



“Mastek Limited Q1 FY17 Earnings Conference Call”

July 15, 2016



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MR. ABHISHEK SINGH – CFO DESIGNATE, MASTEK LIMITED

MODERATOR: **MR. DIWAKAR PINGLE – MANAGING DIRECTOR, CHRISTENSEN**



*Mastek Limited
July 15, 2016*

Moderator: Ladies and gentlemen good day and welcome to Mastek Limited Q1 FY17 Earnings Conference Call. As a reminder all the participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Diwakar Pingle. Thank you and over to you sir.

Diwakar Pingle: Thank you Zaid. Good afternoon, good evening and good morning to all of you. Welcome to the Q1 FY17 Earnings Conference Call of Mastek Limited. Joining us today on the call to discuss the results and answer your questions we have the top management represented by Mr. Sudhakar Ram – Managing Director and Group CEO, Mr. Jamshed Jussawalla – CFO of Mastek, Mr. Anant Thakrar – Senior Vice President (Finance) and Mr. Abhishek Singh – CFO Designate, Mastek.

To begin with Mr. Sudhakar would give a brief overview about the performance of the quarter and this will then be followed by detailed financial analysis given up by Mr. Abhishek Singh. The Q&A will follow that and I hope all of you have got the results. For those of you have not got it you can also look it up on our website at www.mastek.com. We have put out the press release, investor presentation as well as the revenue analysis sheet which would give you complete details about the quarter of business and operational highlights.

Having said this, I will now hand the call over to Sudhakar. Over to you sir.

Sudhakar Ram: Thank you Diwakar and good day to all of you. This quarter has been pretty much in line with expectations. We serve growth across all our businesses, the UK Organic Business grew, the Indigo Blue Business grew and so the India Government Business, so that way it was a reasonable quarter. We also saw good client additions, almost 11 new customers came on board. We have more than 90 active customers now, so we have a good base to grow our business on. We did see the improvement in margins I think particularly important thing is that the project that was under trouble, we have managed to go live on that project in that quarter, so it was a major achievement by the team. So to that extent it happened faster than expected and the drains and the losses on the project will be at much lower levels going forward. So that should improve our profitability further as we go forward. So those are I think our key highlights.

Apart from that we started our US operation at Digility. We have bagged our first customer in the US which was a US company where we had done work in the UK has now hired us to do program for them in the digital area in the US and this is in the Financial Services business, so I think that is a very good break. We also brought in a president for the Digility operation - Madhu who is ex-Hexaware and we expect him to bring solid leadership to help us grow the US part of our business going forward.



*Mastek Limited
July 15, 2016*

The unexpected occurrence in the quarter as all of us were aware was Brexit. We did not anticipate it. It is good that I mean we thought there would be a delay in terms of the new prime minister coming on board. It is good that that has happened much faster but we have to really study the impact over the next few quarters.

One thing which has impacted us and which will impact us from Q2 FY17 is if the pound continues at its current levels which below Rs. 90 to a pound I think it has a straight impact on our topline. It is almost 1% for every rupee drop in the pound. And the bottom-line impact is now linear because of our onsite cost. So there will be a bottom line impact but that will be far more muted than the top line impact. And let us see how it pans out over the next few quarters. So a reasonably good quarter, so let me hand it over to Abhishek to take you through the numbers.

Abhishek Singh:

Thank you Sudhakar. Good morning and evening to all of the participants on the call. Let me take you through the highlights of the quarter.

We ended the quarter with operating revenue of Rs. 130.1 crore as compared to Rs. 124.3 crore in the previous quarter. This reflected a QoQ growth of 4.7% in rupee terms and a rise in constant currency by 5.7%. Last year same quarter year-on-year, we did Rs. 133.3 crore in revenue which reflected a drop of 2.5% in rupee terms and a 1.3% in constant currency terms. Sequentially our growth was driven by growth in revenue in all the businesses across the segment. We saw revenue growth in UK, we saw revenue growth in our consulting practice as well as India business.

In terms of our total income, we have ended the quarter with Rs. 133.6 crore as compared to Rs. 127.6 crore in Q4 FY16. This is a 4.7% growth again on quarter-on-quarter basis. Year-on-year we had a degrowth of 3.9% in rupee terms. Our Q1 FY16 revenue was Rs 139.1 crore.

Our EBITDA stood at Rs 10.8 crore for the quarter at 8.1% of the total income as compared to Rs 4.0 crore for the last quarter at 3.1% of the total income. In Q1 last year we did Rs 16.6 crore in EBITDA which was 11.9% of the total income so to that extent we have had a degrowth here as well.

