“Mastek Limited Q4 & Full Year 2016 Earning Conference Call”

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Mastek Limited Q4 & FY-2016 Earning Conference Call. As a reminder, all 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 would now like to hand the conference over to Ms. Asha Gupta. Thank you and over to you ma'am.

Asha Gupta: Thank you, Karuna. Good Morning and Good Evening to all of you. Welcome to the Q4 and Full Year FY-'16 Earnings Conference Call of Mastek Limited. Joining us today on the call is top management from Mastek, represented by Mr. Sudhakar Ram – Managing Director and Group CEO; Mr. Joe Venkataraman – Chairman, Mastek UK Limited; Mr. Jamshed Jussawalla – CFO of Mastek; Mr. Anant Thakrar – Senior Vice President, Finance of Mastek and Mr. Abhishek Singh – Designate-CFO of Mastek.

To begin with Mr. Sudhakar Ram will give you a brief overview on the business update for the quarter and for the full year FY16 and this would be followed by Mr. Abhishek Singh giving you a detailed financial analysis. After that we will throw open the floor to Q&A. With that said, I am handing over the floor to Mr. Sudhakar Ram. Over to you sir.

Sudhakar Ram: Thank you, Asha and Good Day to all of you. Thanks for joining in on a holiday; I know many of you are on holiday today. So in terms of the performance for the quarter, the revenue was down as compared to previous quarter. It was expected; part of the reduction was because of the LPT JV which had a revenue booking in October-December and that went off the book this quarter; also a couple of projects ramped down; and we also got hit by the currency impact that the pound actually weakened and to that extent it had an impact on our revenues. But despite that I think we could manage in terms of profitability aided partly by an R&D tax credit that we got in the UK.

So overall if I see the year, I think while it was an eventful year with the de-merger going through and unlocking value on the Majesco front. For Mastek it has been a year of ensuring that we find our feet in this market as a pure solutions company, get our digital transformation story together and work out a strategy and an execution plan by which we can actually be a leader in the Digital Transformation space. So the numbers do not really reflect the fundamental strengths that we have built as a company during the year.

The key thing that we did is a renewed focus on large complex programs aimed at the Digital Transformation part especially in the Government, there is a huge opportunity because the UK government is going Digital by default, so there is a lot of investment happening and they are looking at smaller companies like us. So we have had very good successes in opening departments and growing these departments and building a momentum in the Digital transformation space. So we are pleased to report that almost 48% of our business is now Digital Transformation programs that are on various Cloud, Analytics, Mobility and so on. So as a strategic thrust, we are uniquely positioned to leverage the opportunities which are growing not just in Government but also in Retail and Financial Services.

The IndigoBlue acquisition which happened in the beginning of the year has started working for us not just in terms of their own momentum and revenues that they bring but also in terms of cross sell/up sell opportunities that we can go to market together, things where existing clients of IndigoBlue we have opened up in terms of Mastek services and a new framework that IndigoBlue takes us on to. So that acquisition is working well and we will be able to see much better results happening jointly based on that acquisition going forward. While our position is largely in the UK as 96% of our business is in UK, in India we have started winning more deals, we have been announcing deals in the Government sector and we are also trying to open up things in the Private sector especially in the Financial Services area.

One area of thrust given the strong fundamentals we have in Digital Transformation is to re-enter the US market, both organically and also through acquisition. So we do expect that in the coming year we will be able to acquire a company or two totaling to about $20 million to $30 million in terms of revenues which will give us a stronger base as far as the US operation goes.

So while the year has not been great in terms of financial performance, I think we have done fairly well in terms of adding new customers; I think we have added 31 new customers during the year which is a record performance for the Solutions end of the business, definitely helped by IndigoBlue which had a much stronger deal momentum, though those deals tend to be much smaller, but Mastek Solutions business also had a fairly good run in terms of new account openings and that should give us the base for building up growth and profitability in the year ahead.

