



“Tech Mahindra.Q4FY12 Earnings Conference Call”

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MODERATORS: MR. VINEET NAYYAR – VICE CHAIRMAN, M.D. & CEO
MR. SONJOY ANAND – CHIEF FINANCIAL OFFICER
MR. AMITAVA ROY – PRESIDENT
MR. L. RAVICHANDRAN – PRESIDENT
MR. MANOJ BHAT – SVP, CORPORATE PLANNING

Moderator:

Ladies and gentlemen, good day and welcome to the Q4FY12 Earnings Conference Call of Tech Mahindra. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Vineet Nayyar. Thank you and over to you sir.

Vineet Nayyar:

Welcome to the Tech Mahindra Fourth Quarter and Annual Results call. I have with me the senior management of the company. I have Mr. Sonjoy Anand – Chief Financial Officer; Amitava Roy – President, Tech Mahindra; L. Ravichandran – President, Tech Mahindra and Manoj whom perhaps most of you know.

Before I get into the quarter's performance, let me spend some time on the current economic conditions. As you all know, we have a crisis in the Euro Zone which could impact and reshape the world economy. Relative to Europe, the US seems to be doing much better; however, there are signs of weaknesses even there. Closer home, the situation is also equally mixed. The economic conditions in India remain problematic with high fiscal deficit, slowing growth and policy paralysis. So far as our limited world of technology is concerned, the free fall of the Indian Rupee at least in the short term has certain positive benefits for us.

From the Telecom domain perspective, economic indicators are compelling telecom operators to review 2012 strategic priority. Visibility of large capital intensive projects continues to be elusive. Wireless services continue to sustain growth, thanks to new devices and applications and data service are assuming an increased importance. We are looking to invest in areas like LTE deployment. The key trend is that most of them are looking to form portion of their CAPEX needs to reduction in operational spends and this is where we see opportunity for Tech Mahindra going forward. We do believe that we can assist operators in achieving cost optimization. We have been doing that with a number of telcos, ranging from Indonesia, Qatar, Bahrain and Australia. We are now looking at some interesting opportunities in Europe and in the rest of the world. In fact, as I speak to you, we are in front of 6 to 7 opportunities of this nature in the range of 20 to 150 million TCV.

Coming to the numbers, this quarter has been difficult on the revenue front, as we had few customer specific issues mainly relating to our business in India. Although we saw BT stabilizing in Q4, we had an impact on our revenues as a result of 2G license cancellation order issued by the Supreme Court. For the quarter our revenue was \$282 million, EBITDA was \$48 million and profit after tax was \$62 million. Profit after tax includes \$46 million as our share of profit from Mahindra Satyam. Our EBITDA margin improved by 90 basis points during the quarter due to an improvement in utilization and some currency benefits.

For the year ended 31st March, our revenues were at \$1,156 million; EBITDA at \$194 million and profit after tax at \$230 million. Profit after tax for the full year includes \$115 million of the share of profits from Mahindra Satyam. On a full year basis, our non-BT business showed a growth of 20% if one was to exclude the bought outs of EDB in FY11.

Coming to BT, revenue grew by about 2% sequentially. In BT, the retendering process has slowed down; however, we continue to remain cautious in the long term. So far as we have managed to retain and enhance our estate in BT.

Growth track from emerging markets continued with 48% growth in FY12; Americas grew by 13% in FY12, while Europe saw a growth decline of 4%.

We added around 2,500 employees in FY12 taking the total headcount to 40,763. Our attrition levels have come down during the year and are at 19% in Q4 FY12.

As we look forward, we do see a sustained growth momentum in our non-BT business. Our investment in our capabilities have positioned us well to capitalize on the new market opportunities which are emerging and which I talked about earlier.

With these brief comments, I would like to throw open the floor for questions and our leadership here will endeavor to do its best to answer.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Srivatsan Ramachandran from Spark Capital. Please go ahead.

