



“MphasiS Q2 FY11 Earnings Conference Call”

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**MODERATORS: MR. GANESH AYYAR– GROUP CEO, MPHASIS.
MR. GANESH MURTHY – GROUP CFO, MPHASIS.
MR. MANIK TANEJA – SENIOR RESEARCH ANALYST,
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- Moderator** Ladies and gentlemen, good day and welcome to the Q2 FY11 Results Conference Call of Mphasis Limited hosted by Emkay Global Financial Services. We have with us today Mr. Ganesh Ayyar, Chief Executive Officer and Mr. Ganesh Murthy, Chief Financial Officer. 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. If you should need assistance during this conference call, please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would like to hand the conference over to Mr. Manik Taneja, Senior Research Analyst at Emkay Global. Thank you and over to you Sir.
- Manik Taneja** Good morning, thank you for joining us today. We would like to welcome the Management of Mphasis Limited and thank them for giving us this opportunity to host this call. I would now like to hand over the call to Mr. Ayyar, over to you Sir.
- Ganesh Ayyar** Thank you very much, Manik. Good morning to everybody, thanks for joining the call today. Let me begin by taking you through revised MD&A. Hopefully all of you would have received it. This was developed based on the feedback that we received from you in the last quarter. We have re-formatted it and we have added more information too. Towards the end, after the call, we will like to receive your feedback on this and if we have to enhance it further we certainly would like to do that as well. On that note let me take you through the highlights of our financial performance and link it to our strategy and talk a little about the future as well.
- I would like to start by touching on four facets of our strategy. First part of our strategy was direct channel growth, so I will talk about it a little bit. Second strategy was in two parts, one was HP Enterprise Services, and the other one was growth beyond HP Enterprise Services. Third part is select industry verticals that we were focused on and I will comment on emerging markets as well. On that note, let me take you to the numbers. Consolidated revenue for Quarter ended 30th April 2011 was ₹ 1,257.1 crores which is \$281.5 million, an increase of 1.9% compared to ₹ 1,233.5 crores in the previous quarter. In dollar terms, the increase in the revenue was 3.9%. Operating and net margins for the Quarter ended 30th April 2011 was 16.5% and 17.3% respectively. EPS for the quarter was ₹ 10.35.
- Let me move on to comment on the same numbers on a year-on-year basis. Mphasis consolidated revenue grew by 3.0% to ₹ 1,257.1 crores for the quarter, compared to ₹ 1,220.5 crores in the corresponding Quarter in the previous year. In dollar terms the revenue grew by 4%, from \$ 270.7 million to \$ 281.5 million. Operating profit was ₹ 206.9 crores/ \$ 46.3 million compared to ₹ 274.8 crores / \$ 60.9 million reported for the same period a year ago. Let me add a little bit of colour to the financials. Direct channel revenue witnesses significant sequential growth of 8.6%. This is first time that we are witnessing this kind of sequential growth and in dollar terms it was 10.7% to be precise. With this high-growth in Direct channels, the ratio between HP and Direct channel business changed to 33% coming from direct business. Prior Quarter it was 31%, so the ratio has now become 33:67. We added 17 new clients in the Direct

channel out of the 30 new clients that we added. So in other words, 13 were added in HP and 17 in Direct.

A quick comment on Emerging Markets and India. Our business in Emerging Markets was pretty good. Our India business particularly did well. On a sequential basis, our Emerging Market grew 24%. Quick comment on business from HP let me divide it into two parts. Let me comment on HP Enterprise Services where we have significant amount of business. Q2 it predominantly remained stable, in actual number terms it actually had a marginal decline of 0.4% compared to prior quarter. Our revenues from outside ES within HP saw a sequential growth of 13.2%. I am happy to report that the focus that we are putting in building our partnership outside ES is all set in one large deal that we have won together with our Professional Services Organization of HP. Obviously we have lot of opportunities and work to do, to see how we can tap on to the potential outside of Enterprise Services.

Let me move on to vertical performance. During the last quarter I had mentioned that we are focusing on select verticals; Banking & Capital Market is the first vertical and Insurance is the second vertical. Both these verticals have shown good sequential growth of 7.5% and 6.9% respectively in Rupee terms. We are clearly building talent, solution expertise in these two verticals and also building partner ecosystem to ensure that we have clearly differentiated value proposition in this space.

A comment on share of wallet. With the amount of focus that we have put in, the investment we had made around our sales force competency and solutioning, the number of clients above \$ 10 million annualized revenue has increased from 22 in the prior quarter to 25 this quarter. Quick comment on operational excellence. As you would see in the MD&A our utilization has increased by 4% in Offshore Applications Services and 5% in Offshore ITO services. DSO was down from 94 to 89 days so that is an improvement of five days.

