

“Tech Mahindra Limited Q2 FY-’16 Earnings Conference Call

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Moderator:

Ladies and Gentlemen Good Day and Welcome to Tech Mahindra's Q2 FY-'16 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. Vineet Nayyar -- Vice Chairman, Tech Mahindra. Thank you and over to you sir.

Vineet Nayyar:

Good Evening, Friends. Welcome to Tech Mahindra Financial Results for the Second Quarter ended 30th September, 2015. After two quarters of muted performance, we are pleased to witness growth. The numbers are in line what we had expected. Revenue for the quarter was Rs.6,616 crores or \$1,011 million, up 5.1% quarter-on-quarter which translates into 2.2% in dollar terms and 20.5% year-on-year in rupee terms and 12.3% in dollar terms. EBITDA margins improved by 160 basis points and were at 16.6% for the quarter versus 15.0% in Q1. Profits after tax for the quarter were Rs.786 crores or around US\$119 million, up 16.4%.

For us what is a milestone really and which we rejoice in is the fact that this was the first quarter where our revenues exceeded \$1 billion and where our profits if I may be permitted to use another currency exceeded Rs.1,000 crores.

Just to remind you folks we touched \$1 billion 5-years ago, but that was an annual number. So in these 5-years we have grown 4x.

Coming back to the present, our Communications business posted a 3% quarter-on-quarter growth after 3-quarters of subdued growth; however, I do think that we are still facing a difficult environment as we continue to be in midst of a consolidation wave in the ICT space. This will continue to constrain our Communications growth in the near term. However, as you know, we have seasonal business which will lead to better H2 FY16 than the first half of FY16 for the Communications vertical.

The Enterprise business had a constant currency growth of 3.1% quarter-on-quarter and 13.1% year-on-year. So we had been witnessing large deal traction in verticals like Manufacturing, BFSI. We have also begun to see traction in the emerging verticals as well. This quarter we closed a large deal in public services and in an emerging region like Nordics. Also, last quarter, we closed a deal in Healthcare, another emerging vertical for us.

Our Deal Pipeline continues to be good with TCV signing almost \$300 million worth of new business this quarter and added one customer in \$50 million category. Our active customers count went up by 18, taking the number to 788 in Q2.

From Geography perspective, US grew 4.6% quarter-on-quarter at the back of Comverse deal. Europe has a steady growth of 1.7% quarter-on-quarter while the rest of the world growth was flat in constant

currency terms. We have seen a constant currency growth across all verticals except Retail which we believe should do well next quarter.

Last but not the least, Yield Management, Automation and Industrialization: We have given renewed focus and vigor to this initiative.

As we indicated in the last call, one area of focus was to optimize our operations. The first results of which you have seen in utilization improvement of 4% which now stands at 79% versus 75% in Q1. From our perspective, while the first stage of rapid change in metrics has happened, we still expect that our Industrialization and Automation initiatives will help us optimize further and improve both our yield per employee as well as margin per employee over the coming quarters.

Another area where we have been able to improve significantly is in cash flows on account of the reduction in debtor days and improved margin.

We added 1562 Associates in Q2 taking our headcount to 105,235 Associates.

Now I will turn quickly and touch upon the recent acquisitions -- LCC and SOFGEN: While the integration is progressing well this quarter LCC has a flat sequential growth with some margin improvement. You will appreciate that any large size cross cultural acquisition will undergo some realignment. As a part of our potent network strategy we have decided to review and discontinue some parts of the unviable business around civil works, etc., and focus on the network core business. This will result in about US 15 to 20 million annual revenue shrinkage and we would have seen about US\$3 million decline in LCC revenue in this quarter itself. We are optimistic that we should be able to complete our integration activities in the next couple of quarters.

In the time of such volatile economic spins, it is imperative that we build a sustainable organization for the future. Our efforts have been recognized with Tech Mahindra getting selected as an index component of Dow Jones Sustainability Indices under both emerging markets and world categories. I am told we are one amongst only three companies from India to make it to this index. Further, this quarter Tech Mahindra was Ranked 3rd among 100 Most Sustainable Corporations in Asia in the 2015 Channel NewsAsia Sustainability.

With these brief comments I hand over to Milind Kulkarni for giving us some insight into our numbers.

Milind Kulkarni:

Hello! Good Evening, Everyone. Let me take you to some of the Financial Highlights for the Quarter-ended September. In Q2, as Vineet said, we hit 1 billion revenue mark with our revenue at 1011 million versus 989 million which is USD growth of 2.2% quarter-on-quarter and 12.3% year-on-year. Now, this quarter saw a cross currency headwind of about 80 basis points due to depreciation of Sterling, Australian dollar, Canadian dollar, Brazil currency against the USD. Now, if we adjust for the cross currency headwinds, sequential growth is 3% quarter-on-quarter.

