



# “Mastek Limited Q1 FY-18 Earnings Conference Call”

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**MODERATOR: MR. DIWAKAR PINGLE – CHRISTENSEN IR**



**Moderator:** Ladies and Gentlemen, Good Day and Welcome to Mastek Limited Q1 FY18 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If 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 from Christensen IR. Thank You and over to you Sir.

**Diwakar Pingle:** Good afternoon to all of you and thanks for joining the Q1 FY18 results. Results and presentations have been mailed to you and you can also view this on our website [www.mastek.com](http://www.mastek.com).

To take us through the results today and to answer your questions, we have the top management of Mastek, represented by Mr. John Owen - Group CEO and Mr. Abhishek Singh - the Group CFO. John will start with the brief overview of the quarter gone past which will be followed by Abhishek who will go into the detailed financials. We will then take the Q&A session.

I would like to remind you that everything said on this call that reflects any outlook for the future or which can be construed as a forward-looking statement must be viewed in conjunction with the risk and uncertainties that we face. These risks and uncertainties are included, but not limited to what we have mentioned in the prospectus filed with SEBI and the subsequent annual reports that you can find on our website.

With that said I would like to hand over the call to John.

**John Owen:** Thank you, Diwakar and let me add my Welcome to the Mastek Earnings Call. I will just give you an update on the business and then Abhishek will go through the detailed financials. Q1FY18 has been a real solid start to the new financial year. We continued to deliver excellent enterprise software solutions to our clients and we have grown in our key markets of the UK and the US and India has been flat. This is reflected in a solid account growth of 12 new logos which increases our trailing customers to 161 with increase to our capacity in our engineering talent by moving our employees to 1,684 and this is being reflected in our revenue growth of 5.3% in constant currency and we are improving our 12-month order backlog by 3% in rupee terms. Operationally, the TAISTech integration is going well and is on track and we are starting to see the benefits of that integration in the market place. We are implementing Vision 2020 which is our business strategy to become leaders in digital transformation. And that is to simplify our operating model so we have got a scalable platform for growth and that is being reflected in the service lines that you see reported today. Some are nascent, some are more mature and that is how we are basically running the organization.

Before handing over to go through the numbers, I think the numbers are driven because we have got very loyal customers who respect and basically appreciate the value that Mastek delivers which is delivering these enterprises grade software solutions in a digital world. And I would also like to pay tribute to our employees who have the talent, the professionalism and the

dedication to deliver those solutions to our clients. So with that I will hand over to Abhishek to go through the financials.

**Abhishek Singh:**

Thank you, John. Hi everyone on the call here. We will go through the performance highlights based on the deck that was circulated moments before the call. If you go to the Slide 3 of the deck, we are talking about our QoQ financial performance. I would like to qualify that all the numbers for the current quarter as well as comparative period is as per IndAS. With that said, our revenue for the current quarter stood at Rs. 188 crores as against Rs. 183.4 crores, up 2.5% quarter-on-quarter. Our operating income stood at Rs. 185.5 crores versus Rs. 180.4 crores, up 2.9% in rupee terms. Our constant currency revenue growth was at 5.3% on a quarter-on-quarter basis. In terms of profit metrics – our EBITDA was Rs. 24.8 crores versus Rs. 21 crores for the last quarter, up 18% quarter-on-quarter basis. EBITDA margin stood at 13.2% in current quarter as against 11.5% for the last quarter giving 170bps margin expansion. Net profit stood at Rs. 14.7 crores versus Rs. 10.5 crores last quarter, up almost 40% on a quarter-on-quarter basis. Net profit margin stood at 7.8% in current quarter as against 5.7% in the last quarter. In terms of cash balance, our cash, cash equivalents and fair value of the mutual funds holdings stand at Rs. 150.4 crores versus Rs. 153 crores for the last quarter. In terms of order backlog, the 12-month order backlog stands at Rs. 344.6 crores or ₹41.1 million as on 30<sup>th</sup> June, 2017 as against Rs. 333.2 crores or ₹41.2 million as on 31st March, 2017, a growth of 3% in rupee terms.