Comment on billing rates. Average price realization has increased during the quarter in both Application Services and ITO Services. This increase in average billing rate has been achieved through an improved mix of resources. No changes were seen in billing rates to HP business in Q2. Cash position: we continue to generate cash at a healthy rate. During the quarter, cash flow from operations was ₹ 255 crores / \$55 million. We exited the quarter with ₹ 1,864 crores or approximately \$ 422 million in cash against \$ 389 million at the end of last quarter.

A quick comment on acquisition strategy because this is often discussed. Our strategy remains the same; we continue to focus on acquiring strong companies which add value to our strategy and to our capability in the verticals or Emerging Markets. This is obviously, furthering and accelerating our strategy.

Comment on human resources: we added net head count of 680 during the quarter, growing the head count to 41,739 as on 30th April 2011. I am very happy to share with you that the attrition rate has started coming down.

Some comments on salary increment: as far as our annual increment cycle, eligible employees will receive salary increments starting from May 1st. We have adopted a market benchmark approach for increment using external agencies to ensure that we stay in line with the market and ensure that talent retention remains a priority for us, so that we can enhance value to our customers which results in growth and improvement of share of wallet.

In summary I would like to conclude by sharing with you that our direct strategy is working and we are on course in terms of growing our revenue and numbers reflect our direct strategy. Business from HP ES in Q2 remained stable with a marginal decline of 0.4%. This is the business which has remained stable to negative in the last two quarters, Q1 and Q2. We continue to explore business opportunities and expand our offering beyond HP ES. Currently we have a good win with Professional Services Organization; tremendous focus is being put to ensure that we tap on to that potential. Emerging market business did well, particularly our business in India; we won some reasonable and significant deals in India. As far as operational excellence, is concerned we are very focused and are ensuring that our utilization and DSO are on track. Cash positions remain strong, enabling us to make important choices, especially on M&A. On that note, once again I want to thank you for your support, your focus and I want to hand this back to the moderator so we can take your questions. Over to you.

Moderator

Thank you very much. The first question is from Anand Bhaskaran from Spark Capital. Please go ahead.

Anand Bhaskaran

Just want to understand, we have seen provision write-back now for two quarters in a row. Just wanted to know if there's any indication whether we could see some more in the future?

Ganesh Murthy

This sort of provisions reversal is a normal process for any company. There are certain provisions which are created on an estimate basis at the end of the quarter and future developments indicate that the provision is excess or less, and then the true-up is done in the following quarter. What we have done in Mphasis, is from the last quarter we have increased the transparency to our shareholders and investors and we have started reporting that as an item separately in the notes to the accounts. That is why you are seeing that as an additional item. However, if you really look at it on an overall basis, you will see that even though there are certain accruals that have been reversed, there are also certain one-time expenses that have hit the P&L and on an overall basis our EBIT margin will be roughly the same. If you discount the one-time expenses as well as the accruals and the Forex due to Rupee appreciation, you will notice that the EBIT margin is slightly better on a normalized basis than what we have reported.

Anand Bhaskaran

Just quantify the one-time expense that was there during the quarter?

Ganesh Murthy

One-time expenses details are provided in our MD&A. We had a claim from a customer that we have accrued which is about ₹ 80 million. There are certain fixed price project expense provisions that we have created for ₹ 156 million and there is one acquisition or a large deal activity. The expense that we incurred in respect of this activity was ₹ 30 million.

- Anand Bhaskaran** In terms of direct channel strategy we have seen strong client addition. Just want to know what is your geography and vertical spreads of the same?
- Ganesh Murthy** The geography is both in India in Emerging Markets as well as in the US. These are the two geographies where we have witnessed significant direct channel growth. It is a mix of volumes driven by new clients as well as our existing clients. Our existing clients have also given us more revenues and what is significant is that 17 customers have been added in this quarter and this will actually help us get the door open for these customers.
- Anand Bhaskaran** Sure, thank you.
- Moderator** Thank you. The next question is from Vihang Naik from MF Global, please go ahead.
- Vihang Naik** My first question is that this rise in the offshore billing rates that we have seen. Could you just give us a colour, how has this resulted?
- Ganesh Murthy** On the offshore billing rates, if you see both Application Services as well as the ITO billing rates have increased from \$19 per hour to an average of about \$20 an hour. This is a mix of two factors, the major factor that has influenced the increase in realizations is the improved mix of resources that we have used. Second factor that is impacting it is that the new customers and the new business that we have achieved are at slightly higher rates.
- Vihang Naik** So a large portion of this, around 5% rise in billing rates could be because of better growth in direct channels?
- Ganesh Murthy** It is that plus improved mix. I think the major factor is improved mix of the resources.
- Vihang Naik** Right. I just missed the one-offs, could you just quantify if it is possible?
- Ganesh Murthy** The total one-offs / one-time expenses is ₹ 266 million and that is broken up into a claim from a customer for ₹ 80 million. Then we had certain fixed price projects provisioning of ₹ 156 million and certain expenses related to a large deal activity amounting to ₹ 30 million. There is also a forex impact. The total forex impact that is impacting EBIT margins and gross margins is ₹ 293 million because of Rupee appreciation.
- Vihang Naik** Okay. So when you have given the normalized operating margins at around 18.3% in your financial overview. It is adjusting for the Forex as well as all of the one- offs, is it?
- Ganesh Ayyar** It is only adjusting for the forex. We have not adjusted the one-offs as such.
- Vihang Naik** Okay fine will come back for follow-up later. Thanks.
- Moderator** Thank you. The next question is from Shrishti Anand from Angel Broking. Please go ahead.

