

Transcript

Earnings Conference Call of CMC Limited – Q2 (FY 12)

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

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Moderator

Ladies and gentlemen good day and welcome to the Q2FY12 results conference call of CMC Limited hosted by Tata Securities Limited. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Ashish Aggarwal Tata Securities. Thank you and over to you sir.

Ashish Aggarwal

Thanks, on behalf of Tata Securities, I welcome you all to CMC Limited Q2FY 12 results conference call. Before starting, I would like to thank the management for giving us an opportunity to hold this call. Today, we have with us from CMC Limited Mr. Ramanan – CEO and Mr. J. K. Gupta – the CFO. Without much further ado, I would like to handover the call to Mr. Gupta for his opening remarks. Over to you sir.

J. K. Gupta

Thank you Ashish and a very warm welcome to all the participants in this call to discuss Q2 FY12 results of CMC which were approved by the CMC board yesterday. Yesterday evening, we had announced the results and put up on the CMC website also and I am sure participants had an opportunity to go through those numbers so that we can have a good discussion on that.

Before I handover the call to Mr. Ramanan to take you through some of the major business initiative, I will take you through some of the key highlights of financial performance of this quarter. CMC had an excellent quarter of growth that we have delivered on a quarter-on-quarter basis for the second successive quarter. Company earned its highest quarterly revenue of Rs. 356 crore in Q2, which is an increase of 32% YoY and 17% on Q-on-Q basis. This is the highest quarterly growth in the recent times which was contributed by all business segments of the Company.

The growth of business has been widespread. It's a broad based growth that we were able to have. India revenue grew 14% Q-on-Q and 22% YoY to Rs. 146.09 crore. Similarly international revenue grew 19% QoQ and 40% YoY to Rs. 211.07 crore. Share of international revenue in total revenue from sales and service grew further to 59.1% from 58% in the last quarter and 55.7% in Q2 of last financial year. As we have seen the trend over last one and a half years, America continues to contribute significantly to the growth of international business of the Company. Our American subsidiary CMC America Inc. grew 49% YoY and 17% QoQ in dollar terms and share of American geography in the overall operating revenue increased to 49% this quarter.

Services revenue grew 29% YoY and 17% QoQ to Rs. 316.46 crores and share of the services revenue in total revenue from sale and service was 88.6% compared to 88.7% in the last quarter.

Company reported consolidated operating profit i.e. EBITDA of Rs. 52.66 crore in Q2 which is an increase of 5% on a QoQ basis resulting into an EBITDA margin of 14.7% versus 16.5% in the last quarter. Here I would like to give a bit of color for us to really understand the drivers of EBITDA in this quarter. As we shared last time, the Company normally effects its annual wage hikes in the month of July, so we have given almost 9% hike to people in the month of July. So that was one significant impact in this quarter. In addition, company incurred an exchange loss of Rs. 3.63 crore basically on mark to market of forward covers. Salary cost increase in this quarter has been Rs. 9.5 crore out of which about Rs. 4.25 crore is an account of addition of 691 people during the quarter and about Rs. 5.25 crore due to revision of salary. This Rs. 5.25 crore includes one-time impact of Rs. 2.2 crores due to

revaluation of the carry forward gratuity and leave liabilities. We consider Rs. 3.63 crore of an exchange loss and Rs. 2.2 crores of revaluation of gratuity and leave liability as one-time extraordinary items. If we remove these two items, EBITDA during the quarter was Rs. 58.49 crore which grew 17% QoQ giving an EBITDA margin of 16.4% which is almost a same level as we had in the last quarter. So the broad point is that we grew 17% on the QoQ basis and we protected our margins. Company earned a consolidated profit after tax of Rs. 32.63 crore giving a PAT margin of 9%. Here also there is a one-time extraordinary item. In this quarter, Company's subsidiary CMC America declared and paid a dividend of 5.5 million dollars. On 5.5 million dollar, company paid a tax of Rs. 4.16 crore at the rate of 15.45%. So we had an increase in tax without corresponding increase on profit on a consolidated basis. If we add back this additional tax which is a one-time extraordinary item, our profit after tax works out to Rs. 36.79 crore, which grew 5.5% on a QoQ basis resulting into a PAT margin of 10.1%.

Effective tax rate reported is about 38%, but if we remove Rs. 4.16 crore from this tax rate which is a one-time item, effective tax rate is 30.2% which is almost at the same level as we had last quarter. As you are aware that effective tax rate has gone up primarily because of STPI concessions have gone off and in this quarter, we had some additional implication for capitalization of SEZ assets. As we had shared last time, we have been now capitalizing phase II of SEZ in parts. Major capitalization happened in this quarter. We are expecting that as the utilization of SEZ assets increase due to increase in the business of international, we are expecting over the period the tax rates to start falling and we are expecting the yearend tax rates to be around 26-27%. We strongly believe our business outlook remains very robust as you have seen reflected by 17% QoQ growth. In this quarter, we added 23 new clients. You are aware that last quarter we had added 16 clients.

Company had other income of Rs. 5.46 crore in this quarter. The major component of that is income from mutual fund investments, which was Rs. 4.70 crore.

As I mentioned earlier, company added 691 people to this quarter taking total manpower strengths to it 8500 people.

