“Tech Mahindra Limited Q3 FY-’16 Earnings Conference Call

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Moderator: Ladies and Gentlemen, Good Day and Welcome to Tech Mahindra's Q3 FY-'16 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. C P Gurnani – M.D. and CEO, Tech Mahindra. Thank you and over to you sir.

C P Gurnani: Hello! Maybe it is Good Afternoon and Good Morning depending on where you are. Thank you for joining your company's Q3 FY-'16 Earnings Interaction. As I dive into the dynamics of our business, I think it is important to look at what the last quarter has been. This quarter our revenue is at US$1015 million, it has grown 0.4% quarter-on-quarter, if I put it in INR it is a growth of 1.3%, our growth annually is about 9.8% year-on-year, our constant currency growth has been 1.2% quarter-on-quarter, our EBITDA margins improved 30 basis points from 16.6% in Q2 to 16.9% in Q3, PAT is at 115 million. Overall I would say a satisfying quarter considering that some of our sectors did extremely well and some of the sectors continue to lag a little bit. So if I go back three quarters back we had articulated a journey towards gradual recovery of TechM and I believe that both the businesses are showing decent recovery, enterprises obviously has grown significantly and communications, oil and gas will continue to be a sector which will be part of the volatility of the global challenges.

Our deal pipeline continues to be stable; we have had a total TCV wins of about a billion dollars over last three quarters, we saw almost $275 plus million of new business sign in Q3. Active customer count went up by 13 to become 801 in Q3.

From a geography perspective, ROW has grown 6.7%, Europe was flat in currency terms and US there was a de-growth of approximately 1.7%. Overall from a margin point of view, I think the firm has done well considering that we had recovered a little bit by improved utilization, by currency benefit, better SGA management and we did have a few headwinds like the normal furlough, some of the challenges of seasonal weak quarter and very-very marginal very small effect of the Chennai challenges.

As a company, I am actually very-very happy that the growth that we have seen in the Enterprise sector, Retail sector has done well, Manufacturing sector has done well, Healthcare has done extremely well. So in general I would say a satisfactory Q3, satisfactory trajectory, a lot to be done and I am also encouraged by overall Digital new wins, we have had wins in the connected vehicles, connected solutions category, we have had wins in the connected utility sector, we launched Mobo Money, India's First Contactless Digital Payment Ecosystem. We expect over the next few years to have Mobo Money Smart Pay Points about a million of them. I think overall launch of AQT in the previous quarter, acquisition of Pininfarina which has been very-very well received by our prospects and customers. I think it has been a very-very satisfactory quarter.

I am going to let Milind share with you his perspective and then we will open it up for Q&A.

Milind Kulkarni: Good Evening, Good Morning, Good Afternoon, everyone. So let me take you through the Financial Highlights in little more detail. Our Q3 revenues were at $1014.7 million Vs $1011 million in Q2, which is a sequential growth of 0.4% and 9.8% growth Y-o-Y. The quarter saw adverse cross currency headwinds of about 80 basis points due to depreciation of GBP, Euro, Canadian dollar and INR against USD and a sequential revenue growth in constant currency term was about 1.2%. Revenue in INR terms was Rs.6,701 crores versus Rs.6,615 crores in Q2, a growth of 1.3% quarter-on-quarter and 16.5% Y-o-Y. Communications business saw a higher adverse cross currency impact of 90 basis points primarily due to GBP and Euro depreciation while Enterprise business won adverse currency impact of 60 basis points sequentially. Enterprise business has a healthy growth of 4.4% quarter-on-quarter while Communications business we saw a decline of 1.8% in the constant currency term. Now Communications decline is a factor of normal furlough and ramp down of some of the projects in some of our top customers which is reflected in top-5 customer sequential growth. Our endeavor would be to resume growth trajectory in the next quarter.

On the margin front we saw 30 basis points improvement on a sequential basis with EBITDA margin improving from 16.6% to 16.9%. The margins improved despite a seasonal weakness as a result of furlough and despite a sequential decline in our Communications business in Q3. The margin tailwinds came from cost optimization program, improved utilization, lower SG&A. In absolute term EBITDA for the quarter was $171.9 million as against $167.6 million in Q2. On Y-o-Y basis the margins were impacted by some of the acquisitions where we are still improving their performances, the increase in the onsite execution ratio and change in the business mix.