- Shrishti Anand** My question pertains to margin only, if I adjust for all the one-offs in terms of expenses as well as the reversals, so this particular quarter I am lining up with the EBITDA margin probably at 16.5% and gross margins around 26.0%. If you compare with any other peers, it is on the lower side at the gross margin level. What are the levers that you are looking at to kind of take it upwards?
- Ganesh Murthy** There are two big levers that we are looking at, one is of course utilization and as you have noticed we have already worked hard on it and the utilization has significantly improved by 4% in Application services offshore and 5% in ITO services. The other lever that we are looking at is, we aim to keep our sales expenses as well as our G&A under tight control, so there is a significant amount of leverage that will be able to obtain from these two areas.
- Shrishti Anand** Are you trying to say that in terms of the absolute leverage probably for S&M at 65 and G&A at 55, it would contribute probably 9% of your revenue which is again on the lower side as compared to your peers? So you'll be able to sustain this kind of an absolute level even if the growth is coming through?
- Ganesh Murthy** Yes, we will be able to. Let me explain the reason why it appears to you that our selling expenses are on the lower side. That is not actually the case because 70% of our business is coming from HP channel. A large portion of that is migration work and rate card driven work or internal work in HP for which we do not need any sales; we have very little sales effort that is required. So what we have done over the last six months is we have reallocated the sales force, assigned a larger number of sales resources on the direct channel and lowered the number of sales resources in the HP channel. In that way with the same amount of expenses we have been able to have more feet on the street so far as the direct channel is concerned. So we think we are on the right track and we do not envisage any higher sales expenses.
- Shrishti Anand** You mentioned about the wage hikes that is due in this quarter, so what is the quantum of wage hikes you are looking at?
- Ganesh Murthy** We have taken a wage hike of roughly between 10 to 12% on the offshore employees and on the onsite employees we are looking at an average of 3% wage hike. This will have an impact of around 2.5% on our gross margin.
- Shrishti Anand** And just few bookkeeping questions, what is the CapEx you are expecting for this year?
- Ganesh Murthy** Not very significant CapEx because we do not envisage any purchase of any real estate or anything like that. The CapEx will be basically in respect to our fitouts for facilities that we are signing up on lease. Last quarter we have signed up for three new SEZs, one in Pune, one in Chennai and one in Bangalore. So it will be in that direction.
- Shrishti Anand** What will be the maintenance CapEx, if you could give that figure?

- Ganesh Murthy** CapEx in second half of this financial year is likely to be around ₹ 500 million.
- Shrishti Anand** And also one thing that you mentioned that attrition is going down, so if you can just put a number to that?
- Ganesh Murthy** The attrition has gone down. If you look at the last 12 months attrition, we are down from 29% in APPS offshore to 27% in this quarter. Similarly in the ITO from 26% we are now at 25%.
- Shrishti Anand** Just one more question, in terms of the investments, you did mention that you invested into these FMP's which mature every six months, so what kind of yields we can look at?
- Ganesh Murthy** That was in the previous quarter. I do not know if you are aware, but in Q1 as well as in our Q2, the interest on fixed maturity plans shot up, so we were getting a return of around 7% on our liquid mutual funds and interest on FMP's shot up to around 9 to 10%. So what we did is in Q1 we invested a significant portion of our surplus cash in fixed maturity plans for 90 days and we were able to realize a huge upside because of this interest rate differential. Now the interest rate has more or less stabilized and we are looking at around an average of around 6.5% pre tax.
- Shrishti Anand** That's it from my side. Thanks.
- Moderator** Thank you. The next question is from Pratish Krishnan from Bank of America Merrill Lynch. Please go ahead.
- Pratish Krishnan** This is on the infra-management business, any reasons for the sharp margin fall in the quarter, in terms of gross margin levels?
- Ganesh Murthy** Actually Pratish we have explained that in our MD&A. If you see, in the last quarter we had shown a one-time reversal of certain provisions that was amounting to ₹ 130 million which pertained to ITO business. In this quarter I had mentioned about the one-time cost on certain fixed priced provisioning and that is ₹ 110 million. So if you really net it out, there is an accrual reversal in the last quarter and a one-time expense in this quarter. So it is sort of double impact. On a normalized basis, the gross margin for Q2 would be 33%.
- Pratish Krishnan** So what is the steady level that one should look at, in terms of the gross margin levels?
- Ganesh Murthy** I would say, 30 to 33%.
- Pratish Krishnan** And in terms of the open billable position if we can get the numbers for the three segments?
- Ganesh Murthy** The open positions for Applications are around 1,000 and for ITO it is around 600. So totally around 1,600 open positions.
- Pratish Krishnan** I believe that this would be flattish, on a sequential basis?

