“MphasiS Limited Q1 FY2012 Results Conference Call”

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<u>MphasiS Participants</u>

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Mr. Ganesh Murthy – CFO, MphasiS Limited

Moderator Ladies and gentlemen, good day and welcome to the MphasiS Earnings conference call for the First Quarter ended January 31, 2012. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference call, please signal an operator by pressing "*" followed by"0" on your touchtone telephone. Please note that this conference is being recorded. To start today's proceedings I would like to hand the conference over to Mr. Shiv Muttoo. Thank you and over to you, Sir.

Shiv Muttoo Thank you. Good morning everyone and thank you for joining us on the Q1 FY2012 Results conference call of MphasiS Limited. We have with us today Mr. Ganesh Ayyar – CEO and Mr. Ganesh Murthy – CFO. Before I begin, I would like to state that some of the statements made in today's discussion may be forward-looking in nature and may involve certain risks and uncertainties. A detailed statement in this regard is available on the Q1FY12 Results announcements release that has been emailed to you earlier. This conference call will be archived and the transcript will be made available on the MphasiS corporate web site www.mphasis.com. I now invite Mr. Ganesh Ayyar to begin the proceedings of the call. Thanks.

Ganesh Ayyar Thank you Shiv. Good morning everybody. Thanks for joining the call. We will discuss our operating and financial performance for the first quarter which ended on January 31, 2012. I hope that you have had the time to go through the financial results and overview release that we sent you yesterday.

Traditionally, Q1 tends to be a subdued quarter given the annual holiday shutdown resulting in lower billable hours. Despite this, this quarter was a satisfactory quarter for us with revenues growing by 5.2% sequentially, aided by rupee depreciation which contributed to 4%. Due to our hedging strategy part of this rupee depreciation gain got negated and our revenue, net of hedge grew by 4.1%. The traction in the Direct business continues to be robust growing 14.4% sequentially, led by the Infrastructure business which grew around 49% QoQ. We are confident of sustaining above industry growth rates in our Direct business. In Q1, we have seen significant Direct Business expansion in Mature as well as Emerging markets, growing 10.4% and 27.7% respectively QoQ. It is noteworthy to mention that the HP/Direct channel mix shifted from 62:38 in Q4 FY2011 to 58:42 in Q1 FY2012, which is a significant step towards addressing client concentration risk. We added 28 new clients during the quarter, of which 17 additions were in the Direct business.

Revenues derived from the HP channel remains flat sequentially owing to annual holiday shutdown and ramp down in some projects. On constant currency basis, our sequential revenue from HP ES declined by 3%. We continue to build upon the good foundation we laid in 2011 for business beyond HP ES and accelerate growth in the newer areas within HP. Given the encouraging pipeline, we expect a significant growth in these new areas.

Yesterday, we announced the appointment of the two Non-Executive Directors nominated by HP: Mr. Antonio F. Neri, who is the Senior Vice President and General Manager, HP Technology Services and Mr. Ravichandran V, Vice President of HP's Global Business Services. HP now has five Directors on our Board.

Let me move on to talk a little bit about our profitability. A positive feature of our quarterly performance is the turnaround that we have seen in both our EBITDA and operating profit margin. Our EBITDA margins saw an improvement of 60 basis points this quarter to 18.5%, reversing the trend over the last few quarters. We will look to enhance and sustain our EBITDA margin in our targeted band of 18-21%. Our EBIT margins were at 15% as compared to 14.7% during the previous quarter. Margin expansion can be attributed to proactive planning to curb the impact of annual holiday shutdown, and the cost optimization drive which is yielding results and generating operational efficiencies. Increase in offshore Applications and BPO utilization rates, tight controls on discretionary expenses and intense focus on profitability improvement have been the features of this quarter.

DSO for the quarter remained flat at 88 days. We continue to manage our cash flows well. Cash and cash equivalents increased to Rs. 21,819 million. Gross increase in cash balance during the quarter was around $34 million if you consider nearly $2 million parked in earnest money deposits for some government contracts.

We continue to strengthen our sales and marketing efforts and during this quarter we added 18 personnel in the sales and solutioning team. Our drive in the direction of hyperspecialization will see us launching industry-specific solutions and platforms, and platform-based process as a service in the coming quarter. These initiatives will help us move up the value chain.

