

Transcript

Earnings Conference Call of CMC Limited – Q3 (FY 12)

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

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Moderator

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

Ashish Aggarwal

Thanks Lavina. I welcome all the participants for the CMC limited FY12 results conference call. Today, we have with us Mr. Ramanan – MD & CEO and Mr. J. K. Gupta – the CFO from CMC Limited. Without much further ado, I would like to handover the call to Mr. Gupta for his opening remarks. Over to you sir.

J. K. Gupta

Thank you Ashish and very warm welcome to all the participants in this call to discuss the Q3 results of CMC. CMC announced its Q3 results on Friday and I am sure all the participants had an opportunity to go through the results. I will just take you through some of the key highlights of financial performance of this quarter before I hand you over to Mr. Ramanan to take you through some of the business initiatives and the strategic initiatives that we have taken during this quarter.

Company had a very good quarter 3 with highest quarterly revenue in this quarter. Our consolidated operating revenues in Q3 were Rs. 395.84 crore, which is an increase of 45% YoY and 11% QoQ. Revenue including other income crossed Rs. 400 crore mark for the first time. The revenue growth that we got was broad based with almost all geographies and business segments contributing to growth. India revenue was at Rs.152.33 crore which is a growth of 23% YoY and 4% on a Q-on-Q basis. International revenue during the quarter is 243.51 crore which is a growth of 63% YoY and 15% Q-on-Q. International revenue share in total revenue from sales and services improved further to 61.5% from 59.1% in the last quarter and 54.7% in Q3 of last year.

America continues to drive growth in international business. American subsidiary of the company is CMC Americas grew 55% YoY and 4% Q-on-Q in dollar terms. Share of American geography in the overall operating revenue increased to 51.1% in this quarter.

Services revenue grew 44% YoY and 11% Q-on-Q to Rs. 351.84 crore and share of the services revenue in the total revenue from sales and services increased to 88.9% compared to 88.6% in the last quarter.

The company earned its highest ever consolidated operating profit that is EBITDA of Rs.60.02 crore in Q3 which is an increase of 14% Q-on-Q and 19% YoY. EBITDA margin during the quarter was 15.2% versus 14.7% last quarter. Company earned consolidated profit after tax of Rs. 41.37 crore giving a PAT margin of 10.3% versus 9.0% on Q-on-Q basis. Average effective tax rate during the quarter was 29.2%. Effective tax rate during current year is higher due to STP tax concessions phasing out during this year. SEZ Operations, as we mentioned earlier, commenced in April 2011 which will enable us to reduce effective tax rates in the coming quarter. We initiated our second SEZ in Kolkata during this quarter with 350 seats capacity which will enable us to serve our international customers better.

Business outlook of the company remains robust. Company added 21 new clients across geographies during the quarter. Four of these clients were added in Americas, 2 in Europe, 1 in MEA and 14 in India.

Our other income during the quarter was Rs. 4.26 crore which included income from Mutual funds investment at Rs. 3.54 crore.

Company added 1474 employees during the quarter, taking the total employee strength to 9974. Attrition rate of the employees was down to 18.7% during the quarter from 22.2% in the previous quarter.

Company ended the quarter with cash and cash equivalent of Rs. 226 crore after meeting the several expenditure of Rs.27 crore during the quarter. Out of this Rs. 226 crore, company had investment in debt based mutual funds to the extent of Rs.173 crore.

So this was the brief snapshot of financial performance of the company during quarter 3. With this, I hand you over to Mr. Ramanan to take you through some of the initiatives on business growth and business strategy front. Mr. Ramanan..

R. Ramanan

Yeah thanks J.K. and good morning to everybody and thank you for joining the call. As J.K. already shared in terms of the numbers, we are quite pleased with the performance that CMC has been able to establish in this quarter and is in line with our continued focus on growth that we have been sharing with you over the last year. It's also pleasing for us to note that we have been able to maintain our business mix of about 88.9% as value adding solution and services even as we have grown to the current quarter numbers. And it is a happy milestone for us to cross the Rs. 400 crore mark in total revenue for the company with the operating revenue as Rs. 396 crore.

Also geographies that we have been focusing on have resulted in good dividends for the company. We have been able to grow not only in the Americas but also in other international geographies and we have been able to, as a result of that, add 21 clients to the base that we already have.

We have also focused sharply on people excellence and people productivity initiatives in the company and J.K. has probably not shared the productivity numbers but our productive numbers have also gone up. And we have also been awarded PCMM Level 3 Certification during this quarter which is a very important achievement for us in terms of People Excellence Process and People Productivity Enablement.