Revenue in INR terms was Rs.6,616 crores Vs Rs.6,294 crores, a 5.1% quarter-on-quarter growth and 20.5% year-on-year growth. On the margin front, we saw 160 basis points improvement on a sequential basis. EBITDA for the quarter was 167.7 million, Rs.1101 crore versus USD 149 million in Q1. Q2 EBITDA margin was 16.6% versus 15% in Q1. The tailwind came from currency benefit of about 60 basis points lower visa cost compared to Q1 80 basis points, utilization improvement and other cost optimization efficiencies of 150 basis points. The headwinds were on account of transition cost on some of the large deals of about 30 basis points and higher SG&A of 100 basis points. On a Y-o-Y basis the margins were impacted by acquisitions, wage hike and higher SG&A.

Let me take you through the hedges which we have: Hedges as on September were GBP 167 million at Rs.105.8, Euro 138 million at Rs.81.8 and USD 1504 million at Rs.68.5. MTM loss as on September was USD 9 million, out of which USD 1 million was taken to P&L and USD 8 million was taken to reserves based on the hedge accounting treatment which we follow. Other income for the quarter was 24.9 million versus 21.6 million in Q1. We had FOREX loss of USD 1.5 million against gain of 14.7 million in the previous quarter. This was mainly on account of the sharp depreciation in currencies like Australian dollar, Canadian dollar, Brazilian currency; however, on a half yearly basis our FOREX gain was about 0.7% of the revenue in line with most of our other peers. Profit after tax for the quarter was about 119.3 million versus 106.3 million and the PAT margin was 11.8%. In INR terms PAT was Rs.786 crores Vs Rs.676 crores in Q1. Tax rate for the quarter was 24.7 marginally higher than 23.7 in the previous quarter.

You would remember that we had told you in the last call that we would focus on reducing our DSOs. We have achieved some success in this and our DSO were 108 days as against 113 days in June. We recognize that there is a further scope of improvement and we will continue to focus on improving this matrices. The cash flow from operation for Q2 was USD 142.7 million which is 85.1% of EBITDA as against USD 55 million in Q1 largely contributed because by improvement in DSO. Cash flow from operation for H1 was USD \$198 million, 63% of EBITDA. Cash and cash equivalents were USD 532 million versus 526 million in last quarter. Net cash after adjusting borrowings was 402 million versus 401 million in Q1. Though the improvement is marginal, let me add that this improvement was after a dividend payout of 96 million in the quarter.

With this I open the floor for questions.

Moderator:

Thank you. We will now begin the Question-and-Answer Session. Our first question is from the line of Sandeep Muthangi from IIFL. Please go ahead.

Sandeep Muthangi:

I have a few questions on the growth in the Enterprise vertical. First one is on the TME sub-vertical, where it has been a terrific quarter (+14%) growth. Can you just give me some color on what is driving the growth, and how sustainable it is?

Manoj Bhat:

This is Manoj. I will just request Manoj Chugh who is in the call to pick up the questions on the Enterprise vertical.

Manoj Chugh: In terms of the TME vertical you would remember that we had said that we are greatly driven by what we see in terms of spending patterns of individual customers. So you would see that in terms of the performance, some quarters have been great and some have been less spectacular. This quarter I think we fired on all cylinders and you have seen the growth because of the spending pattern that we have seen around our customers. And again we will continue to be governed by how we see our customers spending. As you know, in Q3, we do see a furlough which occurs in this specific sector which certainly will impact numbers to a certain extent, but we continue to be confident about our longer-term growth opportunity in this vertical and you would see us perform as we go along, but certainly as far as Q3 is concerned, we will see the furlough effect.

Sandeep Muthangi: So while we are on the Enterprise verticals, can you also give me some color on the Manufacturing and BFSI? Manufacturing... I have a very specific question. Because last quarter, the commentary was very bullish, in fact, CP had even referred to it as one of the fastest-growing verticals going forward. So after a decent quarter, this quarter it did not grow or it declined. So what is causing this volatility? Also on the BFSI, if I remove SOFGEN in 1Q, the growth has declined for the past three quarters. So what is happening at BFSI?