Ganesh Murthy It has come down from the previous quarter. That is again linked to utilization, so if you see, our APPS head count went down slightly because we implemented a freeze on the APPS head count and that was the only way we could ensure that we maintain an increased utilization.

Pratish Krishnan Lastly the terms of the cash use, you had articulated an acquisition strategy, any update on that?

Ganesh Murthy I will give you some initial comments and I will ask Ganesh Ayyar to add on to that. Our acquisition strategy remains as focused as before. We are looking at focused acquisitions in the banking capital market space or in the insurance space; good companies which have a lot of IP or domain expertise in these two industry verticals. We are looking at sort of midsized acquisitions because one of our primary imperatives is to ensure that our EPS is not diluted and there is a good cultural fit. So all those M&A strategies remain very consistent to what we have stated earlier. In Q2 we were on the final stages of one particular acquisition but unfortunately due to the various reasons including that the valuation became slightly excessive and beyond what we felt was the right price, we declined to pursue it any further. We have other acquisitions in the pipeline and we are hopeful that some of them will close probably in Q3 or Q4. Ganesh, would you like to add something?

Ganesh Ayyar Ganesh Murthy has elaborated the plan. That is key part of our cash utilizations strategy and we are quite focused on that. I have a dedicated team which is looking into it.

Anand Bhaskaran Fine thanks.

Moderator Thank you. The next question is from Vimal Gohil from Asit C Mehta, please go ahead.

Vimal Gohil Sir, I would like you to comment something on the number of working days in all the three towers because last quarter your number of working days had gone down because of holiday issues. So what has been the number of working days in all the three towers this quarter?

Ganesh Murthy No major changes in respect of the working days.

Vimal Gohil The HP business is not really picking up since the past two quarters. So can we have a time frame as to when the HP business will pick up or possibly what can be done to revive the HP business going forward?

Ganesh Ayyar Thanks for the question and that is probably the key element of our strategy. So if you really look at it, our HP business gets divided into two parts. First part as HP Enterprise Services where we use them as a partner, where our concentration is almost like, if you take away HP as a customer, almost 95% of our business comes from there. Now that business in the last two quarters have seen decline with a little bit of decline in 1st Quarter and little bit of stability in 2nd Quarter and at this point of time that part of a business remains challenged. As a strategy what we did six months ago is to change the way we were investing our sales resources, our solutioning resources. And literally our sale cost, (and Ganesh Murthy alluded that to you

earlier) is divided roughly with 30% focused on HP side and 70% focused on outside HP. So the growth of direct and the growth outside of ES is a key part of our focus. At this point of time, I cannot predict how HP ES will behave and when it will gain the momentum of growth for our standard. First two quarters did not give any indication that it has dropped.

Vimal Gohil

Thank you, I will come back with further queries.

Moderator

Thank you, the next question is from Madhu Babu from Systematic, please go ahead.

Madhu Babu

Sir, could you talk about the nature of deals we are pursuing in Emerging Markets, Direct channel?

Ganesh Ayyar

In emerging markets our focus is to play at the intersection of Infrastructure, BPO and APPS because majority of the customers in emerging markets are dealing with their ability to cope with the market growth of revenue. Our pipeline is very strong in these spaces of Infrastructure and BPO.

Madhu Babu

Sir, how would it impact the margins, our focus is on direct channel, on emerging markets. How would the EBITDA margins be, going forward?

Ganesh Ayyar

I cannot predict the EBITDA margin per say, but fundamentally our focus is on the normalized basis to operate in this zone that we are operating in our Q2 number. And we are not focusing on business which is going to significantly dilute our EBITDA and at the same time even in M&A, which you heard, Ganesh Murthy was mentioning, when we are looking at it, we are not focused on acquiring a company which is either EPS diluted or fundamentally results in a EBITDA dilution as well.

Madhu Babu

Sir, our sales guys, they are like vertical driven organization or service line organization?

Ganesh Ayyar

In the Mature Market, our focus is to be based on vertical. So they are either Banking Capital Market sales person or they are Insurance sales person or they are Emerging Industries sales person; and they carry the target for all three lines of businesses. However, there is a specialized sales force which is focused on Infrastructure Services as well because it is bought as a horizontal by many customers. So that is it on the Mature Market. In Emerging Market they are geo based and once again it is not service line driven, it is customer focused so they carry all three lines of businesses APPS, BPO and Infrastructure. Once again we have a specialized sales force which backs them up with the Infrastructure Services.

