



“Mastek Limited Q1-FY13 Earnings Conference Call”

October 19, 2012



**MODERATORS: MR. SUDHAKAR RAM – CHAIRMAN, MANAGING
DIRECTOR, CEO, MASTEK LIMITED.
MR. FARID KAZANI – GROUP CFO, MASTEK LIMITED.
MR. YASH GADODIA – ANALYST, CHRISTENSEN INDIA**



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Moderator

Ladies and gentlemen good day and welcome to the Q1-FY13 Earnings Conference Call of Mastek Limited. 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 touch-tone phone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Yash Gadodia from Christensen Investor Relations, thank you and over to you sir.

Yash Gadodia

Welcome everyone to the Q1 FY13 Earnings call of Mastek. Joining us from the management are Mr. Sudhakar Ram – Chairman and Group CEO. Mr. Farid Kazani – Finance Director and Group CFO. At this point I would like to hand over the call to Mr. Ram for opening remarks. Thank you and over to you sir.

Sudhakar Ram

As you can see the quarter continues the trend of growth that we have registered over the last two-three quarters and particularly pleasing is the performance under North American front where all the investments that we have made in insurance seem to be starting to pay off and North America itself has registered a handsome growth. Overall as a company we have been able to get to a quarter-on-quarter growth both in rupee and dollar terms have almost 6% and annually the same quarter last year in comparison we have grown almost 40 plus percent in rupee terms and 20 odd percent in dollar terms, so obviously the base last year was low but still I am pretty happy with that performance.

We have had a bit of aberration; the order book which kept growing quarter-on-quarter, this quarter there some orders which have slipped to the right and to that extent the backlog has come down but given the indications from the business, I am pretty confident that we will be able to make up and improve on the order backlog position in Q2. The growth has been largest in North America but even the UK has grown on the back of existing accounts, on the back of relationship that we have with our partners. India in rupee terms has done well but in dollar terms because of the dollar conversion rates it seems to have degrown in dollar terms but actually in rupee terms it has performed marginally better than the previous quarter. So, overall on all parameters both from revenue as well as the pipeline that we see as well as the traction that we see in the market place, I think we seem to be well-equipped to continue our momentum of growth and register a good growth rate in top line this year therefore it should translate to better bottom line performance this year. Let me hand it over to Farid to take you through the numbers.

Farid Kazani

Thank you Sudhakar and good evening and good morning to all on the call. You would have reviewed the results which have been mailed to you. , We are pleased with the performance in Q1 as we believe that we have done better than our own internal expectation. The Q1 revenue came in 223 crores as against 210 crores in the previous quarter; that is 6.1% growth in rupee terms. It is also a 5.2% growth in constant currency. It is on the back of the US business and



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US revenue shaping and that is encouraging because the investments that we have made, as Sudhakar mentioned, in North America has yielded results both on the P&C side and the L&A which is also shaping up well and we expect growth on that account also to go to be there in the next quarter. In terms of net profitability we ended up with 6.5 crores as against 22.2 crores in the previous quarter and as I had mentioned in the last call, the previous quarter included the year end adjustment on account of incentives, and you would have to keep that aside and look at the normalized profitability. The Q4 EBITDA reported was 13.6% but the normalized EBITDA was 8.3% and against this we have actually ended up with 8.1% in this quarter which is also very good performance considering that we had to take the salary increase, this being our first quarter of the year. The salary increase impact has been 1.5% in this quarter, so even after considering the 1.5% impact of salary increase we have been able to achieve 8.1%. Point to note out here is the salary increased impact is only 1.5% in this quarter because we have given the wage or salary hikes up to certain grade levels in the organization starting from July and we have staggered the salary and wage increase for the rest of the organization which will be effective October impacting quarter two and that is expected to impact the profitability by 1.8% in the next quarter. So, overall 3.3% impact on margins due to salary increase in the organization.