In terms of net profit, we were at Rs 3.6 crore in Q1 FY17 as against Rs 5.9 crore for the last quarter. The growth was impacted due to some of the events that we had this quarter mainly in the areas of tax. Last year Q1, we did Rs 4.4 crore in PAT

In terms of clients, we added 11 new logos during the quarter, 2 of them were in India in Government space and 9 of them were in UK. This means that our total active client count now stands at 92 on LTM basis.



Mastek Limited
July 15, 2016

In terms of 12-months order backlog, it stands at Rs. 216.5 crore as against Rs. 205.5 crore at the end of Q4 FY16. This represents a 5.4% growth quarter-on-quarter. Our top 5 clients' revenues were at 52.5% and top 10 clients contributed 71.5% of the revenues this quarter.

We have had good cash collection this quarter and our DSO stood at 55 days vis-à-vis 66 days at the end of Q4 FY16. It was 73 days as of end of Q1 FY16 and as a result of this we have had a good jump in our cash. Our net cash position stands at Rs. 139.5 crore as against Rs. 119.9 crore at the end of last quarter. Mastek's hedge positions are also covered well. We have close to £14.2 million in hedge which is covered at Rs. 108 for every pound.

And as Sudhakar mentioned the verticals we are in across Government, Financial Services, Retail. So Government is our largest vertical at 48% of the revenue, Financial Services contributes 27% and Retail contributed 14%. Rest of it is constituted by IT and other domestic businesses.

Our total headcount stood at 1,302 people at the end of Q1 FY17 as against 1,298 at the end of Q4 FY16. And our billable utilization also moved north. It is now at 80.2% as against 78.7% last quarter. These are the summary updates of financials. Let me hand back to the operator for Q&A.

Moderator: Thank you sir. Ladies and gentlemen we will now begin with the question and answer session. The first question is from the line of Mohit Jain from Anand Rathi. Please proceed.

Mohit Jain: My question is related to revenue growth. So what kind of visibility do we have after a strong Q1 and are you seeing any slowdown because of the whole Brexit thing that is happening specially on the Government side?

Sudhakar Ram: Thanks Mohit. Yeah, definitely that is something we are watching out for because with the new Government coming in, will there be a delay in terms of Government decisions which are in the pipeline. As of now the situation is not all that clear because the new prime minister in place pretty fast. But we would know within the next few weeks whether there has been any delay in terms of order book. So if there are delays in starting up new programs it will have an impact this quarter but if that delay is not there I think we will be well set.

Mohit Jain: You were not experiencing anything as of now?

Sudhakar Ram: It is too early to know that Mohit.

Mohit Jain: Okay, second is on the currency movement you said there will be an impact on revenues. So given that bulk of your revenues are coming from GBP, we assume like a flat currency rate on your exchange rate or how does the hedging work for you for second quarter?



*Mastek Limited
July 15, 2016*

- Abhishek Singh:** Our Q2 is reasonably covered. We are more than 60% covered but the key question here is that consolidation related impact would still be there given that the current rate Pound is sub-90. So to that extent we will experience some top line impact. But the bottom line impact would not be there because of the natural hedge that we have. Our spend is also in GBP.
- Mohit Jain:** So what you are saying is revenue will be hit to that 8-9% extent whatever is the currency rate for this quarter and that will flow through to EBITDA but in other income you will try to cover up through hedges.
- Abhishek Singh:** Partly correct Mohit. The other part of it is that it is not exactly the spot rate but it is the average of the six months that would come into play as on 30th September, so it would not be like exactly 89 or 88 the spot that would be running. But yeah, the top line impact would be there.
- Mohit Jain:** Second thing is what kind of natural hedge do you have? What kind of margin impact will it have if you have this 1% or 2% move in the currency on the average side?
- Abhishek Singh:** Being an onsite team out there, so my expenditure is also significantly in GBP. So to that extent I do not have a margin erosion. The impact would be to the extent of what we do from offshore and that we expect that it would be anywhere between 10 to 25 basis points.
- Mohit Jain:** So, the impact would be partial?
- Abhishek Singh:** No, that is the total impact I am telling you. The top line impact would be there for every Rs. 1 movement there would be 1% impact on the top-line.
- Mohit Jain:** Even if the exchange rate moves by 8% to 9% your margins will only move by 10 to 25 bps, that is what you are saying?
- Abhishek Singh:** Correct, I do not have margin expansion significantly because my offshore footprint is not that big.
- Mohit Jain:** So that is clear. Third is on the troubled project. What was the quantum of loss in this quarter and what should be assume going forward?
- Sudhakar Ram:** No, with the system going live I think we have contained losses pretty significantly in this quarter and so the impact going forward will be quite small. And as the other business grows I think we will be able to manage it.
- Mohit Jain:** So how much was it in the last quarter?
- Sudhakar Ram:** That we would not be able to share Mohit.



