



“Zensar Technologies Q3FY13 Earnings Conference Call”

January 21, 2013



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Moderator

Ladies and gentlemen, good day and welcome to the Zensar Technologies Q3FY13 Earnings Conference Call. We have with us today from Zensar Technologies Dr. Ganesh Natarajan – Vice Chairman and CEO and Mr. S Balasubramaniam – Executive Vice President & CFO. As a reminder for the duration of this conference, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Dr. Ganesh Natarajan. Thank you and over to you sir.

Dr. Ganesh Natarajan

Good evening to all of you. Our Board Meeting just finished at 4 o'clock so I am aware that you must have got your note just about half an hour back. So what I will do is I will try and walk you through the numbers and tell you what to read in them and of course Bala will add a little more and we are also fortunate that we have Nitin Parab. Nitin is the Chief Executive of our enterprise business based in San Jose, California but he is also here today because of the Board Meeting. So he will probably give you a little more guidance on what is happening on all the verticals of Zensar and what is our future plan going forward. So we will make this brief and then of course we are available to answer any question. So just as a matter of preamble I think as all of you know this has historically been a weak quarter for us because of two of our major clients have 8-day shutdowns in December so obviously in Cisco for instance we lost almost 6 crores of revenue in this quarter. But in spite of that our verticals have continued to do extremely well both in terms of revenue and order booking, in fact the quarter on quarter revenues or the verticals grew 1% in dollar terms. However, we have had some setbacks in this quarter in Akibia which is the company we bought 2 years ago primarily because some of the onsite accounts got closed somewhere during this quarter which was earlier than we expected but the good news is that these accounts are also coming back as offshore accounts in much larger numbers over the next two quarters. So while this has been a bad quarter for IM particularly for the data center and the products business, I think the services business will continue to grow. In fact if you look at the order book, I mentioned in the last call of the previous quarter that we had a \$120 million pipeline in IM. The good news is we have closed over \$20 million of that during this quarter and there is a renewed pipeline of almost \$105 million, so all this is good news for the entire business. We have also been fortunate that we have closed some very good deals in the vertical space which Nitin will talk about and we have just signed a \$24 million from one of the large insurance companies in the US and we expect to see a lot more from this client as well as from other clients. So overall the health of the business is good. As many of you know we have also embarked this year on a fairly significant best practices exercise, where we have been working with one of the leading consulting organizations who are experts in this area called Process 360 and we have done a full exercise with them to look at all areas of weakness and strength. There is obviously a cost initially associated with that but we expect to see benefit because of that in this year which will more than neutralize what we are paying them and more important going forward it will improve our bottom-line next year. So overall if I look at this quarter it is been a little weak.

As I said the core business is doing well, IM is not so good. The shutdowns did not help. But I think we have all the parameters in place for a very good fourth quarter which is really worth going on and definitely next year we are looking at doing even better than this year because the order book is very-very substantial as we go forward. During this quarter we have also reduced people, in fact we got rid of a few non-productive accounts which had one or two people, almost 70-75 accounts in IT. Also got rid of some domestic BPO business, so the manpower is been trimmed by about 321 people, mainly in BPO and also in IT and we are today at very high levels of utilization, very high levels of productivity and I think the stage is set for really growing very profitably going forward. So this is broadly where we are. I am going to request Nitin, our chief executive from US to talk a little bit about the verticals and how they are doing and then give it to Bala and then we will start the questions.