We continue to follow rule-based hedging policy consistently and our hedges as on December were £173 million at Rs.106.9. The September figure was £167 million at Rs.105.8. We have covered €172 million at Rs.81.5 which was in September €138 million at Rs.81.8 and USD 1342 million at Rs.69.4

Now, MTM gains as on December were USD 12.8 million, out of which 0.13 million was taken to P&L and a gain of $12.6 million was taken to reserves based on the hedge accounting treatment that we follow.

Other income for the quarter was 9.6 million as against 24.9 million in Q2. The interest income on our surplus fund remains the same, but there was drop, higher income in Q2 was due to dividend income of 9.9 million on treasury stock and the sales tax refund about $5 million. FOREX loss for the quarter was about 1.5 million similar to what we have seen in Q2. Profit after the tax for the quarter was about US$114.9 million Vs $119.2 million and the PAT margin was 11.3%. INR terms the PAT was 759 crores Vs 785 crores in Q2. The tax rate for the quarter was 23.2% Vs 24.7% in the previous quarter. As mentioned earlier, our tax rate would be in the range of 23% to 24% for the current year.

One of the highlights for this quarter and also for the year is our cash flow improvement. Cash flow from operations for Q3 was 225.2 million, 131% of our EBITDA Vs 142.7 million which is 85% EBITDA in Q2. Cash flow from operations for 9-months was USD423 million, 87% of EBITDA. Our continuous focus on DSO reduction has resulted in improvement of 4-days from 108 to 104 in this quarter. Our DSO have reduced by 9-days over last two quarters from 113 to 104. We will continue to strive to optimize the DSOs over next few quarters.

Our cash and cash equivalents kitty has improved by 214 million sequentially. Our cash and cash equivalents as on December was $747 million Vs $533 million in September. Net cash after adjusting for borrowing is $613 million Vs $402 million in September.

To Conclude: We have had a satisfactory performance despite weakness in Communications business. We would continue to focus on our cost optimization initiative as well as DSO improvement initiative while we go through the business ups and downs.

With this remark, I now open the floor for Questions.

Moderator: Thank you very much. We will now begin the Question-and-Answer Session. Our first question is from the line of Sagar Rastogi from Ambit Capital. Please go ahead.

Sagar Rastogi: First, the project ramp-downs that happened. Did you lose share in a particular large client or the clients budget is shrinking? Was this phenomena concentrated in one or two large clients or was it in a number of your clients?

Manoj Bhat: Sagar, this is Manoj. I think if I got your question right are you talking about the decline in some of our revenues in our top customers. So if I look at it I think there are multiple reasons for it, of course first reason is I think there is a cross currency impact which has hit in customer growth. The second is of course there is the seasonal impact of furlough which is hit in a couple of our sectors namely probably Communications and TME. Lastly is the 3rd impact is on the project. I think slowdowns are ramped down which we saw. I would roughly distribute at as probably 1/3rd, 1/3rd, 1/3rd loosely and I am just giving that as a high level metric and if I look at it I think this is just a cycle and I do anticipate that as we go forward while our customers transform we will have to participate with them and work through and try to make improvements in some of our growth prospects with them.

Sagar Rastogi: But I just wanted to understand if this was a customer-specific issue or it was across the entire sector the ramp-downs bit?

Manoj Bhat: I think we saw it may be more than a couple of customers, we have seen it across some of our customers across the board, it is not just one customer if that is the question.

Sagar Rastogi: In the last quarter you had mentioned that you were pursuing five large deals including the opportunities from M&A in your top clients**.** Did any of those close in this quarter?

Manoj Bhat: I think on the large deals I think one of the things we are seeing is a very elongated decision cycle and that is a phenomenon which we have seen continuing and I think the situation on some of these deals remains the same as we are in discussion and some of these decisions are something which the customer is still deliberating upon. I think the other question you had was on M&A. I think let me kind of cover the entire gamut. So three of our large customers are in that process of acquiring other competitors in their market in one case certain other diversification. Broadly if I look at it, two of them are still awaiting final regulatory approvals and one of them has received the approvals and I think we are looking to guidance from the customer in terms of when we can participate in the growth prospects coming out of that. Does that kind of answer your question?

