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Transcript

Earnings Conference Call of CMC Ltd – Q3 (FY10)

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

Event Date / Time	**:**	**15th January 2010, 11 AM IST**
Event Duration	**:**	**1 hr 09 min 04 sec**

Presentation Session

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

Ashish Aggarwal: Okay. Thank you Imran. Good morning everybody. We at Tata Securities are pleased to hold this call of CMC Limited for third quarter FY 10. I would like to offer my sincere thanks to the management and the participants for sparing their valuable time for the call. Without much further ado I will like to handover the call to the management to discuss the results. Over to you sir.

J.K. Gupta: Thank you Ashish, and a very warm welcome to all the participants in the call. I'll first take you through the key highlights of the financial performance of the company for quarter three, after which I'll hand you over to Mr. Ramanan to take you through the key business initiatives that the company has taken in this quarter and has planned for the time to come. Just to give you a summary, the results of operation of the company for Q3 of FY 10, got approved by the board yesterday, which reflect all round improvements in line with the key strategic focus of the company i.e. to improve margins and cash flow through improvement in quality of the business, more particularly improvement in business mix, with a larger contribution from services and international business, improvement in

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operating profit, i.e. EBITDA and margins and improvement in cash flows. In this quarter, the company had consolidated operating revenue of 211.18 crores, which is a decline of 4% Q-on-Q and 1% YOY, primarily due to decline in equipment revenue by 45% Q-on-Q and 40% YOY to Rs.17.86 crores in line with the company's strategy to improve quality of revenue. Services revenue grew 4% Q-on-Q and 5% YOY, and share of services business in total revenue from sales of services was at 92% compared to 85% in the last quarter. Similarly, international revenue grew 6% Q-on-Q and 11% YOY, and share of international revenue in total revenue from sales and services improved to 52% from 48% in the last quarter. International revenue growth has been driven primarily by American subsidiary of the company, CMC America Inc, which contributed significantly to the growth of the international services revenue. CMC America itself grew almost 9% Q-on-Q and 29% YOY in dollar terms. With this, share of American geography in the overall operating revenue, increased to 40% compared to the 36% in Q2 and 26% for the last year as a whole. Improvement in the business mix, as I just elaborated, has had improvement in the operating margin of the company. Consolidated operating profit measured as EBITDA in Q3 was Rs.43.25 crores, which grew 10% Q-on-Q and 29% on a YOY basis, which resulted in the highest ever EBITDA margin of 20.5% verses 17.9% last quarter, giving us an expansion of 260 basis points on a quarter on quarter basis. Company earned consolidated profit after tax of Rs.36.26 crores, which is an increase of 5% on a Q-on-Q basis and 34% on a YOY basis; giving us a PAT margin of 16.9% verses 15.5% last quarter, resulting in an expansion of 140 basis points on a Q-on-Q basis. Our average effective tax rate during the quarter was 15.2%. Due to change in the MAT rate in this financial year, from 10% to 15% the Company got covered under the provision of MAT and accordingly we have taken Rs.3.62 crores as the MAT credit entitlement to be availed in future. This quarter has been pretty good in terms of client addition on the business side. Company added 17 clients during the quarter, three of which were added in America in the areas of Embedded Systems apart from deepening our relationship with key clients in America with new orders. One client was added in UK in ITES area, one client was added in MEA region in the insurance area, and 12 clients were added in India in e-Governance, financial services, energy, defense, security and infrastructure space. Company had other income of Rs.2.81 crores in this quarter, which included income from mutual funds investments at Rs.1.62 crores.

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We had very good quarter on the manpower side. Our annualized manpower attrition rate came down further to 10.7% compared to 11.4% in Q2. It also helped us, improve the manpower productivity, measured as a net value added per person month which increased 5% in this quarter over Q2. Company had very good quarter in terms of cash flow. Company ended the quarter with Rs.226 crores of cash surplus of cash and cash equivalent, of which Rs.200 crores is invested in debt-based mutual funds. When we look at the cumulative performance of first nine months of this financial year, we have achieved significant improvement in the revenue mix, continuous improvement in margin and Profit after Tax. Our services revenue increased by 7% during first nine months compared to the corresponding period last year. Share of services revenue was 86.6% compared to 73.8% last year. Equipment business correspondingly declined by 56% to Rs. 67.78 crores. International revenue increased by 12% compared to last year. The share of international revenue in the overall revenue was at 48.5% compared to 39.5% in the last year, same period. We had an increase of 30% in the Earning before Interest, Tax and Depreciation to Rs.113.46 crores. Profit after Tax increased to 98.93 crores which is an increase of 27% over last year. Our EBITDA margin expanded by 529 basis points. PBT margin expanded by 460 basis points and we had a PAT margin expansion of 430 basis points. We had an effective average tax rate of 14.8% for the nine month cumulative in the current financial year. So, this was the snapshot of financial performance from our side, with this I hand you over to Mr. Ramanan to take you through some of the key business initiatives and the key strategies that the company has followed during the current financial year. Mr. Ramanan.

