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Transcript

Earnings Conference Call of CMC Limited – Q3 (FY 11)

Participants:
Mr. R. Ramanan, Managing Director & CEO
Mr. JK Gupta, CFO
Mr. Prashant Shukla, COO

Event Hosted by	**:**	**Tata Securities**
Event Date / Time	**:**	**14th January, 2011, 12.00 PM IST**
Moderator	**:**	**Mr. Ashish Aggarwal, Analyst, Tata Securities**

Presentation Session

Moderator: Ladies and gentlemen good day and welcome to the Q3 FY 11 Results Conference Call of CMC Ltd hosted by Tata Securities Ltd. As a reminder for the duration of this conference, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Ashish Aggarwal from Tata Securities, thank you and over to you sir.

Ashish Aggarwal: Good morning everyone. On behalf of Tata securities I welcome you all to CMC Limited Q3 FY 11 results conference call. I would like to offer my sincere thanks to the management for sparing their valuable time for the call. I would now like to hand over the call to the management to discuss Q3 results. Over to you sir.

JK Gupta: Thanks a lot Ashish and very warm welcome to all the participants in this call to discuss Q3 Results of CMC which was announced yesterday and approved by the board. I will now give you on snapshot of the company financial results and after that I will hand over to the Mr. Ramanan for taking you through some of the business initiatives that we have taken or we are proposing to take. Just to recapitulate some of the summary points on our financial performance:

CMC had consolidated operating revenue in Q3 at Rs 272.64 crore which is an increase of 29% on Y-O-Y basis. All the four business segments contributed to this growth of 29% Y-O-Y. Services business of the company grew 26% Y-O-Y to Rs 244.14 crore and the share of services revenue in the total revenue from sale and services was at 89.5% compared to 91.5% in the corresponding period last year. Company had international revenue of Rs 149.15 crore which is a growth of 35% Y-O-Y and the share of international revenue in the total revenue from sale and services was at 54.7% up from 52.5% in the corresponding period last year. America continues to be the biggest driver of our growth in the international business and continues to give us robust growth.

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Our subsidiary, CMC America grew 43% Y-O-Y in dollar terms and the share of America geography in the overall operating revenue of the company in this quarter was 42.3%. Company earned a total consolidated operating profit i.e. EBITDA of Rs 50.40 crore which grew 17% on a Y-O-Y basis giving an EBITDA margin of 18.5%. Company earned total consolidated profit after tax of Rs 45.37 crore which is an increase of 25% on a Y-O-Y basis giving a PAT margin of 16.3%. The company had at average effective Tax rate of 14.9% and the company considered a MAT credit entitlement of Rs 4.14 crore in this quarter.

During the quarter, the company added 24 new clients out of which 8 clients were added in America in the areas of embedded systems and software services. 16 clients were added in India in the space of manufacturing, e-governance, IT, energy, Telecom, high-tech and Education space. Total other income during this quarter was Rs 5.62 crore which includes income from investment in mutual fund at Rs 1.51 crore and interest on refund of income tax at Rs 2.04 crore. The company added net man power of 39 during the quarter and the total man power at the end of the quarter was 6691. During this quarter the focus has been on full utilization of 678 people that we added in Q2 which included 332 trainees. The company has cash and cash equivalent of Rs 270 crore at the end of the quarter which is an increase of Rs 11 crore in this quarter and which is after a capital expenditure of Rs 29 crore, majority of which was on SEZ facilities at Hyderabad and also repayment of loan of around Rs 5 crore by our American subsidiaries. We have an investment of Rs 215 crore in debt based mutual funds.

Let me just take you through some of the numbers on a cumulative period. On a cumulative nine months basis the company achieved significant growth in both revenue and profitability and expanded its margins. Company has a revenue growth of 23% during this period which is contributed by all SBUs. Services revenues increased by 29% and share of services revenue was 91% compared to 87% last year. Equipment business during the nine month period declined by 18% to Rs 69.87 crore. International revenue increased by 42% and the share of international revenue increased to 56% in the first nine-months compared to 49% last year for the corresponding period. The company's EBITDA increased to Rs 156.12 crore which is an increase of 38% over last year. Profit after tax increased 37% Y-O-Y to Rs 135.44 crore in first nine months. Company achieved an EBITDA margin expansion of 210 basis points. PBT margin expanded by 220 basis points while PAT margin expanded by 180 basis points. On a cumulative basis we had an effective tax rate of 15.3%.

So that’s the highlights of the financial performance of the company during this period and with this, I invite Mr. Ramanan to take you through some of the key business initiatives and the key business strategies that we are focusing on.

R Ramanan: Thank you JK and good afternoon everybody and thank you for joining the call. As JK has very comprehensively summarized, we continue to consistently follow the strategy that we have been adopting over the last couple of years in focusing on value adding solutions in

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services and focusing on growth both in the domestic market and the international market and in the key segments in which CMC is in.

And we are glad to report that over this quarter as well as over the last nine months this strategy has paid off in terms of our growth both in revenue, profitability and in the various segments in which they are in. During the last quarter as JK had mentioned we had absorbed about 650 people in the previous quarter and they were deployed on projects of course that is an initial period of learning and training that's comes along as a part of the induction. But we have been able to maintain and continue on our services revenue, profitability, margins as well as we were able to register a growth on both PBT and PAT during the quarter as compared to the previous year. We continue to see good opportunities, growing opportunities in India and the e-governance sector in the manufacturing sector, in the power, energy sector as well as in retail and we are also looking at law-enforcement and security becoming important areas of growth opportunities for the company.

There is also a lot of investment happening in infrastructure where in terms of construction, real estate, SEZ township and so on and we do see an increasing technology spend in all of these areas particularly the demand for intelligent township, digital township increasing. So that is an opportunity that CMC traditionally has been good at and is focusing on exploiting in the market.

