"MphasiS Q4 FY2011 Earnings Conference Call"

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MphasiS Management Participants

Mr. Ganesh Ayyar, CEO

Mr. Ganesh Murthy, CFO

Mr. Shiv Muttoo

Good morning everyone and thank you for joining us on the Q4 FY2011 and the full year FY2011 results conference call of MphasiS Limited.

We have with us today Mr. Ganesh Ayyar, CEO, and Mr. Ganesh Murthy, CFO.

Before we 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 some risks and uncertainties. Detail statement in this regard is available on the Q4 2011 results announcement release which has been emailed to you earlier. This conference call will be archived and the transcript will be made available on MphasiS' corporate web site www.mphasis.com.

I now invite Mr. Ganesh Ayyar to begin the proceedings of the call.

Mr. Ganesh Ayyar:

Thank you, Shiv. Good morning everybody. Thank you for joining us on this conference call to discuss our operating and financial performance for the fourth quarter and full year which ended on October 31, 2011. I hope that you had a bit of time to go through the financial results and the financial overview release that we sent you yesterday.

To begin, I am very pleased to inform you that the Board of MphasiS has recommended a dividend of Rs. 6.50 per share for FY11. This represents a 63% increase over the dividend declared for the previous year, and is in line with the Board's commitment to share our profits with our shareholders.

On that note, let me go on to our performance. Q4 was a satisfactory quarter. We have started seeing the results from the journey of our transformation initiated a year back. Revenues from Direct channel saw quarter on quarter growth of 18.9% in Q4, 14.3% came through organic and rest of it came through our acquisition of Wyde which contributed to 4.6%. As you know, this acquisition got completed on 29th of August 2011.

Direct channel revenue crossed Rs. 500 crore or the Rs. 5 billion mark for the fourth quarter, expanding significantly by 16.5% and 27.9% respectively in Mature and Emerging markets. The HP to Direct channel mix moved from 67:33 to 62:38 in just one quarter. In the past, our attention in the HP space was more focused on HP Enterprise Services (HPES) business. While consolidating our relationship with HPES which actually is about 20% of overall revenue of HP's universe, we have endeavored to expand our presence beyond HPES. During the fourth quarter revenue from the business outside Enterprise Services with HP saw an intense traction to grow sequentially at 24.9%. Our engagement now extends into many new areas with HP such as Imaging and Printing group, Networking, Technology Consulting, providing good platform for us to grow in the coming quarters and year. Overall, revenue derived from HP channel excluding one time revenue realization in Q3, and impact of rupee depreciation remains flat sequentially and HP pricing remains stable. Here I would like to clarify that as communicated to all of you in the last quarter, Q3 has seen a deferment of revenue recognition on contracted services that have been rendered but revenues not recognized due to unavailability of purchase order. Such deferment is not a one time event but part of the normal billing process that gets repeated every quarter. In this quarter also we have similar amount of deferment of revenue recognition in the HP channel.

Following the recent announcement of the Q4 results, HP continues to build its reputation in the market and we continue to work with them to see how we can add value and focus on opportunities not only with ES but also, as I mentioned, with Imaging and Printing Group, Technology Consulting, and Professional Services Organization of HP.

Our strategy of being 'inch-wide and mile-deep' has enabled us to create greater domain expertise and leadership in specific verticals like Banking and Capital Markets (BCM) and Insurance. During Q4, Banking and Capital Markets vertical revenue grew sequentially by 7.4% and Insurance vertical revenue grew by 21.6%. The acquisition of Wyde contributed 16.4% to the Insurance vertical revenue growth. We added 4 BCM clients and 2 Insurance clients during the quarter. Further we are seeing success in the Emerging Industries vertical incubated a year ago which grew 6.2% sequentially and saw 13 new client additions.

Our operating margins saw a significant improvement this quarter up by over 200 basis points on a normalized basis as compared to the preceding quarter to 14.7%. The cost optimization initiatives undertaken by us are generating significant benefit. The flattening of delivery pyramid, consolidation of our Real Estate and centers resulted in strong productivity gains. Rationalization of bench and a marked increase in utilization rates across all towers during the quarter further facilitated margin expansion. In addition, the product development expenses of Javelina have been substantially reduced because the product continues to grow from being in a development stage to the deployment stage. At the same time we have won an award for Javelina in the market as a product which generates the best return on investment. Our focus on creating a high value portfolio is resulting in average margins in new logo wins improving by over 500 basis points on a sequential basis. We plan to utilize the levers at hand to augment our EBIT margins further and move towards our targeted band.