Moving to the next slide, which is year-on-year comparison, our total income for the current quarter stood at Rs. 188 crores versus Rs. 133 crores last year which is a 41.4% growth. Operating income stood at Rs. 185.5 crores versus Rs. 129.2 crores, up 43.6% in rupee terms. In terms of constant currency revenue growth, we have 65.2% growth year-on-year basis. In terms of profit metrics - our EBITDA stood at Rs. 24.8 crores versus Rs. 9.8 crores last year which is a 154% growth year-on-year basis. EBITDA margin is at 13.2% for the current quarter as against 7.3% for the same quarter last year. Net profit stood at Rs. 14.7 crores versus Rs. 2.3 crores last year and the net profit margin stood at 7.8% in the current quarter versus 1.8% for the same quarter last year.

Moving on to operating highlights in the subsequent slide: We added 12 new logos during this quarter. Our total active client counts on “last twelve months” basis stood at 161. Top 5 client contributed 41.3% of the revenues and top 10 clients contributed 53.8% of the revenues. Total employee count stood at 1,684, split as 1,143 offshore and 541 onsite as compared to 1,577 for the last quarter of which 1,045 was offshore and 532 onsite. Our DSO stood at 72 days as of 30th June, a significant increase from last quarter but this was purely driven by timing; we are back to the mid-fifties as of date. Forex hedges for the next twelve months, we have got ₹11 million of GBP coverage at an average rate of Rs. 96.92 for the next twelve months.

The next slide is a tabular representation of the financial metrics that we just spoke about. So we will move on to the subsequent slide which just covers the PAT walk as per the new accounting standards. So last quarter we reported a Rs. 14.5 crores in PAT and the restated number as per IndAS was Rs. 10.5 crores. And the key contributors to that adjustment was the business combination that took away Rs. 1.6 crores, employee benefit expenses which is predominantly

your ESOP expenses that contributed to Rs. 2.7 crores of the cost and the deferred tax. So adjusted for these factors, our PAT for the last quarter came down to Rs. 10.5 crores. We wanted to give this a view so that all of us on the call have a sense of how the numbers have moved.

Moving on to the next slide in terms of our revenue analysis, revenue by regions Q1FY18, 69.4% of our revenue comes from UK, 27.2% comes from US and 3.4% is Others. No significant movement here, UK continues to grow quarter-on-quarter. Revenue by industry during the quarter, Government continues to contribute the significant amount of our revenue at 34.7%, Financial Services grew to 19.3%, Retail was at 37.6% and IT and Other Services is at 8.5%. In terms of revenue by type, the split between Fixed Price and Time & Material, we saw some increase this quarter, so our fixed bid revenues increased to 19.3% and Time & Material revenues at 80.7%.

I would like to tell all our analysts on the call here that we have started to track our business by service lines and hence for the first time we have introduced our revenue break-up by service line and over subsequent quarters we will continue to talk about it and possibly focus just on this. So, the six service lines that we have identified for our business is Application Development which stands at 42.8%, Digital Commerce which stands at 27.2% for the current quarter, Application Support and Maintenance which is at 10.5% of the revenue, BI and Analytics at 8.9%, Agile Consulting at 8.4% and Assurance and Testing at 2.2%.

So, with that I conclude the financial presentation and I would like to offer it back to you Diwakar to take us through the Q&A session

**Moderator:** Sure sir. Ladies and gentlemen, we will now begin with the question-and-answer session. The first question is from the line of Baidik Sarkar from Unifi Capital. Please go ahead.

**Baidik Sarkar:** I am sorry this is a repetition but just wanted to check are we completely done with the integration of TAIS Tech consolidation into our books?

**Abhishek Singh:** Yes, we have.

**Baidik Sarkar:** Okay so that was completely reflected in Q4, did Q4 reflect the entire three months of it or just a part of it?