We have also been recognized for corporate governance by the Institute of Company Secretaries. This is something that we are proud of. We have been

ranked among the top 7 companies in the country in terms of corporate governance. And this is the second time in a row that we have been getting and we will be striving to continue winning this recognition in subsequent years and also be more transparent in the way we are running the affairs of the company.

In terms of each of the SBUs and I am happy to share that all the 3 strategic SBUs CS, ITES, and SI have shown good growth in terms of revenue ranging from 10% to 14 - 15% in each of SBU. E&T had a flat quarter but we still have a Y-on-Y growth but in terms of the quarterly performance we did expect some amount of flatness in the performance because of the fact that this is typically period where you have a number of holidays and also people are studying for their exams for the coming quarter.

We have been able to ensure that our asset based solution and services thrust have gained momentum. In fact we are looking at growing with the Middle East-African geographies where our solution related to transportation, insurance, ports and cargo, and e-governance would gain momentum in these markets because of the similarity of reach and the environment which enables us to position these products very effectively.

We have also been focusing on strengthening our presence in the European market. We have strengthened our sales presence now in the European market and we will also be strengthening our sales presence in Americas in the coming quarters. This will help us to keep the momentum going in terms of new client addition as well as additional growth in embedded systems, digitization and work flow management systems, and in SI solutions in these markets.

In terms of people count we have added 1474 people during this quarter. Of course as we all know we will maintain a very healthy balance of regular employees and contracting manpower. And this is in order to make sure that we are appropriately staffing for projects which are of a nature demanding skills both senior levels and experience levels as well as at junior levels. We will continue to add our employee to the base in the coming quarter and as we build our business plan for the coming year.

In terms of the opportunities and pipeline that we see, we see for CMC in the areas that we are in. We continue to see good opportunities both in India as

well as in the international markets. And with more utilization of our SEZ work space that that we have already built both in Gachibowli as well as in Kolkata, it is going to help us in our profit after tax. I am very happy to share that between the last quarter and this quarter, as J.K. has given the numbers, we were able to grow 27% Q-on-Q on our PAT number and we hope to continue improving our PAT through better leverage of our SEZ facilities.

So with that both J.K. and I will be very happy to answer any questions that you have or provide any clarifications that you may need

Moderator

Thank you very much. We will now begin with a question and answer session. The first question is from Priya R from, please go ahead.

Priya R

Yeah, hi, good morning to the management team and congrats on good set of numbers continuing growth momentum in the good top-line front. Just a couple of question, one in terms of how do we see our margin outlook because last 2 – 3 quarters we have seen an acceleration in the top-line growth. Are we investing at a much higher pace compare to what we had earlier envisaged for margins will remain in the narrow band? Second thing is if you could just also share of exports in each individual business. Third, what would be the share of TCS in our revenue and fourthly, if you could also give us the effective tax rate which one should take in to consideration for FY12-FY13?

J.K. Gupta

Priya, I will answer your later 3 questions first before Mr. Ramanan takes up the first question.

Priya R

Sure.

J.K. Gupta

You wanted to know revenue from TCS during the quarter?

Priya R

Yes Sir.

J.K. Gupta

It is 54%..

Priya R

And that's gone up from 49% in Q2.

J.K. Gupta

Last quarter was 50% so from 50% to 54%. And what was the next question about domestic and international in various business segments?

Priya R

Right Sir.

J.K. Gupta

So, let me give you few data points. We have total revenue of 93.15 crore in CS we have total revenue of 93.15 crore out of which domestic is 81 crore so 12 crore is international. In SI our total revenue is 228 crore, out of which domestic is 36 crore. In IT enabled services, total revenue is 55 crore of which domestic is 20 crore and E&T is all domestic. Third thing, this quarter our tax rates are down to 29.2%. Last quarter we had an extraordinary tax of Rs. 4.46 crore on dividend distribution. In case we remove that impact in the last quarter, our effective average tax rate was 30.2%. So this quarter we have come down to 30.2% to 29.2%. We are expecting Q4 tax rates to be around between 27.5 – 28%. So effectively this year tax rate will remain higher. But I think in the next financial year that is fiscal 13, I guess our effective tax rate should be anywhere around 24% or so. This is slightly higher as compared to what we had envisaged earlier. There are 2 reasons for that. Number 1, we have got higher onsite profitability of America. In America, onsite profitability is taxed at an average rate around 38 – 39% that's the one reason. Second is that, we were initially expecting all the new international businesses to be executed out of SEZ but what happened as some of the businesses is an extension of old contract which we are not technically able to give it to SEZ so STP operations continue. So because of that reason, there is a bit of you can say about 100 – 200 basis points higher tax rate as compared to what we had originally envisaged.

