Transcript

Earnings Conference Call of CMC Limited – Q2 (FY 14)

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

Event Date / Time	:	**16th Oct 2013, 10:00 AM IST**
Event Hosted by	:	**Tata Securities**
Event Duration	:	**1 hour**

Moderator: Ladies and gentleman good day and welcome to the CMC Limited Q2 FY'14 Earnings Conference Call. As a reminder, for the duration of this conference, all participants' line 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. Should you need assistance during the conference call, please signal an operator by pressing "*" followed by "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ashish Aggarwal from Tata Securities. Thank you and over to you sir!

Ashish Aggarwal: Thanks Shyma. On behalf of Tata Securities I welcome you all to CMC Limited Q2 FY'14 Results conference call. Before starting I would like to thank the management for giving us an opportunity to host this call. Today from CMC, we have the top management Mr. Ramanan the CEO and Mr. J. K. Gupta the CFO of CMC. Now, I would hand over the call to Mr. Gupta for his opening remarks.

J.K. Gupta: Thank you Ashish. Good morning and very warm welcome to all the participants in this call who have taken time out on a holiday to discuss Q2 results of CMC. And before I start, I wish all the participant season's greetings and a happy festival season ahead. CMC's Q2 results were taken on record and approved by the board two days ago. It has been a wonderful quarter for us and the best quarterly performance that CMC has ever delivered. Company earned consolidated operating revenue of Rs. 560.75 Crore in Q2 which is an increase of 15% Q-on-Q and 22% on a Y-o-Y basis. Services revenue of CMC grew 19% Q-on-Q and 20% Y-o-Y to Rs. 522.35 Crore and share of services revenue in overall revenue

from sales and services was 93.2% compared to 90.2% in the previous quarter and 94.8% in the same quarter last year. We had healthy growth in the international revenue which increased 23% Q-on-Q and 28% Y-o-Y to Rs. 387.90 Crores and the share of international revenue reached 69.2% in Q2 versus 64.6% in Q1 and 66.4% in Q2 of last year.

America continues to contribute significantly to growth in the international business which grew 15% Q-on-Q and 15% Y-o-Y in Dollar terms and the share of American geography in overall operating revenue increased to 61.1% in Q2.

Company earned consolidated EBITDA of Rs.88.41 Crores in Q2 which is an increase of 16% Q-on-Q and 16% on a Y-o-Y basis. EBITDA margins in this quarter were 15.8% compared to 15.7% in the last quarter. While computing EBITDA in this quarter we had absorbed impact of salary revisions that are normally granted in Q2 every year to our employees.

Company earned profit after tax of Rs.67.31 Crores which is an increase of 27% Q-on-Q and 36% on Y-o-Y basis. PAT margin this quarter has been 12.0% compared to 10.7% Q-on-Q and 10.7% on Y-o-Y basis. We were able to reduce our effective tax rate further to 20.0% in this quarter. Last quarter we had an effective tax rate of 22.5% after adjusting additional tax payout of Rs.9.6 Crores on dividend distributed by CMC America in Q1.

Company continues to have robust client addition. In first quarter we had added 16 clients, in Q2 we added 19 clients. One client was an international geography in ports and cargo area and 18 clients were added in India geography in wide spectrum of industries.

Company continues to focus on improving people utilization. We had a net addition of 66 people and ended the quarter with the total manpower strength 10,818. Company had a wonderful quarter in terms of being able to manage its cash flow. Our cash and cash equivalent in this quarter increased to Rs.228 Crores which is an increase of Rs.25 Crores during the quarter after meeting the capital expenditure of Rs.26 Crores in this quarter and distribution of Rs.26 Crores as dividend. Hence net accretion, if we adjust for capex and dividend, has been Rs.77 Crores in this quarter. We had an investment of Rs.98 Crores in debt based mutual funds at the end of this quarter.

We had very good performance in terms of our AR days which reduced from 89 days to 79 days during this quarter.

A brief snapshot of cumulative performance till half year and September 2013. We had an operating revenue of Rs.1047 Crores in first half of this financial year which is a growth of 15% over corresponding period last year. Services revenue grew 14% to Rs.961 Crores. International business growth has been 17% to Rs. 702 Crores. We had an EBITDA growth of 9% to Rs.165 Crores. We had PAT growth of 12% to Rs.120 Crores and we were able to reduce our effective tax rate for the first half year to 21.2% compared to 23.9% that we had in the first half of last financial year.

So this is the brief snapshot of financial performance of the company that we had in Q2 and the first half year. I request Mr. Ramanan to throw some light over or on his understanding of market conditions and the strategy and the business plans that we have got.

R. Ramanan: Thank you JK and thank you everybody for joining the call. Very good morning to all of you and festivities of the season to every one of you. As JK has pointed out we have had a good quarter with all round performance on all parameters of the company also what has been heartening is our strategy that we have been focusing on which is value adding solutions and services. Growth in emerging geographies as well as international geographies, focus on increasing operational efficiencies within the organization and ensuring that our asset base solutions and services mix continues to grow in multiple geographies and ensuring that we are improving in delivery excellence and process excellence within the company all of these aspects have played a role in the achievement of our numbers.

In terms of the market trends and the pipeline that we see we continue to see good opportunities for CMC in the market place especially in the niche areas that CMC is in which is SI, systems integration, infrastructure services particularly in emerging geographies and in India, embedded and real time systems in the advanced geographies and now increasingly in the domestic market too. Education and training has been a little flat for us but we have launched our vocational training program last quarter and we expect that to pick up during the coming quarters and digitization services which continue to play an important role in CMC's growth strategies both in emerging geographies as well as in the advanced geographies.

