"Mastek Limited Q2FY13 Earnings Conference Call"

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MANAGEMENT:	**MR. SUDHAKAR RAM – CHAIRMAN, MANAGING DIRECTOR, CEO, MASTEK LIMITED.**
	MR. FARID KAZANI – GROUP CFO, MASTEK LIMITED.
MODERATORS:	**MR. YASH GADODIA – ANALYST, CHRISTENSEN INDIA**

Moderator: Ladies and gentlemen, good day and welcome to the Q2FY13 Earnings Conference Call of Mastek Limited. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. Should you 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. At this time, I would like to hand the conference over to Mr. Yash Gadodia from Christensen Investor Relations. Thank you.

Yash Gadodia: Hello and welcome everyone to the Q2FY13 Earnings Call of Mastek. Joining us from the management are Mr. Sudhakar Ram – Chairman and Group CEO and Mr. Farid Kazani – Group CFO and Finance Director. At this time, I would like to pass on to Mr. Ram for opening remarks.

Sudhakar Ram: This quarter has been pretty satisfying in terms of performance especially on the order book. Last quarter there was a level of concern because orders had right shifted and our backlog came down and we have managed to make up and our order backlog has reached a historical high of about 538 crores. The growth in order book is on all fronts. US, UK and the India, Asia performing on the order book as well as from the verticals perspective we have had wins both in Insurance, Government, in Retail and other Financial Services. So it has been an all round performance. For the quarter, growth was bit muted quarter-on-quarter, mainly because of the right shift of orders of the previous quarter and since the orders have come in we do expect the revenue growth on a sequential basis to get back on to a growth momentum in the coming quarters of this financial year. The overall performance in terms of year-on-year growth has been pretty good on all fronts. In terms of profit we are inching our margins up, it is still not at a level at which we would feel happy, we are still some distance away but at least we are moving our EBITDA margins up quarter-on-quarter, so from about 8% last quarter we crossed 9-9.5% this quarter. So there is a steady improvement on the performance there. And at the first half I think we are pretty happy with the way the markets are shaping up. The order pipeline looks pretty good. The traction on the Insurance product is good. What was satisfying is we booked our third deal in North American L&A segment with Elixir North America again being selected by Gerber which we announced. It is an important deal for us because Gerber is a high volume business and so Elixir will get proven under large volumes and it is a validation of the fact that Elixir North America has arrived in the market. So the rest of 2013 will be focused on implementing Forrester, Wawanesa and Gerber and that should build a very strong foundation for growing the L&A business next year in 2014. On the P&C front momentum around billing continues. We still remain the leaders there both on existing account performance as well as new business; I think the teams have done exceedingly well. That is a very high level overview of the business from a qualitative perspective. I will hand it over to Farid to take you through some of the numbers.

Farid Kazani: Welcome to the Q2 update. As Sudhakar said it has been a pretty satisfying quarter for us although the revenue seems muted. But considering it is a December quarter it still been decent improvement on the top-line also. We closed the operating income at 224.6 crores in this quarter as compared to 223.3 crores, 0.5% increase in constant currency. At an H1 level, we have ended up with 447.9 crores as compared to 328.5 crores in the corresponding H1 last year that is a 36.3% growth in rupee terms and 21.3% in constant currency.

As you would remember, in the last quarter, we did mention that in Q2 starting October we will have the impact of the salary increases that had to be given to the rest of the organization and we were expecting to make good the impact in terms of margins. The good news is that we have more than offset that impact of the salary increase. We ended up with an EBITDA in absolute of 21.6 crores as compared to 18.1 crores in the previous quarter that is up 19%. In terms of percentage to revenue it is at 9.4% as compared to 8% that is up 140 basis points.. And in terms of profit after tax, we have done 7.56 crores as compared to 6.5 crores that is up 16.3%. The tax is higher in this quarter at approx 7 crores since it includes roughly 3 crores as tax that we paid on the dividend amount that we repatriated from the UK subsidiary to the Mastek Limited India and these funds were utilized towards our buyback program. So there was a one-time impact of a tax that got reflected in Q2 and we believe that dividend was the right way to go about instead of using funds at a higher cost in India.

