TRANSCRIPT: NIIT Technologies Ltd Q4 FY2016 Results Conference Call

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FROM NIIT TECH:

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- MR. SUDHIR CHATURVEDI, CHIEF OPERATING OFFICER (COO)
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(1 crore = 10 million)

Moderator: Good day ladies and gentlemen and welcome to NIIT Technologies Q4 FY16 Earnings conference call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhinandan Singh, Head of Investor Relations at NIIT Technologies. Thank you and over to you sir.

Abhinandan Singh: Good afternoon and welcome everyone to our Q4 FY 2016 conference call. Present along with me today on this call are Mr. Rajendra S Pawar, our Chairman; Mr. Arvind Thakur, our CEO; Mr. Sudhir Chaturvedi, our Chief Operating Officer; and Mr. Amit Garg, our CFO.

You would have received our emails with the results already. The same is also available at our website www.niit-tech.com.

We will begin today's forum with opening remarks by our CEO and our COO, and after that the floor will be open for your questions. Before I hand over the floor to Mr. Thakur, I would like to make one more announcement. We are organizing an investor & analyst meet in Mumbai next month on the 7th of June, which will be in the afternoon. More details will be forthcoming in a few days but I wanted to give you a heads-up so that you can block your calendars because we intend to bring in not just our top leadership team but also some heads of businesses such as Digital Services; the intent is to make it much more informative and interactive.

And, with that, now I would like to hand over the floor to our CEO Mr. Arvind Thakur for opening remarks.

Arvind Thakur: Thank you Abhinandan. Let me begin by sharing with you some comments on our fourth quarter revenues. As advised in our last call, Q4 was expected to be soft as we had experienced closure of some large projects in our Travel & Transport business. Consequently, consolidated revenues are marginally up to Rs. 6847 million representing a 0.9% sequential growth and 12% over the same period past year. In constant currency terms, revenues were flat quarter on quarter. BFSI segment grew 6% sequentially during the quarter, increasing its revenue share to 40% of the overall mix. Travel & Transport declined 8.2% during the quarter due to decline in revenues from EMEA, as fresh business in the segment to compensate for closures was taking time to materialize. Travel & Transport now contributes to 32% of the revenues, manufacturing & distribution to 8% and government at 4% of revenues for the quarter.

Share of our top 5 and top 10 clients are now 31% of revenues and 43% of revenues, respectively, as a result of softness in Travel & Transport that we have seen in the quarter. Amongst the geographies America's share stood at 45% whereas EMEA's share stands at 33%. APAC and India now contribute to 22% of revenue. Onsite revenue represents 61% of total revenues. Reflecting a bit on margins, operating profits increased by 2% sequentially to Rs.

1261 million representing a 26.5% growth year on year. Operating margins improved 20 basis points to 18.4%. Expansion in margins has been mainly due to an increase in revenues from our GIS business which is seasonally strong in the fourth quarter of the financial year. Net profits improved 6.4% sequentially to Rs. 790 million due to improved operating profit and lower effective tax rates. Effective tax rate stood at 18.2% of PBT during the quarter.

Now let us throw some light on this order intake and business during the quarter. I will request Sudhir to share his comments with you.

Sudhir Chaturvedi: Order intake of $120 million was secured during this quarter. This included a large outsourcing deal with an Insurance client in the UK and a multimillion dollar engagement with a new Insurance logo in the US. The total outsourcing deal for the UK insurance client is a large deal with over $20 million TCV over a 5-year period and includes applications and infrastructure services. The US engagement is a new logo, as I mentioned before. Both transitions will commence in Q1 FY16. In all we added four new customers during the quarter, 2 in the US and 2 in Asia Pacific. The order book that is executable over the next 12 months now stands at $301 million. I would like to mention that we have an impact on the executable order book due to a renewal on the Morris engagement. So the Morris engagement that we have had, which has been there over the last five years, gets over in August 2016. We are currently discussing the renewal which is why two quarters of Morris revenues are not included in our executable order book. This quarter we also had some very significant go-lives. We had Sompo Japan Canopius ReInsurance which went live on Navigator, which is our new next generation policy and claims admin platform. We have also deployed robotic process automation (RPA) in our BPO business in partnership with UiPath. One of our large travel clients is leveraging a digital factory that we have set up for Rapid Apps Deployment and Development. We also have created, from a digital integration perspective for one of our Insurance clients, a loosely coupled micro-services based digital integration platform of the future. Several new engagements that we have done from a digital perspective as well as outsourcing deals from our large deal perspectives is the combination that has delivered a $120 million of order intake.