Manoj Chugh: Yes, first of all on Manufacturing we have grown in constant currency terms, as you know, our manufacturing footprint is highly diversified across multiple currencies and Milind has already spoken around the effect that we have seen in many of the countries, which traditionally have been important contributors to our manufacturing business. So I would say in terms of constant currency, Manufacturing has grown at 1.6%. Our pipeline continues to be strong, Sandeep, and again it depends on when specific deals actually land. So I would say that longer term we continue to be optimistic around Manufacturing and you should not read too much about one quarter what happened and so on. We have grown in constant currency terms and we continue to be optimistic, our pipeline continues to be strong. In terms of BFSI, we have had a flattish quarter in terms of constant currency. This was because certain deals that we were expecting to see occur in Q2 slipped by a few weeks. So you should see us bouncing back in the BFSI vertical Q3 onwards. So I continue to be very optimistic about continued growth in the Manufacturing vertical, and certainly, as far as BFSI is concerned, you should see an uptick Q3 onwards.

Sandeep Muthangi: The past couple of quarters was because of client-specific issues only in the BFSI, not in the Manufacturing?

Manoj Chugh: Again in BFSI, as you know, SOFGEN has been a wonderful addition to the family and we are in the process of seeing how we can cross sell and up sell to that customer base which is a very rich and important customer base for us. It obviously does take 2 or 3 quarters to make sure that we can integrate in a seamless fashion and then obviously we see the impact on revenue. So we are at the end of this exercise and you should see a better performance going forward.

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

- Sandeep Shah:** The question is more on the Telecom and Communications. Last quarter, we indicated that there are a couple of large deals which Tech Mahindra has been chasing. So can you update especially in the network management side along with the LCC?
- Manoj Bhat:** Manish, you want to pick that up?
- Manish Vyas:** Yes, sure, absolutely. Sandeep, you are right. We had stated last quarter and I continue to maintain that the large deals across the board in telecom we are working on 4 or 5 very significant size deals, including in the network services space, in fact, the one deal that we were referring to last quarter which we eventually went ahead and closed is the deal in Nordic region, which is one of those deals which clearly exemplify the strategy that we have put together over the years which is investing in multiple pillars, IT network, BPO, infrastructure, security and the stuff, and that exactly is what is constituting as part of the deal with Nordic Communication Services company. Network happens to be more or less close to 50% of our deal. That said overall we continue to have these deals and I am expecting that over the next couple of quarters, we will see some of these deals coming to fruition in the Network Services space and they happen to be across different parts of the world, right from Africa to Europe to Latin America.
- Sandeep Shah:** Vineet's comment about H2 being better than H1. Does that mean that close to a 3% QoQ revenue growth? I am not asking for exact number, but can we maintain in Q3, Q4 with some seasonally better quarters for Comviva as well as LCC going forward?
- Manoj Bhat:** Sandeep, we never put a number there, but suffice it to say I think a couple of things we have said, right -- so one we have said that... and its obvious from Manish's answer that decision-making cycles are taking longer than before and that has been the state for some time. I think if I look at the other factor which is around M&A and their closure which is one of the triggers we have been kind of waiting for I think currently it seems like that is still in the regulatory process, only one of them is just closed I think a month back or so. So that is the second thing. And then we obviously know that furloughs are coming and then we have a seasonally strong business in Comviva which is a vast business. So it is going to be a combination of all four and I do not want to say it is going to be higher than 3%, lower than 3%, we never put a number or guidance like that.
- Sandeep Shah:** Just a clarity on the SG&A. When I look at the sales and support staff, if look at from Q4 it was at 7,636 and Q2 it is 7,065, if we look at SG&A as a percentage to the revenue it has been going up, while the SG&A expense as a percentage to the revenue has gone up by 100 bps in this quarter. So, where is the disconnect and one can expect that the leverage can come going forward?
- Milind Kulkarni:** If I compare to Q4 I do not think there is a difference. If I look from Q1 to Q2 there has been an increase. I think what we anticipate is as the growth comes I think again we will see lowering of SG&A going into Q3, Q4 and I think some of it is investments, and I think these investments as they pay off in terms of increased growth, we will see some of that reduced. So I do not think the cost

increases we are seeing currently are non-headcount-based because the headcount based cost clearly are driven lower by optimizing and looking at all possible avenues of saving.

Sandeep Shah:

On the utilization, if we look at, 77% for IT service, it looks like almost at the peak rates of Tech Mahindra's historic averages, while at the same time, I think for the last two quarters IT Services headcount has been going down. So is it a deliberate effort that we can now break beyond 77%, 78%, and move it further to early 80s?