Last quarter, I talked about the project which had cost overruns, which has led to almost Rs. 31 crores of losses during the year. I think as expected there the losses have started tapering down from last quarter to this quarter but it will continue over the next few quarters as we complete this entire engagement. But I suspect that the other parts of the business which are growing should be able to make up for it, over a period these losses should not be a major hit to our own profitability.

So as I look at the year ahead I think we are looking at good momentum, we have the pipelines, we have the existing base of customers, we have very strong capabilities in Digital and Agile, I think we should be able to translate all that to much better results in the year ahead.

So with that let me hand it over to Abhishek who will take us through the numbers for this year and quarter.

Abhishek Singh: Thank you, Sudhakar for the Business Update. Hello! Everyone on the Call. Before we deep dive into numbers for the quarter-ended 31st March and FY16 we just want to call out the fact that the comparable number for FY15 is not in line given that it was total company including

Insurance Products and Services business, so these are not exactly a like-to-like comparison. With that said, the highlight for Q4FY16 includes the fact that we did an operating revenue of Rs.124.3 crores as compared to Rs.137.8 crores which is a 9.8% de-growth quarter-on-quarter in rupee terms; in constant currency terms we had a de-growth of 6.4%. The total income stood at Rs.127.6 crores as against Rs.140.7 crores for Q3FY16 which is a 9.3% sequential de-growth. The revenue de-growth can essentially be attributed to LPT and the closure of projects as Sudhakar had outlined apart from the obvious impact of currency fluctuations. Our EBITDA stood at Rs.4 crores for this quarter which is 3.1% of the total income as against Rs.3.6 crores which is 2.6% of the total income in Q3FY16; it is a 50 basis point improvement quarter-on-quarter. On net profit level we were at Rs.5.9 crores for the current quarter as against Rs.0.8 crores for the last quarter. The growth essentially can be attributed to our realizations on mutual fund investment as well as the UK tax credits that Sudhakar alluded to earlier.

For 2016 whole year, our operating revenue stood at Rs.526.9 crores as compared to Rs. 1,012.6 crores in FY15 which was a much larger company prior to the demerger and not a comparable number. Our total income stood at Rs.544.3 crores as against Rs.1029.7 crores for FY15. Our EBITDA for the full year stood at Rs.33 crores as against Rs.61.1 crores for FY15 and Net profit was Rs. 13.8 crores for current year as against Rs.17.7 crores for the last year.

Our client adds for the quarter stood at 11 new logos; 9 of them originated in UK and 2 of them were in India, and our total clientele stands now at 88 on LTM basis. In terms of our 12-month order backlog we are at $31.02 million or Rs.205.5 crores as against $31.7 million or Rs.210 crores at the end of 3rd quarter. Our top-5 clients contribute 59% of the revenue whereas top-10 contributed 73% of the revenues for the quarter.

During the quarter, the company incurred restructuring cost of Rs.0.63 crores which was related to stamp duty payable in respect of demerger of the Insurance Products and Services Business. On DSO side we stand at 57 days as compared to 54 days for Q3FY16. Cash and cash equivalents is a good story for us; we are at Rs.119.9 crores as against Rs.110.3 crores for the last quarter. Hedges are also very well positioned for the company; we have hedged close to £13.9 million at an average rate of 108.7 per pound.

In terms of Vertical division of our revenues we are 50% in the Government space, 24% in Financial Services,14% in Retail and the remainder 12% in IT and Other Services. Our total headcount stood at 1,298 in Q4FY16 and 1,302 was the last quarter numbers; we are flat. Our utilization stood at 78.5% as against 81.7% for the previous quarter. So at a broad level the utilization dipped obviously on account of some of the project closures that we experienced in Q4FY16. That kind of sums up our financial performance in key metrics reference for the current quarter. I will hand it back to our operator to go through the Q&A Session. Thank you.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. First question is from the line of Baidik Sarkar from Unifi Capital. Please go ahead.