Ramanathan Ramanan: Yeah, thanks J.K. for a very comprehensive update and thank you everybody for joining. Happy Makar Sankranti and Pongal, and greetings of the season, and also a very, very Happy New Year to all of you. I am quite pleased to say that the directions that the company has been following are bearing and continue to bear fruit and continue to bear dividends for this company. We have been, as we have been stating earlier, following the strategy of moving into high margins solutions and services business, and moving away from low margin business. And that has got reflected in improved margins and improved absolute EBITDA levels for the company. EBITDA, as J.K. had shared, has grown 10% quarter on quarter. And also in the areas of focus for us, that is both

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the international business as well as in the domestic market in solution services business. This quarter I am also happy to note that, we have been able to improve margins in all the four SBUs consistently, including the ones which were not performing during the last quarter. We have improved our margins in the CS business from 5.6% margin to a 10.5% margin this quarter. We have also been able to improve our E&T margins to about 17.5% in this quarter, besides, also some revenue growth in the E&T. We have added 17 clients during the quarter, 5 of which are in the international market and 12 of which are in the domestic market. Again these are being in the areas of embedded systems, digitization services and niche solutions that CMC is providing in the system integration space. Our focus will continue to remain during the rest of the quarter, as well as for the year going forward to continue improving our solutions and service businesses and the mix of these businesses. At the same time, I also feel that the ability of this company to penetrate a newer market as well as newer areas within the emerging domestic market is very strong. For example, the data center market or the large e-Governance projects, infrastructure management services as well as in the education & training market. So we will continue to focus on these while we re-emphasize and grow our specific point solutions that have had success in these markets. Our employee engagement initiatives as well as our focus on improved cash flow have also yielded results. In a fairly tough market, we have been able to reduce attrition in the company to a level that we had not reached before. And also we have improved our cash flows to a level that we had not achieved before. So we have a 226 crore cash balance at the end of the quarter which is the highest, over quite some time. And a lowest attrition level, which is again speaking well in terms of employee engagement and employee satisfaction within the company. So with this, I am very happy to answer any questions along with my team, J.K. Gupta as well as Mr. Prashant Shukla who is the COO of the company.

Question and Answer Session

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

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participants, if you have any questions, please press * and 1 on your telephone key pad.

Our first question comes from Mr. Vinayak Kulkarni from HDFC Mutual Fund. Mr. Vinayak, you may go ahead sir.

Vinayak Kulkarni: Good morning sir. Congratulations on the good set of numbers. Mr. Ramanan, I just want to ask you a question. You know the large cap IT companies have started declaring results and they are also showing good volume numbers on the back of improving environment, especially in the safer side and North American markets. So, while we have indeed improved our business mix, when do you think that the acceleration on the volume front can be seen? Or is it that, you'll have a different trend in terms of growth rates as compared to the typical services oriented tier one companies? Thank you.

Ramanathan Ramanan: Yeah. Our focus will remain on growth in revenues from now on, but with the sort of mix that we have been talking about, so that we are not compromising on our margin business. I do see potential for CMC's revenue growth, in the areas that we have been talking about. And I think, we have achieved quite whatever we wanted to achieve from the business mix and the type of business that we want, for the company to stabilize on. So I guess, within a couple of quarters, you will start seeing the growth in revenues for this company in line with our strategies. Our initial focus was during the course of this year, to first go away from dissipating our energies in businesses that we should not be in. And to that extent, I think we have been able to achieve whatever we wanted to achieve. So from now going forward, growth in revenue will be something that we will be strongly focusing on. Now we do expect that we will also grow in accordance with the industry standards or better than industry standards in terms of revenue. But, not compromising on the type of businesses or on the margins that we are already enjoying.

Vinayak Kulkarni: Sir, can I have a follow up?

Ramanathan Ramanan: Yeah, sure.

Vinayak Kulkarni: What sort of investments you are making in sales marketing, say client facing teams or is this business model totally different, because it is more solutions driven?

Ramanathan Ramanan: We are making investments in the sales, marketing as well as in client facing engagement. But our model is going to

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be slightly different from what is traditionally being followed by many companies. As you are aware we are very solution focused company. And this is something, which is a unique differentiator that this company has, and we will continue to build on this, on this focus. The other thing is, CMC has been into long term relationship, where whatever solution we are deploying has the potential for us engaging on a multiyear basis if not at least some of them even signing 5 to 10 years. So, that is where the strength of the company actually lies. And we will continue to re-emphasize on that part and ensure that, that becomes our focus area. Many of the existing customers that we have are very good customers. So we are going to increase our focus on account management and strategic relationship management and mine these customers, a lot more than what we have been traditionally doing. As you are aware, CMC enjoys almost 400 to 500 very good customers in India. And these customers, they have also realized that there is a lot more value that CMC can bring to them, than the traditional businesses under which they have been operating. So I see an upside for us to cross sell all our existing capabilities into the existing customer base and be able to substantially improve our revenue as well as the type of business in which we are into these customers. So you will see in CMC, a stronger focus on accounts management and relationship management than on best new business development. New business development would be in the international market, but again there we will leverage our relationship with TCS, much more than trying to build a complete sales base in our international market, because it doesn't make sense for us to not to leverage that. Here in TCS, the existing customers provide us a huge opportunity for expanding our solutions and services in both SI as well as in embedded systems and ITES. So we will leverage that. So our sales and customer facing model is going to be slightly different from whatever the other traditional players in the market. Because of our existing customer base in India which is a growing market, as all of us realize, and because of our ownership by TCS, which has a strong presence in the international market and which we would leverage.

Vinayak Kulkarni: Thank you sir. All the best.

Ramanathan Ramanan: Thank you.

Moderator: Thank you sir. Next question comes from Mr. Aseem Gupta of DSP Black.

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Aseem Gupta: Hi sir. Congratulations on a good set of numbers. I just wanted to know, your view on the system integration side of the business for the coming year.