**Abhishek Singh:** The entire three months.

**Baidik Sarkar:** I remember when we spoke I think in Q2 or Q3 of last year, we have been given to understand that at an operating level the margins would eventually head towards 15 % plus. I think we had this conversation when we were in a series of taking one offs. I think it has been two to three quarters since you have passed that turf and margins are still at about 12% - 12.5%. So I mean is this a new normal or have there been any one offs or is the pricing environment exceptionally weak? If you could just help me understand that.

- Abhishek Singh:** So Baidik, that was an aspiration that we put forth; it was not a six to twelve-month journey. This kind of margin improvement happens over a period of time. That said, if you look at our improved EBITDA margins along with the growth, you realize that we are delivering the margin improvement quarter-on-quarter after absorbing the Cost of Growth. So we continue our journey with the same aspiration; we have the game plan towards it and every quarter we move in that direction.
- Baidik Sarkar:** Okay but given our existing cost structure what we are working with is about 12% - 12.5%, I mean given our existing cost structure, is that right?
- Abhishek Singh:** Yes.
- Baidik Sarkar:** Okay. John, I understand we have an extremely small base, if you could help us understand what exactly is driving momentum for Mastek in digital - is it pricing or is it capability or what exactly is it?
- John Owen:** It is definitely not pricing. I mean Mastek will not play in this "race to the bottom". With the consolidation of the market in the UK and Europe and the US markets, people are looking at preferred suppliers that run it basically streamlined vendor basis and that is a race to the bottom and Mastek cannot and will not play. So we are competing on the value, we are competing on our engineering heritage. More importantly we are competing on our delivery track record. If you have a business impacting project it does not matter about the cost, it is about the impact on the business and the delivery timeframe and that is where we are getting good traction with our customers.
- Baidik Sarkar:** So could you help me understand what an average margin range or a margin profile would be for an average digital engagement?
- John Owen:** I think it is standard, it is not a premium in that respect I think they are just standard margins.
- Baidik Sarkar:** Okay so which means it is in the 12% range, it is not significantly higher than 12%, is that right?
- Abhishek Singh:** Actually, not Baidik. We have to also look at the fact that there is a cost of growth; if you see we have been growing QoQ and to that extent the cost of growth is there; the structural changes, the investment that we continue to make, none of those have stopped. We have been tweaking within those parameters.
- Baidik Sarkar:** So could you help us quantify the kind of investments that you have made in sales and when I mean that obviously will be a fixed cost after a time lag. So what quantum are we looking at and where are we right now?
- Abhishek Singh:** So we are fully invested as far as the cost structure is concerned. With the investment in sales folks in the appropriate geography, rightfully speaking, anywhere between three to five quarters is where you would look at the return from all the new sales folks that we have invested in.

**Baidik Sarkar:** Okay the amount of new logo additions that you guys report in every quarter has always been impressive so if I just run a sum total of all the additions you have done over the five quarters I get a number of about 52, right. So that is obviously sort of client logo additions but optically that quantum does not reflect in the quantum jump of your revenues ex the acquisition of TAISTech. So I am just trying to understand what is the quality of engagements with these new logos you are having I mean is there a very high level of attrition or are we not able to scale up once we make an initial contact with new logo?

**John Owen:** I think the logos are spread across our consulting business. So, the average yield of valuing consulting and the average tenure is relatively small and I would say transactional in nature. In the digital commerce world, again it is a project to implement an Oracle ATG digital commerce platform. I think what we will see is we are now starting to link our consulting business and we are doing cross sale initiatives and up sale initiatives so I would like to think it is not about just driving customer numbers, it is about driving share of wallet in those customers.

So we are investing as Abhishek said in account management and our sales because of our delivery track record once we deliver, we have got to be seen and we have got to become the incumbent and then move within those organizations and become more relevant to them as a supplier. That is why partially we have gone to service lines so it is easy for the customer to understand Mastek the area that we are building, the competency and the fact that they can expect a guaranteed delivery outcome in testing an assurance or agile consulting or digital commerce or application development. So I think it is both a quantum of new logos but it is how much growth are we getting from our existing base and we are getting growth from both sides. But strategically the broader the account base the more stable our revenues and predictability will become.