Priya R.

Okay and what would be the share of government vertical in overall revenue?

J.K. Gupta

Let me just work it out. I will give it to you later.

Priya R

Sure and Mr Ramanan if you could just throw light on the margins outlook, how do you see the buoyancy in the revenues which you have seen in the past 2-3 quarters continuing?

R. Ramanan

Yeah as I was just sharing, we are making necessary investments to continue our growth momentum first of all. And so we have been sharing the view that we would like to operate in the 15 – 17% operating band of EBITDA and to ensure that we are able to continue the growth momentum that we have been targeting. We have able to achieve improvement in margins and I feel that possibility is still there as far as continuing improving our margins but we

would be taking adequate steps for ensuring necessary investments both in product development, R&D as well as in manpower in a proactive manner so that we are able to enable growth. We want to ensure that we will continue maintaining our business mix of value adding solutions and services, to at least 85%. So we have been taking this consistently. We are operating at 88% right now but one should be ready to see our value adding solutions and services to be operating in their 85 – 90% range. In terms of international markets, we are focusing on value adding solutions and services as well as the hi-tech area for embedded systems and we see potential for CMC to continue both in existing accounts as well as new accounts. Of course the international market you do have the rupee volatility and the dollar volatility which we have to closely watch and JK is taking adequate steps to address that. But that notwithstanding we will be increasing our utilization of SEZ which will also result in better profit after tax for the company.

Priya R

Sure. And if you could just throw a little bit more on how the government version of performance has been and how do you see this in FY13 especially in the backdrop of your UID project?

R.Ramanan

The government project, we have been very good SI projects. We have 14 clients who recently added in India out of which about 50% of them came through the government. We have been adding in very specific areas, related to solutions that we have for example, the transportation sector, we have got GPS based vehicle tracking systems that CMC had developed. And which we will continue to focus on, we did have some wins in Karnataka State Transport Corporation which we are trying to replicate at other places. We have also been able to build e-governance project particularly in Police computerization in the CCTNS in this space which is again a core competency that the company has and we see the opportunity of replicating the CCTNS in other states because that is an initiative to roll it across to many other states in the country. And the third area that we have been seeing in the government is in the area of treasury management that CMC has been able to implement solutions in Orissa as well as some of other Kerala and so on and we are seeing momentum there. We are also seeing momentum in digitization projects particularly the projects related to digitization of man records or in spot billing and meeting which is combination of core digitization and some services related to ES. So in terms of the UID projects we are looking at what is happening right now. I think most

of the UID projects are in a state of suspense because of the clarity that is required in terms of who is going to be owning what portion of the UID projects whether it is UIDAI or whether it will be the Registrar General and so on. So we are waiting for that clarity but I think that is just a matter of time before it gets decided who is going to do what and in terms of the opportunity, we are still looking at the opportunity in the UID space. We are already there as you are aware in some of the key UID projects. But I guess that momentum will gather only in the next financial year.

Priya R. Okay, That's helpful and if you could just revert later what is the share of government vertical to our top-line?

R.Ramanan Yeah that I will ask JK to do that.

Priya R. Sure. Thanks so much and wish you all the best.

R.Ramanan Thank you very much.

Moderator Our next question is from the line of Dhananjay Misra from Sushil Finance, please go ahead.

Dhananjay Misra Good Morning. Congrats on good set of numbers. Just one question about our CapEx. Till last quarter we had done about 56 crs and this quarter we have done 26 crore. And for full year we were targeting 200 crore, so have you seen any deferment on CapEx plan because for Q4 years we have to do about 120 crore CapEx to reach a 200 crore target.

J.K. Gupta Last quarter we did almost the same level about Rs. 26 – 27 crore. This quarter also we have done Rs. 27 crore. Our cumulative CapEx for the first nine months have been Rs. 82 crore. There would be certain phasing differences of CapEx, we expect full year CapEx to be around Rs. 135 – 140 crore now.

Dhananjay Misra Okay so we are bringing down from 200 crore target to 135-140 crore. What will be the next year target then after deferment?

J K Gupta Next year initially we were thinking doing about Rs. 100 crore next year but all the deferment that are there in this year, will get added to next year. We are still to work out the CapEx plan for next year which will be part of business plan but I guess this should be in the range of Rs. 200 – 250 crore.