Let me give you an example of the success that we had in terms of platform-based process service. We had our first success in the space of hyperspecialization. This quarter we won a deal with Jetstar Australia, a wholly-owned subsidiary of Qantas Group. Jetstar is Australia's leading low fare carrier operating across 17 domestic destinations and 15 overseas destinations. MphasiS will implement "M-Fin" – an end-to-end Accounts Payable Solution for Jetstar, a platform-based BPO approach. The solution looks to facilitate payment processing with reduced human intervention. The solution involves crossed over integration and leveraging our strength in Application Services, Business Process Outsourcing and ITO.

To summarize, I am quite satisfied with the performance this quarter. We are seeing a change in demand dynamics in the industry. We expect discretionary projects to remain under pressure and the sales cycle to be elongated with some customers resorting to vendor consolidation as well. At the same time, I believe there is enough demand to fuel a reasonable growth for the industry through higher level of specialization. As we look ahead to 2012, we believe the transformation journey that we undertook 15 months ago has made us stronger in terms of our value proposition to our customers. Our effort this year would remain on driving profitability by building a higher margin portfolio, tightening spends, improving utilization rates and enhancing value to the customers for better billing rates.

With that once again I thank you and Operator if you could open it up for questions.

Moderator Ladies and gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Vihang Naik from MF Global. Please go ahead.

Vihang Naik First question, can you just break down this margin movement this quarter on currency utilization as well as pricing?

Ganesh Murthy **O**ur EBITDA margins went up by 60 basis points QoQ from 17.9% to 18.5% and out of that if you break it up, the rupee depreciation helped us in getting 40 basis points. So without the rupee depreciation, we improved our EBITDA margin operationally by 20 basis points.

Vihang Naik And this lesser impact of the Rupee on the margins is because of the fact that you take forex losses in revenues, right?

Ganesh Murthy Yes, two reasons. Our sensitivity to the exchange is much lower than other Indian companies, primarily because we adopt a long-term hedging policy and for the first 12 months we cover 70% of our revenues which we net off against the revenue line. And as you are aware, most of our hedges have been taken at around Rs. 48 and odd, and the average rate was significantly higher during the quarter. So that reduced some of our Rupee depreciation gains. The second reason is that about 38% of our revenues are on a Rupee rate card. We have domestic revenue of 11% which is entirely Rupee rate and some portion of the HP business is also on a Rupee rate card which is about 27% of the overall revenues. So 38% of our revenues experience absolutely no impact because of the Rupee depreciation since it is in Rupee rates.

Vihang Naik Secondly, on the billing rates front, your offshoring Applications billing rate showed a slight improvement this quarter. The onsite Application billing rates have been seeing a decline since the last three quarters. So what has moved billing rates this quarter? Is it like-to-like and what is the outlook going forward?

Ganesh Murthy It is like-to-like. If you see, our Application offshore billing rates went up from $20 per hour to $21 per hour and this is sustainable. There is a lot of effort to look at new growth businesses at significantly higher margins, which means significantly higher prices than our existing book of business. So that helps us in improving our overall price realization and we believe this will be a continuing trend in the future. Regarding the onsite billing rate, there has been a development with just one customer because we have a forex clause with that customer and owing to the Rupee depreciation we had to reduce our billing rate, which is why you see the onsite reduction.

Vihang Naik So, this would be a top five customer?

Ganesh Murthy Yes, but not HP.

Vihang Naik So essentially, if next quarter we have an equivalent sharp appreciation the rates would increase with this customer at least?

Ganesh Murthy Yes, there is a threshold. I cannot get into details of that but there is a particular threshold for any exchange rate movement. This is one of very few contracts that we have where we have an exchange rate clause in the contract.

Vihang Naik The last question is on your offshore Application headcount which has seen a significant drop of about 7% QoQ. Is this because of the ramp down; was it planned or is it because of the attrition, and what is the outlook on the headcount going ahead?

Ganesh Murthy There is a conscious attempt to keep the headcount at lower levels so as to push up the utilization. If you see both our BPO utilization and our Apps offshore utilization have increased and this has been a continuing trend. It has even increased in the last quarter and it is a conscious attempt to really control the headcount. Also, bear in mind that over the last two quarters we have had 1,300 college hires getting into the system and during Q1 and Q2 they will be put into various billable projects. So we need to make sure that we control the headcount situation very carefully.

Vihang Naik Have you deferred any campus offers?

Ganesh Murthy No, we have not deferred any college hire offers and this is the first time we are hiring college hires in such large quantities. This will help us to optimize our cost structure.

Moderator Thank you. The next question is from the line of Divya Nagarajan from UBS India. Please go ahead.

