Transcript

Earnings Conference Call of CMC Limited – Q3 (FY 15)

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

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Moderator: Ladies and gentleman, good day and welcome to the CMC Limited Q3FY15 Results Conference Call hosted by Tata Securities Limited. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nikhil Gholani from Tata Securities Limited. Thank you and over to you sir.

Nikhil Gholani: Thank you Margaret. A very good afternoon to all of you. On behalf of Tata Securities Limited, we would like to welcome all participants to Q3FY15 Earnings Call of CMC Limited. Today we have with us Mr. Ramanan – the MD and CEO of the Company and Mr. J.K. Gupta – the CFO. We will start with the highlights of the results from Mr. J. K. Gupta followed by a brief takeaway from Mr. Ramanan, post which we will open the floor for Q & A. Over to you sir.

J.K. Gupta: Thank you Nikhil and a very good afternoon to all the participants in this Q3FY15 Earnings Call of CMC. First I will give you a brief overview of the financial performance of the company for Q3 of fiscal 2015.

As you would have noticed the company earned consolidated operating revenue of Rs. 638.12 crore in Q3 which is an increase of 3% on Q-on-Q basis and 14% on Y-o-Y basis. Out of this, service revenue was Rs. 601.03 crore which grew 5% Q-on-Q and 19% Y-o-Y and the share of services revenue in overall

operating revenue increased to 94.2% in this quarter compared to 92.5% in the previous quarter and 90.2% in the same quarter last year. This revenue growth was significantly driven by the international geographies. Our international revenue was Rs. 460.3 crore which grew 7% Q-on-Q and 21% on Y-o-Y basis and the share of international revenue in overall operating revenue was 72.1% in Q3 compared to 69.5% in previous quarter and 67.6% in the same quarter, last year.

On EBITDA front, the Company earned EBITDA of Rs. 93.37 crore which is an increase of 3% on the Y-o-Y basis.

When we talk of international revenue, the growth was significantly driven by America, which continues to be leading geography for the company. American revenue in this quarter grew 6% Q-on-Q and 23% on a Y-o-Y basis in dollar terms and share of America geography in total operating revenue increased to 64.1%.

The profit after tax of the company was placed at Rs. 72.12 crore which is up 2% on a Y-o-Y basis.

In terms of client addition, the Company continued to have robust addition in the client. In this quarter, we added 18 clients, of which 4 clients were added in America in the IT-Enabled Services and Software Services area. One client was added in Europe in Ports area. Four clients were added in MEA in Retail, Insurance, and Embedded Systems. Nine clients were added in India, which were in the areas of Retail, Education, Financial Services, Infrastructure, and e-Governance.

Other income of the company during this quarter was normal. It was Rs. 2.11 crore which included Rs. 1.28 crore as income from investment in mutual funds.

Company had robust addition of manpower during this quarter. We added 825 people and ended the quarter with total manpower count of 12,410 people.

We had very good quarter in terms of cash flows. Company ended the quarter with cash and cash equivalent of Rs. 282 crore which is an increase of Rs. 34 crore over the previous quarter and this is after meeting the capital expenditure

of Rs. 14 crore in this quarter. Out of Rs. 282 crore, Rs. 161 crore was invested in debt-based mutual funds.

So, this was a brief snapshot of financial performance from my side and with this, I handover to Mr. Ramanan for a commentary on the business side of the company.

R. Ramanan: Thank you J. K and good afternoon to everybody, and thank you for joining this call. Greatly appreciate the same. As JK has run you through the numbers, it has been a good quarter for us. The third quarter of the year is generally one of those quieter quarters but in spite of that being a quieter quarter we did have a good addition of clients.

We have added to our manpower as he has mentioned 825 people. We have also been able to grow in revenues in the international market. So our international business continues to see good growth. The additions of clients have also been heartening in the fact that 50% of our additions have come from the international market and 50% from the domestic market. So both are seeing good traction. At the same time, we have been able to increase the operating efficiencies and cash flows of the companies. We have been able to reduce receivables for the company and that has also been good progress in that front

So overall the company has had excellent performance during the quarter. We hope to continue to build upon the client base that we have acquired. Also in the verticals that CMC has been seeing growth, we continue to see growth in the government sector, in the ports and transportation business, in the Insurance market, and in Financial Services market, and we have also been able to penetrate some Retail in the international market. So these are the sectors that we see growth during the course of the coming quarter and coming year, we hope to strengthen our growth in these areas in synergy with TCS as well as in the opportunities in the market place.

