"Tech Mahindra Q4 FY17 Results Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Tech Mahindra Q4FY'17 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. In case you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Vineet Nayyar – Vice Chairman, Tech Mahindra. Thank you and over to you, sir.

Vineet Nayyar: Good Evening, Gentlemen and Ladies. Welcome to Tech Mahindra's Financial Results Performance for the Fourth Quarter and Financial Year ending 31st March 2017. We have ended the fiscal year with a revenue growth of 10% at around US$4.35 billion which is up 7.8% and our profits after tax were 420 million which was up 7.8% YoY. Revenue for the fourth quarter was at $1.13 million, up 1.3% and 10.6% YoY. Profit after tax for the quarter was $89 million which was down 29.3% QoQ. Our cash and cash balances stood at US$830 million in FY'17. With healthy cash position during the year, the board was glad to propose a dividend Rs. 9 per share. Last year we had a dividend of Rs.12 per share which included a special dividend of Rs.6 per share to commemorate our 10th Year of Listing. So this year in a way we have upped our dividend by additional Rs.3. The total dividend of Rs.9 per share would result in a payout ratio including dividend tax of about 37%. We added over 12,000 associates in FY'17 taking our headcount to 117,693.

Further, as you are aware, in March 2017, we strengthened our Healthcare and Life Sciences footprint with the acquisition of the US-based HCI Group. The company works with some of the world's most prestigious Tier-1 healthcare science providers, primarily in the US and UK, focusing on providing end-to-end implementation of electronic health records and electronic medical records, software, training and support services. I am pleased to inform you that we have closed the acquisition on 4th May 2017.

Coming to the Broader Economy: The US economy has shown signs of our entry with group business, Trump administration promising regulatory relief, substantial tax cuts, and more spending on pocket first. The ambitious new administration wants to double the growth rate from 1.6% to 3%; however, Trump's America first agenda and focus on curbing the immigration especially around H1B visa policies will hurt the IT sector, the non-proposed radical shift in policy related to visa quota and allotment thereby leading to a tough application procedure and higher cost of Indian IT company, looking to bring talent to the United States. Many other countries like UK, Australia, Singapore, etc., have also tightened the visa requirements. We all will have to realign our business models to the new realities and have already optimized our visa requirements and focus on local hiring. Having said that, I would add that I do not see that as a major setback. There are adequate numbers of engineers available in these countries who can be hired and of course part of this work can be shifted offshore.

On the other side of the globe, we have seen surprising strength in not only Germany but in the whole of Euro zone which posted 0.6% growth in Q1. The strong data mean that euro zone is closer to or longer needing extraordinary stimulus provided by the European central bank to €60 billion in a monthly bond purchase. The UK economy has been fairly resilient post referendum. On March 29, UK formally triggered the Art. 50, starting a two-year countdown for UK's divorce from Europe. UK is going for general election and post which the new government would begin negotiations with Europe. These are unsettling times in both on the politics and economics of both Europe and US. However, the demand for technological services continues unabated. We do believe that given our resilience we will be able to see our way through this current fog. So personally, I am not too pessimistic. I still think that we are innovative enough to go through these relatively tiny problems and continue to grow further.

With these general remarks, I would hand over to CP to expand on our "Business Performance."

CP Gurnani: Thank you, Vineet. As a sector on one hand some of the challenges are daunting and clearly the opportunities are exciting. So coming back to FY'17, some headwinds, some positive movement, overall a mixed bag of a quarter. Enterprise business as you know grew 3.4%; Service Provider business has stabilized, that is showing growth. Network Services business, Engineering or reprofiling or repurposing is continuing and as I predicted to you in December last year that we know what is to be done, we are initiating actions and you know that we took some extraordinary decision but our Network Services I think we know what is the business we do not want to do and what is the business we want to do. Our Products business continues to be little asymmetrical because certain quarters we do well and certain quarters the response is not all that great. We obviously need to add a few more products to bring little more stability into that business but in this quarter if there was a drag I would say that was planned drag because of Network Services and a little bit of surprises on the Products business. But overall as a year, BFSI, Manufacturing and Retail did exceptionally well; BFSI grew 36% constant currency, Manufacturing grew 20% in constant currency, Retail grew about 18% in constant currency and overall the Enterprise business almost grew 12% in constant currency, clearly ahead of industry. Overall, when I look at both the communication pipeline and the Enterprise Services pipeline I think it is a better pipeline that what I had around the same time last year. If I were to look at the negatives of this year, #1 is on EBITDA margin, I think we still need to work harder on that; #2 is some of the restructuring of our business or the projects restructuring or some of our products business realignment, I think we need to complete that exercise so that we can give you a little more predictable quarters. I can only promise you that as a management team I am conscious that I need to get some of the challenging part of the business out of the way and we also need to improve some of our operating margins. Those are two clearly our focus areas. The third focus area for us is reskilling. As you know the talent factors are changing, the technology is changing, consumers are changing and we need to make sure that our people are changing with the time. So we would be getting our teams ready to face some of the market opportunities.