Sagar Rastogi: Yes, sure. So basically you are saying that it is still in process, it is not that you have lost those deals, it is just that those deals are hanging and in suspended animation right now?

Manoj Bhat: Yes, that is what I would categorize it as.

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

Sandeep Muthangi: I wanted to drill a bit deep into the telecom thing again. How close are you guys to the bottom in some of these accounts or these accounts are so volatile that you cannot still call how close you are to the bottom in these accounts that are ramping down?

Manoj Bhat: I will jump two quarters forward because I am looking at it as a portfolio, so you know that Q1 we are seasonally weak business coming from Comviva, LCC is seasonally weak in Q4, so I think if I look at the portfolio that is where CP was mentioning that the next two quarters I think Communications and Oil and Gas could be a bit up and down and it is not necessarily specific to the customer, but as a portfolio business it could be a bit up and down in the next two quarters.

Sandeep Muthangi: But do you have visibility based on your …I am not talking about the seasonal businesses, but the core lines and services growth and stuff like that, do you have visibility of growth improving say after the two quarters or do you think the pain will continue?

Manoj Bhat: I want to say that the worst part of the declines are over, but clearly if you ask me for visibility two quarters hence what is going to happen, I do not think we are in that phase of business today because the client decision making cycles are relatively very slow.

Sandeep Muthangi: On the margins and specifically on the offshore angle. Because of the acquisitions, the offshoring is now pretty low, it is at 37%. But what I found surprising is YoY the absolute dollar amount of offshore business fell which I find quite surprising given that there is still an organic growth of around 5% say for the company. I just want to drill a bit into is this because of some unexpected ramp-downs or lack of some focus on delivery during this year because of all these acquisitions, what is happening with the offshoring, why is it down YoY? Last year first nine months it was 1.2 bill, now it is 1.1 bill first nine months. Manoj, the percentage can be explained because you have acquired LCC, heavy onsite business, so mix has come down from say 45 to 37, that is okay. But I am talking about when you just do a simple calculation of revenues, it is down from 1.2 to 1.5. I am just thinking whether this is because of some rampdowns or most of the business that you won on the Enterprise side also seems to have happened onsite, any color into that and basically whether this will be a bit from margin lever going forward?

Manoj Bhat: I have not looked at it that way, but at a high level my feeling looking at what the question is that if you look at the ex-LCC I think if you look at the mix I think clearly we have seen Communications go down as a percentage of revenue and inherently Communications was more offshore-centric and that could potentially explain what you are articulating, but I have not looked at the data, I am happy to discuss it offline but my suspicion is that why absolute volume has come down.

Sandeep Muthangi: The actual question was when you talk about margin levers, utilization and the cost savings, etc., comes very prominently. But you also look at offshoring being fairly material margin lever in the future.

Manoj Bhat: So clearly offshoring is a margin lever but currently I think if you look at the profile, while on the Enterprise side we are seeing growth, I think typically in the first year of growth or first year of new account, you really are focusing more on customer experience and being close to the customer and trying to establish good transition and service delivery, while on the com side of course we have seen some decline, so clearly that is not the ideal environment to incrementally offshore work. So I think as the business settles down I think you will see that emerge as a lever going into next year is my view.

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

Nitin Mohta: I had two questions; firstly on the Enterprise side obviously a good show. So if you can help us understand was this positive surprise versus your own expectations?

Manoj Bhat: Nitin, I do not know how to answer that question because obviously in a way I think obviously you know in this business everything is in the funnel for 3 to 6-months. So if you ask me I think some of these deals were in the funnel and we converted. So I do not know whether I can categorize it as a positive surprise or a negative surprise. But clearly I think what is good is there is traction, what is good is I think the profile of deals are moving more towards the digital side, what is good is that we are adding customers on the Enterprise business. So I think that is my perspective on the Enterprise business really.

Nitin Mohta: Any color in terms of was there any particular vertical which helped you do this or it was really more broad-based?

Manoj Bhat: So I think two verticals -- one is of course the Retail vertical which is always strong for us in Q3 and the second is Healthcare. In addition to that of course Manufacturing grew well. So I think those are the three main verticals I would say.