Manoj Bhat:

So clearly I think one is it's a deliberate effort if we have moved about 5.5% points in two quarters. So if I really look at what we said that what are the levers we have clearly operating efficiency in the form of utilization was a big one and I think that is one we are actually actively pursuing almost on a weekly basis and as I see it with that momentum you could temporarily see it going up further for sure. Now there is a second question there which you have not asked but let me answer is that if I really look at the optimum level we still believe the optimum level is between 77 and 79 and may be the range has gone a bit higher than what we would have thought earlier, but may be if you ask me next quarter it could go up for sure because the momentum is there but then over a longer period of time I think you should think of it as that 77 to 79 range.

Moderator:

Thank you. The next question is from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon:

I have a couple of questions here; one, the year-on-year organic revenue, that seems to be slightly negative, considering about 95 million from LCC, 10 million from Mahindra Engineering, and about 9 million or so from SOFGEN. But you have shown really strong revenue growth in Americas year-on-year. So your weakness seems to be in the rest of the world excluding Australia. I think last quarter this was attributed partly to Comviva, but seems to be persisting even in this quarter. Could you give us a little color on what is happening in the rest of the world?

Manoj Bhat:

So I think you have identified parts of the issue correctly. So I think if I look at the rest of the world the one factor you must adjust for is the cross currency if you will. I think our estimate year-on-year is about 4.5 to 5%, it is an adjustment you have to make for currency. Secondly, I think we have explained in our previous calls that over the last 2-3 quarters, the Communications side of our business has been going through several issues around some of our key customers going through some profile and spending rethink. If you see that that has impacted to a certain extent. So I think between those two, my guess is our organic constant currency growth should be between 5% and 6% broadly and then I would attribute that the next whatever the gap is because some of the Communications revenue over the last 2-3 quarters has not really grown that well.

Ravi Menon:

I am looking at the Tech media and entertainment vertical, Sandeep earlier asked about some color, I think you have given some explanation. But what sort of contracts are we seeing? You said that it really depends on the spending patterns in TME of individual customers. So are you saying that these are more short-term projects and they are not really typical maintenance work?

- Manoj Chugh:** Clearly, the answer is it is always a mix. When you look at many of the tech firms while we have long term rate cuts which we have signed with them, but really many of the projects that come along are work package based and are related to the product engineering deliverables of our customers themselves. So while the contracts for longer term in terms of intent the actual work that is done is in the form of work packages. So as work packages close down newer work packages come in and sometimes our customers kind of manage their budgets differently based on the environment that they are seeing externally. So it is very different from the typical ADMS long-term maintenance kind of work that we do in some of our other verticals like Manufacturing or BFSI or other verticals. So the work is very intense, it is long term commitment that the customer gives but then clearly many times the customer defines the areas and the pace at which we need to work. So really it is the pace that the customer defines which then translates into the kind of growth that we see on a QoQ basis. Again, as we know, Tech customers are greatly governed by what they see in the macroeconomic environment and their perception about the growth of their own business.
- Ravi Menon:** You spoke about Retail probably making a recovery of sorts in the third quarter. Usually, the commentary that I have heard from other players is that Retail goes into pretty much cold lock down for the holiday season. So you do not really see great traction in Retail. Is that the right interpretation or am I missing something here?
- Manoj Chugh:** Yes, actually for us it is the other way around, we see huge traction in the holiday season, particularly around our BPO Business Solutions Group Services that we offer to Retail customers. So this is busy season for them and this has a positive impact on our Retail business and we should see that happening in this quarter as well. Hopefully, people will be spending more this Christmas season than in the last one.
- Moderator:** Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.
- Nitin Padmanabhan:** With regard to LCC, you spoke about \$15 million to \$20 million annual shrinkage. By when should one expect that to happen?
- Manoj Bhat:** So Nitin let me explain the context. So what we have identified is a business which gives us \$15 million to \$20 million every annum as something we want to discontinue, #1. That discontinuation is already implemented to a large extent, 3 million is out of the quarter already, so loosely translated 12 million run rate is out, the balance we expected to go out in Q3 and what we are getting in return is I think the margin has gone up by about 2% point this quarter and we expect further improvement going into Q3 on NCC on the margin front.
- Nitin Padmanabhan:** Q3 is seasonally the strongest for LCC, am I right?
- Manoj Bhat::** Yes, our Q3 is seasonally the strongest for them.