So overall I can only say that the opportunities in the technology sector still continue to be very high, they continue to be very-very exciting and it is for us to take advantage of those opportunities, levers for EBITDA I think we have a roadmap, we are very clear what we need to do and the management team is committed over the next two quarters that they would be very disciplined and you would be able to see uptick in our operating margins. So the business FY'18 we do not share outlook, so I am not going to share with you what the outlook would be but if we were to say, "Am I concerned about some of the protectionism or some of the geography challenges?" Yes, I am, but at the same time I do believe that we are as much a local company now, I have six centers in US, I have two centers in Canada, and I have two centers in Australia, three centers in UK. So we are trying to adopt ourselves, but the technology people are not so readily available. So there will always be a little bit of a challenge. In global trades, it is nothing new. I know that it may have a marginal impact in terms of the kind of projects we do but if we continue to be innovative, and if we continue to look at alternate methods, I think this would not be, this is a surmountable challenge, that is the way I look at it.

On an acquisition side, very happy with all the four acquisitions in the recent past, particularly HCI which started on 5th of May, the deal flow is phenomenal, synergy benefits are coming true and it is showing results. Pininfarina, as you know, signed two large deals and they announced it in the Geneva Motor Show, they have announced it in the Shanghai Motor Show, they even announced it that the new Eurostar train the interiors is being done by Pininfarina. I think it is a very-very good turnaround and again the synergy benefit is very visible. Similarly, Bio and Target both are doing extremely well. So overall, your company is feeling a lot more confident about this acquisition. As I said, the repurposing of LCC also is now almost definite and it is only a matter of now the next two quarters where we are able to complete the reengineering.

So I think with this, I will pass it on to Milind or maybe open it up for questions because clearly I know that this quarter our EBITDA performance has not been satisfactory and Milind, I and Manoj have a lot of explanation to do.

Milind Kulkarni: Siddique, what I would do is maybe a few financial performance parameters I will just share and then we can open it to question-answer. You covered most of it. So Good Evening to you. Our Q4 revenue we saw a sequential growth of 1.3% and in constant currency term it was 0.9% sequential growth and 12.1% on YoY basis. The EBITDA for the quarter was 136.7 million VS 175 million in Q3. The EBITDA margin dropped by 370 basis points sequentially and it was impacted by multiple reasons. We have been talking about weakness in Networking business, primarily LCC business and we decided to exit some of the contract, we restructured those contracts and we had taken a one-time hit of about 20 million which is about 180 basis points. There has been certain the reprofiling of spend in our Legacy business in this quarter and that resulted into a charge of about $15 million for the quarter, so about 140 basis points. There has been also an impact because of the rupee appreciation. So currency has brought down our margin by about 40 basis points. So there are certain factors which are one-time, there are certain factors which will be able to recover over maybe a couple of quarters. Currency is difficult to predict.

Other income for the quarter was about $35.6 million Vs $23 million in Q3. Included in this other income is FOREX gain of 24 million as against 13.4 million in the previous quarter. The depreciation for the quarter was 42.8 million Vs 36.6 million. The depreciation is higher partially because of the software purchases for internal and customer use which we depreciate in the quarter of purchase instead of taking it charge over a period of time. Software we take it in the year of purchase. Net profit after tax for the quarter was about 88.8 million against 126.3 million.

On the full year front, our revenue was 4351 million against 4037 million, a growth of about 7.8% which in constant currency terms is about 9.4%.

Just wanted to share with you that we have been focusing for last few quarters on improvement in working capital cycle and this has resulted in improved cash generation. Our cash flow from the operations for Q4 was 139 million which is about 102% of EBITDA as against 90% of EBITDA in Q3. So cash flow from operations for the year is $541 million Vs $494 million in the last year. Cash and cash equivalent were $830 million and if we take out the net of borrowing about $210 million, the cash surplus is about $620 million.

Let me talk about Hedging: Our hedging strategy which we have been following consistently, continue to serve us well. We have hedges of about $1,030 million at 72.95, £201 million at 99.80 and $155 million at 81.87. As you know, these are much higher than the current spot rate and we have an MTM gain as on 31st March of USD149 million. Based on hedge accounting, we have taken a gain of 36 million to the P&L and a gain of 130 million is carried forward into reserves.

If I were to conclude our margin for the year, we are a tad lower than our expectation and I have already shared with you the reasons for this. We still have margin levers like automation, improvement in our portfolio company performance and the pyramid which will improve as we go along with the number of trainees we have added in the last year and they get into billable roles.

As Mr. Nayyar mentioned the board has recommended a dividend of Rs.9 per share which works out to a payout of about 37%.

I think with that we can open the floor for "Questions."

Moderator: Thank you, sir. Ladies and gentlemen, we will now begin with the Question-and-Answer Session. The first question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: I have a couple of questions for CP and one question for Milind. CP, to start with you, what do you think is hurting us so much? I agree that the growth rate was not very disappointing, but still if you see we are not yet able to pick up the momentum and we do not really know how much more dent can be there in the Network Services part of the LCC part. If I recall rightly, last quarter almost we were on the verge of like we are done with all the bad parts, but then in December, some more updates came in. I think further looks like deep cut has happened in this quarter as well. So your sense on that? Secondly, very contrary to other players reporting if you see, everyone has given a very strong number in the telecom space but we have little weak number again this quarter. Is this only related to the Networking Services and if so then can we expect good growth going forward from here in overall communications side? One question to Milind. Just if you can give some numbers like you said there is some impact of currency of 40 bps and there is some impact of another additional item of 140 bps. So if you can help us to break up the 12% EBITDA margin which is there this quarter, what it would have been if those one-time which you think had impacted, where would the margins be – it will be 13.8% or it will be 15.3%?