Divya Nagarajan Just following up to the question on headcount, I notice that while ITO Services we have indeed had a drop in utilization rates, utilization in Applications Services has been quite healthy which is where you had a significant drop in headcount. Should I read this as some sign of slowing revenue growth/volume growth in the next couple of quarters?

Ganesh Murthy No, I do not think you should read it in that manner. We are going to hire only based on our demand environment. You would have noticed that our Direct channel has grown significantly. Even in dollar terms, it has grown by 8.8% QoQ which is quite encouraging and I believe that will be higher than peers in the industry. However, we faced a decline in the HP Enterprise Services, about a 3% volume drop in dollar terms QoQ and because of this we have adjusted the headcount making sure that we improve the utilization.

Divya Nagarajan So essentially we are looking at further declines in HP continuing?

Ganesh Murthy It is difficult to say at this point of time because there is a big dependency on HP Enterprise Services. In this quarter there was a seasonality factor also built in. The decline in HP channel was 3%, 1% of which was because of the annual shutdown that HP had, which is a seasonal factor which will not recur during the year, but the balance 2% is a permanent decline. There is a large amount of dependency based on HP Enterprise Services worldwide results. If you look at their results, I do not think they have performed reasonably well in terms of QoQ growth. In fact, I think their figures show a decline QoQ and that actually has a rub off effect on us.

Divya Nagarajan So just to recap, in the last few quarters, we have seen HP go from a flattish kind of revenue to slight declines every quarter. When do you think that trend will stabilize and you will probably go back to a stable kind of trajectory here?

Ganesh Murthy It is very important to relate that to the HP Enterprise Services growth. So, if they grow then I could anticipate that we will also grow in tandem. That is only relating to HP Enterprise Services but in non-Enterprise Services, we have a very healthy pipeline and order book. This quarter we have been impacted because of the shutdown because most of the work that we do is internally to HP and since HP is closed for about 10 days we had that kind of a billing loss. But from the next quarter onwards, we are anticipating significant growth in the non-Enterprise Services segment.

Moderator Thank you. The next question is from the line of Pratik Mehta from Bajaj Allianz Life Insurance. Please go ahead.

Pratik Mehta If I heard you correctly, you mentioned that the impact on revenue is due to less number of working days at HP was 1%. If I remember correctly, last year in the Jan quarter the impact on the revenue due to lower working days was close to 3.5%- 4%. So can you just clarify why lesser impact this quarter compared to last year?

Ganesh Murthy I think it all depends on the number of days where HP has been shut. I think same time last year it was shut for 11-12 days. I think this year they have been shut for a lower number of days, so that is essentially the reason. Also, if you look at our overall volume of revenue with HP Enterprise Services, it has in itself come down significantly.

Pratik Mehta This shutdown in HP impacts just 10-12% of the revenue which is HP as a client or that impacts the overall 58-60% of the revenue that we get from HP as a channel?

Ganesh Murthy It impacts the entire revenue, i.e. 1% on the total revenue. There are also some customers of HP who are US based customers, having shutdown and so there is an impact beyond internal HP work.

Moderator Thank you. The next question is from the line of Hitesh Jhaveri from Birla Sun Life Insurance. Please go ahead.

Hitesh Jhaveri Could you throw some color with regards to your business in the top half of Fortune 500, especially in North America in terms of kind of engagements that you have with them, quality of relationship, Direct versus through HP?

Ganesh Ayyar We are engaged with many of the Fortune 500 companies for the last few years. If you take Banking and Capital Market, we have a mix of services ranging from Applications to Business Process and that business remains robust and we continue to grow. With regards to your question on how we work with HP ES or what is our go-to-market strategy as Direct, the point is that when we are open to doing Direct as well as HP ES, our sales force is divided into two parts: one part is entirely responsible for the Direct business and another part of our sales force is working with HP ES. The numbers of deals that we have completed are few because what has happened is customers have become more sophisticated and knowledgeable. They are literally having separate swim lanes, one meant for the so-called global giant, the other meant for the offshore players. So as a result there are many times when we clash and our job is to ensure that we remain ahead of others in the offshore game, whereas HP has its own go-to market which is focused on ensuring that they are ahead of their strategic peer group. Let me add one more point. Clearly, I am seeing in the market discretionary budgets are under pressure. But at the same time because we have gone for hyperspecialization, what we have worked for over the last 15 months, the type of projects that we are engaged in are projects which are highly focused on customers' business and customer's customer. The newer business model that we are introducing where we are doing platform-based BPO, the example being Jetstar, that also helps us to buck the trend. So that is kind of the mix that we are seeing in the marketplace.

