



“KPIT Cummins Ltd Q4 & Annual FY13 Earnings Conference Call”

April 30, 2013



Management: Mr. Ravi Pandit – Chairman & Group CEO
Mr. Kishor Patil – Managing Director & CEO
Mr. Anil Patwardhan – Senior VP and Head of Corporate Finance & Governance
Mr. Pankaj Sathe – Chief of People & Operation Officer
Mr. Sunil Phansalkar – Head, Investor Relations & General Manager M&A

Moderator: Mr. Hardik Shah- Analyst, KR Choksey Shares and Securities Pvt. Ltd

Moderator

Ladies and gentlemen good day and welcome to the KPIT Cummins Limited Q4 and Annual FY13 Earnings Conference Call hosted by KR Choksey Shares and Securities. 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. If you should need assistance during the conference, please signal an operator by pressing '*' followed by '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Hardik Shah from KR Choksey, thank you and over to you sir.

Hardik Shah

Good afternoon every one. On behalf of KR Choksey Shares and Securities, I welcome all the participants to KPIT Cummins Q4 and annual FY13 results con call. Today on the con call we have Mr. Ravi Pandit - Chairman & Group CEO, Mr. Kishor Patil - Managing Director & CEO, Mr. Anil Patwardhan - Senior VP and Head of Corporate Finance and Governance, Mr. Pankaj Sathe - Chief of People & Operations Officer, Mr. Sunil Phansalkar - Head of Investor Relations and General Manager, M&A. We would like to thank the management for giving us an opportunity to host this con call. I would now hand over the call to Mr. Sunil, over to you sir.

Sunil Phansalkar

A very warm welcome to all of you on this quarterly and yearly post earnings concall of KPIT Cummins. I would request you to limit your questions to one or two because then we will get all participants to have questions and I hope that you have received our investor update; we have tried to put in a detailed investor update for you to understand our business performance better. As a normal process, we will have the introductory remarks by Mr. Ravi Pandit on the performance of the quarter and the year and also plans into the next year's guidance and the overall business outlook, after that we will throw open the floor for questions. Once again a very warm welcome to all of you and now I will hand this over to Mr. Ravi Pandit.

Good evening everyone. In my initial comments I propose to talk about how the yearly performance has been, how the quarterly performance has been, how do we look at the next year and some other related questions that normally interest everyone.

Looking at the yearly performance, our revenues grew from about \$309 million to \$410 million showing a growth of roughly 33% in dollar terms. In rupee terms the revenues grew from Rs.1500 crores to about Rs.2240 crores again showing a growth of almost 49%. The profits actually grew from Rs.145 to Rs.199 crores showing a growth of 37%, so if you were to look at the performance vis-à-vis guidance, we had met the revenue guidance which we had given at the beginning of the year, we have beaten the lower end of, profit guidance which we revised in the last quarter. At the beginning of the year, we had said that during the year we will improve our EBITDA percentage, our operating margins by 50 basis points and I would be glad to tell you that we had improved that about 180 basis points taking it from 14.5 to 16.3. We have declared dividends at 45% essentially keeping our dividend payout ratio still at very conservative 10%. While the growth itself has been important, I would like to state something about the nature of the growth. You would recollect that in the last 2 or 3 years, we have started focusing on only a key set of verticals ensuring that growth comes only from these verticals, ensuring that we are able to bring some extraordinary set of solutions from our customers in these verticals.

So during the last year, our automotive and transportation vertical grew about 49% which is the rate of the growth. Manufacturing grew by about 57%. Energy and utilities grew by 89% and others grew actually by 10% so vis-à-vis our overall growth the others was almost like negative. As a result of that others contributed something like 17% of our revenue in year end March '12 and that came down to less than 13% in March '13.

So the strategy of focus on a few set of verticals has been helping us. We have also added active customers largely within these areas

and for these verticals we have been able to create better solutions, we have been able to create better software products for them and we have been able to become important partners to major ERP players like SAP as well as Oracle and all focus verticals, so all in all our position within our chosen vertical has actually improved quite significantly. If you have to look at it from a quarterly performance perspective, our dollar revenues went up from 103.5 to 105.5, showing a quarter-on-quarter growth of 2%. In rupee terms, this growth is 1.2%. If you have to look at this from a constant currency terms, the growth would be a little higher because some of the European currencies have lost their value vis-à-vis the dollars as a matter of fact we have lost out some part of the growth. Our profits increased from Rs.50.4 crores to about little over Rs.51 crores giving us a growth of about 1.5%.

