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Transcript

Earnings Conference Call of CMC Limited – Q1 (FY 11)

Participants: Mr. R. Ramanan, MD & CEO
Mr. J. K. Gupta, CFO
Mr. Prashant Shukla, COO

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Presentation Session

Moderator: Good evening ladies and gentlemen. I am Gopal, moderator for this conference. Welcome to the conference call of CMC Limited. We have with us today, Mr. R. Ramanan, MD and CEO, Mr. J.K. Gupta, CFO and Mr. Prashant Shukla, COO of CMC Limited. At this moment all participants are in listen only mode. Later, we will conduct a question and answer session, at that time if you have a question, please press * and 1 on your telephone key pad. Please note this conference is recorded. I now would like to hand over the conference to Mr. Ashish Aggarwal, from Tata Securities. Please go ahead sir.

Ashish Aggarwal: Thanks Gopal. Good morning everyone. On behalf of Tata Securities, I welcome you all to CMC Limited Q1 FY 11 results conference call. I would like to offer my sincere thanks to the management and the participants for sparing their valuable time for the call. Without much further ado I would like to handover the call to the management to discuss the results. Over to you, sir.

J.K. Gupta: Thank you Ashish and a very warm welcome to all the participants in this call on behalf of the CMC management. I'm J.K. Gupta, Chief Financial Officer of the company and with me are Mr. R. Ramanan, MD and CEO and Prashant Shukla, the Chief Operating Officer. First I'll take you through some of the highlights of the financial performance of CMC for Q1 of FY 11 based on the results that were approved by the board yesterday. And after that I'll hand over to Mr. Ramanan to take you through some of the business initiatives that we have taken and that we have planned for the time to come. So, in terms of summary of the financial performance, result of operations of the company for Q1 of this financial year reflect continued all round improvement, with improvement in business mix,

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improved margin and cash flows. The company had consolidated operating revenue of Rs.243.82 crores in Q1, which is an increase of 6% Q-on-Q and 16% YOY; and all the business segments contributed to this growth. Service revenue in this quarter grew 7% quarter on quarter and 40% YOY to Rs.227.75 crores. And the share of service revenue in total operating revenue from sales and services was 93.4% in this quarter compared to 92.4% in the last quarter. Similarly international revenue grew 13% Q-on-Q in rupee terms and 47% YOY to Rs.140.57 crores. And the share of international revenue in total revenue from sales and services improved further to 57.7% from 54.2% in the last quarter. Americas contributed significantly to the growth of the international business. American subsidiary of the company i.e. CMC Americas, grew 16% Q-on-Q and 66% YOY in dollar terms. In this quarter CMC Americas commissioned its first onsite delivery center in the month of April 2010. Improved business mix helped us improving operating margins further. Our consolidated operating profit i.e. EBITDA in Q1 was at Rs.52.77 crores, which gave us a growth of 9% Q-on-Q and 71% YOY. We had the highest ever EBITDA margin of 21.6% versus 21.0% last quarter, which is an expansion of 67 basis points on a Q-on-Q basis. This EBITDA number of 52.77 crores is after one time impact of Rs.3.36 crores on account of additional provision of gratuity liability due to recent change in the limits as per the payment of Gratuity Act. Company earned a consolidated profit after tax of Rs.46.45 crores, which is an increase of 5% Q-on-Q and 66% on a YOY basis. Company had a PAT margin of 18.7% in this quarter. Our average effective tax rate on a consolidated basis is 14.6% in this quarter, and company has considered a MAT credit entitlement of Rs.3.98 crores in this quarter. Company added 15 clients during this quarter, six of which were added in Americas in the areas of embedded systems and software services. In addition, we deepened our relationship with key clients in Americas with new orders. In fact, we increased our business with all the top five clients in America which helped us grow in America geography 16% on a Q-on-Q basis. We added one client in Europe in the embedded system area, one client in Australia in software solutions and services. In domestic market we added seven clients in India, in financial services, education, energy and transportation space. Company had other income of Rs. 3.98 crore in this quarter, which includes an income from mutual fund investment at Rs.2.01 crores and foreign exchange gain of Rs.91 lakhs. Company added manpower to the extent of 139 during the quarter, and the total manpower at the end

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of the quarter stood at 5690. Company has cash and cash equivalent balance of Rs.284 crores at the end of Q1 which is an increase of 21 crores in this quarter. Company incurred a capital expenditure of 16 crores during the quarter. Out of 284 crores, we had an investment of Rs.217 crores in debt based mutual funds. So, from my side this was the summary of the financial performance. With this, I'll hand you over to Mr. Ramanan to take you through some of the key business initiatives that we took during the quarter and what we have planned as a strategy for some time to come, before we open up for any questions. Mr. Ramanan.