CP Gurnani: Again, as the division heads, who runs this businesses on the call so I will definitely request Manish and Ritesh to chime in but so my perspective I think what I told you guys in December was we know what the bottom of Communications business is, we are communicating with our customers and we will have what I would call as a transformation plan and all I can say is that we are no longer getting surprised about our transformation. If I look at my rest of the Communications business outside of this Network business, then actually I am very happy because my business in Communications have grown 7.7%. It is only the Network business which we are conscious, we are treating it, and it is just a matter of two more quarters and hopefully that is the last time we will be discussing it. So why do you not Manish, you add your commentary, because I think Sandeep has asked from a shareholder perspective a very valid question?

Manish Vyas: I would just maybe add a line to what CP just said that we have been saying it that we have put the strategy in place sometime back, build around all the three key top important imperatives of a service provider and we are doing well on almost all the three dimensions in terms of helping them, continue to do those run deals, we have signed as a matter of fact last 12-months more mid and large size deals in the run category than in the previous year. So that is a clear indication that we continue to win and win more in the space that we have historically dominated. Our account growth continues to happen. We have also secured businesses for a very long time with some of the major accounts and all of that clearly is continuing to be a good foundation as we continue the transformation journey and find new revenue areas in the change and the grow category of business which is the transformation.

Sandeep Agarwal: If that is the case, the growth was…?

Manish Vyas: It is the Network Services business where we are continuing to focus on reprofiling, we are doing both, working on both the spectrum, so on one hand we are continuing to invest in network of the future strategies and we have had about 10-12 consulting wins in the last two-three-months and at the same time we are making a big surgical shift as far as correcting the businesses that we have, consciously decided not as a surprise sometime back but as you can imagine that this is not something that a business that is far flung and in complex, it takes a while to find the right models to try and do these changes. So we are pretty focused. I would say that at this point that in the CSP space, I still do not see anybody winning as much business as we do in the conventional service provider market.

Milind Kulkarni: On margin front, Sandeep, EBITDA margin for the quarter were impacted by about 370 basis points and three main reasons – one was as was mentioned we decided to exit one of the loss-making contract in the Networking side of business. Now that has meant a hit of about $20 million. Now 180 basis points on margin terms. Now that is clearly one-time. There is certain realignment of our legacy business spend and that impacted about 15 million, about 140 basis points. Now that we will recover over a period of two to three quarters. Third one is 40 basis points which are on account of currency. Clearly, Q1 that impact is likely to be there. Now, how the currencies will move? It is very difficult to predict.

Sandeep Agarwal: But sir, next quarter if you see we will have visa cost impact, in Q2 we will have wage hike, and Comviva will also have a negative impactness. But it looks like we will still continue to have one or two more quarters of even more muted margins only and maybe some recovery from here could happen with the one-time item which you spoke of 180 basis points but still it will not be close to 15% as was earlier?

Manoj Bhat: Sandeep, this is Manoj. Your reading is right. I think if you go to Q1, clearly, there is visa cost, and there is the Comviva seasonality and potentially the full impact of currency because I think we had partial impact of currency in Q4. So those are headwind. I think the way to look at it is as we are speaking, there are various measures we are doing to improve some of the near-term levers. So you should expect the movement in utilization which is going to be done on a war-footing as we go through this process, you should expect some of the changes in terms of recoveries and some of the cost levers we have outside, I would say personal kind of cost. So I think there are several measures we are doing on a war-footing. If you look at what Milind said, we do believe that some of the loss in margin is due to the spend reprofiling. I think maybe a couple of quarters we should be able to recover it. The one-time goes away. Currency is actually anybody's ball game but I think the only difference for us is I think we are fairly well positioned; as of March 31st we have about 115 million of hedge gains on the balance sheet. So while I think it will hit the EBITDA margins, I think the gains will flow through other income. So we will compensate to a certain extent while we lose at the EBITDA level. So I think that is the way to look at it. The other thing I think CP alluded to it, if we look at our products business in the VAS area, because of the events which have happened recently in the Indian telecom ecosystem, I think one of the reasons why this quarter was weaker than we anticipated was there were certain spend deferrals and so on and so forth in that area and that product business has displayed weaknesses. You know these businesses have typically very-very high profitability because they are effectively like license sales and those have not come through in this quarter, and in fact, if those had come through as we had anticipated, I think some of these issues around such a steep margin drop might not have been there. So I think that is the way to look at the next one or two quarters, Sandeep. If I can answer anything more in depth, happy to do so.

Moderator: Thank you. The next question is from the line of Divya Nagarajan from UBS. Please go ahead.

Divya Nagarajan: Manoj, you spoke about some utilization levers that you can pull. Could you just give us some color on the kind of margin improvement that you are expecting from that? There has been a deferral of wage hikes. Will that eventually come through in FY18 and how we are allowing for that? Assuming if the currency continues to be where it is, what other levers do we have for utilization going into FY18?