Baidik Sarkar: Abhishek, could you help us understand the like-to-like revenues to the IT Services business ex-LPT?

Anant Thakrar: Let me just take that question. We do not have the full number Q1 to Q4 but we can give you Q3 to Q4; last quarter in terms of revenues on LPT at the consolidated level were about Rs.7 crores and as you know the LPT business came to a closure last quarter, so that was the position at the end of last quarter, this quarter we have not got any of those revenues.

Baidik Sarkar: I missed the commentary on the stamp duty expenses incurred this quarter. What was the quantum again?

Abhishek Singh: That was Rs.63 lakhs.

Baidik Sarkar: Could you come again on how many quarters exactly we expect this contract thing on which we have been suffering losses to go on? I recollect you clarified this in the last quarter.

Sudhakar Ram: No, that is a long-term project, but like I said the impact of the losses will keep tapering quarter-on-quarter, so within the next 2-3 quarters I do not think it will be a significant part of our overall portfolio.

Baidik Sarkar: So could you quantify the losses we took on that account this entire year as well as this quarter?

Sudhakar Ram: This entire year was about Rs. 31` crores, that is what we shared, and for this quarter is Rs.5 crores.

Baidik Sarkar: We expect this to taper off by Q3 of FY-'17, is that correct?

Sudhakar Ram: That is right.

Baidik Sarkar: So on steady state basis once we are done with that, what do you think our steady state EBITDA margins would be at?

Sudhakar Ram: If you do a simple math at a PAT level… I think Anant or someone can work out the EBITDA also, but at the PAT level we are at about Rs.13.8 crores now and add back about Rs.31 crores, we are at about Rs.44.8 crores in terms of total PAT for the year.

Anant Thakrar: At an EBITDA level if we add Rs.31 crores back to the whole year number of Rs.33 crores we will get to Rs.64 crores. This is EBITDA % of 11.8% based on total income of Rs 544 crores compared to 6.1%

Baidik Sarkar: Thanks, this was useful. Going ahead FY-'17 what do you think a base case revenue growth rate might be, I mean in the context of aggressive logo that we witnessed in the past few quarters, you mentioned in your opening comments it might translate….?

Sudhakar Ram: See it is difficult to comment on future revenues, we do not give guidance, but you can make out that on the basis of the fact that we do expect good growth next year.

Baidik Sarkar: So would that be in range with NASSCOM guidance or would that be slightly lower/slightly higher?

Sudhakar Ram: I wish I knew so or I wish I could share this.

Baidik Sarkar: But you think the bottom end of NASSCOM guidance was something that we can do?

Sudhakar Ram: No, I am saying we do not give any guidance. So you will have to make your own estimates.

Moderator: Thank you. Next question is from the line of Mohit Jain from Anant Rathi. Please go ahead.

Mohit Jain: One is on the acquired entity. What was this company into? Then you acquired it for a very small sum with no revenue. So what is the business of this acquired entity?

Sudhakar Ram: No, that is the company that we are planning to incubate, just to get the incorporation done we had done it outside and it has been acquired within Mastek. So the intent is to build a business around that.

Mohit Jain: So right now is there anything in that company losses or anything?

Sudhakar Ram: That is a shell right now.

Mohit Jain: Second is looking at your utilization, is it safe to assume you do not need to hire any employees for next year?

Sudhakar Ram: No, it is not safe to assume that.

Mohit Jain: So then it will be a function of revenue growth? I am just trying to build your margin profile given that you are saying that the new project losses will keep tapering off and then if the revenue growth continues to be the way it is from these four quarters, then actually given your utilization at 78.5% that should be enough to run the company?

