"Mastek Limited Q3 FY12 Results Conference Call"

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MR. FARID KAZANI – GROUP CFO, MASTEK LIMITED.
MR. YASH GADODIA – CHRISTENSEN INDIA

Moderator Ladies and gentlemen good day and welcome to the Mastek Limited Q3 FY12 Earnings Conference Call. As a reminder for the duration of this conference all participants' line will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference, please signal an operator by pressing '*'and then '0' on your touch-tone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Yash Gadodia, Christensen Investor Relations. Thank you and over to you sir.

Yash Gadodia Good evening and welcome everyone to the Q3 FY12 earnings call for Mastek. Joining us on the call from Mastek are Mr. Sudhakar Ram, Chairman and CEO, Mr. Farid Kazani Group CFO and Finance Director. At this point I would like to hand over to Mr. Ram for opening remarks. Thank you and over to you sir.

Sudhakar Ram Thank you Yash and good evening to everyone. As you would have seen that the results this quarter have been positive we have finally returned back to profit after almost 6 quarters. We have registered a healthy growth in top line both in rupee terms and in dollar terms, that has been encouraging and what is more encouraging is that we have seen growth in the UK, we have seen an order book and pipeline improvement in the US and even our India geography has started doing pretty well from a growth perspective. We did add five new accounts this quarter and the overall momentum in terms of new deals and insurance is looking positive as there are more companies looking at making new investments in policy admin as well as billing system both within the property-casualty as well as the life and annuity segment. So the investments that we have made over the last 2-3 years in developing the product, we see them having a good chance of starting to pay off as we go in the quarters forward. So we have seen a turnaround, we have definitely got into a growth momentum; it has helped us get in to the black again. We expect to continue on this growth track given the pipeline that we have. So with this let me hand it over to Farid Kazani, our Group CFO, to take you through the actual numbers.

Farid Kazani Thank you Sudhakar, and I hope all of you would have got a copy of the results and the text that has been sent out. It's been an all around improved performance consistent with what we have seen in the last quarter to this quarter. We have seen improvement on the top line and the bottom line and back to profitability after 6 quarters. In terms of the main headline numbers, revenue was at 185 crores as compared to 173 crores, which is a 7% growth in rupee terms; in dollar terms it has grown 10.1% and in constant currency at 9.2%. EBITDA was at 17.6 crores as compared to 5.6 crores in the previous quarter which reflects an expansion of 600 basis points as against 3.2% that we did in the last quarter, we have done 9.4%. In terms of bottom-line profit after tax was 7.1 crores vis-a-vis a 1.5 crores loss in the previous quarter. On a YTD basis Q3 March ended the revenue was 513 crores as compared to 449 crores in the corresponding previous year and that reflects a growth 14.5% and in terms of EBITDA for the nine months it is 11.6 crores as compared to a negative 9.2 crores in the previous period. There has been an improvement of the order backlog as Sudhakar mentioned; again it is an all-round improvement. We ended up with 401 crores at the end of March as compared to 369 crores, which reflects an 8.6% growth in rupee terms; in dollar terms it is much higher. Coming back to the revenues we have seen growth across all the geographies with UK and India Asia Pacific showing a pretty decent improvement whereas North America has shown a dollar growth which is a marginal dollar growth in this quarter. Albeit in rupee terms it has been down because of the exchange rate being lower in this quarter as compared to the previous quarter.

We added five new clients taking the total clients accounts to 95 at the end of March and the five new clients came in both from North America and from the India Asia-Pacific. Utilization ratios have been pretty much constant. In the period ended March utilization was 88.5% and the headcount ending at 2983 as compared to 2926, there has been some increase in the headcount and we expect with the revenue growth expected in the future quarter we would add some additional headcount in the next quarter. Our products spends have been focused in North America in the L&A and P&C business and in this quarter we actually spent 12.2 crores as compared to 11.5 crores. Total spend up to 9 months is close to 35 crores.