What has also been heartening is that we have been able to grow our international footprint to 69% of our revenues now, so this has been very encouraging both in the Americas as well as in some of the other markets that we are dealing with, in particular our asset base solution and services in ports and cargo, in transportation and in insurance have been finding new markets and new clients in the emerging geographies as well as in the international market.

We have also been focusing on the emerging trends in cloud, mobility, big data analytics and everyone of our assets today that we have and the assets of products that CMC has created over the years is being enhanced and cloud mobility big data analytics and smart technologies are being integrated into every one of our solution and this is also finding good traction within our existing clients because our existing clients are looking at harnessing these technologies for their own business improvements, productivity improvements as well as efficiency improvement. So all in all it has been a pretty decent quarter and we are pleased with the progress that we have made. We continue to focus on also TCS-CMC synergies both in India as well as international market and we have had some good wins during the last couple of quarters together with TCS and a joint go-to-market strategy which is going to play itself out in terms of revenue in the coming quarters. So with this I will be very happy to answer questions from all of you and we look forward to a well productive session.

Moderator: Thank you very much sir. Participants we will now begin the question and answer session. We have the first question from the line of Vinay Kulkarni from HDFC Mutual Fund. Please go ahead.

Vinay Kulkarni: Sir, congratulations to the management for a great set of numbers. My question was on the operating margin. In a quarter when international revenues have grown satisfactory and the rupee has depreciated steeply could you give us the breakup of why the margins are just about stable compared to the previous quarter in terms of headwinds and tailwinds?

J.K. Gupta: Vinay, we had about 70 basis points impact of the salary revisions that we had granted during the quarter as we mentioned in the opening remarks. We had a tailwind of around 170 basis points because of exchange gains that we had during the quarter.

Vinay Kulkarni: Could you throw some light on the efforts towards building the IMS platform which you have discussed in the past?

R. Ramanan: We have a very strong Infrastructure Management Service practice particularly in India which we continue to grow but what we are also doing is we are creating new offerings which are asset based infrastructure management offering. For instance, by using new technologies and network management and system management technologies we are able to create new platforms for ticket based service models rather than an FTE based service model. An FTE based service model is really manpower intensive and it is very commoditized as a result of which you will not be able to make substantial impact especially in a emerging geographies where cost considerations are very, very strong. So what we are looking at is creating an IMS platform which is essentially going to leverage technologies and tools developed by us or harnessed what is already in the market and we able to offer new service models for engaging the customers. We have already initiated that in quite a few of our customer bases and we are seeing very good response to that. During the next 12 months to 18 months we will be rolling it out across multiple clients and we will see some major impact of that.

Vinay Kulkarni: Sir one last question from my side, as far as the India business is concerned do you see any impact of delayed decision making in terms of either project rollouts or receivables from the clients especially on the government side?

R. Ramanan: In India it is always a challenge both the decision making cycle very often we win projects and then we find that it takes quite some time for the actual contract to come due to protracted negotiation or decision making or even the paper movement within the government so that's the part of the reality that we face and we try to ensure that we have a sufficiently good mix of private and public sector type of projects which are going to ensure that we don't get caught into this cycle though it does have an impact. For instance we have won quite a few good projects but we are not even able to declare it because it has to go through the formal wheels of the government. So yes, the brief answer to your question is we see that as a reality, this we have to balance with good portfolio of private and public sector which is what we are doing right now. The other aspect in terms of payment cycles and so on in general, the government is, you are always able to recover all the money that is owed to

you but again it goes through its own process. It takes time and so what we have to be very careful is maintaining the cash flow and the impact of negative cash flows due to delayed payment. But in general in government projects we have not, while there has been delays in some of the acceptances and so on due to bureaucratic processes still we have been able to maintain a fairly good ratio of receivable base as compared to many other companies.

Moderator: Thank you. We have the next question from the line of Vimal Gohil from Sharekhan. Please go ahead.

Vimal Gohil: Congratulations to management on good set of numbers. Could you just give me a breakup of your employees on rolls and employees on contract please?

J.K. Gupta: We had total employee strength of 10,818 at the end of quarter two, 4542 are on regular rolls and 6276 are on contract.

Vimal Gohil: Could you give me a breakup of your domestic and international revenues in your SI, CS and ITES service lines please?

J.K. Gupta: Our total revenue in SI is Rs.363.84 Crores of which domestic revenue is Rs. 36.92 Crores. In ITES, our total revenue is Rs. 83.94 Crores of which domestic revenue is Rs. 45.02 Crores, E&T is all domestic. In CS our total revenue is Rs. 89.05 Crores of which domestic revenue is Rs. 77.27 Crores.

Vimal Gohil: Sir a question on your margins, strong performance there in your ITES vertical your margin almost been at 400 basis your outlook over there?

R. Ramanan: We continue to see good traction in ITES. During this year we have grown well. We are seeing increasing opportunities in ITES particularly digitization projects in India and we are now also seeing some new potential in the emerging geographies in some client locations that we have already present in so that will continue. The growth opportunities continue to be there and we will focus on them.

Moderator: Thank you. We have the next question from the line of Urmil Shah Kimeng Securities. Please go ahead.