Company ended the quarter with cash and cash equivalent of Rs. 222 crore after meeting the capital expenditure requirement of Rs. 27 crore and parts of dividend outflow of about Rs. 20 crore. Out of these Rs. 222 crore, Rs. 183 crore was invested in debt based mutual funds which gave us an yield of around 9.3%.

So this was a brief financial snapshot of performance that we have during the quarter and now I will hand over to Mr. Ramanan to take you through some of the business strategies and the business initiatives and the kind of progress that we have made.

R. Ramanan

Thanks JK and good afternoon everybody and thank you for joining this call. JK has very comprehensively shared the numbers as well as some of the details behind them both in terms of our EBITDA as well as our margins and so on. So I am not going to repeat any of that.

All I want to add to what he had said is this has been consistent with the strategic directions that the company had embarked at the beginning of this year and really towards the end of last year where we have said that we want to focus on growth and we will be making the necessary investments for growth both in terms of manpower and other investments that we need to make related to R&D training product development and so on and while factoring all of that, we have been able to deliver fairly good quarter with increase in revenues by 17% quarter-on-quarter and 32% YoY. But the more important part is that we continue to maintain good business mix and the business mix is 88% of our business comes through solutions and services which are more and more of a sustainable nature. So we have not shifted that focus.

Our equipment business still continues to be within the 10% to 15%. We had indicated during our earlier interactions with you that we may continue to look at equipment being up to about 15% in our business mix because, in the very nature of the SI projects that we undertake, this possibility have to factored in. But we have also had very good growth in the international market. Growth in international market has been 19% and in America, it has been 17% which were fairly good. Growth in the domestic market is at about 14%. So it has been an all-round growth for the company. Every SBU has

grown, CS, ITES, Education and Training, embedded system and SI. So that is also a positive part that needs to be viewed when you are looking at a company performance. We have also been able to focus sharply in some of the emerging markets like Africa and Middle East where we are continuing to look at new opportunities which would be able to leverage whatever we have developed in India and replicates them in these markets. In terms of manpower count, we have added 700 people to the manpower. This is in line with what we need to do for businesses on hand as well as what we need to do for anticipating new businesses based on the pipeline.

We have added the 23 clients in this quarter and they have been in the strategic areas of focus for us whether it has been the government or whether it has been the private sector. One important thing that I have been sharing with you is we are focusing increasingly on increasing our presence in the private sector and that has also been quite good both in terms of sales pipeline and in terms of our initiative there.

With that, we will be happy to answer any questions that you have related to the performance.

Moderator

Thank you very much. We will now begin with a question and answer session. The first question is from Sandeep Agarwal from Antique Stock Broking, please go ahead.

Sandeep Agarwal

Question on the tax rates, sir I see there are two cost items have increased significantly in this quarter. One is on the subcontracting part and the other one is on the tax part. Can you please throw some light on the same?

J.K. Gupta

Yeah, I think on tax I explained to you that the tax includes an extraordinary item of Rs. 4.16 crore that we have paid on repatriation of dividend from CMC Americas. America has declared a dividend of \$5.5 million on which we suffered an additional tax of 15.45%. As you are aware, while consolidating the accounts of CMC and CMC America that income will not reflect, so income effect of that is zero and the tax is that increase in tax. So that's what I have explained. As regards increase of subcontracting costs, I think this is purely because of our business model. We are into certain businesses of IT enabled services and some other businesses and we have got various hiring models that we have elaborated in past. We have got a hiring

model where we use our own regular staff who are taken in the company up to the age of retirement then we take some people on contract that come in the companies with commitment period of one to three years after which their contracts can be either renewed or they can be absorbed in the regular and we also take people from the staffing companies. Those costs are resting in subcontracted. So my feel is, in any analysis, you can combine this subcontracting cost and the people cost together to do all the analysis. All this increase if you see is in line with the growth in business.

Sandeep Agarwal Okay and sir can you throw some light on the utilization rate and the attrition rate during the quarter?

J.K. Gupta Our attrition rate during the quarter has fallen by about almost 200 basis point and utilization rate is about 81%.

Sandeep Agarwal It is excluding trainee right?

J.K. Gupta It's including everything.

Sandeep Agarwal Okay thank you. That's all from my side.

Moderator Thank you. The next question is from Amar Maurya from Indianivesh Securities, please go ahead.

Amar Maurya Yeah hi. Sir I wanted to know a little bit breakup about the revenue in terms of like how much percent of the revenues coming from TCS subcontracting and how it has grown in this quarter?

J.K. Gupta Actually first of all I don't want to call it TCS subcontracting. I think our TCS relationship is very strategic and synergy between CMC and TCS have been the cornerstone of the CMC performance ever since we have become a part of Tata Group. So we have to see from that prospective. Yeah, I can give you a few data point. Our revenue through such synergy projects which we are build billing to the end client through TCS because of variety of reasons that they have got a client relationship or they are more dominant brand name in the market through which it becomes easier for us to acquire the client and there are multiple such reasons. So if we look at the numbers in this quarter, 51% of

our operating revenue came from such synergy accounts in Q2 and last quarter was 47%.

Amar Maurya Last quarter was 43% or 47%

J.K. Gupta 47%

Amar Maurya 47%, okay and now in terms of the geography like North America contributes how much percent?

J.K. Gupta Yeah I told I think in my opening remarks. North America contributed 49% out of 59% international.

Amar Maurya Okay, so like TCS this strategic revenue which is coming from TCS, this all is coming from the North America side or it is?