The EBITDA margins improved by about 210 basis points. The EBITDA margins have improved on account of variety factors. The composition of our SBU income has changed, so the SBU which has typically given us in the last year or so, lower EBITDA margins namely the SAP SBU, the growth of the non SAP businesses has been quite substantial, so if you were to look at the growth that we have had in automotive embedded, it is quite high, so is the growth in integrated enterprise solutions or Oracle related products, so these two SBU which give us better margins have grown better giving us overall better EBITDA performance. The IES area has grown despite the fact that Cummins has not grown. As a matter of fact, during this quarter Cummins degrew by about 12%, however, if you were to look at our top 5 customers, the non Cummins top 4 customers grew by about 7%, the non Cummins top 9 customers grew by about 12%, so our growth has been in the area of automotive embedded. It has been the area of IES, which is specifically JD Edwards, we have also seen growth in certain segments of geographies and we believe that this is good sustainable growth.

Taking this performance into account, we have given guidance for the next year. In our guidance, we have given that we would reach revenue of anywhere between \$465 to \$475 million and we would get a profit or anywhere between Rs.231 crores to about Rs.239 crores, which shows a significant improvement both in the top line as well as in bottom line. We are also expecting that our EBITDA margins will move about 50 basis points. We plan to add about 1000 people during the current year. Our anticipation of the growth is based on the traction that we see currently in the automotive embedded area where actually we are working on some really cutting-edge technology in the area of power train, electrification, infotainment, safety and almost every area where there is electronics used in the automotive, so we are basing our growth projections on that. We are also basing our growth projections from the increased Oracle products revenues. We are expecting some stabilized revenues in the SAP area and we hope that we will be able to get better profitability in that domain. Moreover, we are also expecting significant contribution to our growth coming from our other major accounts outside of Cummins.

The guidance that we have given is based on organic growth and this is in line with the overall trends that we have. We believe that the growth that we are looking forward to would take us forward in our journey to a billion dollar revenue.

The other update that I would like to give you is on Revolo. So we had mentioned last time that we are doing trials on a smaller set of vehicles, something like about 40 vehicles or so. These trials are continuing and we are getting continued good results giving a fuel improvement benefit of anywhere between 30% to 40%. We are also working on cost projects to bring down the cost of our solutions and those projects are also going on fine. The area from which we are working on is a regulatory matter. To carry out large scale trial say 200 to 300 vehicles in multiple cities calls for a separate permission for trial which is to be issued from the Ministry of Road Transport

and that permission is awaited and we are hopeful of getting it in the near future.

The other area on which we are working is for creation of homologation rules. In the case of standard vehicles, the rules have already been framed for standard, when I say standard I mean either the internal commercial engine vehicles or the battery powered full electric vehicles. In these areas the homologation rules have already been formed, whereas there have been no rules for hybrid vehicles and especially for vehicles which are retrofitted with hybrid solution, so we have been engaged with the regulatory authorities to form the homologation rules. We expect that the homologation rules should be over in another 2 months time, on the basis of which we believe that with all things going well, we should be able to do some trial run production in the second half of this year. During this period, we also won Mahesh Modi Environment Excellence award, which is an award for innovative technologies which are more environmental friendly, Revolo continues to get recognition for its technology talent, for its technology superiority and Revolo also continues to deliver the fuel saving benefit that it has promised, so this is where we stand as per our overall operations are concerned. As Sunil mentioned, we have given a fairly detailed update regarding where we stand. In the update, that we have given, we have talked about the 3 verticals in which we work and what are the technology trends and how we are shaping up to become a strong technology partner. Then we have also looked at the financial aspect as well as we have looked at each of the 3 SBUs that we are working on. The focus of the company is to build a strong technology focus company which covers every aspect of usage of information technology whether it is a part of the business processes or whether it is in the products that our customers sell, so we have tried to build on the two foundations of strong technology and secondly very strong customer relationships that has been the path of the growth of the company and we hope that this path will take us to the vision of billion dollar company in the year 2017, so with this I will close my

initial comments and we would welcome questions from you thank you.

Moderator

Ladies and gentlemen we will now begin with the question and answer session. We have the first question from the line of Pranav Tendulkar from Canara Robeco, please go ahead.

Pranav Tendulkar

A couple of questions, in Cummins can you give more color on what type of, so there are parts that I understand that is auto and there is ERP, so more color on which business is going slow batch and how you see FY15 in that case and second is you have revealed a number of solutions or products in this presentation, for example KPIT Vehicle infotainment, so out of all those solutions or products you have any current customers in engineering side more in the engineering side products and solutions?

Kishor Patil

About Cummins, basically we work in two areas, one is IT systems and then embedded areas engineering. The reason for decline in revenues is basically because Cummins is cutting down on their expenses significantly and they have made some organizational changes. Overall in their market segment we are still gaining more market shares in the comparable vendors, so currently we are still winning new businesses from the other vendors, so in terms of their overall spend, our share is still going up. Overall the spend cut has come little more in terms of IT, because that is where they have deeper cut. Engineering has seen only smaller cut in that perspective. We do believe that the significant cut has happened during this quarter, the next quarter revenue would be more or less flat or a very marginal dip in that and in the second half of the year, we do expect that there may be possibility of revenue coming back.