Ramanan: Thanks J.K. and thanks for covering it so comprehensively. All I want to add to everything that J.K. has said is our focus and our strategies for improving the quality of the business mix are thrust into the international markets, as well as our focus on ensuring operational excellence. All these three factors have contributed to both the growth in revenues as well as in profits for the company. I had mentioned last time that we will be focusing on growth in revenues starting this quarter. And I am pleased to share that and as the results indicate that we have been able to grow at least 6% quarter on quarter. And we look forward to ensuring that our thrust on increasing revenues while not compromising profitability or margins will remain and continue with added vigor during the coming quarters. What was also pleasing for us was the fact that all the SBUs grew in profitability during this quarter. And also some of the regions that we were looking for additional business also, we were successful. We had new clients from APAC region, we had client addition from Europe and we had six clients added from the United States and then we had number of clients in India. Overall, we added fifteen clients as J.K. had shared during the quarter. I think from a business point of view we have done some restructuring within the organization. We have introduced vertical heads who will be responsible for specific verticals that CMC has been particularly strong in, which include energy resources, utilities, transportation as a vertical, BFSI as a vertical, BFS as a vertical and insurance as a vertical. In all of these we have domain knowledge as well as we have solutions, SI solutions and products. And we intend to replicate these solutions and these products into, to grow the business in the SI markets not only in India, but elsewhere. We are, we were also pleased to note our growth in embedded systems during this quarter, both in terms of new business acquired as well as deepening the relationship as well as revenues from existing customers.

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This last quarter we also established the first onsite delivery center in US to support our operations in the United States as well as to be able to expand on our operations in India. So, this has resulted in a greater focus and greater flexibility that we will be able to offer to our customers in providing solutions and in a truly global networking model, delivery networking model. Also operational excellence in the company has resulted in improved cash flows and our cash position ended at 284 crores, which was an increase of 21 crores in this quarter as compared to the last quarter. Overall, our manpower productivity also increased. We added 139 people during the quarter as J.K. had mentioned. But, what was also pleasing was that our productivity has continued to be on the upward trend and it has been consistently so for the last few quarters. Finally, our international business really performed well at a time when most of the recession in the US looks like it is just ending, but there have been other trends in Europe. But, in spite of all of that CMC has been able to grow because of our niche focus. We grew internationally by 13% quarter on quarter and 47% YOY. But, in the Americas which has seen better growth, we were able to grow at 16% quarter and quarter and almost 66% YOY. So, with this we will continue to be focusing on value added solutions and services, international, domestic business mix as well as product development and enhancement of our replication solutions in specific verticals where we have also put an organization structure to support that. So, with that I'll be open to any questions that you may want to ask.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone key pad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key.

Our first question comes from Mr. Aseem Gupta from DSP Black Rock.

Aseem Gupta: Hello sir. Congratulations on a good set of numbers. I just wanted to understand one point. From our previous interactions, I think it was mentioned in previous interactions that we are getting help from TCS also as far as the sales and marketing is concerned. Would it be right to say that?

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Ramanan: No, CMC synergizes with TCS in certain areas and in large projects in India. But, CMC also focuses on its own sources of revenue. So it has, we have an arms length relationship with TCS. And there is sales synergy whenever there is a right opportunity for the sales synergy. At the same time we are neither constrained nor limited to just following that, because whatever would be an opportunity for CMC might not necessarily be an opportunity for TCS. And so we will continue to focus on those areas where our solutions and our services can have maximal impact. And we can be a value accelerator to TCS as well as a value accelerator to the customer.

Aseem Gupta: Makes sense sir. Sir, would it be possible for you to give us some idea as to what percentage of this growth that we are seeing now is coming through our synergies with TCS?

J.K. Gupta: Actually we continue to grow our direct business as well as business in synergies with TCS. And the share of the business that we get through the TCS synergy is in the range of 45 to 47%. As Mr. Ramanan said, our synergy with TCS is very strategic. It depends on the kind of markets, the client base, whether it's an existing TCS client where our offerings can fit very well and all that, so we go as per that. And in fact, we have very clearly laid out way of working together. So, definitely since we have got about 45% to 47% of business that comes in synergy with TCS, it's a very important and integral part of our strategy to grow. And we definitely get access to the market with the help of TCS also.

Aseem Gupta: Sir, just to understand, the 55% business where we are going to market ourselves, as investors we want to understand how things have changed internally that now the company is on a different growth trajectory as compared to what we have seen in the past?

J.K. Gupta: Sorry can you repeat the question; I think there was a break in voice when you were speaking.

Aseem Gupta: Yeah, yeah, sure sir. Sir, I am just focusing the 55% portion of the business where we are going to market ourselves. So, we just want to understand what steps changed internally within the company that now we are at a different growth trajectory as compared to what the company has seen in the past?

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J.K. Gupta: Well, I just want to clarify; this 55% and 45% is not that has significantly changed over the recent period. Ever since this company was acquired and became part of Tata Group, one of the key considerations of acquisition at that time was to bring the benefit of TCS's global presence in client relationship for CMC to be able to address those markets and clients where CMC was not present. So, this is possibly the reason why we have got significant business coming through synergy. But, this position has not changed over last three, four, five quarters; I think we continue to be in the range of around 45 to 47%. So, it's not that, we required a significant change in terms of how do they address the remaining 55%. And otherwise also, as Mr. Ramanan said and he can elaborate further on that, is that we have started doing lot of focus on vertical basis where we are much closer to our client and all that, which is taking care of the remaining 55% portion of the business, which we are marketing on our own. And I think Mr. Ramanan and Prashant can elaborate further, how exactly we are going forward in terms of addressing that 55% space for which we are doing our direct marketing.