J.K. Gupta You know it is in India as well. Let me just briefly narrate the whole framework in which we are working together. In America because, TCS is a very large company and they have very old relationship with large clients. It was easier for us to approach and using their brand leverage easier for us to approach large client and that has been now one of the primary driver of our growth in America. So I will actually give lot of credit to this TCS-CMC synergy for growth in America. So that is one part. Second part in India is that we have been working along with TCS on some of the large transactions like MCA has been a great example. We are working on passport seva project. We are working on some state data center projects. So some of these projects are very large projects in which we find when we are in the competitive situation, it help us leveraging TCS balance sheet and go along with that. Second thing is that some of these projects require mix of capabilities, capabilities which relate to infrastructure, which relate to training and digitization which are strong capabilities of CMC which we bring to the table. TCS is strongly capable in developing some application so we combine all this things. Other thing is that some of these projects require large amount of capital investment, which could be bigger than our balance sheet. So I think it is great combination of TCS-CMC addressing some of these opportunities together. So you can say these are two basic framework in which we are working with TCS.

- Amar Maurya** Okay so like just wanted to have a flare like for the 51% of the TCS revenue like how much percent is coming from US, if you can give me some numbers?
- R. Ramanan** Out of this 51%, US would be contributing almost 39% and 12% will be outside US.
- Amar Maurya** Okay thanks a lot.
- Moderator** Thank you. The next question is from Shikha Jalan from Smifs Securities, please go ahead.
- Shikha Jalan** Thanks for taking my questions. My question is about future hiring plans? What are the future hiring plans for us sir?
- J. K. Gupta** future hiring plan of the company
- R. Ramanan** Yeah, the future hiring plan based upon what we are seeing in terms of the marketplace and opportunities. There are some opportunities which we have already won which will call for additional hiring during the next two quarters and there are some projects that we are anticipating and based upon winning that we may increase our hiring. However we have invested in additional manpower in the last couple of quarters, which will keep us going for the current set of projects that we have.
- Shikha Jalan** Okay, what kind of growth are we expecting in terms of like just today the tier I company Infosys came out with the results and as per them they are expecting a balance growth of 17-18% growth YoY. So are we following the league, are we seeing similar kind of trend for our company as well.
- J.K. Gupta** Actually I think it is not fair to compare CMC with Infosys because of the size and difference in dominance in different geographies. One is that their size is pretty large. Secondly is that they are dominant players in US and they have huge presence in BFSI segment and all that. If we look at six months, I think the six months period Infosys are grown almost 18% or so. We have grown almost 29%. So the base effect can also be there. So I don't think that we would like to compare ourselves with any particular growth rate of some other companies. But of course we are looking at our own potential to grow. And as

we had mentioned at the end of last year, the focus of the current financial year is actually going to be growth and we said that we would like to grow at a rate faster than the industry. I think at this point in time that all we can reiterate that our intention is to grow at a rate faster than the industry.

Shikha Jalan

Okay sir what about the hedging policy in, if you can just give us some color on that?

J.K. Gupta

As of now, we have forward covers worth 18 million dollars and all this covers are going to mature in the current financial year. So we have currently not hedged for the next financial year.

Shikha Jalan

Okay, sir that is all from my side as of now. Sir I will come back for some follow up questions later.

J.K. Gupta

Okay.

Moderator

The next question is from Mitul Mehta from Lucky Securities, please go ahead.

Mitul Mehta

Yeah, good evening sir. Sir actually I just logged in bit late, sir can you just explain there was certain one offs which we took in the P&L in this particular quarter for revaluation of gratuity and what was that amount and there was some ForEx loss. Can you just explain these two?

J.K. Gupta

Yeah, FOREX loss is Rs. 3.63 crore and one time impact of gratuity and leave revaluation is Rs. 2.20 crore. If we add these two items, our comparable EBITDA works out to Rs. 58.49 crore. This gives us a growth rate of 17% QoQ. Another one time item was in tax. We had Rs. 4.16 crore tax payout on dividend distribution by CMC America, which we brought to India. So we don't have corresponding income sitting in consolidated PBT, but we have got additional tax payout of Rs. 4.16 crore. This should be taken as a one-time extraordinary item.

Mitul Mehta

Sir in the earlier call, you did mention that the certain contracts that we won had a higher portion of the onshore component and so as we move forward once we start shifting out the work offshore, we do have levers to improve our margins. So can you just elaborate on this, I mean where are?

J.K. Gupta

Actually some small movement offshore happened last quarter, but I think that movement will happen towards the end of third quarter and more in fourth quarter. I think when the contract gets fully the stabilized. We are expecting that contract to give us almost 80% offshore with only 20% onsite. As of now it's majorly onsite. So I think that upside is still to be captured in the numbers.

Mitul Mehta

When will that happen?

J.K. Gupta

It has started happening. Last quarter also happened a bit, but in a very small manner. It will start happening towards the end of Q3 and in Q4 we expect to have major movement in this.

Mitul Mehta

And sir which means that from the current in this quarter the margins, we do have levers to improves?

J.K. Gupta

Yeah, this particular onsite offshore movement is definitely a lever to improve margin.

Mitul Mehta

And sir in terms of the sales pipeline, can you just elaborate in which geography are we building a decent pipeline in terms of the embedded software?