Ramanathan Ramanan: The system integration business in CMC revolves around the solution that CMC has developed. And these include the insurance, the ports and cargo, the e-Governance, defense, rail and transportation business as well as in the securities and financial services. In all of these we have strong solutions. We see an increased opportunity for CMC to leverage these solutions in the market, because that is going to be spent on all of these sectors. We have already seen insurance market growing rapidly for us. And we have achieved, I would say, reasonably strong success in the private sectors general insurance market, in addition to what we had been enjoying conventionally in the public sector market. On the mission critical projects in India, we see an opportunity for leveraging our treasury management, HR management, police computerization as well as biometric and identity management solutions which are going to have a lot of scope for replication in the country. For example, there has already been declarations by various organizations in the government including police or NCRB and so on, that they are going to focus on increasing the solutions for security solution, surveillance solution in the market place, and these fall right into our category. We do see an increased competition for many of these solutions, where organizations are trying to pair up with alternate solution providers from overseas or from the local market. But our traditional presence, our indigenization capabilities as well as our R&D capability for coming up with very competitive value added solutions, I think can stand us in good stead for us to continue operating in the entire market and increasing our presence there. We do see an opportunity for growth here.

Aseem Gupta: In the last call, you were pretty positioned on GST related migration and also the APDRP project. Normally our SI projects are between 5 and 10 crores, but APDRP projects would be like 100s of crores. Would you be interested in participating in those kinds of projects also?

Ramanathan Ramanan: We will participate in those projects, as a partner to TCS or some other organizations which can leverage our solutions. We have just successfully moved away from issues related to low cost equipment sale and so on and so forth. And these projects, the 500 plus crore projects, which are there, it is best for CMC to follow a strategy of partnership rather than front ending those projects at this

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point in time, for two or three reasons. One, some of the financial qualification requirements itself for these projects, demand a level of revenue and financial operations, which is much more than what CMC has currently. So, it makes sense for us to partner with TCS on this, or, if TCS is not participating in some of these bids, to partner with some others. Second, we want to continue our focus on services business and the solutioning business. Each of these projects has the opportunity for CMC to really provide very good level of service capability, whether it be in infrastructure management, whether it be digitization, whether it be training and rollout of the APDRP solution across the country, so that is our focus. So while we may not be participating directly as a frontend for some of these, except where we see the risk is low as well as our ability to drive this end to end, we would participate in a partnership mode for the APDRP. But there are other projects in the Government which are amenable for direct frontend participation by CMC and we will continue to focus on that.

Aseem Gupta: Many of the projects, working capital cycle is pretty long. So would it be like, TCS will be supporting us in terms of working capital or would we be taking it onto our books?

Ramanathan Ramanan: We will see what, is the best strategy for the company to ensure that the cash flow remains positive. We want to operate in a positive cash flow environment. We also want to ensure that, our payment structures and payment terms and conditions that we are going to adopt, will not be detrimental to our working capital. So we will be working with suitable partners, whether it be a financing partners or whether it be front ending partners to ensure this.

Aseem Gupta: Sir, could you please share what the day's receivables for the company now?

J.K. Gupta: We have been able to reduce the day's receivables by 12 days in this quarter.

Aseem Gupta: The number now?

J.K. Gupta: We have reduced it from 104 days to 92 days.

Aseem Gupta: Thank you sir. That's it from my side.

Moderator: Our next question comes from Mr. Sanjeev Hota of Network Capital.

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Sanjeev Hota: Yeah, hi. Congrats on the good set of numbers. My question pertains to the margin expansion that we have seen. Already in the last three quarters there has been a margin expansion of 600 basis point. So could you throw some more color on the lever that had driven the EBITDA margin expansion during this quarter, despite an appreciating rupees scenario? And is the current margin sustainable? If yes, if there is a further room for margin expansion that we can expect in the coming quarters?

J.K. Gupta: Margin expansion in this quarter compared to last quarter has been an account of improvement in business mix, as what is stated earlier. Our services business mix has improved to 91.5% and international business mix has improved to 52.5%. So, that is one aspect or factor behind this improvement. Second, is that we have been able to reduce our operating cost or cost of delivery of the services. So it is more arising out of reduction in operating cost and less arising out of reduction in our SG&A expenses. So, this is a combination of these two factors, which has resulted in the escalation of these margins. Another factor behind this margin improvement, when we look at percentages of 20.5%, is the share of the equipment business. In this quarter, we had equipment business share of only 8.5%. But since equipment has got lumpiness in the nature and there could be equipment business as part of our larger services deal, which can continue to fluctuate quarter after quarter. So, possibly one single quarter may not be a right measurement for this purpose. If I just take you through some of the numbers on a cumulative basis, on a nine month basis, the equipment business is about 13.4%. And on a nine month basis, our operating margin is about 17.7%. Possibly, this becomes a kind of normalized margin status. So with 48.5% international business share, about 86.6% of services business share, and equipment of 13.4%, our EBITDA margin is 17.7% and I think this tells the story of how these key elements are having interplay in terms of affecting the margin. And this is something on which we want to build on. So I think if we want to make out a trajectory of how the margins have improved and how these are going to behave in the future, possibly, let's have a look at a nine month number on a cumulative basis. On a nine month basis also if you look, the margin expansion has been phenomenal, from 12.4% to 17.7%. So, on a cumulative basis it is giving us almost 530 basis points margin expansion. So I think, this is something which is sustainable, and this is something that we would like to improve upon from here.

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Sanjeev Hota: Okay and my second question is around the education business, if the margin is tripled, so what is happening over there? And would you comment something more on the future outlook over there?

J.K. Gupta: Yeah. Margin expansion, as we have been sharing in past also, in E&T business, has very strong relationship with the volume growth. When we expand our volume, margin expands much faster. We have been sharing with all of you that, we strongly believe that this business can always give us margin beyond 20% and we still believe in that. As we grow our volume, there is a likelihood of our again clocking 20% margin in E&T business segment. Some of the growth that has come out in this quarter is on account of corporate business which is more profitable as compared to some of the retail business. Because some of the retail business is like commodity, where the margins have significantly shrunk and we had to share certain part of that revenue with franchises and all that. So we have been consciously trying to focus on the corporate businesses in E&T segment. And with IT segment looking up, with the hiring by IT companies is looking up, we expect that more of the business demand growth can take place in this segment, which is positive for this segment.