From a revenue split between the geographies - UK in this quarter have end up with 50%, North America at 42% and India Asia Pacific at 8%. There has been an improvement in India Asia-Pacific because of a good decent growth that has happened, whereas North America there has been a marginal reduction comparatively. On a vertical split insurance ended up with 39% in the quarter; government has improved a little over 30% and the other two verticals total to 31%. There has been also a good improvement in the cash and cash equivalent position of the company at the end of this quarter. We ended up with 129.4 crores as compared to 113.7 crores in the previous quarter, which is reflective of 16 crores improvement but if I have to look at a position net of debt as against 94 crores last quarter, we have actually improved it to 123 crores which is an improvement of 29 crores between Q2 and Q3. This has come about in terms of a conscious management on our working capital including reduction in the receivables from 220 crores down to 200 odd crores and as seen, there has been a positive EBITDA that has helped in terms of improving the overall cash position of the company. The receivables stand at around, around 58 days and the total receivable including the WIP stands at 90 odd days. The improvement in the order backlog gives us definite confidence of improvement in the overall financial performance of the company and we do expect to kind of show a much better performance both in terms of revenue and in terms of profitability going forward. In this quarter we had our revenues to the extent of five crores that came in from a customer where we were able to kind of close out some clarifications and in an agreement, we received money and we were able to bill the five crores to that customer so that has been reflected as a notes to account.

As you would all be aware that we implemented AS 30 from the previous quarter that is from Q2, where we have the mark to market on our forward covers being reflected actually as a part of the reserves and not being routed through P&L account. So in this quarter with the exchange rate moving down, the dollar rupee exchange going down from 53 in December end to March at around 51, the position in the reserve account which was standing a little over 14 crores has gone down to 7 crores so that gain has quite reflected in the reserve account as opposed to P&L if we had not followed AS30. In the P&L account it reflected a small Fx loss which is akin to the translation loss of around 65 lakhs as opposed to a 45 lakhs gain in the previous quarter. So overall a pretty good financial performance and we hope to maintain that going forward. Thank you and if there are any questions we are happy to answer them. Thank you Sudhakar.

Moderator Thank you so much. We will now begin with the question and answer session. We have a first question from the line of Yash Ved from IIFL, please go ahead.

Yash Ved Sir, I just want to know going forward, how do you see the order backlog coming off? Do you expect more orders coming off?

Farid Kazani As Sudhakar did mention that we have seen a good improvement in our pipeline There is bound to be an improvement in our order booking which will also translate into an improvement in the order backlog. In terms of statistics, we started the year with 309 crores order backlog in July and we have improved that by almost close to 100 crores in three quarters and we expect this also to improve in the next quarter.

Yash Ved Sir, what's your investment plans on CAPEX if you can tell me in this quarter and going forward?

Farid Kazani We have capacity in our existing facilities and we don't need any buildup CAPEX, whatever CAPEX is incurred is only maintainable CAPEX and that would be in the region of roughly 10 crores per annum.

Yash Ved Okay and in terms of acquisition you have not spoken about, could you tell me like the last quarter acquisition you were trying…?

Sudhakar Ram Nothing in the near horizon, obviously we are in the look out to complement our capabilities but nothing that is expected to close in the next quarter or so.

Moderator Thank you. We have our next question from the line of Subhankar Ojha from SKS Capital and Research, please go ahead.

Subhankar Ojha Sir, looking at your current quarter as you have mentioned that after 6 quarters you have been able to post a profit actually. I would like to know the sustainability of this trend in current quarter. Are you going to see a similar trend going forward? Secondly, what all factors have helped you to post a profit in the quarter?

Farid Kazani One of the lead indicators that we have been guiding the market is in the order backlog and we did say that we will see an improvement in the revenues with a lag as we see the order backlog improving. We have the order backlog improving pretty decently in the last four odd quarters and that has propelled the revenue growth in this quarter. Hopefully, we should see that continuing we expect to grow the order backlog in the next quarter. We should see the momentum in the revenue growth going forward. Although, we will not be able to give exact statistics of what will be the growth in the next quarter but we are definitely positive that there will be a growth in the top line. On profitability there has been a conscious improvement in all areas, whether it is at an operations level or in the other cost buckets across various support functions and corporate functions and the cost management has helped with the actions that we had taken in the last few quarters. So there will be an improvement in the profitability as we see an improvement in the revenue because we will get the benefit of leverage and we hope to comeback to a decent level of profitability in the next few quarters. Keep in mind that we have our start of the year in July, where we do give salary increases in Q1 and we will have to work towards mitigating some impacts of the salary in the Q1 which is the September quarter.

Subhankar Ojha And sir no growth projections as such but if we are looking at your current order book, is it possible to maintain the growth for the next couple of quarters or for next one year?