In the international market we have seen continued growth in embedded system in the form of 8 customers that we added. We added customers in embedded system, we added customers in some of the emerging economies like Nepal and we are focusing on Africa where many of CMC solutions can find the place in getting replicated and the spend in these countries is also increasing not only due to the growing economy but also because of World Bank and United Nations and other agencies funding into these markets. In Europe and UK we continue to focus on the high end solution and services mainly embedded, ports and cargo solutions as well as in digitization services.

We have focused on our process improvement internally in CMC over last several years and this year we also added some greater focus in terms of adoption of the Tata Business Excellence Model and in the interest of not only building business excellence but also scalability. We are investing in new infrastructure; the SEZ facility in Hyderabad is coming up and going to be a 2500 seater organization for us in Hyderabad. We are also expanding some of our other centers in different parts of the country. So with this we also need to have the ability to scale up and our processes to robust enough to ensure rapid scaling. And therefore the focus on process improvement and certain initiatives like PCMMI. We have launched PCMMI initiatives which is people capability maturity model where we are aspiring for level three to level five maturity certifications and that really looks at how we ensure that the people that we employ are not only highly competent but also find CMC a place of choice and a fun place to work in. So these are some of the other initiatives on the, angles related to process excellence and in terms of business opportunities.

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New initiatives that we've launched in India during the last two quarters and some of you may have read it in a newspaper is what we have called e-Pragati. e-Pragati is an empowering emerging India initiative and is an initiative targeted towards smaller cities, emerging cities in India and to ensure that we are able to play catalyzing role as well as leadership role in technology, job enablement, educational and training and they are inter pacing with both government and Academia in these emerging cities to be able to bring the benefits of technology for the growth of these cities as well as to the rural market. We have done certain project before but now it is a time that we focus and we have conducted an e-Pragati road show in Pune and Indore and we're going to replicate it across multiple cities in India.

So this should give you an idea about what is happening within the company and in terms of both, business opportunity, growth opportunity, people excellence and process excellence. The focus of the company is to ensure that there is high productivity; high profitability and we're oriented towards growth. With this I am very happy to answer any questions along with my team here.

Moderator: Thank you very much. The first question is from Anoop Upadhayay from SBI Mutual Fund. Please go ahead.

Anoop Upadhayay: The continuation of customers in services to the overall revenue if we look over the last three years have been coming down but in the last two quarters we have seen an increase in the contribution. So is it part of a larger strategy to ramp up again the segment and if you could also comment on the demand track from that we have seen?

JK Gupta: In fact in terms of the share of CS in the overall revenue we have been sharing that CS is the SBU where we have got most of the hardware portion which has certain amount of quarter on quarter volatility depending upon what is the delivery schedule of the project execution when we get into a turn-key project. Over last 2-3 quarters we have been sharing that though our current equipment portion in the overall business is only about 9% but on the quarter on quarter basis there could be some volatility and our business model is such that equipment portion of around 12% is something which is going to be over a longer period. I just give few data points, for the 9 months period our equipment portion is only about 9% and for this quarter the equipment portion is about 10.5% and Q2 it was 9.4%. So because of this slight volatility on the equipment portion you may see some kind of variation in CS SBU business share. So the current combination of businesses are very much inline with overall long term business combination strategy. There is nothing unusual about it.

Anoop Upadhayay: Okay sir great. On demand traction I specifically wanted to understand in system integration, are there any specific verticals or the service lines which is driving most of the growth and elaborate on that?

R Ramanan: In the SI space, insurance, banking, financial services are important verticals which continue to invest and where we see opportunity particularly with our product like Genesis, Vedas,

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BOLT and the DP secure product which are quite popular in the market and where we continue to see increase of opportunities and where we have also won some new customers. The other areas which we see in the domestic market is e-Governance particularly related to the Municipality's governance or the tax computerization or the SAAS product that we have which is governance with the regional services or the portal that we have developed for government agencies which is currently in progress. We see opportunities for replicating these and the treasury management products and the police computerization product that we have. We also are seeing increased opportunities now in the rollout of infrastructure for retail sector and we have got a major new customers also added during last quarter. The rollout service as I mentioned is where we are rolling out application, infrastructure across the series of retail outlets of the country for a large manufacturer or distributor or and FMCG company or a retail company. And this requires a combination of service capability, it requires ability to develop some application, it requires ability to integrate that application with the larger application which is centralized application. It requires the ability to implement the local infrastructure at a particular outlet and it requires ability to train the people and this is a very good combination of services that CMC offers and therefore CMC is among the leaders in the country right now to provide holistic end to end service for many of the retail companies and many of the manufacturers and that is also growing. The fourth sector that we see which is also growing in the country is the infrastructure sector, what I mean infrastructure it includes transportation, rail, road, it includes shipping and port because the number of ports are coming up in the country and which are requiring modernization and the construction which is through the township or which is through the SEZ. Now all of these require technology infrastructure spend and technology solutions which we have, for example transportation we do have freight management, logistics management packages as well as we have capabilities in vehicle tracking system and so on. So these are opportunities that we are tapping. If I look at the shipping and ports we have MACH & CALM which are two flagship products of ours which are finding increased number of implementation and we have responded to a number of bids in that. And if you look at airport modernization or if you look at construction, we have recently completed for one of the major townships in Pune, the first digital township. It is an end to end digital implementation of a township which includes marker, which includes automated metering systems, billing systems, portal and inventory management etc. for a large scale township including access to these services through a single window portal in every home that is occupied in the township. So this is we see more and more demands for such digital townships or digital SEZ are coming up and again here there is a combination of infrastructure management SCADA and Real Time process control system, Smart management system as well as application which have to run, the traditional application like SAP which have to be integrated but in addition to that we need other applications. So these are the areas that we see in the domestic market growing. In the international market we are seeing a resurgence of IT spend. The economy in the US is improving in the areas which CMC has been in, like Embedded System, Real Time system, product R&D Engineering. More and more companies are looking at outsourcing there R&D Engineering to India and so that they can manage their cost better and also the solutions that we have for the ports and transportation or for core

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banking or for insurance are finding good opportunities now in Africa and in the Middle East and in certain neighboring SAARC countries where they are having both the ability to invest and there are looking towards India providing such solutions or Indian companies providing such solutions. So this is the state of the market and these are the sectors in which we are growing or we see opportunities to grow and so there is reason to be optimistic about the opportunities.