Aseem Gupta: Right sir, that is what I would want to understand, because it's a reasonable chunk, it's not like it's a small component. Because we are growing so much, we think that the change within the company which is resulting in this kind of a growth.

Ramanan: Let me answer this question. First of all I think the focus and the strategy has not been different from what we have been stating all the while. We have mentioned that we would like to focus on TCS synergy where the opportunity is right. Now what is a right opportunity for a TCS synergy? Either it is an existing customer of TCS in the international markets who is not leveraging the type of services that CMC has to offer. And because today we are part of TCS that is an opportunity for us to offer these services and thereby value add to TCS. So, this is one opportunity. The second opportunity is that there are large opportunities where TCS would not be able to build without taking a CMC synergy into account, because of the fact that CMC has done that, been there, has competencies, has solutions which would be value adding. As an example, we do projects in the MCA projects, the Ministry of Company Affairs, Passport Seva project, projects for various State Governments like the State wide area networks. There are projects which TCS has partnered with CMC and which we have gone and given a better value proposition than what any other company could give.

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Because, the size of the project demanded a type of customer, a type of vendor like TCS to be able to bring that level of financial muscle as well as program management capability or application development capability. And it required a CMC to be able to leverage its pan India support capability and its deployment capability or its solutions, specific solutions in value adding to the solutions. So, these are the two types of opportunities that we have. At the same time there are a number of opportunities that CMC on its own would go after. And as an example, there are small ports in the country; there are embedded systems which are a very strong inherent capability in CMC where many of the customers are new customers, because TCS has not been in that space. And these are spaces which CMC can go after directly on its own, where TCS, if the size of the opportunity is very large and it makes sense for us to partner with TCS, then we would do that. But, even there the significant component of that service which is CMC competency will be leveraged by TCS. So, these are the ways in which we are synergizing. And so, this has been our strategy all the while, except that it has taken some time to start bearing fruits, which we had predicted even earlier that we needed some time for us first to clean up the type of issues that we had within CMC because of what we had inherited in the past. And after having cleaned that up, we said we would be on a growth trajectory. And we have reorganized now our organization internally also to be focused on growth. So, we had a SBU service practice layer which was on these four service practice SI, ITES, E&T and customer services and embedded systems. Now we have added a vertical layer which is going to focus on growth in specific verticals in the service areas that we have. So, this combination is the change that I would say, but I would not say it is a change of strategy because it was all the while there. It has now made sense for us to crystallize our focus in verticals as well as in the horizontals.

Aseem Gupta: Right sir. Thank you so much. Thank you.

Ramanan: You are welcome.

Moderator: Next question comes from Mr. Vinay Kulkarni from HDFC Mutual Fund.

Vinay Kulkarni: Yes, congratulations on a good set of numbers sir. Just some numbers which I wanted, what was the CAPEX in Q1?

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J.K. Gupta: 16 crores.

Vinay Kulkarni: Okay. Sir, have we preponed our salary hikes because in Q4 concall if I got it right, the salary hikes were to come in July?

J.K. Gupta: Yeah, we continue to have the same cycle. We have not preponed it.

Vinay Kulkarni: Because your manpower costs are higher.

J.K. Gupta: No, because as I told you in the briefing that we had to take a one time hit of Rs. 3.36 crores on account of change in the gratuity limit which was due to amendment in the payment of Gratuity Act, so it was primarily on that account.

Vinay Kulkarni: Sir, we have seen some jump in operating and administrative expenses, could you comment on that? Is it a one time hit or these levels of expenses would continue?

J.K. Gupta: No, it is basically in line with the increase in the services business. There is no one time element in this. And as a percentage of revenue, it has not gone up. As we move away from equipment and move more in services, there will be definitely attached operating cost. But, our margins have improved, so it means our operating cost in aggregate have come down by 67 basis points.

Vinay Kulkarni: Right, right. What were the box sales in Q1?

J.K. Gupta: It's Rs. 16.07 crores.

Vinay Kulkarni: Right sir. Could you help me with the number in Q4 and Q1 FY 10?

J.K. Gupta: Yeah Q4 was Rs. 17.38 crores, so we have actually reduced it by 8%. Q1 of last year was Rs. 48.35 crores.

Vinay Kulkarni: So, this is sustainable for now.

J.K. Gupta: Actually I would like to just clarify over here that it's not like sustained, fall or anything that is by design. Of course, last two years we have been actively working towards readjusting the business mix and actively reducing equipment. Now, whatever equipment is left over, I'll not categorize this as a box sale. You know that in India when we execute the work, most of the works are integrated work and most of the solutions assignments also will have

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a portion of equipment coming in. Now, whatever left over is there, will be an integral part of our business model. Actually some quarters you may see this percentage of equipment portion going up from 6% to 10% also. I think in the last concall also I had told you that equipment component of anywhere between 12 to 15% is an integral part of our business especially in India. So, I think this ratio of equipment to services and all that, whatever adjustment was that we were aiming at has been completed last year.

