



“Tech Mahindra Limited Q3FY12 Results Conference Call”

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MODERATORS

- MR. VINEET NAYYAR – VICE CHAIRMAN, MD & CEO**
- MR. L. RAVICHANDRAN – PRESIDENT, IT SERVICES**
- MR. AMITAVA ROY – CHIEF OPERATING OFFICER**
- MR. SONJOY ANAND – CHIEF FINANCIAL OFFICER**
- MR. SUJIT BAKSI – PRESIDENT, CORPORATE AFFAIRS & BUSINESS SERVICES GROUP**
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Moderator: Ladies and gentlemen good day and welcome to the Q3FY12 Earnings Conference Call of Tech Mahindra. As a reminder, 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. If you should 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. I would now like to hand the conference over to Mr. Vineet Nayyar. Thank you. And over to you sir.

Vineet Nayyar: Hi, folks, good day to all of you and thank you for the courtesy of joining us for our third quarter results. We have had a satisfactory quarter despite the challenging economic environment. The Euro Zone crisis and the prospects of a prolonged period of low or no growth have changed customer behavior in the recent months. Decision making cycles have become longer and customers are cautious. We expect the activity to remain muted in Europe. Though rest of the world the demand has been relatively vigorous and we expect it to continue to do so. There is a revival of demand in the US on the back of a very impressive growth rates which it has achieved in the last quarter. Net-net, we can look to the next year with an element of optimism.

The other aspect which needs to be underscored is that even though we expect IT spend to be flat or slightly declining, there is an increased demand for offshoring and we are seeing an activity and traction as a suggested earlier in East Asia as also in the UK.

Our Managed Services and platform business continues to see traction with opportunities across geographies. I am happy to report that we completed one of the largest transitions in the Managed Service area for the operations of one of the Australia's largest telecom service provider. Our ability to create such clients references is helping us create a key differentiator and we believe that this expertise and experience we are picking up will hold us in a good stead and we do believe that large number of other operators are similarly going to outsource their operational activities.

Reverting now to the numbers, our Q3 revenue was at INR 1,445 crores, up 8.4% sequentially. On a YoY basis, our revenues were up 19.3%. Our EBIDTA was at INR 234 crores and PAT at INR 276 crores. EBIDTA expanded by 90 bps QoQ. Overall, I would say that we have had a stable quarter despite seasonably lower bill days. Our non-BT business continued to perform well with a sequential growth of 11.9% in Rupee terms. Growth traction from the emerging markets continued with a sequential growth of 8.6%, North America saw a decline of 3.2% and Europe was 6.7% in large measures due to lower bill days and cross currency impact. Total employees headcount stood at 42,700 while attrition was stable at 20%.

As we look forward we do see a sustained growth momentum in our non-BT business. Our investments and capabilities have enabled us to grow at a steady pace even with headwinds in our largest customer. Our growth going forward is a function of our ability to capitalize on the multiple opportunities in both emerging technologies as well as in a traditional system, consolidation and optimization in this space.



With these brief comments, I will open the house for questions and hand you back to the operator.

Moderator: Thank you. We will now begin with the question-and-answer session. Anyone who wishes to ask a question may please press '*' and then '1' on your touchtone telephone. Participants are requested to use handsets while asking a question. The first question is from Srivatsan Ramchandra from Spark Capital. Please go ahead.

Srivatsan Ramchandra: It will be pretty helpful if you could just talk us through what is your view from BT at this point of time. Have we seen most of the declines already factor into numbers or is there a possibility of some more decline and what could be made over the next two, three quarters on BT account?

Sonjoy Anand: I think the position remains the same as what we had mentioned to you last quarter which is that part of BT stake is being put up for tenders. This is in a number of packages, segmented areas. Some of the ITTs have come for closure and the implication of that is incorporated in our current quarter's results. They remain a number of ITTs which BT is still in the process of working through their process and we already expect over the next two quarters this would come to a close. Up till now in the ITTs which have been closed we have retained our share of business and as we go forward we do expect some headwinds from BT in terms of revenue and margins.