We continue to manage our cash flows well. The company generated cash of Rs. 2,371 million from operations during the quarter, in line with the recent monthly run rate of Rs. 700 million which is approximately $15 million per month. Improvement in company's DSO for 91 days to 88 days also contributed to the operating cash flow. We consummated, as I mentioned earlier, the Wyde acquisition on 29th August which resulted in cash utilization of Rs. 4,183 million. This acquisition has given us an excellent platform to provide innovative services around the Wynsure platform and grow in the Insurance vertical. Our M&A strategy going forward is focused on acquiring deep domain expertise. We will continue to look for value accretive opportunities in Banking and Capital Markets, Emerging Markets, and Emerging Technology areas.

To close, I reiterate a satisfactory Q4 performance made even more encouraging as it comes in the backdrop of a weakening global macroeconomic situation and flat IT spending. Here at MphasiS we are increasing the intensity of our efforts in growing the Direct business. We are accelerating growth in HP outside Enterprise Services while staying committed to maintain the ES business. We are continuing our aggressive approach to reduce costs and overheads, and to improve mix of high value relationship in our portfolio. These initiatives are expected to drive growth and expand our margin next year.

With that I would like to open this call for questions.

Operator:

At this time, participants who wish to ask any question, please press *1 on your telephone keypad and wait for your name to be announced. If you wish to cancel the request, please press hash or the pound key.

First in line we have a question from Mr. Ashwin Mehta from Nomura. You may go ahead please.

Mr. Ashwin Mehta:

Hi Sir, in terms of our HP non-ES business, what is the outlook there? We are at around $30 million in terms of revenues this year, so where are we looking to take that business to?

Mr. Ganesh Murthy:

We find our HP non-Enterprise Services business growth to be very encouraging and we are pretty optimistic about that. Currently, we have a run rate of about $35 million on that. We are actually hoping to expand it very significantly and probably cross $100 million in FY12.

Mr. Ashwin Mehta:

This is on a full year basis or on a run rate basis?

Mr. Ganesh Murthy:

We are talking about a full year basis. The initial forecasts and pipeline looks very encouraging and we have already entered into several contracts which gives us the confidence that we will be able to achieve these revenue targets in FY12.

Mr. Ashwin Mehta:

Secondly, in terms of growing this business, would the kind of resources required for the HP non-ES business be similar to what is currently deployed in HPES business or it will be a different skill set altogether?

Mr. Ganesh Ayyar:

It is not exactly completely different but there are areas where it will have some differentiation. So, in that sense, there is a possibility to use the common resource planning that we do, significantly in that area too.

Mr. Ashwin Mehta:

Okay. And secondly in terms of the HPES portions, how are we looking at that business going forward? Do we see that stabilizing because HPES business has been declining for us for the past two quarters?

Mr. Ganesh Murthy:

We see a stable environment there in HP Enterprise Services; we are looking at a flattish scenario.

Mr. Ashwin Mehta:

Okay. And just the last question, given our hedges, to what extent would we participate in the current rupee depreciation and what is our current OCI balance?

Mr. Ganesh Murthy:

We have continued to be very consistent in our hedging methodology. As you know, we are hedged for over 24 months. We take a long-term position and we are hedged up to 70% of our foreign currency revenues. So to that extent we will not see the entire impact. If the rupee has depreciated around 7-8% we will not see the entire impact or benefit flowing to us, but the whole idea of the hedging is to minimize the volatility and to minimize the risk. We have re-examined our hedging policy and we feel there is no reason to deviate from our current hedging policy. Because of our high hedging policy, the impact on our revenues because of the rupee depreciation is slightly muted and at the same time even the impact on our EBIT margins is also relatively less when compared to other companies who are relatively less hedged. So for every one rupee depreciation we will see only an increase of 10 basis points in our EBIT margins. And the OCI balance, we have a negative balance of Rs. 73 crore as on 31st of October.

Operator:

Thank you, Mr. Ashwin. Next in line we have a question from Mr. Pratish Krishnan from Bank of America, Merrill Lynch. You may go ahead please.

Mr. Pratish Krishnan:

This is on the HP non-ES segment. If you can give some color in terms of what is the nature of work here and from a margin profile point of view, how different would this be from the HP Enterprise side?

Mr. Ganesh Ayyar:

It is a combination of things that we are working on and obviously we are working hard to see how we can significantly expand. So the type of work that we do ranges from specialized work on workflow which enhances the capability of somebody to do process automation and is able to get the benefit of process automation. The second type of work which we do is, we are productizing the services, so in some sense you can catalogue it and in a modular fashion you are able to have value added services being provided to the customer. Third, is expanding our current testing working with HP's Professional Services Organization on their platform and see how we can enhance our footprints into that account. So, these are three examples. Now to really analyze it, the catalogue services, testing services, they are all similar in nature as to what we do and not exactly different. The difference is in terms of business model, and when it comes to workflow we are leveraging on our process knowledge within BPO whether it is in the space of let us say Invoice Processing or Account Opening, and then leveraging a workflow platform on top of it.