Anoop Upadhayay: Sir just one final question. What would have been the growth in our international revenue during the quarter?

JK Gupta: During quarter our international revenue grew by 35% on a Y-O-Y basis.

Anoop Upadhayay: Okay and sequentially what would that have been?

JK Gupta: Sequentially it was almost flat.

Anoop Upadhayay: Okay would there be any specific reason for this flatness?

JK Gupta: We had some adverse impact on the exchange rate variation. This amounts to about Rs. 3.8 crore because at an average dollar had fallen about 2.7% compared to last quarter.

Anoop Upadhayay: Okay sir great thanks a lot for your answers.

Moderator: Thank you. The next question is from Vinay Kulkarni from HDFC Mutual Fund. Please go ahead.

Vinay Kulkarni: My question is also regarding this slight flattishness in IT-Enabled services as well as System Integration, revenues over the quarters

JK Gupta: Yes in fact, Vinay, you know that in both SI as well as in IT-Enabled services we get bulk of revenues in the international market. So there have been two things in these, number-one is that there has been impact of Rs 3.8 crore on account of exchange variation and second, December quarter is generally a bit of flattish quarter because of some discretionary budgets getting expired and some additional SOWs request not coming because of expiry of budgets etc. So there is nothing unusual about it. So it's generally expected, this flattish quarter, and it is not very significantly flattish if you look at our System Integration there has been a growth of about a percent and in IT-Enabled service we have small decline from Rs. 42.68 crore to about 40.96 crore. So these are not significant variations.

Vinay Kulkarni: Okay sir, just one more follow up question on international revenues, could you throw some light on various aspects of this revenues in terms of what sort of revenues you get within the international revenues from products and number two on services what sort of off-shore on site makes you manage and what are the rough cut billing rates for off-shore on-site?

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JK Gupta: So far as the major sources of international revenue is concerned there are three segments of businesses which are dominantly international. One is Embedded System; you can see Embedded System revenues are about 98% international. So we have got about only 2% domestic. Second major international revenue share is from IT Enabled Services. I can give you few data points here, in this quarter we have got total IT-Enabled revenue of about 41 crore and out of this 41 crore, domestic revenue is about 14 crore. So that is another area where the bulk of the international revenue comes. Third major source of international revenue is Systems Integration. In this quarter we had SI revenue of 144 crore out of which our domestic revenue is about 34 crore. So these are three basic segments from where the international revenue comes.

Vinay Kulkarni: Right sir and generally what sort of off-shore on-site mix you have and what are the billing rates in these two?

JK Gupta: Embedded system revenue we have got about 65% offshore and about 35% onsite. In case of IT-Enabled services we have got about 85% off-shore and about 15% onsite. And Systems Integration you can have a ratio of around 50:50 onsite off-shore.

Vinay Kulkarni: And what are the rough cut range as far as your billing rates are concerned?

JK Gupta: For most of our work on IT-Enabled services and Embedded Systems, I don't think it is right to judge on based on billing rates because most of this work come on an assignment basis so there is scope that we have to deliver and that scope is kind of fixed-price one and where we have to deliver a particular assignment, it's not linked to the rate. In SI also there is a combination of solution based businesses which again does not depend on the billing rate but it basically depends on the solution that we are going to deliver. There are certain T&M kinds of assignments where the billing rate will be there and our billing rates have been really stable over last four quarters. There has been no major change in the billing rates.

Vinay Kulkarni: Sir final question on passport Seva project, could you give us some update on how it is moving and when will we see revenues?

JK Gupta: Yes some revenues are coming in that project, more details can be taken from TCS but from our perspective, because we have got knowledge about a portion business that we are executing to them, the pilot roll out is complete, that is about 7 sites and they are now going into the balance roll out. So some revenue is showing up in these numbers but the major portion the revenue is yet to come.

Vinay Kulkarni: And they will start next year definitely? FY 12 should be the time?

JK Gupta: There will be some planning of rollout which has been done by TCS and possibly they will be able to get you a better judgment. I can just tell you that 7 pilot sites are over and some revenues already shown in our books but major revenues yet to follow in the coming quarter.

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Vinay Kulkarni: Thank you sir, all the best for the next year. Thank you.

Moderator: Thank you. The next question is from Nirav Dalal form ShareKhan. Please go ahead.

Nirav Dalal: First question related to the e-Pragati initiative that you've taken up, could you just tell us how much you have invested in this project?

R Ramanan: The investment is in two kinds, one is we are developing solutions which are relevant to the emerging cities and this could be e-governance solution, it could be applications for example we have a lot of cooperative banks in all the emerging cities having a separate solution for cooperative banks or mobile solutions for insurance and payment and so on. So the nature of R&D for the emerging cities is quite different from some of the large institutions that are there and we are doing appropriate investments in R&D. The second investment that we are doing is in terms of beefing up our sale force and our physical presence in many of the cities. Because these are something that you need to be on the ground to be able to interact with the companies as well as with the local government and academic institutions, that is like I said it is the combination of creating jobs also so that we can locally serve the projects which are executed and prevent the brain drain or urban brain that is there because we have a lot of people who keep migrating to the city. So the whole e-Pragati initiative is creating the ability of not only empowering through technology but also through interactions and through a connected platform which is what we are doing. So we do believe that this is a long gestation, there will be some long gestation period but it needs to be done right away and this is something which CMC because of its national presence as well as its pan-India support capability is best equipped to take this initiative and so we have taken this initiative. Of course the investments in terms of marketing and organizing the platform for engineering needs discussions that will be done in every city. We are identifying about 15 to 20 cities to focus on and then as more and more cities come up and keep adding to that.

