely keep you posted.

Ganesh Shetty: One of my last question is regarding present economic environment all over the world wherein there is certain feeling of worry and expansion takes some time and the tech spend ratio which our customers will do may affect us going forward. What is your take on this when you talk to your present customers or new customers so can you please give some guidance on these?

Sudhakar Ram: Essentially since 60% of our business comes from the government, they tend to be more recession proof and it is also based on cycles, government initiatives and large programs rather than based on any revenue. So 15% of our business not really linked to cycles and that is why we are diversifying into retail, into financial services because they may have different cycles associated with it. So given that we are a very small player, I do not think it is impacted by macroeconomic trends as much as the company specific issues that we face.

Moderator: Our next question is from the line of Subhankar Ojha from SKS Capital. Please go ahead.

Subhankar Ojha: Last quarter, I mean December, what was the impact of revenue from LPT? And secondly, obviously you are not giving a guidance for us but do we expect revenue growth in March quarter sequentially and finally what is our sustainable margin range?

Sudhakar Ram: High-teens.

Subhankar Ojha: That is margins. In terms of what was the revenue contribution from LPT last quarter?

Sudhakar Ram: On revenue perspective it was Rs 6 crores.

Subhankar Ojha: Okay, and in terms of outlook what would it be in the coming quarters?



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- Sudhakar Ram:** We do not have any guidance. We do expect to continue growing on a sequential basis.
- Moderator:** As there are no further questions I would now like to hand the floor over to Mr. Diwakar Pingle for closing comments. Over to you sir.
- Diwakar Pingle:** I will just hand it back to Sudhakar. Sudhakar, any specific takeaways for the investors at this point of time as we move onto the next quarter in the next financial year may be you can just give a brief background and then close....
- Sudhakar Ram:** Sure, I think the fundamentals of the company remain strong. I think the nature of expertise and capabilities that we bring to a digital transformation program are unique. I think very few companies in the world are capable of doing what we are doing. It is a question of getting the right side of customers to express this capability and grow along with them. I am pretty bullish about the prospects of the company; the pipeline is building. We seem to hit it off in all the verticals that we have opened up. As we add some acquisitions I think we should get back to a growth momentum and get to a better than industry growth in the coming years. So with that thank you for your continued support on Mastek and looking forward to speaking to you next quarter. Bye for now.
- Moderator:** Thank you very much members of the management. Ladies and gentlemen that concludes the Mastek Limited Conference Call. Thank you for joining us and you may now disconnect your lines.