Ravi Pandit

The other question that you had was on the products that we have, so as our write up talks about, we have come out with technology products both in the engineering as well as in the business IT area, so the engineering products are a kind of solution that we have for safety or for AUTOSAR or in vehicle network, so we have customers

in these areas, but who are in different stages. So for example, for AUTOSAR we have quite a few customers, there are many Tier-I in the world who use our AUTOSAR products and have been using our AUTOSAR products for the past few years. Similarly we have some customers in the area of diagnostics. We don't have full products customers for infotainment platform yet, but we are hoping that we will be able to get them. We have similar solutions also on the business IT, and these are not very large sales just now, but we see that these sales growing every year.

Pranav Tendulkar How much part of your revenue is contributed by solutions and products?

Kishor Patil At this point of time we do not specifically mention about that number, but in due course we will do that.

Pranav Tendulkar Any targets like in 2016 how much it would be, any rough strategy road map that you have?

Kishor Patil In our billion dollar strategy we expect about 15% of our revenues to come out of non linear revenue across engineering and IT, that is our goal is in the next 4 years.

Moderator The next question is from the line of Vimal Gohil from Sharekhan, please go ahead.

Vimal Gohil I had one question regarding SAP. In the latest results SAP gave out quite positive comments especially on their market share strategy, so looking at SAP gaining some momentum going forward against their rival like Oracle, do you feel your SAP share could grow better which is I think in last year you had won quite a few SAP contracts worth 100 million and above, so where do you think your SAP embedded solutions are heading from here on. Do you feel that you are gaining traction out there as compared to your Oracle Solutions?

Kishor Patil At this point of time our overall order book and the growth is stronger in the Oracle based services on both the JD as well Oracle

pipeline. In case of SAP, it has largely grown in Asia-Pacific and the growth has been little muted in the other parts and again the growth wherever it has happened it is largely in the new range of products which are on cloud and mobility those kind of places where the ratio of the products to consulting revenue is pretty low and the large deals we had mentioned is number of those deals have gone down specifically in North America. We will not see any significant improvement in that business, naturally we will see it on the bottom line, but not overall in the revenue side. But at the same time, in line with the SAP strategy we see good pipeline building in the Asia part of the business and we do believe that it will start reflecting into revenues in the later part.

Moderator The next question is from the line of Deepan Shah from Kotak Securities, please go ahead.

Deepan Shah Just had a couple of questions, firstly on the macro front, the auto embedded business has been doing well, can we get some more insights into how are the budgeting cycle there and R&A discretionary spend a longer term decisions also getting taken there?

Kishor Patil So if we look at automotive business and the way we look at it either from a different practices as well as from our key customers, in case of all of our key customers for the automotive we see significant growth opportunities in the engineering space and most of these are related with either vehicle programs or some of the fundamental changes in the technology such as AUTOSAR products being adopted for functional safety or diagnostics, etc. If we really look at the traction it is significant in case of AUTOSAR where the European standards are being adopted largely for the architecture, these are basic standards and helps in a better architecture design and that is now getting a significant traction in the market. The way it works is the OEM adopts it and then all the tier 1 and its suppliers also buys from us and we see a good pipe line in that perspective. The second area of growth is in case of power train area where there is a growth both in the conventional power train area which is largely in the

emerging markets. The second area of growth is in the electrification area which is more into developed market, based on our competency we are able to address both the market segments and there is growth momentum. The other area is lot of companies are going through model development which is basically moving into automated coding area and that is very significant as the number of complexity of software is going up, so I think that is another area where we have seen growth and infotainment is absolutely a growth area mainly for services and as Mr. Pandit mentioned we hope to really get some products into that, so I think these are some of the areas in terms of growth. From budget perspective what we feel is looking at overall companies cycle I think most of the companies are spending significantly into these areas so looking at our pipeline and in our existing customer we see these are significant growth areas, we are not looking at acquiring a new customer to sell these products and services significantly, so we are relying on our existing customer base to consume these services. When you look at our pipeline, we have probably the strongest pipeline we had in automotive currently and we also see that more discussions happening in this. So it is very difficult in automotive area to see whether it is a discretionary or nondiscretionary because the discretion is whether you are in a position to come out with a product in future which will impact your future revenues or then committing to the current program, so naturally the current program forms part of over 70% of our IT services in this area, which are based on actual vehicle program and about (+30%) spend is based on this new initiative, so we see this traction in our current customers based on that.

Deepan Shah

Second part maybe on the acquiring the balance stake in SYSTIME, we had said it will be happening in the first quarter, so are we on track for that?

Anil Patwardhan

Yes, very much, our plan is to complete the transaction by the end of this quarter.

Deepan Shah

Another macro question from my end, last one, can you bifurcate our revenues more into annuity type and project based and can we get the proportion of annuity revenues in the overall revenues?