Hitesh Jhaveri So, out of the ~40 odd $5 million customers that you have around two-thirds of them are through the HP channel. How many of them would be aimed at inside of Fortune 500 and what has been the trend in scaling those businesses up for you?

Ganesh Ayyar This is a longish conversation. I will provide some data to you as to the distribution between Fortune 500 and others; may not be able to answer that question on this call.

Hitesh Jhaveri One last question from my side is with regard to your fixed price contracts at around 11-12% of the revenue, would you want to see that number going up in the future?

Ganesh Ayyar I think before we talk about the pricing model you need to think about what kind of solutions we are bringing to the market and increasingly we want to bring solutions which have an element of BPO, an element of APPS, and an element of IP - maybe our IP or our partners IP, presented in a holistic manner, and in many cases having a variable cost model. The objective is not to shift from Time and Material to Fixed Price. The objective is to become a business partner and as a result of that you will see the shift happening because whether it is Fixed Price or Time and Material or transaction-based, it is your ability to execute your projects effectively and efficiently which results in better profits. The model per se can be harmful or beneficial. So you cannot conclude one model is better than the other.

Moderator Thank you. The next question is from the line of Nitin Mohta from Macquarie. Please go ahead.

Nitin Mohta The question I had was on the 17 new deal wins that you have in the Emerging segment, if you can elaborate a little more on the nature of these deals, service offerings that you are doing and possibly if the deal sizes can be disclosed?

Ganesh Ayyar In the Emerging segments, we have had substantial success with Infrastructure Services and we are involved in different types of projects. The deal size has ranged anywhere between $20 million total contract value to $50 million total contract value. Of course, there are smaller deals at the lower end of the segment where you have $200,000 to $500,000 projects as well. And our goal is to have a deal which can be replicated and I am happy to share that many of the deals that we have won are based on the replication model. We have been successful in one area and we are just replicating in other areas because that is how you bring greater value to customers and higher profitability to shareholders. We are involved in infrastructural projects which are fairly large in nature across multiple State governments. We are also involved with financial institutions to roll out some interesting models into rural banking, which will be based on financial inclusion and transaction-based pricing. So the solution set that we are working on is highly specific to Emerging markets and scalable and replicable. That has been our success story in the Emerging space.

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

Pinku Pappan I just wanted a follow-up on your comment that you are having a lot of solutions catered to the government. My question is in the future do you see your DSO days turning up because of your high increasing share towards government projects?

Ganesh Ayyar Today, the percentage of business in the context of overall Direct business is still small and it is true that when we deal with a Government the DSO does go up. I do not foresee that having a significant impact in the near future as far as our Direct business is concerned in terms of DSO days. That is a typical model especially when you are dealing with the Government, i.e. your DSO tends to be higher. So far, we have kept it under check; as you can see our DSO days have been flattish and in the Direct space it is also kind of flattish and we will continue to track that very carefully.

Pinku Pappan You made a comment that you are seeing new business at significantly higher prices. I remember earlier you were saying that your Direct business you were getting the same margins as your HP business. Can you just elaborate what has changed and what are the kinds of services that you are seeing significantly higher prices?

Ganesh Ayyar The type of solutions that we are working on in the Emerging space as I mentioned earlier, are highly replicable. So when we execute the first project, your margins will be lower, when you execute the second one, it tends to go up. So that is one area which we are focused on. Second area that we are focused on is combining our strength in BPO, APPS and Platform to bring a differentiated value proposition. We actually cracked this deal with Jetstar in the last quarter and it is based on execution we wanted to go to the market. So in the project, we have reached a critical milestone and done it successfully. That has helped us and we talked about it today. Similarly, we are going to be having a platform-based service introduced in the vertical area as well. That is the second thing which we are doing. Now, the third area which we are focused on is sales discipline. We are ensuring that we do not do deals below certain margins and that is the discipline that we have inculcated in our entire organization, cutting across both sales and delivery organization and that discipline is auguring well for us. Hence our participation rate in low margin deals has gone down, which is good, and participation in high margin deals have gone up. The new logos that we are securing are clearly at a much higher margin than what we have been doing before.

Pinku Pappan So may I assume that contrary to the past your Direct business margins are going to move higher than your HP business margin?

Ganesh Ayyar The question is not whether we are going to move higher than HP business margins, the point is that as we move ahead, our margin situation in the Direct space and in new logos will continue to improve and that is in line with our commitment to all of you and to the market as a whole, that our focus is profitability improvement. We have shared the band within which we want to operate and we will stay focused on improving our profitability.