The net profit for this quarter of Rs. 6.5 crores after considering higher tax, as I had mentioned that this year the tax rate and that effective tax rate would be higher since the large part of the profitability is coming from North America where the tax rates are significantly higher than what it was in India therefore after considering the tax rate we have ended up with the profit of 6.49 crores. On the 12 month order backlog we ended up with 421 crores as against 485 crores reported in the previous quarter. It shows the drop of 13.1% rupee term impacted, also because of the translation of the dollar -rupee which was at a close of 56 at the end of June, has gone down closer to 53 at the end of September. In dollar terms it has degrown from 87 million to 80 million which is a drop of 8%. Sudhakar did mention that this is an aberration this quarter. There are quite a few orders which are expected to close in the next quarter and the order backlog will definitely pull back pretty well in the next quarter, so it is not a cause for worry at this point and time at all.

The other notable improvement in this quarter has been the cash and cash equivalent position - we have ended up with 153 crores approximately at the end of September versus 138 crores at the end of June and if I have to consider the balance net of debt, it is 153 crores as against 132 crores- it's almost an addition of close to 21 crores in this quarter. So, it builds up a good war chest which can be used for growth in future. We have also added four new clients and we have reported both the numbers the client based on what we have been reflecting regularly and also client base on a 12-month trailing basis. So, we ended up with about 114 clients vis-à-vis 112 clients and as per the previous reporting we ended up with 104 clients as compared to 100 clients. There has also been a headcount increase by 6.5%. We added 194 employees up from 3083 to 3277. The increase includes the employment of trainees which will go into production



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shortly to support the growth for the coming quarter. The product investment cost has been more or less at the same level, it has been at 10.1 crores in this quarter as against 10.3 crores so we continued to kind of invest in the business in North America in the P&C and L&A. We would see the same levels of investment in the next quarter with a shift in the investment more on the P&C side as opposed to L&A.

On a vertical perspective, insurance vertical has grown to almost 42 odd percent of revenue as against 41%. Government has been at the same level closer to 28% and the other verticals have seen a minor drop at 30% against 31% and that has been largely in the IT verticals in North America which is due to some volume fluctuations. From a geographical standpoint, US has now taken the lead and is shaping up at 47% in this quarter as against 46% and UK that is 45% as against 46% in the last quarter. India- Asia Pacific has been more or less at the same level. With the inclusion of the trainees and the required bench for supporting growth, our utilization ratios are lower at 88.8% as against 91.5% in the previous quarter.

Going forward, we do expect good traction from all the three geographies. North America is expected to shape up with the growth in the P&C and the L&A business. In the UK we are seeing good signs of build up happening in the UK Government and India is expected to see good order flows happening on the Government side. So, overall it has been a pretty satisfying quarter for us. I am happy to kind of answer any questions that anyone of you would have and if there is any specific question which you would like in detail I am happy to even receive an email from you, thank you.

Moderator

Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Mr. Pranav Tendulkar from Canara Robeco Asset Management, please go ahead.

Pranav Tendulkar

I just wanted to ask about the two large deals that we won in last quarter, one was I believe \$30 million, so how much of that revenue has come in this quarter and of those both the deals and could you just please elaborate on the type of deal that is how much of it is licensed and do we expect anything above the disclosed amount in services related to revenue from those two deals.

Farid Kazani

Revenue from this big deal has started kicking in this quarter including the license revenue We actually account the license revenue over the implementation period so the license revenue in this quarter has helped both the top line and bottom line. I will not be able to give you the revenue amount of this client numbers because we do not give that. In this quarter we have accounted the license revenue for the three months and we have had some bit of client engagement revenue also.. Over all this client is shaping up well and there will be revenues beyond 30 million because the 30 million actually includes only the licensee and the AMC, AMC starts kicking in from next year but there will be implementation revenue that have started kicking in and hopefully it should build going forward.



