



“Tech Mahindra Earnings Conference Call”

August 12, 2011



MODERATORS: **MR. VINEET NAYYAR - VICE CHAIRMAN & CEO**
 MR. SONJOY ANAND – CHIEF FINANCIAL OFFICER
 MR. SUJIT BAKSI – PRESIDENT, CORPORATE AFFAIRS
 MR. MANOJ BHAT – VICE PRESIDENT, CORPORATE PLANNING

ResearchBytes.com

Moderator

Ladies and gentlemen good day and welcome to the Tech Mahindra Q1 FY12 results conference call. As a reminder for the duration of this conference all participant 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. Vineet Nayyar. Thank you and over to you sir.

Vineet Nayyar

Ladies and gentlemen, good day. Thank you for joining our 1st Quarter result call. We are in many ways having this call at a very important inflection point in the world economy. All of you are aware of the recent events in the US and European economies and the consequent turmoil in the financial markets. From our perspective, we have not seen any major change in the broader telecom demand so far, partially because, as you all know, the sector has been lagging the other verticals in terms of the demand recovery. Discretionary spend, especially in the developed market, continues to be low. Our customers in the US and European markets have been focusing on organizations through the last couple of years by using the global delivery model to deliver benefits. On the other hand our customers are faced with new challenges, like network congestion and network modernization. Business models are being redefined with the advent of social media and new technologies like Cloud, this has led us to believe that the long-term demand trend is intact.

Coming to our performance this quarter, we have maintained our pace of steady growth. Our Quarter 1 FY12 revenue was at \$290 million, up by 4.1% quarter-on-quarter, 15.4% year-on-year. Our EBITDA was at Rs. 241 crores and Profit After Tax at Rs. 276 crores. Our Profit After Tax got a boost from the Mahindra Satyam share of profits which were at 96 crores for this quarter against a loss in Quarter 4. Growth tractions from the emerging markets continued with a sequential growth of 15.3, while American and Europe saw a steady sequential growth of 2.3% and 1.8% respectively. Non-BT had a sequential growth of 5.5%, while BT revenue grew at 1.6% quarter-on-quarter aided by an appreciating Pound Sterling.

Our BPO business in Africa was fully transitioned in the quarter and we are now delivering services from all the countries in our scope. We have added approximately 4500 employees in Quarter 1, of which around 2800 were in the BPO, taking the total headcount to above 42000. We added 1600 employees in IT services, a large portion of whom were trainees resulting in a decline of utilization levels by about 3%.

As we look at opportunities ahead as always there are some head wins and tail wins. The immediate challenge ahead are the impact of salary hikes effective 1st July and the fact that our largest customer has decided to put significant pieces of business for tender. As always there are operational levers available within the business through productivity measures and growth to mitigate over time the depth of these head wins.

Our view on the product market remains positive. Our large wins in the past quarters are in early stages of execution and should start contributing to the revenue line in the later part of the year.

With these brief comments I would like to throw open the floor for questions.

Moderator Thank you very much. We will now begin the question and answer session. The first question is from the line of Vihang Naik from MS Global. Please go ahead.

Vihang Naik My first question is, I know you kind of alluded to the impact of the macro events, but are you seeing any kind of change in the buyer behavior across markets as in Europe versus North America, is it any different in both these geographies?

Sonjoy Anand I think these specific macro events which we have seen in the last week or so in terms of the escalation of the debt crisis in Europe or the downgrade of the US, I think it is too early to assess what their impact is going to be in terms of the market behavior or demand. Clearly sentiment has been affected. Whether anything more fundamental is going to happen, we would have to wait and watch.

Vihang Naik A couple of data related questions, what was the constant currency revenue growth in this quarter?

Sonjoy Anand Volume growth was 2%.

Vihang Naik What was the growth of BT in GBP terms?

Sonjoy Anand It was flat.

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

Pinku Pappan Could you just elaborate on the line you mentioned about BT putting significant pieces to tender. What exactly is happening here and what do you expect to happen from Tech Mahindra point of view? Would we see more competition in this space? What are you looking here in terms of outlook?