So, with that we would like to throw up in the floor for questions and answers and probably answering in greater detail anybody with questions that you may have.

Moderator: Thank you very much. We will now begin the question and answer section. The first question is from the line of H. R. Gala from Panav Advisors. Please go ahead.

H.R. Gala: J. K just a couple of book keeping questions before I turn to Mr. Ramanan. How much is the total surplus cash and ICD the number that I did not get properly?

J.K. Gupta: Surplus cash and cash equivalent is Rs. 282 crore and investment in mutual fund is Rs. 161 crore.

H.R. Gala: How much?

J.K. Gupta: One Hundred and sixty one crores.

H. R. Gala: Hundred and sixty one crore that is included in the investment, current investment, but you do not have any ICD or anything?

J.K. Gupta: No, we do not have ICD.

H.R. Gala: Okay, any reason for a significant jump in depreciation because of the change in rate.

J.K. Gupta: Yes, depreciation policy was revised effective from first of April where we had revised the estimated life of assets. The biggest change was in land and building which we had revised. Now we are depreciating over a period of 20 years.

H.R. Gala: Earlier was.

J.K. Gupta: Earlier was 60 years.

H.R. Gala: Okay 60.

J.K. Gupta: So that was a major change actually.

H.R. Gala: But otherwise no major capital expenditure in 9 months.

J. K Gupta: No major capital expenditure as we are just about finishing our capital expenditure planned in Hyderabad and Kolkata. So Hyderabad operationally is

complete. Only some peripheral facilities are yet to come up, so that may consume only about some Rs. 10-Rs. 12 crore more.

H.R. Gala: How far we have spent?

J.K. Gupta: So far we have spent about 410 crore in that property.

H.R. Gala: In the nine months.

J.K. Gupta: No, no, this is right from the beginning. So Rs. 410 crores that we have spent there in that building and we will be spending another about 10-12 crore rupees to finish the peripheral facilities. Production facilities are already commissioned. So all the number of seat, whatever 13,000 seats we had, those have already been commissioned.

H.R. Gala: This is you are talking only about Hyderabad.

J.K. Gupta: This is only Hyderabad. Kolkata is under progress. Its basic civil structural work is over. We have made all the eight floors. Now the interior work and all other work will start. We expect to complete that project by say August-September maximum. So, there we still have to incur over 50 crore rupees.

H. R. Gala: Five zero.

J.K. Gupta: To finish. So these are two major capital expenditure programs. The rest is all related to business expansion. As we add number of people, we had to increase the capacity of your IT equipment.

H.R. Gala: So that is right. In FY15 how much will be the total CAPEX that we will incur in all these projects?

J.K. Gupta: Like I told you Kolkata project we need to still incur about Rs. 50-55 crore. Total cost of the project is about Rs. 75 crore and as I told you Hyderabad, we have to incur only about Rs. 10-12 Crore more to finish the peripheral facilities.

H.R. Gala: So total will be how much…?

J.K. Gupta: Rest of regular expenditure is to the tune of about Rs.20- Rs.25 crore a year.

H.R. Gala: So how much will be the total amount in this year?

J.K. Gupta: In current financial year so far we had spent about Rs. 50 crore and in the last quarter we may spend another about Rs. 25-50 crore.

H.R. Gala: Okay, that is all and how many seats we will be creating at Hyderabad and Kolkata put together?

J.K. Gupta: Hyderabad is 13,000 seats. Kolkata, we will create 1,500 seats.

H.R. Gala: Okay, thousand five hundred. Okay fine. That is one part of the question. The second is our effective tax rates had gone down substantially in 9 months from 24% to 14%. Any particular reason?

J.K. Gupta: Yes 9 months, it has come down to 14% because we have got increase in international revenue as we mentioned in the opening commentary and now we are executing almost all of our international businesses out of SEZ and which are exempted from tax.