- Nitin Padmanabhan:** This \$12 million going to \$20 million in terms of a cut, that could possibly impact next quarter is what you are saying?
- Manoj Bhat:** The other way to look at it is that 2 million potential run rate hit could be there in Q3.
- Nitin Padmanabhan:** There are some changes in the previous quarter's numbers on cost of revenue and interest costs. I am just trying to understand what was the nature of that change?
- Milind Kulkarni:** There have been some discounts in the nature of finance charges which earlier were treated as discount and now have been regrouped under replace category. So it is early payment discounts, some customers they have been charged.
- Moderator:** Thank you. The next question is from the line of Manik Taneja from Emkay Global. Please go ahead.
- Manik Taneja:** Just wanted to get some sense if you could break out the margin improvement across the different parameters that is for the current quarter? And also if you could give us some sense of how do you see margins over the medium term, and if you could talk about what levers do you see essentially it is helping you as you see wage hikes in Q4.
- Manoj Bhat:** I think Milind alluded to this in the opening statement, Manik, but let me kind of touch upon the key points again. We said currency was positive about 60 basis points, absence of visa cost was about 80 basis points, utilization and other cost levers was about 150 basis points, headwinds were that higher SG&A and I think there was a question on that and I did answer that, that was about 100 basis points, and then transition on some of the large deals was about 30 basis points. I think that is the loose kind of, there might be other items, but these are the significant items.
- Manik Taneja:** If you could talk about how do you see margins more over the medium term. And given the fact that you have already improved utilization, what levers do you see helping you going forward?
- Manoj Bhat:** So I think let me refer back to my answer on utilization. I do believe the momentum will take us up further into Q3 and then we will reassess our comfort in the past has been about 77-78, now we are looking at a range of 77 to 79. So in addition to this I think some of the answers are in my headwinds which I spoke about which was some other transition costs we have on some of these deals. As we go into production I do believe there will be levers created as service delivery starts. If I step back and look at the initiatives we have taken it is about automation, industrialization, yield management; I think those are necessarily longer term levers, it will take two quarters to start and then it should be a continuing thing after that for some time. So on the headwind side, of course, wage hike is coming and currency I do not want to predict because it goes up and down, but really the only headwind I see is wage hike, it would be our endeavor to see if we can partially mitigate the wage hikes also going into Q4.
- Moderator:** Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal:

I have a couple of questions; one, while you have not given the exact organic growth number, although you have given a rough estimate of 5% to 6% organic growth, this year, probably, our organic growth when we complete FY16 will be very minimal. What is your view going forward over next two years -- do you think that inorganic is the only way to grow, or you think our organic business even in constant currency terms has the potential to at least grow at the industry level? Question #2, although you said that the loss of \$15 million to \$20 million revenue in LCC, which is the business which is probably low margin and we do not want to do. So what happens to the consideration which we will have given or whatever consideration has gone behind this deal, what happens to this \$20 million which is going out from the revenue? And also is margin only the compensatory factor on that?

Manoj Bhat:

I think your first question was on organic growth this year and you kind of asked the question is our strategy of growth only inorganic. I just wanted to take this opportunity to remind you about the last 2-years; I think if I look at FY-'14 it was about 12.5% organic growth and FY-'15 was between 14 and 15%. So clearly, our strategy is not around growth through inorganic and I think if I go back 2, 3, 4-years that is clearly reflecting in our numbers. #2 is I think this year as I said there has been a currency impact and there has been slowness in our largest vertical which is Communications, so we are looking at a picture which is clearly... and this is something we have communicated over the last 2-3 quarters is something which we see as a readjustment, we are hoping that readjustment will be over soon and then we should be back on the growth track. I think the other question was about LCC. I think in every acquisition and I can probably count all our acquisitions we would be looking critically at every piece of business, whether it is of economic value or not, and if it is accretive to us and to our shareholders, we will take the right decision. So actually it is value destructive business which we are removing. So I think we are doing the right thing in cutting that out so that whatever is left is at a much healthier margin and provides better return. Did I cover all of your question Sandeep?

Sandeep Agarwal:

No, obviously, one question is left, which is basically a combination of the questions which I wanted to ask and based on your answer. Broadly, what I want to understand, and I know you do not give guidance, and I do not want a guidance, but my broad question remains is that do you see based on our communication weightage of almost 50% of revenue, and our excellent track record in the past, I am not denying that, but based on our heavy weightage in that segment, and we do not know how much more readjustments is pending, do you see at least next year we can do organic growth which is in line with the industry or at least at the low end of industry average and then we can bring in some additional revenue probably some acquisitions which will be in pipeline or something like that? And can we see back as 17%, 18% EBITDA margin next year at least given rupee has also helped us a lot? So do you see that kind of scenario coming back at least in '17?