Nitin Parab

Ganesh did mention some of these points but I am going to elaborate a little bit on this. The focus on the vertical strategy is very clearly now showing its results. If you look at our performance in some of the key verticals we have seen a 25% growth YOY in manufacturing, 18% growth in insurance and the two other businesses that we have which is really the Cisco and SAP business, which align with the manufacturing vertical, have both shown 16% and 23% growth respectively. So by and large all the focus verticals for us they have done extremely well. The other area which again Ganesh mentioned is the big deals, and there has been a concerted effort which has gone in over the last three quarters in focusing on going after big deals be it within the existing customers or new customers and one of the things that has happened is with some of the existing customers where we had annual contracts those have now have been converted into 3 years and 5 years contract. The one that Ganesh mentioned in case of insurance company is about \$24 million. We have similar \$5 million and \$10 million contract that have been signed with manufacturing companies as well as insurance companies. So the other thing which has also happened is as much as we are doing away with those small accounts, the customer portfolios adjusting itself to include lot more Fortune 1000 customers. So particularly in this last quarter there has been an addition of some marquee names from Fortune 1000 customers. And last but not the least I will certainly like to dwell on the point that Ganesh mentioned about the whole organization excellence, so we looked at various parameters around utilization, people productivity, project management practices, sub-contracts, costs etc which have all contributed to the overall efficiency and an increase in the margins.

S. Balasubramaniam

Good evening ladies and gentlemen. I will give you the usual data so that the call can be very productive. In terms of the cash balance as of December our cash balance was 172 crores as against 141 crores in September. So the net accretion is about 30 crores. In terms of our forward exchange cover we have covered for 59% of our exposure at an average rate of 57.14. In terms of Capex in the first three quarters we have expanded about 11.4 crores and in terms of our days covered, it is pretty healthy at 56 days as against 59 days. I would also like to highlight the fact that our SEZ strategy has paid us the benefits, which is why you will see the effective tax for this quarter at 30.5%. So these are some quick financials which I thought I will highlight. We will take your questions as they come along.

- Dr. Ganesh Natarajan** Thank you very much. So we now open up the floor for questions.
- Moderator** Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Karan Torani from IFCI Financial Services. Please go ahead.
- Karan Torani** I just wanted to know firstly on the revenue front what actually you lost out because 0.5% return is actually weak, so what was anticipated and what exactly went wrong in this?
- Dr. Ganesh Natarajan** As I mentioned what was anticipated was of course that there would be a slowdown in two clients, because they have this 8-day shutdown in December so that was anticipated. As I mentioned earlier Cisco itself we had 6 crores lower revenue this quarter, which was expected. What was not anticipated was an abrupt shutdown of two of our onsite clients in the infrastructure management business. So the IM business actually declined quarter on quarter 4% in dollar terms. So that was unanticipated. But as I mentioned earlier in the call fortunately those same accounts are now coming back as offshore accounts which will actually substantially improve both profitable revenues and the revenues itself over the next few quarters but this is been aberration for IM. Given the order book that we have and the pipeline, both IM and the vertical will continue to grow. So we were expecting a lower revenue this quarter and as Bala mentioned our focus was on TM, the profits have moved up very smartly. But going forward given the fact that the verticals are growing very-very smartly and services -
- Karan Torani** But sir last quarter you had mentioned that IMS business got slowed down and that was like the one-time ramp down from the client and that would take time for the IMS ramp up to begin again in Akibia in US. What is the traction on that front? When do you see they start improving and when do you see Akibia coming back into action?
- Dr. Ganesh Natarajan** Let me answer your question very quickly. We are expecting that Akibia from now onwards will continue to grow, in fact they are now well integrated that with our global IMS strategy and other Chief Executive – Vivek Gupta is right now in Boston. He is actually managing the whole business. So, if you look at the next 4 quarters we are expecting to see on a year-on-year basis a 15% growth in global IM revenue and Akibia will also be in it – we do not foresee further problems in the Akibia business at this point in time.
- Karan Torani** Now just coming to your margins, your margins have remained flat in spite of levers like offshoring and utilization improving, your offshoring went up by 2%, utilization to 1%. So what was the drag on the margins this quarter?
- Dr. Ganesh Natarajan** Only drag was the payment that we made to the consulting house and this has really been the last payment we have been doing that for the last three quarters and Akibia of course was lower in terms of margin. So I think those are the two drags, but if you look at the core business what you pointed out is right, since utilization is higher I think the overall margins are much better. We have to sustain that even going forward.