Abhishek Singh: So our utilization was at 81.7% in last quarter, that came down to 78.5% given some of the movement in projects we had this quarter. We always endeavor to have higher utilization because that has a direct bearing on profitability. The fact that you have churn in the employee base which needs to be filled in and the growth in the revenue would need to be implemented by the headcount augmentation so …

Mohit Jain: What I mean to say is if you look at last four quarter revenues they are more or less stagnant to declining. So if we continue on the same path….?

Sudhakar Ram: Obviously, if we are stagnant or declining, we will not hire any more.

Mohit Jain: So even in that case we are building in an EBITDA level of 10% to 12% as you suggested earlier?

Sudhakar Ram: I just gave you the comparable for the profit for this year if you add back Rs.31 crores.

Mohit Jain: What I mean to ask is if our revenue stays the same and the losses taper off for that one project, in that case if I compare FY17 into FY16 you will still be able to do 10-11% or 11-12% EBITDA margin without assuming growth. Is that a fair assumption?

Sudhakar Ram: Number wise you can come to that conclusion. Like I said we cannot guide you either on the top line or the bottom line.

Mohit Jain: What was the tax reversal that has happened in this particular quarter?

Sudhakar Ram: That is normal; I think we get our UK tax credits in the last quarter of the year, whatever we do in R&D terms, and we get a benefit in the UK.

Mohit Jain: So your tax rate is supposed to continue at the same rate when I calculate ETR or do you think this tax break is something which was related to something happening in FY16 and may not recur in FY17?

Sudhakar Ram: You cannot assume that we will consistently get tax credit, so you cannot make that assumption that it will be the same.

Mohit Jain: So what should be your tax rate for FY17?

Sudhakar Ram: About 30%.

Mohit Jain: So this year turns out to be 17%?

Sudhakar Ram: Yes, that is because of the credit.

Moderator: Thank you. Next question is from the line of Parag Bharambe, individual investor. Please go ahead.

Parag Bharambe: Congratulations, this quarter you have added 11 clients. My question is that this year you added lot of clients but this client addition has not materialized into a growth in revenue. I am just wondering where is the mismatch and why it has not yet materialized?

Sudhakar Ram: There is no mismatch. This is typical especially when we come to Transformation deals that initially the customer does some pilot. So it is not a huge impact on revenue, but they are just testing out and we are ensuring that the capabilities match their expectations and that there is chemistry between the teams. Once that confidence builds up then they start increasing the size and nature of programs. That is part of the normal process. So in Q3FY16, we added 6 customers, while in the current quarter we have added 11 customers, that is the only difference.

Parag Bharambe: Out of this 11 this quarter you said, 2 is in India, 9 is in UK. Out of that how much is Indigo and organic Mastek?

Sudhakar Ram: 6 of that is in Indigo.

Parag Bharambe: One other thing is there is a reduction in the fixed price project in this quarter. Is it because of the some projects have completed in time or is there any other reason?

Sudhakar Ram: Yes, mainly project completion as well as LPT was largely fixed price with LPT JV getting closed, that has also come down.

Parag Bharambe: I could not hear when somebody asked how much was LPT's revenue reported last full financial year. Could I get that number please?

Sudhakar Ram: Last quarter was Rs 7 crores, for the full financial year we do not have here.

Parag Bharambe: Indigo, we have completed 1-year of that acquisition. Did it materialize as per your expectation and how much do you cross sell… I know you gave a little hint of that, but could you just elaborate little bit more on that please?

Sudhakar Ram: I think it is in line with the expectations, what we expected was that it would add new capabilities, it would give us credibility in the Agile program space, we would be able to go and sell into IndigoBlue' s existing customers and we would be able to go-to-market together for winning new deals. I think on all four fronts we are seeing good progress.

Parag Bharambe: I think you have not reported any US revenues. So I suppose it is yet to start incurring the revenue. Is that correct?

Sudhakar Ram: This financial year is when we are planning to restart the US.

Parag Bharambe: Because I think in last quarter you reported that you got one project in US but…?

