



“Mastek Limited Q2 FY 2017 Earnings Conference Call”

**October 18, 2016**



**MANAGEMENT:**    **MR. SUDHAKAR RAM – MANAGING DIRECTOR AND GROUP  
CHIEF EXECUTIVE OFFICER, MASTEK LIMITED  
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**MODERATOR:**    **MR. DIWAKAR PINGLE - CHRISTENSEN IR**



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**Moderator:** Good Day, Ladies and Gentlemen and Welcome to the Q2 FY 2017 Earnings Conference Call of Mastek Limited. As a remainder, 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, you may signal the 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:** Thanks, Margaret. Welcome everyone and thank you for joining for the Q2 FY 2017 results ended 30th September, 2016 for Mastek Limited. I guess, the results and the presentations have been mailed to you; and you can also view this on our website at [www.mastek.com](http://www.mastek.com).

To take us through the results and to answer your questions today we have the top management of Mastek Mr. Sudhakar Ram -- Managing Director and Group CEO; Mr. Abhishek Singh -- Group CFO and Mr. Anant Thakrar -- Senior Vice President (Finance). Sudhakar will give a brief overview of the quarter gone past which will be followed by a brief overview of the financials by Abhishek and then we will go over to the Q&A session.

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

With that said, I would now like to hand over the call to Mr. Sudhakar Ram. Over to you, Sudhakar.

**Sudhakar Ram:** Thank you, Diwakar and good afternoon to all of you. This has been a reasonable quarter in terms of top-line. In challenging times, we did grow the top-line in constant currency terms by about a 1.5%. Revenue was down in rupee terms because the Pound depreciated by more than 8%-9% over this quarter so, we did have an impact. But overall, the underlying business has grown our order book in a slightly better shape than it was last quarter. But what is more heartening is the fact that the profitability has gone up and we are back to double-digit EBITDA; we have doubled our profit after-tax this quarter and this is on the back of handling the troubled program , getting the issues resolved and also improving on some SG&A levers that we have in the cost management and the kind of revenue profile that we have.

The UK constitutes a bulk of our business but this quarter we also saw the billing from our US operation -- Digility.. Their first customer is an existing client in UK who are US based and they have been giving us more business in the US but we do expect to expand our foot print over the next couple of quarters and by Q4 we should start generating revenue in the US from other customers as well.



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The India business has remained steady; it has grown up in line with our expectation as a breaking even or turning marginal profit as oppose to the past where it used to make losses. So, doing business in government is more of a social impact rather than for the profitability but we did want to ensure that we breakeven and do marginal at least positive bottom-line rather than just lose money in the process and that has also worked out.

Overall the pipeline looks better and we do expect there were some orders which we should have closed this quarter, which got shifted to October but we do expect that the business will start growing in the digital space over the next couple of quarters.

So, with that, let me hand it over to Abhishek to take you through the numbers.

**Abhishek Singh:**

Thank you Sudhakar. Hello, everyone on the call. Prior to this we just sent out our deck that I will walk all of us through and then it will be followed by the Q&A session.

Coming on to the Slide #4 of the deck which has the performance highlight summary for Q2FY17. Our total income stood at Rs. 128.4 crores which was down 3.9% on quarter-on-quarter basis. Our operating income was at Rs. 125.9 crores which was down 3.2% on quarter-on-quarter basis again in rupee terms. However, in constant currency terms our revenue grew by 1.5% on quarter-on-quarter basis. The significant event of Brexit and subsequent conversations in UK has bought a significant bearing on pound and which depreciated by almost 7% to 8% for us just between two quarters and that has had a bearing on top-line that has been reported in rupee terms.

In terms of profits – our EBITDA was Rs. 13.8 crores, up 27.3% on quarter-on-quarter basis. EBITDA margin stood at 10.7% in Q2 as against 8.1% in Q1. PBT was Rs. 10.3 crores versus Rs 7.7 crores in Q1 which was up 34.1% again on quarter-on-quarter basis. Net profit stood at Rs. 7.7 crores, up 113.7% on quarter-on-quarter basis and net profit margin stands at 6.0% versus 2.7% for the last quarter.

Our cash and cash equivalent is steady at Rs. 138 crores as on as on 30th September, 2016. Our 12 months order backlog stands at £ 25.3 million as against £ 23.8 million last quarter; in INR terms it is Rs. 220 crores as against Rs. 216 crores significantly impacted by the degradation in pound rates.

Moving on to the next slide - performance highlights for H1 fiscal 2017. Our total income stood at Rs. 262 crores as against Rs. 276 crores for the last year same period which is down 5.1% on a year-on-year basis. Operating income at Rs. 255.9 crore is down 3.4% in rupee terms. However, in constant currency terms our revenue grew by 1.4% on a year-on-year basis.