Urmil Shah: Hi sir thanks for taking my question and congratulations on the strong numbers. Sir couple of questions first on system integration, the margins for this quarter again like in last year they have dipped on a quarter on quarter basis, should we read something into that and what is the outlook for the margins in this segment?

J.K. Gupta: No Mr. Shah, I think the margins have been range bound, this is like 100 basis point or whatever change that we have seen. I don't think there is significance to read into this. There has been a bit of shift in terms of onsite offshore ratio which is largely in systems integration which has got some impact on the margins. During this quarter we had a shift around 170 basis points in favour of onsite during this quarter which has an impact on average margin that we have seen in this. There is nothing more significant there.

Urmil Shah: Right. So would it be possible to share onsite mix for the international business?

J.K. Gupta: This quarter our offshore has been 20.7% in first quarter it was 22.4%.

Urmil Shah: Secondly because of this shift I guess the subcontracting cost has gone up, should we assume similar number for the third quarter and only in the fourth quarter when the domestic business mix up it would go down?

J.K. Gupta: Actually I am not expecting any significant change to take place in the remaining two quarters. We did have an offshore shift taking place in Q2 also but we increased our onsite portion more rapidly than offshoring and while this offshore shifting will continue in the remaining two quarters but we continue to see progressive increase in onsite portion so this ratio is not going to change significantly and that's why even subcontracting cost is not going to see any significant change in the remaining two quarters.

R. Ramanan: I just want to add that you know the conditions in the international market are very dynamic at this point in time, so our strategy is the following, we are continuing to focus on increasing the offshore pie through projects that we have already won, so there is going to be an initial lag when you win a new project it is going to be primarily onsite and then you have to keep pushing the work offshore and it requires not also certain physical amount of time to be elapsed but also it requires certain negotiations to be done with the customers who

may be a little vary of pushing things offshore in the current climate that is there in the US or other geographies. At the same time we don't want to stop new projects from ramping up and if there are new projects which come we don't want to be halting them just worried about the margin impact of that because any new project that we win in the international market has the potential and scope for turning in offshore revenues over a period of time and so it would be imprudent of us to turn down any new business which comes in that so from that perspective one has to take into account some real time dynamics that may play and should not read too much into the numbers or the margins at this point in time. What I would rather look at is - are we consistently increasing our onsite and offshore pie and that is the important thing for us to focus on in absolute values because every onsite project that we get and onsite revenues that we get right now has the potential to yield offshore revenues at some point in time in the future.

Urmil Shah: Sure sir that was helpful thanks for the explanation. Sir just needed couple of data points, the revenue number for America and the average exchange rate for the quarter?

J.K. Gupta: Average exchange rate for the quarter is Rs. 62.86 in this quarter and the last quarter was Rs. 56.84 and our America revenue is $53.45 million.

Moderator: We have the next question from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: Thanks to the management for taking my question and also congratulation on a very good set of numbers. Sir, I know that they have asked lot of questions, before me also this question has been asked multiple times on the margin front but I will still ask one more question on that same front, sir if you see this quarter has been extremely helpful from the currency side and the margins and I know you gave the number just two questions back but in spite of that if you see our margins are not very exciting and I know primary reason is onsite ramp up is just very, very fast and I believe that growth is so fast that probably the offshore tail is not able to provide the margin lever which should happen but sir can you give some broad range or something like some outlook on that side because let us say if rupee goes back to old levels 55-56 and then is it possible that our margins might fall further from here because then that becomes a very difficult environment because margins

are consistently falling below mid teen levels so that was one question and second follow up on that again was that what is leading to so much of decline or let me rephrase it what is leading to so much of non uptake in the margins in spite of such a good growth keeping aside the onsite growth separately, if you can throw some light on that and what can we expect on the margin?

J.K. Gupta: In fact if you see, so far as margin is concerned, we have been talking about a margin range of 15% to 16% for the current financial year and we are in that range. First quarter was 15.7% and this quarter 15.8%. Yes in every quarter there could be different-different elements affecting the margin, like in this quarter we had the impact of wage hike, some of that is having an one time element also where we realigned liability valuation for leave and gratuity liability which does not get repeated so the question is that in every quarter there could be some one time item but overall our intention is to be within the range of margins that we have promised. In the current quarter as we explained that there was an adverse impact of movement in offshore ratio by 170 basis points but as we mentioned that we are on track in terms of offshore movement of some of the contracts that we have already won and we were successful in Q2 and we will continue to work on that in Q3 and Q4 also to neutralize any other impact on the margins. So far as the exchange rate is concerned and the impact of exchange rate is concerned you see in the last quarter though in the middle exchange rate had gone up to Rs. 68 and close to even Rs. 69, at an average we have accounted for our earnings at an exchange rate of Rs. 62.86 which is very close to our current exchange rate. If you say whether exchange falls below Rs. 60 and will it have an adverse affect on the margins I say yes it can definitely have an adverse effect because we are not completely immune to margin impact. But we still continue to watch the market and we have got certain tools available with us in terms of taking hedging and all that we have been very effective in using hedging as a tool to safeguard ourselves from adverse exchange rate movements and we will continue to watch the market and ensure that the impact of any adverse movement in Dollar Rupee rate from here we are able to neutralize through hedging activities. To give you a flavor in terms of the implication of exchange rates a one Rupee variation in Dollar Rupee rate impacts our topline to the extent of around 6-7 Crore in a quarter and a bottomline impact of about Rs. 1.8 to 1.9 Crores in a quarter and we are pretty confident that we will be able to manage the impact of such volatility through the means that

are available with us. We still feel that we can continue to deliver our target margin range of 15% to 16% that we have been talking about.