Madhu Babu

Are these acquisition targets onsite companies or what is the kind of EBITDA margin of these target companies that you are looking?

- Ganesh Ayyar** As I mentioned, our focus is not to do business which is going to dilute significantly our EBITDA or dilute our EPS. Currently in our pipeline we have a combination of opportunities which are either offshore and onsite combined and some of them are onsite specialized as well.
- Madhu Babu** And lastly what is the tax effective tax rate going forward, effective tax rate?
- Ganesh Murthy** Effective tax rate is 24% going forward. If you look at Q2, for two months the effective tax rate was over 11.5% and for the month of April we had an effective tax rate of 24%, so a weighted average of around 15.3%. But moving forward it will be over 24%. We are striving to channel all our new growth and new export customers into SEZ's. But that will take place over a period of time. Obviously we cannot shift existing business into SEZs.
- Madhu Babu** Thanks a lot.
- Moderator** The next question is from the line of Sandeep Shah from RBS Equities. Please go ahead.
- Sandeep Shah** On the APPS business wanted to understand, if you look at the employee decline it is less than 1%. But the utilization increase is sharp even the billing rates like flattish-to-a positive basis, if you look at overall revenue growth it has declined. It is not being matching across metrics?
- Ganesh Murthy** The overall revenue growth decline as you say is primarily because of ForEx. So if you look at it, it was 1.9% because of the ForEx impact.
- Sandeep Shah** Okay, because even in dollar terms if we look at, what we report separately without the hedging, it seems in dollar terms also there is a decline of 1% excluding the hedging game.
- Ganesh Murthy** No, that is not right. In dollar terms our Application Services revenues grew by 0.4%.
- Sandeep Shah** Including hedging reserve or excluding hedging reserve?
- Ganesh Murthy** Excluding hedging reserve.
- Sandeep Shah** Okay, even in the ITO this time the growth has been much better in double digits. But ITO used to be generally business coming largely from HP channel. So what has driven this growth?
- Ganesh Murthy** The growth is in respect of two channels, both HP and Direct Channel. HP had won one major contract with a multinational company and we have started ramping up and delivering for that. We also had very significant growth from the acquisitions we did one year ago i.e. Fortify Infrastructure Services and that is doing remarkably well and we are experiencing double-digit growth in terms of revenue in that acquisition which is reflected in the ITO revenue.
- Sandeep Shah** But still for this quarter more than 90% of the ITO business would be through HP channels?
- Ganesh Murthy** Yes, I would say so.

- Sandeep Shah** Okay. Is there a six-monthly cycle on the rate renegotiation with the HP? Do you expect this to happen with the flattish scenario in the coming quarters or there could be some up-and-down going forward?
- Ganesh Murthy** There is no such thing as six monthly cycle; our MSA expires in October 2012. And there is a rate card in the MSA but HP periodically comes asking us for rate reductions and we plan to handle them as per what the market is seeing. So our entire approach to any rate reduction for HP will be based upon what the rates are in the market for the industry.
- Sandeep Shah** For the last two quarters there has not been any renegotiation with HP, right?
- Ganesh Ayyar** No, rate reduction that has been extended because some contracts came to an end got renewed on a different basis. Fundamentally you are right, there was no rate reduction given per se. Talking about the practice, the point is, either party can initiate a discussion on rate and sometimes it is possible for us to initiate the rate negotiation as well. Nothing prevents us from doing that.
- Sandeep Shah** Okay, you also commented that within the sales and marketing strength there is some re-jig from HP channel into the non-HP, is it like on a medium-to-longer term basis we expect that the growth opportunity with an HP enterprise services is unlikely to come back or turn around?
- Ganesh Ayyar** I expect on short-term basis that our growth triggers will be direct and outside ES.
- Sandeep Shah** Okay thanks.
- Moderator** Thank you. The next question is from the line of Shikha Jalan from Smifs Securities. Please go ahead.
- Shikha Jalan** This is regarding the top-line, I understand margins will be taking care as in when we leverage our SG&A. What are exactly growth levers going forward in terms of top-line because we see a kind of flattish growth quarter-on-quarter and YoY also, triggering from HP and non-HP as well?
- Ganesh Ayyar** So the growth as I said, we re-jigged the entire sales force six months ago, where we have divided it into three parts. Part one focus on HP-ES where we have fairly small investments. Second is outside ES, and third is investment into Direct Channel. Obviously, within the direct space we have focused on two verticals, Banking Capital Market and Insurance. In terms of the third area, our focus is on Emerging Geo, I clearly expect that will be a growth trigger for us. At the same time because our footprint is very small outside ES, I am fairly hopeful in time to come we will begin to see reasonable growth rate outside ES.
- Shikha Jalan** Are we increasing any sales force or initiatives towards Direct Channel growth?