Pinku Pappan My last question is could you share the quantum of revenues in dollars in the HP non-ES side?

Ganesh Murthy It is around $11 million in this quarter.

Pinku Pappan What was the last quarter?

Ganesh Murthy Last quarter it was around $12 million.

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

Dipen Shah Just wanted a book-keeping answer, what was the volume growth from HP and the non-HP channels in this quarter?

Ganesh Murthy In dollar terms Direct channel grew by 8.8% QoQ while the HP channel in dollar terms, declined by 4% QoQ.

Dipen Shah But what would be the volume growth?

Ganesh Murthy This has been the volume growth or the negative growth after taking out the rupee depreciation impact.

Dipen Shah Yes, but there will be the impact of the realizations in the dollar revenue?

Ganesh Murthy No, realization in dollar revenue will not be looked at in the revenue line, that goes into the forex line which is below operating profit.

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

Sandeep Shah Can you give us the update in terms of the outstanding hedges and what would be the strike rate for the next three quarters of FY12?

Ganesh Murthy For outstanding hedges, the details have been provided already in our MD&A. The strike rate for the next 2-3 quarters for these hedges which were taken nearly a year ago, I would anticipate would be around Rs. 48.

Sandeep Shah Sir, because Ganesh Ayyar's comment was this year is a focus on profitability. So if you look at rupee at 49-50, this loss from hedges may continue in the revenue line. We are running a tight bench despite Time and Material contracts and on the SG&A also with more and more growth coming out of the Direct channel there may not be headroom to actually pull out levers out of these. So what would be the levers where we are saying that margins may sustain or improve going forward?

Ganesh Murthy There are number of cost initiatives that we have started. Some of them we have already mentioned, like for instance on the US medical insurance, we renegotiated the medical insurance which started effective from January this year. So only one month impact has been seen in our quarter and going forward you will see the full impact of that. This is just one example.

Sandeep Shah Can you quantify that benefit of medical for one-month?

Ganesh Murthy One month would be around something like about Rs. 2 crores.

Sandeep Shah Which is a saving?

Ganesh Murthy Which is a saving and there are numerous other initiatives. One of our major initiatives is the reduction in our overall headcount to improve our utilization. As a result of that we have a lot of vacant seats which we have given up and are in the process of reducing our footprint there. As we speak, till yesterday we have closed down around 1,450 seats across three cities in India and all this is going to be a significant saving in our rental cost.

Ganesh Ayyar The other aspect which I wanted to highlight, while you have highlighted all the parameters which are on productivity or cost-based; when you talk about margin improvement, you need to focus on two areas, one is clearly cost and productivity and the other one is quality of revenue and profits at which you are doing the deal. In the previous question I was answering the point that we have these three things which we are focused on to improve the quality of revenue and profitability. Both of these put together forms our foundation for improving overall profitability in time to come.

Sandeep Shah Sir, even when we talk about the quality of revenue in the Emerging markets, I believe that there was some hardware purchase related revenues also. So if we strip out that the growth is lower by 2% to 3%. So my question is within the emerging markets, what is the kind of growth we are foreseeing and in what region the growth is coming out?

Ganesh Ayyar If you look at the Emerging sequential growth and the Direct base, we grew almost 28%-29%. So that was a fairly robust growth and the business which you are referring to is much smaller compared to the numbers that we are talking about. Our pipeline continues to be strong in this space and we are expecting robust growth in time to come, especially in Infrastructure Services business for Emerging markets.

Sandeep Shah Okay and within the Emerging market, which markets are driving this growth?

Ganesh Ayyar Today our predominant growth came from India and right now we are working on a couple of other countries. The next country that we are focused on is Sri Lanka and then we want to start driving some business in Indonesia, so these are the three countries that we are focused on as far as Emerging markets are concerned.

Sandeep Shah Okay and Sir, just to repeat you said you have 17 new deals which have been signed in the Emerging markets?

Ganesh Murthy Overall 17 new deals are in the Direct channel.

Sandeep Shah Okay and last question can you share the attrition in the different towers?

Ganesh Murthy Our APPS attrition is around 19% and our ITO attrition is around 22%.

Sandeep Shah Sir, any color in terms of the wage inflation this year? Will it be similar to last year?

Ganesh Murthy It's difficult to answer at this point of time. Our wage increments are applicable from May onwards and we are still in the month of March so we haven't yet taken any decision.