Manoj Bhat:

So from our perspective, clearly, we are seeing the business as it comes and if I look at our Communications growth. I think it has happened because of two or three things; one is our continuous investment in capabilities; the second is I think it has been on the back of winning large engagement. I think we are in a period where some of the decision-making has been delayed on some of these things

and you heard Manish say that there are four or five which we are pursuing and we will have to see how we close them and when we close them, because if we close them in Q3, Q4, I think next year will look start looking better, if you close them in Q1 and Q2, the deals it will be looking that much weaker. So I think it is a question of timing and we are giving you visibility as we have it, #1. #2, we also said that somewhere probably that as customers look at their budgets and we will have better visibility may be in two or three months about that and each of the customers going through a different cycle; #3, on the Enterprise side I think you heard Manoj, I think the funnel there I think it is more broad-based and growing and I think that is something which we are quite confident of achieving a steady growth, and if you see the last two to three quarters, I think our growth has been ranging between two and three, three-and-a-half percent on an average, and we have had quarters which we were more than that, but broadly, at least two percent is what we have seen on a constant currency basis. I am not answering your question directly because I do not want to put a number, but our goal would have been always to be in the industry average, but we do recognize that we are in a situation where Communications has been weak for some quarters, so driving a large amount of year-on-year growth mathematically on a profile is going to be difficult, with the profile has been declining and flat this year. And margin as I said I think there are levers and we would be looking at some of these levers to go forward. I cannot put a number whether it will be 17% or 18% that is something which as you see each quarter unfold you will see some of the impact of the margin improvements come through.

Sandeep Agarwal: This 3 million which we are saying that we have already got rid in the quarter. So the benefit part of that kicking out of the revenue has also happened in the quarter?

Manoj Bhat: The EBITDA improvement because of that revenue going away, yes, that has happened. So that is what I said our margin has improved by 2% in that business.

Moderator: Thank you. The next question is from the line of Viju George of JP Morgan. Please go ahead.

Viju George I had a question on margins. I know you guys have given the breakdown as to how the margins have behaved in this quarter. If I look at your margin improvement, almost all of it has come from just the INR depreciation and visa costs, which you were expecting anyways, and utilization gains have been offset by transition costs and higher SG&A. You have been talking a lot about wanting to raise the structural margin profile of the company, other avenues like onsite/offshore mix, automation, project efficiencies, etc. How are we to think about how this will play out over the medium to longer-term?

Manoj Bhat: A great question. That is what I was trying to answer that we do realize that utilization as a lever, it has some momentum left, because these levers do take some time to impact in the numbers. So I think we internally at least our view is that should start kicking in from maybe Q3 end, that is the way we are looking at it, and unfortunately I do not have a better answers saying it will impact us 3 basis point in Q4, but that is the trajectory, that is the trend and I think all of us are quite committed in trying to make that happen.

- Moderator:** Thank you. The next question is from the line of Mukul Garg from Societe Generale. Please go ahead.
- Mukul Garg:** You guys have mentioned a number of times that you are looking at four, five large deals and they might be substantial. So if you can give a little bit more clarity on that, what size range are these deals you are looking at? How much of that will be network-related? Will that be dilutive to your margin profile because network deals normally are of lower profitability?
- Manoj Bhat:** First of all I never said substantially large deals, we said large deals. So clearly I think I just wanted to correct that impression if they are giving that impression. Secondly, I think every deal follows its profile that initially it is margin dilutive, we have said this in the past. Maybe I did not get the exact question, what is your question about margin impact or revenue growth or both could you amplify?
- Mukul Garg:** It is regarding both, given that you are looking at four to five deals, which will potentially have both network as well as IT Services component, I just wanted to get a better understanding that whether, on a standalone basis, each deal can provide a boost to your revenue growth, and correlated to that whether it can have a near-term margin impact on the consolidated basis?
- Manoj Bhat:** We have had Comverse, it has come into the revenues this quarter, and we have said there is a transition cost there. So, first is every time we win a deal, I think you will see that in the revenue growth metrics, and as I said it will be margin-dilutive initially, but maybe two or three quarters from now, the Comverse profitability profile will be different. I am just giving that as an example not particularly about Comverse. That is the typical profile of all our deal. So I think when we talked about four or five deals, that is the funnel, and of course there is a success rate in every funnel, and when they convert you will see that in the numbers and typically we would announce some of the major ones well in advance of them coming into revenue, for example, the Comverse deal we are referring to.
- Moderator:** Thank you. The next question is from the line of Sagar Rastogi from Ambit Capital. Please go ahead.
- Sagar Rastogi:** Could you share your strategy around becoming a payment bank as to what is your thinking there when you decided to enter this business, the potential cash infusion that it would require and the timing around that?
- Manoj Bhat:** I will just deal with the cash infusion and how to look at it and we have Jagdish Mitra here who handles Strategy and Growth Factory. So I will ask him to talk about the overall approach, why and how and when kind of questions. From a cash perspective, I think clearly there is an investment of Rs.100 crores which is required, which is mandatory. On top of that we do anticipate that there will be sudden start-up investment and in terms of just making sure that we have the basic operation set up, and at the outside that number is looking like another Rs.100 crores and this will be split between ours and Mahindra Finance... I am just giving you a loose feel number for the moment and I will let Jagdish talk more about why and what is our strategy there.