Srivatsan Ramchandra: In terms of the closing point on the margins front how do you see it? Most of the things are taking **its shape** and the resultant pricing impact from BT deals, has it effectively flown through or do we see some more pains going through on the margin side because of the ramp downs in BT?

Sonjoy Anand: I think your question was on margins. As you know we do not give guidance. As we look forward I think we do see some headwinds from BT as an account, but there are also levers available to us from an operational perspective, there is more we can do on the utilization in terms of pyramid, there is still an opportunity in Tech Mahindra, we also can do more on the utilization side. Cost optimization is something we always focus on, so we will have to see where the balance settles.

Moderator: Thank you. The next question is from Sandeep Shah from RBS Equities. Please go ahead.

Sandeep Shah: It would be helpful if you can break down the USD revenue decline of 2.5% into volume, pricing in constant currency and a cross currency headwind?

Sonjoy Anand: I will give you the high level picture and then any specifics you want you can offline take from our investor relations team. Overall, the impact on volumes is flattish, maybe 0.5% down, the rest is cross currency which largely comes to us from the higher Sterling exposure.

Sandeep Shah: But, with the higher onsite efforts, despite that revenue has declined, so is it fair to say even in constant currency, pricing has gone down?



- Sonjoy Anand:** I think pricing, as I said we have seen the impact of some of the BT, ITTs this quarter and then there has been a combination of impacts there. However, on the non-BT side, the pricing scenario continues to be stable. In fact, there remains an element of positive bias there.
- Sandeep Shah:** In terms of last time we started saying that within the 'Others' as a segment which we defined as some joint execution with Satyam. Even this time if you look at the revenues from 'Others' as a segment has gone up sharply. So, is it largely to do with contracts and joint execution with Satyam or is it beyond that?
- Sonjoy Anand:** We always historically had some business in the 'Others' segment and yes, as we work together with 'Satyam' as a company, as you know, our capabilities are complementary and there are always opportunities for us to supplement each other and like last quarter there are projects on which we are working together with Mahindra Satyam.
- Sandeep Shah:** Is it possible within that 265 crores run rate how much percentage coming through joint execution from Satyam ?
- Sonjoy Anand:** I would not like to share any specific percentages on that. In any case, this is something which goes up and down from quarter-to-quarter depending on. It would not be a very large number; in any case, the total number is not very large.
- Sandeep Shah:** And is it here we invoice to Satyam or is it we also work directly with the end client?
- Sonjoy Anand:** It varies from contract to contract.
- Sandeep Shah:** Can you give us an update on the hedge?
- Sonjoy Anand:** In terms of our hedge portfolio, we have got £305 million which is Pound to INR at Rs. 83 and \$540 million at the rate of Rs. 51.
- Sandeep Shah:** And you also said that there are some headwinds in the revenue and margin ahead for the BT as a whole and you also in another comment said that some of the businesses which are getting retendered within BT, it is likely to close in the next two to three quarters. So that means that the revival in BT maybe away by two, three quarters?
- Vineet Nayar:** I think in the areas which have been tendered that is the timeframe as far as the rest of the state is concerned. We always compete for every opportunity as to what opportunities will emerge and what will get converted; it is difficult to say at the moment.
- Sandeep Shah:** Even if we look at top two to five, there is a stable or a flattish kind of a growth in this quarter. So, is it within some of our top clients within North America also, is it like a quarterly aberration or -?