Nitin Mohta: If I can circle back on the Communications piece of the business, my calculation seem to suggest that the organic piece would hardly see any growth and would be pretty much no growth here and two parts over there, is that a fair assessment and secondly, I know you said visibility at this point of time is not beyond next two quarters, but what are your initial discussions with the clients suggesting for CY'16, are there budget cuts or it is just more of a vendor consolidation, what exactly is driving the pain there?

Manoj Bhat: So I think your calculation on the organic business is correct. Manish, can I request you in terms of just articulating in terms of what are customers thinking about in the next four quarters and how are they thinking about budget?

Manish Vyas: I think where the Communications business is heading towards it pretty much is in line with what we have been saying for the last few quarters. One, clearly, the consolidation related activity has its impact both in terms of the planning cycle that is getting prolonged and hence the spend cycles are getting impacted. Clearly, given that the conventional data, conventional voice-related revenue are under pressure, there is constantly going to be this budgetary controls that the communications services providers will continue to put. That is also a big factor in how we are seeing this business over the next couple of quarters. The third of course is the fact that there are going to be a capital project that will happen in areas which are relatively new to the industry, whether it is the video space, the entertainment space and of course the modernization of the networks. So keeping these two or three very macro level aspects in mind, we believe that while we are very well positioned given the presence that we have across the board the relationships are extremely strong, we will continue to gain on each of these areas, but the next couple of quarters we will have to remain patient and remain engaged as the clarity emerges from the consolidation and the spend patterns. Hope that answers your question, Nitin.

Nitin Mohta: Would it be fair to say that double-digit growth for CY16 on Communications business would be a bit of a stretch or a tough ask at this point of time?

Manish Vyas: I would not be able to unfortunately answer your question either in a yes or a no because things are shaping up as we speak, in fact, in some of the major customer of ours not just in the western markets but even in the emerging, the budgets are still not frozen for the calendar year and that is largely because of the various factors that I spoke about earlier. So it all depends on how quickly things will move while we are like I said well positioned, but it will all depend on the ramp-ups and the decision cycle, like Manoj said earlier, some of the deals that we have been engaged in, those decision cycles have prolonged. So it all depends on how some of these decisions take shape and over the next 30 to 60-days there are several discussions lined up to try and get a better clarity on it. But it will be a period of close watching on how both macro level as well as some of the specific discussions we have with the customers pan out.

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

Diviya Nagarajan: Two questions here; one is on the margins. I think while we do agree there is a plenty of margin drivers coming in, if I were to look at the next 12-months or specific next fiscal '17, what is the kind of margin target are you looking at?

Manoj Bhat: I think if I really look at our margin journey I think clearly we have moved the utilization lever quite significantly over the last two or three quarters. I think as we look at the next four quarters in terms of what are the key initiatives I would say increasingly we are looking at productivity as one of the major levers and as you know we have come up with a framework which we have worked on and implemented internally is called AQT. I think some of those will start playing through the course of the year. The other one is I think in terms of offshoring while I want to call it a lever, clearly it is very customer-specific and then if I look at this quarter, of course, there is some margin loss because of furlough which I am hoping that we should be able to recover some of it going forward. So in terms of FY-'17 I think clearly our target would be to try and improve the margins on a full year basis. Now unfortunately, I cannot give you the number by what degree, but I think if I look here I think given the amount of levers we have, I would say we are fairly confident that we will put all our efforts into, trying to improve the margins from here and go forward from there.

Diviya Nagarajan: Secondly on the M&A front, what is the direction that we can expect from here on? We seem to be favoring so far the discounted entities. The one area where we have been talking about but we have not seen any acquisition that in SOFGEN as BFSI, some thoughts on how you expect this to play out in the next 12-months to long-term?

Manoj Bhat: The broad M&A philosophy is I do think it will be value biased. So if I step back and look at the M&A strategy clearly, we have articulated that there are certain gaps in some of our verticals, I think Healthcare and BFSI, and then some of the service offerings where we are investing whether it is Engineering Services or Platforms, in BPO and so on and so forth. So I think I would say that our philosophy is that it would be value buyer. The second point is of course you would see investments like Fixstream which we have done which is basically in a new technology area where clearly we are willing to incubate and partner with innovators and take it forward. Thirdly I think in terms of probably more mature companies we would be open to taking a minority stake. So I do not think there is one formula saying that we would be a M&A player only in deep discount deals or otherwise. I think if it makes sense from all perspective we would take a call then and I do not want to be restricted by any valuation norms or any guidelines, I think it is really about what fits the situation and what is best for us in that situation, but obviously bias for value.