R. Ramanan

You know most of our wins, I would say over the last two quarters have been in embedded systems space. Embedded systems revenues have grown quarter-on-quarter by about 10% and most of the embedded contracts are long term contract. They are more offshore development center or an engineering centers type of contract and so we continue to see good traction in that. We are also seeing good traction in ITES solutions and services in India particularly with you know the digitization projects and the UID projects and so on. We have had good traction on SI solution both in the domestic market as well as in the international market particularly ports and cargo solutions and our insurance solutions in the international market. And in terms of our education and training SBU, we continue to focus strongly on India, though we are exploring opportunities in Africa and Middle East.

Mitul Mehta

Okay thanks a lot sir and wish you all the best.

- Moderator** Thank you. The next question is from Radhika Merwin from PUG Securities, please go ahead.
- Radhika Merwin** Yeah hi, good evening sir. Congrats on a good set of numbers. I got logged off in between, I just wanted to understand more segment wise in terms of your revenue, in terms of customer services which I see grown almost 12% sequentially. So how much of this is the hardware side of growth coming on a sequential basis?
- J.K. Gupta** Our hardware growth during this quarter is 18% on a sequential basis.
- Radhika Merwin** Alright, so we stand at what percentage in terms of hardware, has that in a shift in terms of mix or..?
- J.K. Gupta** It is almost the same Radhika. Last quarter was 11.3% and this quarter 11.4%. So it is pretty much the same.
- Radhika Merwin** Okay so the growth basically has come from both the hardware and services side of our customer services?
- J.K. Gupta** Yeah
- Radhika Merwin** Okay, so considering that we are at the same level as you know last year the whole transformation process have gone through considering that this is the base, can we expect this kind of growth for the year you know 12 to 15%, I mean try to understand what is the normal growth? Is there any pent up that has coming in because you know try to restructure from the 8% to 12% of hardware business. So is there anything because of that that we have seen this additional growth or this is the normal growth?
- J.K. Gupta** Radhika it is like this, there could be certain amount of volatility in hardware on a quarter to quarter basis because of the basic nature of lumpiness of hardware. We explained in the earlier calls that given the basic nature of our business which have got turnkey project execution in India especially, certain amount hardware is an integral part of our business model and that hardware could be anywhere between 12 to 14%. So in a particular quarter, if you see hardware component going up to 15%, I think should not be surprising. In some quarter you can have 8-9% growth and some quarter you can have 14-

15%. I think when we see over a longer period, the current level of hardware around 11-12% is something which can be expected over a longer period.

Radhika Merwin

Alright okay. So coming on to the system integration, as you are mentioning the embedded solution has grown by almost 10% right out of this sequentially. Okay so how much is due to the onshore component, is this also significant as we saw the last quarter?

J.K. Gupta

No embedded system most of the growth that has happened is offshore.

Radhika Merwin

And some color on the ITES which is also grown very robust in this quarter on 24%, what exactly do we see most of the wins that you had you know discussed last quarter coming in to the revenues from this quarter onwards?

J.K. Gupta

No one thing is that ITES revenue has grown 13%. It has been both in India and international geographies that we have grown, more in India geography actually. The deals that we talked about last time I think the full effect of the deal is yet to reflect in this ITES revenue because of initial ramp up is taking some time. So we are expecting more to flow in the subsequent quarters may be starting from this quarter, may be starting from next month onwards.

Radhika Merwin

Okay, just one final from my side. The margins as you know 16-17% can we come back to the level considering that you know we take off all those one-offs, we won't have these wage hikes in PAT from the next quarter onwards. Are you confident of coming back to 16-17% margin for the full year?

J.K. Gupta

Radhika if I add all onetime items of exchange loss and onetime implication of leave and gratuity revaluation, in this quarter also we have got an EBITDA margin of 16.4%. So we are actually operating in the band that we have been saying that we are going to operate 16-17%.

Radhika Merwin

Alright okay and at this point, final take on the UID, the LIC-Aadhar project, can you just throw some color as to what is the status of the work we are doing currently on that?

R. Ramanan

Yeah, this project is currently on and we are executing the project and there was some temporary delay because of some interactions which was not in our

control but between LIC and other parties but that has got resolved and we are back on track. So this project is on.

Radhika Merwin

Alright. Okay thanks a lot sir.

J. K. Gupta

Thank you Radhika.

Moderator

Thank you. The next question is from Abhishek Das from Canara HSBC Life, please go ahead.

Abhishek Das

Good evening sir. This is Abhishek here. I just wanted to know the next track for the coming quarters where we could actually see some margin improvement that coming from which segments of your business and if you could also throw some light on your client additions if you have any.

J. K. Gupta

We had a client addition of 23 in this quarter. And this is across verticals so it is very difficult to identify which vertical has given more addition. Last quarter we had added 16 clients. So far as margin is concerned, I think we have said that we are going to operate in the current margin band of say 16-17%. In the current quarter also we had about 16.4%, last quarter we had about 16.5%, because the focus clearly has shifted to growth. So we are trying to deliver growth and through that we are trying to deliver EPS expansion and I think we are targeting the margin in the current band.

Abhishek Das

Okay. That's about it from my side. Thank you.

Moderator

Thank you. The next question is from Vinay Kulkarni from HDFC Mutual Funds, please go ahead.

Vinay Kulkarni

Hello?