Sonjoy Anand I think what we are saying is that BT has put significant pieces of business out for tender. As always when you compete for business, you win some and you lose some and because it is a significant client and we had earlier indicated a range of £70-72 million as stable in the short-term, we just thought it would be correct for us to bring to your attention, the fact that there is an event happening which could have implications. We may have to see how it falls.

Pinku Pappan But do you see a downside to that £70-72 million number?

- Sonjoy Anand** I think clearly there is an uncertainty arising from this process and we will have to see what the outcome is.
- Pinku Pappan** Next question is more on the book keeping side. You showed a sharp drop in depreciation expenses this quarter. Could you explain why Sir??
- Manoj Bhat** I think the main reason is some of our assets especially computers, etc., we purchased in some large chunks which have completed their useful life. I can give you more details off-line. I do not have all the details with me here.
- Pinku Pappan** The last question is on your cost of employees side. We are seeing close to around 300 bps increase in your cost of services. Is it only because of the employee numbers increasing or is it because some portion of this salary hike spread in this quarter?
- Sonjoy Anand** I think salary hikes are effective 1st of July. What you are seeing there is the impact of the increased head count.
- Moderator** Thank you. The next question is from the line of Deepan Kapadia from B&K Securities. Please go ahead.
- Deepan Kapadia** I wanted some clarification, since our hiring on the BPO front has been quite a lot and it is a low margin business. Do we continue to see this kind of hiring in the next couple of quarters? Can we say that the emerging market geography that is growing at a higher percentage, is also going to affect our margins?
- Sujit Baksi** In BPO there are two kinds of hiring. One is for attrition back fill and one is for the growth. So you would definitely see growth and attrition that we are hiring already happening. As we told last quarter, we won some significant orders. We also have re-batched about 1100 people which has come to the headcount. So you will see some more re-batching happening in Africa. We told you about the large order that we have got in the domestic market last quarter and 2000 people are under training currently and hence you will see a continuous hiring in BPO, it depends on attrition back fill and growth. Margin-wise, rest of the world has its own challenges but most of the business that we are doing in the rest of the world is on transaction based or output based pricing. So there is a certain amount of control we have on productivity increase on quarter-on-quarter which will probably normalize ____.
- Deepan Kapadia** There is a significant rise in our other incomes. This is mainly due to our hedges going correct?
- Sonjoy Anand** Yes, the major component of that is exchange gain.
- Moderator** Thank you. The next question is from the line of Prasad Balari from Tech Mahindra. Please go ahead.

- Prasad Balari** The active clients count did not increase from 128, from the June to now. So will there be an increase or is there anything to be done on that aspect?
- Manoj Bhat** I think your point is correct that the active count did not increase. I think you must remember we are in the telecom vertical, so large customers are not going to be added every quarter. I do not think there is anything to read into the customer count but I would request that you take these questions up on an internal basis please.
- Moderator** Thank you. The next question is from the line of Ashwin Mehta from Nomura. Please go ahead.
- Ashwin Mehta** Just wanted to check in terms of, we have seen a reduction in cash of almost 110 crores quarter-on-quarter, while the debt has also gone up by around 55 crores. What is causing this almost 100 crores reduction in cash despite adjustment for the dividend payout?
- Sonjoy Anand** I think what happens from an operational perspective is that collections tend to bunch at the end of the month or quarter and sometimes it will spill over, that is one of the things that happened this quarter. In the first week of July, we had some rather significant collections coming in.
- Ashwin Mehta** So has there been a jump in terms of our DSOs and what would that number be as of now?
- Sonjoy Anand** To the extent that those collections that I am talking of, they spilt over from the previous quarter to the current quarter, there was an impact of days of sales.
- Ashwin Mehta** Second question is in terms of our ex of BPO revenues. So our IT revenues seem to be flattish. What is happening there and given the deals that we have signed in the past, when do you start to see the ramp ups, would it be Q3 onwards?
- Sonjoy Anand** Our non-BT business has continued to show growth and yes, in terms of the deal we signed in the recent past, they will start kicking-in as we go through this year and the timing of those deal kick-ins will vary from deal to deal.
- Moderator** Thank you. The next question is from the line of Pratish Krishnan from Bank of America. Please go ahead.
- Pratish Krishnan** This is from the BT side? If I understand correctly the BT anyway renews their contract every year with all the vendors, so what is different this time when you say it is a tendering process, what has changed from a BT off shoring point of view?
- Sonjoy Anand** I think the point that we were trying to make is that, we have been saying for the last few quarters that in the immediate short term, we see revenues at £70-72 million. This event of, as you are saying, the customer does it fairly often but that event has

