“Tech Mahindra’s Acquisition of Hutchison Global Services -- Conference Call”

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Ladies and gentlemen, good day and welcome to the Tech Mahindra’s Acquisition of Hutchison Global Services. We have with us today, Mr. Sonjoy Anand – CFO; Mr. Sujit Baksi – President, Business Services Group; and Mr. Manoj Bhat – Senior Vice President & head, M&A & Corporate Planning, Tech Mahindra. As a reminder, for the duration of this call, all participants’ lines would be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today’s presentation. Should you need assistance during this conference, 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. Sonjoy Anand. Thank you and over to you, sir.

Sonjoy Anand

Thank you. I would like to start by outlining the rationale for our acquisition and the dimensions of the acquisition. We are very excited by this acquisition because above all it takes our relationship with the Hutch Group to the next level. Additionally, it gives us an end-to-end capability in customer lifecycle management which we believe we will be able to leverage for significant opportunity with our other customers in the telco space.

Financially, this business brings to us $850 million of committed revenue over a five-year period. We have paid $87 million for it. The company that we have acquired has $20 million of cash and of course all the assets of the company move to us. The transaction is EPS accretive and the margins are in line with what we do in our BPO business.

We are particularly delighted about the quality and caliber of people who have come to us with this acquisition and we look forward to making a huge success of it.

With this I would like to open for questions.

Moderator

Thank you very much sir. We will now begin the question-and-answer session. The first question is from the line of Jitendra Jain from Canara Robeco. Please go ahead.

Pranav Tendulkar

This is Pranav from Canara Robeco. Just wanted to ask how is the scalability of the business because what I understand from Voice BPO that it is not that much scalable and are we getting any platforms in this business? And would you elaborate a little bit about the margins of the business?

Sujit Baksi

It is a combination of Voice, E-mail and Chat, it is not only Voice. In terms of margin it is at par with any international business that we do in Tech Mahindra BPO. Scalability, if you look at the historical, I think last four years they have grown from 8,000 to 11,500 people so far. That is their track record. We cannot forecast what will happen in the future.

Pranav Tendulkar

So basically you will be using the same facilities for other telecom operators also?

Sujit Baksi

Yes, we can. There are a certain restrictions in terms of network and client secure networks and all that where we can use the same facility. So if there is space available, yes, we can.
Pranav Tendulkar  All the facilities are situated in India, right?

Sujit Baksi  Yeah, it is Mumbai and Pune.

Moderator  Thank you. The next question is from the line of Pinku Pappan from Nomura. Please go ahead.

Pinku Pappan  Could you put a number to what margins you make in your international BPO, how much is it?

Sonjoy Anand  Generally, our average margins in the BPO business are a bit below our IT business. So, mid-teens kind of margins is what we make.

Pinku Pappan  This is similar to that in terms of margins?

Sonjoy Anand  We said it is in line with what we do in our BPO business.

Pinku Pappan  And you also talked about $20 million of cash. So your net acquisition cost is 67 million then is it or is it debt also?

Sonjoy Anand  That is correct. There is no debt on the company’s balance sheet.

Pinku Pappan  And at the net level, this company has been profitable for the last few years, is that right…?

Sonjoy Anand  Yeah, it has been profitable and as I said we expect it to be an EPS accretive for us.

Moderator  Thank you. The next question is from the line of Vimal Goel from Asit C Mehta. Please go ahead.

Vimal Goel  Just wanted to know the process of the human resource transition and if the salaries are in line with what Tech Mahindra is paying to its current employees, I mean taking into consideration different levels of the pyramid.

Sujit Baksi  This is completely different from the back office work which we earlier do in international, so obviously, salaries will be different. Their Australia timings are different from UK timings. So, the comfort of the UK timing is not their in the Australian shift allowances. You cannot do an apple-to-apple comparison, but the compensation is in line with the market norms and we do not intend changing any compensation at this stage of time and there is no reduction of manpower at all.

Vimal Goel  The manpower numbers will be consolidated in company’s statement from the next quarter itself?