R. Ramanan: I want to give a slightly different perspective that you need to keep in mind when you are looking at CMC. You know what is important for us is that all the growth comes with still the same type of business mix that we are focusing on and all the growth that we have seen we have not compromised on the fact that 93% of our business came from solution and services, I think that is more important thing that I would suggest one should have when you are looking at an growing organization like CMC. Are we growing in the right direction or are we growing in the wrong direction? If we grow with lower margin business then we are growing in the wrong direction and we want to make sure that all our growth is coming in sustainable value adding margins. Now if you want to do that as an organization at our levels we have to make some proactive investments either in manpower or in technology or in tools or in product development and so on. And so one of the reasons why at least I would like to maintain a 15 to 17% prediction target for our margins is because if we are able to do better we will actually like to plough back some of that money into proactive manpower or product related investments or even other investments that we think are appropriate for helping our growth. So I would say a good yardstick to measure CMC is are we growing with the right business mix, are we growing in the right geographies and on both these counts I think CMC is doing the right things and has been able grow in the right places - America has grown, international geography has grown to 69% and our business mix has remained at 93% of services and I would use these parameters in sort of judging the company for at least the next couple of years until we reach a sizable portion where we are able to make proactive investment without even affecting the margins and growing the margins.

Sandeep Agarwal: Sir thanks a lot for detailed explanation but I have one more question on that. I have been tracking CMC for quite a long time and I have seen that CMC has always outperformed on all parameters any other midcaps and the quality of earnings, quality of business growth everything has been very good but only worry which is coming for last 6-7 quarters if you see the numbers also is that in spite of all the qualities of being playing out like a large cap our margins are sometimes even below the midcap range, I agree that we should not see the margins for next two years because of the high growth but I am sure that JKG

must have some concrete plans or some vision where you are seeing the margins going ahead and secondly if you can also throw some lights on kind of investments which you are mentioning and thirdly if you can give light on vocational training business which is coming up very aggressively in the Indian context?

R. Ramanan : Yes from a finance point of view JK is closely tracking what are the levers we should have to improve a margins and like I have said we have consistently been saying we want to improve our margins so there is no question of going back on anything below 15% and we want to see it upward going up to whatever value that we can potentially push it to. Product development and asset creation is a very, very important part of our strategy. If you look at what differentiates CMC in the market place - it is our intelligent transport system, we actually recently won an award from Financial Times as a Regional Asia Pacific Winner for an outstanding implementation of intelligent transport system with maximum urban impact and it was an urban ingenuity award and that is the sort of application system that requires investment both in hardware design, we developed our own GPS system we developed our own command control system and tracking system for the buses and we have developed our own display system interfaces. So you know this sort of investment is very important when we are looking at replicating this. And what is the potential of this - the potential of such an intelligent transport system is 26 States in India are going to implement Intelligent Transport System over the next couple of years. The first one of its kind was awarded to CMC and it is a great implementation and so we look forward to a multiplying effect of that. The other example is ports and cargo. We have to invest in ports and cargo technology and we continue to invest in that. We are the leader today or one of the top three leaders in the world in marine and container handling, cargo logistic management, terminal operating system and global invoicing systems for shipping lines and for ports and we continue to invest in that. Third one is insurance, we invest a lot on general insurance, we are the leader today in Indian market - 75% of the general insurance policies leverage CMC's product for Genisys. We have now taken it to Middle-East & African market. We are doing our first implementation of both general and life insurance in Africa for a leading insurance customer. We expect that after that is done, it is going to be rolled out to multiple insurance companies in Africa because we would have a solution for Africa.

We are looking at Mining. CMC has developed one of the state-of-the-art pit-to-port mining product. The pit-to-port mining product is essentially you are able to monitor from the time iron ore is being dug out from a pit to the time that it is shipped out from a port you have a complete monitoring, tracking of the iron ore that is being dug as well as being refined and then finally being pushed out and the whole idea is this command control mining management system will improve productivity for mines by anywhere between 5 to 10% and that means several Crores of savings. We have implemented the first of its kind. There are 27 Mining companies in India and 12 of them today use our product called Dynamine. So we are looking at expanding into all 27. And internationally there are more than 4000 mining companies. We are looking at how to target all of them. So you know these are all important assets which are unique that CMC has and we think that investing in these assets and being a world leader in this can help CMC in the long run and that is the way we are going.

Moderator: Thank you. We will take the next question from the line of Shashi Bhushan from Prabhudas Lilladhar. Please go ahead.

Shashi Bhushan: Congrats Sir, good quarter, thanks for taking my question. The margin for system integration and ITES is in contrast, expansion in ITES and contraction in system integration, what was the reason for the same Sir?

J.K. Gupta: I think I explained in the beginning of the call. Our system integration margin contraction is because of the shift in onsite offshore ratio but if you look at in absolute terms systems integration PBIT has gone up from Rs.62 Crores to Rs.71 Crores. Iit is a very healthy growth in terms of absolute numbers. Percentage margin has contracted because, as I had explained above, 170 basis point shift in favour of onsite. And in ITES the shift was not required and most of the growth that took place was in offshore. We were able to get some very good deals. We have been very conscious in terms of picking up deals which are margin enhancers and whatever exchange benefits that was available was fully captured in the margin of IT enabled services.