Dhananjay Misra Okay. And sir one question on this subcontracting cost. You had indicated last quarter that it should go down because we had initial ramp up in some project because of that the cost had gone up but still in this quarter it has gone up to Rs. 121 crore, so can you throw some comment on that?

J K Gupta I remember having shared with you how we should look at subcontracting cost. My sense is that we should look at subcontracting cost along with staff cost because it is arising out of various modes of hiring people that we have done based on the nature of business that we are executing. If we add both staff cost as well as subcontracting cost, it has remained at the same level. Last quarter we had 60.5% of operating revenue as staff and subcontracting cost put together. This quarter we have got 60.4% staff cost and subcontracting cost put together.

Dhananjay Misra But from earlier quarter if you compare it has gone up about 3%. Earlier it used to be 56-57% now it is about 60%. So I mean we should take.....

J K Gupta It is true. You have seen that we had given some salary increases in the last quarter so that was bound to have some impact on the people cost. That's what we shared in the last quarter itself.

Dhananjay Misra What is your break up of current staff, in terms of contract and permanent?

J K Gupta We have got 4545 regular staff and 5429 contract staff as on 31st December.

Dhananjay Misra Okay. And the last question about what was the benefit from Rupee in this quarter in terms of our America subsidiary in terms of what kind of growth we have seen Q-on-Q?

J K Gupta In America we have seen 4% Q-on-Q growth in dollar terms. And the benefit in Rupee terms, this growth works out to around 16% on a quarter-on-quarter basis.

Dhananjay Misra Okay and what was the absolute number for America subsidiary in terms of dollar?

J K Gupta It's about \$39.6 million.

Dhananjay Misra Okay that's all from my side.

J K Gupta

Thank you.

Moderator

Our next question is from the line of Radhika Merwin from PUG Securities, please go ahead.

Radhika Merwin

Broadly in Systems Integration I wanted to understand the nature of growth that has come in because we have been talking about predominantly onsite ramp up that are happening in that space. So some color on the nature of the project, are we seeing those other opportunities we were discussing in the SI space apart from embedded solutions?

R.Ramanan

Yeah I will answer that. We have been having increased offshore growth and we have had an increase in offshore revenues during the last quarter. We are expecting that momentum to grow further in the coming quarter as we had mentioned earlier also we had won some key projects in the US which have an initial onsite ramp up and onsite transition phase. Typically the onsite transitions are between 3 – 6 months. And by the end of this quarter you are going to see the impact of many of that in terms of results in off shore growth. We had won these projects about a quarter ago, these got initiated a quarter ago though we had won it in the previous quarter. And so you will see a ramp up. Second is we have won a new project, of the clients that we have mentioned, out of the 21 clients we have won some projects, several international clients. All of them would have offshore revenue and that will continue to have further impact. We have also been able to increase our solutions implementation in the international market. So there is a licensing component but normally we don't indicate it separately. We integrate the licensing component in the service component of the project and in terms of more uniform billing and so on. So we will see benefits of that even though it will not be immediately services but the licensing component of the revenue will kick in as and when we implement these solutions.

Radhika Merwin

Sure. That was very helpful sir. On the margins I just want to understand a little bit further. If I look at individual services like your SI or ITES is, so we are at the margins we were talking about 25%, 30% in terms of ITES but when it comes down to overall margins, these additional investments that you are making over the quarter on quarter basis, just want to understand the nature of these investments because since it is not apportion to any particular service

line, what is the nature of this additional expenditure which were incurring on increasing basis quarter on quarter?

R.Ramanan

Yeah there are 3 characteristics of the investments in it. One is in R&D. we are strengthening our product portfolio and we are ensuring that the product that we are having now, we are really making them available in the international market. We have had initial clue successful implementations in the international markets and we know exactly what is required in order to do that. That is one part. The second part is, we have a new focus on CMC 3.0, I have shared with you last time. CMC 3.0 is a strategy that we are adopting in terms of our growth and the new areas that we need to focus on during the coming 5 years to 10 years. In that, these components which we are very sharply focusing for every solution that we have, for every product that we have and for every service line that we have. This is in the cloud area, in the mobility area and in the analytic area. So for example if I look at my solution and my product, are they cloud enabled, are they mobility enabled to take advantage of the rapid scale up of mobile phones, mobile apps, the new operational systems like android and I phone and windows phone and so on so that our products are in tuned with the expected usage of both the cloud and the mobile devices and the smart phone devices in the market. Similarly we are adding the component of analytics in each of our products and solutions because take our insurance product, we already now have an excellent base of customers in India and we are targeting this for international market. We want to make sure that it is directly enhanced with analytic tools which will help analyze the data and help our end customers to be able to take better decisions. Already our product is flexible in terms of being able to consider new products but how you consider the new product, the decision for that has to be based on the analytic tool available in our genesis product. So we have an initiative for example in genesis which is called genesis mobile, genesis cloud and genesis analytics and this is going to drive the further growth of the product. And the other side for the standard services that we have take for example infrastructure management for digitization and work flow management or embedded system management, there is a requirement for mobile infrastructure management, cloud infrastructure migration and mobile application in the embedded space as people want to manage the devices over the cloud or through their Smartphone and so on. So we are looking at strengthening our service capability in all the SBU which is in line with these 3 strategies that we have adopted. So this is the