So that is the type of work we are doing. The profitability profile of these services is no different than the profitability profile that we want to have for any other service. So, this is definitely not diluted to our profitability factor.

Mr. Pratish Krishnan:

In terms of the onsite and offshore mix in this part of the business, I mean this should be more offshore driven or how should we look at this?

Mr. Ganesh Ayyar:

I think there may be some variation in terms of offshore mix. It may not be as intense on offshore, but in terms of profitability pattern for overall services remains fairly consistent with what we do. So, in that sense if you look at it from a financial standpoint it is not diluted but you may see a bit more of onsite mix in this.

Mr. Pratish Krishnan:

Sure, and just in terms of the confidence in terms of going from $30 million to may be a $100 million, I am just trying to understand this, have you got some breakthrough in terms of the deal there? What has changed for you to get that level of confidence?

Mr. Ganesh Ayyar:

The level of confidence has not happened overnight. We have been working on it for the last 12 months. We have done two or three pilots, and we have built platforms, we have entered into agreements and we have developed services supply chain. All this work has been done over the last 15 months and now go to market areas are also being worked at. So that gives us the confidence rather than anything else, and this confidence is based on a set of work that we have done and the kind of interactions we are having with our partners in HP and external customers.

Mr. Pratish Krishnan:

Sure. In case the economy were to deteriorate would you maintain this number or can this change?

Mr. Ganesh Ayyar:

Economy is a very big word. The number could be affected if the economic climate changes. But at this point of time we have not seen any signals which show that the economy has impacted our confidence. But can it in future? It can, it depends on how bad it gets.

Operator:

Thank you, Mr. Krishnan. Next question comes from Mr. Hardik Shah from K.R. Choksey. You may go ahead please.

Mr. Hardik Shah:

Just have a book-keeping question. Sir, last quarter there was a deferment of revenue for ~Rs. 35 crores. Is it fully booked in this quarter?

Mr. Ganesh Murthy:

Yes, it is fully booked in this quarter but in this quarter also we have a similar amount which has been deferred and we anticipate, as Mr. Ayyar said, for this to be a recurring feature. You know there is a certain amount of work that gets started off in the quarter but we cannot recognize revenue because we insist on receipt of purchase orders before we recognize revenue. So this is sort of becoming a regular feature and we anticipate this kind of deferment to continue in the future also.

Mr. Ganesh Ayyar:

In other words, in Q4 there was no impact literally of one-offs in totality. You know one came and the other went out, so it has got netted off.

Mr. Hardik Shah:

Sure Sir. And Sir, I just want to confirm your HP non-Enterprise revenue is Rs. 45 crores roughly in Q4?

Mr. Ganesh Murthy:

Non-enterprise HP part is about Rs. 58 crores.

Mr. Hardik Shah:

And Sir, in the last quarter you mentioned in the Direct channel you are expecting compounded quarterly growth rate of around 3-5%, so do you expect some improvement in that or you are maintaining the stance of 3-5% compounded quarterly growth rate in Direct channels?

Mr. Ganesh Ayyar:

Is this question relating to 2012?

Mr. Hardik Shah:

Yes Sir.

Mr. Ganesh Murthy:

If you look at our track record, over the last three to four quarters we have grown in double digits in the Direct channel, and it is difficult to give out a prediction but we are pretty optimistic of the growth in our Direct channel. That continues to remain one of our key strategies.

Mr. Hardik Shah:

But you expect the strong momentum to continue in Direct channel in coming quarters, considering the environment remaining stable?

Mr. Ganesh Murthy:

As I mentioned this is a key strategy for us to grow Direct channel in line with the industry or above the industry.

Mr. Ganesh Ayyar:

Let me put it this way, we cannot cite a number at this stage because that would literally be providing forward guidance

Operator:

Thank you, Sir. Next question comes from Mr. Anand Bhaskaran from Spark Capital. You may go ahead please.

Mr. Anand Bhaskaran:

First question is, can you just comment on the Enterprise side of the HP business and what is the probability of decline from the current levels?

Mr. Ganesh Ayyar:

Okay, so probability is a factor of both market volatility and how the situation pans out. We are looking hard to have this business stabilize and this shows a level of stabilization in Q4 but at this point in time it is hard to predict whether it will remain stable or not, but that is the work that we are putting in.