Shashi Bhushan: Sir, our subcontracting cost has gone up quarter on quarter, so is hiring made in anticipation of project ramp up?

J.K. Gupta: Not really. We don't have those idle manpower sittings and waiting for the assignments. Subcontracting is completely aligned and variable to our revenue. If you look, subcontracting cost have gone up both in America as well as in India. In India subcontracting cost is in line with increase in IT enabled services business which consumes large part of subcontracting cost and in America large part of subcontracting cost is consumed by onsite operations and since we had an increase in onsite operations we had corresponding increase in subcontracting cost. So both these costs are variable costs.

Shashi Bhushan: Do we expect it to come down as a percentage of revenue if not in absolute term?

J.K. Gupta: We see this as variable with revenue so I think if the revenue goes up this can go up when the revenue goes down it can go down. The whole purpose of getting into subcontracting is to get out of the fixed cost commitment and make it more variable so that we are able to capture the benefit of variation in revenue. So this will continue to reflect the trend in revenue in both these onsite SI as well as in IT enabled services business.

Shashi Bhushan: What would have been the contribution of this non linear revenue which is you know from solution of intelligent transport system and port and cargo solution or general insurance.

R. Ramanan: When we look at our asset base solutions and services revenue what we measure is the end to end revenue of the impact of an asset and so when we look at that and while when we don't publish these figures officially because it can tend to be confusing. We have more than 28% of our revenues coming through asset base solutions and services. What we are intending to do is take this to somewhere around 40 to 45% that is our aim so we are working on that but we don't publish these figures because very often an asset cost or a license cost we may integrate it with the entire end-to-end service cost and therefore it becomes difficult for us to publish anything that is making sense or which will not mislead the market.

Moderator: Thank you. We have the next question from the line of Bharat Sheth from Quest Investment. Please go ahead.

Bharat Sheth: Good morning and congratulations Mr. Ramanan and JK. Sir just an academic question, JK I just read that how much absolute value exchange impact on top line and PBT levels?

J.K. Gupta: In absolute terms, about Rs. 36 Crores in topline and in bottom line about Rs.14 Crores.

Bharat Sheth: 14 Crore is positive?

J.K. Gupta: Positive yes.

Bharat Sheth: ITES capital employed has substantially shot up from 70 Crores to 113 Crores so is there any specific reason?

J.K. Gupta: No specific reason, because we had some large contract execution during the quarter and you know that normal collections cycle in India is about 60 to 90 days so because of that some amount is lying in this assets deployed. If you see on overall basis we don't have concerns with regard to recoveries. I think our performance in terms of collection is very healthy; we have been able to reduce our AR days from 89 to 79 days.

Bharat Sheth: Going ahead again it will normalize to 70-80 Crores which was generally in ITES so there will be some additional cash flow from this business?

J.K. Gupta: Yes, there could be because this quarter we had seen revenue increase from 72 Crores to 84 Crores, going forward there could be some improvement on this, but these are like normally collection period and billing period, there are no other stuck-up investment, these are all liquid capital employed, there are no long-term capital employed in this business.

Bharat Sheth: What is the Capex plan that whatever we have stated earlier is on schedule or is there same Capex?

J.K. Gupta: There could be some slippage. We had a Capex plan of about Rs.230 Crores in this year and we have so far spent 64 Crores. Our Hyderabad project, which is the bulk of this Capex plan - this year our plan was 112 Crores, that is fully on schedule. I think before the

end of the year we will end up spending all the money that we have planned for. We had planned for spending Rs.50 Crores on Kolkata property. It is slightly behind schedule, we may not end up spending whole of Rs. 50 Crore rupees so, I think our actual capex during the year may be in the range of around 190 Crores instead of 230 Crores.

Bharat Sheth: Where do you see tax rate, which was around 21% in H1, for full year is it going to remain the same.

J.K. Gupta: Yes it is going to remain. I think further ability to reduce tax from here is a bit limited, reason being in India we have already optimized our tax rates significantly. Our average tax rate in India this quarter has been 8.7% and we are covered by MAT. We have got 20% average tax rate, because in America we continue to suffer full tax rate. In America average tax rates is in the range of 38% to 40% and as we continue to have our profits in CMC America we continue to pay the tax. So I do not see any significant improvement in tax rate going forward from here, it is going to remain in the range of 20-21%.

Bharat Sheth: How do we, in long term say, because we really want to bring down say CMC America is one side paying 38% almost and then again we have to pay on the dividend distribution tax also in India, so overall what is our strategy to bring it down?

R. Ramanan: Look, it is like this, the pricing between CMC America and CMC is governed by the transfer pricing norms. Large amount of profit that is in CMC America pertains to onsite operations and nothing significant can be done about it. The only way to handle the situation is to increase offshore revenue so that we get more tax exempt revenue available here and we execute more business out of SEZ. Already we have seen that benefit accruing, we had significant growth in our SEZ operations this quarter, which helped us in bringing down the average tax to less than 10% and that effort will continue. So I think when we do more offshoring, automatically tax benefit will be reflected accordingly.

Moderator: Thank you. We have the next question from the line of Nishidh Shah from Ambika Fincap. Please go ahead.