Manoj Bhat: Maybe I will talk about each of the levers. So if you really look at it, there is utilization, our utilization has dropped; we were at some point if I look at it, I think excluding trainees, we were at almost mid-80 levels, so that has come off about 3-4% points over a period of time. So clearly that is the first lever in my mind that how do we push that up again to a fairly high level and that is something which we believe I think we can control the inflow of manpower and make that happen in a more rapid manner. The second thing is that I would loosely call it portfolio companies. But really there are two businesses which are causing most of the issues right now which is if you look at the Network business and we have spoken many times that we are going to go through a restructuring, you are seeing parts of it happening in Q4 and I think some of these calls and events which we have mentioned even in the previous quarter's call and in subsequent conversations we are actually actioning them now and hopefully as CP mentioned over two quarters, those should also be something we should have substantially cleaned out what we believe our business is, we should exit in that area. The third thing is as I said the VAS business, it is a very unique business, just some color, and I think Q1 is typically a loss, Q2 is breakeven, Q3 YTD is breakeven for the year and most of the profitability comes in Q4. So Q4 is a critical quarter as I said, we experienced weakness in Q4. As we look into next year, that business this year has done much-much worse in terms of EBITDA compared to last year. I think that will get normalized this year as we go into because part of these deferrals will start coming through over the course of the year and we are taking certain measures there to make sure that we address the product mix and the cost structure around that. So some of those actions are also happening. So that is the portfolio company piece. The third piece is really about automation. I think three quarters back we started the exercise. I think what we have achieved so far is in a group of projects 10% kind of level of automation. My sense is that our internal targets are much more than that and that will help improve margins as we go forward. The fourth is one really I think when we look at the group of projects which we have identified which are not really up to the mark in profitability, we are approaching each of them… and this is I am talking in our normal IT business, not in the Network business, we are in various stages of I would say recovery and I think that would be a margin lever going forward. So broadly there are many such margin levers and this is in addition to obviously the average cost coming down as campus recruits join the main population and get absorbed. As you know, last year was our very big investment in campus recruits. I think it is the highest ever we have inducted into the workforce. Most of them came out of training in Q3 and Q4 and they will get absorbed this quarter. So that is the way I look at margin, Divya, and I am happy to dive deeper into any aspects.

Divya Nagarajan: So from what you have just said, I think there are two incremental levers that you have this year is that you have better visibility on how LCC is going to progress and your campus hires actually kind of coming into production this year. So what I am trying to get to hear is that even last year we had some of these levers, but in FY17; those levers we were not able to engage those levers as well as we hoped. So other than these two factors, what gives us the confidence that we can do that in FY18?

Manoj Bhat: Some of this is probably just mathematics, right. So if I look at our Network Services business because of whatever we have done during the year… I think the year before it was a mid-single digit EBITDA and I think if I look at this full year, I think it will be almost double digit negative EBITDA give or take. So that is the kind of swing we are talking about. That is because of all these events we spoke about; we said we have cleaned up, some of the structures have changed, some of the people have changed, some countries we have exited, and we are exiting some contracts. So if I look at it that itself just that Network Services piece itself is a hit of almost on a full year basis 0.6-0.7% on margin. This year even if I assume a worst-case scenario it breaks even, I think that is a margin lever by itself. So some of these are mathematics, right. The second thing as I said, the VAS business which was a typically about mid-teens to high-teens EBITDA and most of the margins came in Q4, I think we are in mid-single digit this year and that is because of the deferrals of given the situation in the Indian telecom market. Again, that is not a permanent situation. We do not expect it to continue. On a full year basis, we would see that normalizing itself and that itself becomes a margin lever. What is different from last time? I think these are the differences. Incrementally, I think how are we doing this better. If I really look at it the last two years almost, all the campus recruits which we have invested in increasing the intake, I think there have been net investment actually because you train the campus recruits for six months. This year is finally when we would see them getting absorbed in larger numbers and that is what we are going to try and do across our business. So that is the way I look at it, Divya.

Moderator: Thank you. The next question is from the line of (Giriraj Gorani from JP Morgan). Please go ahead.

Viju: This is Viju here. Just a question to the management on LCC. What are the lessons you have learned in terms of future M&A in making sure that LCC does not rise going forward? Second would be that despite disappointments we have had from LCC for a while; you have gone ahead and still made the bunch of acquisitions after that. What makes you so certain that some of the disappointments in LCC will not attach to some of the other acquisitions?