- S. Balasubramaniam** If you really look at our overall employee cost they have actually come down. And whatever drag has been there in the margins as Ganesh mentioned, the one time cost that we have paid the external consultant and the fact that the third quarter typically is a fairly high quarter for the infrastructure business for product sales, that also further brings down the margin.
- Moderator** Thank you. The next question is from the line of Dipen Shah from Kotak Securities. Please go
- Dipen Shah** in terms of utilization you said there is still a lever in terms of utilization, so from 83% how far do you think you can stretch it up to?
- Dr. Ganesh Natarajan** 83% is as good as it gets. And in fact, we are now running at almost 90% utilization on practices like the application management services, but fortunately the good news again here is that the induction of trainees has been steady into the projects. In fact next year we expect to add about 350 trainees in a total addition of 500 so in terms of the flattening of the pyramid and all the good parameters, it is very strong at this point of time. But utilization will remain here. We do not expect it to go up very substantially but the real benefits next year in addition to what we have seen will come because of we are including a lot of these lean techniques where you can actually manage services with lower manpower or lesser manpower and all that is already, in fact that is already been implemented in three of our large engagements and will continue across the board. So those are the kind of benefits that we expect to see which will add to the bottom line next year.
- Dipen Shah** And if you can just throw some more light on the overall macro scene, how is the decision making panning out and are you seeing any trends as far as next year their current year budgets are concerned, calendar year 2013?
- Dr. Ganesh Natarajan** Nitin mentioned that we are seeing a lot of what we call big deals. In the pipeline we have at least 4 deals which are in the \$6 to \$18 million bracket and there is another \$26 million deal that we are negotiating with the same client that gave us the \$24 million commitment. So there is no softness in the market. It is too early to make a prediction but right now we are tracking on the verticals at about 13% growth. Unfortunately Akibia is much lower than that but if Akibia comes back on track and as I mentioned that the IM business is also 15% growth next year, I do not see any reason why we cannot do at least 15% volume or dollar growth in the next financial year as well. So the business looks robust, order booking is good, the pipeline is good in all verticals, so I do not see a problem. Nitin, you want to add something to that in terms of what we are seeing?
- Nitin Parab** No, you have said it all. The only thing that I would add to it is that the whole impact of the ecosystem that we have created around the big deals. The results have started showing because for our existing customers where it were annual contracts we have been converting them into long-term 3-year, 5-year contracts which also increases the predictability and also the fact the size of the deals have gone up. If you look at the pipeline and if you look at therefore typically the kind of deals that we have been working on in the last two quarters,

each one of them is in that \$5 million category. Also we have given a clear mandate to the sales organization to go after big deals as against the regular deals that we chase.

Dipen Shah Okay, and lastly like if more or less you can just give me what were the hardware revenues in the December quarter versus the September quarter

Dr. Ganesh Natarajan You mean product sales?

Dipen Shah Yes.

Dr. Ganesh Natarajan Product sales in December quarter was 62 crores against 67 crores in the earlier quarter.

Dipen Shah So these are the ones which are typically coming with lower margins, am I right?

Dr. Ganesh Natarajan Yes, that is right.

Moderator Thank you. The next question is from the line of Shravan Goyal from UTI Asset Management. Please go ahead.

Srivatsa I am sorry if this question is repetitive but I just want to understand the total benefit which arises out of this payment to the consulting company in terms of, in which areas are we expected to see benefits or we are already seeing benefits and what is the kind of longer term change that we are seeing because of this engagement ?

Dr. Ganesh Natarajan As I mentioned there are 3 or 4 things here. One is that it is best practices in terms of pyramid, utilization of people, etc. The second is this whole approach towards lean manufacturing or lean execution of projects. The third we also did some studies in Akibia in terms of what could Obviously the costs were front-ended so we paid more in this quarter and the last quarter. Next quarter there are no payments, the benefits will accrue

Srivatsa So the benefit would be more in terms of say flattening the employee pyramid or lowering the delivery cost?