Sanjeev Hota: And my question out for Mr. Ramanan, sir could you provide some update on the Go-To-Market strategy with TCS, especially on how things are moving on the UID project. And, if you could give some color on the domestic pipeline on the e-Governance piece? Thank you.

Ramanathan Ramanan: Yeah. We continue to synergize with TCS on the domestic market. Our clear strategy is for all the mission mode projects in India, we will synergize with TCS. We will also synergize with some of the large projects in e-Governance at a State level, depending upon the scope and the nature of the project. Parallelly, we will also work on other projects directly, where TCS will support us at the backend, where we have strong relationships with that existing customer and there are large projects with these existing customers, TCS will continue to support that. So we have a very strong working arrangement relationship with TCS on the India synergy area. We are still watching the UID status. I think, still there is a lot of uncertainty about the type, time and nature of projects that will get rolled out during the course of the year. There are two aspects to the UID projects that we look at. One is the solutioning, which involves application development,

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database related application development or the biometric related application development and so on. So that is one part. The other part is, the services part for infrastructure rollout for digitization, for IT enabled services and for education and training. So that's the second part. We see an active participation. Our belief right now is that we will come out as a series of different projects rather than one single large project. So we will be positioning ourselves appropriately in the solutioning part along with TCS, considering the mission critical nature of this UID projects. And on the services part, we may be engaging with, either directly or with TCS in different States. Because this would involve capture, validation, verification, testing of data across the country, and so my belief is that you have State related projects as well as you have Central related projects.

Sanjeev Hota: Sir there is book keeping question, what is the debt, the current debt and our yield on the investment and the employees?

J.K. Gupta: Our yield on investment is about 4%. Our current debt is about 34 crores that we had taken for SEZ in Hyderabad. And our employee productivity has improved by 5% point, as compared to last quarter.

Sanjeev Hota: Sir, current employee count?

J.K. Gupta: Our current employee count is 5266.

Sanjeev Hota: Okay, thank you.

Moderator: Our next question comes from Miss. Subhashini Gurumurthy of Ambit Capital.

Subhashini Gurumurthy: Hi. Congrats to the management on the great set of numbers. I have a question on the margins. While we have improved our margins drastically on a sequential basis as well as on a YOY basis, as earlier you had mentioned in the call, we should probably look at a normalized margin of around 17%-18%. What are the areas which you are looking at from here on, which would basically contribute to margin increase from here on?

Ramanathan Ramanan: Yeah, we see margin expansion in two areas. One is customer services, that we can improve our margins. We would like our customer services to operate at 15% to 20% margins, so, our immediate short term target for now. We also see education and training margins to improve as we

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grow the volume of businesses. Because education and training, there is a strong relationship between the volume and the margins, because of the fact that there is a certain threshold level that we have to maintain in terms of expenses. But once you cross that threshold level, a lot of the revenue goes to the bottom line. So we see a possibility for expansion in those margins. As our business mix changes and does increase in the international market, we do see that international business in ITES, CS, SI, can help in still further improvement of margins. So we are looking at new opportunities in these markets so we can improve on those margins. What I would like to say is, at the same time, we are conscious. Now we have reached a point where we are conscious that there may be some SI projects that we may want to take. And these SI projects often have an element of both solution as well as, perhaps an equipment which is part of that, so that can still affect some of the margins, but we don't want to go below the 18% to 20% EBITDA margin that we have been talking about. So whatever projects we select, would ensure that we continue to operate at these levels of margins.

Subhashini Gurumurthy: Sure, and the kind of projects which you said you are targeting within SI, are they more from the power sector or more from the e-Governance side. How does the pipeline look at this point of time?

Ramanathan Ramanan: It is in all the areas that I mentioned. We have insurance. We have e-Governance solutions. We have solutions in the defense; we see an increased opportunity in defense. In fact, we did win a good contract in defense last quarter. We see opportunities in the shipping and ports area because there is going to be increased computerization of ports. And there are new ports being added in India, we did win a couple of those ports and we are actively working on these ports. We also see, opportunity for financial services. We are seeing some increased trend in core banking at a corporative banking level. In fact, there has been a recent message which has gone out, where even corporative banks are supposed to get into core banking. So we see an opportunity for leveraging our TC4 solution. So these are solutions which we already have, which we are growing and which we are maintaining. And we do see an opportunity in all of these. So we will continue to focus on these. But again I just want to caution, that we will be very careful in selecting the projects, so that we don't slip back into the red zone either in terms of profitability or in terms of our cash flow.

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Subhashini Gurumurthy: Sure. Just one last question, earlier during the call, you had mentioned that you would go in for more client mining, going forward, given the fact that you have a very good base of around 400-500 clients. So, would we see more investments coming on the sales side, now that our focus is kind of slightly shifting, going forward?

Ramanathan Ramanan: Yes. We are actually relooking at our sales team and we are doing some changes to our sales team. There are three aspects of the sales team that we are looking at. One, new sales, where we are focusing on certain verticals as well as in certain solutions with new clients. Second is, existing accounts, where we have inducted a strategic relationship management cell, which will focus on the top hundred existing accounts of CMC and see how we can double the revenues or triple the revenues from these accounts, because we see the potential there. And the third is, we are looking at the international market, to see how we can increase our sales, more of direct sales in segments and in countries where TCS is not focusing on, for example, the smaller counties or the States in the US, where TCS is currently not focused on, so that we can be a value accelerator for TCS, and at the same time, certain other geographies like Middle East and eastern Europe geographies, where we see a potential for our solutions there. I would like Prashant Shukla, COO to add on to whatever I have said.