Moderator Thank you. The next question is from the line of Dipesh Mehta from SBI Cap Securities. Please go ahead.

Dipesh Mehta ICT segment margin has declined this quarter. Just want to understand Asia-Pacific and ICT is growing at a good growth momentum, so what is driving the growth and what we expect going forward? The second question is about HP non-ES, you mentioned in your conversation it is largely because of HP internal, so as we expect HP non-ES to grow faster, do we expect client concentration to increase from HP? And last question, what was our realized average exchange rate for the quarter?

Ganesh Murthy So let me take it one by one. In our Information, Technology & Communication segment, the margins slightly declined, there is only a 1.3% decline quarter-on-quarter primarily because of the furlough. Major portion of our HP business is booked under that, especially the internal HP business, and that was impacted by the shutdown. So the entire shutdown impact would flow down to the bottom-line.

Dipesh Mehta APAC and ICT is growing very well, so what is the primary driver and what we expect?

Ganesh Murthy On HP non- ES, we still expect a growth because, as I mentioned, the order book is looking very promising. We have signed off rate cards at a premium with one particular section of the business and we have started receiving orders in respect of the three areas or the four areas of the business we are engaged in. We expect somewhere upwards of $75 million during this year coming from the non-ES business.

Dipesh Mehta Non-ES you have said is largely internal, so do you expect the HP concentration to increase?

Ganesh Murthy No, when I said largely internal I was talking about Q1, but the growth that we are going to see in the HP non-ES area will be largely external.

Dipesh Mehta And what was our realized exchange rate?

Ganesh Murthy We do not have a realized exchange rate, we do not publish that. What I said is that in our MD&A we have given details of what is our USD growth because the problem is in our company we have 11% domestic revenue which is denominated in rupees, and also we have 27% of billing to HP which is in the Indian rupee rate card. So because of that we do not derive a dollar rate. But as I mentioned our overall revenue growth before the hedge grew at 5.2% QoQ and out of this 5.2%, 4% was because of the rupee depreciation. So our volume growth in dollar terms grew by 1.2%.

Dipesh Mehta Because we are hedging you said around next 12 months we hedge around 70%. But let us say for a quarter when we say Q2, how much we are hedged?

Ganesh Murthy We are hedged at 70%.

Dipesh Mehta Is it almost similar for the next four quarters?

Ganesh Murthy Yes, we follow a very consistent hedging policy. We do not make any change. So it is 70% rigorously, a monthly rolling hedge, so every month we make sure that it is at 70%.

Dipesh Mehta Okay, why am I asking is because our hedged position is declined QoQ and if it is a similar position then we expect that kind of a decline?

Ganesh Murthy The only reason that we have reduced this is based on our forecast and the RBI has come out very strictly on over-hedging. So at any particular point of time if you are over-hedged there is a huge problem for the company, both from RBI regulations as well as the debit to the P&L because the OCI that we carry has now turned into a debit balance. So we need to be very careful in monitoring the hedge and making sure that it never crosses a 100% and we never have a case of over-hedging.

Moderator Thank you. The next question is from the line of Vibha Salvi from Anvil shares. Please go ahead.

Vibha Salvi One question on basically towers, is it possible to give the revenue breakup across applications as in ITO and BPO for this quarter?

Ganesh Murthy Actually it is given there in our MD&A. If you look at it on page 10 of our MD&A, we have Service-wise revenues and if you look at Applications, there is Applications Maintenance and Applications Development. If you look at BPO, it is Knowledge Process and Transaction Process and if you look at ITO it is a Customer Service Desk, and Infrastructure Management Services. So you have the data already, you just have to add it up together and arrive at it.

Vibha Salvi Just wanted to get views on buyback plans. What would be the tentative timeline if at all?

Ganesh Ayyar Every quarter our Board meets and looks at our cash strategy and in the cash strategy we are focused on two areas, one is acquisition and the other one is potential buyback. Right now the fact is if we are formally taking it up, we will have to inform the Exchange two days prior to taking it up. At this point of time we are focused on improving utilization. This quarter we have looked at our cash strategy and we decided we want to focus on seeing whether we can do some inorganic acquisition which is going to accelerate our strategic plans and that is where we stand; next quarter again we will look at the cash strategy and the situation whether we have a strong pipeline for acquisition or whether we have effected some of those acquisitions and make a choice. To summarize, we have not announced any share buyback this quarter and this discussion will happen in the next quarter's Board meeting.