Kishor Patil

Currently we are not reporting that specifically, and we are tracking it. To tell you very frankly, there is no specific definition of annuity revenues and in that sense specifically looking at that type business which we are doing and looking at linearity and nonlinearity, etc., so we do not have that definition. As we have always mentioned that specifically in some areas like SAP where annuity revenues are low and we are expecting that to grow in future. In case of IES business where our annuity revenues are reasonable because one it consists of Cummins as well as some of the larger accounts so annuity revenues are reasonable. In case of engineering area, it is a little difficult definition for annuity business and that is what I explained just before this question.

Moderator

The next question is from the line of Jiten Doshi from Enam. Please go ahead.

Jiten Doshi

Only thing I would like to know is despite 20% devaluation over the last couple years in the currency, we have not seen a complete improvement in the margins in that proportion, so for example, if you expect the rupee to appreciate by another 4 to 5% in the course of the year or probably anytime in the future, how would that impact our margins and how much of the currency gain has got translated into discounts to our customers?

Anil Patwardhan

If you see our FOREX realization, we have been following hedging policy, so we have certain sort of hedge position which we have been reporting end of each quarter, so naturally the overall realization would get restricted based on the hedging position, but if you see the overall operating margin improvement, you will find that on the year-on-year basis we had sort of targeted certain improvement and we have been actually able to get that and whatever margin improvement even in the last quarter has

happened, I believe it is like based on the initiatives taken on operational excellence and I believe that is like sustainable going forward.

Sunil Phansalkar

I think what we can also look at is the SBU level margins, so we have talked about automotive SBU margin at about 24 to 25%. If you remember last year that number was about 20%, this is the SBU where we have the maximum offshore and the maximum benefit of the rupee depreciation also flows there. Of course there are operational improvement efficiency gains also in that SBU. If we look at IES and that is split into SYSTIME and then the other IES business. When we started the year in SYSTIME, we started at 5.5% last year and as we end the year we will be around 15% in SYSTIME. Overall IES as an SBU is around 18%. Even that SBU overall at the beginning of the year was about 15%. What has really not moved or it has actually moved in the other direction is SAP, because SAP for the whole year is at around 4 to 5% margins and we started the year at around double digit margins and we are hoping to have the margins in the 12 to 13% range, but as we have said last quarter, there were some changes that happened in the overall SAP technology which has affected us for two quarters and we believe that one more quarter we will be affected, so that SBU is actually pulling down the overall company level margins.

Ravi Pandit

And there is never any negotiations with the customer, whereby the customer says that rupee has become of lower value why don't you give me some discount, so our rates with our customers are not dependent on our rate realizations on our cost. They are on the basis of the value that we bring to customers.

Jiten Doshi

So there are no major discounts something offered when there is currency devaluation like the one we experienced in the last 18 months?

Ravi Pandit

None at all.

- Jiten Doshi** Last year you had guided that you want to exit 2013 with a quarterly run rate equivalent to \$500 million and obviously that means you were targeting for revenue in FY14 to exceed \$500 million, does that hold good now?
- Ravi Pandit** We always talk in terms of whatever vision we have and we always talk in terms of the guidance, so the money guidance that we had given was where we have targeted and which we have reached. This time we are giving a guidance of \$465 million to \$475 million, hopefully if things become good, we will do better than that.
- Jiten Doshi** So is the normal kind of conservative guidance that you have all just put out, but the internal targets will be surely there to achieve \$500 million plus?
- Ravi Pandit** No the vision is to do \$500 million, guidance is to do \$465 million.
- Jiten Doshi** And you hope to better your margins because of productivity gains?
- Ravi Pandit** Within our guidance the improvement in the margin is on account of productivity gains as well as on account of the changes in the three SBU compositions that Sunil talked about.
- Jiten Doshi** What are you estimating you would achieve in terms of the rupee dollar in this guidance?
- Anil Patwardhan** We are at existing level, so if rupee-dollar continues to be at existing level then these numbers are guided for.
- Jiten Doshi** But you have already got hedges above that level, right?
- Anil Patwardhan** Our hedge position is already there as a part of our communications, so we have around \$70 million hedge at average rate of Rs. 52.
- Jiten Doshi** Given from where you are, you are quite comfortable that there could be a margin improvement?

Anil Patwardhan I think we should go by whatever we have guided and that is what we should stick to at this point in time.

Ravi Pandit So in the guidance there is an embedded improvement in the margins, I mean the guidance is for 14 to 16% top line growth and 16 to 20% bottom line growth.

Jiten Doshi And this implies what sort of employee hiring growth?

Pankaj Sathe We have factored about 1000 people addition.

Jiten Doshi So what will that take the total to?

Pankaj Sathe It will take to 9500.

Jiten Doshi You are talking net basis or gross basis.

Pankaj Sathe Net basis 1000.

Jiten Doshi So 1000 is net, so you will definitely see revenue productivity and a better service mix right?

Ravi Pandit Yes.

Moderator The next question is from the line of Ajay Vora from Enam Asset Management. Please go ahead.