- Ganesh Ayyar** That is what we have done. As I have mentioned, six months ago we had made significant investments in that change and you will see the results.
- Shikha Jalan** That means that we can foresee a double-digit growth going forward?
- Ganesh Ayyar** I will refrain from commenting on double-digit growth or whatever but if you really look at Q2 we had a sequential growth of 8.6% in Rupee terms and 10.7% in Dollar terms from Direct Channel and that will remain our focus. Obviously if you look at it from a sequential growth perspective 8.6% is way above the market rate but significantly our growth trigger will continue to be Direct and outside HPES.
- Shikha Jalan** Okay, thanks a lot for the answers and all the best for the future.
- Moderator** Thank you. The next question is from the line of Dhananjay Mishra from Sushil Financials. Please go ahead.
- Dhananjay Mishra** My first question is with regard to volume. What was the overall growth in volume in this quarter?
- Ganesh Murthy** Overall growth in volume was 2.6%. Let me give you the full breakup. In Rupee terms, we had 1.9% overall growth in revenues, out of that volume was 2.6%. Because of the mix and the price it was 1.8% contribution to the revenue growth. And ForEx had an adverse impact of 2.5%. So as you can see both the volume as well as the mix, we are significantly positive but a large portion of that was wiped out because of the Rupee appreciation.
- Dhananjay Mishra** Okay, my next question pertains to HP business, given a flat guidance for their business, so how do you see our business shaping up. Do you see any impact because of their guidance on our business?
- Ganesh Murthy** Still too premature to say. HP is a pretty large company and we do not know exactly how the impact of their flat guidance will impact us. What we are doing is, as Mr. Ganesh Ayyar mentioned, we are looking at how to grow the direct business and how to grow beyond HP Enterprise Services, so this remains to be our focus.
- Dhananjay Mishra** And during the last quarter one of our participants had suggested whether we could continue to provide guidance like HP is doing, so have we taken any decision on that front?
- Ganesh Ayyar** Thanks for asking that question. As I mentioned, I tabled it in my board meeting. At this point of time, we had extensive discussions about how we can provide disclosure. We took your feedback and had this discussion, so you see the results of that in our MD&A in our entire approach to the investor community and to the analyst community. But fundamentally regarding going towards forward guidance, we are not going to follow the practice of forward guidance at this point in time.

- Dhananjay Mishra** At least we could give some outlook on margin front because we have seen a continuous decline in the margins for the last 3 to 4 quarters, if you see the normalized margins taking out provisions; we have seen 250 basis point decline in margins. Going forward, given the next quarter will have rate revision, whether we could hold the margin what we have achieved in this quarter?
- Ganesh Murthy** In case of margins, there are additional impacts like the foreign exchange Rupee appreciation and so forth, which are really outside our control, so it is very difficult to give an accurate prediction about the margins but our aim and intention is to retain an EBIT margin between 15 to 18%.
- Dhananjay Mishra** Okay, thanks a lot.
- Moderator** Thank you. The next question is from Yogesh Agarwal from HSBC. Please go ahead.
- Yogesh Agarwal** Couple of questions. One, Ganesh can you throw some light on what is the kind of work you are doing with HP outside Enterprise Services the one where you are seeing good traction right now?
- Ganesh Ayyar** So let me share with you the opportunities or areas which we could potentially focus on as Mphasis and what we are doing. Let me talk about services business beyond Enterprise Services that they have. They have something called Technology Services business and off the top of my head, their run-rate per annum basis is roughly \$10 billion and then you have a Professional Services Organization business which is part of HP Software and they specialize in providing implementation, consulting services around HP's Software offering. HP Software is world leading software today in the space of management and testing and all of the above. So they provide those services. So from services standpoint these are the two areas where we could bring our expertise and the work with them and see how we can enhance their ability to win and serve their clientele. So that is one area of focus. There are services opportunities in the product side as well, the world is changing dramatically, devices are becoming far more intelligent and as a result we have the ability to participate in a specialized sense with the product side as well. The whole area of taking profit, reconstructing current process, which exists in the private world taking in to cloud and ensuring that the smarter clients are linked to the cloud that gives us an opportunity. So these are some of the areas that we are focused on. Our first major win came through in partnership with Professional Services Organization. Well it is just one win. I do not want to call it a major victory at this point of time. But in time to come, that is where our focus is going to be outside Enterprise Services.
- Yogesh Agarwal** Right, isn't Technology Services mostly warranty, support, etc., which is mostly onsite work or is it larger pie which we are not aware of?
- Ganesh Ayyar** Their biggest pie happens to be the Maintenance Support type of services. But they also have Technology Linked Services which are closer to Infrastructure side and people call it Infra-App applications side or Infra-Apps type of services. And that is where we are working with them in

productizing certain services and then working with them to deliver that through a combination of onsite and offshore.

Yogesh Agarwal Okay and secondly, all the provisions this quarter, will they start to accrue again for all the write backs which we took or we can model the cost on the current run-rate especially the manpower costs?