Srivatsan Ramachandran: Just wanted your comments on BT and non-BT business. In BT business, profits seems to be flat. So just wanted to know have we hit a trough in terms of the BT business? That is question one. Question number two, there has been a bit of a decline in non-BT business also due to the two specific components you highlighted. Has that piece of business also troughed out in this quarter and we could see improvements going forward.

Sonjoy Anand: As far as the BT business is concerned, in this quarter we did see a sequential increase. Our outlook on BT, as we mentioned, the retendering process has slowed down. Overall, as we focus in that account on margins, we do see the possibility of some trade-off in terms of volumes and revenues. As far as the non-BT is concerned, in the current quarter, you have seen the impact of the implications from what has happened in the Indian market. Other than that we expect growth in non-BT to reemerge in the next quarter.

Srivatsan Ramachandran: And in terms of the specific provision you have taken, I do believe it is on the prudent side but just wanted to know if one of these customers had an escrow arrangement if I am correct, so just want to know if we could expect amount some approach from the 68-odd crores to flow through as and when the payment happen?

Sonjoy Anand: One of these customers we had covered by bank guarantee. That bank guarantee has been encashed within the quarter. As far as the 60 plus crores is concerned, this is the provision we have taken for the uncovered dues from two parties in the Indian Telecom sector. It does represent the provision. The situation as you know in the sector is difficult where we continue to pursue legally and otherwise recovery of that money we will, but based on prudence, we have taken the decision to provide the unexposed amount in this quarter.

Srivatsan Ramachandran: My last question is the decline in BPO that we have seen on headcount, is it more due to some of the specific accounts that we are discussing or is it more that we have not had any anticipated growth that did not come through?

Sonjoy Anand: The headcount decline that you have seen in BPO is arising out of rationalization of some of our Indian BPO business.

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

Pinku Pappan: You mentioned that you saw the possibility of some trade-off in volumes and revenue. As you are implying that there is further pricing pressure in BT and you are going to accept those pricing cuts that are demanded by BT?

Sonjoy Anand: The point I was making was that we are going to be focusing on margin in that account and it is possible that there could be some volume and revenue trade-off there. Of course, our attempt always will be to maintain our market share.

Pinku Pappan: So far have you maintained or increased or has it declined in terms of...?

Amitava Roy: I think basically on the market share we have been a strategic partner with BT and we continue to do so. We have not declined on that and we believe that we will continue to grow marginally with them based on the discretionary spend that BT will have.

Pinku Pappan: On the non-BT side, do you expect some more declines in the next quarter, all the impact has factored in this quarter?

Sonjoy Anand: No, on the non-BT side, the impact from the Indian Telecom sector is factored into Q4. We would expect growth to re-emerge in the first quarter as far as non-BT is concerned.

Pinku Pappan: Could you also talk about your IT headcount which has been declining for three quarters now? Just want to get a sense of what is your strategy there, are you tightening utilizations and what's your range of utilization there?

Sonjoy Anand: We have been focusing on utilization and therefore lateral recruitment to replace attrition has been on a need basis.

Pinku Pappan: Some impact on the headcount because of the different clients that you saw contract losses. Is that also part of the decline in headcount, how is it, only because of...?

Sonjoy Anand: I think if you look at this quarter, the reduction is largely in BPO and that is because we have been taking a hard look at some of our Indian BPO business and optimizing that.

Moderator: Thank you. The next question is from Pankaj Kapoor from Standard Chartered Securities. Please go ahead.

Pankaj Kapoor: Just a couple of clarifications. The provision that we have made in this quarter, is it only for Etisalat or does it also include any provision made for **Stel**