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- Pranav Tendulkar** And the same is the case with the other large deal?
- Farid Kazani** On the other deal also in the P&C side, we should be expecting revenue going forward building up
- Pranav Tendulkar** Okay that has not come still now in the quarterly results.
- Farid Kazani** That has not come in this quarter
- Pranav Tendulkar** And how is the insurance vertical in the sense US thing because I am getting from various media reports or from various consultancy reports and seeing that there is a traction in transition from mainframe to the new technologies in insurance vertical in US so that thesis remains that insurance vertical in US is undergoing CapEx stage or how is your demand scenario.
- Sudhakar Ram** Well all the analysts' reports that we have seen and people we talk to seem to be reinforcing the same position and the fact that the pipeline is building up and we also have a healthy velocity of deals, the insurance segment seems to bear that out from our own experience as well. Clearly, insurance is an area with a huge backlog of legacy applications, applications which are actually not helping them be agile in their business or launch new products easily, serve their customers better so for a long time people have been expecting insurance to transform slowly we see that huge opportunity starting to materialize - not at very brisk rate but definitely we will see the momentum there.
- Moderator** Thank you. The next question is from the line of an individual investor, Mr. Nilesh Patel, please go ahead.
- Nilesh Patel** Quick question on the margin, so when can we expect and in which quarter can we expect the double-digit EBITDA margin and hopefully double-digit profit margin, any guidance or any sort of indication on that front?
- Farid Kazani** The attempt would be do that as soon as possible but it is dependent on two factors, how the growth of revenue builds up quarter-on-quarter and secondly what are the impacts on account of the FX rates both on the GBP and the USD. Our expectation is if we reach close to \$45 million revenue base per quarter we should get into a double-digit EBITDA and then going forward with further growth and the various profitability initiatives that we are carrying on it should hopefully also end up giving us double-digit at a net level.
- Nilesh Patel** Any of these either on EBITDA side, can we expect this to happen any time this year.



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- Farid Kazani** There has been good growth quarter-on-quarter on the revenue so this quarter also we have seen 5% dollar growth and reaching 45 million is not difficult and hopefully when we are at that level we should be close to double-digit EBITDA level.
- Moderator** Thank you. The next question is from the line of Pranav Tendulkar from Canara Robeco Asset Management, please go ahead.
- Pranav Tendulkar** I just had a question about UK Government vertical what is the scenario there in the sense we had some soft time period in that revenue stream, so what is exactly changing or what is the reason of increasing build up there.
- Farid Kazani** We have not seen dramatic increase; it has been incremental improvement with penetration in our existing partner accounts. and as the partners start winning additional business from their principles. The UK Government is still on austerity measure as they call and there are no huge programs which are coming up.
- Pranav Tendulkar** Any color on how is the sales organization is shaping up or how are you building them or how are you incentivizing them for the increased insurance revenue in US or any distinct changes in the sales organization that you are making now currently.
- Sudhakar Ram** The sales organization has been built up over the last six quarters and I think the teams are coming together and they are performing well which is why if you see the order backlog itself over the last six quarters, every quarter we have seen an improvement and especially in the last three quarters we have seen a distinct improvement. We also have to recognize that typically in any year we used to win about 12 to 14 new clients, in the last financial year that number crossed 20 and that's largely because of the sales team and that increase in winning will lead to better revenues going forward because every account has its own lead time in terms of revenue build up. So, overall I am pretty happy with the way the sales teams are performing now. Market opportunities are also supporting them that customers are more willing to spend money on major transmission programs and we have pretty much almost fully staffed in terms of sales so we do expect the better SG&A leverage as the growth happens.
- Pranav Tendulkar** Okay and last question about the new hiring that is happening, any vertical specific or any work experience specific hiring that you are doing?
- Sudhakar Ram** Yes definitely because 45% of our business is insurance and in laterals especially if people have insurance background that definitely helps us.
- Moderator** Thank you. The next question is from the line of Snigdha Sharma from Karma Capital, please go ahead.



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Snigdha Sharma I have two questions. One, your utilization rates have actually come down from 90% to 86% during this quarter. Can you throw some light on that and what is the outlook going forward? And secondly, you have talked about the order backlog decline and you said it is an aberration can you also talk about in some more detail?