Manoj Bhat: Both are great questions. So on LCC I think two-three things, right. What we have learnt? I think one of the big learnings is a distributed set up across multiple countries with each country being little bit of smaller presence. I think that is something which we are now saying that those kinds of acquisitions we will be very-very careful in evaluating. Second is the market change and that change we have now started spending a lot of time in terms of assessment of the market and trying to assess what these changes would be. So in my mind, those are the two big changes. There are obviously other internal changes in terms of transition or an integration approach, etc., which have changed. I think if I look at the other fundamental change which we have done in our acquisitions strategy is if you look at the last three-four acquisitions, two-three things; one is have been in the newer technology areas, in fact, as we speak, each of them is doing phenomenally well, whether it is a bio acquisition which already has got us two or three large customer engagements as part of the synergy or on the target which has done extremely well and has met some of the targets which were set out for them or Pininfarina where I think our vision there was that how do we combine Italian design, German engineering and a global delivery model and how do we offer the best solution to the customer. I think it is already in a public domain. They have picked up recently a spate of orders about three or four of them with a couple of Chinese manufacturers and Middle Eastern manufacturers. So that model is also working. Viju, I think some of these is a continuous journey. But clearly every time we have gone through such a phase I think there are some learnings, we are incorporating those into our methodologies.

Moderator: Thank you. The next question is from the line of Ananta Narayan from Credit Suisse. Please go ahead.

Ananta Narayan: I had two or three questions: Firstly, can you maybe expand a bit more on this legacy realignment that you spoke about, what exactly is that? Second, Manoj, you have given us a fairly detailed pluses and minuses for margins, getting into next year. But essentially what does it all mean, if we look at your FY'17 EBITDA margins of 14%-odd, is that the base from where we can hope to see some expansion? Third question is what is the annualized revenue of the LCC business now and where does it bottom out?

Manoj Bhat: The way to look at it is as we think of most of our customers as they go through this allocation of spend of Legacy versus Digital, the engagement structures we are adopting is where we would actually help optimize some of the legacy work we are doing and help funnel that investment into Digital, which means that at the beginning of such an exercise, we would actually in effect be helping the customer, cut his spend and get some levers like automation and right shoring over a period of time and that typically catches up in a couple of quarters. So that is what we would mean by spend realignment. So that is the first point. I think the second point was about LCC and the Network business. I will just answer a bit of the question and request Manish to expand but LCC we have now integrated it with our Network Services business. I think clearly there are certain lines of business which we are consciously say exiting and certain countries we are exiting. If I really look at the run rate today probably it is in the 250 million range but then some of the business is already coming through the TechM books. So I think that is getting incrementally difficult to track but if I really look at what was the standalone LCC books, it must be about 250 million. Manish, do you want to expand on some of the strategy we are using for LCC and reflect upon what are the changes we are making there?

Manish Vyas: Yes, absolutely. Three things that I would like to highlight as far as the Network Services business is concerned and again thematically we have stayed consistent with this for the last couple of quarters. One, that we will continue to focus from a growth standpoint in what we are calling as "Network of the Future" and the transformation of network. What we have corrected ourselves there and homed in on a little bit more into what is called the "Core of the Network" rather than on the access and the field side. So that is one strategic shift that we have taken. As a result, to Manoj's point, we have also identified lines of services and in specific certain countries which has run through select set of criteria not just profitability but skill set base, the type of customers, the overall profile of our contract and we have consistently been moving away and decided to close. What you do not see sometimes is basically the time factor because it does take time given all the other client commitments and the stuff. So that is the second part. The earlier question that I think Viju asked, I want to also address that while answering your question, is we have also in terms of the learning from the LCC business what I would very confidently tell all of you is the fact that one of the greatest wins that we have had as part of the LCC acquisition is the understanding and the access and a very clear distinct positioning in the marketplace as a Network Services company. So amongst all the competitors that we have, I am glad to share with all of you that your company still stands out in terms of having taken a pet in what continues to remain the largest spend in the marketplace from a service provider standpoint, and that is increasingly becoming more and more software. So, it is only a matter of time and not if in terms of how this strategy will eventually play out. I and the team continue to remain very-very confident about this approach that we are taking to business. So from a short-term standpoint just to conclude, we are really looking at countries, portfolio, type of services and the other geopolitical issues that we are looking at in a few countries that we were present in that we inherited that we will be looking to exit over the next couple of months as well besides whatever we have done so far.

Ananta Narayan Manoj, getting to my third question on the EBITDA margin, so relative to that full year '17 number of 14.4%, what do all the pluses and minuses mean? Also the LCC issue the $250 million number that you mentioned, how much more get shaved off before we hit bottom?

Manoj Bhat: I think we are pretty close to the bottom I would imagine, because I think with all the planned exits, I would suspect our effective run rate should be between close to 200-220 million, that is a broad range. So we are pretty close there… I am giving you a full year number, so on the quarterly profile, it is already below that. On the other question, Ananta, I do not think I will be in a position to guide whether the margins on a full year basis will be up or down. I am telling you there are significant levers. The other way to look at it is that if I look at this year, just my restructuring cost which we have identified and pointed out is 0.8%. So that is why I am taking this time to explain that if I look at the full year profile, there are significant changes and costs which we have taken in restructuring and also because of certain customer-specific events, for example, in the VAS business. So that is where we feel confident that while Q1 looks weak, Q2 onwards we should be able to present a much better margin profile.

Moderator: Thank you. The next question is from the line of Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah: Just a question on the margin. So over a longer period of time, if you look at FY'14 base, it was 19.4% and now we are in FY'17 at EBIT level it is 11%, so it is more than 800 basis points which has been shaved off. Here it looks like that the restructuring in the LCC is not a main culprit. So now our margins are lower than some of the mid cap companies also and if you look at, the scale benefits are not coming. So is it like, we are more taking a reactive approach in terms of a margin management, what are the learnings here because it looks like that like our strategy in the past is more behind growth without any respect to the margin as a whole.