- Sonjoy Anand:** It covers all our exposures in the Indian Telecom sector.
- Pankaj Kapoor:** And second, the growth that we saw in the BT business in this quarter, if you could give some sense whether it was volume-led or you had a realization growth in this?
- Amitava Roy:** I think overall from BT perspective, we have sort of arrested the decline which was happening and we believe that it is more stable today. Some of the additional revenues come based on some one-time discretionary spend that BT has actually also incurred and we have been beneficiary for that.
- Moderator:** Thank you. The next question is from Sandeep Shah from RBS Equities. Please go ahead.
- Sandeep Shah:** Just on the BT, when we are saying that the rebidding pressure to some extent has slowed down and there would be a trade-off of volume and pricing. So, on volume front, do you believe that the worst maybe behind and the current volumes can be maintained at BT levels?
- Amitava Roy:** We are cautiously optimistic but right now, while there is a sort of slowdown in terms of the bidding process, it can open up after sometime. So, we will be cautiously really looking at it very closely and then acting based on how it goes.
- Sandeep Shah:** What is the nature of the growth on BT? Is it more outsourcing coming through BT global services or is it the other segments of BT which is driving growth?
- Amitava Roy:** It is across the board.
- Sandeep Shah:** And can you give some visibility in terms of margin on a constant currency going forward and can you compare the same with any wage inflation which we are looking in the coming year?
- Sonjoy Anand:** I think if you look at margins for the coming year, as you know, we do not give guidance; the tailwind is going to come, one from currency. If you want to do on a constant currency basis I think we continue to see opportunity a little bit on the utilization front, some continuing improvements on the employee pyramid and there is a lot of focus on our fixed price projects in terms of productivity. In terms of the employee cost side, we have not yet taken a view on salary increases but clearly, pressure on that front is distinctly lower this year in the current economic situation.
- Sandeep Shah:** So, there is a possibility we may not give wage inflation?
- Sonjoy Anand:** No, I think we have not taken a decision on that yet.
- Sandeep Shah:** And in terms of what Vineet said that couple of 6 to 7 deals which are coming, in terms of cost optimization, is it largely coming out of Asia? We also said that Europe is opening up. So, what about North America?
- Sonjoy Anand:** In fact, of those deals more are in Europe and US than they are in the rest of the world.
- Sandeep Shah:** What is the nature of these deals? Is it coming more from a managed services or it is more out of the outsourcing of enterprise services?

Manoj Bhat: On the deals itself, I think it is mainly around managed services and existing spend. A lot of them are in the nature of vendor consolidation. If we really look at it what started as initial engagements in Asia Pacific for us in managed services, we are clearly seeing a trend which is moving, so the next big win for us is in Australia and now the deals are moving into the western markets, so clearly, from an overall growth profile of this business, I think more and more of the western telecom operators are looking at these kind of deals and in a sense, our experience and expertise on these deals which we have kind of garnered through probably three years of effort in the emerging markets are helping us kind of give a proof of our capabilities, because obviously, volumes are much higher in some of our engagements here and that has held us in good stead. So, I think what we are seeing is this trend which is kind of emerging now and we will have to wait and watch whether how long it will continue but from an operator perspective, the objective is to clearly reduce OPEX and kind of save some money left over for their capital needs. So, I think that is the broad trend we are seeing right now.

Sandeep Shah: You said that all these deals you believe the margins are similar to the company average?

Manoj Bhat: I think the margins per se are probably similar but I think the profile of margins would be more back-ended because there is transition efforts, there is some sort of an initial investment which you will have to do in terms of kind of getting to a base line on SLAs and from thereon I think what we have seen is the margins start to pick up. So the margin profile will be slightly different but overall margin I do not think is too much different from the other business in the same location.

Sandeep Shah: And just on the hedge position, if you can let us know and the OCI which is outstanding on the balance sheet?

Sonjoy Anand: In terms of the hedge position, we were £290 million covered at 83.4 and \$460 million covered at 51.9. The mark-to-market in reserves at the end of the quarter was a loss of around \$70 million.

Sandeep Shah: Just on the tax rate, what should be model in the coming year?

Sonjoy Anand: I think for next year somewhere between 22 to 24%.

Sandeep Shah: Because if you look at even this quarter the adjusted tax rate may come to closer to 24, 27% and if you are looking at 22, 24%, you expect some growth to come from SEZ?

Sonjoy Anand: We have created more SEZ capacity both in Noida and in Hinjewadi.

Moderator: Thank you. The next question is from Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: Just wanted to get a sense on the couple of large deals that you announced in a quarter both from North America and Europe. Will they be similar in size to the deals that we won in Australia? And any upfront investment that we might see in the initial part? Just wanted to get a sense on our SG&A expenses because that element has continued to go up over FY12. So, what kind of numbers do we consider for FY13 and FY14?