Ajay Vora In this guidance of 14 to 16% what sort of growth are we looking from Cummins for the full year?

Kishor Patil We do not give our customer wise guidance and we stopped it for some time, Cummins is less than 20% of our revenues, so I would like to just say that we have not factored any growth projection from Cummins.

Ajay Vora Is the ex Cummins top 9 or top 4 customers whatever growth we had in this quarter, is it sustainable or do you think that even that can be quite lumpy going forward?

Kishor Patil

Certainly we are looking at good growth from our key customers, in specific from non-Cummins customers; we are looking at good growth opportunities.

Anil Patwardhan

As you know we have a base of 75 plus customers where we have million dollars plus run rate, so I think it will be a combination of the growth coming through all this set of customers, not only top 8 or 9.

Moderator

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

Rahul Jain

Referring to the commentary for the automotive segment that we have given about the GM and Ford and player like Chrysler seeing good number much better than what they used to do December 2007, so I am saying how does we see this kind of improvement affecting player like us who are involved with the outsourcing?

Ravi Pandit

First is how large players in the US the three big players are doing that is one part, but the other part and probably the more critical part is the overall increase in electronics as a component of cost of any vehicle, so if you look at the complete range of vehicles from the low end to the high end, but the amount of electronics in each of those vehicles is going up and we believe that our future in the automotive embedded domain is more tied to this trend than to the trend of how many vehicles have sold, so even in the years in which the volumes of car sold went down, our revenues from automotive embedded went up because people wanted cars, which were more energy efficient, which were more safe to drive, which were more comfortable, which had more infotainment in it and the whole lot and almost each of these things point towards higher usage of electronics, which is what we are basing our focus on, which is what has given us the growth in the past and we believe that over the next decade or so this trend should continue. We believe that the automotive industry is in a state of a major change towards more automation, more usage of electronics and we think that a probably amongst the largest independent software vendors to be in the

embedded electronics site to the automotive industry globally our position should improve.

Rahul Jain

And the industry size number of \$274 billion by 2017 or even assuming what we have right now \$190 billion, if you could share some breakup of what component goes to the hardware, software services because considering as you are saying the per vehicle electronic spend has increased dramatically, but large chunk of it would have also gone to the software and the hardware component of it?

Ravi Pandit

So we play in the software component of the electronics and the proportion of hardware and software as you know in the case of most of the industries world over, the software proportion has kept on growing and we believe that so it would in the years to follow.

Rahul Jain

Any sense a rough estimate of breakup of this expected 274 billion by 2017 in the total addressing provision of what we are addressing versus the other party?

Ravi Pandit

It is difficult to give a number to that because it is a volatile situation to illustrate for example when a new product is being introduced, obviously the software component of the cost is quite high, as time goes by the overall hardware costs go down and naturally the overall cost of the product also goes down, so I cannot put a number on how much is hardware and software, nor can we put a number on how much will be sold by non Tier-1 hardware vendors, if a global Tier-1 like a Denso or a Delphi or a Bosch is selling some electronic parts which has both hardware as well as software, how much of that will be culled out and taken by OEM or players like us is difficult to say, but I could say that going forward we feel that the growth that we have had in the automotive embedded in the year past will continue in the years to come.

Rahul Jain

Let me put it little differently, from the current size of 2012 which we have what is the current addressable component which KPIT has capability of and out of which how much is outsourced in KPIT?

Ravi Pandit

Some of these data points are in the presentation that we have put up, so typically if you look at it today about 8 to 10% of the total R&D is outsourced that is expected to grow at a much faster rate than the total growth of R&D that is expected to grow at about 8.5% as against the 6.5% growth in total R&D spent over the next 4 to 5 years. If you look at the cost of electronics in a single car, which was about 10% about 4 to 5 years back could be around 20 to 25% today and is expected to go to about 35 to 40% in the next 4 to 5 years, so that is the growth and roughly you can look about 50% of it as software.

Rahul Jain

And the success factor 25 odd employee addition, can you give some clue on the cost investment that we have undertaken and what is the immediate conceivable business opportunity to be converted out of it?

Kishor Patil

The success factor is a new technology so basically not much is available in that area so from that perspective we are looking at growing our capabilities in this area and therefore we have added this team and their customers. Currently their revenue on the full year basis would be around \$4 million, but many of that revenue is not repeatable, so that is not the revenue we are getting from them next year so we will have to build a revenue in our existing accounts based on that. We see that as a good opportunity and we believe that in next one or two quarters we will start getting good revenues out of this.

Rahul Jain

Current cost investment we have not measured?

Kishor Patil

No.

Moderator

The next question is from the line of Madhubabu from HDFC. Please go ahead.