Prashant Shukla: Yeah, Mr. Ramanan rightly pointed out about all the solutions and assets where we have considerable expertise over an extended period of time. For example, our biometric domain experience goes back at least 10 to 15 years and that is a huge value add that we see. There is shipping and port, where we have had experience over an extended period of time. I think the key point that we are trying to do over here is the repeatability of business in assets and areas where we have strong domain focus. And we found the validation of this strategy in winning some good customers. Some of these customers that you are looking, that we have added, especially in shipping and port and other areas is validating our assumption. There are two things that happen as a result of this focus. Number one, repeatability means better references over a longer period of time. As we win more customers in that particular domain our ability to convince all the other future customers become important and that leads to our easier customer acquisition process, so that's the first thing.

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The second thing that happens as a result of this repeatability is our cost and operational margins, the costs go down and the operational margins improve. So, because we are doing the same thing over and over again; and that too we are seeing in some of the businesses, some of the customers that we have acquired. So this twofold strategy combined with focus in account management and combined with the right level of investment in sales, is what we look to achieve in the coming year and over the next several quarters. And that will give us the revenue expansion that Ramanan was talking about.

Subhashini Gurumurthy: Sure, sure. Thanks to the management team, that was pretty helpful.

Moderator: Our next question from Mr. Srinivas Seshadri of RBS.

Srinivas Seshadri: Yeah, hi, this is Srinivas from RBS. Just most of my questions are answered, so just a few book keeping questions. One is, just wanted to get the number of international revenues as well as equipment sales for this quarter.

J.K. Gupta: International revenues this quarter is Rs. 110.83 crores. And equipment revenue is Rs. 17.86 crores.

Srinivas Seshadri: One-seven point?

J.K. Gupta: 17.86.

Srinivas Seshadri: Okay. And wanted your head count without the subcontractor employees.

J.K. Gupta: 3540.

Srinivas Seshadri: Okay. And then your other income seems to have dipped a bit during this quarter. Just wanted to understand whether it is some singularity or some other issue like FOREX loss etc. Just wanted to know.

J.K. Gupta: No, FOREX loss is not a part of other income. Other income is lower because in the last quarter we had maturity of some of the FMPs, where the profit is booked at the time of maturity. And this quarter there was no maturity of FMP.

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Srinivas Seshadri: Okay. And then your tax rate has also has gone up a bit, so just wanted to understand what is your outlook for the next quarter as well as from a medium term perspective?

J.K. Gupta: Yeah, average tax rate in this quarter has gone up because the profit in American subsidiary went up, where the American subsidiary is a full tax paying company. We have about 34% of tax rate. So that's one of the reasons why on a Q-on-Q basis the tax rate has gone up. If you look at the average tax rate for nine months period is about 14.8%, I think in this quarter we have about 15.2%. I think about 15% is the range of tax that is going to be there for some more time.

Srinivas Seshadri: Okay. And then in terms of the margins, you have commented that nine month would be more of a normalized margin for you. So from a very near term basis, should we assume that there would be a spike up, as you said of more of a equipment sales based on the large SI deals that you are pursuing. And while you may have a better top line growth, you might actually see the margins come down a bit from current levels.

J.K. Gupta: Actually, let me just clarify about that comment. What we want to say is that the current quarter, 8.5% equipment share may not be the representative. If we look at the nine month period, we had about 13.4% equipment share. And as Mr. Ramanan was saying, equipment do have lumpiness and some of the transactions may have some equipment, and it depends on which quarter that transaction materializes. So we can't say in quarter four there is going to be more equipment or quarter one of next year is going to be more equipment. What we are saying is that, you can see some quarter where the equipment share is more than the current share of 8.5%, and in that quarter on a percentage basis, you may see some impact on the margins. But our effort is going to be that in absolute terms, we should continue to expand our EBITDA. Like in this quarter we had expanded EBITDA by almost 10%. That is going to be an effort that we continue to expand EBITDA on a sequential basis in absolute terms.

Srinivas Seshadri: That's helpful. And one more book keeping question, just wanted to get the number of the living expenses which are booked for this quarter.

J.K. Gupta: Rs. 2.13 crores.

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Srinivas Seshadri: Okay. And finally on the passport project, just wanted to understand, what is happening? Because we hear a lot of things in the media, in terms of say, some pushback from the Government employees or say some delays in terms of implementation. So just wanted to get a clear picture of what is happening and maybe if you can give some quantification in terms of what revenue may be booked during the quarter.

Ramanathan Ramanan: On the passport project, since it is front-ended by TCS, I think it would be best if you address this question to TCS. We are synergizing with TCS in the execution of the project and in that area we have continued to provide necessary services which are related to infrastructure management, ITES, digitization as well as in education and training. So I would rather have you address this to TCS, because since the right context and the right answers would best be given by them.

Srinivas Seshadri: All right sir. Thanks, that's all from my side.

Moderator: Thank you sir. The next question comes from Mr. Nirav Dalal of Capital Markets.

Nirav Dalal: Good morning sir. Sir, I just wanted to know what is the share of the international business in the core segments.

J.K. Gupta: You already have got our total segment wise revenue. I can give you the domestic portion of this. In customer services, domestic revenue is Rs. 48.13 crore out of the 51.87 crores. Systems integration is Rs. 32.26 crore out of Rs. 119.14 crores. ITES is Rs. 10.22 crore out of 27.82 crore. Education and training is completely domestic.

Nirav Dalal: Okay, thanks a lot sir.

Moderator: Thank you sir. Next question comes from Miss. Dhanya Thoppil of Dow Jones.