Nishidh Shah: Congratulations on a good set of numbers, Ramanan and JK. The question is on topline. On a six month it has grown at 15% obviously over the last six, eight quarters what you have been investing is not for a 15% kind of a topline growth, could you give a color on how you see that shaping up over next several quarters and where you see the growth happening now going forward?

R. Ramanan: Nishidh I didn't understand your question, are you saying that you are not happy with 15%.

Nishidh Shah: Yes that is right.

R. Ramanan: It is always a question of how much one can be happy with but we have been saying that we want to grow faster than the industry and industry growth. So clearly that is our target and we want to make sure that we will do better than the industry. NASSCOM has predicted 14% to 16% as the average growth so obviously we will be trying to target higher than that. We do see, we are quite encouraged with the pipeline that we are seeing, the opportunities that we are seeing, and our wins in the last quarter and the previous quarter. So these will all help us in being able to grow we are seeing increasing traction in the international markets and so there is no reason for being less optimistic than what we are right now. So at this point in time I think things are on track, yes one could always want to do much better than what the rest of the industry is doing and we are constantly looking at opportunities, but some of the opportunities do take time especially in the SI business like I said in the earlier part of the call that there have been few important major wins that we have had in India and it does take time for some of them to actually start getting realized and so we are hoping that those will all kick in during this quarter or the next.

Nishidh Shah: On the same related issue in this quarter you have added 19 clients and almost all of it except one is in India. So my question is in terms of international market with the kind of vision on 3.0 and all is there some slowdown that you see in terms of client additions in the international markets?

R. Ramanan: No, we do not see that. And the win that we have had in the international market is a substantial win. So I would say that one win is better than several showing five different

wins. We do not give the value of that but it is a very good win. So I do not think one should go by the number rather the quality of the win and which we see is going to be very beneficial for us. Incidentally last quarter and the previous quarter we had won quite a few international assignments and that has started yielding fruit during the current quarters and we see that continuing to expand. We do have a number of opportunities that we are currently tracking in the international market, which are awaiting closure. So we do not see a decrease in the pipeline of opportunities that we expect closure on.

J.K. Gupta: Nishidh if you see in the international markets our growth in revenue has continued to be robust, like in this quarter we have grown 15% QoQ in dollar terms and 23% in rupee terms. You know that like most other IT companies, in the international geographies, majority of our growth comes from growing the existing clients. So once we acquire the client any growth that comes from that client in the future period does not get reported as a new client addition, but we continue to draw significant growth out of that. Like most other companies, we also get almost over 97% of our revenue from existing clients. So our dependence on growing existing client to deliver growth in the international business is very significant just like any other company. That is the typical nature of this business. So I think the metrics, more important metric to track is how much we have been able to grow in the international business. India, we report client addition because India has got large portion of business, which is like project driven business, so every time you have to go and win a client you have to go and win a business because growing clients in India is not the same ball game as a growing client in the international geography. You are aware of the different way of doing business in India and the international geographies.

Nishidh Shah: I agree JK. The other question was on the tailwind that you had on the Forex gain. Now even if I factor in that you had a 70 basis points increase because of salary revision then 170 basis points gain because of foreign exchange, you had a net positive impact of 100 basis points and you had a very strong top-line growth coming in so the only comfort I want is that are you significantly investing for the growth in future and is that what Ramanan would you want to leave a message with us.

R. Ramanan: Yes, I have been consistently saying that we are significantly investing in product development asset creation for the future and just for your information we have

actually strengthened our product team with people from some of the leading institutes of technologies in India as well as in the market place and academic partnership. So these are all other investments, which don't directly manifest itself immediately but over a period of time and so these investments are very strong. If at all CMC's future has to be assured it has to be assured on the basis of asset creation and product development and differentiation. There is no other way CMC can differentiate itself in any meaningful manner from the big boys who are there in the market.

Nishidh Shah: When do you expect the magical figure of $500 million coming in, it will have to be next year one will have to wait isn't it?

R. Ramanan: Well I have taken a Vijayadasami resolution that we will work very hard towards that in the earliest.

Nishidh Shah: But you know the rupee is making your things harder even more harder.

R. Ramanan: It works both ways. A billion dollar means if the rupee goes down we can reach it faster, if it goes up we will measure in Crores.

J.K. Gupta: Nishidh, we would still wish dollar to rise, I think in terms of prioritization, instead of $500 million target we would like to see more bottom-line going up.

Nishidh Shah: See the thing is given the current import and export scenario, it is no brainer that right now it is being sustained or going up only because of FCNR and all of those measures, but till structural things happen then rupee is on a downward trend only, isn't it.

J.K. Gupta: So you are comforting us.

Nishidh Shah: No I am only saying that it is a very difficult thing to take a call on that.

J.K. Gupta: I know Nishidh. I think it is a challenge for any treasury runner; this is something on which you cannot take a decision and sleep over it for sometime. I think it is so dynamic and CMC touch wood has been very successful in terms of tracking market developments. Every time we have been benefiting from the rate movement either way. We have seldom

declared a loss on account of exchange rate movements, even in the adverse conditions we were hedged when rupee was going up and we were unhedged when dollar was going up so touch wood so far it has been working fine for us. And we are vary cautious and we know the implication of dollar rupee movement on our top-line and bottom-line and to the best of our ability we are managing that.

Nishidh Shah: That is exactly what I am saying. So you have been doing the right thing and not making an extreme call is the best thing to do either side and we have seen corporates taking extreme bets and then burning their hands. So this is the right way to do.