In terms of profit parameters, our EBITDA was Rs. 24.6 crores, down 3.4% year-on-year basis. EBITDA margins however expanded by 20 bps to 9.4% in H1FY17. PBT was Rs. 18 crores versus Rs. 15.8 crores in H1 fiscal 2016 which is up 13.6%. Our net profit stood at Rs. 11.2



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crores versus Rs. 7.1 crores in corresponding period last year which is a growth of 58.4%. Net profit margin at 4.3% versus 2.6% for H1FY16. The board has announced an interim dividend of 20% or Re. 1/- per share for this quarter.

Moving to the operating metrics highlight. We added 8 new logos this quarter and our total active client count stands at 91 for the last 12 months' period. Top 5 clients constitutes 52.3% of the revenue and top 10 client constitutes 73.1% of the total revenue. We have 1,317 employees of which 923 are offshore and onsite we have it at 394. The same number was 1,302 as of last quarter 30th June, 2016.

Our billable utilization continues to move northward at 81.5% as against 80.2% in Q1 last quarter. DSO moved up marginally to 63 days as against 55 days last quarter just a bit of the seasonality here that we expect to cover in this quarter. Our total Hedges included in GBP is at 11.5 million and it is at an average rate of Rs 107.1 per pound.

Moving on to Slide #8 which has key financial highlights. The same numbers are represented in a tabular format for the quarter-on-quarter and year-on-year as well as H1 view. The growth that we recorded in this quarter in our profit as well as EBITDA margin expansion has been driven by the operational improvement initiatives and the cost management that we have been driving for last few quarters and we expect to build on it as we move along in the financial year.

Moving on to Slide #10, it has revenue analysis and break-up of revenue by region, by industry, by offerings and revenue type. In Q2 fiscal 2017, 91.8% of our revenue were delivered in UK, originated in UK whereas 8.2% of that was from APAC and other areas. The corresponding number in Q1 was 94.9% from UK and 5.1% from others.

Revenue by industry, the Government continues to be our largest vertical, it is at 42.6% of our total revenue followed by Other Financial Services at 29.2%, Retail is at 13.7% versus IT and other services put together is at 14.5%.

Revenue by offering between Development, Maintenance and Consulting, Development continues to be the core at 72.4% of our total revenue, Maintenance is at 16.6% of revenue and Consulting is at 11%.

In terms of revenue by type – i.e. Fixed Price and T&M our T&M still continues to be the major share at 74.1% and Fixed Price is at 25.9% of the total revenue.

So, with that we conclude the presentation here and I will offer the floor for Q&A.

**Moderator:**

Thank you very much. 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:** Abhishek, first one for you. Could you help us quantify what the quantum of losses in this quarter were regarding the cost of our programs that we have in our legacy books?
- Abhishek Singh:** Hi, Baidik. So, we did not have any impact in the current quarter, it was all closed as of 30th June and that is what we had outlined in our call last quarter. So, current quarter did not have any impact, current quarter rather had the benefit of the closure that we achieved in Q1 FY17.
- Baidik Sarkar:** Right. So, going forward in an erstwhile JVs or any pending legal expenditure or any of the legacy projects you are saying that we do not expect any cost over runs we booked in the coming quarters?
- Abhishek Singh:** So, different engagements will have different flavors Baidik but having said that in this case we are moving into the maintenance phase so to that extent those will continue. But in the normal course we do not expect any other project to go through that life cycle.
- Baidik Sarkar:** Right. So, you know if that was the case I was looking at your EBITDA margins that obviously minus your other income that stands at about 8.9% right so, I am taking your revenue base at about Rs. 126 crores. So, I am just trying to understand if that was the case I was assuming that should we see the booking losses our margins would translate to only double-digit. So, is anything I am missing here?
- Abhishek Singh:** So, it is a phase where multiple projects are in ramp as well Baidik and while we expect it continue to expand it is not just on the delivery side but also on our SG&A base and we have continued to maintain that our SG&A is disproportionate to the size of the revenue that we have had. So, that also is a lever that we will have to play on and which is what would reflect in the EBITDA margin expansion as we size ourselves up.
- Baidik Sarkar:** Okay. So, how do I read that comment of yours? I mean if SG&A is disproportionate in the coming quarters I mean do we see to spend to more to win new logos in the US, some comments on that?
- Abhishek Singh:** No, the US should be looked upon differently; US is in the investment phase as we speak. Our sales team got established over last 6 weeks to 12 weeks. But having said that the rest of the business across UK and India, the size of SG&A that we have, we have significantly invested as far as UK sales and marketing is concerned It's essentially the G&A that we should look upon to see how do we size it to the business. US will continue to be invested in, UK will be realignment of the numbers. No cutting if that is what you are alluding to, we are not looking at that and it is the G&A especially that will be focused upon.
- Baidik Sarkar:** Okay. So, as things stand today given the cost structure do we have I mean is it fair to expect any cost lever, any margin livers to play out in the next two quarters?