Dhanya Thoppil: Yeah hi. I just wanted to clarify this bit on the margins, because you talked about your margin levels for the next quarter being customer service, education and training and then improved business mix. So given that, do you expect the sustained margins of 18 to 20% that you talked about? You said that there may be some SI projects which you want to take but, probably you would only take if you can sustain the margins at around these levels.

Ramanathan Ramanan: Can you repeat the question once more?

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Dhanya Thoppil: Yeah. What I wanted to know is, you talked about the margin leverages, which could expand your margin in the next quarter to three points. And you also talked about wanting to take some SI projects only if you sustain the margins at the 18% to 20%, it wouldn't slip below that. So does that indicate that you are looking at a margin expansion in the next quarter, probably to sustain it around 18% to 20%?

Ramanathan Ramanan: Yeah. Like I had mentioned, we have been always stating that we wanted to operate in EBITDA between 15% to 20%, if you remember a couple of quarters ago. And we are very glad that we had reached 20% margins. I do think that the company stated goal and the type of project that we want to work in are such that, we want to maintain our EBITDA margin at 18% to 20% levels. So whatever we do would be consistent with that. And this would be at a, I would say, at a yearly level, we would like to end the year with these margins. So, there may be some seasonality associated with these margins in a particular quarter, at the end of the day, it should result in an overall margin expansion or maintenance of these margins at these levels. Because that is the type of business that we will get into, we will not get into those businesses which will deplete our margin.

Dhanya Thoppil: Alright. Does that indicate that probably in the next fiscal year, you are looking at some kind of expansion revenue? When do you expect to get back to revenue growth?

Ramanathan Ramanan: If you look at it slightly differently, our services business is growing, and we have been showing year on year growth as well as quarter on quarter growth. And this is in line with what we have been wanting to do. So, we are now going to accelerate our further revenue growth. What you have seen, when you see a decline in our revenue is because, we have decreased our equipment sale almost by 45% quarter on quarter. And so, if I removed that portion, and if I looked at pure services, both on international market as well as on a year on year basis and on a quarter on quarter basis, we have been improving our service revenue. So the fact therefore remains, that any growth that you see has to ensure in absolute terms and in absolute numbers, service revenue growth and solutions growth.

Dhanya Thoppil: Alright sir, okay. One last question, that is on the UID project that you talked about. You had referred to the fact

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that you would either be partnering with TCS or will be going directly. Can you give some clarity on what your plans are with respect to the UID project?

Ramanathan Ramanan: See, in UID, we see, like I mentioned two types of opportunities. One, which would be a large mission critical opportunity driven by the Central authority in UID; UID, AIR or whatever, that would be a large project. Which would be mostly application driven, deriving developing an application at a national level, whether it be a biometric based application and huge databases and so on. And we also see opportunities for the data collection, dissemination, processing, validation, verification, infrastructure rollout, which would have to happen at a State level and would have to have multiple projects associated with it. So, there are certain projects where we would take direct ownership on, because they are at a State level or they would be better driven by CMC. But whatever mission mode, mission critical projects are there, we would synergize with TCS.

Dhanya Thoppil: Alright, okay. That's about it. Thank you.

Ramanathan Ramanan: Thank you.

Moderator: Thank you madam. Dear participants, if you have any questions, please press * and 1 on your telephone key pad.
Next question comes from Mr. Akshay Shah of Quest Investment Advisors.

Akshay Shah: Good morning sir.

Ramanathan Ramanan: Good morning.

Akshay Shah: Yeah, congratulations on the good set of numbers. Sir, just from your talks, what you had said that, we are looking at more of the services business and also as well as equipment business. So just can you guide us with, going forward, how do you see the business excluding the equipment business our services business growing in say by 25%-30% yearly, because now you have got a good base now. So can you just guide us on that?

Ramanathan Ramanan: I think it is reasonable to target 25% to 30% growth in service business every year. And we, our current strategies are focusing on that. So I would assume that you are somewhat accurate in those numbers that you are

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talking about. And we see the opportunities in both India as well as abroad. So that would be our focus.

Akshay Shah: Okay sir. Then in that case, in our nine months thing, because I am not going back quarterly basis, out of that total sales of 640 crores, how much was the equipment charge? Totally it was 20% or something?

J.K. Gupta: No, it was 85.64 crores that is about 13.4%.

Akshay Shah: For the nine months?

J.K. Gupta: Yes in nine months' period.

Akshay Shah: And the balance was services and education and training?

J.K. Gupta: That's right.

Akshay Shah: Okay, okay. And then in that case sir, how would you have margin in services business grow up? You said that 18 to 20% with equipment we want to maintain, but per se with our more and more volume coming in, do you think that margins in services business will catapult in a faster pace?

Ramanathan Ramanan: Margin in service business depends upon two things. One, if it is a solution based, then our margins are better. Because we are replicating a solution and we are using a solution that we have already developed. If it is in high tech areas like embedded systems, then that is going to improve. But if it is pure volume driven services, then it would be a competitive market out there and we will probably ensure that we are at par, if not slightly better than what the industry is having.

Akshay Shah: Then carrying forward, say suppose in a year, how much was the services margin in nine months and how can it improve if you can elaborate on that.

J.K. Gupta: Actually the service margins in all the business segments are comparable to what the industry is. If you look at the margins in a nine month period, system integration had 28.3% margin and IT enabled solutions got 37.5% margin. So these are the two business segments we are strongly focusing. These are the largest contributor to our profits and these have grown faster than all other business segments. Our margin drivers have been the growth in ITES and SI. E&T may not be representative as of now, because only this quarter we have been able to turnaround. First two quarters have not been too good for

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E&T. This quarter we had 17.5% margin in E&T and as we shared a little while ago, we do believe that crossing 20% threshold in E&T margins is something which is very, very feasible, which we will be targeting. So, in terms of services if you look at all these, at an average we get a margin of somewhere close to 26%-27% on services. And in equipment, there is still a margin of around about 3-3 ½% maximum. This is the kind of margin mix that we have.

