Mindtree Limited

(NSE: MINDTREE, BSE: 532819)

Transcript of analyst call

Second Quarter ended September 30, 2016

October 21, 2016

Welcome to possible

Moderator: Good Day Ladies and Gentlemen and welcome to the Q2 FY17 Results Conference Call of Mindtree 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 after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sushanth Pai. Thank you and over to you sir.

Sushanth Pai: Thanks, Margreth. Welcome to this conference call to discuss the Financial Results for Mindtree for the second quarter ended September 30, 2016.

I am Sushanth from the Investor Relations Team in Bangalore. On this call, we have with us Senior Management Team:

Krishnakumar Natarajan – Executive Chairman

Rostow Ravanan – CEO &Managing Director

Parthasarathy NS – Executive Director and COO

Jagannathan Chakravarthi – CFO

The agenda for the session is as follows: Rostow and Jagan will begin with the brief overview of the company's performance, after which we will open the floor for the Q&A Session.

Since we have introduced an audio webcast, some of you may have joined the webcast; the webcast is in listen-only mode, but you can post questions. We will take the webcast questions once we complete the questions through the conference call mode.

Please note that this call is meant only for the analysts and investors. In case there is anyone from the media, request you to please disconnect as we just concluded the media briefing before this call.

Before I hand over, let me begin with the Safe Harbor Statement: During the course of the call, we could make forward-looking statements, these statements are considering the environment we see as of today and obviously carry a risk in terms of uncertainty because of which the actual results could be different. We do not undertake to update those statements periodically.I now pass it on to Rostow.

Rostow Ravanan: Thank you, Sushanth. Good Evening and Good Morning to all the participants from the financial community on this call. Our revenue for Q2 was $193 million, which was a sequential quarter decline of 3% and a Y-o-Y growth of 7.4% in dollar terms. In constant currency terms, the revenue decline was 1.7%. We have a decline across all 4 verticals; however, if you look at it from a service line perspective, our IMTS group posted a good growth of 5.1% Q-o-Q and 26.8% Y-o-Y. Overall, as anticipated and indicated earlier in our mid quarter update, the revenue decline in Q2 was due to the slower ramp ups in a few large clients across different verticals, weakness in our UK based subsidiary Bluefin and competition in traditional services leading to price compression in renewals.

Some other Highlights of our Results are:

At the end of the quarter, we had 337 active customers. Our million dollar customers grew by 9 taking the total count to 107. We have added one more client in the $25 million category taking the total to 6.

Some good news on the attrition front - Last 12 months attrition was 16.4%, more or less flat compared to the last quarter. Quarterly annualized attrition has reduced considerably to 15.7% compared to 18% of the previous quarter. At the quarter end, we have 16,219 Mindtree Minds reflecting a gross addition of 744 people in this quarter. During the quarter, we added 438 campus graduates.

Strong wins in this quarter - which included a major US airline. For this existing client, Mindtree was chosen as a strategic quality engineering and assurance partner to provide testing services for their entire commercial application portfolio. This is also Mindtree’s largest single independent testing deal in recent times. For a leading product company which is enabling digital transformation for the BFSI segment, Mindtree was appointed as the professional services partner for their digital platform. For a leader in the electronic hardware and software design solutions, Mindtree was engaged to provide digital services for its customer entitlement system and the fourth was a multiyear, multimillion dollar digital deal for a global consumer product company to help them with their digital transformation initiatives. Mindtree was chosen as a digital anchor partner for a range of digital solutions.

During the quarter, we signed orders worth $ 183 million of which renewals were $119 million and new orders were $ 65 million. Look at it from the other way, orders for less than one year were $ 152 million and $ 31 million is for greater than one year. Digital contracts signed during the quarter were $ 64 million.