- Madhubabu** S&M expenses have come down substantially quarter-on-quarter; going forward would that be the range or any blip in this quarter?
- Kishor Patil** It is mainly based on our large sales and marketing event so in this first quarter in the calendar year, there is no major event like in the last quarter there is a Oracle Open World, it is a big event, so the cost vary based on the actual events. On a year to year basis the cost would be the same, on a quarter to quarter basis it could vary.
- Madhubabu** Most of the margin expansion has come from the reduction in S&M expenses for this quarter?
- Sunil Phansalkar** There are two components, one is at the gross profit level if you see there is some margin expansion what has happened is some of the regrouping has happened from SG&A to direct cost, so I think it is better to look at the EBITDA number rather than looking at these two areas, yes some of it has been contributed by reduction in sales cost, but as Kishor said I think it makes much more sense to look at the annual sales to revenue percentage and then will more or less be at the same level next year.
- Madhubabu** What could be the wage hikes if at all, what is the guidance on wage hikes?
- Pankaj Sathe** We will be looking at between 8 to 9%.
- Madhubabu** For off shore? And hiring target you have said 1000 employees, would that be predominantly offshore driven hiring because the last one year I think onsite has been growing very fast for us in terms of so, whereas this head addition would be on offshore side?
- Pankaj Sathe** We do whatever is right for our business there will be a mix both at onsite as well as off shore but there will be predominantly more hiring at offshore the way I see it right now.
- Madhubabu** If you can break up this other income, there was a loss of around 8 crores this quarter?

- Anil Patwardhan** Actually that is basically arising out of FOREX loss that is currency translation, currency rate per GBP, Euro and Dollar all three currencies they have come up from the last quarter's closing, so the translation of foreign currency denominated assets results into these losses, so that is the major component. It also includes certain income which is arising out of mutual fund investments to the extent of say 3 crores is the income, the rest is all loss.
- Moderator** The next question is from the line of Ashish Agarwal from TATA Securities. Please go ahead.
- Ashish Agarwal** I have 2 questions, first of all I missed your comment on the SAP business, so when do we expect these SAP business to start growing and secondly just a data point on the cash which we had, if we look at Q-on-Q, our cash has declined, what is the reason for it?
- Anil Patwardhan** Basically for cash decline I would say there is a DSO increase, so that five days increase has resulted into some net working capital increase and there is certain pay out of term loan which has happened during the quarter which is \$1.5 million, and there is a CAPEX during the quarter which is around \$2.5 million.
- Ashish Agarwal** Is it fair to say in the quarter we would have a negative operating cash flow?
- Anil Patwardhan** I would say from the business operations there is a cash flow generated which net of CAPEX and repayment of loan, there is a minor reduction in the cash reserve.
- Ashish Agarwal** Sorry for persisting on this, because if I look at your investor update, it shows the operating cash flow is 138 crores whereas for the first 9 months it was already 150 crores?
- Anil Patwardhan** I think we have reported annual cash flow status, so if you see the annual working of cash flow you will find that we have generated 535 million as the cash surplus during the year based on the operations, which is net of all the working capital adjustments as

well as payment for fixed assets and dividends and including the deal payout.

Ashish Agarwal

On SAP business?

Kishor Patil

SAP business as we discussed currently we do think that for another quarter or two, the business will remain like this, actually we are focusing on the change business opportunities in the new area in terms of cloud mobility, BI, analytics, etc., but more importantly we see a very significant traction in two areas, one is in North America mainly in the utility segment, we have a significant deal pipeline and we hope that some of that can come true in a quarter or two and the second in the Asia, we see a significant pipeline which is building and again at a later part of the year we believe that should give us significant revenue.

Ashish Agarwal

Just one last question, in your interview on TV you said that you are factoring in better second half. So is this confidence coming from the sales pipeline, do you see the incremental growth is, will it be in the SAP or on the Automotive side?

Sunil Phansalkar

Ashish, what has happened is that a question was asked about Cummins. And the answer was given with respect to Cummins as an account and not overall KPIT.

Ashish Agarwal

But the growth this year will be more or less evenly spread?

Sunil Phansalkar

Yes, that is correct. We are expecting a balanced growth throughout the year.

Moderator:

Thank you. We will take the next question from the line of Hardik Shah. Please go ahead.

Hardik Shah

What is your unearned payment and consolidation payment for SYSTIME, CPG and Sparta in this FY14?

- Anil Patwardhan** There is no balance payment left for Sparta. For SYSTIME as we have said it could vary in the range of about \$20-23, 24 million, that would be the range and CPG which comes probably at Q3 end would be about \$4-odd million.
- Hardik Shah** SYSTIME payment will be in the Q1FY14 itself?
- Anil Patwardhan** Yes, end of Q1.
- Hardik Shah** And wage hike will be effective from 1st April 2013?
- Anil Patwardhan** Yes, correct.
- Hardik Shah** And what was the impact on the margins like onsite and offshore?
- Anil Patwardhan** Let us come back to you on this. Right now, we do not have a number.
- Hardik Shah** And CAPEX plan in FY14?
- Anil Patwardhan** I think we will continue to do this maintenance CAPEX which would be like say between \$7-8 million annually.
- Hardik Shah** What is the tax rate going to be in FY14?
- Anil Patwardhan** You know there is a surcharge impact and my guess is that we need to increase it by say a couple of percentage. So currently, it is 26.5% which may go up to 28.5%.
- Moderator:** Thank you. The next question is from the line of Aishwarya K from ICICI. Please go ahead.
- Aishwarya K** Can you please give a breakup of SYSTIME and non-SYSTIME in your FY14 revenue guidance?
- Kishor Patil** I think now it is very difficult to have this, because as we have said, it is fully integrated entity we have been talking about it only for

this year since this was the first year. As we have said, IES as an SBU will help us grow faster. So SYSTIME is a part of IES SBU now.