J. K. Gupta

Yeah Vinay.

Vinay Kulkarni

Congratulations on a great set of numbers especially in the SI segment. Just wanted to get some more color on where this growth is coming from. We mentioned embedded system is one, anything you can tell us about the verticals and number two, how is Europe shaping up now for us?

J. K. Gupta

Mr. Ramanan, would you like to take this question?

R. Ramanan

Yeah Vinay, can you repeat the question please?

Vinay Kulkarni

Yeah. One, some more color on the strong revenue growth we have seen in this quarter over and above the embedded systems part which you mentioned and how are things going on in Europe, I think we are planning some front-end initiatives there and so on.

R. Ramanan

Yeah. So first of all in terms of our growth, it has been broad based. All the 4 SBUs have grown SI,CS, ITES and E&T and within SI the embedded systems business also. So it has been encouraging. Our E&T business grew by about 21% quarter-on-quarter, CS business has grown by 12%, SI has grown by about 19-20%, embedded systems grew by about 10%, and ITES business has grown by about 13%. So this has been a uniform growth and we will continue to focus on uniform growth in all the SBUs. We also see good opportunities both in India as well as in Americas and both have grown well. In terms of Europe, we have brought in some new focus to Europe. And so we have set up a team there with stronger focus particularly on 3 areas. One, we feel there is lot of opportunities for CMC in embedded systems and we are going to be tapping that. The second is on digitization services particularly in the UK, we feel CMC has good capability of being able to leverage its capabilities for that market and third is for SI solutions, we are looking particularly at the transportation industry and the government vertical to be able to deliver solutions in SI which we have already developed here whether it be in railways or whether it be in ports and cargo, or whether it be e-governance. We see opportunities in the European market for us to be able to position our SI solutions. On education and training, we will be focusing more on Middle East, Africa, as well as in India. So that is the geography where we want to focus on for now and then if it makes sense, you may also add Latin America particularly Brazil to this education and training initiative. In terms of customer services SBU, we are focusing on increasing our International footprint now and both in the United States as well as in UK and then we will follow it up by other geographies once we have set up a reasonable operation there.

Vinay Kulkarni

Okay sir. Thank you very much and all the very best.

R. Ramanan

Thank you.

- Moderator** Thank you. The next question is from Apoorva Oza from Standard Chartered Securities, please go ahead.
- Apoorva Oza** Thanks for taking my question sir. Just wanted to understand what sort of margin uplift we got from the rupee depreciation this quarter, how much would that have helped us in terms of the margins?
- J. K. Gupta** Rupee depreciation one is that we have from forward cover. So we utilize the forward covers and I told you the net exchange loss that we incurred is Rs. 3.63 crore. But on the other side we have got a revenue implication of close to about Rs. 4 crores on account of rupee depreciation. So I will say net and net is got neutralized that way.
- Apoorva Oza** Right sir and just a few bookkeeping questions, in terms of overseas living expenses, could you just give me the number that we have last quarter?
- J. K. Gupta** Yeah this quarter overseas expenses were Rs. 2.22 crore. Last quarter was Rs. 2.43 crore.
- Apoorva Oza** Right sir and in terms of the staff break up, the approximate 700 number that we have, could you give me a breakup in terms of overall in terms of regular versus contract employees.
- J. K. Gupta** Yeah, regular employees as on 30th September is 4334 and contract employees are 4166.
- Apoorva Oza** Right sir and in terms of the TCS revenues, you said that 51% of our revenues are through contract which you billed through TCS, could you give me rough breakup in terms of how much of our employees workforce would be on these projects?
- R. Ramanan** It could probably be close to about a 1000, 1100 or so.
- J. K. Gupta** No there's lot of work doing offshore here has not reflected because a lot of work is executed in our facilities for which we don't have.....
- J. K. Gupta** Ashish can I give this number later to you, I don't have a ready number available.

Apoorva Oza

Yeah

J. K. Gupta

I'll give this number later to you because I don't have this. 1000 number are the people who are working on the TCS site. Others are working in our facility on TCS projects. So the numbers are not readily available with me.

Apoorva Oza

Right sir. I'll follow up offline. Okay that's it from my side. Thank you.

Moderator

Thank you. The next question is from Neerav Dalal from Sharekhan, please go ahead.

Neerav Dalal

Sir thank you. All my questions have been answered.

Moderator

Thank you. The next question is from Bharat Sheth from Quest Investment, please go ahead.

Bharat Sheth

Yeah. Sir I have this ITES, the first half if you really see I mean has grown around only by 9% and whereas PBIT some de-growth has seen, so what is the reason for slow growth vis-à-vis other businesses?

J. K. Gupta

I think last time also we shared that especially in the international geographies we are in the consolidation phase of ITES because actually there was a step kind of pattern that you saw in US. Most of the growth that we are seeing here has come from the India geography and as you are aware, that India geography profitability is different compared to international geographies. So it's a small variation that has happened. So if you look at total profit is more or less flat you can say. So basically it is because of changing mix between India and international.

Bharat Sheth

How do you see it going ahead international vis-à-vis domestic or will continue at this level?

R. Ramanan

We are equally focused on enhancing both the domestic and international operations and we will continue the focus on that. So there has been no shift in strategy as far as our approach to the market is concerned, as well as the opportunities like I mentioned digitization, work flow management, services are in demand both in United States as well as in UK and will be pursuing those opportunities and at the same time, India is also offering some very good

opportunities because of UID and related digitization requirements in corporate, so we will be focusing on that too.