Sonjoy Anand  Yeah, the deal is effective 4th of September.

Moderator  Thank you. The next question is from the line of Arti Mishra from CLSA. Please go ahead.
Arti Mishra  I just wanted to ask a little bit about the $850 million of confirmed revenues from the current client base. Are these ongoing contracts or is this new business? Because can we envisage any rebidding or any price cut in this $850 million worth of business? Secondly, the key clients are the three networks and Vodafone if I am not mistaken. What sort of client concentration numbers be like at an organization level post the acquisition?

Manoj Bhat  I think approximate revenue levels are about 160 million. Out of which about close to 60% is UK, close to 35% or so is Australia, and the remaining is Ireland. I am just giving you broadly to get a feel. And revenue commitment is a five-year revenue commitment where they have committed to procure this amount of revenue from us. The deal structure guarantees our margins. So that is the structure broadly.

Moderator  Thank you. The next question is from the line of S Vivek Gedda from HSBC. Please go ahead.

Vivek Gedda  I just wanted to find out what is the percentage of business which is inbound versus outbound? And there is another question, are there any external clients and if they can cross-sell any current services outside to other clients?

Sujit Baksi  It depends on which season of the year. Currently, outbound is not more than 15% of the total business. It does not have any external customers outside the three that Manoj had shared with you and you can indeed showcase this for getting other customer business into Tech Mahindra.

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

Sandeep M  Do you intend to raise debt?

Sonjoy Anand  For us our overall business is financed through a combination of debt and internal accruals. As you know at the end of last quarter we were a net debt company. So to that extent from an overall business perspective debt will go up.

Sandeep M  The other question I had was when you refer to the commitment of revenues, are these contractually guaranteed and are there any penalty clauses if things do not go well?

Sonjoy Anand  Revenues are contractually guaranteed. Like in any other operating business in this industry there are certain SLAs that you need to deliver to your customers. If you do not meet those like in any other business there would be penalty.

Manoj Bhat  Sandeep, whether you are asking about the penalties for not meeting the revenue commitment?

Sandeep M  Yeah, absolutely, that was my question.

Manoj Bhat  There is a structure in there of course to protect us. Beyond that I cannot get into the specifics on the call.
Moderator        Thank you. The next question is from the line of Ashwin Mehta from Nomura. Please go ahead.

Ashwin Mehta     Are these revenues largely evenly spread out in terms of the deal?

Manoj Bhat       So the way to look at it is that the guarantee structure is of course on a cumulative as well as on a yearly basis assuming flat revenue. Now the actual business profile depends on the underlying performance. What we have is I would assume in the best case scenario floor to our revenues, right.

Ashwin Mehta     Secondly, when does this acquisition become effective or start to reflect in our P&L?

Manoj Bhat       As of today, 4th of September 2012.

Ashwin Mehta     And finally, in terms of Voice versus non-Voice, what would be the proportion in terms of this business?

Manoj Bhat       Non-Voice is negligible. So, for all practical purposes it is Voice.

Ashwin Mehta     Can we cross-sell? Because we serve some of the Vodafone customers and geographies other than Vodafone as a vendor in other than these geographies that the company serves in, can we start to serve say geographies like Middle East and all through this acquisition?

Manoj Bhat       First of all, this is Hutchison and Hutchison also has a lot of other properties. So, our efforts would be first obviously increase the volume of work we are doing with current whatever properties of Hutch and then the second effort would be to tap other group companies of the Hutchison Group which are not been serviced today, and then obviously, there is also the angle of selling it to other customers globally.

Ashwin Mehta     But do other vendors work in these geographies other than their own captive in terms of the same kind of work?

Manoj Bhat       As we mentioned in the press release for the services this center offers, there is exclusivity in India for our acquisition.

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

Rahul Jain        My question is firstly on the utilization front and second is what would be the payment flow?