Ganesh Murthy You can model the cost on the current run-rate; you just have to take the one-time costs also into account, so totally we had ₹ 266 million of one-time costs. So you need to factor that in.

Yogesh Agarwal But that is in IMS, but provision write backs is gone so you do not need to make more provisions going forward is it?

Ganesh Murthy That is right.

Yogesh Agarwal Lastly, there have been a lot of one-offs lately; understandably your size is not very small now compared to many other smaller IT companies in India. Is it because the business model is changing or the kind of projects that you are taking are asking for more one-offs or is it more internal restructuring which might settle down going forward or is it going to be recurring affair, just trying to understand the origin of these one-offs?

Ganesh Murthy One-offs are sort of a common feature in the IT industry and there are various fixed price projects and certain fixed price projects do not go too well, then you will have to accrue for the future cost if you estimate that the cost for delivery and completion is higher than what you had originally estimated. This is part of the accounting policy that we follow and we have to accrue for those costs. There are also certain cases where delivery does not go too well, there is a claim by the customers and we have to make good those claims. What you are seeing is increased level of disclosures on the part of Mphasis, so right now for the last two quarters we have been very clear and we want to present a very transparent and high level of disclosures. That is why you will see these notes to the accounts.

Ganesh Ayyar Let me add a couple of things. This is a reflection of what actually happens in the market. At the same time we have also started an initiative to see how on one hand we can increase disclosure and in times to come you will see that what we want to do while ensuring that we are absolutely compliant with law and accounting standards, we want to see how we can smoothen the curve so that you do not see the impact on the financials on quarter-by-quarter basis. We have formed a small team to look into all these transactions and see what practices we can improve internally, so that you do not see this more. So those are the two actions that we have taken, first action has already taken as you can see based on the details of disclosures. Second action depending on what we get this team to recommend after which we will see smoothing of curves.

Yogesh Agarwal Great. Thanks a lot gentlemen.

- Moderator** Thank you. The next question is from the line of Rahul Jain from Dolat Securities. Please go ahead.
- Rahul Jain** My question is if you can help me on what all constitutes for the Emerging Industries because if I look at the segmental reporting format, this is one area where we have lost big time on profit and even the growth is quite flat?
- Ganesh Murthy** Emerging Industries is all the other industries other than Banking and Capital Market, Insurance, Information Technology, Communication and Entertainment. So for us what will be in this is Healthcare, Manufacturing, Logistics, Transportation, Retail, and Government.
- Rahul Jain** And what is the status of the business because if we look at the segmental profit on a YoY basis we have lost a significant amount of money there in terms of profit. So what is the status right now and what is the outlook going forward?
- Ganesh Murthy** In this quarter, as we have mentioned, there was a claim from a customer and this customer happens to be part of the Emerging Industries. So we had this claim from the customer which is still under negotiation but on a conservative basis we made an accrual for ₹ 80 million. That is why you see a decline in the profit as compared to the previous quarter.
- Rahul Jain** But I am talking from a YoY perspective, where the total profit is just ₹ 99 crores as compared to ₹ 160 crores on the corresponding period, there is a difference of ₹ 61 crores?
- Ganesh Murthy** That is on account of certain ramp downs that have happened. In a high-value business that happened in the earlier quarter which are no longer available with us.
- Rahul Jain** And that will remain the status going forward as well?
- Ganesh Murthy** I would say the status once you normalize this claim which was a little unusual, should be the status going forward.
- Rahul Jain** Okay, and if you can tell what is the status of various incubation efforts which were discussed and the possible timeline for us to start monetizing the same?
- Ganesh Ayyar** The incubation that we focused on was Product Engineering Services and Payment Solutions. We club all this together and we call it "New Ventures". Let me just give you a sequential growth rate on New Ventures. It is roughly around 12% of sequential growth that we are seeing. But here this will be a bit more of a mid-term investment and I do not expect short-term results. We are seeing a significant traction in two areas; one is the Payment Solution area where we have a healthy pipeline. Second is the area of Product Engineering Services, so in time to come we believe that this will be a fairly viable business for us.