second part of investment. The third part of the investment is on people and processes and investor structures which we have to proactively hire people and train them on these technologies even before we can win a project and therefore tremendous focus on proactive hiring and proactive training and setting up the infrastructure to enable that. These are the 3 categories of investments that we are doing and therefore we don't want, if we have to grow then we have to make these investments before we build the project otherwise the catch 21 situation where you try to win something and you cannot without making the investment.

Radhika Merwin Sure sir. That was very helpful. So if that were to be kept in mind then I would expect the other investments to stay around that level for the time being right. So you will continue to invest in these areas for a couple of more quarters.

R.Ramanan Yes absolutely. I would say we will continue to make the investments at least through the next financial year and you will see that.

Radhika Merwin Sure. Just one final, when you were mentioning about, the SI growth, if I take in dollar terms, and you are mentioning it comes to 4% in Q on Q, so is that sort of a moderation that we are seeing in SI or however viewed because if I really take out the rupee effect, the dollar growth is around 3 – 4%. So how do we view it going forward?

R.Ramanan I don't think too much we should be viewed in that. The fact that sometimes the SI growth in a particular quarter is more because initially there is ramp up, there is initially requirement specifications which get finalized and so in a particular quarter we may have 3 – 4% growth in a subsequent quarter we may have 6 – 8% growth. So that has to be continuous growth and some of these seed on to the subsequent quarters especially in SI projects. Because it starts out with some initial soup-to-nuts type of things you are having a soup, then the main course, then finally it is nuts so that's the sort of curve that you normally see on SI projects and we expect that. At the same time, what happens is as we move in to the post-project implementation phase, then comes the phase of steady revenue and steady sustainable revenue in terms of routine enhancement support, regulatory enhancement that we have to do for these products. So you see a mix of all of that reflecting in any particular quarter.

Radhika Merwin Thanks a lot sir. It was very helpful and wish you all the best.

- Moderator** Our next question is from the line of Nirav Dalal from Sharekhan, please go ahead.
- Nirav Dalal** Sir I just have book keeping question. I wanted to know what were the interim losses in the other expenses this quarter.
- J. K. Gupta** Can you repeat, I didn't follow.
- Nirav Dalal** The interim losses for the quarter? The ForEx losses for the quarter.
- J. K. Gupta** ForEx losses, exchange loss during the quarter was 28 lakhs.
- Nirav Dalal** Right sir. That was against 3.63 in the Q2
- J. K. Gupta** Yes Rs. 3.63 crore in Q2
- Nirav Dalal** Okay. Thanks a lot.
- Moderator** Yeah. We will take our next question from the line of Puranik from Enam Securities, please go ahead.
- Puranik** Ramanan and J.K congratulations for a wonderful quarter. I think couple of my questions has been answered but I have 2 questions, one is about the asset based solutions that you talked about and the large deals. In terms of asset based solutions, you also gave some examples of genesis, how you are making genesis look better, you are modernizing genesis. Give some examples of how you are taking other asset based solutions platform products to the next level in terms of the look and feel of the products and also in terms of ability to get large deals in these solutions especially in the way you work with TCS, to get large deals in this area. Because some time back you articulated that you will be billion dollar company and all that, for that purpose you need the combination of these 2 large deals in asset based and large deals in other IT services. It will be great to hear from you both.
- R. Ramanan** Yeah. Thanks Puranik and thanks for reminding us constantly that we should reach a billion dollar quickly. But yes you are absolutely right.

Puranik

You have all the character of becoming a billion dollar company.