Bharat Sheth

Okay. Thank you. Sir in subcontracting, if we see at a standalone level, it is only 5% at half yearly level increased whereas consolidated YoY in 6 months has grown by 50%. So can you throw some light on this?

J. K. Gupta

Yeas basically because lot of sub contracting is being done for onsite work in Americas basically because of that.

Bharat Sheth

So once the off-shoring will start, slowly it will come down.

J. K. Gupta

That's right.

Bharat Sheth

Okay and that will leverage the margin.

J. K. Gupta

That's right.

Bharat Sheth

Okay, thank you very much.

Moderator

Thank you. The next question is from Neerav Dalal from Almonds Global, please go ahead.

Neerav Dalal

Yeah thanks for taking my question. Sir the tax rate, even on adjusted basis, you had earlier mentioned was 30.2%. Now in the last con-call you all had mentioned that the effective tax rate will come down from 29.6 to about 25-26%. But still we have seen 30.2 on an adjusted basis. So can you throw some light on that?

J. K. Gupta

Yeah in fact one addition element that we have is a significant asset capitalization that took place in our SEZ facility. Because of that our absolute profits came down in this quarter because the corresponding revenue growth will take time. So what happens is when we capitalize this, the complete block capitalization that happens as per the income tax then the large depreciation gets charged off so because of that our tax rate average went up. It's temporary. It happens in the quarter when we have our major capitalization.

Neerav Dalal

Okay, so going forward in such capitalization expected to continue?

J. K. Gupta

No we are making efforts to increase of revenue from SEZ facilities so that we are able to neutralize the implications for increase depreciation. In fact if you see our depreciation in this quarter has gone up to around Rs. 5.3 crore. It is a significant jump in depreciation in India. So this form Rs. 3.6 crore to Rs. 5.3 crore, the most of the increase in depreciation is in SEZ. So that is brought down. And this is the accounting depreciation as per income tax that is much higher. So that is keeping in our tax rate going up.

Neerav Dalal

Okay so next 2 quarters it's expected to come down to 26% or so right?

J. K. Gupta

I guess about 26-27% by end of the year.

Neerav Dalal

And in FY13, expected tax rate would be?

J. K. Gupta

We are expecting it to be about 22%.

Neerav Dalal

Okay fine. Another question on the margin front, if you exclude the extraordinary, extraordinary includes the exchange loss right?

J. K. Gupta

exchange loss on basically mark-to-market.....

Neerav Dalal

Yeah. What was the exchange loss last quarter?

J. K. Gupta

Last quarter we had a small gain of Rs. 26 lakhs.

Neerav Dalal

Okay and can you give me the mix of domestic and international clients out of the 23 clients, how many are domestic and international?

J. K. Gupta

It's I think it is largely domestic. We had 2 international and about 21 domestic.

Neerav Dalal

Okay fine. Sir so on the margin front, are we expecting an increase in margins from next quarter onwards because that is what you have referred to in the last one?

R. Ramanan

I think we have been fairly consistent in 2 things and I would like to reiterate that. One is we have been seeing that we would like to be operating in 16-17% margin and as JK had pointed out in this call, if we remove this extraordinary elements of our taxation and margins and so on and one-time expenses, we

would still be operating within that band. And we will continue to operate in that band. We have also said that we are focusing on growth and therefore while individually projects may be operating on higher margins, we will be ensuring that we are not compromising on our growth aspirations and therefore we will be making necessary investments both in terms of manpower as well as in other areas, that we need to, to ensure that we are able to grow as fast as the industry if not better.

Neerav Dalal

Okay one last question on prospects for ITES and SI segment. Can at least ITES keep growing at a double digit pace in the next few quarters?

R. Ramanan

Our hope and attempt is always to grow everything at a double digit pace. So we will try to definitely do that. And I do think there are some opportunities in the pipeline which can enable us.

Neerav Dalal

Okay and out of these 23 new clients, can you throw some light on the major ones like how significant they are and which verticals and what is the nature of these big clientele.

R. Ramanan

Yeah we had quite a few verticals, one is in the government, second is in the transportation vertical, we have been able to add new clients, and third is also in insurance, we have got some large clients in insurance. Fourth is we have been able to also penetrate the MERU vertical which we call Manufacturing Energy Resources and Utilities. That includes the mining and manufacturing operations. In the hi-tech vertical is that we have been able to penetrate for embedded systems.

Neerav Dalal

So out of these 23, how many would be really large ones?

R. Ramanan

I don't have an exact number but most of them are what I am sharing are not small ones, but it would mean a multi crore type of deal. And they would be also we are looking at the sustainable service components in that, so they are deals which can potentially enable us to increase our presence within that clients also.

Neerav Dalal

Okay fine. Thanks a lot. And all the best.

Moderator Thank you. The next question is from HR Gala from Quest Investment Advisors, please go ahead.

H R Gala Hi JK and Ramanan, congratulations. Most of the questions are answered. I just like to know in the next 2 quarters what would be our CapEx plan?

J. K. Gupta Actually we had a CapEx plan of Rs. 246 crore for the year. And we have spent almost Rs.56 crore so far. But I think now my revised assessment is that we may be spending close to about Rs. 200 crore in this year. So, next 2 quarters it should be in the range of around Rs. 140 crore or so.