Jagdish Mitra:

From Payment's Bank perspective, while Manoj talked about the investment, I think one of the key things that we told ourselves is part of our strategy is that I think digital opportunities is not just limited to being Digital IT Services or a solutions provider to our customers, but our opportunity to obviously look and create new businesses and Tech Mahindra has always taken a forefront opportunity in this area, Payment Bank is one of the ones that we fairly publicized because of the way the process ran, but if you look at our history we have done things around EMRI, HMRI, we have done Saral Rozgar, Mobile Money which was a prepaid wallet, there are few things around this which we have always thought Digital allows us to start now creating business opportunity. So from our perspective, Payment Bank is just the right opportunity because a) within the Mahindra Group I think we have all the ingredients that make sure that we can actually take advantage. I am sure you are aware that it is a multibillion dollar payment opportunity in India and therefore we wanted to take advantage of the brand, rural reach, the fact that Mahindra Finance which is our 50–50 partner in this initiative, our own platform on technology with Comviva and our experience with Mobile Money, all of that put together creates the right ingredient for successful business we think. Now, how does it help the rest of the company and what does it do to others? I think two things – one, we are getting more and more closer to the businesses of our customers. I think running a bank and creating a bank with though we primarily will probably be the bigger technology partner and Mahindra Finance will bring in a lot of the domain in running this business, enables us to create and service our banks and customers especially in these markets and emerging markets more successfully because we will understand their operations better. And secondly, the technology change that will be brought in here because of the Payment Bank requirement as you would know that this is not about running a physical structure, a lot of it will be digital, a lot of it will be driven through consumer experience and giving a much more enhanced customer experience to the customer who is currently not used to the enhanced customer experience that will be required to run it as lean and thin as possible. So those technology developments that will bring here will enhance a larger Tech Mahindra to take the solution to the market, and also will enhance our relationship with the schedule commercial banks here because their products and services and those BFSI industry here in India, can work collaboratively with our Payment Bank because as you know the Payment Bank has certain restrictions and therefore we are already in discussions with a lot of our commercial bank partners who will work with us. I hope that answers your question.

Sagar Rastogi:

That was useful color, but you mentioned this is a multi-billion dollar opportunity, and actually that concerns me a bit, because on one hand, we read news reports about how Alibaba-backed Paytm is burning through millions of dollars and you are essentially going to be competing with them. Am I to understand that you have essentially capped your total outgo to Rs.100 crores total contribution from your end, and if it goes beyond that you will basically spin it off or bring in another investor?

Jagdish Mitra

So I think know each company will have its own strategy, so I cannot comment on what Paytm and Alibaba doing in the eCommerce world which is going to be very different than the banking world. So from our perspective, the opportunity lies in defining the right product and services and so our strategy will not be about going big bang and trying to capture every consumer that is worth it,

because this is a very large market and we will go into this market with a very focus strategy and a very specific geography, and once we build it to up to a certain level we will spin it off and attract other investors to come into this entity. So any case, this will be a separate company to start off it which is a JV between Tech Mahindra and Mahindra Finance, and this company up to the certain milestone that we are setting ourselves as threshold will start attracting other investors to be party to it. But again, your comment on what eCommerce companies are doing in India in terms of what Flipkart or Paytm or Amazon, I think that is a very different game than what Payment Bank discusses.

Sagar Rastogi:

Any comments on the pricing environment in your key clients? Is it stable or you mentioned that there was a lot of consolidation happening in your company, is there some pricing pressure coming through?

Manoj Bhat:

That is a big shift from Payment Bank and to pricing. Overall, I think from a pricing environment perspective I do not think there is any unusual push and pressure. I think whatever has been happening for the last two, three to four quarters is the same situation. I think if I look at Communications and Enterprise customers, their behavior I think from that perspective is the same. So pricing is stable, I do not think it is under any extreme pressure, which is not there.