Sudhakar Ram: It was a pilot phase, not much revenue, but this year I think it should start picking up.

Parag Bharambe: Recently, you have announced changes in pricing policy. What is the significance and impact on Mastek profitability as such?

Sudhakar Ram: At a group level there is no impact on profitability, it is only to reflect the change and control and how business is done. So it impacts the transfer pricing from Indian tax and from the UK tax perspective. So we have changed based on the changes in structure and the nature of business that we do.

Parag Bharambe: About tax, because most of the revenue earned is in UK, so is the company paying tax on UK revenue or there is a separate Indian tax.

Sudhakar Ram: No, we do both, obviously, we have to pay tax in UK and tax in India, whatever income is earned in the UK, it gets taxed in the UK, what income gets earned in India, gets taxed in India.

Parag Bharambe: There is one project that significantly affects the whole profitability of the company. Is it not like too much things are relying on just one project, not necessarily one, but kind of one project?

Sudhakar Ram: That is part of the game when you come to large transformation programs and fixed price projects. So in the past we have had the other part also; one single project has contributed lot to profits also. So when you do a fixed price you run the risk and you win some, you lose some. That is part of the business we are in.

Parag Bharambe: How many loss making projects are in your portfolio now significant?

Sudhakar Ram: We cannot talk about how many loss making and how many profit making projects.

Moderator: Thank you. Next question is from Ganesh Shetty, individual investor. Please go ahead.

Ganesh Shetty: You have hinted at some acquisition. Can I get some update on that sir?

Sudhakar Ram: Whatever we have, we have shared; we are intending to acquire companies in the $20 to $30 million range.

Ganesh Shetty: Is there any initiative you have done or any further progress in that, sir?

Sudhakar Ram: No, there are all these things that we are evaluating as part of this process, it is a regular thing that we keep looking at companies and see what has a strategic fit and what is affordable. As and when something develops we will definitely share with all of you.

Ganesh Shetty: Recently, there was a news item that you have won a deal for Digital Transformation for a home loan company. Are you looking for such deals in the future?

Sudhakar Ram: Yes, that is part of our Financial Services practice.

Ganesh Shetty: So there are a lot of players in Digital integration space now, digital program, digital transformation and many other things also. Where do Mastek stand in that entire crowd, how we can compete and win a profitable business over there?

Sudhakar Ram: Every part of the business is competitive, you are not going to find a space where there are no competitors, but we have a track record in the Enterprise Digital Transformation, not just small front end Digital Marketing or Digital Siload Projects and Solutions but End-to-End Solutions. What we have done for the Home Office in UK there are End-to-End Enterprise Solutions which has sunset many legacy systems and made them digitally capable. So those are the kinds of things we are very strong at and we have a track record.

Ganesh Shetty: So during first quarter of this year, are we expecting any new logos or is there any deals in the pipeline which we are talking about for large Transformation projects?

Sudhakar Ram: There are always deals and we will have wins, like this quarter we had 11 wins, we hope to have significant number of wins in the next quarter also.

Moderator: Thank you. Next question is from Ravindra Agarwal from KPMG. Please go ahead.

Ravindra Agarwal: I had a question regarding the acquisition part. Like you mentioned Mastek is actively looking at some potential acquisition. So could you throw some light on acquisitions in what particular vertical or may be more clarity on those front?

Sudhakar Ram: We are just stating an intent that we want to acquire and the pipeline is being built and we are evaluating. You will get some clarity as and when something happens.

Moderator: Thank you. As there are no further questions, I hand over the floor to the management for their closing comments. Over to you sir.

Sudhakar Ram: So thanks everyone for your sustained interest in Mastek. We hope to continue growing and consolidating our position and we hope to have much better results in the quarters ahead. So thanks again and meet you next quarter. Bye-bye.

Moderator: Thank you very much. Ladies and Gentlemen, with this we conclude today's conference call. Thank you for joining us and you may now disconnect your lines.