- Manoj Bhat:** This quarter I think because of Christmas holidays, etc. there has been a little bit of quarterly aberration. I do not think there is any trends like that which we see specific to two to five.
- Sandeep Shah:** On the margins, despite 11% Rupee depreciation gross margin has come down by 20 bps. So, would you like to share the breakup in terms of the gross margin movement in this quarter?
- Sonjoy Anand:** I think the two factors which are there on contribution which I think I had mentioned were that we do have some projects in transition and also a little bit contribution varies with mix of business, both the geographical mix as well as the type of which work is being done.
- Sandeep Shah:** But even the pricing would have impacted the gross margin this quarter?
- Sonjoy Anand:** We had spoken about the implications on what has happened in BT. The fact is that the revenues have gone down. Some impacts from the ITTs have come.
- Sandeep Shah:** And you never give guidance, last question is on a constant currency you believe the tailwinds are enough to maintain the margins?
- Sonjoy Anand:** I think as I had shared what I see are the headwinds and what are the potential opportunities to compensate on the margins front. I can repeat that the challenges in terms of what is happening in BT as an account. The opportunities are a combination of pushing productivity, utilization, improving receivables 3 years in the pyramid and there are various other areas of cost optimization and, of course, if you look at our non-BT business it continued to grow well. Growth itself is very helpful from a margin perspective.
- Sandeep Shah:** And any impact because of the 2G license breakdowns?
- Sonjoy Anand:** It is too early to really comment. I mean, it has been a significant thing in the Indian Telecom industry, however, how the current players are going to respond in terms of, are they going to take any legal recourse, are they going to bid for licenses, what are going to be their business plans, we do not know. We do have, as you know, with Etisalat we have had a significant relationship with them.
- Sandeep Shah:** Can you share the number of employees working with Etisalat?
- Sonjoy Anand:** We did an end-to-end deal with them. So, it is not an engagement which you can assess depending on a number of employees and you must also remember that substantial part of our engagement with them is covered by a bank guarantee.
- Moderator:** Thank you. The next question is from Pinku Pappan from Nomura. Please go ahead.
- Pinku Pappan:** You mentioned that you are confident of maintaining your share within BT. Can I read that as going forward you think results in the BT segment would be better than what we saw this quarter?



- Sonjoy Anand:** The comment on retaining our share was related to those ITTs in which BT has completed their process. If we look at what is going to happen in BT in the next few quarters, there remain a number of ITTs on which they have to complete their process and we do have some concerns there in terms of revenue and margin headwind flowing from there.
- Pinku Pappan:** Can you share the OCI losses currently in your book?
- Sonjoy Anand:** In reserves on a mark-to-market basis our losses were at \$88 million at the end of last quarter but as you know currency has been very volatile, at the end of last quarter the Rupee was at its weakest since then it has recovered, so those numbers today are substantially different.
- Pinku Pappan:** Any update on new initiatives spending at BT? Last quarter you had mentioned that BT has started to spend some of the new initiatives. Any update there?
- Amitava Roy:** I think primarily from a BT perspective a lot of effort going on, on that front, in the enterprise services that we provide through BT global services and also in their Open reach segment which is the last mile and we are involved in a multiple opportunities with them in those areas and we believe there will be a good progress in the next one or two quarters.
- Moderator:** Thank you. The next question is from Srivatsan Ramchandra from Spark Capital. Please go ahead.
- Srivatsan Ramchandra:** Hi, just a couple on book-keeping questions. One was, what was the nature of the miscellaneous income that was reported in the financials and then what kind of tax rate we look at 13?
- Sonjoy Anand:** The tax rate this quarter looks to be at 17% but the underlying tax is closer to 24%. We have had a refund in UK, the money came in for this quarter which is why on the face of it the tax rate looks to be lower.
- Srivatsan Ramchandra:** And then what can we look for FY13, any broad numbers we could look at, pretty similar to the core tax rate we have seen for FY12?
- Sonjoy Anand:** For the next fiscal the range of tax is going to be somewhere between 22 to 24%. As you know, the 10A benefits, there is a sunset and it also depends on what proportion of business is there from SEZ.
- Moderator:** Thank you. The next question is from Sandeep Shah from RBS Equities. Please go ahead.
- Sandeep Shah:** On the foreign currency loan, can you just give us the update to what is the exact amount out of that 1376 crores?
- Sonjoy Anand:** Foreign currency loan, we use packing credit itself, number which keeps varying. Any specific point that you wanted to understand there?