H.R. Gala: So going forward we can expect around 15% type of ETR.

J.K. Gupta: I mean it really depends on what still remains to be taxed. One is our onsite business in America continues to be taxed at full rate and our domestic business continued to be taxed at full rates.

H.R. Gala: Right.

J.K. Gupta: So my guess is that on an ongoing basis, it still should be factoring at around 18-19% tax rate.

H.R. Gala: That is what we should factor in?

J.K. Gupta: Yes.

H.R. Gala: And the last question is that there has been increase on account of this manpower mainly this outsource and all that, do you think when do we get back to the normal level of our manpower cost?

J.K. Gupta: Basically in this quarter we have added 825 people, it's all determined by the nature of business that are getting. So far as the combination of our manpower and subcontracting people that we are using, that is driven by two considerations, one is that it helps us manage the cost well and second is it makes the cost more variable.

H.R. Gala: Right.

J.K. Gupta: So there are certain businesses which require quick scale up and scale down and this is the reason why we use outsourcing model.

H.R. Gala: I understand that.

J.K. Gupta: If you see last few quarters, it has been the practice of the company.

H.R. Gala: Right.

J.K. Gupta: So it has become part of an inherent cost model of the company.

H.R. Gala: Okay. So one has to look from that angle. How would be bench right now?

J.K. Gupta: We don't maintain bench as I told you except that out of this 825 people a large number of people are still under Training. So if we consider that, otherwise we literally don't maintain bench.

H.R. Gala: Now turning to Mr. Ramanan, I have finished the book keeping part of the question.

R. Ramanan: Yes, go ahead.

H.R. Gala: Mr. Ramanan, now it seems that our company is getting merged with TCS as we have announced. So now going forward, what will be the direction that our company will have or either as a division of TCS.

R. Ramanan: Yes, first of all the company's merger with TCS has been based upon complementing and strengthening its core competency and providing wider access to the market place through TCS presence as well as using the TCS financial muscle to go for much larger projects than the ones that CMC has conventionally been going. So the opportunities for CMC are both as an integral

part of the TCS now would be very strong in the India sector where we are seeing increasing traction and increasing potential for businesses and CMC is the conventional strength in the Indian market place, its presence in the government as well as its focus on large national projects. And its ability to execute such project is very big. The value add that TCS will be able to leverage in India. The other is the solutions of CMC in the products that you have whether it is the Insurance products, the ports and cargo products, the mining products, the e-Governance products as well as the products in other areas like games management and so on. These we expect to grow in the Middle East, African, and emerging geographies along with TCS presence in these markets and in these markets also the partnerships that we can now have with the strength of TCS can really be a big booster for many of these products that we are having. In the advanced markets, our solutions and competencies in embedded and real-time system, in digitization and workflow management services and in Infrastructure services where TCS already has a strong presence but now CMC can complement and it can also be leveraged for these markets, particularly in emerging geographies where today TCS is focusing more on the advanced markets for Infrastructure services whereas in emerging geographies CMC can complement it in a very good manner.

H.R. Gala: Okay I understand that. So that would be a good compliment.

R. Ramanan: Yes.

H.R. Gala: Any of the areas which TCS might like to exit like Education and Training for example nothing much is happening. So what is?

R. Ramanan: In fact that is in Education and Training, the whole idea of Education and Training in CMC has been threefold. Number one, we have changed the contexts of our business over the years. So Education and Training, we are focusing on the corporate sector. And Corporate Education and Training now can achieve maybe some significant potential with the current client base that TCS has and second is in the national project that we see especially in India or in emerging geographies, there is a big element of Education and Training. We are already supporting TCS in projects like Passport Seva or MCA. So we will be exploring how to expand that in many of the projects that we will be

addressing. And the third area is of course we will take a call on the other areas of Education and Training that we are in how best to elaborate it with the TCS presence and at this point in time we have not decided to exit any business and first explore how we can significantly build it with the TCS presence and synergies.

H.R. Gala: Okay. Just last question from my side is the dollar volatility how much has it affected in the current quarter?