Vinay Kulkarni: Okay, thank you. And regarding the good increase in business from North America, could you comment a bit, give some more color on that? And how do you see that going ahead?

J.K. Gupta: In America we have grown 16% Q-on-Q. And if I remember correctly last quarter also we had grown 16% on a Q-on-Q basis. And the growth that we have seen in Americas is very wide based, it is broad based growth that we have. We have grown almost all the horizontal services, practices that we are following over here. As we have been sharing, in America, we get substantial business through embedded systems; IT enabled service and software service and solutions. So, these are the three main stake business segments which are delivering business to us. All the segments have grown. Not only that, at least top 5-6 clients that we have got in America, every client has grown in revenue in this quarter. So, we have got Q-on-Q growth from all existing clients. We were able to add six more clients in America. So, I'll say this Americas business growth is not coming out of one particular client or one particular business segment; it is pretty broad based growth that we have got in America.

Vinay Kulkarni: Okay. In line with your new focus on verticals, could we have the break up of the current business on terms of verticals?

J.K. Gupta: I think from the next quarter onwards we will start sharing vertical wise business. As of now we are completely reorganizing targets and everything on vertical basis.

Vinay Kulkarni: Okay, great sir. Thank you very much. All the best.

J.K. Gupta: You are welcome.

Moderator: Next question comes from Mr. Ashi Anand from Kotak Investment.

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Ashi Anand: Yes sir. Good evening and congratulations on a good set of numbers. I just had a couple of questions on the working capital side. What do you understand across the different business units that we have how much does the working capital cycle actually vary in? Which segment is it high and which segment is it low?

J.K. Gupta: Working capital we have been keeping a very tight control. I don't think that we have got significant variation in working capital by segments. There has been a small increase in our AR days by about three days. And that's not very significant. I think we have been hovering around 90 days AR. So, I don't think there is any major variation in any segment.

Ashi Anand: Okay, so they are all broadly around the 90 days kind of mark?

J.K. Gupta: That's right.

Ashi Anand: Sir, and there is one part of the working capital cycle which is called unbilled revenues in the annual report. Could you just explain what that is and is that links to a particular segment?

J.K. Gupta: Actually unbilled revenue is more in CS business as compared to other businesses. A small part will be there in SI business also. What happens is that when we get engaged into either a fixed price project or a turnkey project, so in a fixed price project you know that we have got this concept of percentage of completion based accounting. So, even before the billing happens we had to do the revenue cost match. And corresponding to the cost incurred, the revenue is recognized. So, all those projects which have got milestone based billing, we will have this component of unbilled revenue.

Ashi Anand: So, basically it is kind of understand and say for example if you are buying a hardware for the client who is giving a large project, we would only kind of bill once we have completed 30 or 40% of the work. But, you have actually done more work until that is where we when we've done 20% of the work.

J.K. Gupta: You are right. I think you precisely got it. I'll give you another example. Suppose we are executing a turnkey project in India, where we are supplying the equipment, but because it is a turnkey project, the client contact says that

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he is going to pay us 60% of the supplied equipment. Now, you see equipment as these are supplied that revenue cannot be broken down in pieces, because the whole value has been transferred to the client, he becomes the owner of the equipment. So, we have billed him 60% and the remaining 40% of the equipment value will have to be recognized as the accrued revenue and may be billed when the installation is complete. Value has been delivered, billing has not happened.

Ashi Anand: Okay, absolutely. So, actually the biggest kind of difference actually comes in when we are actually supplying equipment, but you've not billed for the entire equipment?

J.K. Gupta: It can happen in a fixed price software project also. Suppose we have got a project where certain billing is going to happen on say on pilot acceptance. So, whatever work have gone where the pilot has not been accepted, has not been reached, but we have done the majority of work, so in terms of the cost revenue match, the proportion completion accounting will happen and the revenue will be recognized. This is as per the accounting standards prescribed. So, there is no alternative available with us.

Ashi Anand: No, it's okay sir. If you hadn't put it here, you would have to put it into capital.

J.K. Gupta: Yeah, otherwise you have to defer your expense recognition.

Ashi Anand: Okay sure, super, perfect. And sir, just one question on the customer services business, if you just look at the kind of profitability of the business vis-à-vis your other kind of segments, both in terms of the EBIT margins and on the ROC, it's significantly kind of lower. Just wanted to understand the strategy on this particular segment going forward, will it be a focused segment? Are there any ways to actually increase profitability or will be kind of de-emphasize on the segment over time?

J.K. Gupta: No, only one portion I would like to cover and then Mr. Ramanan can take over. One is that this is one segment where most of the equipments that we are still supplying is there. So, this segment in any case will be always showing an average margin which is lower than other segments which are predominantly services segment. So, that's one portion. Second, when we talk of margins, this segment was traditionally giving us a margin of only about

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5-6%. And if you see, we have already taken it to about 12-13% now, directly because the component of the equipment has come down. So, when we talk of looking at the margins, we have to really understand that it is not the same business as SI and ITES, because of the equipment business. Also this business is predominantly India business. It does not have significant international business. Because of this difference in the business mix which is very peculiar to this business segment, the margin structure will always remain a bit different compared to other business segments. I just wanted to explain to you what goes into, why the margins are looking like the way these are looking like. This is inherent with the business that we are doing in this particular segment. And in terms of what are we doing to increase the margins and all that, as we have been stating that we have cut down our equipment portion, we are focusing more on getting into services and increase services and all that. So, that's one portion which has already seen doubling of the margins. And going forward what are we going to do in terms of growing services further maybe Mr. Ramanan can add a bit more on our strategy in respect of growing service in CS business.