- Sandeep Shah:** Just wanted quantification. That is all.
- Sonjoy Anand:** At this point of time we probably have something like \$125 million.
- Sandeep Shah:** And you said the OCI losses are \$88 million in the balance sheet, right?
- Sonjoy Anand:** That is correct. But, as I said Rupee has been volatile and then it has appreciated so that numbers are no longer relevant.
- Moderator:** Thank you. The next question is from Ankit Pandey from SBI Caps. Please go ahead.
- Ankit Pandey:** I just had a question on the onsite shift seen during this quarter around 2%. What is the reason there and can we quantify the impact on the top-line?
- Manoj Bhat:** If you remember a couple of quarters back we won a large deal in Australia and we have been in transition and that deal has started generating revenue for us this quarter and as is usual, the initial part of the engagement is typically more onsite-heavy and over a period of time we transition work offshore and that profile onsite/offshore ratio keeps changing and that is the main reason for that swing. It is not going to be a permanent shift in our view. I would imagine if I look at that engagement over a period of two or three quarters we would expect that onsite percentage to come down.
- Ankit Pandey:** I am just wondering, if that account has come into our top 10 or something?
- Manoj Bhat:** If it is not in our top 10, it will surely be in a couple of quarters because we follow trailing 12-months kind of account.
- Ankit Pandey:** And did I miss the pricing impact on the top-line?
- Manoj Bhat:** We gave a view on pricing. I think broadly we said that BT is under kind of going through a process and so there are elements of volumes and pricing there. And non-BT broadly stable, we are seeing selective price increases in some accounts.
- Ankit Pandey:** Can I have your outlook for the non-BT growth going forward, given that NASSCOM has come out with 11-14% kind of outlook for the next year?
- Manoj Bhat:** I think we do not put out a number but I think from a market perspective to give you a flavor, I think if you see the franchise we have built in Managed Services for example, and there is a list of at least three or four large accounts which we have won in the last 12 months. So that is the trend which we see repeating which is the usual trend which we see is an element of vendor consolidation in the Managed Services area which is happening. It started off as a trend for us in the rest of the world region and now we are seeing that happening in Europe and we are hopeful that at some point US might also be one of the potential markets there. In terms of the network services area we are seeing a lot of traction and potential. The quantity of deals we are addressing today are higher than before but I think the flip side of that is somewhere decision-making cycles are longer. So, net-net I



think we feel confident that our capabilities will allow us to address the market potential but unfortunately I cannot give you a number.

Ankit Pandey: I was just focusing on the rest of the world kind of growth. So some new projects will start there. I am just wondering the most deals that you won recently have they come from the new tenders put out there or are there sort of vendor churn kind of a deal?

Manoj Bhat: I think if I really look at it last 12 months most of our deals I would say are kind of reconfiguration of existing spend. I think there have been a very few deals which have been new spend by Telco and there are two ways to look at this, that is a negative and a positive. The positive is, of course, at some point they have to start spending and our initial expectation was that in the second half of this year, but clearly, the events on the economic front have changed that view a little bit. So, what is happening is that there are a lot of action on the ground in terms of RFPs, etc. We are hoping that it will translate into some revenues in the future.

Ankit Pandey: But, especially from Europe and Americas, can you give us a perspective of what kind of deals that you are already involved in or in sort of a process in finalization, and can you put that in perspective of this particular Australian deal that you are talking about, how long can that take to get finalized?

Manoj Bhat: Typical, large deal and the recent ones which we have won have been probably I would say four to six months sale cycle.

Ankit Pandey: So, that is not terribly worse, is it?

Manoj Bhat: As I said the last one was about six months back, so I think the situation has changed a little bit. Having said that I would say that today we are in front of about three or four large opportunities and they have been in the pipeline for about 2.5 to 3 months already and I think a couple of them happen to be in Europe, so as we go forward and we will come back and update you probably next quarter on what has happened.

Ankit Pandey: And these deals that you talk about, are they more on the cost take out front or are they transformational in nature?

Manoj Bhat: See, what is happening broadly is there was a cost. What people are looking for is to create a budget for transformation through cost take out on the operational front and what that means is you use a combination of system rationalization, consolidation, vendor consolidation, try and create a budget which then takes care of some of your new build activities and that is the trend we are seeing whether it is billing, OSS or network, that is the most of the deals predominantly are structured like that.

Moderator: Thank you. The next question is from Pinku Pappan from Nomura. Please go ahead.