R. Ramanan: J. K, can you answer that question?

J.K Gupta: Yes. We had a positive impact of dollar change in this quarter. Dollar changed from Rs. 60.62 to Rs. 62.33 average. It had a positive impact on revenue by about Rs. 12 crore.

H.R. Gala: 12 crore and overall at the bottom line?

J.K. Gupta: Bottom line was Rs. 3.4 crore.

H.R. Gala: Positive.

J.K. Gupta: Yes.

Moderator: Thank you. The next question is from the line of Neerav Dalal from SBICAP Securities. Please go ahead.

Neerav Dalal: First if you could give me the split the exports and domestic in the various segments.

J.K. Gupta: In the various business lines.

Neerav Dalal: Yes sir.

J.K. Gupta: Yes you can take. Our total revenue in customer services business segment is Rs. 93 crore, of which Rs. 83 crore is domestic. SI – total revenue is Rs. 439 crore, out of which Rs. 43 crore is domestic. IT-Enabled Services total is Rs. 77 crore, of which domestic is Rs. 40 crore, and Education and Training is all domestic.

Neerav Dalal: All domestic. Okay, also just wanted to know the spike in the expenses. What is the type of this project that you are handling at this moment which is leading to such a spike in the costs?

J.K. Gupta: No, basically most of the spike in costs is on account of operations. These are all project-related expenses. So you must have seen spike in outsourcing cost also.

Neerav Dalal: My question is more zeroed in on subcontracting cost.

J.K. Gupta: So subcontracting cost has gone up mostly in outside India because on the standalone basis there is no significant jump but on a consolidated basis, there is a jump. So most of this increase has taken place because we hire a lot of subcontracting people.

Neerav Dalal: I got that. It is just that what I guess it would be in system integration.

J.K. Gupta: Yes, it is a large part of system integration.

Neerav Dalal: Yes. So is it towards industry or segment or what sort of work that is leading to such a sharp spike?

J.K. Gupta: No, basically this is on Application Development. Some onsite positioning which are of temporary in nature because some of the work has to stay onsite for some time and then move offshore. So a lot of people would like to come on a temporary basis. So, it is basically that onsite work increase that happen during this quarter and there has been the practice earlier if you try to plot it over a period of 4-5 quarters, you will see a similar kind of a correlation there.

Neerav Dalal: How do you see this move now?

J.K. Gupta: Basically it depends on the nature of job coming in. If you get a more similar kind of a job corresponding to revenue the cost increase of similar nature can take place. So this cost is absolutely variable. We do not have any bench over there. So there is a perfect match of revenue and cost there.

Neerav Dalal: No, because the margins have come up sharply and this level has not been there for the last 12 quarters. So just wanted to check how would it be?

J.K. Gupta: There is no further decline in margin that is expected from hereon. We do not expect any margin erosion.

Neerav Dalal: What is the split of employees into subcontractors and normal employees?

J.K. Gupta: Out of 12,410 employees as I told you in the beginning, our regular employee count is 4,747 and contract employees are 7,663.

Moderator: Thank you. The next question is from the line of Deepesh Mehta from SBICAP Securities. Please go ahead.

Deepesh Mehta: Yes, on employee cost I think this quarter including subcontractor, our cost has increased by roughly 42 to 43 crore and correspondingly revenue increase was around 21 crore kind of thing only?

J.K. Gupta: No, because there is decline of over Rs. 10 crore in equipment.

Deepesh Mehta: That is because of?

J.K. Gupta: Equipment revenue has declined. So this is the reason why this overall increase is not looking corresponding to the increase in manpower cost.

Deepesh Mehta: Even if we adjust, it is 31 and 42, so my question is whether we have seen drop in utilization first thing.

J.K. Gupta: Not really. Except for as I told you that we have added 825 people in this quarter which included almost half of them are freshers which are not productive. So we consider that in the drop in the utilization rate, yes.

Deepesh Mehta: Okay, otherwise we largely maintain our utilization excluding trainees or freshers.

J.K. Gupta: Yes.

Deepesh Mehta: And second question is about this margin movement because of the nature of work and our focus on maintaining variable cost in nature, we take more subcontractor kind of thing. How we see the margin profile for us, because this quarter we have seen sizeable change in margin.