Dr. Ganesh Natarajan Lowering the delivery cost is the primary objective and also areas like contracts for instance, I mean we have done a full review of all contracting. We look at all loopholes where we would not be able to charge for something and we have corrected that. So it is really taking every best practice possible from the global services industry and incorporating that. So it is the whole bunch of stuff, I mean if any of you are interested we can send you 12 areas of activity and each of these areas what benefits we have found. But it has been an excellent exercise for us in terms of integrating the operations and building the platform where if we grow the revenues we are making sure that there is no waste at all in the delivery process.

Srivatsa Okay. My worry is that if I look at your margins it is between say 13% to 14% when the rupee rates are pretty favorable. So what is the kind of longer term margin that you would look

because definitely this kind of a margin with this rupee rate may not be sustainable for a business because if the rupee comes to 50 or below there would be a huge dip in the margins?

Dr. Ganesh Natarajan

Yes right, in fact our first goal for next year is to make sure that what we expected to do this year which could not happen in Akibia which is to kick up the PBT for Akibia about 10-11% that is going to happen. The PBT for the other businesses, the vertical businesses is already doing well and both insurance and manufacturing attain critical mass. So to answer your question the goal is very simple, that we can give you exact numbers in April but if you are looking at growing volumes next year of the whole business by 14% you would certainly expect to see margins moving much faster than that. So like we have done in the last few years, the margin growth will be actually higher than the revenue growth and we expect both to be good next year. So the aberration this quarter has been of course one revenue drop in Cisco and the other one is of course a slowdown in Akibia which I mentioned earlier. But once Akibia corrects which is going to happen this quarter and certainly next year and Cisco is still growing pretty well. As Nitin mentioned, it is year-on-year 16% growth over last year. So both these are margin kickers for us and will continue to drive margins for themselves.

Srivatsa

Okay. And just in terms of those large deals, like is the focus on the existing Fortune 500 or Fortune 1000 clients that you have or you are chasing new clients as a part of this large deal program?

Dr. Ganesh Natarajan

70% is new clients to answer your question and 30% is what Nitin was saying that if we are doing something with an existing client. We have a team out there which is looking at all the opportunities, converting to managed services, we just converted one of our South African clients, which is again in insurance from what was just sporadic projects coming through to a formal 3-year managed services engagement. So, to really make sure that they commit to what they can give us and we are also able to plan much better. So that is the 30% where existing clients are also being brought to the party but more important is to get new clients and I think the combination of services that we have today, which is not only application management but also infrastructure management and BPO is helping us in the chosen verticals. So manufacturing, retail and insurance, we are now seeing the integrated play of these really coming in and creating larger deals.

Srivatsa

And in terms of new clients like would you expect to take over some data centers or employees as part of the deals or these are just small-ticket deals of \$4 to \$5 million you are chasing?

Dr. Ganesh Natarajan

We are open to that. The honest answer to that like for instance there was one bit that we did in Europe which take over an existing data center of the company in India, but quite honestly it did not make sense in terms of the pricing that they were expecting. So I think we will choose to be conservative in terms of, we are quite happy to take over employees as well as assets if the deal is right but we do not want to be too adventurous in terms of doing something which will create problems for our bottom-line. So I think in the next 5 quarters there will be

larger deals, as I said the range is between \$5 and \$25 million but at the same time not pushing the boat too far in terms of buying business which is not something we would like to do.

Srivatsa And have we kind of seen any negative impact of these large deals because what I understand from a lot of fears is that when a large deal starts it generally has much lower margins at the beginning. So has it also contributed anything in the last couple of quarters?

Dr. Ganesh Natarajan No, I would not agree because that is in some cases where we have been competing against some of our friends who are willing to give the entire transition free, etc. So that is what is the front-end at the cost of large deals. We do not have any proposals in place like that which is why I am saying we being a little more conservative. So I do not think that the large deals that we are chasing have anything to do with initially having any profit pressure on whatever we think. No such problem.