Arvind Thakur: I will talk a little bit about our people. Total headcount at the end of the year stands at 9476 which is a reduction of 41 during the quarter. Attrition has improved and now stands at 12.73% on an LTM basis during the quarter.

We had good collections during the quarter. Cash and bank balances stand at Rs. 4241 million which is an increase of Rs. 1123 million over previous quarter. There has been significant reduction in our DSO as a result, in Q4. Debtors at the end of the quarter now stand at 80 days of sales outstanding.

Capex spend during the quarter was Rs. 425 million, of which Rs. 163 million was spent on a campus in Greater Noida.

Just a few points with respect to our annual performance. Revenues are up to Rs. 26,824 million representing a 13.1% million growths over last year. The impact of rupee depreciation against the dollar has been lower as compared to peers due to the lower proportion of dollar revenues and lower hedge gain in FY16. The currency gains in the year was only 1.6%; in constant currency therefore revenues are up by 11.5% over last year. International revenues have actually grown 17.2% during the year whereas domestic revenues declined by 14% because of our reduced focus on the government domestic business.

Operating profits increased 36.9% during the year to Rs. 4733 million. Operating margins increased by 308 basis points to 17.6% over last year and this has been predominantly due to the increase in revenues from our international geographies and reduced exposure to domestic government business as well as increased proportion of revenues coming from digital services. Outstanding hedges in US dollars are at 67.5 at an average rate of Rs. 69.78 per dollar. In GBP we have 13.45 million outstanding at Rs. 104.68 per GBP and in Euro we have 4.5 million at Rs. 77.31 per Euro.

The overall macroeconomic environment indicates a moderation amidst increased uncertainty. We are seeing the US GDP growth coming at the slowest in 2 years, the UK economy is also slowing down. There is economic rebalancing in China. Eurozone recovery is broadly stable but the economy is expected to take some more time to deliver accelerated performance. India appears to be a clear outperformer and not surprisingly the IMF in its World Economic Outlook released last month has announced India would be the fastest growing economy in the world.

The outlook for the industry segments that we focus on continues to be positive. In the Travel & Transport, space IATA has indicated better demand for passenger travel. In banking and financial services according to fresh insights from research firms we find that the compounded annual growth rate of technology spend would be 4.2%. Insurance IT spend also is likely to grow at 2.6%. So overall I think the environment with respect to the industry segments that we are focused on look positive.

Our top clients in Travel & Transport have experienced some program completions and these have resulted in a decline in revenues in the fourth quarter. It will take another quarter to recover as fresh business builds in these accounts. Quarter 1 is traditionally a weak quarter as we see a seasonal decline in our GIS business. Hence we expect revenues to remain soft during the quarter. However, momentum will pick up in quarter 2 on the back of the strong intake of fresh business secured in both the last quarter and the quarter before that. And we hope to see continued momentum in closure of large deals in the coming quarter. Major industry segments of our focus, which is Travel, BFS, and Insurance continue to invest in technology and are particularly focused on digital transformation, which is becoming a sweet spot with our platform-led strategy. We hope to build on this momentum to deliver robust growth in FY17. With these opening remarks I would now request you to ask your questions.

Moderator: Thank you very much sir. Ladies & gentlemen we will now begin the question and answer session. The first question is from the line of Nitin Jain from Credit Suisse, please go ahead.

Nitin Jain: My first question was on revenue visibility. What kind of revenue visibility does your order book provide? Is double-digit growth a possibility in FY17?

Arvind Thakur: There is definitely a possibility because our intake has been strong and as Sudhir also explained our order executable over the next 12 months is also likely to expand with this renewal that we are likely to execute in the first quarter of this year.

Nitin Jain: Given that 1Q is going to be a soft quarter, do you think you can pick up sufficient momentum in the remaining three quarters to get to a double-digit number?

Arvind Thakur: That is what I said, it is a possibility.

Nitin Jain: Okay. And sir just a follow-up question or somewhat related, so this Ofcom deal was expected to start contributing in 1Q itself. So the outlook which you have given for 1Q, is it including the Ofcom deal or it is slightly pushed back?

Sudhir Chaturvedi: The Ofcom deal completion was done in Q3. We started transition in the middle of Q4 and this will end in the middle of Q1. So we will see some contribution of Ofcom in Q1 but the major contribution will start from Q2.

Moderator: The next question is from the line of Abhishek Kumar from JM Financial, please go ahead.

Abhishek Kumar: First question was on Travel & Transport. Just wanted to understand if this decline or this prolonged softness, is it only because of certain program closures or do you think we are at the wrong end of vendor consolidation in this account?