Ramanan: Yeah, first to answer your question, can we improve the margins in CS business? Yes, we can. And so we are going to be focused on that. The margins in CS business increases directly in proportion to the percentage of equipment that becomes lesser in fact that is one aspect. Because, any time you introduce an equipment component, as J.K. had explained the margins on equipments are lower, so by nature it will drag the margins little down. But on the other side, the upside for customer services is if we are able to focus on high end service margins, which means you are looking at newer areas of customer service which includes storage, equipment, servicing, you are looking at cloud computing and web based services and infrastructure support, you are looking at data centers and green data centers type of service support and we are looking at consulting offerings for virtualization, server virtualization and architecture optimization and so on. So, there are a series of high end services which our people are now focusing on in various verticals to be able to bring greater value to the customer. And typically these are not the run off the mill projects. CMC has been doing run off the mill projects for quite some time which are the standard AMC type of contracts and maybe facility management, which are little higher end than the AMC. But, the newer type of projects that we are

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going to be focusing on will revolve around data center, infrastructure outsourcing, cloud computing related services, server virtualization and so on. And also we will be focusing on remote infrastructure management, not only in India, because if you do remote infrastructure management in India, it can help increase the profitability of our existing service. But, we would also be focusing on how to increase remote infrastructure management service for the international market.

Ashi Anand: Sir, has the RIM services really taken off in India?

Ramanan: Pardon?

Ashi Anand: RIM service, in India has clients actually started opting for remote infrastructure management?

Ramanan: No, they have not. But, there are some of the clients are open to that. And it basically depends on how you structure the contract and how you are able to show that you are able to reduce the cost to the customer. And I think increasingly customers are willing to look at some of the models. So, we will be focusing on RIM, not only, in India we stand a good chance of focusing on RIM because of our existing base of customers who maybe willing to look at us and at newer models of delivery service, so that it reduces their cost and improves the quality of services also.

Ashi Anand: Okay sir. Sir, just in terms of the competition in this segment, who would we really be competing against in customer services in India?

Ramanan: Customer services, most of the standard players are there like IBM and HP. Wipro and HCL is also offering those services. I would say IBM, HP would be more focused on providing these services, provided their platforms are being used, whereas CMC being agnostic to platforms, we maybe able to offer services to customers who are a heterogeneous mix of platforms and that would be a value addition from a customer point of view. So, the customer is not piped down to a particular vendor or a particular vendor's equipment. Wipro and HCL also are in this business, so they would also, we would be probably competing with them in that area.

Ashi Anand: And just lastly what's the kind of growth we see in this segment?

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Ramanan: The opportunity for growth is good. But, we want to make sure, we have been a little cautious in entering into projects which have the, most of the Government projects have poor payment terms and conditions and penalties associated with that, which becomes a very contentious thing to resolve. So, we are looking at only large projects where our value addition would be very high and we don't want to compete with small vendors who may be bidding on some of the smaller projects. Secondly, the private sector is a very good area for us to focus on in infrastructure management services and that is another area that we will be focusing.

Ashi Anand: Okay. Thank you so much sir. Appreciate it.

Ramanan: Thank you.

Moderator: Next question comes from Mr. Shekar Singh from Goldman Sachs.

Shekar Singh: Hi sir thanks a lot for the questions. Just wanted to understand like earlier between the March quarter and the June quarter, there used to be a drop in revenue and a sharp drop in margins and this time you have actually been able to sustain the margins and show an improvement in your revenues. So, is it primarily on account of the change in the business model or is it like one off something like which has happened in this quarter?

J.K. Gupta: No, this is not one off. I think your first observation is absolutely right. As we moved and as we improved the business model and as we reduced our dependence on this one time projects especially equipment etc., we were expecting this kind of trend to take place. So, you are absolutely right. It's a result of our conscious effort to improve the business mix.

Shekar Singh: So, does it then mean like margins for the year as a whole because it used to be the lowest margin quarter and in this quarter you have shown 22% margins. So, does it mean for the year the whole you can sustain a sort of 22% EBITDA margins?

J.K. Gupta: See, what I am trying to say is that we have reduced the seasonality. So, don't say that Q1 of this year is similar to Q1 of last year and then you can extrapolate. No, frankly speaking that, we share that in the month of March also, is that the significant improvement that we saw in terms of margins was due to significant improvement in terms of the

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business mix that we had and because we were completely focusing on improvement in business mix. And we also shared with people that most of our effort in terms of adjusting the business mix are complete. And we are now looking at growth. So, because of that you may not see that kind of margin expansion that we saw last year, because we will be actually depending more on growth to deliver growth in bottom line instead of looking at business mix change as a source of improvement.