- Manoj Bhat:** I think in this quarter what we have announced I do not think any of those deals or of the scale and profile of the Australia deal which we announced, number one. So, there is not going to be any significant kind of transition on other expenses associated with these deals.
- Sonjoy Anand:** On SG&A, we have always said that we believe that an optimum level is somewhere between 15 and 16%, but there will be periods when it is higher, and periods when it is lower, and I do not have a specific number for you for next year.
- Manik Taneja:** And adding on to that large deals side, last quarter you indicated that you have seen three, four opportunities both within Europe and US and some of them on a Managed Services side, so, any progress on that front?
- Manoj Bhat:** When we spoke about it last time, I think they were at a different stage of maturity. Of course, the maturity cycle of those deals have progressed a little bit but I do not think none of them have closed yet but we are hopeful that some of these decisions would be done in the Q1 of this year.
- Moderator:** Thank you. The next question is from Rahul Jain from Dolat Capital. Please go ahead.
- Rahul Jain:** First of all, there is a 4 million slip in these accounts on the India business. What is the ramification of business from Etisalat on the non-India business post this event?
- Manoj Bhat:** In fact, all of the slippages probably on account of the India business. Ex-the India business I think the only other slip we have seen is in the US where we had one of our customers, Cox Communications about six months back, they closed down their wireless division. So, the last of that revenue is also out of the system.
- Rahul Jain:** The second part was what is the ramification of the business in Etisalat non-India portion considering the event that has happened?
- Manoj Bhat:** Your question is what is happening to the global Etisalat relationship. I think that continues to be strong and we are working with them in a couple of other places but I unfortunately cannot get into further details on that but a short answer is that there is no ramification of what has happened in India on our global relationships.
- Rahul Jain:** And telco in a box which you said has been launched. So, what are the trends you are seeing for MVNOs rollout and what is the arrangement with Redknee in terms of the revenue share?
- L. Ravichandran:** In terms of the revenue share kind of we are actually seeing, it is based on our licensed revenue for Redknee themselves and then revenue for us. We are very optimistic and we are excited that this platform we have launched and we have support from Redknee and we have support from Microsoft and hope to see some strategic deal soon.
- Rahul Jain:** Just if you can give some color, what is the trend in trends of new MVNOs launched in various geographies?

- L. Ravichandran:** In terms of new MVNOs, basically smaller country of course and there is an interest in actually reducing the IT cost and so we are optimistic and I think that our results will show it in about a couple of quarters.
- Rahul Jain:** And we are just basically marking up some components on the embedded solutions of Redknee right?
- L. Ravichandran:** No, we are the system integrator, we actually connect and we actually use Redknee as the best platform and then we also have other kind of products which actually create an end-to-end solutions on the Microsoft platform and so that there is are full solutions, that there is a system integration, the whole business logics and then the business workflows and those are the inputs from Tech Mahindra.
- Rahul Jain:** Lastly, what do we see in the coming year in terms of what the potential growth drivers considering the fact that in the last two years the mix of the business considering that BPO has been growing faster than the rest of the business and our EBITDA has declined 9% for two years now despite 10% plus growth on the top-line. So, how we see the business growing in terms of what could be the contributors, what could be the laggards in the business?
- Manoj Bhat:** I think one clear driver which we are seeing for growth going forward is as we spoke about it, the whole managed services wave, which is now kind of maturing into the western markets and our belief is we are positioned very well there given that we have done this for a lot of customers in the emerging markets. I think the other growth areas, which we see is around network services and infrastructure management services. These are the two areas in Telcos which are looking positive for us. From a customer viewpoint, I think Amitava gave you a view on how we are looking at BT and from a non-BT perspective; I think there are enough opportunities which kind of lead us to believe that the potential to grow is still there. The profile of the demand has changed from discretionary to kind of vendor consolidation and cost restructuring and I think in this market we are adapting ourselves to what the customers needs for and capitalizing on those opportunities.
- Rahul Jain:** So, when we see this shift and whatever the demand trends do we see, the profitability will follow in tandem with the revenue growth or the mix. The new mix would be envisioning further deteriorating the profitability?
- Manoj Bhat:** I think on profitability there are two or three things which have impacted this current year. One is we have incurred significant transition expenses through the course of the three, four quarters which have impacted full year profitability. Second is we all know and we have spoken about it in the past in terms of the BT retendering which has impacted. Lastly, you must be well aware, a low growth environment there are very limited levers for manpower pyramid flattening and so on and so forth. So, I think some of those measures which we would have usually done we could not do because of the low growth environment. I think a combination of these three reasons is probably a reason for the decline in profitability at a broad level.
- Moderator:** Thank you. The next question is from Srivatsan Ramachandran from Spark Capital. Please go ahead.
- Srivatsan Ramachandran:** I just wanted a couple of more inputs on the Africa BPO business which you have taken over. If you could just give us some update on where we are or is it kind of now are we moving into the profitability territory on that piece of business and what kind of growth is anticipated there?