Sudhir Chaturvedi: As Arvind said, there have been some program completions and the new program ramp-up is going to take a little longer to happen. We have in one of our travel account some management changes which has slowed down the activity and hence slight delays in ramp-ups. But this is not because of vendor consolidation, this is merely due to the changes in management. So we would like pick up in those accounts, these travel accounts from Europe from Q2 onwards.

Abhishek Kumar: My second question is on margin. Now, even GIS has gone back up to historical levels. So first, what is the margin outlook for FY17? And what would be some of the incremental margin levers we have?

Arvind Thakur: I think the significant lever that we have is the growth in our digital services business and in fact that has been contributing also to the improvement in the margins that we have been seeing over the last couple of quarters in our businesses win. So these businesses are coming with better rates and better margins and that is going to be the prime focus of the organization in driving margins.

Abhishek Kumar: Just one last follow-up if I may, Sudhir you mentioned that August is when Morris will be renewed, so first question is it is at $28 million annual run-rate give or take couple of million. So if we have to include the entire Morris, so we would be around $315-320 million executable order book, is that assessment right?

Sudhir Chaturvedi: Morris on its own standalone basis is about $6 million a quarter.

Abhishek Kumar: And any risk is terms of renewal or it is almost in the bag?

Sudhir Chaturvedi: We are having a final discussion for this. It is a joint venture which continues to provide great value to the client, so it will continue going forward.

Moderator: The next question is from the line of Aniket Pande from Karvy Stock Broking, please go ahead.

Aniket Pande: Can you please give me the guidance on your order book and are you planning any inorganic expansion? And you are planning double-digit revenue growth, so please may I know the revenue trigger for this growth?

Arvind Thakur: I am afraid we cannot give you any specific guidance but only direct you to the fact that our order intake has now improved a step level from the level we were in quarter 1 and quarter 2 of last year when we were at about $80-90 million per quarter to now about $120 million a quarter. So I think that should give you some insights into the momentum that has been built into the business which will drive our growth.

Aniket Pande: Can you please explain regarding your transport business, how you are planning to grow in that business in the coming years?

Sudhir Chaturvedi: In the Transport business what we are seeing in the environment is essentially a digital driven business now. Almost all their investments is in technology platforms and digital solutions for their end consumers. So what we will see in Travel is change in approach to smaller duration projects plus a lot more of them. In fact, that is the kind of demand that we are seeing, so as I am talking about digital services driving our revenue growth going ahead, that will primarily be the model that we will grow Travel & Transport in. And the good thing is that you know those deals do come at high margins and also that the quality of the work that is done there as I said, we are focusing on quality of revenues to drive up our margins and that impact it has had on us. So there are, as I said, some Travel accounts that will be a little soft in Q1 but they will pick up from Q2 onwards.

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

Sandeep Shah: First question is if we look at entering into FY17 I think because of the two bad quarters of 3Q and 4Q the exit trades are not so great. And 1Q because of seasonality caused by GIS, I think even if we assume a flattish kind of a growth to go to a double digit kind of a growth rate you require almost like a 7% compounded Q-o-Q in the three quarters starting from 2Q FY17 to 4Q FY17. So how feasible is this target because you still believe that this is achievable for which my sense is over and above the booked orders you have to further accelerate in terms of your order book going forward.

Arvind Thakur: You can see that our intake in Q1 and Q2 resulted in softer Q3 and Q4. So our intake in Q3 and Q4 is going to result in improvements in the quarters going forward, but for the fact that Q1 is a seasonally weak quarter. So I think the good news is that our order intake has improved dramatically and consistently and, perhaps Sudhir pointed out, the deal momentum is good and if we continue on that track I think we should be okay.

Sandeep Shah: So we believe that 6% to 7% QoQ growth could be possible in the next three quarters after 1Q? I am not asking a specific guidance but that could be a feasible target to look at?

Arvind Thakur: That is what we will be aiming for.

Sandeep Shah: Secondly in terms of margins, I think there is excellent execution in this year. So we exited at 17.6% for the full year while at the 4Q it is at 18.4. So you believe that margins can be maintained at 18.4 or there would be headwinds like wage inflation, visa cost going forward where 18.4 would be difficult to maintain going forward?

Arvind Thakur: Yes, for full year basis it would not be 18.4, because Q1 itself will have an impact of at least 200-220 basis points on account of wage hikes but I think we will pick up going forward particularly as the proportion of our Digital revenues increase.

Sandeep Shah: In terms of Travel & Transportation, Sudhir is there any other client specific issues or you believe outside the top client in Europe, the growth momentum is being stronger and will remain stronger?