Shekar Singh: And sir, last quarter you had mentioned that the CAPEX plans for the year included some 186 crores for the SEZ. Is that still there?

J.K. Gupta: Yeah, still there.

Shekar Singh: So, the CAPEX for the full year will be around 186 crores?

J.K. Gupta: This is what the plan is as of now and the bigger portion of the CAPEX is going into SEZ. We are very keen to complete that project before the end of the financial year. So, we are still with the same CAPEX plan.

Shekar Singh: Okay. And lastly like in terms of the tax rate, you are expecting 14 to 15% to continue?

J.K. Gupta: Yes. This quarter our effective tax rate has slightly gone up, because we had larger profit in America subsidiary. But, more or less we are in the same range of around, between 13½ to 14½%. And given the current business mix and the way the sources of profit that we have got, we feel that at least for the current financial year, we should have a similar kind of tax rate.

Shekar Singh: Just one question which comes from CAPEX, like you are spending so much on SEZ, whereas if I look at your size of the exports, the portion of the exports revenue, that's not that much. So, is it an indication of the good that you are expecting or is it like you are just preparing the infrastructure in advance and then you expect like, okay probably the exports will pick up?

J.K. Gupta: I think there are two things in this. Whatever infrastructure we are going to build up is going to be used jointly by TCS and CMC. So, the whole of the facility is not going to be used by CMC alone. In the first phase we created almost 2700 to 2800 seats which are completely being used by TCS. And we are earning rentals. We had shared that our rental earring is about 3.1 crores per quarter that we have

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got. In second phase also it is going to be, we are going to create almost 7000 seats, out of which CMC is going to have facilities of around about 2500 seats, give and take some 100 and 200 seats. And the remaining seats are going to be used by TCS. So, this CAPEX itself cannot be used as an arithmetic basis to determine how much business we are talking about. But, definitely the capacity that we are building up is building up for growth also and that will take care of our growth in international business as we continue to grow. As we have shared with you already, we have seen some robust growth for the fifth consecutive quarter in international business. America still continues to grow, most portion of which is going to be delivered offshore, so definitely we need a lot of offshore delivery capabilities. So, we definitely are investing for future. And to some extent, you are right, but I just want you to clarify that a portion is for facility to be used by TCS.

Shekar Singh: But sir in terms of rent yield on the CAPEX that you are putting in, is it much higher compared to what you are getting on the liquid investments?

J.K. Gupta: Yeah, definitely. I can just give you an idea. In the first phase we spent about 43-44 crores. And that phase has given us a rental of 3.1 crores per quarter. I think that can give you an idea of yield that we are getting on this.

Shekar Singh: Okay, great sir. Thanks a lot.

Moderator: Next question comes from Mr. Srinivas Seshadri from RBS Equities.

Srinivas Seshadri: Yeah, hi and congrats on a good quarter. I've a few questions. Firstly, just wanted to understand what is happening in the ITES business. We have seen a fairly strong growth quarter on quarter here. And even through last year also there was a fairly decent growth. Just wanted to understand whether in this particular quarter are there kind of any project specific, manpower or something or any kind of one time investment? How things are looking going ahead in this?

J.K. Gupta: I can give you a color about the number that we have seen till now. And what is going to happen, possibly Mr. Ramanan can add more to that. Most of the growth that we have seen in IT enabled services space is through increased businesses from our clients. And I think in the opening remarks, I shared with you, an onsite delivery center we set up in America. That onsite delivery centre is

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also primarily a delivering IT enabled services. So, we have been able to grow almost all the clients that we got in IT enabled services sector. Most of the growth is coming out of extending business with our existing clients. In terms of how it is going to grow further, possibly Mr. Ramanan can share, what initiative we are taking in terms of growing the ITES. But, one thing is very clear; it is one of the very, very important business segment that we have got, one of the most profitable segment we have got. We have seen very good growth happening in past and definitely it is going to be one of the key focus area for delivering growth on value added services. Mr. Ramanan.

Ramanan: Yeah, thanks J.K. See, on IT enabled services CMC has gone slightly different route as compared to many other companies. And I just want to explain a little bit about that. We have taken digitization and work flow management as the core platform for expanding on our IT enabled services. And we took the work that we had done in census project in India and we built upon that capability. And then we have been expanding in the market. Now that has given us a certain positioning both in terms of the uniqueness of the service that we are offering as well as the fact that we have developed assets and tools which give us a certain unique differentiator while offering this service. These tools are workflow management and data management tools which can substantially increase the productivity of the work that is being done. Also the second aspect of our digitization and work flow management services is, there is a component of knowledge processing which enters soon after we start doing the initial work with any customers. So, it is not limited to just a digitization, end to end digitization service, but it really evolves into higher levels of knowledge processing. And when I talk of knowledge processing, it is really once you extract the data and once you have digitized the data, what do you do meaningfully out of that data and what value can you further add through a service that you are rendering on that data, that is the focus of CMC. And what we have been doing in this is, making sure that our knowledge of vertical segments and domain knowledge whether it is in securities market, whether it is in banking market, whether it is in insurance market or whether it is in the transportation market, this domain knowledge is being brought to bear in the knowledge processing service, which evolves from the digitization and the IT enabled services. So, that is why we are very bullish about the potential of growth of CMC in this segment. And we are also quite confident that the type of value addition that we are doing can command respectable

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margin from the customers. We do think that all the segments of verticals that we are in, lend themselves to growth for IT enabled services for CMC. And we hope that we will be able to capitalize on it in the coming quarters, both in India as well as in the international markets. Prashant, you want to add anything to that?