*Mastek Limited
July 15, 2016*

- Mohit Jain:** And fourth quarter you shared around Rs. 5 crore, is that the right number?
- Sudhakar Ram:** Overall for last year we shared Rs. 30 crore.
- Mohit Jain:** And we should not assume anything going forward.
- Sudhakar Ram:** Yes.
- Mohit Jain:** So lastly Abhishek on the tax while it is so volatile for us, this quarter also you paid almost 50% in taxes.
- Abhishek Singh:** I will cover that part and I have also got Mr. Jamshed on the call if you need any specific details. Having said that we changed our business model wherein UK becomes the prime and India is the sub. Because of the change in the marketplace domestic UK needs to take lot more decisions and risk. So to that extent that change called for certain contractual changes and that one-time revenue came into India books for which we had to provide for the taxes.
- Mohit Jain:** Going forward or even for FY17 your tax rate is likely to be closer to 30% or 40% or 50%?
- Abhishek Singh:** It will be definitely lower than what you have here but would not be significantly lower.
- Mohit Jain:** And lastly were there any revenues from US in this quarter which were booked, you talked about one contract win?
- Sudhakar Ram:** Nothing major but there were revenues from the US this quarter.
- Mohit Jain:** And that is ramping up in Q2-Q3, is it a major chunk?
- Sudhakar Ram:** Yes, over this year it will ramp up.
- Mohit Jain:** Can you share the quantum of the growth that can come from there?
- Sudhakar Ram:** This particular contract is a few million and I think we will execute it over the next 15-16 months, but we expect new business with our teams coming together. In Q2 there would not be much impact but Q3-Q4 we will start seeing new accounts being developed in the US.
- Moderator:** Our next question is from the line of Parag Bharanbe, who is an individual investor. Please proceed.
- Parag Bharanbe:** In the presentation it is mentioned that 48% of the revenue is from the Government and in the last 5 quarter you have added around more than (+40) clients. So does the majority of the client belong to private sector or they are more skewed towards the Government sector in UK?



*Mastek Limited
July 15, 2016*

Sudhakar Ram: Actually we have had a reasonably mix across Government, Retail, some Financial Services customer also. So it is across all sectors.

Parag Bharanbe: So going forward do you see any reduction in the amount of revenue coming from the Government or you are not targeting anything like that. As and when it comes you are willing to take it?

Sudhakar Ram: That is right because Government is a very important segment and we are one of the few players who have got the ability to deliver digital transmission for the Government. So we compete with the handful of companies who are all local companies. So we are well-positioned competitively in the Government space and we do see Government business growing. So we have no intent to reduce percentage of Government business, but quarter-on-quarter there will be variations.

Parag Bharanbe: And another thing is the quantum of fixed projects which are being executed they have come down from 42% to 28% in last one year. So is there any reason?

Sudhakar Ram: That is a good observation. What is happening is as more of our programs become Agile it becomes quite tough to do fixed price in an Agile mode where the scope keeps varying. So between the customers and all we are struggling to find a model where we can still go back to fixed price but as of now we have not found that. So given that its Agile program tends to be more T&M but the programs are still managed by us. So we still own the program, we still are accountable for the outcomes. The only thing is the pricing mechanism is difficult to have a fixed price when the scope keeps changing.

Parag Bharanbe: But at the same time even there are more onsite resources this means that your net margin would be significantly less as compared to the fixed price. And additionally the company would not be able to position or give as much benefit to the client in terms of pricing as your wish if the project is executed offshore.

Sudhakar Ram: That is correct.

Moderator: The next question is a follow up question from the line of Parag Bharanbe who is an individual investor. Please proceed.

Parag Bharanbe: I think I forgot to ask a question. There was one project which was incurring losses and I have not seen the number shared in this press release about the losses this quarter. So I am just wondering if you are sharing the losses or you are not sharing the losses this quarter?

Sudhakar Ram: The losses have been reduced quite substantially. So that led to an improvement in margins this quarter.



*Mastek Limited
July 15, 2016*

Parag Bharanbe: Because I think last quarter they were around Rs 4 - 5 crore, so this quarter is not significant to think or to worry about.

Sudhakar Ram: It has started. Going forward I think we have got the project under control.

Parag Bharanbe: Ok got it. Thank you so much.

Moderator: As there are no further questions, I now hand the conference over to Mr. Diwakar Pingle for closing comments. Over to you.

Diwakar Pingle: Sudhakar, any other closing remarks before we can wind up the call?

Sudhakar Ram: No, I think like I mentioned this is a quarter which has been in line with expectation, no real surprises. The good part is that the troubled program is coming back under control. We have started our US operation. Our pipeline and new client additions have been healthy and we expect all this to translate to better growth in the quarters ahead.

Moderator: Thank you sir. Ladies and gentlemen on behalf of Mastek Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.