Moderator: We will take the next question from the line of Mr. Apurva Shah from Dalal & Broacha. Please go ahead.

Apurva Shah: Congrats on a good set of numbers. Sir in terms of employee strength I understand like we do not follow the linear model but if you look at last four, five quarters number then our employee number per se is stagnating but there is a significant increment in the top-line growth so how do we read into this so I understand like our asset base solution is also increasing and in previous one of the question you answered like it is currently contributing around 28% so I just wanted to understand can you share the number to help it understand better as to what was the same number last quarter and in terms of utilization as well how has been the improvement?

J.K. Gupta: Last quarter employee strength we added 63, our last quarter employee strength was 10,755 if I am not mistaken and if we measure our people productivity in terms of net value added per person month, because we have got a wide variety of offerings that we are making so we take net value added per person month as a measure for productivity. It has gone up about 6.7% during this quarter as compared to Q1. So far as you talked about linear and nonlinear model and our employee strength being constant while revenue is rising - the another input that goes into delivering our business is our subcontractors. So we utilize subcontractors also to deliver our business against which we get revenue but that does not reflect in our employee strength. So I think in case of CMC you have to have a different metric to track. I think on an overall basis how are we performing in operating profit and how do we relate it to revenue, I think that is a better measurement.

R. Ramanan: I just want to also share that the whole idea of having this flexible model is to cater to, there are two aspects to CMC's positioning in the market place, one is we do SI project, and when we do SI project they are temporary in nature there will be a ramp up and there will be a ramp down and we have to have enough people who are required to sustain it going forward in terms of enhancement and so on. So when we win an SI project and that is normally the beginning of any long-term relationship that we have with the customer we hire on a need basis taking into account the high end value add work that needs to be done and the high end value add work that needs to be sustained after the project is over and therefore this flexibility in our manpower structure is very important to maintain the margin considering that we are not just an outsourcing company we are an SI company.

Apurva Shah: I understand sir and like if I look at the absolute number sir in terms of employee strength we are at same as Q4 FY'12 so if you can help me to give me the number like what was our utilization level same quarter last year and how much was the contribution from asset base solution so that can help us to understand better.

R. Ramanan: Yes the asset base solution last year we were tracking at about 20% so we have increased that to about 28% now and in terms of our utilization well I do not have an immediate answer, we will get back to you afterwards.

Apurva Shah: Thanks sir and sir second question is on E&T how is the outlook in E&T segment because again in absolute numbers, again eight, ten quarters back we were at the same number, so obviously there was some ups and downs during a brief period. How is the outlook going forward?

R. Ramanan: There are three parts to E&T like I said, one is our retail E&T which is through the franchisees that we operate, we have 116 franchises that we operate from various part of the country, the second is corporate outsourcing where we work with corporates or we work on projects where we would have very specific training needs identified and we will do the training and that could include a rollout training, for example when we rollout a particular software across the country there is an element of training whether it is in Passport Seva, whether it is in MCA, whether it is in Hindustan Lever and whatever we do there is an infrastructure rollout component where there is a major training involved. So that we classify

as corporate training and the third is job enabling training program, which we run at our own centers and that is called as CMC, CJET training program and we have now expanded that to vocational job enabling training program, which we are doing in partnership with leading players in the market place as well as with the industry. So these are the three components of education & training. We are very conscious that we do not compromise on our margins in education and training so we want to grow the revenue healthily and we want to focus on differentiation and job enablement. So with that being the focus we do feel that vocational job enabling training and CMC job enabling training program can expand in a major way and both are quite profitable if I look at the overall breakup within the E&T segment and we are continuing to focus on growing this in some significant manner. In terms of the last couple of quarters if you look at education and training in general, CMC actually operates quite healthily in terms of margin as compared to many others who may have much higher volume but in terms of margins they are not as well placed as CMC is and so we want to make sure that can be increase only and not decrease.

Apurva Shah: Right sir. What can be the sustainable growth? What are your internal targets?

R. Ramanan: We would like to be at least, if I look at the next three to four years we want to be operating between Rs. 250 to 300 Crores of revenue just from E&T alone.

Apurva Shah: Fine sir. And sir last thing on how much was the contribution from TCS?

J.K. Gupta: GTM revenue that we got through TCS is 59% in the last quarter that is Q2.

Moderator: Thank you. We have the next question from the line of Vishal Desai from Axis Capital. Please go ahead.

Vishal Desai: Hi, thanks for taking my question and good set of numbers in the quarter. I just wanted to take a update in terms of the margin breakup, as you all mentioned that you all got around 70 to 80 bps headwind in terms of an impact on salary cost and what was the other part, because if you see on a QoQ basis the margins have probably just moved from 15.7 to 15.77 so if you could just help me reconcile may be I missed it in the earlier part of the call.

J.K. Gupta: I think Mr. Ramanan explained about the investments that we are making in terms of trying to diversify into various geographies, strengthening the sales team and all that. We have been sharing over past few quarters that we want to diversify international geography mix to add additional business from MEA, APAC and emerging geographies. We have strengthened our teams over there we are making investment. Second as I explained is that about 170 basis points shift that we had in the offshore leverage in favor of onsite component so that also had an impact on percentage margin, but if you look at in absolute terms we have been able to grow our profits.

Moderator: Thank you. We have the next question from the line of Akshay Shah from Quest Investment. Please go ahead.