Prashant: Sir, I think you have covered it.

Ramanan: Yeah.

Srinivas Seshadri: Yeah thanks, that's very helpful. Just a follow up on that, historically this particular segment what we have seen is, I am not talking about the past 4-5 quarters which have been fairly good, but maybe more in FY 07 and FY 08, when we typically had a fairly good growth in a quarter. The next quarter typically had a lull, because typically we used to have these fairly big digitization exercises and then once they get over they should, there used to be a revenue decline. Just wanted to understand if in this particular quarter is there such a situation that we have done a kind of a large digitization in place?

J.K. Gupta: No, this quarter we didn't have this transactional or transformational component. But, you are right. In 2007-08 when we started engagement, we had backlog to be converted as a one time activity. But, now that component is not there.

Srinivas Seshadri: So, even the current revenue base can basically be sustained going forward, is that the way to look at it?

J.K. Gupta: The only comment I'll make is that we don't have a one time component in that. And the rest of course I think since the business is on a continuous basis, we can reasonably expect that.

Srinivas Seshadri: Right, right, great. The other question that I had is with respect to the salary hikes, just wanted to understand whether you had finalized in terms of how much hikes are to be given and what is the likely impact on the margins for the next quarter.

J.K. Gupta: Hikes are going to be in the range of around 8% average. And this will be effective from 1st of July. So, this is what I am talking of average for the eligible people, not for any individual, because we have got a performance based salary compensation structure where people can get definitely more than the average also.

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Srinivas Seshadri: Okay. And any sense on how much this could impact the margins by for the next quarter?

J.K. Gupta: I'll guess in next quarter it can have an implication of around say about Rs. 3.5 to 4 crores, in a quarter.

Srinivas Seshadri: Okay great. The other thing I wanted to check is, you spoke of some provision relating to some gratuity. Is this purely one time or is it like?

J.K. Gupta: It is one time, because you know that our carry forward liability has to be restated based on the new limits. So, it's a one time implication.

Srinivas Seshadri: So, no portion of it is kind of, because of an enhanced kind of thing, not very material is it?

J.K. Gupta: No, no, every quarter will have the small component, because of additional elapsed service of employees. So, definitely quarter will have some component. But, that's not very significant. Every quarter we have been having that. This Rs. 3.36 crore is one time because of change in limits. It's not going to be repeated again.

Srinivas Seshadri: Okay, great. And then I have a couple of small data points. I just wanted to know the employee headcount ex the sub contractors.

J.K. Gupta: Yeah, total employee headcount is 5690, of which our regular employee is 3698 and contract employees are 1992.

Srinivas Seshadri: Okay. And also the cost of living expenses for the quarter.

J.K. Gupta: This quarter we had Rs. 1.92 crores. Last quarter was, we were having Rs. 1.74 crores.

Srinivas Seshadri: Okay, okay, great. Thanks J.K., thanks a lot. That's all from my side.

J.K. Gupta: Thanks.

Moderator: Next question comes from Ms. Priya Rohira from Enam Securities.

Priya Rohira: Good evening to the management team and congratulations on a good set of numbers. My first question relates to the pie of Government vertical which

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not contributes to your top line and how does the growth look over here? The second question relates to if you could just give us some color on the embedded practice and the ITES practice and what growth rate should one expect? The third question relates to how the average deal size is inching up for CMC consolidated. And the fourth would be the new organization structure impact your sales initiatives?

J.K. Gupta: I think we have to remember all the four questions that you have asked Priya. Yeah, you talked about embedded growth?

Priya Rohira: Yeah.

J.K. Gupta: This quarter we had an embedded growth of around 10-10½%.

Priya Rohira: Sequentially?

J.K. Gupta: Sequential growth. And second question you talked about...

Priya Rohira: How does the outlook look over here?

J.K. Gupta: Yeah, outlook I'll leave it to Mr. Ramanan to reply. And you talked about IT enabled services. I think we have been able to deliver decent growth, both in terms of revenue, profit, profit margins and all that. The numbers are already there with you.

Priya Rohira: Sure. But, this 39% margin, it's largely because of a higher share of insurance vertical over here or is it more to do with digitization pie increasing?

J.K. Gupta: No, digitization is a horizontal service. Insurance is a vertical. We can deliver digitization to insurance sector also. But, in terms of the sector that we are serving, I think the largest pie in this is coming out of financial services. Insurance and logistics and transportation is also some of the verticals which we are serving in this particular segment. But, so far as the growth is concerned, the numbers are there with you. And which was the third question? Sorry I told you that I'll forget.

Priya Rohira: The third was with respect to the outlook both on the ITES and embedded practice.

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J.K. Gupta: So, that I'll hand over to Mr. Ramanan. If you have got fourth question from me...