H R Gala Okay as it happens, do you think that the further capitalization that we keep on taking place will act as a negative level as far as our effective tax rate is concerned the way it happened in this quarter.

J. K. Gupta In the current year, majority of capitalization has happened, only one ODCs is yet to be capitalized. So yes, when we do that capitalization, there could be some jump but what we are actually taking necessary action to immediately have utilization and revenue flow over there. So I am not expecting any significant additional pressure because of capitalization. We have lined up complete capacity utilization. I'll tell you the next capitalization that is going to happen is going to be completely used by TCS as they are ready with the projects. So I think right from the day of capitalization, we will be able to earn our rentals and all that, so I think depreciation will be fully taken care of by that. So I don't see much impact on that.

H R Gala Okay and the rental income that we will be earning from TCS, is it taxable or not?

J. K. Gupta No, because that's an income as a developer. The developer income is exempt from tax for 10 years.

H R Gala Okay but MAT provision is applicable?

J. K. Gupta As of now they are applicable. So in the quarter also we almost used Rs. 3.5 crore of available MAT credit.

H R Gala Okay fine. One last question in general, what kind of IT spend trend is emerging in the global markets. Like if you have to say divide the IT span in 3

major heads, like are we getting more of the transformational type of transactions or more of change of platform or more of discretionary spending, how things are moving?

R. Ramanan

Actually, our deals are of a different nature. I think the standard IT company is this clarification that you have mentioned, this transformational deal or this engagements or you mentioned sorry what was the third one?

H R Gala

Change of platform.

R. Ramanan

Change of platform yeah. See ours is more in the hi-tech area where it is product engineering outsourcing. It is also in ITES and digitization services, so in a way digitization and work flow management could be considered as a combination of transformational and platform. The third area we are in is SI solution. SI Solution is more product based solution and services we provide and therefore again they are very mission critical to the customer. They may not be transformational deal where you do an initial consulting, consulting engagements are normally have been done with these customers. Then they say that this is the product or this is a solution that we need and then we embark on that. Now that is a discretionary spend. However, they are long term projects and with the sustainable component of service associated with it and that is the business in which we are in. So it won't strictly fall into the 3 categories that you said. End of those categories is what we are in and that is to be understood because we are a system integrator and as a system integrator, the system integration portion normally comes in after the transformational thinking has been done.

H R Gala

Okay fine. So probably when we work with TCS, why I ask this question, because from the TCS' perspective I think these 3 heads under which the IT spend normally takes place would be very relevant and then I think based on our capabilities, I think what we get is what you describe just now.

R. Ramanan

Exactly. See another thing I want to share is in our business, we deal more often with the business people and the R&D people.

H R Gala

Instead of CIOs

R. Ramanan

Instead of CIOs.

H R Gala

Okay thank you very much. Wish you all the best.

Moderator

Thank you. The next question is from Priya Rohira from Enam Securities, please go ahead.

Priya Rohira

Hi, good evening to the team and congrats on a very good top line. My main question relates to one how do you see your visibility from your rental income, that's one. And how do you see your outlook for ITES business because here your documentation expertise can win a lot of business through which could come to you. So if you could just throw light on these 2 questions and also a third on an insight on how do you see the public sector clients doing for us?

J. K. Gupta

Priya I'll first tell you the information about rental income. I am expecting rental income of around Rs. 22 crore in this year.

R. Ramanan

Yeah in terms of ITES, we definitely see an opportunity for ITES like I said both in international and domestic. I think even in domestic it is increasing quite rapidly because there are lot of large scale computerization projects and many of these computerization projects have a very strong component of digitization and work flow management integrated into that. And take for example, the Passport Seva project, MCA project that we have been executing along with TCS, there is a very strong component of that. The UID projects have a lot of digitization and so on. So that's opportunity base in India is increasing for us and we continue to focus on that. In the international market, it is more integrated with the high end business process and knowledge management related activities and we have been steadily penetrating that market and the margins are good when we do it in international markets because it is in a niche area, which combines a combination of digitization and certain amount of knowledge processing. So I think both are good. We need to be able to replicate some of the successes that we have had and we are focusing on that. The third question that you asked was on public sector. As far as public sectors are concerned CMC has always had a strong presence in them. We recently won a couple of engagements in the public sector, in the financial services, and insurance sector as well as in the manufacturing and energy sector. Of course the other institutions like transportation or government and so on and so forth, we have been choosy about where we are focusing. We want to make sure that we are in the value adding areas of the business. We are

wanting to make sure that we will be in asset based or solution based space rather than pure services based space in the public sector.

Priya Rohira

Sure. I am looking more from the point of view that what is dependence now and how do you see this because this is more India-centric dependence so if you could just share on how much of our revenues we get from the government verticals in true sense.

J. K. Gupta

Government is about 40%.

Priya Rohira

40% of India business?

J. K. Gupta

Because India revenue itself is 41% and out of India revenue we get almost now about 60% from the government so out of the aggregate revenue we get about 24% from the government now.

Priya Rohira

Okay I am just stepping back to the ITES outlook which you mentioned Mr. Ramanan that there is a good deal pipeline. So in a first half, we have done a single digit number in terms of YoY growth. Do you see this stepping to the earlier growth rates of around 45-50% given the pipeline which you have seen?