Sudhir Chaturvedi: Well it is specific to our client where there have been large scale management changes especially in their CFO function and which has led to a new process that they have put in place for projects going forward. So there is a backlog of proposals that we have in place. So we will pick this up from the next quarter onwards.

Sandeep Shah: And within top 10 while entering FY17 we do not foresee any other client specific issue within top-10 or top-20.

Arvind Thakur: I think right now we are only dealing with the Travel & Transport clients.

Sandeep Shah: And these two new deals which have been signed in this quarter are largely new businesses?

Sudhir Chaturvedi: Both are fresh order intakes as they are not renewals. So with the existing Insurance client in the UK, that is a new engagement, as I said a large deal engagement over 5 years. And the US acquisition is a multimillion dollar engagement again with a new logo, so it is a new logo with a significant TCV.

Sandeep Shah: And Sudhir can you give some update in terms of the integration of Incessant with the sales team of NIIT Tech and how these things are yielding results in terms of orderbook in digital or in terms of follow up integration work of front-end with backend on digital.

Sudhir Chaturvedi: Speaking about digital more broadly, digital is now 16% of our revenue. In fact the last two quarters have delivered very significant growth for us quarter-on-quarter and if you see again the Incessant numbers you will find that they have shown excellent year-on-year growth. So the integration is proceeding well. More importantly, I think we are able to now bring them to opportunities globally as you will see that their US and Europe revenues have also expanded. And we see more traction from that perspective. Our focus when we acquired Incessant was to actually leverage our scale in US and Europe to drive growth and that is what we will remain focused on.

Sandeep Shah: Can you just share what was the capex being spent on Greater Noida for the full year of FY16?

Arvind Thakur: Rs 70 crore in FY16.

Sandeep Shah: And one can assume now that capex would not be repeated in the coming year?

Arvind Thakur: Yes, I think we are done with investments in the campus. There should not be anything significant in this financial year.

Sandeep Shah: And I think there was a good execution even in terms of controlling the debtor days, which was one of the key corporate agenda which we had set at the start of the year. So can we expect a further improvement or you believe that this could be one of the optimum levels which we would like to carry forward?

Arvind Thakur: There is definitely scope for improvement and the reason why we had good debtor days was closure of some large programs as well as clean sign offs on some significant milestones. I think our collection has improved quite significantly as a result of that.

Sandeep Shah: And just last question Sudhir, in BFS I think we are hearing a mixed noise from the vendors. Some are bullish, some are bearish. So what is your sense while talking to clients?

Sudhir Chaturvedi: In BFS we are essentially focused on wealth management and asset management. In those two sectors we still see good traction because there is a significant amount of investment that clients are making to engage more digitally with their customer base as well as streamline internally. So that's some of the digital integration work that we are doing there. What I would from our perspective be seeing is in Insurance; we are seeing this as a sector which is modernizing, in fact I would say re-platforming their technology landscape and those modernization initiatives are resulting in both demand for our services as well as demand for some of our software products. So it is a combination of our experience and expertise in Insurance as well as our focus in Insurance along with the market conditions that make us quite bullish on the Insurance part of the BFSI market going forward.

Moderator: The next question is from the line of Dipesh Mehta from SBI Cap Securities, please go ahead.

Dipesh Mehta: I have a couple of questions. First, to start with data points. Can you provide revenue and margin for Morris, GIS, NIIT Insurance, Proyecta, and Incessant?

Arvind Thakur: GIS is Rs. 386 million. Morris is Rs. 401 million and Incessant Rs. 414 million. Spain Proyecta is Rs 138 million and Insurance is Rs. 408 million.

Abhinandan Singh: That's NITL, that is ROOM Solutions.

Dipesh Mehta: And margin for the respective businesses?

Arvind Thakur: GIS is 28%, NITL 20%, Incessant 22%, Morris 5% and Spain is negative 7% (-7%).

Dipesh Mehta: Second question is about margin outlook. You provided some color but is it possible to provide some – whether we would be where we are in terms of FY16 company average or how one should look at it? And if you can give plus-minuses of the margin – which levers would play out, so headwinds and tailwinds; that would be very helpful.

Arvind Thakur: I think there are some costs which are increasing which is around visas and some of these things which are adding to the cost structure of the organization. At the same time the organization is driving a lot of automation which is improving productivity. So there is a strong focus both within the industry as well as within the organization to drive our productivity using automation tools. So I think that will be a big driver of margins going forward.

Dipesh Mehta: So can we interpret we would be closer to F16 in terms of our aspiration to maintain margin from YoY perspective?

Arvind Thakur: Yes.

Dipesh Mehta: And can you help us understand lower ETR this quarter and how it looks going forward; the tax rate?