Nirav Dalal: And second question but in into the demand side, is there any sector which is lagging behind and demand is not there as you anticipated earlier?

R Ramanan: In what?

Nirav Dalal: On the overall demand outflow is there is any sector what is lagging and it's not picking up as you had anticipated earlier?

R Ramanan: I would say the Defence sector is still not picking up, there has been a lot of information generally in the papers and media about the spend but they do take a longer title time and its taking longer than what that is we have been seen. I don't think it is lack of opportunity but it's the process which is currently being followed which takes quite sometime.

Nirav Dalal: And third question is regarding the sales side, how many people have you hired in a last 9 months in a sales side?

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R Ramanan: On sales we have actually added about 25 to 30 people during the course of this year and we continue to invest in sale both at a regional level as well as in the international geography.

Nirav Dalal: Sir lastly a book keeping question, sir total debts on the book?

JK Gupta: Total debt zero, we don't have any debt on the book.

Nirav Dalal: And sir what is the tax rate be like for FY 12?

JK Gupta: FY 12 in the next financial year. This year average tax is around 15% and we are expecting this tax rate to rise to close to about 19% or 20% in the next financial year consequent upon the withdrawal of STPI tax benefit. If that is extended the scenario will be different.

Nirav Dalal: Sir what is the rent income this quarter?

JK Gupta: Rs. 3.1 crore.

Nirav Dalal: That is it from my side. Thanks a lot.

Moderator: Thank you. The next question is from Bharat Sheth form Quest Investments. Please go ahead.

Bharat Sheth: Sir can you elaborate on how we have planned to leverage our assets through this cloud computing?

R Ramanan: Yes, cloud computing is still in the emerging stages but there is a lot of opportunities for leveraging cloud computing especially in the solutions that we have. We are looking at how we can use for example cloud computing to serve cooperative banks and other banks which are distributed. For rural Micro financing related software one can use that. One could also use cloud computing for retail services. In the area of, for example Fleet management, one can use cloud computing because you need to have be to able to manage or know the position of any particular vehicle and multiple companies can leveraged this. So there are number of areas, you have to be little creative and imaginative in terms of how cloud computing can be leveraged. Also for inventory management systems or university management systems or school management systems one could develop cloud computing based services which are transaction based. Then government citizen services there is a huge opportunity there because you leverage the Internet and you are able to increase the reach and integrating that with mobile technology would make it even more beneficial. So there is a group which is focusing on it within the company and we are looking at some of our existing solutions and seeing whether these solutions can be posted onto the cloud providing software as a service and we are also looking at new applications for some of the emerging sectors.

Bharat Sheth: Sir how much of investment do we have to make our product at cloud computing comfortable?

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R Ramanan: In every product you have two aspects, one you can just put it on the cloud and extend the service if it is already a 3 Tier architecture but if it is not having a 3 Tier architecture, if it doesn't have the browser based of architecture then there will be an efforts port it and it depends on product to product and it's not something which one can easily thumb rule or a figure to.

Bharat Sheth: So when do you see revenues kicking in form this cloud computing?

R Ramanan: Some of the products that we already have are on the cloud. If I take the CHOICE project, there is already an internet based for this, it is a Tax based service; it has a transaction based service. For every transaction you will pay, there is some of applications that has been on the cloud, some applications are to be ported. But over the next 2 to 3 years it will gain a lot more maturity and it may become one of the major mechanisms of providing software services.

Bharat Sheth: Then we always say that we are trying to replicate our solutions so sir is it possible these nine-month our service income is around 700 crore, so how much is composition of non-linear and how much is a linear sales that were growth which has happened?

R Ramanan: If you look at 40% of the services that we are rendering would be non asset based and about 60% would be asset based. When I talk asset base it is solution based so for example most of the solutions in India are always asset based also in the emerging economies they are all asset based. If you look at embedded system it would be more service based and if you have pure infrastructure management services that would again be service based. So I would roughly say about 45-55 or 40-60 is a rough composition.

Bharat Sheth: And going ahead we are taking more initiative on this non-linear growth. So how do you see this composition changing?

R Ramanan: I don't see the composition changing much, I would really look at 50% asset based and 50% service based. The issue is not one of trying to change the composition, the issue is one of generating sustainable service fee and an asset base solution helps us to generate sustainable service fee. Let me elaborate. If I sell a trading solution then in the first year I will get huge asset based, licensing component but it will help me for the next 10 years to get service based revenue so both are important. The asset actually enables you to get long sustainable service fees, and the reason is because one can implement to the solution then the customer is locked into your solution and it generates continuous service fees. So strategically having a healthy 50-50 ratio is a good ratio.

Bharat Sheth: And sir one question for JK, how much CAPEX that we had planned something 180 crore for SEZ at Hyderabad and so far we have spent only 29, so how will you see that CAPEX?

JK Gupta: Rs. 29 crore we had spent in this quarter, for the nine month period we have spent about Rs. 69 crore. Major portion of CAPEX we'll be spending in Q4 when we are going to commission

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our first ODC, our first block of the second stage. Some of the expenditure will spill over to the next financial year and that will be we are going to complete both the blocks by June 2011. So overall there can be some moderation in terms of Capex plan that we have for the year. But so far as the operation of SEZ is concerned, the operation of SEZ will start sometimes in the month of April.