J.K. Gupta: Yes, this quarter actually when we see margin decline, there are actually one-time expense item as you know that last quarter we decided about merger. So there were certain add-on cost that we had to take up due to that analysis, study and all that stuff. So those cost were incurred in quarter 3 which are not going to repeated in quarter 4. So my feel is that if you look at 9-month period, our operating margins are 15.6% and I think that is more sustainable. That is what we can look for future.

Deepesh Mehta: Because of now international is growing for us, you expect there is a scope, because 15.6 is what last year we did around 16%, 16.2 I think.

J.K. Gupta: Yes, 15.9% in the 9-month period last year and this year 15.6%, yes.

Deepesh Mehta: So now because of international growing you expect that change or you expect 15 to 16% should be the range for us?

J.K. Gupta: I feel the current levels are more likely to sustain because as I told that a lot of increase in international has taken place onsite and there the margins are not the same as offshore. So these margins are more in line with the average margins that you see.

Deepesh Mehta: Okay and just to understand this quarter growth rate, we reported very robust international revenue growth so if you can help us which area is driving growth for us in this quarter?

J.K. Gupta: This quarter international revenue growth is 7% on a quarter-on-quarter basis and the bulk of the growth if you see has come out of Systems Integration which has got two components – one is Embedded Systems and second is Software Systems and Solutions and we expect this to continue to deliver growth. We have seen some increased traction in IT-Enabled Services as well.

Deepesh Mehta: Okay, so IT-Enabled Services because if we see recent past performance, I think it is largely a stable kind of thing for us, 75 or 80 crores is our run rate right, so you are expecting now become growth engine for us.

J.K. Gupta: Yes, we are seeing some increased traction from last quarter. The last quarter was a better quarter for us in IT-Enabled Services. For some time we were trying to get additional business in the international geographies and we

succeeded in the last quarter. If you see when I talked about client addition, we had added a very good client in IT-Enabled Services during this quarter and which we expect to scale up as we go further.

Deepesh Mehta: Sir in which geography we added it?

J.K. Gupta: America.

Deepesh Mehta: So going forward I think you highlighted some of the areas like Government, Insurance, Retail those would be the growth engine for us.

J.K. Gupta: That is right, in the domestic market.

Deepesh Mehta: And for international market which area you expect?

J.K. Gupta: For international market, we continued to be focusing on our Solutions, Port, Insurance, Embedded System, and IT-Enabled Services, those should be the areas.

Deepesh Mehta: It would be a solution-driven approach for growth?

J.K. Gupta: Yes.

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

Bharat Sheth: Hi, a very Happy New Year to JK and Ramanan both of you.

J.K. Gupta: Happy New Year Bharat and happy new year to you too.

R. Ramanan: Happy New Year. Thanks a lot Bharat.

Bharat Sheth: Ramanan this question is pertaining to how we are seeing the traction in international market. I mean can you give some businesses for each of our vertical that we have particularly in view of slowdown in Europe and other emerging part of the country because of this substantial depreciation in their currency.

R. Ramanan: Yes, see our international business continues to grow well and we have had growth in Europe, US as well as in the Middle East-Africa market. In fact the growth is in different areas. In the US market the growth has primarily been in System Integration Services and it has also been on some degree of Embedded and Real-Time System Services. These are the two areas where we continue to see growth in the American market. In the European market, we are seeing growth in Embedded and Real-Time Systems as well as our ports and transportation solutions. We have been able to add a couple of new ports now to our customers and these are significant. The important thing about all these transportation project is that they are long-term and they will be anywhere between 5 years or 10 year type of projects and so they will create a sustained base of revenue for the CMC in the long run. In the Middle East-African market, we see all our solutions that we develop in India as the potential in these markets. For example our e-Governance solutions, our solutions in Ports, and our solutions in Insurance we have had quite of good growth in General Insurance clients in the African markets and we continue to see very good traction in that. So we have a solution for the African market Insurance and so this is a replicable solution just like in India now more than 70% of the general Insurance markets uses CMC's products and we expect that soon in Africa we will have the same situation. We are also expanding to other emerging geographies. The potential for our Insurance product to go also in to the advanced market is good and we hope that with the TCS amalgamation, we will see opportunities and potential for leveraging that in the advanced markets also. In the Middle East and African markets, we also see potential for ERP integration into the solutions that we have.. For example in many of our Transportation clients or even in our Financial Service clients, there is a need for SAP or ERP integration into the core systems and CMC is seeing increasing traction in that.