Manoj Bhat: So Sandeep, I think clearly there are and we have been explaining the reasons for the decline, and you are very fair to say that from an external perspective, it would probably seem like that. But as I said, I think if I look at what has happened in some of our businesses and some of our pockets of whether it is a geography. So there has been I would say deep variances in margins over a period of time. So clearly I think it has taken us some time to decide and take some of those corrective measures, but all I can assure you is that with these decisions made, I think we are moving fairly, quickly through some of the changes, and as you see, we have already taken one of the steps. This quarter in Q4, you will see more happening in Q1 and Q2. On the detail margin reco, I think the point you are making is valid that there has been a significant decline in margins. I do not know whether we should get into margin reconciliation over such a long period of time. But the point you are making, we recognize it, we are cognizant of it, and all of us are aligned to plan improvement.

Sandeep Shah: Just on the LCC, is it the impairment test has already been taken in the year FY'17 or it may come in the future?

Manoj Bhat: So first of all, I think there has been no impairment charge on LCC this particular year because in line with what we guys are telling you that because of all these changes we are making, I think we do expect that the margins will come up during this year and I think that is the reason, we will test again on a periodic basis, but as of now, there is no impairment for LCC, and I think for the record, it is about $160 million or so is the goodwill value so to speak which we have to test again.

Sandeep Shah: Manoj, just on a sustainable basis, where will be your comfort in terms of EBITDA and EBIT margin, I am not asking for a specific guidance, but where do you believe looking at the current state of affairs, where do you believe we can reach to constant currency margin at what levels?

Manoj Bhat: Sandeep, I think I was asked the same question and I think I will give the same answer that I do not want to give a range, I think we realize that clearly, we have some work to do in terms of convincing that we can improve in certain measures. Maybe appropriate time is to look at this in two quarters and then reevaluate in terms of what we can say because otherwise clearly margins have depth since we last spoke. I think we have our task cut out and hopefully, we are very equal to the task and we will get some of the stuff done.

Sandeep Shah: Just on the wage side with no wage hikes in FY'17, how should we read the FY'18 wage hikes -- will it be two rounds of wage hikes or will it be one round of wage hike, when it will come, what could be the quantum? On the other side as we are differing the wage hike and the other side, we are looking to pull out the utilization also further, do you not believe that this is asking for too much and there could be some delivery issues going forward?

Manoj Bhat: My quick comment is I think clearly FY'18 wage hikes are some distance away. I think we have immediate priorities we have all decided for ourselves as a management team and I think we are focused on making that happen. But I will let Ravi and Rakesh comment on what is the overall situation they visualize in terms of delivery issues and what are the sorts of trainings and how are we planning to go through this change.

L. Ravi: I think on the issue of I think kind of that risk on delivery, we are very-very cognizant of it and so we have identified on accounts, where there is transformation projects, we have identified accounts where there is very critical production support, and we are looking to communicating with the key leaders about basically the issues and basically getting their kind of acceptance that they would be part of kind of this process, and also we are looking at various ways of incentivizing people in terms of project profitability improvement so that lot of incentives for automation, so you do automation and improve profitability, then the project can generate the budget. So there are various ways we are making sure the key staff are actually committed to the company's goals and there is extra reviews and extra touch point with the customers to make sure that delivery risk is not there and huge amount of training in all the centers and even for our overseas staff both online and classroom training has been there for them to learn the automation tools. About 25,000 people have been automation-certified, that means that they have the basic skills to kind of run automation tools and implement it in their projects and then they can improve the productivity. Same thing about IoT, Digital. So there has been the training investments have hugely increased so that people are able to do the jobs. Again, it is a part of kind of key staff and then communication and then additional kind of quality reviews and keeping an eye on critical projects and we are cognizant of it, and we are taking care of it.

Sandeep Shah: Just last on the Enterprise side, looking at three acquisitions, the last been CGS, is it fair to say that FY'18 including these three acquisitions, we have growth rates on the Enterprise side would be higher than the industry?

Manoj Bhat: Manoj, you want to pick up that question in terms of Enterprise growth prospects going in the next year.

Manoj Chugh: First of all, I think there is no industry guidance on growth at this point in time. So, I do not know frankly what benchmark we need to measure ourselves again. From a business perspective of cost arithmetically, when you make acquisitions, the growth in FY'18 will be higher than FY'17 from that perspective. I can only talk historically at this point in time in FY'17 and FY'16; we have grown a little better than what the industry has grown. We will continue to work hard in FY'18. But frankly, I cannot share comparative perspective given the fact that there is no guidance overall that the industry is giving the growth.

Sandeep Shah: Manoj, any comments on the retail which has done well, but for the peers, it looks like a concern?

Manoj Bhat: I think we have had the advantage of base effect, the size of our retail business as you know is significantly smaller than many of our other peers, and again, this is a business where we have continued to gain new accounts, I think that is why you are seeing the effect in terms of growth and certainly it is what we call within Tech Mahindra and emerging vertical on which we will continue to focus.