Akshay Shah: Good morning sir, congrats on a good set of numbers. I just have a question, you said that you are doing investments and asset creation and product development and all that, so that is impacting and you are ploughing back somewhat of your margins and all that, so can you just give a flavor like in the first half how much you must have invested which has impacted your EBITDA to what extent in terms of rupee terms if you can say?

R. Ramanan: I just want to add a couple of things. We have been talking about margins, asset creation investment and I think JK has given a very good and elaborate explanation on how margins get affected by onsite offshore ratio and by other aspects which are beyond just the investment portion. The investment that we do in product creation, development, and so on they are investments which we do either separately or integral to a project so I want you to be really cautious on trying to put a number on investment and say that this is investment, for example and that is the example I gave the intelligent transport system project we may decide that on this particular project we are going to invest more than what the project is capable of giving us in terms of revenue because we see the potential for this project going forward in the future. So it may not be a separate product development team which will start doing that, we may invest it in the course of executing a project because we feel that is a more worthwhile safe and a better way forward than just investing in product development and then waiting for a particular project to happen. So our investments are to be measured in light of what is the total investment we do in asset creation and that is a continuously increasing number that we do and so I just want you to be understanding of the nature of investment rather than many

organizations will say we have a R&D budget and there is an R&D team and our R&D is integral to our project.

Akshay Shah: So you mean to say it is difficult to put any percentage also as a percentage of revenue or say 1% of the EBITDA had this not been there our EBITDA would have been up by 1% or 1.5% it is difficult to quantify.

R. Ramanan: Absolutely.

Akshay Shah: Okay sir fine. Sir these new opportunities with mining, you said there are 29 mines in India, 12 are using that Dynamine product and ports and this new intelligent transport system in which 26 states are going to be there. What can be the growth opportunity in terms of market opportunity how big the pie can be?

R. Ramanan: I give some idea, for example, if I just take India alone we have 76 ports which are in need of modernization and today we are working with almost 12 or 13 ports in India but we still have quite a few ports to address. If you look at the international market you have more than 4000, 5000 ports which are sizable ports where our solutions can have potential. Again in the ports it is a little longer cycle in terms of marketing because if they have an existing system sometimes they make do with the existing system for as long as they can and then they start migrating or modernizing it. So we are constantly talking to various people and good thing is today CMC is well known in the ports and cargo circle as a leading product and so chances are that whenever anybody is thinking of modernizing they would be inviting CMC's so of course we are taking our own steps in ensuring that our brand and the product image is well known within the circle.

Akshay Shah: Point well taken, but my question is something in terms of rupee terms or dollar terms, how big this opportunity can be based on typical project size which you have done?

R. Ramanan: Typical project sizes in each of these ranges from half a million dollars to may be $3 or 4 million.

Akshay Shah: The intelligent transport, 26 states you were saying, you mean to say it is for public transport?

R. Ramanan: Yes.

Akshay Shah: That is at state transport things you are saying.

R. Ramanan: State transport yes.

Akshay Shah: So how about that can be also?

R. Ramanan: They are also pretty big, they all are at least $1 million to $2 million type of projects each one.

Akshay Shah: But are states moving ahead with this kind of project?

R. Ramanan: Yes, we have already implemented in Mysore city, we are now implementing in Andhra Pradesh and so on.

Akshay Shah: Sir, TCS synergy had given revenue of 59% revenue in Q2, so now we have been talking and working in that direction so looking at the TCS how they are growing globally, they have got footprint and solid foundation where do you see the real impact of that thing coming in, we leveraging the TCS thing and we may be working at arm's length and all that but still the real force coming in?

R. Ramanan: No actually the force has been there right from the beginning. If you see, 59% of revenues is a very good indication of the synergies that exist between the companies. The CMC-TCS synergies work on three dimensions, one is we do not try to establish unnecessary presence and sales and expenses related to that in multiple geographies. In all of the geographies we are present we are there, in the other geographies we ride upon the TCS presence and we leverage not only their presence with various clients and various countries but also any development centers and delivery centers that they have established, that is one. The second is we have great process synergy so best practices, TCS is clearly the leader in IT market and there is whole lot of benefits that we get in terms of system synergies and process synergies and the third is we are looking at how we can be a value accelerator to TCS full service play. So in the TCS full service play our service offerings like digitization services, embedded and real time systems, education and training services and asset based

SI solutions are all clearly a value accelerator and a value adder. So we are seeing how to further their full service play and in that process almost their entire client base becomes a potential opportunity for at least one or more of our services.

Akshay Shah: So you mean to say this is going to only accelerate and it will have a major impact in coming years also now.

R. Ramanan: Yes.

Akshay Shah: Sir these new geographies you said that we are targeting apart from US, APAC and MEA, like in Africa you have done it for one insurance company and that will start further going to give business so when do you see this geographic derisking happening really.

R. Ramanan: We see in the next 18 months growth in Europe, Middle East and Africa.

Moderator: Thank you participants. That was the last question. I would now like to hand the floor back to Mr. Ashish Aggarwal for closing comments. Over to you Sir!

Ashish Aggarwal: Thanks Hema. I would like to thank all the participants for taking out their time for this call. I would also like to thank the management for giving us the opportunity to host this call. Thank everyone!

J.K. Gupta: Thank you Ashish and thanks to all the participants. Have a good day ahead. Thank you very much.

Moderator: Thank you Sir. Participants on behalf of Tata Securities that concludes this conference call. Thank you for joining us you may now disconnect your lines.

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