Bharat Sheth: And sir that will again help us in bringing down tax rate in FY 12 onwards?

JK Gupta: In FY 12 the effective tax rate will go up as I answered to a previous question and I am expecting it will be around 19% or so but from FY 13 onwards the tax rate should again start falling. The reason is because that it will take some time to ramp up operations in SEZ while some of the leftover business will continue to be executed out of STP so during this changeover period there will be adverse impact on the tax rates.

Bharat Sheth: Okay thanks a lot.

Moderator: Thank you. The next question is from Dipesh Mehta from SBI Capital Securities. Please go ahead.

Ankit Pandey: Hi good afternoon to you all actually this is Ankit Pandey also from SBI Cap. My question is regarding, can you please broadly elaborate on the factors that affect your EBITDA margin and can you also elaborate on some process improvement measures that you mentioned, Tata Business improvement model, I think it was?

R Ramanan: Yes the Business Excellence model is built along the Malcolm Baldrige Award criteria. There are seven strategic areas which the business model asked every company to focus on and you are rated on each of these through an assessment process. The seven parameters are the leadership category, the strategic planning of the organization category, the customer focus category, the employee focus category, the process management and internal systems category and then the measurement and knowledge management systems category and finally, the business results. These are the seven categories that are very focused assessment done about the processes within the organization. What is the leadership process, what is the strategic planning process, what is the customer focus process and so on? What it essentially does is actually you benchmark yourself against some of the best organizations in each of these categories, not necessarily just with the same company. And you are supposed to enhance your process capability to meet those benchmarks or to even set the benchmark. This is something which calls for very strong alignment of the company's goal and its aspirations with the internal processes that are present in the organization and the ability of all the people in the organization both at a senior level and at a junior level to identify themselves with a clear balanced forecast. So, a balance forecast data-driven decision-making approach is strongly recommended by this. And then at the end of the assessment, a certain set of recommendations are made for opportunities for improvement for the organization and then we create an action plan which is in line with this opportunity for improvement. So, it is a very robust strong process which helps us to ensure that our successes

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are not flash in the pan type of success, it is endurable, it is sustaining, it is replicable, it is process-driven rather than individual excellence heroic and therefore, there is predictability above the organization's performance and growth.

Participant: In the assessment most recently, which are the areas of improvement do you hedge?

R. Ramanan: In each of the areas there are specified opportunities for improvement. I would say that some of the areas in which we are focusing on additionally is the customer focus process. How do we enhance their value additionally differentiation that a customer experiences from CMC, because if you are a smaller organization, then the customer is normally comparing you with some of the larger organizations who are facing against your own service? So the differentiation that you bring through not only the quality of support and service but also the solutioning is very important, so that is an area that we are focusing on.

Participant: Okay, thanks.

Moderator: Thank you. The next question is from Apurva Oza from Standard Chartered. Please go ahead.

Apurva Oza: What was the break-up of regular and contract staff that you had at the end of the quarter?

JK Gupta: We had regular staff of 4,092 and contract staff is 2,599.

Apurva Oza: Okay. And you mentioned your cash balance; I could not get it when you said it earlier?

JK Gupta: Cash balance is Rs. 270 crore.

Apurva Oza: Sure. And also, in terms of living expenses for your overseas contract, what would that be?

JK Gupta: Overseas living expense in this quarter is Rs. 2.32 crore.

Apurva Oza: Thank you, sir.

Moderator: Thank you. The next question is from Sagar Mehta from Dalal & Broacha. Please go ahead.

Sagar Mehta: Sir, this is a repeat question on the TCS contribution. Could you throw some light on it again, sir?

JK Gupta: TCS contribution? You mean to say the amount of business that we get through TCS?

Sagar Mehta: Yes sir.

JK Gupta: It is about 49%, revenue come from TCS on a consolidated basis.

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Sagar Mehta: Okay. And sir, also could you throw some light on the other income, why is it a little high, if you could ……

JK Gupta: This quarter we have about Rs. 2.04 crore of interest on tax refunds that is one-time extraordinary item in this.

Sagar Mehta: Okay sir. Thank you so much.

Moderator: Thank you. The next question is from Priya Rohira from Enam Securities. Please go ahead.

Priya Rohira: My first question relates to the flavor on new client additions of 24 which you have seen. How would you split it across both domestic and international geography that is first question? And the second question is we have a healthy business visibility or exploitation in the international markets with respect to embedded ITES and Systems Integration business. What is your thought process on nurturing the domestic market opportunity over here?

JK Gupta: Just to give you the breakdown of the client addition. We have eight clients in the international geography and we have 16 in India. And in terms of the traction I think Mr. Ramanan can give you details.

R. Ramanan: Yeah, in the international markets, we continue to see growth in embedded systems and in SI services in the emerging economies solutions and also in digitization services. So, we had a fairly balanced growth in all of these in terms of new client acquisition in the last quarter. In the domestic market we are seeing increase in growth in insurance, banking financial services, especially as BFSI sector goes beyond just the traditional urban boundaries and goes into the rural micro financing and other solutions that are needed to penetrate the market better. We are also seeing growth in the retail sector, particularly, rollout services that we are offering. And we are seeing opportunities in the infrastructure sector, which includes transportation, rail, road, shipping and port, and the construction sectors, because all of these sectors there is amount of technology spend which is happening, in terms of modernization as well as in terms of new solutions that these customers want.

Priya Rohira: Sure. And what was the absolute embedded revenues in the current quarter versus the last quarter?

JK Gupta: Current quarter absolute revenues is about Rs. 40.4 crore and Q2 was Rs. 39.8 crore.