Moderator: Thank you. The next question is from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Manoj Bhat, my question is on the LCC acquisition. It has been a year since we acquired. So just wanted to understand how the integration has progressed and when can we expect the synergies from this acquisitions to flow in?

Manoj Bhat: Pankaj, if you look at LCC, clearly, this has been the first four quarters as you correctly said and I think two-three things have happened; one is integration wise I think some of the integration around common financing, common access to resources that level has been achieved. The second level is I think in terms of integrated go-to market to customers I think that is in progress and we are looking at some deals in that space together. The third thing I think we have to put the performance in the context of the market. I think in the context of the market if you look at the network space and the spends which have happened I think they have come down dramatically during this calendar year and it is not just what LCC addresses, I think globally I think we have seen some sort of slowdown if you look at some of the US majors, they have curtailed their spends, some of the European majors have also re-looked at spends and I think this is also to be looked in the context of the 3 or 4 M&A deals which are happening in this space. So if you look at the overall environment have been bad. So from my perspective clearly I think we have laid down what is our objective in terms of LCC I think clearly the first piece around go-to market we believe the first signs of some of that working is happening. In terms of an integrated delivery model, I think we are starting to cross-pollinate and figure out what is the best delivery model in terms of how do we enhance and drive value to the customer and to our ourselves, but I do not have the numbers to report in terms of some of these showing up in the numbers yet. If you look at last quarter, we said that we looked at the business portfolio and looked at certain businesses which we thought were non-strategic and together we took the call that this is something we do not want to continue in. I think fair to say there are various pieces in motion but in terms of looking at the numbers I think the results might be out a couple of quarters at least.

Pankaj Kapoor: Just in that context as well as the broader Communications vertical, you mentioned that there are several deals which I guess have been under discussion for a while. Do you think that some of these actually maybe would already been expiry date kind of a thing, that means that they have been in discussion for so long that they actually may not fructify either because of change in customer priorities or just because of commercial reasons or you think that it is only a matter of time before we get these deals coming up for decisions?

Manoj Bhat: Manish you want to answer in terms of some of these deals which have the pipe for some time?

Manish Vyas: Sure, absolutely. I think it is a great question, so let me answer that first which is the easier part, none of these deals have gone into that hibernation mode as you are referring to. These are very well defined problem statements. Some of them were proactively created between us and by the client organizations to start looking at a few problem statements which are transformational as well as efficiency oriented and some of them were of course the needs that the client organizations created and requested for propositions from us and a few other people. So most of them fall into that category; however, the reason I said the question is interesting is because given what is going on from a consolidation, from spend patterns and the new initiatives, the reason why this is taking long is because people are clearly looking at, are there variants and different ways of solving the same problems. By that not necessarily mean picking different type of partners, but what it definitely means is are they looking at may be solving problems in small pockets or consolidating a few different problems together. So those are the discussions that take time. Of course what does impact is the December period and the early January when people come back and start working on these things. So I expect a lot of momentum in the evaluation process and the decision-making process between this quarter and early next quarter.

Pankaj Kapoor: Manish, just to clarify here, does it mean that the discussion point is largely around the scope or does it also involve the structuring of these transactions and does it mean that as and when these deals are awarded, the actual size of the deal could be significantly different than what we were anticipating when these deals went into discussion?

Manish Vyas: I think all three to be honest because the scope is what drives the structuring and the size. So it is really the scope both in terms of the functionalities as well as the depth that somebody wants to go and take care of the short-term and the long-term problems. That only happens in one or two of these cases that we are fighting, I am not necessarily saying all of them fall into that category. I am really giving an answer to your question in a very generic form. It is not really one specific thing we are discussing at this point.

Moderator: Thank you. The next question is from the line of Ashwin Mehta from Nomura. Please go ahead.

Ashwin Mehta: I had two questions; Manoj Bhat, what is the quantum of salary hikes that you are likely to give for the next quarter? What is the kind of margin impact that you expect? Do we still stand by our view that we would be able to mitigate a large part of it?