**Baidik Sarkar:** Sure and did you say your constant currency growth to 5% or 6%?

**Abhishek Singh:** 5.3%, Baidik.

**Baidik Sarkar:** Could you break that up into the absolute number, whether it is GBP or USD I mean so that it is easy to track it on a quarterly basis?

**Abhishek Singh:** It will be right around the million and £1 increase between the two quarters.

**Baidik Sarkar:** Sorry I do not have the preceding quarters' numbers so if you could just give the absolute for this quarter?

**Abhishek Singh:** When you work backward you get the same one but if I were to hazard it, it is possibly 21 going up to 22.1 Million

**Moderator:** Thank you. We have the next question from the line of Jayant Mamania from Care Portfolio Managers. Please go ahead.

- Jayant Mamania:** Our margin from North America operations are around 5% - 6%. So what kind of improvement can we expect going forward and what kind of growth we expect from North America operations?
- Abhishek Singh:** We have two parts to our North America business one is the pure acquisition and the other one is the organic play that we had talked about. So that continues to be in the investment phase where we have invested and the pipelines continue to be present to that extent you will see the cost structure there. In terms of improvement, as these investments start to give you return it will start adding to the bottom line, Jayant. So we are very, very ambitious about North America as a geography.
- Jayant Mamania:** Sir, these 12 clients which are added, so which geography they belong to?
- Abhishek Singh:** They are across the three geographies, the UK, the US and India.
- Jayant Mamania:** And in financials, the liabilities relating to North America business is around Rs. 141 crores. Can you explain what is it? The segment liabilities in North America is Rs. 141 crores.
- Abhishek Singh:** Jayant, this is a combination of two things one is obviously the loan that we took to fund that TAISTech acquisition and the other part is the present value of contingent consideration. If you recollect, there were two parts to the acquisition one is the upfront cash we gave for which we took the loan and the other one was the contingent consideration which is based on their EBITDA and revenue performance. So this is the fair value of that as well as the loan that we took.
- Jayant Mamania:** Okay. So do you have any assignment from Indian Government relating to GST implementation?
- Abhishek Singh:** No.
- Jayant Mamania:** Okay so what is the revenue from India?
- Abhishek Singh:** It continues to be very, very miniscule so to speak Jayant and we are very clear as we said it in some of our prior calls - We want a very, very meaningful engagement in Indian market. We want to limit it to only profitable engagement. But if you want to just look at it from a quantum point of view it is Rs. 6.3 crores for the quarter.
- Jayant Mamania:** Okay. So how we have planned to use this Rs. 150 crores of cash?
- Abhishek Singh:** Look for meaningful opportunities to invest in and help your company grow.
- Moderator:** Thank you. We have the next question from the line of Mohit Jain from Anand Rathi. Please go ahead.
- Mohit Jain:** I am looking for TAISTech growth what kind of growth you are looking for in FY18?