R. Ramanan

Yeah. I totally agree with you that we have to ensure that we win large projects as well as both with TCS as well as on. The type of changes that we are doing for genesis, we are also doing like I said for every one of our key products. Now take for example other successes that we have had and which is due to such changes, we are actively looking at our Nirdeshak products. Our Nirdeshak products is a GPS based vehicle tracking system and we have implemented one of the largest one of the largest vehicle tracking system implementations in India for IOCL for over 16000 vehicles leveraging our GPS based systems. We have now taken this core product and we are enhancing it to address other sectors also. Because GPS based systems can be integrated in to an intelligent transport solution and ITS, which is intelligent transports solution are large scale SI project that are being adopted both by the government in various states. For example Karnataka State transport corporation, APSRTC, now recently Gujarat is going in for that. All the state would be going for intelligent transportation systems and there are 3 – 4 components in intelligent transportation system. One that is a GPS based vehicle tracking which is required, second you need sensor technology to be integrated for other purposes beyond just vehicle tracking. For example you want to be if you take a mining industry. Each of the vehicles are having a number of sensors in the cold mines or iron ore mined which they are digging. And we are just recently implemented for one of the large private sectors for mining companies in India. A complete end to end mining command and control system that integrates GPS with advance video surveillance system as well as sensor technology which is embedded systems and SCADA system based. So in this what happens is, if you see these projects are large projects which are end to end and which integrates 3 – 4 of our solutions together, so that we are able to be a single stop shop for such a project. Along with TCS in the international market we have won similar vehicle transportation system projects, in Africa, I cannot give the details of that. So that again is an end to end project where we play a role not only in the vehicle tracking but also in interfacing with other systems.

Puranik

So what is the typical deal size in this and international opportunities?

R. Ramanan

See a typical SI deal size in any of these projects would be anywhere between Rs.5 crore to it would go up to Rs. 25 crore.

- Puranik** Lot more on services and solutions only or it has hardware also
- R. Ramanan** I am talking about solution and services. There would be a TPP component in addition to that but we are restricting that to about 15% of our total revenue. And then typically these projects will call for national level support or it will call for state level support or it will call for an enterprise level support. So there is a major service component that kicks in afterwards.
- Puranik** And international opportunities?
- R. Ramanan** Even in international. In the SI project in the international also the same story is true.
- Puranik** I see. But you see lot more international because the deal says it can be bigger space?
- R. Ramanan** Yeah. The deals are only bigger but there we would also want to integrate the third party component, which are not developed by us. Because there the project would involve existing vendors and manufacturers who have already implemented some solutions there and we have to integrate with that.
- Puranik** And as your deal size is getting bigger and better in the last 2 years? Do you see that getting better?
- R. Ramanan** Well hopefully our revenue is indicating that.
- Puranik** Yes certainly. I think it is wonderful. You are in the right direction and keep doing this. All the best to you.
- R. Ramanan** Thanks Puranik. It's all due to support and encouragement from all of you and some very conceptive ideas we keep getting in these calls.
- Puranik** Wonderful. Thank you Ramanan and J.K.
- Moderator** Our next question is from the line of Niral Dalal from Almonds Global Securities, please go ahead.
- Niral Dalal** Yeah Hi. Given that the rupee has depreciated significantly this quarter by over 10% on average the currency, the margin benefit is quite muted at around 30 –

40 bps expansion, so can you comment on the same and even the extent of hedges that you have.

J. K. Gupta

Yeah, we started this quarter with \$18 million of hedge, of which \$9 million was used during the quarter and we carried forward another \$9 million for Q4 to be used at a rate of \$3 million per quarter. If you see because of this reduced hedge position, our exchange loss during this quarter has come down from Rs. 3.63 crore to Rs. 28 lakhs. You talked about the margin impact because we were carrying \$18 million of hedges has restricted the ability to get full benefit of exchange. Without that our profit improvement would have been better.

Niral Dalal

Yeah given that you had just \$18 million of hedges which is probably one – fourth of your quarterly turnover. large portion is still un-hedged. You should have gained from the Rupee depreciation.

J. K. Gupta

Actually we don't gain from Rupee depreciation in case of onsite revenue. We shared in the beginning of the call, that in this year we have got higher onsite revenue because of certain projects having initial onsite components which will later be transferred to off shore.

Niral Dalal

Okay so you will be having a higher dollar cost over there also which is offsetting the gain?

J. K. Gupta

Yeah.

Niral Dalal

Another question on the CapEx front. You have done about Rs. 82 odd crore of CapEx in this 9 months and based on the target you just mentioned you would be doubling the CapEx to about Rs. 55 – 60 cores in the 4th quarter?