- Abhishek Singh:** Absolutely we do and some of them are what we are working upon. So, what is the size of the bench that we intend to maintain for the size of business that we have. Of that bench, what would be the technology focus given then digital growth that we are aspiring for and the significant footprint that we have there. The second one of that would be what is the Grade Mix that we have across various projects during multiyear engagement and most of our revenues come from repeat client and clients get used to certain set of people so, with that Grade mix our cost structures would have gone up but the billing rates would not have. So, those are exactly the microscopic things that we are looking at and those are very clearly identified levers for margin expansion.
- Baidik Sarkar:** Great, that is helpful. Abhishek, could you help us quantify what is your revenues for few quarters might be in constant currency terms I mean, obviously, you have been reporting the numbers in INR but you know just to help us appreciate the trend better, I mean from the current quarter and going forward would it possible to give the flavor of what your numbers in constant currency are as well?
- Abhishek Singh:** So roughly it would be \$13.5 million for current quarter, \$13.3 million adjusted for currency for last quarter and Q4 this year memory fails me so possibly you can come back...
- Baidik Sarkar:** That is helpful; I will get that from you offline. So, you said \$13.3 million for Q1 FY17 and \$13.5 million for Q2 FY17?
- Abhishek Singh:** That is right adjusted for currency.
- Baidik Sarkar:** Okay, adjust for currency, okay. Does your current quarters other expenditure line item have an element of FOREX gain which I might have missed in your disclosure?
- Abhishek Singh:** Other income or other expenses, which one are you talking about Baidik?
- Baidik Sarkar:** I am referring to your line item of other expense, okay. So, you have given that our Hedges are far ahead I mean we have covered it about 107/- obviously, the currency that we have booked over the quarter is at a much-much lesser rate, I am just trying to understand if we have had any FOREX gains in this quarter?
- Abhishek Singh:** Absolutely, Baidik we would have it because as a business practice all of us Hedge ourselves.
- Baidik Sarkar:** Yes, so that is obvious, so, could you help us quantify that?
- Abhishek Singh:** I have to look at the break-up Baidik and get it to you offline but rough and dirty my coverage's were 104 plus in terms of Pound for a Rupee and to the extent of consolidation would keep going down depreciating the GBP that number would keep inflating.



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**Baidik Sarkar:** Before I get back from the queue just one last question for Ram. So, Ram over the last five quarters if I look at the new logos you have added, a simple summation shows me logos in excess of 30 new clients. But obviously, I understand the pace of ramp up initially will be slow. So, even if I go back say five quarters to six quarters that pace of client addition does not really seem to reflect in your revenue so, I am just trying to understand how minable or how lucrative are these new logos that we have been adding?

**Sudhakar Ram:** So, the new logos that we have added the substantial part are through our IndigoBlue acquisition and you should remember that as a program management consulting they get fairly early in the cycle. Some of them are pure consulting engagement which have no further pull through revenue possibly but a percentage of them will have pull through revenue but it will take time to activate that. We are seeing some of the signs like some of the new wins in this quarter have been based on IndigoBlue wins which have helped us pull through start doing delivery work and sort of does the program management work but it is not an overnight kind of a thing it takes its time.

**Baidik Sarkar:** Right. And what kind of investments we think we need to make in our US team to expand our business in that geography?

**Abhishek Singh:** So, we already have core sales and marketing personnel out there these are very seasoned professionals with very successful track record of more than \$100 million deal in the TCV computation. So, these guys are onboard and they are pounding the street as we speak, the focus there in that geography is completely digital, you can have a look at it on [www.digility.com](http://www.digility.com) and that will give you a flavor of the kind of clientele we are focusing. As a matter of fact, we are seeing significant traction being looked upon as a technology disrupter in that space in US as well so, all in Baidik the nuts and bolts are aligning for us to have the first organic win so to speak in the geography but for that the investments to be made are already done and the engine is cranking.

**Baidik Sarkar:** Okay, just last one question, are your tax complications those issues have that been sorted out because after several quarters I noted your tax rates are at the manageable band of 25% - 26% is that complexity done away with, can we expect rational tax bands going forward or what is your outlook on that?