Farid Kazani The pipeline is definitely looking healthy but you should be aware that each deal has a timing of closure and depending upon how soon and what time that we are able to close out deals in our favor will reflect the kind of propensity of growth. So there are definitely positive signs in all the three geographies as we see especially in the P&C segment in US, in some of the government areas in the UK and in the India government areas.

Moderator Thank you. We have the next question from the line of Dipesh Mehta from SBI Cap, please go ahead.

Dipesh Mehta Sir, congratulation on good set of numbers. I just want to understand the nature of that five crores what you mentioned as contractual obligations ,whether it should be recurring in nature or how it is and whether correspondingly expenses are also booked in this quarter?

Farid Kazani No, if you look at the note that we have given in the financial release, the 5 crores was made up of two particular areas, one is where we were supposed to bill a client for the revenue where they were seeking clarifications, where we could then account for it. It pertained to an earlier period and there were certain other contractual obligations that the client was suppose to pay us money which was received in this quarter and we were able to account that as revenues, so that has come in this quarter. Yes, there is no specific corresponding cost in this quarter for that and therefore we don't expect this as recurring revenue however, we do business with this client and we expect growth from this client going forward.

Dipesh Mehta Okay and just about the business side, if I see the US appears to have some kind of weakness this quarter. So can you provide commentary about each geography, what we expect going forward?

Sudhakar Ram Actually if you understand US, the revenues have lagged a bit because the order booking didn't happen at the pace at which we wanted but towards Q3 which is our Jan-Feb-March quarter, we have had a healthy order book in the US which would lead to a better growth next quarter. It was a marginal improvement in dollar terms this quarter, it should improve better next quarter. As you see in this quarter UK turned around and it is registering growth every quarter and so is our India government so on those two markets the backlog is there and the turn around has happened and sustained growth is possible and US that will happen in Q4 which is the April-May-June quarter.

Dipesh Mehta And going forward do you expect the growth rate to be different in each geography or it would be very similar considering our deal pipeline and already won deals?

Farid Kazani Obviously, quarter-on-quarter there would be a variations by geography so it is not going to be the same but on the consistent basis we would say that we would like the US to grow faster, given that, that is the largest insurance market but others not too far behind, the UK and India not too far behind in growth rates.

Dipesh Mehta Excluding quarter-on-quarter aberration it would be more or less similar growth?

Farid Kazani Yes.

Dipesh Mehta And just about the insurance side, about industry side, Insurance also appears to be relatively weak compared to other segments. Sir, can you provide commentary about insurance and government business?

Farid Kazani Insurance is not relatively weak. I think it is just an execution and the project completions in any specific quarter. In fact, if you see the growth and the pipeline, the insurance is a significant part of the pipeline and it is expected to get growth for the company.

Dipesh Mehta So that would drive growth or government you expect to drive the growth?

Farid Kazani It would be more insurance than government.

Moderator Thank you. We have a next question from the line of Madhu Babu from Sunidhi, please go ahead.

Madhu Babu Sir, can you give any hiring outlook in terms of employees for the next one year?

Farid Kazani We don't give the data in terms of hiring plans but in terms of the next quarter, there will be some hiring because we have seen the improvement in the revenues so there will be some improvement but marginal growth in headcount.

Madhu Babu Sir, what is the resource quality you are deploying for the Indian projects and what are the margins, if you can disclose on the Indian government projects?

Sudhakar Ram There is no difference in resource quality because the nature of work that we do is fairly mission-critical for India like we are working in areas like social justice and sales tax and so on so we have to have good resources in India but obviously the margins we make in the Indian market are lower than what we make in the US or UK.

Madhu Babu We have won some deal in the US countrywide for the STG platform. Could you just give an outlook of how this traction is happening on Elixir as well as STG, both the firms?

Sudhakar Ram So on the STG, we are the leaders in billing and if you have seen analyst reports, we have been rated as the best in class in terms of the billing solutions both in terms of technology and in terms of the functionality so there we are looking at larger customers Tier 1, Tier-2 kind of customers and there is an increasing receptivity. Last year we have made substantial investments in technology upgrade to our billing system and today people are finding it to be much better than the competitive offerings from a technology perspective. So that is something where we are looking at very significant growth opportunities over the next couple of years. As far as Elixir goes as you are aware the first customer is Forester, we just had one module of Elixir go live last quarter, we are expecting more modules to go live and the policy admin module will also go live in the middle of 2013 with Foresters. We had also announced one more deal on the back of Fosterer which is a company called the Wawanesa. So that customer will go live towards the end of this year early 2013 and there is a pipeline building up, people are watching how these implementations go so towards the second half in this calendar year we should be able to get our third customer in Elixir in the US markets.