Moderator Thank you. The next question is from the line of Sangam Iyer from AlfAccurate Advisors. Please go ahead.

Sangam Iyer Thanks for the opportunity. I just wanted to understand the HP channel business that we have seen de-growing continuously, where do you look at it stabilizing going forward say by this financial year ending October 2012? And number two, would be on the HP non-Enterprise Services business I remember last quarter you had indicated that we are expecting around $100 million from that segment and now we are looking at around $75 million, could you elaborate a bit more as to what changed and how do we see the opportunity on that front going forward?

Ganesh Murthy So let me take the second question first. We had envisaged about $90 to $100 million of revenue from the HP non-Enterprise Services segment. Our order book still continues to be very good and looks very promising. It is just that the entire scenario has shifted by one quarter so now the revised projections are somewhere between $75 million to $80 million from the HP non-ES portion. It is just that there seems to be a bit of delay in the revenue generation and in clocking the revenue but otherwise we are fairly well set in our overall goal. The first question was on the HP ES - when do we see a growth or when do we see a stable kind of revenue from HP Enterprise Services? As I mentioned, there is a lot of dependency on HP Enterprise Services worldwide. If they grow, then there would be rub-off effect and if they are actually losing market share or if they are declining in terms of revenue then there will be a rub-off effect on us. So it is very difficult to give you any guidance. We are working jointly with HP to do our best to make sure that we have a stable business in this area.

Sangam Iyer I was just going through the results that came out on 22nd of February wherein they have indicated the margin decline in the Services segment and they also mentioned something about restructuring in the Services segment going on. I just wanted to understand how much further pain on the margin front because it is a big part of our total business and would still continue to be so, since we have seen a six-monthly kind of a pricing negotiation with HP going on. So how is it post-December and how should one be looking at it going forward?

Ganesh Murthy So far as our pricing is concerned with HP, we have not had any price reduction or in fact any price negotiation. At this point of time there is nothing going on with HP regarding pricing. We anticipate pricing to be stable or in line with the industry pricing.

Sangam Iyer Okay and in terms of volumes. I mean, when they indicated restructuring, do we see increased volumes for us or do we see that it is a matter between HP India and MphasiS, who in HP takes the call on it?

Ganesh Murthy There is a complete dependency on their revenue growth, and if they grow, and they win new projects or are able to renew existing projects then we will see a rub-off effect.

Sangam Iyer And Sir, finally last two questions will be on 1,450 seats that were closed down, was there in any particular vertical like BPO or Applications Services, could you just give some clarity on that?

Ganesh Murthy This is not BPO; this is mainly in Application Services and ITO.

Sangam Iyer Okay but already we are running a tight seat at around 80%+ kind of utilization in these segments, almost 70% to 80%?

Ganesh Murthy Correct.

Sangam Iyer So considering the ramp ups of the new deals etc that have come in, wouldn't this be a tight stretch for us? Or do we see that 80-81% is a kind of comfortable level of utilization that we are looking at and would be a stable level going forward?

Ganesh Murthy I think at 80% there is still scope. If you really look at it and you compare the other big players in this industry, many of them run at about 81-82% utilization. So I think at 80% excluding trainees there is still scope for a 100 basis points improvement.

Sangam Iyer Okay and Sir finally, any outlook on margins that you would want to share?

Ganesh Murthy There has been one significant factor on the margin front. We have over the last two quarters progressively reversed the trend of declining margins that we had over the last few quarters, and are now showing a margin uptick, and this is also in line with our commitment to our shareholders that we will focus on a profitable growth. In this quarter itself, even if you remove the rupee depreciation impact, our EBITDA margins improved by 20 basis points QoQ, and the full impact of many of the initiatives that we have started off will be realized in the following quarters, especially the 1,300 freshers who will be put into billable positions. So we are aiming for a QoQ growth in the margins and we aim to have our EBITDA margins somewhere between the 18-21% range.

Moderator Thank you. The next question is from the line of Pratish Krishnan from Bank of America Merrill Lynch. Please go ahead.

Pratish Krishnan I'm not pretty clear in terms of the HP Enterprise side where you mentioned that there is dependency on them. I believe the HP will have its own strategy in terms of the Enterprise side. How does the MphasiS management kind of align with the strategy or is it something that you have in mind to completely delink it?