Priya Rohira: Okay. And that is purely because of the December quarter seasonality and do you see this improving in the coming quarters as what you indicated given the fact that embedded has got 98% international revenues?

JK Gupta: Yes basically, December seasonality because additional SOWs become slow and some impact of exchange variation that is also there. So I think in terms of exchange last quarter has been pretty

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bad, and in the quarter end we had about Rs. 44.74 and touchwood unlike last quarter I mean in October, in the beginning, we had a big hit, this time at least the dollar has taken a rebound and it is currently prevailing at around 45.25 or so. And I hope going forward this kind of a shock will not be there.

Priya Rohira: Sure. And just one more data point. You mentioned TCS contributing 49% to the current quarter or was it for the nine months figure?

JK Gupta: This is current quarter figure that I gave.

Priya Rohira: And how much would have been in Q2?

JK Gupta: Q2 was also around 49%.

Priya Rohira: Sure. And also just one more data point with respect to selling and marketing team, you did mentioned that 25-30 people additions were taken in the first nine months, what is your total strength and how would you divide it between say international and India market?

R. Ramanan: Total manpower?

Priya Rohira: Yeah, the sales team.

R. Ramanan: In the international market we have about 12 locations in the US, we have three locations in Europe and we are having Middle East, Africa, we have a location in Middle East, but we are having at least three people looking at the Middle East area. So, roughly we have about 20 people who are looking at the international market and in the Indian market we have close to about 55 people. Of course, international market is very actively supported by the SBUs and we have people who fly down on a need basis, because the cost of maintaining somebody there is higher and unless there is a particular opportunity we do not need to locate all those people there. But we are looking at increasing our presence in Europe and UK and also in Africa.

JK Gupta: Just to give you another data point, Priya, because of this additional investments that we are making in sales and marketing effort and some of the non-hiring initiatives also as Mr. Ramanan said regarding e-Pragati and some of those initiatives, which are like trying to nurture some of the new market and all that, because of which our SG&A expenses we have increase in Q3 to about 11.2% compared to 10.2% last quarter. So, these are some of the investments that we are making for future business growth.

Priya Rohira: And this feature in your others part of the cost of revenues?

JK Gupta: It is not cost of revenue, it is an SG&A expense, this is part of unallocable expenses.

Priya Rohira: Okay sure. It was 11.2 versus 10.2 in Q2?

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JK Gupta: Yes.

Priya Rohira: Sure. And just one more data point with respect to the SEZ. You mentioned just to recollect that June 2011 you expect both the blocks being operational?

JK Gupta: That is right.

Priya Rohira: Okay. I just wanted to confirm on that. Thank you so much and wish you all the best.

Moderator: Thank you. We have a follow-up question from Bharat Sheth from Quest Investments. Please go ahead.

Bharat Sheth: Just, JK, this e-Pragati business which Mr. Ramanan says, is it a part of the E&T business?

JK Gupta: No, no. e-Pragati is a general market development. Basically, trying to address some of the Tier-2 and Tier-3 cities because they have got some different kind of IT requirements compared to the bigger cities and bigger players so that is the basic. It is not only education and training. That also of course be a part of e-Pragati initiatives, but there are other areas that are due to happen as a part of e-Pragati.

Bharat Sheth: Just can you give me your view on this E&T business which is still at sluggish I mean?

JK Gupta: Mr. Ramanan has explained more on the business side of it. I think from a very concerning kind of situation in E&T business we have come a long way in terms of that bringing it back. On a nine-month basis, E&T revenue had grown about 42% from Rs. 28 crore to about Rs. 39 crore and the profitability we have brought it back to around 20%. Last year same period of nine months we had a profitability of 6.3% and this year in nine months period we have grown it to about 20.8%. We have been sharing with all of you that if we are able to pick up the volume, E&T should give us about 20% kind of profitability. I guess we have turned around the E&T business.

Bharat Sheth: But when do we see a meaningful contribution to a total size of the company?

R. Ramanan: That is a fair question that you asked and it is the whole intent was first to ensure that we are reversing the trend that was happening in the company and again I would say we have gone through a phase just like we did before in CS business or in CMC's business where we had to wean ourselves away from non-value adding services into value adding services. In E&T, the nature of the deals is slightly different. We were in the services business but the focus was not on creating jobs but more on conducting training. And when you had that focus, you are having a lot of centres and they were all disseminating trainees, but you are not attracting the right crowds and not attracting the right profitability and the pricing point and so we have moved away from that into growth segment. The growth segments being job enabling training programs, corporate training and we have also embarked upon international training during this quarter. So, we have

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beefed up our sales force as well as we have inducted new leadership in E&T and you are absolutely right in saying that from now on the focus has to be how we can grow and scale us. So, we brought back our margins also to a respectable level in E&T operation. So, we have grown like JK said about 42%, which is not a great growth, but it is definitely a positive trend, and we do expect that over the next year, we are going to scale up in a substantial manner.

Bharat Sheth: Thank you very much.

Moderator: Thank you. The next question is from Priyesh C from Enam Securities. Please go ahead.

Puranik N: Couple of questions. One is I think you guys have stabilized the overall margin and growth rate and the next phase of growth from here on should be to take the sensible top client growth coming in. What I mean is sensible top line is businesses other than the customer services business. So, they are also sensible but they do not contribute to sensible margins.

R. Ramanan: Correct.

Puranik N: So, my question is going forward, how do you see this business contributing to both the top line and bottom line? And system integration and IT-enabled services business, these two are the margins business, the value business. The customer services is the volume business. So, these businesses, particularly, system integration business has stabilized and the IT-enabled business still has volatility. How do you get the top line margin stability in this business? And also in terms of the deal sizes, have you relooked at the deal sizes, are they getting better today, are you getting a deal sizes which are significantly larger than what it used to be? At the end of the day the scalability comes from taking large projects, long projects, bidding for like what you do in the embedded systems business.