Pinku Pappan: You talked about a revival of demand in US. Could you expand a little bit more there and walk us through which areas you are seeing demand in and you also said about a new



spend by Telco, could you just help us understand what you are kind of seeing in the market especially in the US?

Manoj Bhat: In the US, there are two, three trends there; one is I think we are seeing investments going into the LTE space and second trend which we are seeing is a lot of people have kind of invested in assets which over a period of time they want to kind of monetize and so they are creating service around the assets that they have created. Ravi would you like to add anything there.

L. Ravichandran: Basically in US as we told you that that kind of a huge amount of investments are being made in actually kind of looking at a new technology, LTE and kind of 4G. Because as you know that data is going to rule the Telecom segment with voices becoming lesser, we are jointly working with both equipment manufacturers and service providers in those technologies which is going to support faster and faster data and video growth and the same thing we see that operational efficiency and the cost savings which we can bring in, how they can plough back into these new projects and another area which we just talked about in the beginning is a Enterprise Mobility, so various applications on the mobile and smartphone. So if you look at it, it is going to be data video and the high speed services and the Enterprise Mobility and these areas lot of innovation projects are still getting done. And a partner like us who could take over the BIU and save money in operations and then getting up money for the transformational projects are being liked and so that the transformational projects can become self-funding and that is how we see the trend everywhere there.

Pinku Pappan: My last question is regarding your software professional headcount. Over the last two quarters it has declined by around 10%. Is it largely to do with the BT account?

L. Ravichandran: It is the combination. I think that BT account plus we have increased our utilization if you would have seen, that we are reskilling our people to see how we can utilize our guys, so it is both in terms of optimization and the utilization and then getting more people billed and then some amount of reduction in BT.

Pinku Pappan But you think there is further scope to increase?

Sonjoy Anand: What we had said is that one of the levers for us is as we go forward is utilization and there is some opportunity there. But it is not that whatever has happened on headcount reduction has largely come from the fact that there have been attrition and we have been able to start utilizing the people, younger people we had taken earlier from campuses.

Pinku Pappan: Could you give us a number of how many freshers you have hired in the last two quarters?

Manoj Bhat: I do not know the last two quarters. Basically, we can give you the data, so 2,000 is what we have hired over the last three quarters or so and most of them are now trained, I think the number of people in training is a lesser number, so the focus as we go forward is really to get them productive and into the billed category and that is will be the focus as we go along. And what our engagements like Managed Services give us is the potential because



there we have not measured on input, more measured on outputs and SLA and that is where we are planning to use some of these trained campus recruits which we have as a pool today.

Pinku Pappan: And just one last question, the BPO additions, was that in India or was that for the Airtel Africa contract?

Sujit Bakshi: Not only Airtel or another large Indian customer, partly for a large contract we have received from a customer in UK where our hundred people are under training there and we also have about 400 people in training in Philippines and Africa, largely Philippines and Belfast and about ten in Africa are undergoing training for any incremental business, 400 onsite and about 1,000 offshore domestic and 100 offshore for international.

Moderator: Thank you. The next question is from Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain: Can you share the number of BT revenue in GBP terms?

Manoj Bhat: It is about £64 million give or take.

Rahul Jain: Just to understand the kind of run rate we are getting from BT, are we sort of satisfied with the kind of restructuring amount that was decided a couple of years back and the kind of run rate we are delivering for them?

Manoj Bhat: Satisfaction is a very relative term, but let me try and answer the question. I think as we have explained in the past we are going through a process, as per the process, they are inviting competing bids and the competition is pretty much the key vendors which BT has which includes some of the premier vendors apart from ourselves. So, I think we went through a structured process and we are structuring our response in a way which takes advantage of our incumbents in that account and gives us potential to improve margins in the future even though there might be a near-term revenue and margin impact. I am sorry, I cannot answer it more directly than that.

Rahul Jain: Can you give an income tax calculation for the quarter? What is the reversal which you mentioned earlier?

Sonjoy Anand: The effective tax rate that you see is about 17%. The underlying tax rate for us is 24%. The difference is because of a tax refund in the UK.

Rahul Jain: What is that amount?

Sonjoy Anand: 141 million.

Rahul Jain: And this was due to?