- Abhishek Singh:** We do not look at the breakup by geography or by acquisition, Mohit, as we have said it earlier as well. That said, the rate of growth is fairly healthy in a digital commerce space. It is a very exciting space where Oracle is moving all its ATG customers or looking to move all its ATG customers to cloud commerce and that presents a phenomenal opportunity as system integrators in that space. That would open significant opportunity. It is about what pace at which we can execute to actually drive our growth.
- Mohit Jain:** And the order book includes TAISTech also, right?
- Abhishek Singh:** That is right.
- Mohit Jain:** Second is on receivables. So what happened in this particular quarter and why like operating cash flow turned negative suddenly?
- Abhishek Singh:** Purely timing, Mohit. So if this was to be casted on 6<sup>th</sup> of July your numbers would have been significantly different so just by a week.
- Mohit Jain:** So that is an expected revert back?
- Abhishek Singh:** Already have reverted back.
- Mohit Jain:** Okay. And third is on CAPEX if you could give some guidance on CAPEX for FY18?
- Abhishek Singh:** CAPEX will have two fundamental portions to it, one is any investment that we would make in terms of our growth and innovation and the other one is the refresh and replacement. So the innovation part of it continues to be discussed and iterated and as and when the business comes up with an idea, we will look at it in terms of investment required. But the other part of it, refresh and upgrade, we continue to do that continually. Our aging facility requires regular upkeep and there is a bit of an expansion that we need to address from a geographical footprint point of view.
- Mohit Jain:** So the refresh component could be like Rs. 100 crores plus or?
- Abhishek Singh:** No, we are not looking at that.
- Mohit Jain:** Okay and this innovation includes acquisition?
- Abhishek Singh:** It could be one part of it.
- Mohit Jain:** Okay but there is no overall number that is in your mind for the full year?
- Abhishek Singh:** We are generating cash to answer your question we are generating cash and we are looking at anything that presents itself which can help as a business accelerator. We are absolutely open to it.



- Mohit Jain:** So put it differently like this Rs. 150 crores cash that you have, any other use that you are anticipating currently for that or this is something which may stay in the balance sheet for quite some time?
- Abhishek Singh:** To answer your question simplistically, we continue to find opportunities to invest and give a better return to our investors.
- Moderator:** Thank you. We have the next question from the line of Madhu Babu from Prabhudhas Lilladher. Please go ahead.
- Madhu Babu:** So what are the deal sizes in TAISTech and are we present in ATG also?
- Abhishek Singh:** Yes, so we are the SI for their ATG platform and the deal sizes are anywhere in the typical million to 2 million kind of range at this point of time.
- Madhu Babu:** Sir, ATG is no longer being supported by Oracle so do we see any leakage from that part?
- Abhishek Singh:** Actually it presents two very interesting opportunities if you look at it. The first one is that the clients who have adopted ATG in part they would have to migrate necessarily at some point in time. And we have been their trusted implementation partner. They have tested us so we would be an obvious choice. And the second one is that the moment some technology platform is put into sunset there is a long tail to it because people would need the service and not many would be available to service it. So both of them presents an opportunity and we are working towards cashing on the cloud commerce opportunity as well as servicing the tail wind of ATG.
- John Owen:** Just to add to Abhishek's point we have already done an implementation of ATG to cloud so that migration is good knowledge that we want to replicate and we want to become a leader in that migration from on premise ATG to an Oracle cloud commerce platform.
- Madhu Babu:** And sir, I understand that our target segment could be mid-sized clients, so is it possible for us to go into Oracle and other services, how saleable are the clients now?
- John Owen:** I am sorry we missed the question.
- Madhu Babu:** How scalable or how can we cross sell as Mastek traditional services to the TAISTech clients and increase the revenue per client?
- John Owen:** Not the part of the account management program of going into service lines to make sure that each client we cross sell and they get experience of all our service lines.
- Madhu Babu:** Okay and lastly sir, order book has not increased much quarter-on-quarter, why is that?
- Abhishek Singh:** Madhu, again driven by the timing, we did close some but that was all in the first week of July.
- Madhu Babu:** And wage hikes, when do we give wage hikes and what could be the margin impact from that?