Aishwarya K I understand the SAP SBU, the margins right now is 5% and you guys are planning to scale up to 12-13% mainly because of the movement to offshore in Sparta. My question is what will be the corresponding impact on your revenue because of the shift from onsite to offshore just because your onsite bill rates are way higher?

Sunil Phansalkar One correction, we are not looking at taking the SBU EBITDA to 11-12% in FY14, because what we have said is that we will probably have another quarter of margins at this level. Certainly, the margins will improve but we will not be able to take it to this level in FY14. Over a period of time, over the next 2-3 years, yes, that is the target level which we are looking at with a change in mix of business.

Aishwarya K For FY14, what could be the possible SAP SBU margins?

Sunil Phansalkar At this point of time, let us stick to the company level numbers. We have talked about the margins for this year. As we progress we will talk about the SBU margins, but there will be an improvement in the current level for sure.

Moderator: Thank you. The next question is from the line of Rishendra Goswami from Lucus Investments. Please go ahead.

Rishendra Goswami Just wanted to understand on the overall revenue guidance. What is the kind of growth you are expecting from the SBU?

Kishor Patil We have not given the revenue guidance at SBU level. We had said that at company level, we are targeting 14-16% growth which is like \$465 million to \$475 million and we have also said that we see better traction for us in Automotive and Manufacturing verticals and SBU level also auto and IES verticals.

Rishendra Goswami Then, to break it down, you are already saying that SAP is going to be a little softer this year and Cummins is also softer so that about 40% of your revenues, what I understand probably the spend is going to be higher. But then I guess as you are assuming a very high probably growth rate for Oracle and JD E business, right. So do you have that kind of a deal already in the bag for JD E or Oracle business to be meeting that kind of revenue guidance?

Kishor Patil I guess you all will appreciate that we have been very conservative in our guidance that actually last three years we have upgraded our guidance every time when there was an opportunity. So naturally, we are giving the guidance based on the feel we have of our key customers and the overall deal pipeline. And just to add, naturally, the growth areas we are looking at Oracle and JDE as well as Automotive, Engineering.

Rishendra Goswami Within Oracle, JDE, are you seeing the growth coming from your existing clients or ...?

Kishor Patil Both existing as well as new customers.

Rishendra Goswami On overall SAP, given that so much of SAPs, already shifting to the Cloud structure, and that probably shrinks the market for you and the opportunity for you as well, how do you think you will be well placed to capture that and kind of revenue impact that it would have given the Cloud shift going on in SAP?

Kishor Patil It is a big question, but I can give you two answers from the directional perspective. One is there are many regions where there are bigger implementation opportunities as well, like I mentioned in Asia, there are enough opportunities where new plants are coming there, still a lot of ERP opportunities in that space which we have not targeted till now significantly which we intend to do and there we see a good pipeline building up. Second is on the Cloud, we have already quite a steam and started working on that and there were naturally other areas where we are investing and we see bigger parts

of this portion can be delivered from offshore and over the period, it will allow us to increase our offshoring at attractive prices in this area.

Rishendra Goswami Is it possible for you to share how many consultants you currently have in the SAP consulting practice?

Kishor Patil We do not share those details.

Rishendra Goswami Then on margin, given that you have announced 8-9% wage hike, that would have some impact on the margin. So, how do you expect to pull your margins back given the utilization is fairly high?

Kishor Patil Actually, we are trying to do 2-3 things. One is naturally the business growth we bring, the higher contribution we bring, the SG&A leverage which we try to bring and we also see a change in revenue composition with higher growth in IES and A&E which have higher margins. Last but not the least, still there is an improvement in the pyramid we are looking specifically in the enterprise area, wherein last two years, we saw a significant growth and that time we had to hire a more laterals than the freshers. So those are some of the opportunity available in this year.

Rishendra Goswami And do you also expect any kind of pricing uptick in the overall business for the year?

Kishor Patil We have got a significant uptick in last 2-3 years. We have not factored any price hike during this year.

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

Rishendra Goswami Given your minority interest figure, it suggests that SYSTIME's margins have more than doubled compared to the previous 3-4 quarters and almost in line with the company's EBITDA margins. Could you give me some details on what is driving such strong margin performance in SYSTIME?