now come and we just wanted to point that out so that you do not take the £70-72 million for granted.

Pratish Krishnan Is it different than what you see every year, in terms of the renewal of contract?

Sonjoy Anand I do not think I quite understand your point Pratish. I think as always you compete for business, you win some business and you lose some business. I think in terms of the size of the deals which are currently being put up for tender, they are probably a bit larger than you would normally expect at this point of time.

Pratish Krishnan Just a follow-up, anyway BT is not growing, clearly with you being the largest vendor even for the others. So any idea in terms of what is BT trying to achieve here by doing this large size tendering?

Sonjoy Anand For them it is a part of their normal procurement processes.

Pratish Krishnan In this process should we expect that even the current projects that you have, is there any indication of that probably ramping down or probably put on hold?

Sonjoy Anand Pratish, I think the only point we are trying to say is that there is this process in which we will compete for business and when you compete for business you win some and you lose some, there is nothing more than that that we are trying to say at this point of time.

Pratish Krishnan Just on the macro side, earlier you had spoken about a revival in the second half in terms of the broader telecom spend. What would be your view today?

Sonjoy Anand I think Pratish, clearly revival of discretionary spend which we had said would happen in the later half of this year, we will just have to now watch a bit to see whether the change in sentiment impacts that somewhat. So I think it is possible that that assessment could change but it is too early to say whether it will or will not.

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

Sandeep Shah Just with regards to the BT, wanted to understand that in the re-bid, is it a request more in terms of further rate cuts from the vendors or is it a request in terms of a lower volume of business which is coming up for the re-bid?

Sonjoy Anand We will have to see how this process moves forward but it could be either.

Sandeep Shah We actually had a contractual receipt of close to around Rs 9.67 billion around six quarters back. So is it to some extent as a primary vendor offshore side, it does not protect us in terms of an annual re-bid which keeps on coming from Tech Mahindra?



- Sonjoy Anand** All contractual commitments are being met. There are some contracts which come up for renewal and, therefore, there is the opportunity for the customers to take forward a process to decide who will do their business on what terms.
- Sandeep Shah** What would be our stance if they ask for further rate cuts? Are we ready to compromise volumes? Just wanted to get a color how we would be defending this request from the clients?
- Sonjoy Anand** I do not think we would like to comment on our strategy in terms of.... we will take opportunities forward.
- Sandeep Shah** In this quarter is there any one-time cost related to a transition of the Africa BPO?
- Sujit Baksi** No, Africa BPO there is no transition cost.
- Sandeep Shah** So whatever margin has been shown is the recurring margin on EBITDA level?
- Sujit Baksi** There is some transition happening for offshore, which is the service being delivered from India. There are 2000 people in training which will get into revenues by next quarter, there is no transition cost.
- Sonjoy Anand** Transitioning is a normal part of our business. Is there something very unusual happening at this time from a cost perspective? I would say, no.
- Sandeep Shah** What would be the guidance on the tax rate now for the full year?
- Sonjoy Anand** Our assessment is that it will be 22-23%.
- Sandeep Shah** Which is down from the earlier estimate of 24-25%?
- Sonjoy Anand** I think it is in the same range, whether it will be a percentage point higher or lower depends on the final mix of business, which geography, etc. The clear thing is that with the constraint of the 10A clause we move to a higher range, where exactly in the range it will sit, I think depends on the mix of the business, which country, which geography, etc.
- Sandeep Shah** The last question in terms of the new deals, one on the IT services including Vodafone Australia. So there could be some ramp ups coming from the second quarter. So do you believe the quantum of new business to some extent will have some delta coming in the 2nd Quarter on IT services even if there would be some headwinds coming through BT?
- Sonjoy Anand** I think our non-BT business has consistently been growing. If you look at our track record going back many quarters and many years, we continue to see good traction in non-BT and that is about as much as I can say on this matter since we do not give guidance.