Manoj Bhat: The salary hike first of all it is going to be effective 1st Jan. I think the quantum we are still debating. I think the appraisal cycle is done. So I think we are just waiting for that final decision. To your second point, I do believe that I would still maintain the statement that we will try to mitigate major portion of the salary hike as we go into next quarter.

Ashwin Mehta: My second question is on the Enterprise segment which has been strong for us. What are we seeing in terms of outlook there, any headwinds similar to what you are indicating in Telecom, especially in the larger segments like Retail or BFSI?

Manoj Chugh: As you know over the last three quarters, we have shown reasonable growth on a cumulative quarterly growth rate basis of about 3.5% and I have been maintaining for many quarters as you know that results depended in the past on large deals when they land and when they do, they obviously have a positive impact, as you know, we have been on this journey for several quarters and you have seen the results consistently over the last three quarters. What we are seeing going forward is also now the added opportunity around Digital Transformation. As we look at the Digital Transformation journey of our customers, many of them are moving to different models as compared to what it was. Typically many of the models are more related to, "Can we provide everything as a service?" As you do that we make investments in projects to enable the customers to move in that journey and direction. If you look ahead in future quarters again our performance will be clearly dependent on the large deals, we work on several of them each quarter and also on the Digital Transformation opportunities that we can bring to our customers like we have done in the recent quarter. I would say that we have to take a quarter-by-quarter approach. Longer-term clearly we want to grow at industry growth rates. So I think that is where we are looking at ourselves in the Enterprise business. On the growth side you have seen secular growth this quarter, and yes, some quarters some verticals tend to be stronger than others, but I think the diversity of our portfolio is really our strength.

Ashwin Mehta: Just a follow-up, Manoj. In terms of large deals, because of Digital Transformation, because of the shift towards as a service kind of engagements, is the quantum or the number of large deals that you are chasing, has that seen a change versus earlier?

Manoj Chugh: The complexion of the deals has changed, earlier in the past there were pure infrastructure or app there or in some cases a mix of the two. What we are now seeing is the digital angle coming in and playing an important role. So for instance, in the most recent quarter we took a customer's entire workplace and just moved it entirely to the Cloud… a very significant customer in the Healthcare space. Likewise in a traditional utility, it is no longer about, can you come in do ERP or BI, it is about can you integrate IoT so that we can go and optimize energy demand is another example. Really from a Digital Transformation perspective the expectations are changing. Not only do we have to do traditional ERP, but we need to go around beyond and see what can we do around IoT or what can we do around Analytics with the data that we are generating as a result of what we are doing on the traditional IT side. So those I would say complexities and the complexions are changing.

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

Sandeep Shah: When we just look at some of your global MNC players who has almost like 4x eyes in telecom business, they are consistently growing in a constant currency in the last 6-7 quarters and Telecom being a segment where client concentration is high for each vendor, there would be a client overlap where some of your clients would be the clients of the other large vendors also. So what is happening, why they have been able to show a consistent high growth when the demand triggers are not only through M&A related deals but are also from the renewal deals or in terms of digital or in terms of the network management side, so is there any offering gaps despite of a six-pillar strategy, how are we reading this situation and is this troubling us in terms of rethinking of a strategy?

Manoj Bhat: I am trying to see how to answer that question because clearly I do not want to comment on the competitors' capability or lack of it. I would answer it this way that there are cycles and clearly may be your assumption is that the customers are the same and our assumption is different. I would just say that as we stand today we do not see any significant offering gap which is causing this kind of revenue declines in our Communications vertical. What I have heard and I am just going to repeat some of your colleagues views, there are digital capabilities which are driving growth. I do not think that is something which I would attribute as correct. Manish, if you want to add to this, but. I do not want to really go beyond that in terms of commenting on our competitors' capabilities.

Manish Vyas: I first of all want to acknowledge Sandeep that you recognize that the six pillar strategy which is for want of anything call it the 'Diversified Portfolio' continues to remain our greatest strength. This is indeed something that also helps us position the way it does across the several service providers. There always will be on a certain opportunity some variants but overall strategically holistically speaking the portfolio of Tech Mahindra remains arguably the strongest in the Communications business, #1. #2, while Manoj said this I want to reiterate that we will not be able to comment on any competition numbers, but it would be just purely a guess that may be the numbers that you may be referring to which I am not aware of, are not necessarily pure play service provider business that we refer to every single time we talk Communications. As you know, our business is 95% on service provider market and in that space a market where we have actually added almost 20-odd new customer relationships this fiscal. We are pretty engaged across the board and we know that there is not any market share loss that we have had very significantly speaking and hence I do not attribute to the portfolio aspect really.