Moderator: The next question is from the line of Yogesh Agarwal from HSBC. Please go ahead.

Yogesh Agarwal: Manoj, just have one clarification, sorry, I missed earlier. So around 400 basis points hit to the margins around $35 million, what is the impact on the top line because of that, so that is entire thing impacts the top line as well right?

Manoj Bhat: The top line impact because of that is probably closer to between 15-20 million give or take

Milind Kulkarni: About 150 basis points, you are right.

Yogesh Agarwal: You stripped off some LCC business and then some of the projects were closed. So the entire thing should have impacted the top line as well?

Manoj Bhat: No, I am giving you the top line impact.

Yogesh Agarwal: So then the underlying business actually grew 2.5-3%?

Manoj Bhat: That is right in a way because some of the impact has come on revenue, and, in fact, if you actually see what I said that the VAS business had a much softer quarter, then we expected because of the deferrals and we could be deferred into Q2, Q3 because of the situation, we could have even had a better quarter, that is probably what I am saying.

Moderator: The next question is from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: So the first question is on the 180 basis points charge you mentioned. Just want to understand this, is this a provision a) and is this client-specific, any kind of promise productivity benefits?

Manoj Bhat: Ankur, it is a provision, in the sense that agreement to exit this contract and compensate and associated cost was signed after March 31st but before the audit did. So in a sense, as of March 31st, it is a provision for something which will happen in Q1 and this is pertaining to one contract and related cost to that.

Ankur Rudra: So we would have remained an impact on top line for this provision in Q1 there?

Manoj Bhat: So I think the top line impact of this will be there but with many such contracts the top line is small because we were engaged in a discussion with the customer to exit the contract.

Ankur Rudra: Just to be clear, this is also on the Telecom side?

Manoj Bhat: It is in the Network business.

Ankur Rudra: The second question is on the Network business. I see your bet on software-defined networks, but the question I have is, is LCC really the best asset to go after it? That is Part-A. Part-B, we have had $48 million of restructuring charges this year. I understand you are focused on the area per se. But with respect to what you have right now, what would make you sort of throw in the tar and start to sell LCC in the current Network business?

Manoj Bhat: I will let Manish pick up the answer to that question. Manish, you want to answer about LCC and what are the strengths which help us position for this?

Manish Vyas: We have never said that LCC is the answer to all the questions called SDN-NFV. LCC gives us and gave us access to the network market globally, in some cases to more markets than what we probably needed and that was the learning which I pointed out to you earlier which is what we are correcting. #2, networks continue to remain a very local business in terms of understanding the architectures and working locally. So that benefit we do generate a lot including right now as we speak the deals that we are winning it is happening because and will hopefully be able to share some of these good news with you in the next call in a couple of months where we are signing deals which are largely predicated upon our presence and access to the market and knowledge of those networks. Thanks to LCC. The SDN-NFV strategy that we have announced is mostly built around what we are calling as "VNF Exchange" which is our platform and our laboratory where we have integrated the partner products to build the network of the future model, and this is where some of the relationships that LCC brought are also being leveraged in executing these solutions together. Network is a pretty vast field and I would not want us to simplify that. We would not be able to simplify that by saying whether LCC was the right answer or no to SDN-NFV. Our reasons for doing LCC business and acquisition were clearly what we had stated. Unfortunately, some of those things did not pan out. Thanks to the very distributed ownership structure and the management structure and a few other underlying issues that we surfaced going forward. So I would still say that network and network transformation continues to remain a very solid large opportunity in time to come.

Ankur Rudra: Any sort of markers from here in terms of what would keep looking at from a business perspective, not from a profitability perspective particularly to sort of assess whether LCC is performing correctly or should we just exit that and still focus on that area?

Manish Vyas: I think we are very clear that the two things that we are going to be increasingly focused on -- One is the core of the network or the core network as it is called, which is where we will see the priority-1 and priority-2 disruption is happening from a spend pattern standpoint as far as SDN-NFV is concerned. The good news is that we had within Tech Mahindra organically, also built some strength in that space, it has just gotten better over the last 12-18-months. So that is one pivot that we will make. The second from within the LCC portfolio of services, we are very clear that with services which are very engineering and design-oriented is what we will continue to focus on. As far as some of the other strategic shifts that we need to make, we are working on some of those, so we will be able to update to you as we continue to find answers to these questions on. I may not be able to tell you anything more than that at this point.

Moderator: Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: Wanted to understand the legacy business restructuring of the 150 basis points. Is that completely captured in the quarter in terms of impact or could there be a residual impact going into next quarter?

Manoj Bhat: We have not said that this is a one-off event. So the restructuring of the contract which is the one we spoke about, that is one-off in this quarter, but this is something which we have reprofiled and we will recover margins by actually introducing automation and changing our cost structures on this part of the adjustment.

Nitin Padmanabhan: Yes, understood that part. What I was asking that the $15 million impact will be recovered over a period of time which I understand. But is that $15 million or let us say the impact on that contract, has the complete impact on that contract been captured or over and above this, there will be a further impact that we could see in the quarter going forward is what..?.

Manoj Bhat: No, there is no further impact which we foresee.