Moderator Thank you. The next question is from the line of Nihar Shah from Enam Holdings. Please go ahead.

Nihar Shah Just a couple of data points. One was, what was the CapEx that you have incurred this quarter?

Manoj Bhat I think it is about \$12 million.

Nihar Shah What is the quantum hike for the salary that you have given, both onsite and off shore?

Manoj Bhat I think salary will be effective 1st July and the blended offshore would be at 12%, blended onsite would be 2.5%.

Nihar Shah Any ballpark impact on the margins that you see next quarter?

Sonjoy Anand I think there are some things which are going to impact margins negatively and then there are some operational things that we will do but there isn't a specific percentage that we would like to point towards.

Nihar Shah You mentioned that there are 2000 people within your total employee base that are currently under training. Just wanted to know if this is related to the Bharti BPO contract or is this some other contract?

Sujit Baksi It is some other contract..

Nihar Shah This is in the IT service space?

Sujit Baksi On the BPO side.

Moderator Thank you. The next question is from the line of Hitesh Shah from IDFC Securities. Please go ahead.

Hitesh Shah Just wanted to check, when we had restructured the contract with BT, we had said that about 70 million GBP to 72 million GBP is an assured revenue for a period of four to five years. Does that change with this new block on the re-bidding?

Sonjoy Anand I think I need to correct that, we had never said that 70 to 72 million is the range for four to five years. What we had said this that in the near term, that is the level of business that we expect and if you look since that time we told you consistently we have been there or thereabouts as far as that range is concerned. And in spite of the fact that we do not really give guidance, we thought that given that we had been indicated that range we should point out that at this point of time the customer is in the process of running tenders for some significant piece of business and that could impact this range.



- Hitesh Shah** Also just wanted to check, of the payment that we had received from the BT, what portion is yet to be amortized?
- Manoj Bhat** We are into the ninth quarter of amortization, approximately 50 crores a quarter, so that is about 450 crores out of the total payment. so we should probably have 500 crores on the books. I am just giving you rough numbers.
- Moderator** Thank you. The next question is from the line of Srivatsan Ramachandran from Spark Capital. Please go ahead.
- Srivatsan Ramachandran** Just wanted to understand, substantial increase in the BPO business has kind of entered the margins over the year. At least for 12 to 18 months, how do you see margins shaping up in this piece of business especially in Africa BPO business?
- Sujit Baksi** Margins in Africa BPO business or other BPO business is more or less is determined by the productivity that is gained over a period of time. So it is in standard with our normal margins in BPO.
- Srivatsan Ramachandran** In terms of the emerging markets business that we are seeing any specific changes that have been happening because given one of the clients is not growing. Just wanted to know how the order will be there in this quarter, so that kind of gives near-term visibility on the non-BT growth?
- Sonjoy Anand** In rest of the world or the emerging markets we continue to see a robust traction and some customers would be growing faster than the others and there are new opportunities that we are competing for. Also there are businesses that we have won in the last few quarters, which will start billing in the quarters to come.
- Srivatsan Ramachandran** Just a bookkeeping, on the current hedge book position.
- Sonjoy Anand** In terms of hedges, we have got about £340 million which are covered Pound to Rupee at about 82 and we also have about \$355 million Dollar to Rupee at about 49.5.
- Moderator** Thank you. The next question is from the line of Rahul Jain from Dolat Capital. Please go ahead.
- Rahul Jain** Can you help me out with the constant currency growth for BT and overall?
- Manoj Bhat** I think BT was flat as we mentioned at the beginning of the call and overall was about 2%.
- Rahul Jain** If you can share some thought on the budget spends we are expecting in the coming period because we have learnt from our channel check that there are some large telcos that have laid down a multimillion dollar budget towards collaboration and cloud initiatives. So, where we see positioning our self in the similar eco system?