Mr. Anand Bhaskaran:

Second question is what are the margin levers you see for FY12?

Mr. Ganesh Murthy:

There are a number of levers that we have effectively already utilized. For instance, if you see, our utilization has improved across the board in all the towers. We still believe that there are opportunities for further improvement in the utilization. We have also started the process of consolidating Real Estate, and taking Real Estate which are at lower rentals, and shifting out of high rent Real Estate facilities. So that process is under way and we expect to have significant traction in that area in the coming quarters. These are two big areas which we are seeing as huge margin levers. Another thing I want to leave behind is, you know our entire variable pay structure for our senior management earlier was linked to overall company performance. Now what we have done is, we have brought it nearer to the employees' controllable area. So a particular unit head's variable pay would depend upon his actual performance rather than on the overall company performance. This, we believe, will drive accountability across the organization. Another thing you can treat as a margin lever is, earlier if you recollect, we were issuing MphasiS Restricted Stock Units to the senior management team, and the plan going forward is to issue stock options which are at market price to the management team so that they are more linked to the fortunes of the company.

Mr. Anand Bhaskaran:

How different would the profitability of Direct channel be vis-à-vis HP over a period of time?
Mr. Ganesh Murthy:

It is very similar to the corresponding business, so if you compare the Applications business in the HP channel and Direct channel, the margins are more or less the same. For BPO International also, the margins are very similar. We do not have any domestic BPO for HP.

Mr. Anand Bhaskaran:

Sure. And my last question is on the tax aspect, just now for 2012 and 2013 tax outlook?

Mr. Ganesh Murthy:

We are looking at a tax rate of about 23%, ranging between 22 -24%, so roughly around 23% would be the effective tax rate going forward.

Operator:

Thank you, Sir. Next question comes from Mr. Pinku Pappan from Nomura. You may go ahead please.

Mr. Pinku Pappan:

I just wanted to know of the cash balance that you reported in this quarter, does it have any pending pay-outs remaining or is that reflecting the final pay-out for the Wyde acquisition?

Mr. Ganesh Murthy:

We have paid out everything. An amount of $6.1 million has been put into an escrow which is the normal arrangement with any large acquisition where a certain amount is put in an escrow for a period of few years, and that is to cover any future liability that may arise. We have paid out the entire amount for the Wyde acquisition and there is no further payment.

Mr. Pinku Pappan:

Okay. And your comment about HP being flat. Was it in Dollar terms or are you talking about Rupee terms?

Mr. Ganesh Murthy:

I am talking about Dollar terms. HP channel remains flat in dollar terms because if you take out the one time Rs. 66 crore revenue that was there in Q3 and if you remove the Forex, because of Rupee depreciation we had a Forex gain of about Rs. 30 crores in the HP channel, if you remove both, it will be relatively flat.

Mr. Pinku Pappan:

No sorry, I shall rephrase that. I was asking about your outlook for HP-ES. You were saying that you were looking at a flatter scenario in FY12. Is that on a Dollar basis or on a Rupee basis?

Mr. Ganesh Murthy:

It was on a Dollar basis.

Operator:

Thank you, Sir. Next question comes from Mr. Vihang Naik from MF Global. You may go ahead please.

Mr. Vihang Naik:

You know, first of all there is a slight decline in the onsite Application billing rate. I mean is this any kind of a mix change? And how do you look at pricing in FY12 from HP?

Mr. Ganesh Murthy:

This is not a mix change. This decline can be attributed to the replacement of contractors with our own resources. You know, we had the same initiative even in the last quarter and that has continued in this quarter. So with contractors, what happens is the price realization is higher but the margins that we make are lower, and we felt that if we replace them with our own employees the realization will be lower but the margins will be higher.

Mr. Vihang Naik:

Okay. And how do you see the pricing for HP going forward, I mean are you going to negotiate with them with the next couple of quarters?

Mr. Ganesh Murthy:

There is nothing on that, we have no plans.

Mr. Vihang Naik:

Okay. And on some things on the data side, you know about 200 employees from Wyde, would they be included in this quarter’s head count?

Mr. Ganesh Murthy:

Yes.

Mr. Vihang Naik:

So the next head count decline would be something around 1,050 employees?

Mr. Ganesh Murthy:

That is correct and that is conscious decision that we took to drive up the utilization and you can see that reflected in improvement in the margins.

Mr. Vihang Naik:

Okay, and Wyde revenues would be around $5 million this quarter?

Mr. Ganesh Murthy:

It is about $4 million because the Wyde transaction was closed on 29th of August, so we have only two months of revenues in this quarter which is around slightly above $4 million.

Mr. Vihang Naik:

Okay. So, two months of revenues would be $4 million right?