Manoj Bhat       We have already paid the money. The deal is closed. And I think utilization, etc. are detailed at this stage. I think we have just stepped in today. We will do a detailed study of how the operations are and then we will have a view for you and an update as we go ahead.
Moderator

Thank you. The next question is from the line of Ashish Agarwal from Tata Securities. Please go ahead.

Ashish Agarwal

Is there from the guaranteed revenue anything extra which we might need to provide apart from what already has been provided by the Hutchison Global Services BPO right now?

Manoj Bhat

Are you asking that do we need to offer new services to meet the guaranteed revenue?

Ashish Agarwal

Yes.

Manoj Bhat

Really it is a five year guarantee. So, obviously, things move in five years. If there are new service offerings to be developed that we will have to develop. We do not envisage a significant investment in that area. Secondly, as the customers need to move on, we will have to change and offer new services if required.

Ashish Agarwal

But it will be over and above this $850 million?

Manoj Bhat

No, I think the way to look at it is let me try and give you an example, maybe Chat as a medium was not there probably seven years back, today, it is there, right. So things like that will evolve, maybe social media is a moving thing, that will all fall under the gamut of customer management.

Sujit Baksi

If the Voice business is substituted by other channels of customer contact like E-mail, Chat then that will actually be substituted in the revenue. The revenue will be guaranteed in respect of the channel that we use over a period of five years.

Moderator

Thank you. The next question is from Sandeep Shah, an analyst. Please go ahead.

Sandeep Shah

Just one question, with this deal, is there any contingent liability related to any taxation for a transfer of a stake?

Sonjoy Anand

The best way to look at it is tax impacts in two ways. One is relating to the operations of the business and the second is relating to the purchase transaction. The liability relating to tax on the purchase transaction is with the seller. Operating business tax liabilities will be ours.

Sandeep Shah

So any tax liability related to a sale transaction would be borne by the seller?

Sonjoy Anand

That is correct.

Manoj Bhat

Yeah, anything in the nature of like withholding for example.

Sandeep Shah

So those liabilities would not be a part of this deal?

Sonjoy Anand

No.
Moderator  
Thank you. The next question is from the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain  
Just a follow-up that, what is the revenue model for scaling it up? Is it on the headcount basis, transaction basis, what is the criteria?

Manoj Bhat  
I do not want to get into all the commercial details. I think we have given you an outline. As we said, as we go forward, we will try to deliver a model which will work for both of us. Today, as I mentioned we have a margin protected model and that is what we are continuing on.

Moderator  
Thank you. The next question is from the line of Abhishek S from ICICI Securities. Please go ahead.

Abhishek S  
During the day on the television you said that the deal will be funded through a mix of cash and debt. Could you elaborate at least on the per cent of what each constituent will be?

Sonjoy Anand  
I think the point I was trying to explain is that we do not have anything specific as far as this transaction is concerned. Where we need to take debt we take it for our overall business. As you know at the end of the last quarter we had debt on our balance sheet. So, yes, that debt will go up, but there are also internal accruals during the quarter. So, it is going to be a combination.

Abhishek S  
A follow-up to that is would cash from Satyam would be used to purchase this acquisition?

Sonjoy Anand  
Ultimately, in the merged entity, the cash is going to be fungible. If we do anything at the moment, it will be on an arms length basis.

Moderator  
Thank you. The next question is from the line of Soumitra C from Espirito Santo. Please go ahead.

Nitin  
This is Nitin here. Just want to clarify; the cost of the acquisition would be $67 million or $87 million?

Manoj Bhat  
So the consideration we paid is $87.1 million and as we said the asset also has cash of $20 million.

Nitin:  
So basically the net cost would be $67 million?

Manoj Bhat  
Yeah, you could look at it that way but I think as defined in the agreement the consideration is $87 million.
Moderator

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

Sandeep Muthangi

I needed one clarification. In addition to the BPO deal, is there also another IT services related deal? Because I saw something on similar lines in some of the media reports.

Manoj Bhat

I think in the press conference we mentioned that as part of our growing relationship with the Hutchison Group, we recently signed a deal with them in the UK. We have not given the outlines of the deal. It just got signed very recently. That is what the media reports are probably talking.