Arvind Thakur: Yes, the tax rate has improved because we have increased business coming out of our campus which is a SEZ and that is the main reason why we are seeing an improvement in effective tax rate (ETR). And domestic revenues have also reduced. I think these two have contributed to an improved (ie, lower) effective tax rate. Going forward I think 22% is what we can take as effective tax rate.

Dipesh Mehta: And I think at the last Analyst Meet we suggested one of the corporate targets would be to increase our cross-selling index and I think you shared some number at that point of time. Can you provide some color on how we have seen during the year that metric change for us?

Sudhir Chaturvedi: Yes, so actually the last deal that we signed this quarter was a cross-sell to an existing account that we had in the Insurance sector. So that process of cross-selling, which we call wide spaces into our accounts, is continuing and we will continue to work on that. What we will do more of now is combination of digital plus strategic outsourcing. That is really what we will focus on from a cross-selling perspective.

Dipesh Mehta: Okay. And lastly, can you provide capex guidance for next year?

Arvind Thakur: We will have BAU of about 80-85 crore and may be another 10-15 crores of project based capex. So about Rs 100-110 crore.

Moderator: Next question is from the line of Ashish Aggarwal from Principal Mutual Fund, please go ahead.

Ashish Aggarwal: Just need to check, what is the project based capex which you are doing?

Arvind Thakur: There are some clients that we have for whom we create the infrastructure which is basically a data centre and a disaster recovery center. And then we offer services off that infrastructure, that is project-based capex.

Ashish Aggarwal: Last year also at the start of the year we had guided for around Rs. 30 odd crores of capex coming from this type of thing. So is it for the same client or is this a new client which we have won?

Arvind Thakur: No, this is a new client.

Ashish Aggarwal: Okay, and secondly just wanted to clarify, when we said that we could grow double digits next year we are looking at this number on an organic basis, right?

Arvind Thakur: It could be organic, it could be inorganic.

Ashish Aggarwal: Okay, got it.

Moderator: The next question is from the line of Pankaj Kapoor from JM Financial, please go ahead.

Pankaj Kapoor: Just a couple of clarifications. Sudhir, when this Ofcom deal will start coming into revenues from this quarter onwards, and since we have been transitioning for the last quarter or so, so are any associated costs also which will get accounted for in this quarter or in the second quarter?

Sudhir Chaturvedi: No, the costs are already being accounted for as part of transition. So that is when we move from a transition to steady state. There would not be any additional increase in cost due to go-live.

Pankaj Kapoor: And the second question is on this Morris renewal. I mean, Morris obviously has a pretty inferior margin profile, given I think it is highly onsite-centric. So as we are getting into the negotiations for renewal what is the thought process? I mean, are you looking at it from a profitable growth perspective? So is it like revenues over margin? Or you think that at this point of time you want to protect or rather expand margins so you will rather look at potentially improving the margin profile, and if not you may be willing to walk away also if the margin profile is not decent?

Arvind Thakur: No, let me just try to explain to you the margin. The margin that I shared with you is the margin of the joint venture which is there in the United States. That joint venture actually offshores work to NTL in India which has very decent margins. So margin profile of Morris is not too bad.

Moderator: The next question is from the line of Vipul Shah who is an individual investor, please go ahead.

Vipul Shah: Can you give onsite-offshore mix for the quarter and year?

Arvind Thakur: 61% is the onsite revenue for the quarter and 59% for the year.

Moderator: The next question is from the line of Ganesh Shetty who is an individual investor, please go ahead.

Ganesh Shetty: Just let me know whether this quarter has been very good as far as the BFSI segment is concerned. Is it due to recovery and overall digitalization, integration programs? Can you please give some highlight on this?

Sudhir Chaturvedi: As I alluded to previously, in BFSI what we are seeing is that a combination of digital technology is being deployed for improving the customer experience as well as now increasingly being deployed to streamline internal operations and reduce cost. So the combination of services that we have from a digital perspective from and Incessant perspective, our software product as well as the services that we provide to asset management and wealth management companies, it is a combination of all these factors that is driving growth.

Ganesh Shetty: Are we planning to acquire 49% which is Incessant Technologies this year or is there no timeframe for that?

Arvind Thakur: I think the balance has to be acquired over a period of next 2 years.

Moderator: As there are no further questions from the participants I now hand the conference over to Mr. Arvind Thakur for his closing comments.

Arvind Thakur: Thank you everybody for participating in this call. As Abhinandan has pointed out, we will hold our Investor Meet on 7th June in Mumbai and I look forward to seeing all of you there at that period. Thank you and good evening.

Moderator: Thank you very much sir. Ladies & gentlemen, on behalf of NIIT Technologies that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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