Nitin Padmanabhan: Second, do you foresee any further such recession that you could be aware of in the near-term to medium-term?

Manoj Bhat: Clearly, we cannot predict beyond two quarters, but I think I do not foresee any such restructuring coming through. As you know that this is a continuous process of discussions with various customers. So that is an ongoing thing. But this particular kind of restructuring, there is nothing which we visualize right now in the next two quarters.

Moderator: Thank you. The next question is from the line of Vibhor Singhal from PhillipCapital. Please go ahead.

Vibhor Singhal: I just wanted to delve a bit let us say away from the LCC and the margin thing that we have been talking off. Again for the last 8-9 quarters, I think we have been so engrossed in the margin profile of how the company's margin profile has deteriorated maybe because of LCC. I am sure during this period, it has also consumed a lot of management bandwidth. So I just wanted to basically shift the focus a bit from there and wanted to ask you about what we have been asking the other players in the IT spaces about our Digital offerings. Where do we stand in terms of our basically Analytics and the Cloud-based offerings and the Mobility space? Other competitors, for example, started giving out what percentage of their revenue comprises of Digital spaces. When do you think we would be ready to basically provide such a number? My only concern is that in terms of basically coming out of this entire basically LCC trouble that we got ourselves into, I hope it is not the case that when we come out of it, we are actually behind other players in terms of our Digital offerings, and then we basically catch up after that. So just your thoughts on that as to how we are positioned in that and how does that business look going forward?

Manoj Bhat: I think what we will ask is Manoj and Manish because I think they are seeing examples everyday of how we are incorporating Digital and maybe without naming customers, we could give some of the illustrative examples of what we have done. My two bits are clearly we have a percentage of revenue of a definition based on Gartner, how much is digital, it is probably just north of 20% now. But to me, I think the question is that because in every proposal, everything we do now, Digital has become an integral part. It is a question of how much impact that has on that particular proposal. So, I would say that you would see there is ever increasing trend over a period of time. But I will just hand it over to Manoj and then Manish to talk about some of the practical examples of how we are incorporating Digital and Digital technologies and how we are helping the customer along this journey.

Manoj Chugh: Our approach to Digital is actually woven into our specific domains of vertical go-to-market. Let me take an example and this repeats for every vertical that we are focused on. Manufacturing on the Enterprise side of the house is our largest vertical and our key bets in manufacturing are in four areas -- The first is around building smart solutions which a lot of people when they start looking at this area would relate to smart cards, smart products and helping our customers bring that to market, …I will give examples in a couple of minutes. The second is around connected after market. How do we help our customers enable servicification of their products? So therefore now they can offer their products as a service larger than the traditional CAPEX model. The third is particularly in manufacturing very exciting around factory of the future. The fourth is focus Manufacturing, Analytics particularly, when we look at domain-based algorithms and hedge analytics. As Manoj mentioned, I think almost every customer that we talk to have a digital fabric integrated into the offering that we are making to that organization, for example, for one of the large Tier-1 OEMs, we have actually transformed their shop floor by integrating IT with IoT. To the extent that we have been to see very quick productivity improvements. The challenges that you have when you do projects like this is how do you extract data from age old machines which may not be IoT enabled and then how do you integrate that data set and drive analytics on top of that by mashing information through the manufacturing, execution systems and traditional ERP. So if you look at what Tech Mahindra is doing, actually going right on to the shop floor, so that through digital technologies, we can now enable the organization to be more productive in a radically different fashion. We spoke about helping our customers around servicification. So one of the large motor manufacturers, it is an industrial motor manufacturer, we actually took their motors, design sensors, connected them so as to enable new revenue opportunities for their customers. But we are also finding in many of the manufacturing shops particularly in the aerospace industry, taking machining centers and being able to analyze in real-time information through IoT technologies can again unleash significant benefits from productivity and cost perspective. So, if you look at what we are doing with our customers on Digital, it is integrating right into their heart of the business, and traditionally, we used to work on the IT side and we now move right across the shop floor, and as they call, trying to connect the shop floor to the top floor. Like the case of manufacturing, similarly, we have a specific bet that we have taken in Banking, Financial Services, Healthcare and other verticals. So I think that is the approach that we have taken. To your point, "Are these messages resonating?" They absolutely are and we are excited with the results that we have to demonstrate. You would have also seen through the various examples of the wins that we have had in the recent quarter that almost every win is underpinned by Digital.

Vibhor Singhal: Manoj, you mentioned that basically our share of the Digital business probably somewhere just maybe north of 20% as per the Gartner's definition. How much would that have let us say grown in this year vis-à-vis last year… would there be a number to that?

Manoj Bhat: My sense it is probably was about 14%, 15% from memory about a year back, but I will have to double check that, I am not 100% sure of that.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. Due to time constraints, I now hand the conference over to Mr. Manoj Bhat for closing comments. Over to you, sir.

Manoj Bhat: Thank you all for joining and I am sure you have additional questions, Vikas and I and are available to address any questions we might not have been able to cover. Thank you for joining the call.

Moderator: Thank you very much members of the management. Ladies and gentlemen, on behalf of Tech Mahindra that concludes today's conference call. Thank you all for joining us and you may now disconnect your lines.