Manoj Bhat

I think as Vineet mentioned in the beginning of his speech if you look at from a telco demand cycle and initiative perspective, there are 2-3 areas. The first area is the area of network services and network modernization. You must have heard of LTE, 4G, these are upgrades and modernization programs which a lot of telcos are considering, some of them have already moved. That is going to cause trickle through spend into players like us, although the major portion of the spend would go to an equipment manufacturer. The second area of spend is probably on the Cloud because telecom operators clearly have to be early adopters of Cloud and helping these telcos along their journey towards becoming a Cloud enabled provider, I think that is one of the areas of growth for us in the future. I do not know whether I answered your question but you would be seeing initiatives like these, which are going to be announced by telcos as they deal with both issues of the market growth as well as optimization and rationalization of networks.

Rahul Jain

So, on the second leg of it, on the Cloud side where do we see our role coming into the picture and are we seeing any business opportunity at the current?

Manoj Bhat

On the Cloud side, I think as I said, our role would be an enabler. If we have set up a Cloud lab about six months back, to actually figure out how we can assist telcos and help them benefit from this technology. Clearly, I think the follow-through business from that would come through to us because we are dominant partners in a couple of our large customers and any initiatives which happen in the cloud area, we would presume that we are favorably placed to win those initiatives. Regarding specific opportunities, I do not want to discuss that on this call.

Rahul Jain

Just the last one, if you can share some thoughts on the opportunity in the domestic market because we are sort of getting a mixed trend in the news flow at one at we have players scam tainted affected. On the other end, we are seeing some regaining of the bargaining power with tariff rate coming back which could actually help in the spend capability. So how do we see the scope from this?

Manoj Bhat

Domestic market, let me first give an overview of what we do. In the BPO space we are a partner to almost all the telcos. On the IT space, in two or three telcos, we are the end-to-end managed services provider. One of them is a very large account for us. There has been a lot of turmoil in the market in terms of the scams, as you rightly pointed out. From our perspective in most of the accounts, we would imagine that we are largely protected because managed services is an operations kind of service which is required, it is not dependent on the new initiatives. Secondly the tariff growth, potentially could improve the profitability and hopefully give Indian telcos the financial wherewithal, to invest further in terms of upgrading their systems and networks but that is something which we will have to wait and watch because the industry has been in a long period of turmoil on rates. I think overall to put it in context, India is about only 4 to 5% of our business. So while it is an important market it is not a significant market for us in terms of impacting our overall numbers.

- Rahul Jain** Would we rate it better than a year back or at flat, at the moment?
- Manoj Bhat** I think I would say it is flat. I do not see a change in the market really.
- Moderator** Thank you. The next question is from the line of Abhishekh Shindatkar from ICICI Securities. Please go ahead.
- Abhishekh Shindatkar** Since you are referring to the renewal of the contract with BT, does that entail any of the pass through revenues also?
- Manoj Bhat** No, it is our normal business. First of all it is not a renewal of a contract, to clarify. I think what we are saying is, it is a realignment measure by BT in terms of re-tendering. We are at the very beginning of the process. So I think that is where we are coming out and saying that this is happening and the impact of this which way it goes, etc., we will have to see and come back to you guys as the thing evolves. It has nothing to do with pass through revenues, etc.
- Sujit Baksi** The one thing we must clarify is this, the re-tendering of BT in the IT estate is for all the spaces, not only the estates that we operate, even our competitor's estates is upward....so we do not know which way the revenue will come and go. Everybody IT estate is up for re tendering its not only for us.
- Moderator** Thank you. The next question is from the line of Niral Dalal from Almondz Global Securities. Please go ahead.
- Niral Dalal** I have a question on the hiring front. The hiring that has been planned for the forthcoming quarters, is it predominantly in BPO and the Bharti deal, or even in the non-BPO side we are planning hires?
- Sonjoy Anand** We do not specifically talk about our hiring plans for the future. The only thing which we have mentioned is that of campus, we had made 3500 offers of which around 1500 people have joined us.
- Manoj Bhat:** And to add to that, I think this initiative was probably a longer-term initiative to change the pyramid and our 0-3 years which was 33% is slowly moving up, I think it is about 37%, 38% now and that is the metric we are closely following but that is more long-term in nature and that is where you see a substantial amount of hiring, we have done in the last two quarters on the campus recruit front.
- Niral Dalal** So the mix in terms of BPO and non-BPO, I know you may not share the exact numbers but can you give some sense, is it predominantly BPO?
- Sujit Baksi** We have already shared last quarter, how much is BPO and how much is IT hiring. We have already given that.