JK Gupta: Puranik, I think I will first throw some light on the margin question that you have raised and after that possibly, Mr. Ramanan can take over. First, if you look at this two segments that you have rightly identified that SI and IT-enabled services are our value driving business segments. And in both the segments we have got profitability of over 30%. But when we look at this year trend compared to the last year, I think we are firmly focusing on and firmly getting our revenue growth in these two segments. Look at SI segment. We have grown our revenue 24% this year in the nine months period and we have increased our profitability from 28.3% to 30.8%.

Puranik N: That is exactly I want. That should happen to the overall company. You have a top line growth of some 35%, bottom line growth of some 23-24%. Your bottom line growth should ultimately be greater than the top line growth.

JK Gupta: That is what I am saying. If you look at the overall revenue growth is 23%, but within that IT-Enabled Services have actually grown 59% from Rs. 79 crore to Rs. 125 crore. So I think it is very much exactly as per our game plan and there the margins are above 35.3%. I think we have been sharing that when we actually scale up significantly in this business segment, there could be

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certain softening of the margin and we have been actually saying that over a longer period we should be actually looking at a margin of somewhere close to 30-32%, but we are still maintaining at about 35.3%, the biggest margin driver for us. And SI also we have increased our margin by about 250 basis points compared to last year and we have delivered revenue growth better than the average. Now, CS segment, which is a bit lower profit segment, the growth is only 4% from Rs. 189 crore to Rs. 197 crore, but again expanding margin from 7.6% to 9%. In education and training we have grown 42% and we have corrected our margins from 6.3% to 20.8%. I think if you look at the overall performance in the nine months period it is precisely as per our game plan, focusing on value-added business, growing where the business should grow, not growing where business should not grow and the whole restructuring of the margin structure and all these things that have happened, I think it has very clearly reflected in all the business segment.

Puranik N: So you think that you have achieved stability in terms of revenue from net margin profitability and growth as far as these two businesses are concerned, System Integration and ITES.

JK Gupta: Yeah, I guess so. The numbers are actually telling the story.

Puranik N: So, there is unlikely to be any volatility as we used to see in the past?

JK Gupta: Yeah, I think first nine months of this period are a reflection of what we had been promising.

Puranik N: Excellent. And in terms of customer services, what is the margin outlook for that? And also I was asking Ramanan about what are the deal sizes today? Are they larger, longer, better deal sizes because that is what help you get the top line and bottom line growth.

JK Gupta: Again, here I will comment on the margins first and Mr. Ramanan can take over. I think in customer services we have been seeing a margin structure of around 10% and in nine months period we have 9%, so I think it is more or less within the line with what the reasonable profit we have taken in this segment. The reasons for that is that one, it is the hardware integrating the business segment. Second is heavily domestic-centric. So the services also will not attract the same kind of margin as we have got in the international market. So, my feeling is that the margin structure in all the business segment that we have got is completely in line with the business characteristics of the businesses. So, there is no concern on margin front. That is what my feel is. And with regard to the growth, Mr. Ramanan..

R. Ramanan: So, I think Puranik, a couple of points which you have emphasized which I think are very important point for CMC to focus on which we are focusing on. One is SI and ITES, we will continue to focus and I think we are right on track in terms of our plan. CS and E&T are the two businesses which need now additional focus. And both these businesses the scaling possibility is even faster than ITES and ES. But we have to get the right business mix. So, one of the focus that we are driving the organization towards is in CS business we need to have at least 50% in the international business. The day you have that you are going to see a completely different

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system of CS and so there is a conscious focus on how do we increase our CS business mix and see how quickly we attain this 50% international business.

Puranik N: So that will come through go-to-market with TCS or your own sales?

R. Ramanan: Both. So clearly, there is an opportunity synergize with TCS but that is also an opportunity for us to do things directly. The other part in the domestic market, in CS, we want to be in the latest – see, one mistake we have done over the last several years is we have got into such routine items, like the desk-top management and printer management, which can be done by any normal body shop today, so we want to move away into a high end data center management, surveillance management, storage management, virtualization, so you have to move from a trouble-shooting service to a consulting service.

Puranik N: Very good. I am very happy you are coming back to DNA business now.

R. Ramanan: Yeah. If you move into that area, then you may still get the downstream implementation but the consulting service will generate enough margins to compensate for the downstream segment which you can even outsource and you can make good money.

Puranik N: And this can be 30% plus margin business?

R. Ramanan: Absolutely. Like for an example, rather than saying I am Manager – Desktop, if I say I am Manager – IT Shop, that is the different ballgame altogether with a very high margin. So, this is the focus for that we also need to have people with the right skill within the company. But the good part is that we have proof of this everywhere. So it is not like you are building from scratch. For some other companies it will be difficult to so. I mean today I am managing ONGC across the country. I am managing railways across the country and so on. At one point in time, we actually did this consulting and then got only into desktop support service or facility management service. That is where the margins go down which can be done by somebody else. So, you have to go back to the high end. And if you have 50% international, you will see the same thing like how you are seeing in ITES right now.

Puranik N: And this would be typically large deals? Most of these projects.

R. Ramanan: Typically, they would be large deals, because the infrastructure management – our differentiator is I can do a Pan-India, Pan-enterprise, Pan-state, Pan-country type of service, which is what we should focus on rather than going into some small companies then I will do this.

Puranik N: Do you expect 10-20% of your revenue coming from the service?

R. Ramanan: 10-20% of our?

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Puranik N: Total revenue coming from the service, I am talking about CS revenue, which should be about 10-20% at least.

JK Gupta: In CS also in first nine months we have got revenue of Rs. 197 crore and out of these about Rs. 31 crore is international revenue, so we already have around 15% of revenue coming from international.