- Ganesh Murthy** Just to add to that, we have approved an investment plan in the Product Engineering Services and this will involve developments of various frameworks and various labs and solutions for customers. The total investment is roughly in the region of \$4 million that will be spread across a couple of years.
- Rahul Jain** And how do we expect it to monetize, will it be on pay-per-use kind of a model?
- Ganesh Ayyar** If you are talking about our business models with the customers, it would be a combination. It could range from time and material, fixed price, to outcome-based, so all of the above models will be available. The idea is to develop a set of frameworks which can become reusable frameworks which literally becomes our IP, so we are able to do these projects faster and that would be our enhanced value proposition to our potential clients.
- Rahul Jain** And have you put up a number in terms of absolute target for this New Venture?
- Ganesh Murthy** Absolutely, when we approve the investment plan, we have a target, as well as a margin target for the investment and of course, as you are aware, we need to give sufficient time for the business to grow and we will be tracking this very carefully on a quarterly basis.
- Rahul Jain** Actually my question was the current revenue from this New Venture?
- Ganesh Murthy** New Ventures is a combination of current revenue and also new revenues that will arise as a result of the investment. So there are targets for both.
- Rahul Jain** Okay that is it from my side. Thanks.
- Moderator** Thank you. The next question is from the line of Sagar Rastogi from Credit Suisse. Please go ahead.
- Sagar Rastogi** My understanding was that HP had asked you for some more pricing cuts and that you would have started negotiations sometime earlier this month, could you confirm if my understanding is correct?
- Ganesh Murthy** There have been negotiations between HP and us which are ongoing. And probably these negotiations will be concluded maybe in a couple of months' time. We have also made certain requests to HP as we had mentioned last time and we had requested for some details and changes to the rate card.
- Sagar Rastogi** Okay, the second question is, could you talk about outlook on pricing for the non-HP channel, going forward?
- Ganesh Murthy** Pricing is going to remain stable, maybe with a slight uptick in some cases.
- Sagar Rastogi** Okay thanks.

- Moderator** Thank you. The next question is from the line of Pinku Pappan from Nomura Securities. Please go ahead.
- Pinku Pappan** Just two quick questions. You mentioned that you are getting new customers at higher rate, just wanted to talk for this, this new customer from the direct channel or is it the HP channel?
- Ganesh Murthy** New customers in the direct channel because HP channel we go by their rate card. And there are no changes to the HP rate card in Q2.
- Pinku Pappan** And secondly, what is OCI gain on your hedge books?
- Ganesh Murthy** The hedge position, we have provided the full details in the MD&A but just to summarize....
- Pinku Pappan** No, asking the OCI gain?
- Ganesh Murthy** The OCI gain is ₹ 277 million.
- Pinku Pappan** Okay, thank you.
- Moderator** Thank you. The next question is from Omkar Hatkar from Edelweiss Securities. Please go ahead.
- Ganesh Duvere** Hi, this is Ganesh Duvere. I want some thought by the management of utilized cash for either a share buyback or paying out dividend, so any update on what the board thought of this and is there a possibility of that happening in future?
- Ganesh Murthy** So the board has been considering uses of cash. They have been looking at all the four uses of cash, they have looked at special dividend, they looked at share buyback, and they looked at certain specific acquisitions and also certain Real Estate acquisitions. Ultimately I think currently this narrowed down between two items, which is a share buyback as well as an acquisition. As we already mentioned we are looking at suitable acquisitions in the BCM and Insurance space and if we are successful then our cash will be effectively utilized.
- Ganesh Duvere** Okay, but any on the buyback consideration?
- Ganesh Murthy** There is no update that I can tell you, the matter has been deliberated by the board but no decision has been taken at this point of time.
- Ganesh Duvere** Thanks.
- Moderator** Thank you. The next question is from Saurabh Kumar, an Individual Investor. Please go ahead.
- Saurabh Kumar** My question is on the gross margins in ITO business. You see that the gross margins in the APPS and BPO have increased, while in ITO it has declined by 800 basis points. Just wanted to understand the reason behind that?

- Ganesh Murthy** We had already given the reasons but anyway the reasons are also very clearly given in our MD&A. So the last quarter there was a reversal of accrual of ₹ 130 million and in this quarter.....
- Saurabh Kumar** On ITO business that is what....
- Ganesh Ayyar** If you look at Page #2 of our MD&A, it is right at the bottom under our Tower Results. It is the details of this; the reasons for the reduction have been given.
- Saurabh Kumar** Okay. Thank you.
- Moderator** Thank you. The next question is from Bimal Bosmia, an Individual Investor. Please go ahead.
- Bimal Bosmia** I would like to know when HP is going to buyback Mphasis, because the current management has failed to deliver the share holder value, shares prices keep going down and down.
- Ganesh Murthy** That is a question which you should ask HP.
- Bimal Bosmia** What is the management action to improve the shareholders value if HP is not going to do any buyback?
- Ganesh Murthy** If HP is going to do a buyback or not is a matter for HP to decide, we have already told you the actions that we are taking to improve shareholder value.
- Bimal Bosmia** But it is not being reflected. The market does not trust the current management.
- Ganesh Ayyar** Okay, thanks for the question and feedback.
- Moderator** Thank you. Ladies and gentlemen that was the last question. I would now like to hand over the floor back to Mr. Manik Taneja for closing comments.
- Manik Taneja** Thank you everyone. On behalf of Emkay, I would once again like to thank you all for joining this conference call. Have a great day.
- Management** Thank you.
- Moderator** Thank you. On the half of Emkay Global Financial Services that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.