J. K. Gupta

Yeah because the Phase-3 of SEZ have taken off. But there was little delay in finalizing the contracts for that and some initial work that the contractor was supposed to do before the work could gain momentum. The work has now gained momentum and we are expecting it to ramp up faster with larger resource deployment by the contractor. So based on the progress that he is making on the ground, we are expecting Q4 CapEx to be higher than what we have seen in first three quarters.

Niral Dalal

Okay fine and this is totally toward by SEZ development right?

J. K. Gupta

This portion is towards SEZ development. Out of Rs. 82 crore that we have spent in first 9 months, Rs. 61 crore have gone towards SEZ, remaining is other plant and equipment.

Niral Dalal

And the balance for this year would be predominantly for the SEZ?

J. K. Gupta

Largely SEZ because other than SEZ, expenditure is in the range of around Rs.5 to 6 crore per quarter, I think we are going to maintain that tempo. As we add more people, we need to increase our IT installations to take care of additional work, so this Rs.5-6 crore a quarter goes towards that and remaining money is SEZ.

Niral Dalal

Okay fine and if I look at your system integration margins, they are hovering at around 22 - 23% and if you compare this with the levels that you have seen throughout FY11 which are over 30% margin in this SI business. So when can we see any pickup close to these levels of 30% or whether we can actually see margins inching to those levels in this SI business?

J. K. Gupta

As we move more and more business from onsite to offshore, this margin expansion will take place and as it takes place, I think this will have a tendency to move towards 25%.

Niral Dalal

And when is that expected?

J. K. Gupta

Sometimes in the next financial year.

Niral Dalal

Okay so probably 2-3 quarters away?

J. K. Gupta

Yes, you can say 2-3 quarters away.

Niral Dalal

Okay fine and I believe that this UID project as you mentioned it is in a state of suspense. So I believe that would stalled the growth that the company is seeing like there have been delays even in probably some other projects as well. So can you just throw some more light?

J. K. Gupta

I just want to give one comment on UID. The numbers that we have reported here does not have any substantial revenue from the UID project. So we do not think that there is going to be any big concern with regard to our growth potential because of the confusion about UID. Of course if UID confusion gets

over and the project moves up, may be revenue can grow faster but the current numbers are not based on UID.

Niral Dalal

Okay and are you seeing any sort of delays or hiccups in any other projects as of now?

J. K. Gupta

No, all our other projects are on track.

Niral Dalal

Okay fine, thanks a lot.

Moderator

Our next question is from the line of Bharat Seth from Quest Investment. Please go ahead.

Bharat Seth

Congratulations Mr. Ramanan and J. K. We are talking a lot on the solution asset based business, so currently out of all these service revenues, we are approximately at what level and going ahead where do you like to see that?

R. Ramanan

J. K., you want to answer that?

J. K. Gupta

Bharat if you just look at, let us go to our SI revenue that we have got this quarter. Total SI revenue is Rs. 228 crore. I will say out of that Rs. 228 crore, about Rs. 128 crore should be categorized as asset based which includes our embedded solutions.

Bharat Seth

So, that is roughly 56%.

J. K. Gupta

Yes, but I am saying this includes embedded systems. I am categorizing embedded system as a part of asset-based solution.

Bharat Seth

And how much is embedded you said in this quarter?

J. K. Gupta

Embedded in this amount is about Rs. 63 crore.

Bharat Seth

So roughly it is around say 28-30% is our solution business?

J. K. Gupta

Yes.

Bharat Seth

So where do you like to see and how really that helps in improving our margin in that SI business? Ramanan, you have said a lot of initiatives and the investment that we are making on solution.....

R. Ramanan

See embedded systems are an integral part of our SI. In embedded system, the area that we are typically in right now is in product R&D outsourcing. So most of the companies who are engaged with us in embedded systems are actually outsourcing product development or portion of their product development or their product sustenance to CMC in key areas like for example we specialized in automotive electronics, we specialized in office automation electronics, we also specialized in communication electronics, and we are specializing in hi-tech for industrial systems, for example, process control and industrial systems. All of these companies use embedded systems for products which they market to their Tier-2 suppliers who are OEM suppliers to the assemblers of a particular end-equipment; it could be a car, it could be a printer, it could be railroad system and so on and so forth. So one of the things that the key in embedded systems is our ability to create what we call as IP blocks, we call it IP cores. IT blocks are not products per se, but they are an enabler to our product development. They encapsulate a certain functionality and a certain hardware design and a software design or a software development and both of these get encapsulated into an IP core or an IP block which becomes a part of a large product implementation for any company. So we are going to be investing in IP creation and typically this IP creation will not be of the nature of a genesis product. We cannot go and sell IP creation and say this is one product, but it can fit into many products. I will give you an example. We have something called FPGA which is fast becoming mechanism of designing hardware and it is a new technology, and we have field programmable chips that are created and you have to create small IP cores may be for a PC bars, may be for a serial bars and so on which enables a certain functionality and the companies which are wanting to outsource any product development was is confident of doing that because they want something like this to be developed or enhanced or even if they have something which is where they know that we have the IP creation capability. So this is what we focus on in embedded systems in terms of what we call as asset-based service because without his asset creation capability or reference point, he will not be able to even bring the last project that they are talking about.