Sudhakar Ram Utilization as I mentioned in my opening speech that we have added trainees in the employee headcount and those will go on production and once the training period and once we get assigned to projects; the reduction in the utilization ratio is primarily because of that and hopefully this should shape back again, back to normal levels in the coming quarter.

Snigdha Sharma Would you say 90% is a more normal level?

Sudhakar Ram Yes, closer to the 90% is more of a normal level. I would just like to give a caveat out here that this calculation of utilization is eventually based on our headcount ratio and not typically on a kind of build hours to available hours. We are working on building a metric which is generally acceptable as the build hours to the available hours and hopefully we should aim to kind of even report that number in terms of utilization ratio to the street and to the analyst going forward.

Snigdha Sharma And on my second question about the order backlog?

Sudhakar Ram Well, large orders have got slipped that we expected it to close by September end it may happen more in October, so overall we are confident that we should be able to make up for it and get back on a growth momentum and an improved backlog from Q2 onwards.

Snigdha Sharma Right so if you would just see this quarter versus the last quarter has anything really changed in terms of decision-making, people are more willing to close decisions and go ahead with the project?

Sudhakar Ram There is no macro trend here it is all individual case-to-case and we do not see much difference between the two quarters.

Moderator Thank you. The next question is from the line of Raghuvansh Kaustubh from ING Investment Management, please go ahead.

Raghuvansh Kaustubh Again, following up the question on the order book it will really help to understand that the reduction in order book, could you just tell us which particular geography vertical have you seen the reduction happening from and also if you can give a rough breakup of the current order book in terms of verticals if possible.

Sudhakar Ram See we do not break out, but roughly if you see the order backlog it will be in line with the revenue split across verticals and across geographies.



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- Raghuvansh Kaustubh** And this particular slip has happened in any particular vertical?
- Sudhakar Ram** No, it is across.
- Moderator** Thank you. The next question is from the line of Abhishek Shindadkar from ICICI Securities, please go ahead.
- Abhishek Shindadkar** Could you break the impact of EBITDA, the tailwinds and the headwinds which you had in the quarter.
- Farid Kazani** If you look at the EBITDA we ended up with 8.1% that is after considering the 1.5% due to the wage hike as I mentioned with the balance wage hike to happen in the next quarter. Overall in this quarter, we have seen improvement in the revenue that has helped the EBITDA and the various profitability initiatives that have helped. The EBITDA also included other income which was 4 crores with around 1.7 - 1.8 crores on account of FX gain on the capital reduction of one of our subsidiaries There had been no negatives except that in the India Government business we had to provide an additional 110 lakhs – 112 lakhs as provision for doubtful debts which went over 180 days provision and we hope to collect that in the next quarter
- Abhishek Shindadkar** I know this could be a little repetitive, but in terms of order book is it possible that we share a constant currency number which could help us to understand - that is question one. And question two would be, you mentioned that a percent or some large order slipped into the October month so as a percentage could you share as what percentage of the orders you were expecting in September have been booked already in October.
- Farid Kazani** We will give the constant currency impact also in next quarter onwards so not an issue There have been orders in the insurance vertical both on the P&C and L&AI will not be able to quantify that right away for you; Besides there are Indian Government orders that are expected to close this quarter and another order in the UK Government is expected to close in October and that should shape back the order backlog position back to where it was at the end of June itself.
- Abhishek Shindadkar** Okay that is helpful. And largely can you help us to understand what has been your win ratio today let us say in North America market and how that has improved over the past three or four quarters.
- Sushakar Ram** See after the technology refresh our win ratio had actually dropped almost two years back when the PNC platform that we had turned out to be outdated as compared to the competition but once we did that investment and did the refresh I think our win ratios has been very good and we normally end up winning two and three wheels.