Srivatsa Bala can you just give me an updated on what is the net debt or a net cash position used? I thought the figure you mentioned was for gross cash.

S. Balasubramaniam Yes, 171 is the cash that we have. In the quarter we paid off \$6 million so \$36 million is the debt on the balance sheet. \$36 will depend on what is the exchange rate that you convert.

Srivatsa So roughly we are almost debt free.

Dr. Ganesh Natarajan We have a debt of 198 crores as of 31st December.

S. Balasubramaniam 198 to 171, 171 is the month end figure. If you look at today morning may be it would be around 200. SO by and large we are more or less equated. We have kind of achieved that equilibrium, which I said will happen by end of March.

Srivatsa Okay. And in terms of tax rates do we see lower tax rates going into next year as we ramp up the SEZ?

Dr. Ganesh Natarajan Yes, I would expect so.

Moderator Thank you. The next question is from the line of H R Gala from Quest Investment Advisors. Please go ahead.

H R Gala My question pertains to the fact that most of the companies are spending lot of resources in developing the new platforms across Big Data Analytics, Cloud, Mobility and all that – this question is for Dr. Ganesh, if you can just tell me how Zensar is placed in this area?

Dr. Ganesh Natarajan Well it is actually a good point you are making. In fact one of our senior most people in delivery just focused on new technologies as well as what we call intellectual property creation so in all the three verticals, I mean insurance for instance we are doing a lot of work around this whole policy administration services, manufacturing in this area of manufacturing

operations management, traceability so all these are solutions we are building. In fact we have now invested heavily in mobility solutions and recently we are at the Retail Corporation Annual Exhibition in US where we actually demonstrated a mobility platform where for instance if somebody is buying a dress, the mobile phone itself can show the access to shoes and bags and belts, etc. So a lot of these are very vertical domain-specific solutions, which we are building and that is the integration of technology, our service areas as well as the verticals. So absolutely your point is right, both in terms of data analytics which is what goes into throwing up these options as well as using new technologies like iPads, like mobile phones, of course Cloud, which is now almost a standard for every proposal, that is very much part of what we are doing today.

H R Gala

So are we getting any substantial revenue as of now out of these new initiatives or you expect this to grow as we go ahead?

Nitin Parab

If you really look at the revenue streams amongst all the services that we have, very clearly this is one of the fastest growing areas for us and to add to what Ganesh said, see the focus has been on really two things. So far if you look at the traditional services, it is all cost arbitrage, building in efficiencies in terms of doing it and doing at a lower price point. As against that the focus has really been on the business outcomes. And therefore all these so-called digital economy which is mobility, cloud, social media, etc., are discussion with our customer is how to really leverage these technologies to start improving whether it is their own growth in terms of revenue or whether it is in terms of increase in working capital, gaining efficiencies in their operations retaining customers, etc. So those are the outcomes that we have been discussing and we have been leveraging all these emerging technologies to drive that.

H R Gala

Now as far as the commercial terms are concerned when you enter into the large deals and all that, do you still structure around either fixed price or time and material or are they slowly migrating to this business outcome basis where you deliver certain benefits to the customers and you share in it?

Dr. Ganesh Natarajan

No, we still have not gotten into contracts which are outcome based pricing contracts. They still continue to be very much fixed price contracts or T&M as the case may be.

H R Gala

Just talking about next 2 to 3 years, how do you see the outsourcing trends developing because there are lot of news items which shows a lot of promising things happening in US and elsewhere, I am not very sure about Europe, but how do you see over the next 2-3 years, what kind of growth trajectory you will be aiming at?