Bharat Seth

So that is on one part and other this other solution which we have already created in transport sector, so how that you are looking at?

R. Ramanan

So what we are looking at is today we are having about 18 to 20% of our revenues coming from asset-based solutions and services. We want to increase over the next 3 to 4 years to this generating about 40% of our revenue and that means increase profitability and increase stickiness with that customer because once you have an asset-based solution versus a vanilla service. A vanilla service can always be replaced because it gets commoditized whereas an asset-based solution or the service, you have higher stickiness with the customer.

Bharat Seth

The second thing sir, question is for J. K., sir can you tell us in this Rs. 400 crore revenue, how much was foreign currency revenue and how much was the expenses also approximately in percentage terms?

J. K. Gupta

I can give you that. We had about 61% revenue coming from international market. Out of that 61%, about 84.5% of that is dollar based. So all in all, about 52% you can say roughly dollar based revenue of overall 396 crore.

Bharat Seth

And how much is sir in expenses side in terms of foreign currency because as you said there is lot of onsite work going on, so how much would be approximately that in expense term?

J. K. Gupta

Actually net revenue that we are able to repatriate to India after onsite expenses and all that works out to close to about \$5 million a month that is about \$15 million a quarter. Remaining is all onsite.

Bharat Seth

Okay sir and sir how do you see going ahead because once onshore work coming down and off shoring happening.....

J. K. Gupta

In fact currently if you see out of our international revenue, we had got almost 64-65% business happening onsite and offshore is about 35-36%.

Bharat Seth

Where do you like to see that?

J. K. Gupta

We would like to drive it to around 50-50 you can say, 48 - 50% offshore. That is what we want to drive at actually. It used to be at that level 2 years ago i.e. fiscal 2010 and we want to reach the same level.

Bharat Seth

Is that the reason our ITES margin also has been impacted?

J. K. Gupta No, ITES margin I think current level of 30% is what we have been saying is sustainable margin for this and we expect that margin to stay with us.

Bharat Seth Do you expect room to improvement in SI side?

J. K. Gupta That is right because SI is the one which has been affected because of its onsite-offshore.

Bharat Seth I mean where you were very hopeful on E&T, so anything happen on that front?

J. K. Gupta For E&T Q3 is normally a slow quarter.

Bharat Seth For a longer term, are we really taking.....

J. K. Gupta Over the longer term, we remain bullish about possibilities in E&T.

R. Ramanan Let me add to that. E&T continues to be a strategic area that we are focusing on. Like I had mentioned, we are planning to leverage our education and training capability into vocational training space as well as in job enabling training programs in the hi-tech area and in corporate education training and outsourcing so all of these three initiatives are in progress. During this quarter, we will be launching vocational training initiatives as I mentioned in the last quarter and also in our business plan for the year we will look at aggressive growth in the education and training space.

Bharat Seth So that is in investment phase, so over a period that will also help in improving....

R. Ramanan Absolutely and that will be an initial investment which is called for an E&T. E&T has more investment than many other more established areas and investment in terms of advertisement and other media has to be a little more than any of the other areas that we are in and so we are now hereabout where we want to grow and with that we will kick in the necessary investment for that.

Bharat Seth Thank you very much sir.

Moderator Participants that was the last question. I would now like to hand the conference over to Mr. Ashish Agarwal for closing comments.

Ashish Agarwal Thanks Lavina. I would like to thank all the participants for asking the question as well as participating in the call. I would also like to thank the management for giving us an opportunity to host the call. Thanks a lot.

J. K. Gupta Thank you Ashish and thanks to all the participants in this call for taking time out to discuss CMC Q3 results. Thank you very much and have a nice day.

Moderator On behalf of Tata Securities Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.