In terms of client billed during the quarter, we had three additional clients billed which takes us to 7 clients for the six month period. Sudhakar mentioned about the order backlog. It has grown 28% in rupee terms from 421 croreto 538 crore at the end of December. The order booking has come in from all the geographies with good amount of orders coming in from the US, both on the P&C and the L&A side. Gerber was a significant win on the L&A side in North America. In dollar terms the order backlog is at 97.8 million that is a growth of 22.5% as compared to the previous quarter.

In terms of utilization we did mention that we will move to the billable utilization metric based on billable hours to available hours and we have reported that for this quarter. It has come in at 76.7% for Q2. We do not have the corresponding figures for the previous quarter, but for comparison we have, the earlier metric which was 88.8% in Q1 against that we have seen an improvement in the utilization by 1.3%, to 90.1%. Headcount has marginally increased from 3277 to 3296. There has been a marginal reduction in the onsite headcount. Overall, we have seen absorption of our trainees in our production cycle and that has helped in the manpower cost at a reasonable level as compared to the previous quarter.

In terms of cash flows we have ended up with 134.7, this includes the cash and bank balance and the investments as compared to 153 crores in the previous quarter. The 134.7 crores is after having utilized 21.1 crore for the buyback and therefore there has been an improvement also in the cash flow position if we have to gross the amount that we spent for buyback up to December.

There has been an increase in the receivables position. The DSOs have gone up to 92 days as compared to 88 days in the previous quarter as there has been some outstanding in the UK which has been since received in the first week of January and that will get reflected in better cash flow position in the next quarter, We have had some advance billing to a customer which has got reflected in the receivables and in the unearned revenue.

From a geographic standpoint, revenue from North America was at approx 43% as compared to 47%. UK has done better close to 50% as compared to 45%-odd and India/Asia-Pacific has remained more or less steady.

One of the other points that I would like to highlight is our buyback program has gone well and with the latest update we have as against the board approved 36 crores, we have been able to buyback up to Rs. 27 crores or approx 18.05 lakh shares till date.

Another bit of information is that, we have decided in the board meeting today to change our accounting year-end from June 30th to 31st March. So starting this year, we will have our closure as of 31st March. So this year will have a 9 month period ending 31st March, 2013.

You would also have read the press release; we have inducted Mr. Atul Kanagat, an ex-McKinsey partner to the Mastek Ltd Board. He has 16 years of experience as partner of Mckinsey and with his knowledge and exposure to the North America market. we feel that he is a good addition to our board. Overall, it has been a very satisfying quarter. And I am happy to answer any questions.

Moderator: Ladies and gentlemen, we will now begin the question-and-answer session. We have a first question from Yash Ved of IIFL. Please go ahead.

Yash Ved: What is the CAPEX during the quarter? And having any plans in terms of employee strength and what is the current employee strength?

Farid Kazani: I do not have that Capex nos for the quarter as of now. But our plan for CAPEX in these 12 months is close to 20 crores and we are on track to on that CAPEX expenditure plan. As of December end, the employee count was 3296. As you would be aware that we had added almost 6.5% headcount in the previous quarter including trainees and those trainees have actually gone into production in this quarter.

Yash Ved: How does the deal pipeline look?

Farid Kazani: There is growth both in North America and in the UK and the growth in NA is largely coming in from the Insurance.

Moderator: Our next question is from Pranav Tendulkar from Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar: Your Government revenue had a spurt this quarter. So can we expect that revenue growth rate or the revenue run rate further will be same for the next four quarters because that was one vertical not performing very well in last year, there is a really good show there. So what is your view on that?

Sudhakar Ram: You should not compare quarter-on-quarter because depending on some execution, some project completions, the actual revenue by vertical will keep shifting quarter-on-quarter. So broadly I think Insurance is where we are expecting growth but Government also on the back of growth in existing account, we see an improvement over last year. But do not take any variation in one single quarter as indicative of any trend.