Sonjoy Anand: From some of the exemptions that we had sought from the UK tax authorities.



- Rahul Jain:** So, this is a refund. So, we were charged earlier.
- Sonjoy Anand:** It is a refund against what we had paid earlier.
- Rahul Jain:** So, now the exemption is approved, so –
- Sonjoy Anand:** The cash has come in.
- Manoj Bhat:** Rahul, just to clarify, it is a one-time.
- Rahul Jain:** Also, on the CapEx count, what is the CapEx in the nine months?
- Manoj Bhat:** It is 228 crores in the nine month period.
- Rahul Jain:** We have been generating fairly decent gross cash flows but our debt level has been stable for quite sometime. So what is the plan there?
- Sonjoy Anand:** Our approach on the debt level is that, our first priority is to fund the business opportunities and in some of the large deals that we win there are investments that we have to make in the initial periods and then those get recovered overtime. Whenever we have cash which is surplus to the operations, we use it to payback on our borrowing and of course, as you can see we have had segment capital spend because we have been creating our own capacity as well at the level of rented premises that we have had in the past because of rapid growth has been pretty high.
- Rahul Jain:** So is it like we are looking at specific CapEx for next year to build a certain capacity going forward?
- Sonjoy Anand:** This is not a particular number that I want to give you for next year, but I was only responding to your question on why the borrowings have not come down even further.
- Rahul Jain:** At the current juncture what could be the utilization of total seat available?
- Manoj Bhat:** So broadly, I think we should be close to 90% or so. I do not have the exact numbers but it should be in that ballpark. But the way to look at seat utilization is not really at an aggregate level, probably location wise, so some locations we have full up where we are building, and some locations where we have spare capacity we are not building. I think that is the way we will do it.
- Moderator:** Thank you. The next question is from Sandeep Shah from RBS Equities. Please go ahead.
- Sandeep Shah:** Would you like to give some progress in terms of the Satyam-Tech Mahindra merger? What has been progressively done post the last quarter?
- Sonjoy Anand:** As far as Tech Mahindra merger Msat is concerned, we have always said that that is the ultimate conclusion to an initiative of buying Mahindra Satyam but in terms of the final



timeframe, etc. it is the view that the Board have to take. As and when they take that view, we will communicate it to you.

Sandeep Shah: Whether the auditors or bankers have been announced for this year?

Sonjoy Anand: There is no announcement that we made.

Sandeep Shah: So, as of now, this quarter there are no progressive steps taken towards this?

Sonjoy Anand: As and when the Board looks at this and takes a view, we will share that.

Sandeep Shah: Second, despite several deal wins on the BPO, if I look at the revenue run rate from Q1 to Q3 it has been stagnating at \$27 million, \$28 million. So is it more to do with the ramp-up within the Airtel deal is not coming through as per the time?

Sujit Bakshi: Looking at the target, the growth is about 63% in dollar and about 81% in Rupee. As I said close to 1100 in India, including international business and about 400 people onsite were undergoing training. So, this will change the revenue in this quarter with about 1500 people.

Sandeep Shah: So, you are saying 1100 people are in India and 400 onsite were going through training?

Sujit Bakshi: They are undergoing training for which we have already received business. We have got the business.

Sandeep Shah: When do you expect the ramp-up? When these employees –

Sujit Bakshi: In this quarter about 75% of this will get into billing for this quarter. Some of them of course attrition back fill about 75% will start billing in this quarter.

Manoj Bhat: And Sandeep, a clarification on the dollar number, a large proportion of our business is built in Rupees because of the domestic and a good proportion is also in Pounds. So, this quarter when you look at the dollar number you have to factor in the appropriate currency.

Moderator: Thank you. As there are no further questions from the participants I would now like to hand over the conference back to Mr. Sonjoy Anand for closing comments.

Sonjoy Anand I would like to once again thank all of you for joining us. I hope we have been able to clarify all the questions you had. In the event that there are other questions, please get in touch with our Investor Relations team. Look forward to catching up with you in the next quarter.

Moderator: Thank you very much. On behalf of Tech Mahindra that concludes this conference call.