Priya Rohira: The average deal sizes, how is that shaping up?

J.K. Gupta: Mr. Ramanan will reply to both the questions.

Ramanan: What is that?

J.K. Gupta: Deal sizes that we are getting.

Ramanan: Yeah, our outlook both in the domestic segment and international segment looks good. We don't give any forward guidance or numbers on these. But, I can say that our sales pipeline for the next quarter looks as good if not better than what we had for the current quarter. And the current quarter was an improvement over the last quarter. So, with those we don't have, I am not able to give you the numbers, but what I can say is on all the four segments that we are looking at, that is embedded systems, IT enabled services, SI and I would also say in CS we are looking at growth. E&T like I had mentioned last time, we had done some restructuring. So, we have introduced a specific area of focus for corporate training and international training. And we have inducted a new head for corporate and international. So, E&T in addition to the retail and the job enabling training programs that we have been doing, we are going to have added thrust in these. It will take some time for these initiatives to start paying off, but it has had good effect in quarter 1 itself from the point of view of the growth that we have had in Q1 as compared to the Q1 of last year, there has been a substantial jump, though quarter on quarter has remained flat. But we have been actually encouraged by the performance of E&T this quarter, because for the first time we were able to maintain from a Q4 to Q1 the sort of flat trajectory that we had, we've never had this before. And that is a good sign. Also we are looking at from an outlook perspective; ES, embedded system has shown a 10% growth quarter on quarter. And it has most of the businesses that we have won are not one time projects, but they are sustainable revenue projects. So, from that perspective I would leave you to infer onto your own conclusions. But, that's the sort of business that we are focusing on to ensure that there is no volatility in our numbers as well as reduce the impact of one time. Though I don't rule out one time projects which we would gladly take, but then if there is something we will also make it transparent to you in a particular performance in a quarter.

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Priya Rohira: Sure. And just on one thing J.K., if you just could give us the pie of Government vertical contribution to your top line and insurance as well.

J.K. Gupta: Government is almost one third of the business that we have. And insurance number I'll give you in a while.

Priya Rohira: Sure. Just one more thing, Mr. Ramanan if you could just comment on the new structure, how does it change the go to market along with TCS or CMC on a stand alone basis?

Ramanan: Actually it aligns itself even better with the TCS right now, because TCS is already organized on verticals. And there is now synergy between our vertical related presales support and the TCS vertical team. The way we are structured is as follows. Our sales team still drives the sales. Our sales are separate, are divided by region, so India and within India, northern, southern, eastern, western regions. And we have America, we have UK, Europe and MEA and APAC. So, we have sales, regional sales head and these sales heads have teams who would be driving the sales. Our sales team has an integrated sales approach, which means they are customer focused and they are divided by verticals. And within a particular vertical, the sales would have a targeted set of accounts which they would be going after. Now the vertical team that we have put in place, in addition is really a domain knowledge skilled team which is able to value add in a particular vertical. So, they would be more, that there are two parts to this vertical team. One is the offerings, the presales and the offerings that come up and that are defined by the vertical. So, take for example insurance, we have a general insurance SI offering, we would have a general insurance related ITES offering, we may have a general insurance related educational training offering or we may have a general insurance related automation offering, technology automation offering. So, these are different offerings which would be defined by the vertical. And the sales team would run on, would take these offerings and go to the customers. And since our sales teams are customer account focused, so they would be seeing which of these offerings are relevant to a particular customer. And that's where the all structure synergizes together. So, there is close coordination between the sales team, the IP team. And then you have the products which are in the SI part, the software product which are led by different product management teams. And we also have a head of innovation now in the company. And so

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innovation from products perspective in different domains will be led by this innovation team. And they will be focusing, and they will be gathering the inputs both from the IP as well as from the sales. So, that's the way the organization is restructured. The whole idea is to bring lot of synergies, keeping customer as a focus. What is the customer wanting in a particular vertical? What is the service that he looks for? What is the domain knowledge that he is looking for? What is the specific product that would make a difference to our offering to that customer?

J.K. Gupta: And Priya you wanted to have this share of the insurance?

Priya Rohira: Yeah.

J.K. Gupta: It's about 8½%.

Priya Rohira: 8½, right. And what would be the net margin for CMC Americas? For CMC Americas?

J.K. Gupta: Actually CMC Americas is primarily a marketing company and we execute lot of business on an offshore basis from India. So, lot of margin will be actually in India books, as we have got the offshore delivery over here. So, when we talk of America geography profitability that will be over 30%. But, that will be the combined profits in those projects.

Priya Rohira: And the front end?

J.K. Gupta: Yeah, absolutely.

Priya Rohira: Okay great. Sure, thanks very much and wish you all the best and congratulations once again on a great quarter.

J.K. Gupta: Thank you.

Moderator: There are no further questions. Now I hand over the floor to Mr. Ashish Aggarwal for closing comments.

Ashish Aggarwal: I would like to thank the management for giving us an opportunity to host this call. I would also like to thank the participants for attending this call. Thanks, thanks a lot.

J.K. Gupta: Thanks Ashish.

Ramanan: Thank you.

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Moderator: Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant evening.

Note: 1.This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.