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- Abhishek Shindadkar** Okay, so two of the three where you compete or you are in the last top quartile.
- Sushakar Ram** That is right. Even three have been success rate and deals which are finalized and even from an analyst perspective we continue to maintain our lead in the billing solution. We are still the leaders in billing overall in the North American market and we expect that to continue and the gap to widen as this win rate continues.
- Abhishek Shindadkar** And last one, now we have been hiring freshers, so at the end of FY13 what could our pyramid be or what could be the zero to three year band number and relative to what it had been let us say in FY12?
- Sudhakar Ram** Offhand we do not have that thing but we are not, like I said our zero to two typically tends to be much lower than the industry average, but I do not have that off-hand saying that how will the pyramid change, we are expecting obviously one of the margin driver is just to get the pyramid to flattened.
- Abhishek Shindadkar** No, actually I was coming to that so would that be margin lever and if yes how much can we released into the P&L that is what the question was.
- Sudhakar Ram** Yes, Farid's EBITDA improvement plans also come out of flattening the pyramid it is not all SG&A leverage it is also gross margin leverage based on resource cost.
- Moderator** Thank you. The next question is from the line of Pranav Tendulkar from Canara Robeco Asset Management, please go ahead.
- Pranav Tendulkar** I just wanted some color on the consulting expenses that we do per quarter that is one and second thing is any color on the type of insurance customers that we are focusing for the STG say Tier-1 or Tier-2 or insurance brokers in markets and third question is about Elixir how is that shaping up.
- Sudhakar Ram** Let me answer two and three and then Farid can come back and answer one. The STG strategy is actually to go out of royal tiers of the market. Earlier before Mastek acquitted STG was largely in the Tier-3, 4, 5 segments but we have been putting sustained effort and now I mean when that we announced last year was Tier-1 company, it is a Fortune 100 kind of a company and we have been winning and Tier-1 we have been we have winning and Tier-2 definitely a profile of customer has moved upwards but we are not giving up on Tier-3, 4, 5 which is still a viable market and a large base of customers which is there, so we have a multi tier strategy and the product lines and how we will take into market also varies, that is something we have fine tuned. For Tier-1 and 2 we are largely focusing on license sales while for Tier-3, 4, 5 we are looking at an ASP/SaaS Cloud kind of offering because that is something which may be more interactive and more affordable to a smaller customer. So, in January we will be launching our Cloud based offering of the STG, PNC platform. As far L&A goes I think the



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first thing Forrester went live in January. We are now expecting the policy admin system to get live in the Q2 which is October to December. We have another customer Wawanesa which should go live in middle of next year in 2013 and I think we should book one more deal in the Elixir PAS segment this year and that will help us to establish the product and as these things go live the market momentum will build but definitely from an analyst perspective and customer perspective, people are expecting the policy admin system in Life to grow in the coming years because there again people have been setting on legacy platforms which do not serve their purpose so we do expect that once we have proven customers and happy customers that the market for Elixir in North America should also expand.

Farid Kazani

Yes, with regard to the first question our consultancy cost was 36.5 crores in this quarter and it is linked to a project that we do for one of the projects for BT and those are onsite recruits. This cost has grown marginally as compared to the previous quarter and we expect it to grow a bit in the coming quarters linked to kind of additional work that we expect to do in that account, so we will see some increase out you should look at this cost as more in terms of employee cost for onsite recruits which are taken on sub-contractor basis and the reason why we take sub-contractors because the project is a defined time project. it is not a long-term contract and therefore we do not want to take on any permanent employees onsite and subcontractor works well for us right now.

Pranav Tendulkar

Any plans to expand beyond billing in both the markets US and UK in insurance?

Sudhakar Ram

In PNC we also do PAS which is not just billing and last year we did win some PAS customers, so we are planning to also extend the technology refresh to PAS this year - that will be a two year kind of a program to get the entire part of the admin system built out around our new technology but we do expect to win new customers on that so as we are building the platform we will also have revenues coming out of it. In Life and Annuity we are already in policy admin in both the markets. As far as PNC goes we do not have any presence in the UK market and I do not think this year we intend to open anything in the UK because there is just so much happening in the US that we want to focus and get our fair share of that market.