Pranav Tendulkar: Is there any structural change in the Government vertical because it has been performing very well in the last two quarters?

Sudhakar Ram: There are no structural changes, it is just that some existing account we have managed to penetrate and they are growing.

Pranav Tendulkar: So it is safe to assume that it will be around that figure in next one year?

Sudhakar Ram: That is right.

Pranav Tendulkar: And any change as compared to last year or last quarter in terms of Insurance, because what we heard was that Sandy had affected insurance companies badly and they were not in a position to spend for next 1-2 quarters. So is it true or how are you seeing that market in US?

Sudhakar Ram: I think Iinsurance companies have large capital base and so on. This short term things do not impact major transformation programs.

Moderator: Our next question is from Amruta Burde from Nirmal Bang Securities. Please go ahead.

Amruta Burde: I just wanted to know the break up of other income for this quarter, which stands at 5.27 crores?

Farid Kazani: The other income is higher in this quarter because we have realized some of the investment in mutual fund with a gain of roughly 100 lakhs. So the other income has been higher from a normal level of 4 crores;

Moderator: Thank you very much. Our next question is a follow up question from Pranav Tendulkar of Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar: Just on the tax, the increased tax amount has extended due to the cash repatriation or dividend repatriation from the UK subsidiary. So going forward is it safe to assume that all the cash required for buyback has been repatriated or there will be some tax implication even going forward?

Farid Kazani: All the cash that was required for funding the buyback by repatriation from the UK Subsidiary as one-time dividend has been done, there will be no further tax on the dividend because we do not see any further repatriation to happen in this year.

Pranav Tendulkar: So going forward, is it safe to assume 33% tax rate or how is it going to be?

Farid Kazani: 31% is a good level of tax that is coming out. Yes, we do expect to get some R&D tax credit in the UK, which should happen in the next quarter. And if that happens then there will be a lower tax in the next quarter.

Pranav Tendulkar: Just one more question on the margin territory. Your EBITDA margin looks really picking up. So how management is safe for one year, next four quarters from here on; how the margin trajectory would go on from here?

Farid Kazani: If you look at the Q1 and Q2, in spite of the salary increase we now are shaping around between 8-9% EBITDA levels at a revenue level of almost $41-42 million per quarter. If the revenues goes up above $45-50 million we should see an EBITDA level which should go into double digits.

Moderator: Our next question is from Pratik Gandhi of IDBI Capital. Please go ahead.

Pratik Gandhi: Farid, can you give me a dollar number for the current quarter?

Farid Kazani: Yes, the operating income was $41.1 million.

Pratik Gandhi: If you could give the trend which you guys are seeing in Insurance and obviously the other two segments, that is Government, Financial Services. Although Mr. Ram has already touched upon part of it, but if you can elaborate what kind of trends you are seeing in all the three major sub segments that is Insurance, Government and Financial Services would be helpful.

Farid Kazani: The growth in the backlog has happened with the wins in the North America Insurance segment and we also have got some wins in the UK and India. So going forward, we see the Insurance vertical shaping up favorably much better than the other verticals followed by a steady growth in the Government and some pieces of the other verticals. There is some volume fluctuation in the IT Services and Financial Services business in the US and will see some kind of ups and downs but these will be more than made up with the growth in the Insurance in the US and some good accounts that we have been able to grow in the UK.

Pratik Gandhi : Actually when I was referring to insurance I was referring more on the both the sub segment the P&C and Life Insurance. So if you can just throw some light slightly bit, how is the trend in P&C and obviously in L&A in your Insurance sub segment?

Farid Kazani: P&C has shaped up pretty well and we have seen quarter-on-quarter increase in the P&C business. This is now almost run-rating at close to around $42 million p.a. and hopefully by Q4 we should see it grow to anywhere between $45 million to $50 million annualized basis. This is linked to orders that we have won in the P&C and expected to win going forward. The L&A business is slow as compared to the P&C, but the good part is that the Gerber win should help us to see some growth in the L&A side also in the next 12 months.