Mr. Ganesh Murthy:

Yes, $4.1 million actually to be precise.

Mr. Vihang Naik:

Okay. And on the Direct channel, I mean, despite all this macro scenario and you know cut in spending, we have managed to grow on an organic basis in Dollar terms by 8%. I mean what gives us the confidence to see a similar growth in FY12 and how is the macro impacting Direct channel, if at all?

Mr. Ganesh Ayyar:

The macro in fact is showing up in two different ways. One way it is showing up in the existing installed base is clearly looking at discretionary spend optimization and vendor consolidation. If you have good customer satisfaction there, when they do vendor consolidation your opportunity to grow goes up. So while it is a threat, it is also an opportunity. The second thing which we are beginning to see, some of the customers for certain projects because of the external climate are more open to look at offshoring, so that is also an opportunity. So at this point in time, I do not see the macro economic factors having significant impact on the revenue plans that we have developed but however it is at this point of time. You know, as the situation changes it could have an impact. So we have built a process within the organization to act and react to the situation quickly. To summarize, I do not see the macro-economic environment at this point of time having any significant impact on our own revenue plans for 2012.

Operator:

Thank you, Mr. Vihang. Next question comes from Ms. Priya Rohira from Enam Securities. You may go ahead please.

Ms. Priya Rohira:

My first question relates to the fact that the parent, and if one were to read into the results, we have seen a comeback in terms of the focus on Infra Management as their core strength. How would you translate this into opportunity for MphasiS? The second thing is, you mentioned that there was not a pricing decline, it was just a substitution of the subcontractors with own employees. Are we done with this completely and do you see this to translate into increase in margins in the coming quarter? And the third is on your outlook on the employee intake, and the fact that are we at peak utilization rates or do you think that is further juice still left?

Mr. Ganesh Ayyar:

Okay, so let me go one by one. Your first question was HP's direction and the opportunity ahead for MphasiS as a result. I personally believe that we do have exciting potential to grow our footprints with the organization such as Technology, Consulting and other parts of HP which is what we mentioned earlier. So Infrastructure Management is not carried out by one part of HP, there are different parts, depending on what sort of project and what type of relationship, different parts can get involved. So we see exciting potential outside Enterprise Services for us. We obviously need to work to make that happen. Now moving on to talk about Enterprise Services, as I mentioned, in 2011 we did see decline and we have our work cut out to ensure that it remains stable and we are working on it and let us see what comes out of it, so that was your first question. Let me move on to the second question.

Ms. Priya Rohira:

Just a follow up, the MSA comes up for renewal in October 2012 right, correct me if I am wrong over there?

Mr. Ganesh Ayyar:

Yes, that is right. So, what was the second question?

Ms. Priya Rohira:

Second question was on the substitution of the subcontractors with own employees?

Mr. Ganesh Ayyar:

I think that is actually finished. I do not see any major opportunity at this point of time. You know there may be 1 or 2 cases here and there, but a substantive portion of that exercise is over. Then, the third question which you had. Actually it is more levers of what can we do, utilization was one element. I guess your broader question may be- what are the levers available to us to improve profitability. So let me get Ganesh Murthy to quickly chip in with his point of view.

Mr. Ganesh Murthy:

If you look at the utilization, I mean if you take out the trainees and if you look at utilization, i.e. a blended utilization excluding trainees, I think we have reached sort of the maximum in ITO with 84% utilization. Anything further than that may actually hurt the business but I think we still have room and scope in the Applications area and in the BPO area.

Ms. Priya Rohira:

Okay. One more thing, this substitution of subcontractor should ideally lead into better margins, right? So I mean, do you see in APPS we can still have further improvement on the margins because of the substitution?

Mr. Ganesh Murthy:

No I think that is already reflected in the current margins and if you see, the APPS margins have improved. So I think that is reflected there. Because of this reason, there won't be any further improvement in the margins but we have the other levers that we are exploiting which we are hopeful will improve the margins.

Ms. Priya Rohira:

Sure. Just one data point. In the Infra Management business, what is the composition of non-HP clients. Is it just 4 to 5% or have we inched up over there?

Mr. Ganesh Murthy:

About 30% of our total ITO revenue is non-HP; it is Direct channel.

Operator:

Thank you, Madam. Next question comes from Mr. Nitin Mohta from Macquarie. You may go ahead please.

Mr. Nitin Mohta:

First one is on the capital allocation strategy. There is a comfortable cash position. Just wanted to understand the Board's thought process on use of cash.