- Abhishek Singh:** So our wage hike is divided into two phases, the first one is implemented on 1<sup>st</sup> July so Q2 would be the first quarter to have an impact and the senior management and above comes from October so you would see some in Q3 as well.
- Moderator:** Thank you. We have the next question from the line of Mohit Jain from Care Portfolio Manager. Please go ahead.
- Mohit Jain:** I just wanted to know your revenues from Indian operations have gone down 1.7% so any particular reason for that because the company was quite optimistic for greater revenues from India?
- Abhishek Singh:** So Mohit, we have been extremely cautious on the type of revenue we engage in as far as Indian geography is concerned. We are looking for very meaningful engagement which is profitable and viable that is very, very clear for us. We were predominantly into Government both Central as well as State government and we are trying to reduce the engagements where the payment cycles are very, very elongated or for that matter the margins are not supportive of the effort that the company is putting in.
- Mohit Jain:** And do you have any future projections for BI business because it is expected to grow at a CAGR of 8% to 8.5%. So, what are the future projections for that business intelligence?
- Abhishek Singh:** We share your observation that it is one of the areas of growth and that is why it is a service line that we have identified to focus on.
- Mohit Jain:** So do you expect like in the next two to three years major revenues come in from BI?
- Abhishek Singh:** As with the growth of the business and client, yes, we do expect that it will grow.
- Mohit Jain:** Okay last question, who are your major competitors in this particular segment?
- Abhishek Singh:** In UK geography, you would have typically BJSS and Kainos along with other large India based IT service providers. In digital space, we come across a lot of Sapient as well as Accenture in the US market. These are the typical competition.
- Mohit Jain:** And in India any particular competitor?
- Abhishek Singh:** India is fragmented all across from a mom and pop shops to also the good names of mid-tier IT companies.
- Moderator:** Thank you. We have the next question from the line of Abhijit Mukherjee from Lucky Investments. Please go ahead.
- Abhijit Mukherjee:** Sir, you mentioned that a lot of the order flows have actually come in July. If you include that what is the quantum of your order book?

- Abhishek Singh:** I will keep that mystified for the next quarter. I want to give you that reassurance that we have not really missed the bus and it's just the timing.
- Abhijit Mukherjee:** Okay great. Sir, you said that you are covered on GBP till Rs. 96. Till when are we covered and at what rate will the incremental hedge happen and will that impact your margins in any way?
- Abhishek Singh:** So our hedge policy allows us to go up to three years and what we have reported is just the next twelve months. So we have coverage for the subsequent 24 months as well in varied percentages that is allowed by the Board.
- Abhijit Mukherjee:** Okay sir, have you shared a five-year vision as to where do you see this business in five years and how big can it get?
- Abhishek Singh:** Not really, we do not give numerical guidance that long.
- Abhijit Mukherjee:** Okay. So it is fair enough to assume that we will at least sustain the current momentum that you have been displaying for the last two, three quarters?
- Abhishek Singh:** Yes, that is our endeavor.
- Moderator:** Thank you. We have the next question from the line of Bhaskar Chakravarty, as an individual investor. Please go ahead.
- Bhaskar Chakravarty:** Just wanted to understand whether the EBITDA margins that we are seeing in this quarter whether they are sustainable or not as we move to the further quarters of FY18?
- Abhishek Singh:** Yes, we would like to believe that all our efforts are towards sustaining and growing this margin.
- Bhaskar Chakravarty:** But in light of the employee cost increases that are supposed to come over the next two quarters, you feel you will be able to hit this margin for the full year?
- Abhishek Singh:** Yes that would be our effort.
- Moderator:** Thank you. Ladies and gentlemen, as there are no further questions from the participants, I now hand the conference over to the management for their closing comments. Thank you and over to you.
- John Owen:** Thank you very much for joining the call. Hopefully you can say it is a solid start to the new fiscal year and as Abhishek said we are building the foundations for continued growth, sustainable growth and that will yield better profitability. But it comes down to execution and it is a very simple business if we execute that is why we built the target operating model and that is what we are doing in Vision 2020 and hopefully over the last two to three quarters you can start to see that yield enough financial performance. As Abhishek said, it is our endeavor to maintain this momentum but it comes down to having great people and great customers and just keeping to our operating model which is we have got engineering talent and we make sure that



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we deliver on our commitments. So with that I will close the call. Thank you for following Mastek and we look forward to your support in the coming quarters.

**Moderator:**

Thank you very much. Ladies and gentlemen, on behalf of Mastek Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.