Pratik Gandhi: Is it fair to assume that Q3 will again be a slightly a softer quarter largely on account of the order dip in what we have seen in the last quarter?

Farid Kazani: There have been some orders that have got booked between November and December. The impact of those orders could see some revenues in Q3. So hopefully we should see some growth. It all depends upon how we end up with the balance book to ship element of revenues that comes in the quarter. But we are hoping that it will grow compared to this previous quarter.

Pratik Gandhi: But is the aim of hitting $45 million by Q4 still on or I think you will see that will be slipping into Q1FY14?

Farid Kazani: We are not guiding specific numbers on this, but clearly, our expectation is to grow to that level between $45-50 million as fast as possible.

Moderator: Thank you very much. Our next question is from Ankit Pandey of Quant Broking. Please go ahead.

Ankit Pandey: Farid, can you please help me understand the margins movement this particular quarter; can you dissect it into pluses and minuses? I understand that last quarter you guided something like 180 bps impact from the salary hike. So could you help us understand the way it is pluses and minuses?

Farid Kazani: If you look at the overall P&L account which we shared with you, we have manpower cost which has remained steady as a percentage to revenue and in spite of giving a salary increase impacting by almost 1.8% of revenue, The improvement in the overall manpower cost is on account of an improvement in grade mix with the T2s or the trainees inducted in our business this quarter, the ones that we hired in Q1 plus there has been a marginal reduction in the onsite headcount.

Ankit Pandey: Are there any lumpy items otherwise as far as the consultancy charges go for the BT account or for the product development expenses?

Farid Kazani: Consultancy expenses it is at 38 crores, it has grown marginally compared to the previous quarter which is around 36 crores. That has grown in line with that project or business revenue in UK. It will remain now at that level, close to 38-39 crore level. The other improvements in the cost structure we have seen is travel cost and depreciation has been lower because we had an asset block which has fallen off. All other expenses have been steady. The other income too has been marginally higher as I mentioned earlier. In spite of our salary increase impact we have been able to keep the cost structure in line with the previous quarter.

Ankit Pandey: And can you just talk a little bit about your long-term strategy as far as penetrating Tier-IIs and the other product developments that you are making, may be 12-24 month ambition. Where do you see yourself penetrating a lot more, say US process, UK or is it more P&C led? So where is the sort of middle to long-term wish management oriented towards basically?

Sudhakar Ram: The two-year timeframe I think the momentum that we have in the Property and Casualty should help us grow that part of the business nicely. Definitely investments are there in product that we are making there, we may expand that investment base, but the market is there and biggest competitor there is Guidewire at almost $250 million. And even if we are at 45-odd million we are well behind them; there is a huge opportunity to grow and the market itself growing well. In the Life and Annuity segment we expect the step up only after our North American products get into production. So now that we have three sides. Our immediate challenge in 2013 is to get them into production. So it will only be by 2014 that we will start seeing some level of momentum and winning new deals in the L&A because we will have the sites; we will have reference customers who can talk well about us.

Moderator: Thank you. Our next question is from Abhishek Shindadkar of ICICI Securities. Please go ahead.

Abhishek Shindadkar: The first question is regarding the North American operations. There has been a substantial decline on a sequential basis. Any particular reason for this decline?

Farid Kazani: Abhishek, that is due to some of the projects on T&M basis impacted by reduced number of working days in December,. Plus, as I mentioned, some of the Wealth Management and IT Services businesses are seeing some volume fluctuation

Abhishek Shindadkar: And do we expect the momentum to be back again to our usual levels in the Q3 for the company?

Sudhakar Ram: In terms of momentum the North American business will get back up if not in Q3, Q4 it will start showing a growth depending on the project cycles which are there. In terms of overall business we expect to show better growth next quarter in Q3 itself.

Abhishek Shindadkar: One question to Farid, on a standalone number basis the North America margin seems to have had a substantial hit. Now you also mentioned that you have reduced some onsite employees. Is that right to infer that we had this margin dip despite reducing people onsite and were they in North America?