**Abhishek Singh:** Yes, the tax is more or less normalized but having said that I will just call out that there was very limited complexity for the fact that we changed our internal transport pricing arrangement, UK now is an entrepreneur and India is captive so to that extent it was compensated for the loss and future profit and that was recognized as an other income in India that is what gave you a significant tax impact on a consolidated basis they did not give anything but increase in the tax bill and that is all that you had in Q1. Going forward we expect it to be in this plus-minus range.

**Baidik Sarkar:** Right. And FX Hedges GBP 11.5 million how many months does that cover forward?

**Abhishek Singh:** That covers was for fiscal 2017.

- Baidik Sarkar:** So, it covers for the next two quarters?
- Abhishek Singh:** Right. We have coverage for further quarters as well at a different rate and different percentages but that is not reflected here.
- Moderator:** Thank you. The next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.
- Mohit Jain:** Just wanted to check on the expense side. So, this other expense cut seems to be too sever especially if I remove the consultancy and subcontracting charges. So, what is happening there and what should we expect going forward? And on quarterly number basis it looks like coming down to Rs. 150 odd crores so, if I you can help me understand that will be great.
- Abhishek Singh:** It is Rs. 15 crores if you are looking at the consolidated number.
- Mohit Jain:** Yes, I am sorry, Rs. 15 crores I am looking at that number only and I am excluding subcontracting and travelling but that seems to be a little on the discretionary side. Rs. 15 crores versus Rs. 20 crores last quarter.
- Abhishek Singh:** Yes, so Mohit that is the note that we had that our challenging program came to a conclusion and to that extent whatever was the conclusion related to the expenses is what we had in first quarter and that is not reflected going forward so, to that extent you have reduction in the other expenses.
- Mohit Jain:** That should have been in your growth margin no, then your other expenses.
- Abhishek Singh:** Yes, but you are looking at the consolidated results.
- Mohit Jain:** No, I am only looking at other expenses note number 24.
- Abhishek Singh:** Yes, so if you look at it, the representation here is after that we have straight away showing you is the profit from operations before other income, finance and exceptional cost, and to that extend this expense is included there.
- Mohit Jain:** Is it because so, why I am confused it includes things like communication charges rental expenses....
- Abhishek Singh:** Mohit, all of that is needed to deliver the business.
- Mohit Jain:** Okay. So, this is the new level of expenses that we will be incurring or there is further scope of cuts?
- Abhishek Singh:** We expect this level to continue.





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- Mohit Jain:** Okay. And therefore, on the gross margin side should we expect any further improvement or gross margin will also continue to be at the same level as mentioned currently?
- Abhishek Singh:** So, gross margin improvement as I was answering Baidik's question, the gross margin improvement continues to be the focus because it a function of pricing, it is a function of how we staff, and it is a function of efficiencies that we get out of our fixed bid projects so, that continues to be our endeavor every quarter.
- Mohit Jain:** It is in the 79% - 80% kind of is our cost of revenue for last five quarters, it has not moved in any direction so far?
- Abhishek Singh:** That is the million-dollar question Mohit, if we could we would have done it every quarter but we have made an endeavor, we are moving in that direction, that is all we can tell you.
- Mohit Jain:** Okay, all right. And in the presentation, you have shown this outside UK revenue so, anything which has started flowing from the US or it is primarily Europe only.
- Abhishek Singh:** Yes, it is primarily India revenue.
- Mohit Jain:** So, that 8% is primarily India?
- Abhishek Singh:** Right.
- Mohit Jain:** Any expectation on the US revenue from Digility?
- Abhishek Singh:** Yes, so, we continue to source clients, we continue to make those pitch, as soon as we win we would have that. The idea is that in next two quarters to three quarters we should definitely have something going.
- Moderator:** Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Sudhakar Ram for closing comments.
- Sudhakar Ram:** Thank you, Margaret and thank you all of you for attending this call and your sustained interest in Mastek. We have turned around and we do see that from the market opportunity perspective there is really a large opportunity for digital transformation and that is an area of expertise that we have. As I shared in my press TV interview also that analyst have started rating ourselves important disrupter to the UK government market traditionally the big boys use to win the large deal today there are handful of companies and we are among them, we are among the top three who are getting in delivering very large complex programs in agile manner and helping government cut cost as well as cut times in terms of delivery. So, as our reputation we do expect this part of the business to grow. The US has a huge opportunity; we have identified the niche that we need to operate in that. I think the momentum stated but as we get the wins I think it



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should really help us expand our footprint in the US. So, overall I think the business is looking positive, so look forward to giving you better results in the quarters ahead. Thank you.

**Moderator:**

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