Mr. Ganesh Murthy:

We have been exploring various areas for use of cash and I think what the Board is looking at is to continue our acquisition strategy which fits into our overall growth strategy, and essentially as you are aware, we have been focused on making select acquisitions in the Banking Capital Market space and the Insurance space. So far as Insurance is concerned, we have already made an acquisition a couple of months ago when we acquired Wyde. Now the focus would be on the Banking and Capital Market space and also on certain Emerging Technologies which we believe that we need to invest in. So that would be the main focus of our cash strategy .

Mr. Nitin Mohta:

Sir, if I understand this right, given you know the growth revenues that are still there for MphasiS to explore you know a buy-back or a special dividend is not something which is actively being considered?

Mr. Ganesh Murthy:

You are right, at this point of time the Board is not actively considering either of these two options.

Mr. Nitin Mohta:

The second question I had was the hedge position. Do you have the breakup in terms of about US$462 million hedges that you guys have, how many of them are maturing in the current quarter and the quarter after?

Mr. Ganesh Murthy:

So that is a very detailed thing, I think we will get back to you through an email. As I mentioned, we are spread over 24 months and we followed a layered approach. So we have some amount maturing in the next 12 months and some amount maturing in the 13 to 18 months, and then beyond 18 months, so we have a bit of calculation to do.

Operator:

Thank you, Mr. Nitin. Next question comes from Ms. Shradha Agarwal from B&K Securities. You may go ahead please.

Ms. Shradha Agarwal:

Just wanted to follow up on pricing again. We see a decline in our offshore BPO billing. It has come down to $6 per hour now. So I mean the reason behind pricing decline there?

Mr. Ganesh Murthy:

Yes, it has actually come down by 60 cents. Last quarter it was about $6.7 and this quarter is about $6.1, and the main reason for that is in Q3 the Santander account was terminated and in Q4 we do not have that account with us, and that has resulted in a decline in the overall price realization. We have not offered any price reduction either to HP or to any other customer.

Ms. Shradha Agarwal:

Right. And Sir, secondly I think you mentioned close to Rs. 58 crore of revenue from HP non-Enterprise side, which effectively means $12 million. And if I have my number right, last quarter you did $8 million from HP non-enterprise. So that is a growth of 50% quarter on quarter?

Mr. Ganesh Murthy:

Non-ES revenues grew from $10.6 million in Q3 to $12.1 million during Q4. In Rupee terms, revenue grew from Rs. 466 million to Rs. 582 million representing an increase of 24.9%. When we reported Rs. 358 million as non-ES revenue in Q3, this had only Product Engineering Services and did not include non-ES as this was not reported separately.

Ms. Shradha Agarwal:

Okay. And the loan which we have taken on books is probably to fund Wyde acquisition?

Mr. Ganesh Murthy:

No, it is a short term working capital loan that we have taken. This is a packing credit facility that we have obtained and as you are aware packing credit facility is available at subsidized interest rates, so that is just a short term working capital facility that we have considered of $50 million.

Ms. Shradha Agarwal:

Right. Sir, and any color on our hiring strategy going forward?

Mr. Ganesh Ayyar:

As you can see, our demand pattern has shifted in 2011. I believe that it will shift further as our mix changes. So we do not make projections of our hiring plans but keeping in view our focus on profitability improvement and changing pattern of the type of skill sets that are required, we have put in place proper hiring plans. We also undertook a significant fresher hiring in Q4. They are right now in the process of being trained and we believe that they will become productive in the first quarter.

Ms. Shradha Agarwal:

Right Sir, we earlier used to give out the open positions available in all our business units.

Mr. Ganesh Murthy:

Yes, open positions in APPS is about 700 and in ITO it is about 300.

Ms. Shradha Agarwal:

Right, that is helpful. Thanks.

Operator:

Thank you, Madam. Next question comes from Mr. Dipesh Mehta from SBICap Securities. You may go ahead please.

Mr. Dipesh Mehta:

Yes, I just need two data points. One is freshers added during the quarter and for the full year, and second what would be your number of employees in the 0-3 years bracket at the end of year and at the beginning of the year?

Mr. Ganesh Murthy:

In Q3 we hired around 800 freshers. In Q4 we have hired about 500 freshers. So totally in the last 6 months there have been 1,300 freshers who have been added into the system and this is again a very big driver for us in improving our margins because this will help us to flatten the pyramid and this represents a big change in our strategy because all this while we were going more after lateral hire rather than freshers.

Mr. Dipesh Mehta:

Right, what would be 0-3 years at the end of FY11 and when we started year?

Mr. Ganesh Murthy:

I think this is about 1300; we started this fresher hiring about two quarters ago. In FY12, our current plan is to be around the same levels or may be slightly higher.