Moderator:

Thank you. The next question is from the line of Rishi Jhunjunwala from Goldman Sachs. Please go ahead.

Rishi Jhunjunwala:

A couple of questions; firstly, on the margin side, just trying to understand, let us try to keep the quarterly movement away and try to see it on a year-on-year basis, right, our utilization rates have improved by 3-4 percentage points, currency has had a 7-8% depreciation. On the flip side, of course, we had 100 bps impact from LCC and we had the wage hike impact which would have been 150-200 bps which kind of sets off, but our margins are actually down 370 basis points year-on-year. So I am just trying to understand as to basically where have the investments gone, how do we look at that in terms of year-on-year movement in the margin, if you can explain a bit on that?

Manoj Bhat:

I think we can do more of a deep-dive, but you mention currency is 8% but are you saying USD, INR or are you taking cross currency into perspective, how are you coming to that?

Rishi Jhunjunwala:

Yes, USD, INR.

Manoj Bhat:

So I think from a cross currency impact, it is a bit mixed, so it does not all translate. I am going to give you some brief view into that; in our perspective it is probably 60 to 100 basis points, I will give you some top off the head numbers; utilization I think if I look at it has been about 1% to 1.5% give or take positive impact, I think probably closer to 1%, but if I really look at acquisition impact or including SOFGEN, etc., it is about between 1% to 1.5%, on top of that we have had the mix which has changed from offshore to onsite, I think that has had some impact, and clearly I think typically if we had gone through a period of revenue growth, we would have been able to absorb more of the wage hike and given what we have said during this call and before, I think that opportunity was not

there. So I think we realize that we might be a big behind because some of the wage hike impact we were not able to absorb without growth. But that to me is the opportunity into the future. I might have missed a factor or two but broadly that explains with at least from my perspective.

Rishi Jhunjunwala: Because on-site mix would have been included in the acquisition-related impact in a way, right, and that is why LCCs lower margin?

Manoj Bhat: I think these are the big factors. I might be off by 20, 25 basis points here or there, but broadly I think this would get us there.

Rishi Jhunjunwala: The other thing is on utilization. Our revenue exposures are quite concentrated with more than 50% in Telecom, and about 17%, 18% now in Manufacturing, so almost 70% coming from two verticals, which I think is unique among large cap companies, we already are more than 100,000 people. I am just trying to understand is there any reason why we cannot operate on a sustainable basis at more than 80% like some of the peers are doing, especially when our concentration is higher, which basically means that fungibility in employee base is better?

Manoj Bhat So clearly as I said I think there is a huge amount of momentum there and I think we would see the numbers going up further, but at this point I do not want to come out and say, we will rebaseline at some point in terms of what is the right utilization and maybe you are right, maybe it is (+80%), but currently, based on whatever we have seen I think we are just increasing our utilization range a bit from where we were, I think you are saying 77, 78% now, probably, we are saying 77-79% and we will keep reviewing that number, and as we go further into this journey, I think we will keep updating you. May be as I said the movement is happening and I think we fully are aware that if there is a more efficient way to operate we should.

Rishi Jhunjunwala: Just trying to get some sense of the breakdown of the \$300 million deal win in terms of Enterprise and Telecom?

Vikas Jadhav: About 60% would be basically from Enterprise side and 40% from Telecom.

Moderator: Thank you. The next question is from the line of Avinash Sharma from Dalal & Broacha. Please go ahead.

Avinash Sharma: Is it possible to just give me the individual revenue numbers for LCC, SOFGEN, and Comviva?

Manoj Bhat I do not think we split it that way.

Avinash Sharma: Is it possible to give annual run rate for LCC and SOFGEN?

Manoj Bhat: Around 450 million.

Avinash Sharma The Rs.174 crores other income which we see this quarter. What is that, sir?

Milind Kulkarni: We had this is TML Benefit Trust. Whatever dividend it receives which has been declared is handed over to the company. So that is about \$9 million.

Moderator: Thank you. I would now like to hand the floor over to Mr. Manoj Bhat for closing comments.

Manoj Bhat: Thank you, all for joining the call and I know there were a lot of questions, may be some of them are unanswered, so please feel free to reach out to Vikas or me directly and we will be happy to answer your questions. Thank you for attending. Good Evening.

Moderator: Thank you very much members of the management. On behalf of Tech Mahindra, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

Note: The above transcript has been edited for better readability