Akshay Shah: So what you said with embedded systems going higher, I understand it's a metro mix, but overall if you look at it, how are the strategy of growing solutions as well as high end services? So this 26%-27%, over the next two years can go up to 30%-32% kind of?

J.K. Gupta: It depends on the mix of the businesses that is coming up, and the geography mix. For example in this, when we say IT enabled services and SI, the profitability being 28.3% and 37.5% for the nine month period, it's largely because, we had been able to grow both the business segments very, very smartly in American geography. And America geography offers us higher profitability as compared to India geography, in services also. So in this year, our strategy of having a very, very focused approach in terms of geography and key clients and mining our key clients has paid off well. We would like to continue with this strategy with this focus of deepening our engagement with the clients in America and other geographies, with a view to enhance margins with each and every customer. So, I think that this kind of a strategy there is a distinct possibility of expansion of margin.

Akshay Shah: Okay. Can I take it that way, that 26%-27% is like a bottom out thing and it cannot deteriorate but at least it can only improve now?

J.K. Gupta: Actually this 26% has also been improving quarter on quarter, so there is no question of bottoming out. We have not been declining in margin in services also. So what we are saying is that, so far we have experienced an increasing trajectory in services margin, and we expect this trajectory to continue.

Akshay Shah: Okay, so on a consolidated basis I can take a little bit, it can improve, but it cannot go down now.

J.K. Gupta: Yeah.

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Akshay Shah: Okay. Just at the cost of repetition, I want to know Mr. Ramanan; he said that we are working on three ways relationship in India scenario with TCS. Just can you elaborate again, once again, in what way?

Ramanathan Ramanan: Can you repeat the question please?

Akshay Shah: No, Mr. Ramanan, just now you said that, we are working with TCS on India synergy in three ways. Can you just repeat on what are those three ways, something mission critical and I just missed out on that part basically.

Ramanathan Ramanan: Okay. See we are focusing with TCS in the Indian market on mission mode projects. We are also seeing in some of the large Government projects, which require the sort of the financial backing as well as an application component that TCS is able to bring to the table. And we are focusing in the international market in leveraging TCS. The other opportunities, where we have an existing customer of CMC, with whom we have formed relationship, then TCS would support that at the backend, in supporting any new opportunities in these projects. So these are the three things that I mentioned, one is, at a Central level and another is at a State level and third was at the existing accounts of CMC where TCS can play a synergistic role bringing our offerings to the customer.

Akshay Shah: Okay. Thank you.

Moderator: Thank you sir. Next question comes from Mr. Devan Sanghoi of CMC.

Devan Sanghoi: Hello. Good afternoon and congratulations on a good set of numbers. Just want to know in terms of product, what is the status now and how do you see that business taking off? We haven't heard anything for a long period on the same.

Ramanathan Ramanan: Devan, can you repeat the question?

Devan Sanghoi: See, on the products, what are your status of all the products what we are having? And what are the various stages? Are we pursuing that in organic growth strategy and where do you see that contributing to our bottom line?

Ramanathan Ramanan: Yeah. See our focus on products has been very strong in some of the key verticals that I talked about. We have had growth in ports and we continue to grow, we continue to address new customers, and we have a good pipeline in

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the shipping and ports area. We expanded both in India. We got Mangalore Port Trust, Cochin Port Trust and so on. We have also been able to execute projects in the international market. In the e-Governance area, we are bidding now. We have a successful implementation on treasury management in three or four States, which include Karnataka, MP, Orissa and so on. We are seeing opportunities on new treasury management systems in different States, so we are looking at replicating these solutions. We also successfully implemented HR management system for the Karnataka State. And now more and more States are looking at replicating these same solutions in their own States, and so we are continuing to focus on that. Our mining solution in using GPS technology; we have got new clients in the mining area during the last quarter and we are expecting some more additions during this quarter. So the GPS based mining management solutions, DynaMine is having increased focus. Our police computerization solution which is eCOPS as well as FACTS, fingerprinting and criminal tracing systems, these have had new upgradations. We have enhanced FACTS–5 to FACTS–7 now and FACTS–7 is being implemented in a couple of States. And we are participating in the new CCTNS initiatives in the country, so we see an opportunity to replicate that. Our insurance solutions continue to have strong focus. We have today a good base of clients, which include companies like ICICI Lombard and HDFC Ergo and Sompo and so on. So we are continuing to expand on this and see how we can grow this further. And also our solutions related to defense, we are working on expanding our core competency in defense and see how we can develop solution related to command control and so on. So, these are the areas of focus for the company. We see some of these solutions also playing an important role in the international market. We are looking at our insurance solutions being positioned in the MEA market where we see an opportunity because of the similarity of commonwealth countries and so on, and the implementations that we have here. We are also looking at replicating our core banking solutions in the Middle East African market because we have already got client base which includes National Bank of Bahrain, Bahrain Development Bank, and we can see, how we can replicate that. So, these are the areas of focus and we continue to invest in these solutions and grow these solutions.

Devan Sanghoi: Sir, in terms of the contributions, first nine months have we done any sales or is there any one time income arising out

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of it? And second we had lot of pilots which were going on at, as far as the port handling and other fingerprinting, so do we expect any kind of big sales happening in the next one year?