R. Ramanan: We need to scale it up. On the question that you asked, are you seeing large deal sizes, yes, we are seeing that.

Puranik N: I see. What are the deal sizes currently?

R. Ramanan: I know you will ask me that question.

Puranik N: We want large deals; you do not take large deals.

R. Ramanan: What I am saying is that we are seeing larger deal sizes coming and we are also winning some larger deal sizes.

Puranik N: Excellent.

R. Ramanan: So I do not want to give any details on that, because we normally have not been sharing to that level and I am not sure whether JK will…..

Puranik N: No, my question is not a typical deal size, my question is in terms of your approach to bidding, is there a conscious approach that bidding for 1 crore, 3 crore, 5 crore.

R. Ramanan: No, no, absolutely.

Puranik N: I will go for say 25, 50 crore deal, so that makes a serious management sense to be in that business, that is what gets you to a scalability bracket.

R. Ramanan: Yes, our planning and our focus is to win larger size deals.

Puranik N: Larger size deals?

R. Ramanan: Yeah.

Puranik N: And you talked about this digital township, so I think that is the kind of deals that you should be doing, is it not?

R. Ramanan: Absolutely. And those are the larger size deals and they are the value adding deals and they are profitable deals.

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Puranik N: So typically a digital township kind of a deal will be pretty large size deal?

R. Ramanan: Yeah, it can be anywhere between 5 to 25 crore.

Puranik N: About 25 crore? And will have a margin of 30%?

R. Ramanan: Good margins.

Puranik N: Good margins?

R. Ramanan: At least about 20%.

Puranik N: So you qualify? You said your definition of good. The other thing is about your definition of non-linearity, I want to understand, because you seem to be clubbing this embedded business also in non-linearity, that is not problem as long as you are using tools or methodologies or IPRs in there, what percentage of that in the embedded business is the real non-linear, not just the fixed price non-linear, high margin non-linear?

R. Ramanan: Are you saying asset based?

Puranik N: What?

R. Ramanan: When you say non-linearity, are you saying asset based?

Puranik N: Basically, non-linearity is the incremental cost for any given service you deliver is much lower than the incremental margins that revenue that generate. So in that context, typically, in an embedded, I am trying to understand how much of embedded services are driven by the IPR?

R. Ramanan: I will tell you. See, any work that we do in embedded, typically, the IPR would still belong to the customer because he is outsourcing his R&D, but the non-linearity part come where instead of being asked to provide 10 resources you are asked to develop 10 products. So, there your margin and your profitability everything goes up. Because there the customer is telling you now that take charge of this product and then when you take charge of that product development then there comes automatically a value addition which is in terms of designing, in terms of even requirement specification, customer interactions and all of that stuff, which otherwise does not come in if you are just providing – that can be a simple ODC type of service also in embedded systems where they say you give me 50 resources, 50 plus-plus, and I will give you all the work and you are under some ten managers in the US, that model is not what we are going after.

Puranik N: So, this is more of OPD business which will have architecture design and all that?

R. Ramanan: Absolutely.

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Puranik N: So that is how they are different?

R. Ramanan: Exactly.

Puranik N: So in terms of Infrastructure business how big you are going to be going forward including the Cloud?

R. Ramanan: Right now it is difficult for me to give you a number or estimate, but what I would say is the broad guidelines that I had set, 50% of our business should come from international and at least 30% of our domestic business should come from high-end consulting that is the sort of -- business mix if I am able to achieve then the question is of scaling up.

Puranik N: Good. Wonderful Ramanan and JK. Thanks a lot.

Moderator: Thank you. The next question is from Priya Rohira from Enam Securities. Please go ahead.

Priya Rohira: Just a follow-up one more question on dependence on the government's top PSUs in India and how do you see the visibility over the next two to three years given the pipeline of e-governance assignment and given your domain expertise over there?

R. Ramanan: If you read the paper it looks very good. Lot of these projects get – there is definitely going to be large amount of spend in because of UID itself. Because UID itself is ushering in a lot of changes to existing applications, both in the government sector and the private sector. That is we are seeing increased government spend in e-governance project particularly related to government citizen services, portals, treasury management and tax computerization type of projects. There are a quite of few states who have still not got this Wide Area Network set up so there is still opportunity there. And we are also looking at stage data center getting implemented. My own conclusion from that is you cannot have a data center without a lot of applications running on it, otherwise, the investment on the data centers is actually away, so, there would be an opportunity for companies which can creatively come up with applications which run on the data centers and which could be transaction-based or Cloud Computing-based pricing structures can be there and with the economy also growing well, I do not see any reason why there should not be enough opportunity for all of us.

Priya Rohira: Would it be possible to either quantify in terms of the size of the opportunity over the next two to three years, how do you see it for yourself?

R. Ramanan: In terms of numbers you are saying?

Priya Rohira: Maybe directional trend you see it at least growing for you see, today, your dependence will be say 27-28%, and how do you see this increasing purely because of some of the wins which you would have in that particular segment?

R. Ramanan: We definitely want to grow in the domestic market at a minimum of what the industry is growing, but probably, faster than that. And the industry is right now growing at about 20% I guess.

Priya Rohira: Okay. And what was the quarter's dependence on PSUs then to government entity?

JK Gupta: Government business is about 30-32%.

Priya Rohira: And it remains similar as Q2, right?

JK Gupta: That is right.

Priya Rohira: Thank you so much.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I would now like to hand over the conference back to Mr. Ashish Aggarwal for closing comments.

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

JK Gupta: Thanks a lot, Ashish and thanks to all the participants.

R. Ramanan: Thank you very much and Happy Pongal and Sankaranti day to everybody.

Moderator: Thank you. On behalf of Tata Securities Limited that concludes the conference call. Thank you for joining us.

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