Sandeep Shah: Manish, is there a trigger in terms of renewal of network management side of the deal though Manoj Bhat has said that there is IT spend which is coming down on that side? Second, one of the reasons for the same could be the software-defined networks which may lead to some amount of major spending cuts by the service providers?

Manish Vyas: Absolutely, the software defined and the virtualization of the network is like I said earlier is one of the top three initiatives across the world and it is also at different stages of evaluation in different categories of customers, different segments, based on whether they are in which part of the world, what are the competitive pressures they are facing in their respective markets or if there are challenges in a certain market or otherwise. So that phase of evolution and transformation on the network modernization which is also way beyond just as DN&FV is also one of the three or four factors that is impacting the spend patterns absolutely. That also by the way is leading to the uncertainty that we have had for a while now in the network services spend because it is directly related to the strategic direction that each of these companies take.

Sandeep Shah: So with LCC how you will be able to fight with these challenges, is it like we have to add more capability on that side to compensate that challenge?

Manish Vyas: We are continuing to add across all line of businesses, whether it is networks, whether it is IT, we are looking at more and more capabilities around the Digital or whether we are looking at the operations. So across all three planes, we continue to evolve our portfolio aligned with what the customers are likely to spend over the next 12 to 18-months. So I think it is in more ways than what it is BAU for us business as usual in terms of how we are going to be improving the capabilities. You will have to add new skills as the new technology emerges and that process continues with us and we have also seen some gains in that space.

Sandeep Shah: If I am not wrong, on the LCC I think the revenue may not have increased on a QoQ basis looking at the Telecom overall consolidated numbers despite LCC had a seasonally strongest quarter. So is it disappointed or this is what the management expected at the start of the quarter?

Manoj Bhat: If you really looked at it from a three or four months back perspective, clearly, we were expecting that some of the spend patterns would be different and clearly that has not happened during this quarter and the revenue has been marginal kind of increase compared to what we were expecting.

Sandeep Shah: In terms of the cash flow, there is a solid execution but I believe there was some service tax refund which was pending. So is it that has led to this increase and are we confident that this consistency may be maintained and over medium-to-longer-term this may result into a higher dividend distribution?

Manoj Bhat: First of all I would love 131% percentage CFO-to-EBITDA every quarter but realistically there are two factors; one is that our DSO has come down by about four odd days so which is about an incremental 45 million in cash flows and the second is with tax refunds have contributed about I want to say about 45 to 50 million this quarter. You should isolate both these and clearly on the DSO front it is a continuous effort, we will try to make more progress on that, but the service tax is something which is lumpy and as and when we get, we will show exceptional cash flow.

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

Sandeep Agarwal: I have a question for Manoj Bhat. I know that there have been a significant increase in offshore component in the last few quarters and also there have been some challenges in ramp up of a few of the new acquisitions. But if you see systematically, our EBITDA margins even if you see year-on-year come down from 20%-odd range to 17%, this is despite the INR movement. If you see another point in FY14 we were at a very high margin compared to where we are right now. So, what has happened – is it the acquisition part which we have done and they have kind of changed the trajectory of margins or offshore part alone is responsible? We are very-very seeing a different kind of trajectory, let us say there is almost 500 bps decline in gross margin in FY15 over FY14 and then further looks like 200 bps at least decline will be there even this year. So where we are doing something extraordinary earlier and even if you see our utilization is not that low. So is offshore alone the reason of this kind of dip in the margins or you would attribute something else also? I am sure you would have done some breakup of it as well internally. So if you can share some views on that?