Ganesh Ayyar Clearly if you want to succeed with any customer, you need to focus on aligning yourself to their strategy that is how you are able to translate your services or your offerings to the advantage of your customer. So clearly, that is the work that we do every quarter. What gets published once a year or so is a big strategy, but it is the details etc., that we focus on and that is what we continue doing on ES. But at the same time what Ganesh Murthy was highlighting earlier, the decline is a combination of factors; one of the factors that is resulting in decline is based on their own growth. If they grow we will have a greater chance of growing, when they don't grow, we run the risk of decline.

Pratish Krishnan Do they consult you or is there a role that MphasiS plays there from the overall strategy there?

Ganesh Ayyar I think to say that they consult us for their strategy would be a huge thing to say.

Pratish Krishnan No, in terms of the joint go to the market and things like that, from a sales point of view?

Ganesh Ayyar What happens is joint go-to-market discussions take place literally in larger countries at the field level where we do joint workshops, look at the pipeline and look at where they are winning or not winning, look at the strength that we are bringing and see how we can align our sales force and go-to-market strategy to succeed. That doesn't happen at the corporate headquarter level, it happens at the regional level, country level, between different service lines. That's what we have been doing consistently and depending on their ability to grow, we will see the growth in that sense but if they don't grow, the chances of our growth is very little.

Pratish Krishnan And I believe HP on the call mentioned that they are kind of getting a lower pricing for the deal renewals. Is there any chance or have they come back to you for a renegotiation on the pricing side or do you anticipate any cuts in pricing going forward?

Ganesh Ayyar That was what Ganesh Murthy alluded to earlier, that there was no discussion of any pricing cut. We didn't extend any pricing cut.

Ganesh Murthy And they did not come back to us also for any pricing cut. As we have demonstrated over the last 5 quarters, we are pretty firm that any price changes will be industry-led and depending upon how the industry pricing works out.

Pratish Krishnan And just lastly in terms of the number for the open positions, can you just give us the numbers for the Apps and the ITO side?

Ganesh Murthy We have not computed the open positions; we will work it out and let you know.

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

Sandeep Shah Yes Sir, I had an earlier chat with you but just wanted more clarity, if you actually exclude the tax reversal then the tax rate for this quarter is 30%, you expect this to come down to 24%. The question is why a 30% sudden increase in this quarter and how do we expect this to reduce to 24% in the coming quarter?

Ganesh Murthy This reversal was primarily because of certain favorable cases that we won, so we reversed it. To answer your question, some of our strategies are obviously to grow in the SEZ areas and there are also some of our foreign subsidiaries which are currently incurring tax losses; we are not able to take an advantage of that as a deferred tax credit because we follow the accounting principle of virtual certainty and now we are working on how to turn them around and to make sure that they generate profits. With that, these are tax losses that we can actually take advantage of. We are committed to make sure that our tax rates remain at around 24% in the next two or three quarters at least.

Moderator Thank you. The last question is from the line of Hardik Shah from KR Choksey. Please go ahead.

Hardik Shah In the HP non-ES space, you have mentioned that we are targeting $75 to $80 million. Considering the current quarter it is $11 million, so on an average quarterly run rate it will be around $22 to $23 million for the rest of the year. Will we see this from Q2 onwards or will it gradually increase?

Ganesh Murthy No it is not like this. Let me explain to you how this works. This is a new business. This is not related to the existing business. First of all, in this quarter our revenue growth was muted because of the shutdown that HP had which is a seasonal factor and it happens every year. We have worked out partnership agreements; we are now a worldwide partner for Technology Consulting, for their Printing division and also with their Networking. There is a very healthy order book and pipeline and we need to start converting that into actual revenues.

Hardik Shah So on an average, we can expect 50-60% quarterly growth rate in the next three quarters?

Ganesh Murthy It may not happen in exactly one quarter, i.e. 50%, but over the year we anticipate to grow and generate revenue of about $75-80 million.

Hardik Shah In case of Direct channel, was there any one-time revenue or pass-through revenue and can you quantify that?

Ganesh Murthy Nothing significant

Hardik Shah In the cost of revenue, the others component has increased drastically, any particular reason for that?

Ganesh Murthy Yes, these were certain tax provisions that we made for Service tax.

Moderator Thank you. Ladies and gentlemen, due to time constraints that was the last question. I would now like to hand the conference over to the Management for closing comments. Please go ahead, Sir.

Ganesh Ayyar Thank you. I would like to thank all of you for the interest that you have shown and am delighted you could join in the call. We are certainly open to any discussion that you would like to have and look forward to working with you and getting together again at the end of the next quarter. Thank you very much.

Moderator Thank you. Ladies and gentlemen, on behalf of MphasiS, that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.