Sandeep Muthangi

Any implication it would have on the immediate quarter or the near-term revenue margins, etc.?

Manoj Bhat

I think we would be in sort of transition for the first three or four months. After that it will start showing up in revenue. We will have more details for you when we have the quarter end call.

Moderator

Thank you. The next question is from the line of Ashish Chopra from Motilal Oswal Securities Limited. Please go ahead.

Ashish Chopra

I just needed one data point. What would be the tax rate in comparison to the tax rate of Tech Mahindra for HGS?

Manoj Bhat

I think there is no tax holiday available for HGS. So it will be the full marginal tax rate.

Ashish Chopra

Secondly, the deal with Hutchison that is just announced recently, so would it be one of those that you had mentioned in the pipeline of a TCV in the range of 125 to 150?

Manoj Bhat

As I said, we want to present a consolidated update on the pipeline. I do not want to get into that other deal right now.

Moderator

Thank you. The next question is from the line of Srivatsan Ramachandran from Spark Capital. Please go ahead.

Srivatsan Ramachandran

If you could help me through what kind of margins you are looking at, from when you will recognize revenues on this acquisition?

Manoj Bhat

What we said is we will recognize revenues from today and we also said that the margins are below our margins and in the mid-teens.

Srivatsan Ramachandran

This will be an EBIT margin?

Manoj Bhat

This will be EBITDA.
Srivatsan Ramachandran  And then in terms of this acquisition, are we getting any platform or any large IP kind of thing which can be cross-pollinated with other clients or would this predominantly be customer care related work?

Manoj Bhat  There are no large platforms associated with this deal in the conventional sense of platforms. But as part of our overall strategy we are traditionally very strong on the IT side, in the Billing, CRM and BI area. When you combine that with a substantial sale in price of contact center operations like this, really I think we have the beginnings of what we would call an end-to-end offering to a customer. That is what we want to try and see if we can achieve some market traction using that.

Srivatsan Ramachandran  My last question is in terms of the pricing model for this acquisition, is it more kind of a T&M or is it kind of an outcome-based pricing that you will eventually move into for this?

Manoj Bhat  I do not want to spend too much time on the pricing model because it is commercially sensitive. What we said I do not know whether you heard that. We said that the current structure protects our margin.

Moderator  Thank you. The last question is from the line of Pranav Tendulkar from Canara Robeco. Please go ahead.

Pranav Tendulkar  If you could reveal what is the ROE and ROC of the business that we are acquiring?

Sonjoy Anand  We have said it is an EPS accretive.

Pranav Tendulkar  And second thing is, in addition to UK, do we have any other business or any other future plans to have Hutchison in other context, in a sense scalability of the business?

Manoj Bhat  So let me kind of articulate what we are doing currently with the Hutchison Group. We are working with them in Indonesia, Australia and UK currently on the IT side. With this we will be working with them in Ireland, UK and Australia on the BPO side. And I think as the relationship develops we hope to be a major competitor and hope to get a lion share of their IT spend.

Pranav Tendulkar  So basically English speaking countries of Hutchison will be a potential market?

Manoj Bhat  No, I think if I step back and look at the acquisition the potential market to me is not only the Hutchison Group, but I would imagine with the combination of our IT and BPO offerings, it would be offered to all customers globally which we have relationships in. If you know, our international Voice BPO or contact center or customer care operations are very small compared to our overall size. Largely, our customer care operations are domestic and what we believe is that combination of our skills in billing, CRM and BI, combined with the capabilities on the BPO side can be a potent service offering for all our major customers.
Moderator  
Thank you. Ladies and gentlemen, that was the last question. I would now like to hand over the floor back to Mr. Sonjoy Anand for closing comments.

Sonjoy Anand  
I would like to thank all of you for having joined us today. We are very excited about this acquisition. If there are any questions which we have not been able to respond to please come back to us individually to the investor relations team and we will respond to all of them.

Moderator  
Thank you. On behalf of Tech Mahindra that concludes this conference.