R. Ramanan

We have a decent pipeline. So it could not be stretching the imagination too much to target such a growth of double digit.

Priya Rohira

Okay sure. And I think my CapEx question has been answered. Just is it possible for you to share the employee base across the key segment of SI and ITES and more so in terms of employee additions which you have seen in this quarter?

J. K. Gupta

We have a employee addition of 691 as I told and, I can give you segment wise actually I don't have readily available.

Priya Rohira

No problem, I'll coordinate with you. Sure thanks very much and wish your al the best.

J. K. Gupta

Thank you

Moderator

Thank you. The next question is form Ravindra Agarwal from Capital Market, please go ahead.

Ravindra Agarwal Sir I have 2 questions. One is on cash position, what is the cash and equivalent position at the end of this quarter and secondly, what is our outlook on hiring, like how much hiring are we looking for FY12. Earlier we had mention around 400-500, so where does it stand now?

J. K. Gupta Or total cash and cash equivalent as on 30th September is Rs. 222 crores. And as regards our hiring plan, I think during this call we explained that our hiring will be consistent with the growth that we are able to achieve. But since we have got a combination of executing the work through our own people as well through subcontracting, it cannot be directly related to our growth plan. We have already indicated that we would like to grow at a rate higher than the industry average. So I think in that context some more addition, some more hiring will take place but it may be not be right to put an exact number of hiring as we continue to have a combination of resources to be used for our projects.

Ravindra Agarwal Fine sir. Thanks.

Moderator Thank you. The next question is form Radhika Merwin from PUG Securities, please go ahead.

Radhika Merwin Hi. Just a couple of follow ups. Just wanted a breakdown of your international business between different segments, your SI, CS and ITES?

J. K. Gupta We have got in CS you can say international is about Rs. 10 crore and domestic is about Rs. 74 crore out of total of Rs. 84 crore. In SI segment total revenue is Rs. 204 crore, domestic is about Rs. 36 crore and remaining is international. In IT enabled services, out of total of 48 crore, 20 crore is domestic and 28 crore is international and educational and training is completely domestic.

Radhika Merwin Just little bit on the margins in the ITES space if I compare it to players who are in your similar space, I mean in the ITES, what would be the parity that you have in terms of margins because of all your tools, etc., that you use, roughly how much would be the parity that you enjoy vis-à-vis other players?

J. K. Gupta Actually we have been sharing that our realistic margins structure of IT enabled services around 30%. In fact honestly speaking when we were operating at about 35%, that time also we shared but over a longer period we

expect the ITES margins to stabilize around 30% and this is where we are operating. Our first half year margins are at about 31%. I am not too sure about how to compare with others because whether we have got an exact comparable available in the market where people are focusing on digitization services alone, I think people have got combination of services and they don't share segment wise revenue for the separately digitization. But my guess is that we definitely enjoy a premium in terms of margin of about 30-40% because my feel is that other people in similar space may be operating around something like 20-22%. But we don't have precise numbers available with us.

Radhika Merwin

Sure I understand that. Sir in terms of CapEx we planned about 246 for this particular year, for FY12. How much have we done through and how much of it has been capitalized in this particular quarter in the depreciation?

J. K. Gupta

We have spent a total CapEx of 56 crores so far and our plan initially was 246 crores. Given that we are half year through, my guess is that we may end the year with a CapEx of around 200 crore. There could be some slippage of CapEx to the next financial year.

Radhika Merwin

Okay so this would be predominantly on the SEZ space or that is in line with what you were guiding.

J. K. Gupta

Yeah predominantly. That's the largest component of CapEx. Other than SEZ I think the first half year we have spent only about 14 crore and there also actually average is 4-5 crore in a quarter remaining is in SEZ. So I am expecting full year like the first half has been 14 crores and full year could be only about 25 crores max on other than SEZ so remaining about 175 cores is going to be SEZ.

Radhika Merwin

Okay in terms of your depreciation cost includes the 56 crore that you have done so far for this year.

J. K. Gupta

No that's the capital expenditure. That is not capitalization.

Radhika Merwin

Okay. How much have you capitalized in terms of assets for this particular quarter or for the first half?

- J. K. Gupta** Actually our capitalization is more than our capital expenditure. This is the reason our depreciation has gone up. Total capitalization during the first half has been 118 crores.
- Radhika Merwin** Alright. Sir just one last thought on the salary cost if I look at the last margin historical trend, what is the average increase in the regular or contract labor for a year. I mean what is the average rate increase?
- J. K. Gupta** Our average increase this year has been about 9%.
- Radhika Merwin** Okay this is overall or for both regular and sub-contractors right?
- J. K. Gupta** Yeah. And last year also it was around the same level.
- Radhika Merwin** Okay thanks a lot sir. Very helpful.
- J. K. Gupta** Thanks Radhika.
- Moderator** Thank you. Ladies and gentlemen, due to time constraints that was the last question. I would now like to hand over the conference back to Mr. Ashish Aggarwal for closing comments.
- Ashish Aggarwal** I would like to thank the management for sparing their valuable time for this call as well as to the participants. Thank a lot.
- J. K. Gupta** Thanks a lot Ashish and thanks a lot to all the participants of this call for sparing time to come on this call.
- R. Ramanan** Thank you very much.
- Moderator** Thank you. On behalf of Tata Securities Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.