Bharat Sheth: How is the business in India, I mean from government side particularly new government is talking lot on e-Governance?

R. Ramanan: Yes. It is still to takeoff in some significant manner but we have had some good success in India. We have actually added 9 new clients in India during this last quarter. Overall, we see a very positive climate. We are seeing some aggressive plans in different governmental units and we hope that these will all materialize

quickly into projects that we can bid on and we can win. We have won quite a few e-District projects. So many of the states are implementing e-District implementations in government-to-citizen services and Workflow Management Services. So, that is an area that we are already working closely. We are seeing growth in HRMS as well as in transportation. For example, the solutions that we have implemented at Karnataka State Road Transportation for state-of-the-art reservation, bus tracking, and fleet management system that is now implemented in Andhra Pradesh also and we are seeing more opportunities for that in the Indian market place.

Bharat Sheth: And how the competitive things are emerging in all the geographies that we have presence because now lot of people like to take the advantage of technology?

R. Ramanan: We do see competition but what we see is that is more competition for services with many of the IT players focusing on services. On solutions, our products based opportunities, we do not see too much competition from Indian vendors, but we do see local competition, so our challenge is to ensure that we are able to address the local competition and win that and we do have an advantage because the ability for us to service customers from India and also do it more cost effectively than the local players is quite good and so we see opportunities there.

Bharat Sheth: Sir, can you throw some light on how this business opportunity is changing in space of Infrastructure Management – domestic as well as globally, and do we have specific like say the kind of vertical where we are strong there only we get some traction?

R. Ramanan: Now what we see changing in Infrastructure Management space is the fact that internet of things is now becoming more and more visible. What we mean by internet of things is that more and more Infrastructure which is being put into factories, into office automation, in smart cities, in billing, and metering solutions, these are becoming an integral part of the overall solution that the customer is expecting. So for example today even in the ports, they are looking at how you can use Google Glass in order to get immediately an optimal container management and response system. So, you are seeing more and more new

technologies which are sensor based technologies and also the other thing that we are seeing is tremendous amount of focus on virtualization and Infrastructure optimization, cloud services, and cloud migration. So these are the opportunities that are there. I think everybody will go more and more towards the cloud. They will use more and more sensor technologies integrated in their solutions and so when we talk of Infrastructure Management it will no longer be just administration management or database management but it will also involve the management of mobility devices, smart devices that are connected to the Infrastructure to give the end-to-end solution to the customers.

Bharat Sheth: Are we seeing some kind of say vendor rationalization by the client where they would like to source from any larger player for all kind of services?

R. Ramanan: We have not seen any such thing because I think customers are looking for some niche players also in some of the solutions that they want. At the end of the day, the customers are looking for what is going to be advantage to the business and what is going to reduce their cost and if a large single stop shop vendor is going to provide that and that is going to be the preferred mechanism but if sometimes what they want is, they may still select a large vendor or they may do some consolidation for some amount of vendors but they would still want to retain certain areas within their own fold. So this combination is what we are also seeing.

Bharat Sheth: In large customer would like to source their Infrastructure Service Management from smaller company or they would always prefer – because people who can cater to their various location across the globe and all.

R. Ramanan: I think large customers will prefer larger players because they would like some consolidation and they would like uniformity of service that is inevitable.

Moderator: Ladies and gentleman that was our last question. I would now like to handover the floor over to Mr. Nikhil Gholani for closing comments.

Nikhil Gholani: Thanks Margaret. We would like to thank all the participants for their time. Thank you Mr. Ramanan and Mr. Gupta for a detailed discussion of the results. Thank you very much and have a nice day.

J.K. Gupta: Thank you Nikhil. Have a nice day.

R. Ramanan: Thank you everybody.

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

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