- Manoj Bhat:** On Africa, we are now fully operational in all the countries. As it was reported in the press there were a couple of quarters where there were some problems with the local labor, etc. I think we are out of that and so that part of the operations have stabilized. In terms of an overall profitability, I would say we are still in investment mode in Africa and I think from a perspective of planning, I think we are looking to rectify that situation in this coming year.
- Srivatsan Ramachandran:** In terms of the debt repayment is there any specific Indian rupee debt that was repaid or GBP debt that was repaid?
- Sonjoy Anand:** What we have got in our debt portfolio is an element of short-term debt and we have surplus cash. We bring down the debt and if you look at the trend for the last two years you would have seen that we have been consistently doing that and we have done the same thing from the cash generated this quarter.
- Moderator:** Thank you. The next question is from the line of Prateesh Krishnan from Antique Limited. Please go ahead.
- Prateesh Krishnan:** Just one question in terms of the BT. Is it possible to understand what percentage of your BT business would have been retendered already?
- Sonjoy Anand:** The retendering process at the moment has slowed down. There was very little closure as far as retendering was concerned except for a few small pieces which were closed earlier.
- Prateesh Krishnan:** I understand the slowdown but could you say like 20% was done or 50% was done?
- Sonjoy Anand:** I do not think we have a percentage like that, only small bits and pieces were covered.
- Moderator:** Thank you. The next question is from Pinku Pappan from Nomura. Please go ahead.
- Pinku Pappan:** Just one clarification on the statement you made about an incurring significant transition cost this year. Want to understand how far are you through with those transitions regarding the large deals that you signed, are you largely done with those transition costs or do you expect them to continue for a few more quarters?
- Manoj Bhat:** What I was mentioning about the profile of profitability on some of these Managed Services deal, so you will have a curve which is somewhere low and a negative territory in terms of running an EBITDA and then it kind of starts curving upwards. I would say in a couple of those engagements a significant portion of the transition cost is over and we are at a phase where I think we will now look to harvest some of our investments made in transition.
- Sonjoy Anand:** I think the thing that we have to remember is that to some extent transitioning is a part of our business and there will be periods when you will get more transition cost and in other periods where you will have a lesser transition cost.
- Pinku Pappan:** No, I just wanted to understand the possible margin trajectory given where you are in the curve.



Sonjoy Anand: That is why I added that comment. I think the way you should look at it is that on a YoY basis transitioning cost tends to be at a particular level. It can cause a skew between quarters. Of course, there are some years in which it is more, but generally there is some transitioning that happens every year.

Pinku Pappan: Could you help us understand the major items in this transition cost? I understand people transition would be the major one, but are there other significant items there for us to know?

Manoj Bhat: People cost and travel cost I guess, those are the two biggest items there.

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

Sonjoy Anand: I would like to thank all of you for joining us for this call and as always if you have any follow-up questions please get in touch with our investor relations team and we will respond promptly.
Thanks once again for joining us.

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