- Niral Dalal** One more question, can you confirm whether any campus offers made to Mahindra Satyam employees, there have been any deferrals over there by one or two quarters or so?
- Sonjoy Anand** I think this is not the right forum for detailed Mahindra Satyam questions. But overall Mahindra Satyam is seeing good growth, so they would be eagerly looking for people to join them.
- Niral Dalal** Can you give me the exchange gain this quarter?
- Sonjoy Anand** It was around \$8 million.
- Moderator** Thank you. The next question is from the line of Ravindra Agarwal from Capital Market. Please go ahead.
- Ravindra Agarwal** My question is on the telecom vertical. What kind of a deal pipeline we are looking at? My next question is on the CapEx front, what is the CapEx plan for FY12 and FY13 if possible?
- Manoj Bhat** I think let me take the CapEx one first. I think our three year plan, and I cannot give you by year, but our three year plan is about give or take 92 to 100 million over the three years. Obviously this is subject to us continuing to build out new facilities, etc. In terms of your other question on where do we see the telecom demand and how is it panning out for us, if you follow the trend of our recent wins, I think the first trend which is coming out is the entire managed services managed operations space is something where we have found good success. The capabilities of a provider like us who can combine both the global delivery model as well as the breadth of skills required to run a telcos operation, has positioned us very favorably I think. As we go forward, I think we would see ourselves in front of more and more such deals and that is one area of spend. This is in addition to the conventional global off shoring kind of benefits from customers. As I said and as Vineet mentioned also in his initial speech, the telecom vertical, discretionary spend is quite low right now. We are seeing some signs of revival through some of these new initiatives which someone on the call mentioned about Cloud. So combination of all these, I think the demand is there in terms of both existing spend re-configuration as well as some select new initiatives. How we go forward on this will now depend on how we compete and as well as customer behavior I would imagine.
- Moderator** Thank you. The next question is from the line of Somitra Chatterjee from Espirito Santo. Please go ahead.
- Somitra Chatterjee** The first one is for the tenders that have been thrown open, can you give me a ballpark TCV and the duration with regards to BT. Secondly, the tenders that have been thrown open, are they all pertaining to Tech Mahindra on which Tech Mahindra is currently working or there are also new projects that you are expecting through this process?



- Sonjoy Anand** In respect to the first question we cannot share TCVs regarding those businesses. In respect of the second question the business which has been put up for tender includes work which is being done by other vendors as well.
- Manoj Bhat** The third clarification, I think we are saying this is the beginning of the process and this will evolve over time. So I think we will have to wait and watch.
- Moderator** As there are no further questions I would now like to hand the floor over to Mr. Sonjoy Anand for closing comments.
- Sonjoy Anand** I would like to thank all of you for having joined the call and I hope we have been able to answer your questions. If there are any follow-up questions please send them to the Investor Relations Team and we will respond to them quickly.
- Moderator** Thank you sir. On behalf of Tech Mahindra that concludes this conference.