Dr. Ganesh Natarajan

Definitely the opportunities will continue but you have raised a very important point and I think there was a recent economist article also, sourcing, the way we see it is clearly going to change. Like even if you look at the IM business what used to be people working in data centers, each data center having a client is going to go away. So we are in fact working on one project now where the task is to move 40% of the data center activity to the cloud, other 60%

will be through a co-located, means they will locate the data center but we will manage it. So there are these new formats of outsourcing. What this means for companies like us is that there are three important things – one is that we have to be very strong with the domain because we have to understand the business problem and trigger a solution which includes best of technology, best of services. So it is no longer going to be an SAP provider or an Oracle provider. We have to understand the domain and what it takes to make the domain more successful. And probably the more important thing is how do we ensure that we can really do a multisource model which really means like one of the reasons for our Akibia acquisition was not only are we able to provide services, spares, etc., anywhere in the world. Today we are working on one of the largest computer companies. The reason why they worked with us is because they know that we can support them anywhere in the world. That is as important as having an offshoring model. I think the model will migrate to much more of multi-shore model, much more of cloud plus other areas using extensions like the iPad, like Mobility, etc., we have to very cognizant of the changes in the model going forward. Otherwise your core business will get cannibalized at the new businesses. So we are very conscious of that and working very closely with our teams to make sure that happens.

H R Gala

Last question from my side, will the requirement of resources in terms of the capital expenditure, etc., will be sizeable as a keep growing at a faster pace?

Dr. Ganesh Natarajan

No not really, I do not see that happening. Even for the next 15 to 18 months it is really going to be more of software, more of hardware that is really what we require. There will be some investments as I said in intellectual property, building a complete navigator tool which enables project management to happen off a dashboard. So there will be some things like that but nothing is going to be order of magnitude. So I would still expect whatever 35 to 40 crores of CAPEX next year also and that is a continuing process for us.

Moderator

Thank you. The next question is from the line of an individual investor, Santosh Biyani. Please go ahead.

Santosh Biyani

One question, what is your projection for the next year profit and vis-à-vis what do you see the rupee increase?

Dr. Ganesh Natarajan

See, we are not in a position to give formal guidance yet, but as I mentioned earlier in the call, we should definitely be looking at 14% to 15% growth next year as well and equal if not higher growth in profits, which we are already tracking as far as the core verticals are concerned. IM, as I mentioned, is a little slow but that is picking up because of the new orders and offshoreability, so that will happen. As far as the currency is concerned, I do not think we have a current view in this point of time. We do not expect any dramatic changes in exchange, probably the rupee may strengthen a little further but we do not see any dramatic changes happening.

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

Dipen Shah Bala, just had one bookkeeping question – if I look at the other income component as compared to about 9 crores last quarter we had about 1.37 crores, so just wanted to know like what is the average yield and where is most of this money invested?

S. Balasubramiam Last quarter you had 9 crores.

Dipen Shah 8.43 crores is what is the other income which is being shown.

S. Balasubramiam Yes, we had a fair amount of incentive provisions which we reversed in July that is a onetime activity and this quarter we do not have it. So that is basically the difference.

Dipen Shah So we should treat 1.37 as the run-rate for the other income going ahead?

S. Balasubramiam Roughly it is around that 1.5 to 2 crores, again it all depends on the flow and the deployment and things like that. That seems okay, your assumption is fine.

Moderator Sir, I would now like to hand the floor over back to Dr. Ganesh Natarajan for closing comments.

Dr. Ganesh Natarajan Thank you very much. As I said we are now pretty optimistic about the future because the order book is good, the pipeline is good. Our vertical strategy, as Nitin outlined, has paid off extremely well and three core verticals Manufacturing, Insurance and Retail are all fine. . In fact this year we focused a lot on the SAP business because we were very strong in Oracle. So that has also taken off well. So overall the business is good. As I mentioned earlier we have had some setbacks from Akibia this quarter but we expect that given the order book, the current quarter will be good and next year there is no reason why they should not grow at least 15%. So overall I think all is well with the business and all I can say is thank you for your support and we look forward to having a very good future, 4 or 5 quarters. Thank you very much.

Moderator Thank you. On behalf of Zensar Technologies, that concludes this conference. Thank you for joining us.