Ramanathan Ramanan: See, we have slightly modified our business models in terms of these licensing and revenue generation. We are looking at 2-3 different models. One is, not necessarily charging one time license fee but having it in a more staggered manner, because we want to avoid lumpiness in terms of revenues and sudden surprises in any particular quarter. We are also looking at transaction based pricing. We recently won an insurance client, where our core solution, our insurance solution GENISYS is being used, but it is being used in transaction based pricing manner. So, for every transaction, we get paid a certain amount. And the growth of that insurance company, it will result in growth in revenues and profits for us. So we are trying to move into different models, which is creating more predictability and also giving us the opportunity to grow our revenues.

Devan Sanghoi: Okay. In terms of the restructuring, how do you see in terms of this shift towards the services? Until what point in time, you think that will get over so that top line goal starts coming back? Is majority of the shift over?

Ramanathan Ramanan: I would say majority of the shift has been achieved, we still have probably some room to go, a little bit more. But the growth in services is absolutely a focus for the company, so you will see revenues growing. And you have to measure the service revenues part of the company, and I would like us to be measured on that and I would like us to be measured on the absolute EBITDA numbers as well as the overall margins of the company.

Prashant Shukla: In fact to add to it, if you look at the service mix of the overall business, the service side is growing, the numbers are there for you. The service revenue grew about 4% quarter on quarter and 5% year on year. So that is the focus area for us.

Devan Sanghoi: Okay. What percentage of our business would we like to limit from TCS? Do you think there will be certain cap you will put, that beyond this you won't be dependent on TCS and you'll do your independent sales or you'll be 100% dependent as you move forward, on the TCS?

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Ramanathan Ramanan: No, our strategy has not been, to be 100% dependent on TCS. Our strategy is to leverage TCS wherever it is a value accelerator to TCS as well as a value accelerator to CMC. And parallelly have address markets and segments where TCS is not focusing on, but which leverage our core capabilities and core niche solutions. So, the strategy is not going to say; only 10% or 15% or 20% of business should come from one or two of these. Our strategy is, CMC's core strength, CMC's core solutions and CMC's core R&D capability, how do we leverage this to the maximum, either through TCS synergy or directly. And we will not put a limit on the growth of either of these two, because that would be best serving the interests of CMC.

Devan Sanghoi: Okay. Thank you very much sir.

Moderator: Thank you sir. The last question comes from Miss. Sohini Andani of SBI Funds Management.

Sohini Andani: Hello.

J.K. Gupta: Yeah Sohini.

Sohini Andani: Yes, congratulations on good set of numbers. Sir, my question was in the customer services business, where this quarter we have reported margins in double digits. I just wanted to know that, whether this business is still 25% of our total business and which involves a high cost? So is it that within customer services we are changing the profile of this business and what part of this gives you better margins and what parts of these business are we trying to hive off? You earlier mentioned on the call that, you can take the margins, here even higher than the 11% around 15% or so. So what can drive this, sir?

J.K. Gupta: Yeah, I'll just tell you. When we look at 25% of customer services, what all is happening, which is helping this margin growth. One is that, most of the equipment business is part of the customer services. So as we reduce our dependence on equipment businesses, and focus on the services portion of this business, our average profitability improves. So what we have done apart from this shift in the business mix of our customer services, we had very closely looked at the operating cost to deliver whatever business we are delivering under customer services. So we are very closely looking at, and improving our operating efficiencies, we are cutting down the cost of delivery. As we are doing lesser amount of equipment, we are being selective in picking up those transactions where

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the margins are justified and the margins are better. So what we have seen that, during this quarter we have been able to improve our margins on equipment per se. We have been able to improve our margins on services portion also. So, this is the reason why the aggregate, this combination of the shift in the mix of equipment and services as well as the reduction in the operating cost of both these portion of businesses has helped up in improving the margins to 10.5%. And since all these are coming out of certain amount of improvement in the way we are operating and executing the project, we believe that lot of these initiatives are going to give us benefits over a longer period.

Prashant Shukla: To add to what J.K. said, there is another thing that we are doing, which is looking at certain other solutions in customer service, and those are more service focused business, even within the customer service business. So these are divisions which we are very capable of delivering, given our long standing understanding of this business which went beyond just delivering equipment. So on the one hand, we want to move away from the equipment business on the other hand we want to not only continue the service portion of the business but also look at other new opportunities that are emerging in that area and leverage our core domain experience in delivering these services. For example, we know security is a very big area. And video surveillance and security requires a lot of those capabilities that we built over the years with the customer service business. We are very good at it; we are looking to focus on that as one of the examples of new service or niche areas. Then we can expand our presence, given our past experience. So, one is focusing on existing services and growing it. Second is, looking at other areas where the same skill set will give us a bigger business.

Ramanathan Ramanan: I want to once again, emphasize on two things. In customer services, we said, we are moving away from pure equipments. But our focus now is going to be turnkey projects in CS. When we do turnkey projects, there may be an equipment sale but since it is coupled with a strong service component, the margins in this business can be much higher. So we are going to look, for example, if you are saying I want to rollout security surveillance system for a company, that is lot more that just pure equipment, it involves planning, it involves consultancy, it involves support, it involves services and so on. So there the overall margin of the business can improve quite a bit and

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we can even aspire for a 10% to 12% or 15% margin for such projects. So that is why, I see a potential for us in improving on those margins.

Sohini Andani: Sure, thanks a lot sir. Thank you.

Moderator: Thank you madam. Now, I handover the floor to Mr. Ashish Aggarwal for closing comments.

Ashish Aggarwal: Yeah, thanks Imran. I would like to thank the management for giving us the opportunity to host this call and would also like to thank all the participants for taking their time out to understand CMC better. Thanks a lot everybody and have a nice day.

Ramanathan Ramanan: Thank you.

J.K. Gupta: Thank you.

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

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