Farid Kazani: There has been some reduction in the onsite at both Geos, The margin dip has happened as I mentioned because of less number of working days and the revenue drop due to volumes fluctuations hitting the bottom line completely There have also been expenses incurred for the new projects on the P&C side impacting the margins marginally in North America. But that is temporary in nature; we should see better margins in North America in the next quarter.

Abhishek Shindadkar: And is it possible to share what has been the constant currency order book number for this quarter or at least the growth in the constant currency order book?

Farid Kazani: I do not have it worked out right away, I will share that with you Abhishek separately, but on dollar basis it has been 22.5% growth, my guess is it will not be very, way off from this number,.

Abhishek Shindadkar: What has been the debt for this quarter?

Farid Kazani: There has been no debt in this quarter.

Abhishek Shindadkar: The interest component has been more or less the same, right? But the average debt would have declined between Q1 and Q2. So any particular reason for the interest component to remain the same?

Farid Kazani: They are Bank charges and other charges paid to the banks for the transactions.

Moderator: Thank you. Our next question is from Nihar Shah of Enam Holdings. Please go ahead.

Nihar Shah: Just a couple of data points, one was that your taxes have been very high this quarter, on a PBT of 14.7 crores you are paying about close to 7 crores of taxes. Just wanted to understand why this was and what we should take as tax rates going forward?

Farid Kazani: I had mentioned in my opening remarks that in this quarter we had dividend that was paid out by the UK subsidiary to the India Mastek Limited and the dividend atta acts a tax of almost 15% on the amount that you repatriate. The amount that has reflected in Q2 tax is 3 crores and that is a one-time else, if you knock that off, the tax is in line with what we had paid even in the previous quarter.

Nihar Shah: So we should take about 25% as your tax rate going forward which is I believe what you have guided to earlier 24-25%?

Farid Kazani: I think growth in the P&C business with higher profit in North America will lead to higher tax, the effective tax rate is trending to 30% and you can assume that for your working, we do expect some R&D tax credit in the next quarter which should get reflected as a credit in our tax payout in Q3.

Nihar Shah: Just another data point was what was your product development cost this quarter?

Farid Kazani: It was 9.58 crores.

Nihar Shah: And this is expected to remain more or less stable or come down or go up, can you just tell?

Farid Kazani: The product development expenditure it has been in the region of 10 crores, we do expect product development to be lower as a percentage of revenue but we would be spending some amount for our development on the P&C policy admin platform and you could see some increase in the product development expenses in absolute, in Q3 and Q4.

Moderator: Thank you very much. Our next question is a follow-up question from Pranav Tendulkar of Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar: I just wanted to ask that September was a 5.76% revenue growth type of quarter and now December is 1%. So you see September kind of quarter happening in next one year anytime? I know that it is lumpy business. And second question is how you see Obama Healthcare Plan or incremental expenditure is coming into or affecting your business?

Sudhakar Ram: The first one Pranav, obviously it is difficult to predict quarter-on-quarter. Overall, we are optimistic about the growth of the company and there will be a long-term growth trend, but quarter-on-quarter how much it will be is difficult to predict. We do not do any business in the Healthcare space in the US so it does not impact us. Even the Insurance business we have is not Health Insurance. It is either life and annuity or property and casualty.

Pranav Tendulkar: So there is no overlap at all?

Sudhakar Ram: There is no overlap.

Moderator: As there are no further questions from the participants I would now like to hand the floor back to Mr. Sudhakar Ram for closing comments.

Sudhakar Ram: Thanks everyone for your sustained interest. As you can see while the progress has been slow I think there has been a clear defined way in which it happened. Every quarter we are improving on almost all our operating parameters and we expect to continue making these improvements going forward. So, looking forward to a better quarter next in April and meeting all of you in April. Thank you very much and have a great year.

Farid Kazani: Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen, on behalf of Mastek Limited that concludes this conference. Thank you for joining us.