Madhu Babu So sir, now these are all nonlinear initiatives so when can you expect the margins turnaround at the EBITDA level may be at sustainable 10% to 15% kind of EBITDA margins? When will we be back, any timeframe for this?

Sudhakar Ram I can't give an exact time frame but if you see the EBITDA margins this quarter, there has been a very nice improvement of the EBITDA margin from last quarter, obviously part of it is helped by this one-time non-recurring thing that we had but the efforts are on and today you can see that the growth will have a very direct contribution to improvement in EBITDA. The cost actions have been taken and pretty much that part is well set. Now it is a question of getting the growth momentum back and that will immediately translated into EBITDA and obviously, we also want to get back to a double-digit EBITDA as soon as possible but it is difficult to say exactly when it will happen.

Moderator Thank you. Our next question is from the line of Dipesh Mehta from SBI Cap, please go ahead.

Dipesh Mehta Sir, just want to get attrition rate, what was the attrition rate last quarter?

Sudhakar Ram Attrition was under 20% last quarter annualized.

Dipesh Mehta And now it appears to be under control?

Sudhakar Ram In fact, it has come down quite significantly over the last three quarters. As people see the growth and new orders and the kind of programs that Mastek is winning.

Moderator Thank you. We have our next question from the line of Kavita Vempalli from Nirmal Bang Securities, please go ahead.

Kavita Vempalli On this your 400 crores order book, can you just give us some split geography-wise, where exactly is the order book coming from?

Farid Kazani The order backlog is also pretty similar to how our revenue is shaping, it would close to 50% from the UK, 40% odd from the US and 10% from India and Asia - Pacific.

Kavita Vempalli Okay and sir, could you give us your USD revenues?

Farid Kazani The USD revenue is $37.1 million in this quarter.

Kavita Vempalli And what was it in the last quarter?

Farid Kazani 33.8.

Moderator Thank you. We have a follow-up question from the line of Kavita Vempalli from Nirmal Bang Securities, please go ahead.

Kavita Vempalli Sir, could you just give us some idea on the pricing front and when you speak to your clients, are you getting some improvement in pricing and what is the environment there?

Sudhakar Ram Actually we don't see too much difference one way or other on pricing, some customers have given us an increase last quarter or the quarter before that but it is not a prevalent trend across; but having said that, a lot of our business happens in especially product implementations at fixed-price so there obviously our margins expectations are based on our current cost, so there is a price factor already built in there.

Kavita Vempalli Okay and secondly on the IT budgets. Are you hearing something from your clients like any kind of ramp up or stuff like that?

Sudhakar Ram So what we play in is not the keeping the lights on budget but the new initiatives transformation budgets of our customers, which were pretty lower almost non-existent in the last three years because of the slowdown from 2008 onwards and we have seen that part actually opening up because there is a lot of pent up demand for new IT systems which have not been fulfilled. So our own view is that pipeline is improving and as we have checked with the analysts who are focused on the sectors like Celent, Novarica, and Gartner, they are also reporting a lot more deals this year than what it was in the last two years.

Kavita Vempalli Okay so as of now could you just give us some insight, what is this like broad strategy of the management looking for the regular revenue visibility and definitely it has reflected in the order pipelines but at the same time for the EBITDA margins to get back to the double-digit front ?

Sudhakar Ram Right now our growth strategy is largely on the basis of insurance, on the product-based solutions, the fact that we have a strong IP which is very well rated in the American market and we have very specialized services which helps in implementing this IP regarding the benefit for a customer. That story has been unfortunately linked to economic cycle that unless the customers are willing to spend on new transformations we don't do as well. Now that there is an opening up and especially in the US people are seeing a revival of the economy, there is a lot more traction and we expect that part of the market to grow and as our top-line grows it will have a positive EBITDA impact for us.

Moderator Thank you. As there are no further questions, I would like to hand the floor over to Mr. Sudhakar Ram for closing comments, please go ahead.

Sudhakar Ram Thanks Terence and thanks everyone for attending the call and your interest in Mastek. As you see things are looking up and we have turned around as a company, we do expect to report better news as we go forward quarter-on-quarter. So thanks once again and see you again in next quarter in July.

Moderator Thank you. On behalf of Mastek Limited that concludes this conference. Thank you for joining us.