Mr. Dipesh Mehta:

Okay, and last part I just want to stretch further on HP non-ES, because if I read your last release, the number you have mentioned is around Rs. 36 crores, and today you gave for this quarter's number is around Rs. 58 crore. So, in rupee growth number appears to be much higher than the reported 24.9%, so just clarity what we are missing?

Mr. Ganesh Murthy:

In Rupee terms, non-ES revenue grew from Rs. 466 million to Rs. 582 million representing an increase of 24.9%. As I mentioned, when we reported Rs. 358 million as non-ES revenue in Q3, this had only Product Engineering Services and did not include non-ES as this was not reported separately.

Mr. Dipesh Mehta:

Okay. And the last part is, what would be the volume growth for the quarter cumulatively, organic and inorganic?

Mr. Ganesh Murthy:

The total volume growth for this quarter overall including HP and the Direct channel is 4.4% volume growth.

Mr. Dipesh Mehta:

And out of that Wyde would be how much?

Mr. Ganesh Murthy:

Wyde was Rs.199 million.

Operator:

Thank you, Sir. Next we have a follow up question from Mr. Pratish Krishnan from Bank of America, Merrill Lynch. You may go ahead please.

Mr. Pratish Krishnan:

Yes, just in terms of the attrition numbers for the quarter, if you can share segment wise?

Mr. Ganesh Murthy:

Attrition levels have come down quite a bit in this quarter, we are looking at about 19% of attrition in this quarter for Applications which is the main focus area for us.

Mr. Pratish Krishnan:

Okay, and ITO?

Mr. Ganesh Murthy:

22% in ITO.

Operator:

Thank you, Sir. Participants are requested to please press *1 if you have any question.

Next in line we have Mr. Rahul Jail from Dolat Capital. You may go ahead please.

Mr. Rahul Jail:

Yes, just wanted to understand the outlook basically on the Application and BPO business because if we look from the eight quarter run rate it is more over flat or slightly below. So what is the outlook going forward from these two business segments?

Mr. Ganesh Murthy:

As I mentioned, we do not look at it that way i.e. Applications and BPO. We look at it more from our verticals that we are focused on. And as you are aware we are focused on two verticals that is Banking and Capital Markets and Insurance. We envisage good growth in both these areas in the future; in fact in the Insurance area actually we have grown 21.6% quarter on quarter and in Banking & Capital Markets we have grown 7.4% quarter on quarter.

Mr. Rahul Jail:

Basically, what I am trying to understand is, is it like ITO becoming more of a strength that is driving everything and you know the other two service segments are not able to deliver, or there is something which we need to work on there?

Mr. Ganesh Ayyar:

Let me give the answer differently. Actually we have won some good contracts in BPO especially in Banking and Capital Market area and at the same time we are seeing traction for Applications as well. So the ITO business that you are seeing is because we have had good success with the acquisition which we made, Fortify, about 18 months ago and especially in the Emerging Market segment they have succeeded well, but I continue to see reasonable pipeline for APPS and BPO especially in the verticals that we are focused on.

Mr. Rahul Jail:

Now, if you can give some sense of what is the sustainable level of profitability, either blended level or the segmental basis, because it has gone down significantly over the last several quarters and we are not seeing any respite even on the quarter basis.

Mr. Ganesh Murthy:

If you look at our EBIT margins, last quarter if you remove the one time impact of the revenues and if you remove the write back of accruals, you would see a normalized EBIT margins of around 12.5% and currently this quarter there is one thing that is significant to notice that there are no one-time revenues and neither is there any write backs or accrual reversals. We are committed to continue with this trend. Also, if you look at our normalized operating profit, it is 14.7%, so that represents actually an increase of over 200 basis points from the previous quarter and we hope to continue this trend of improving our margins. I think over the next few quarters we aim to deliver higher EBIT margins on a normalized basis.

Mr. Rahul Jail:

But from the current point of view of this 14.7%, if we are able to deliver the kind of growth which we have in our mind, possibly we will deliver better operating margins from this level?

Mr. Ganesh Murthy:

We are definitely committed to deliver higher operating margins from 14.7%.

Operator:

Thank you, Mr. Rahul. Next question comes from Ms. Radhika Mave from P.U.G. Securities. You may go ahead please.

Ms. Radhika Mave:

Sir, just a couple of points I wanted to clarify. One was on the one time revenue that we discussed last quarter, which was not recognized due to incomplete documentation, and as you mentioned this is a regular feature, so on a quarter on quarter basis it has tended to kind of net off. If I have to look back say a year ago, what was the level of this quantum of this revenue and was it existent at that point of time or this is something that has just changed in the last two to three quarters?