Sunil Phansalkar There are two components. One is, yes, margins have improved as I said earlier, we started at around 5.5% and then we are at 15%, but there have also been significant growth, because when we consolidated SYSTIME it was doing about \$13 million a quarter, and last quarter it was around \$20-21 million. So there has been a substantial growth and improvement in margins. So, both of these has contributed to the increased profitability in SYSTIME.

Rishendra Goswami: And so EBITDA margins would be around 15% for SYSTIME?

Sunil Phansalkar That is correct.

Moderator: Thank you. The next question is from the line of Gaurav Jain from Altavista Capital. Please go ahead.

Gaurav Jain: The amount of hedges has kept declining over the last few quarters. Can you just remind us of your hedging policy again?

Anil Patwardhan Actually, hedging policy continues to be two quarters on a rolling basis. What we do is, 75% of our net exposure, we go ahead and hedge. Based on the hedging policy of course, we had taken two years hedges in dollar terms. So we had taken for FY13 and FY14 which has got declined because we are not going ahead with two years hedges under the existing policy. We are going with two quarters hedging policy.

Gaurav Jain: So this number like 70 million, does that cover you for the next two quarters or it is still covering you for more than two quarters?

Anil Patwardhan No, this covers for FY14.

Gaurav Jain: Then, your D&A has also kept ticking down. So, will it stay at this number of 2%?

Anil Patwardhan It will continue to be at this range. So there is no any exceptional item there.

- Gaurav Jain:** You mentioned that your CAPEX will remain at maintenance levels, but if we are hiring 1,000 people, do you not need to construct new facilities?
- Anil Patwardhan** We do not have to, we do have existing facility and then we can always go for lease facilities whenever there is any. It is a mix of onsite/offshore, not all 1000 are going to be at offshore.
- Gaurav Jain:** But what is the level of maintenance CAPEX, like 2-3%?
- Anil Patwardhan** I said around \$7-8 million is what we would spend during the year.
- Gaurav Jain:** Plus some growth CAPEX, so that is it, because last year your CAPEX was more like around 50Cr, right?
- Anil** Correct.
- Gaurav Jain:** We have the US immigration policy and what they are talking about the H1B employee restrictions. Now you have acquired companies over the last few years. So, would one be correct in thinking that because we have acquired onshore businesses you might have a lot many more local people on your rolls than other Indian companies?
- Pankaj Sathe** Your point is valid. When we look at the mix that we have in the US, we do have locals and then we have people on H1. Totally, we have more than 1,000 people onsite in the US right now. And if we really look at the breakup then I think we do have pockets where we have substantial number of US hires, and then of course, there are pockets where we have more people with H1.
- Gaurav Jain:** You stated, intend is to go and acquire more companies. Does this change the way you are looking at acquisitions, because the bill is not law, it is going to be probably the next 7-8 months before first it needs to pass the senate, then it will go to the house and the house is preparing its own bill, then they will go to the president, so it is a long process still. So how do you think about acquisitions between now and till the time the bill gets passed?

Kishor Patil

We are not looking at any acquisitions in response to H1 rules changes. Actually, we are not looking at any acquisitions just to grow our business. We are reasonably well on acquisitions, it has been completely in line with our business strategy and the customer priorities. And we do believe that in the last few years what we have been in a position to do is get substantial rate hikes based on our value proposition from customers and that allows us to hire locally significantly if required. So we believe that we are reasonably in control to respond to the market position as and when it happens. We do not have to do anything different as in where we are today.

Gaurav Jain:

Is there any concern that you heard from client so far, rather the other way, are you bidding at contracts differently since the time this bill has come, because the cost might change dramatically if it really becomes law?

Kishor Patil

We have not done anything significantly different. The business what we do onsite is significantly into transformational areas and where we do hire local people and as you know our rates are significantly higher than particularly offshore player in onsite. So from that perspective, we have not seen any difference at all.

Gaurav Jain:

I remember you had mentioned that one way to increase margins in the SAP business will be more offshore, because the SAP business did not grow probably a lot of people were on the bench. Is that a still way to improve margins in the SAP business?

Kishor Patil

Certainly it is. I did not talk about any bench, but what I mentioned is over the period as the Cloud products become stronger, we will be in a position to do more offshoring after gap of sometime.

Moderator:

Thank you. Ladies and gentlemen, due to time constraints, that was the last question. I would now like to hand the floor back to Mr. Hardik Shah for closing comments. Please go ahead.

Hardik Shah:

We thank the management for giving us the opportunity to host the call and all participants for joining the call. Thank you.

Sunil Phansalkar

Thank you, everybody. If there are any more questions left I would request you to write to me and we will be very pleased to get back to you. Thank you for joining the call and have a great evening.

Moderator:

Thank you, management and Mr. Shah. Ladies and gentlemen, on behalf of KR Choksey that concludes this conference. Thank you for joining us and you may now disconnect your lines.