Manoj Bhat: Like-to-like if I see last 12 months clearly there are 2-3 factors as you said. So one is acquisition. They have been dilutive to the margins and that is a big chunk of it, about 150-170 basis points give or take. The second thing is if I look at the mix, the onsite mix both organic & including the LCC bit it has moved up higher a bit. So that has obviously caused because that the onsite business is not as profitable. So those are the two major factors which I would attribute. Clearly if I look at some of the other metrics like SG&A, etc., I think there is hardly any difference. These are the two major reasons. What is the way forward? I articulated some of those clearly on the LCC front an integrated delivery model or an ability to leverage in terms of more revenues coming through from go-to market. That is one. In terms of offshoring there is some potential. Our head-to-tail ratio is substantially lower than some of our peers and that is something we need to continuously keep working on. That is what we are going to try from here. Given that if I compare the two years back, I do not have all the factors but, broadly speaking directionally if I look at it, largely the mix of businesses which has changed over a period of time and that is what causing the margin decline compared to two years back.

Sandeep Agarwal: But if I can rephrase, like if you see on the reported numbers we have kind of lost 6% in last two years in EBITDA margins in spite of movement of INR. So if you do the math maybe it looks like 8-9% movement. So, will it be possible to at least get back half of it in next couple of years once your integration of LCC I guess LCC should start giving you some benefit in the second half of FY17 if not in first half by FY17 end you should also be able to see some cooling of the onshore ratio, so will it be fair to assume that if not 22% which was there in the peak in FY14, we should be in between our current and that number something like 18-19% which is on the radar or you have some thought through that or you think that has structurally gone because of the change in business mix and the acquisition?

Manoj Bhat: First of all I would not say it has structurally gone. Clearly, there are levers which we can see which will move us towards that trajectory. Some of these levers are inherently longer-term in nature because it would need a lot of productivity measures, lot of usage of some of the recent frameworks which we have been starting to use over the last 2-3 quarters and that is something which we do expect will contribute and start driving some of these improvements as we go forward. I do not have a number for you whether it is 18 or 19, but clearly we are all committed on operating metrics and we are seeing some of that already happening. If you look at it we are moving margins up, we are moving cash flow metrics up, we are moving DSO down and some of those basic in terms of some of the key metrics are something which is falling in place, we are running intensive program internally to focus on this and make sure that we move back margins to some of the levels of the benchmark you have quoted and hopefully we will be able to do that as time passes by because as I see it the levers are there and you mentioned most of those in your question itself. So I hope that answers your question that directionally that is where we are focused towards and we want to do that.

Moderator: Thank you. We will take one more question from the line of Ashish Chopra from Motilal Oswal. Please go ahead.

Ashish Chopra: Just a couple of quick ones from my side. Firstly, around the attrition numbers, so it is marginally up compared to already high levels of this time last year. So, Manoj, just wanted to check with you firstly is that in anyways distraction to the business at current levels? Secondly, is that also one of the thought processes or the factors that we did not do your discussions or debates at this point of time around the quantum of wage hikes that you will be deciding upon this quarter?

Manoj Bhat: Obviously, any attrition beyond a certain level is something which we debate and see if it is impacting the business. Attrition is a concern. Is our model capable of sustaining this level of attrition today? I think the answer is yes. Do we want to bring it down? The answer is yes there also. I would not necessarily link it to the discussions around salary hike, but every salary hike of course we do a benchmark with the market and we take the right call in terms of what is right for our business. I do not think it is necessarily linked one-on-one to the attrition level. Short answer is I do not see that impacting our capability to deliver, but we are monitoring it closely and seeing how we manage our talent pool**.**

Ashish Chopra: Healthcare has been doing extremely well for you and now in the last couple of quarters there have been more than one significant deal you announced in that segment and it has contributed fairly significantly to the organic enterprise growth. So, just wanted to understand, is there a commonality in terms of the set of services that you are winning across these deals and also probably in the pipeline which is driving this or each of these deals are very different in their own characteristics?

Manoj Bhat: The commonality is both of these are provider deals which is the space we were not in at all, but in terms of the kind of deals, the nature of these deals is quite different from each other. Clearly, on the Healthcare side, I would say that we are looking at significantly enhancing our presence in that market and as I said initially also that that is a focus area for us in terms of how do we grow our business there. You will have to watch this space as we move along.

Moderator: Thank you very much. I would now like to hand the floor over to Mr. Manoj Bhat for closing comments. Over to you, sir.

Manoj Bhat: Thank you all for joining. There have been a lot of questions, but if any questions have been unanswered clearly, all of you can reach out to Vikas or me. Thank you and good evening to all of you.

Moderator: Thank you very much members of the management. On behalf of Tech Mahindra that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

Note: The above transcript has been edited for better readability