Moderator

Thank you. The next question is from the line of an individual investor Mr. Prabhakar Deshpande, please go ahead.

Prabhakar Deshpande

When will the company return to 140 crores net profits, 200 crores net profit, you have been there earlier?

Sudhakar Ram

It may take a few years.

Moderator

Thank you. The next question is from the line of Raghuvansh Kaustubh from ING Investment Management, please go ahead.



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Raghuvansh Kaustubh Just in terms of the competition the PNC space, the opportunity as we hear is pretty good so do you also see an increase in competitive intensity and also how difficult you think it is as somebody asked to cross-sell your billing platform customer, can you sell the policy platform is that also going to happen sometime soon.

Sudhakar Ram In terms of competition, these are not things where you suddenly get competition because it takes quite a long time to build a product and understand this domain. Our competitors remain the same that the traditional competitor has been CAC and their hottest group that we keep facing on a day-to-day basis is a company called Guidewire which had its IPO last year and that is almost \$200-\$225 million company now. So, that remains a prime competition. What was the second question?

Raghuvansh Kaustubh I am saying in terms of like we are very good in PNC...

Sudhakar Ram Yes in terms of cross-sell, it is not so easy to cross-sell because all these had different business requirements and they emerge at different timeframes just because somebody has bought billing does not mean they will replace this policy admin immediately, but as an when they come up for a replacement of policy admin we have a good chance. But it will not happen just one after the other because each one is the major program and people do not take multiple programs on together. Having said that, there will be some customers who take all three together, they take billing, they take policy admin, and claims together. I mean last year one win we had was all three together, which was the Cypress deal.

Moderator Thank you. The next question is from the line of Pranav Tendulkar from Canara Robeco Asset Management, please go ahead.

Pranav Tendulkar I have read all the transcripts for last four quarters if I have missed somewhere, is this order book includes the extra revenue other than mentioned in the media that is 30 million of 60 million that is the service revenue other than the just license revenue is built in the order book or it is not built in the order book.

Sudhakar Ram Yes, it will include service revenue in the order book, 30 million does not but our current order backlog does.

Moderator Thank you. The next question is from the line of Abhishek Shindadkar from ICICI Securities, please go ahead.

Abhishek Shindadkar Could you just quantify the quantum of salary hikes we gave in this quarter?

Farid Kazani Yes the salary increase this quarter has been three crores which is around 1.5% to the revenue and the balance hike is around 4 odd crores, which is going to be in the next quarter it would be 1.8% to the revenue.



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- Abhishek Shindadkar** So this quarter the impact was 3 crores and the next quarter it will be 4 crores.
- Sudhakar Ram** 4 additional crores.
- Abhishek Shindadkar** Separately what I was asking is the percentage quantum also if you can specify what you gave for offshore and onsite.
- Farid Kazani** 8% for offshore and 3.5% for onsite.
- Moderator** Thank you. The next question is from the line of Amit Rane from Quantum Securities, please go ahead.
- Amit Rane** My question is on US geography. Basically, the nature of that market is bit complex because of the different regulation of various states and all, so after we actually implement Forester partnership will we be able to get client references in other states like if you can throw some light on that, what are the plans on that front?
- Sudhakar Ram** Forester itself operates in many states in the US, I do not think they operate in all 50 but fair cross-section of them and the SEG platform that we bought has content across all the states of US, so that is not an issue.
- Moderator** Thank you. As there are no further questions I would now like to hand the floor back to Mr. Sudhakar Ram for closing comments.
- Sudhakar Ram** Thanks everyone for participating in this call. I really appreciate the interest and persistence that you have had in being behind Mastek and as you can see we have turned the corner and I am optimistic that we will continue on our growth part and return to good profits over the next few quarters in few years, so thanks everyone and see you in January.
- Moderator** Thank you. On behalf of Mastek Limited that concludes this conference. Thank you for joining us.