Mr. Ganesh Murthy:

Actually, it was not there in the previous year and this has happened only in the last 2-3 quarters and the reason for that is earlier when we were part of EDS we were following the EDS process where there was no such thing as a purchase order. HP has started migrating their Accounts Payable from the EDS process to the HP process and as per the HP process there is a requirement for a purchase order for every project. So what tends to happen is, if there is a new project, we start the work based on a written confirmation from the clients and the purchase order usually takes about one month to 40 days because it has to go through numerous approval levels in the HP system. But we continue to follow a very strict revenue recognition and we do not recognize that revenue without getting the physical purchase order in hand, and so this has started happening in the last two quarters and we see this continuing to exist because HP has their normal lead time of about 30 days to 40 days to generate the purchase order and we do not see that changing.

Ms. Radhika Mave:

Just on the revenue mix, now that HP is as you know almost 62%, and you had also mentioned in terms of how the HP channel is going to pan out over the next year. So, what would you look at the ideal mix as of now, would this be the sustainable mix between both the channels or are we looking at further reduction on the HP side?

Mr. Ganesh Ayyar:

The objective is to accelerate growth and profitable growth. In that sense, we are clearly seeing a good traction in the Direct business. We are also beginning to see a good possibility and traction in the business outside Enterprise Services and until now if you look at FY11, our business with ES has had a decline. So that is the mix which we have looked at and we will continue to focus on this. So the percentage which will emerge will be as a result of our business rather than setting an objective, and to be honest a range where we are in our channel mix of HP is in and around 60%, which is a fairly comfortable percentage for me, and I certainly would like to see our Direct business in and around 40%.

Ms. Radhika Mave:

Sure. Yes, that is quite helpful sir. And last on the client adds if I see you have mentioned two have been in the Insurance vertical, so is this inclusive of the Wyde acquisition?

Mr. Ganesh Ayyar:

No it does not. Wyde came with 25 clients of their own. So this does not include Wyde.

Operator:

We have Mr. Ankit Pandit from SBICap Securities. You may go ahead please.

Mr. Ankit Pandit:

I just had a question about the Javelina product. Can the management put a number as to how many customers there are in this product and what exactly is the reason for the reduction in investment. I understand moving to the deployment stage, but could you please give us a clearer picture there?

Mr. Ganesh Ayyar:

Okay, so Javelina product is specific to the US and it is in the Healthcare segment. Lots of solutions existed but they were based on old technology. The customers were looking for flexibility in a new platform because as the policies change they wanted to incorporate it in the platform and in the older technology they found it difficult to incorporate policy changes in the platform. That is when we decided to develop an entirely new platform called Javelina. This was introduced to the market after the initial development phase, about 15 months ago, and right now we have about four clients. As you develop the product and you have initial set of clients, you will require further development because when they get deployed there is a strong feedback, so you have these initial anchor clients which provide the necessary robustness and functionality to the product and that is why we were heavily invested in the development. There came a stage when the product became feature rich and stable. At that stage you have to switch out of the significant investment that you are making in development and increase your capacity in deployment, and that capacity can be more variable than the development capacity. Hence, we went about doing that, and just about one month ago this product has actually now on the 'Best Product' from Return on Investment perspective.

Mr. Ankit Pandit:

Okay. So Sir, just to be clear, the development stage is over that means?

Mr. Ganesh Ayyar:

Correct. I mean development will continue but a significant portion of initial product development is over.

Mr. Ankit Pandit:

Okay. So I mean, did the Javelina product make a profit this quarter?

Mr. Ganesh Murthy:

We do not comment on individual profits of individual products.

Mr. Ankit Pandit:

Okay, I mean last quarter we did report a Rs. 166 million sort of a loss on investment.

Mr. Ganesh Murthy:

That was the cost of the product development.

Mr. Ankit Pandit:

Okay, just the cost of the product development. And just one more question. How exactly do we calculate the billing rate that we report, I mean is it net of the various provisions and reversals written back?

Mr. Ganesh Murthy:

There are no reversals this quarter, there are no one times.

Mr. Ankit Pandit:

No, previous quarters, compared to say $70 for Application Services in Q3.

Mr. Ganesh Murthy:

Yes, that is without all the one time and net reversals.

Mr. Ankit Pandit:

Okay fine, thank you so much.

Mr. Ganesh Ayyar:

Thank you very much. I want to wish all of you who are on the call a Merry Christmas and a Happy New Year and look forward to working together for a prosperous year for all of us. Thank you very much.

Operator:

Thank you, Sir. That concludes our conference for today. Thank you for participating on Reliance Conference Bridge. You may all disconnect now.