Some points on revenue outlook for the second half of this year, some of the short term challenges are expected to continue in the coming quarter as well, with a delayed recovery. Therefore we expect Q3 to be subdued as well; however, our endeavor is to arrest the revenue decline as quickly as possible. We believe the business fundamentals, strategic direction and market positioning continue to look strong in the medium term especially with our investments in digital and managed services. Our pipeline continues to be strong including very good demand for our digital offerings. Our acquisitions in the digital space continue to be relevant and enhance our story; however, due to the economic environment in Europe including Brexit, we are seeing slow traction in Bluefin.

Some steps that have been taken to address the growth challenges in Bluefin include restructuring the business and driving faster integration. Jagan will cover some costs that we have incurred during this quarter in this regard. The cross selling initiatives continue to yield fruits. We recently won deals to introduce additional Mindtree service lines in an existing customer of Bluefin. We expect to see such cross-selling opportunity increase over the near term through more closer monitoring, greater traction by participating in flagship SAP event and driving further operational synergy. Magnet 360 has been seeing very strong traction and integration is progressing as per plan. With that, I would like to pass on to our CFO, Jagan to share a few other financial highlights.

Jagannathan C Narasimhan: Thank you, Rostow. Good evening all. Before I begin my update, I would like to point out that we have moved to IndAS accounting standards effective 1st April of the current financial year. Consequently, we have restated the financials of Q2 FY 2016 for comparative purposes. The main difference affecting our financials are as follows.

On revenue, cash discount expensed under IGAAP is now reduced from revenue resulting in marginal decline in revenue. At EBITDA level, cost impact for the quarter ended September 30, 2016 is insignificant. At PAT level, the main element is business combination related expenses such as amortization of intangibles offset by mark-to-market gain on investments thereby lowering the PAT margin by 70 basis points. In Q2, our fee revenue has declined by 2.7%, volume declined by 1.8% and price realization has decreased by 0.9%. Q2 EBITDA margins are at 12.5% as compared to 14.7% last quarter. There was an impact of about 2.3% due to salary increment and restructuring cost of 500K which had an impact of 0.3% on our margin. This impact was partially offset by operational efficiency of 0.4%. We have taken many operational efficiency measures resulting in reduction of travel costs, subcontractor costs, relocation costs etc.; however, these were not sufficient to negate the impact of salary increases, losses of subsidiaries and revenue decline.

Mindtree margins excluding acquisition is at 14.3%. Forex loss for quarter two was $430,000 as compared to $1.4 million gain last quarter. Effective tax rate was 25.9% as compared to 24.3% last quarter. PAT for the quarter was 7.3% as compared to 9.3% last quarter. EPS is at Rs. 5.64 compared to Rs. 7.35 last quarter. Our DSO was 66 days compared to 65 days last quarter. Our utilization including trainees has remained unchanged at 71.4%. Utilization excluding trainees has improved to 73.1% compared to 72% last quarter. Hedges as on 30th September were at $ 36 million at the average rate of 68.09. CAPEX spend for the quarter is $ 4.3 million. YTD CAPEX spend is $ 6.9 million. Cash position is at $ 77 million. EBITDA to operating cash flow conversion is 81.4% and free cash flow is 63.2%. Board of Directors have recommended on the meeting held on October 31, 2016 an interim dividend of 30% for quarter ended September 30, 2016.

Some points on margin outlook – we are mindful of the fact that margins are not in our desired zone. We have implemented a range of operational efficiency and cost control measures. Some of these measures have started yielding positive results. We are also increasing our efforts towards integration of Bluefin as explained by Rostow. However, the full benefit of these measures may take few quarters to have an impact on our margin improvement. With this, I conclude my financial update for the quarter.

Rostow Ravanan: We can now throw this open for questions.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Sandeep Muthangi from IIFL. Please go ahead.

Sandeep Muthangi: Rostow, I want to get some clarity on the situation that is going on with the top customers. Leaving the top account, the issues seem to be fairly broad based. Are these somehow client specific issues or is there a structural reason like continuous pressure on the pricing whenever the deal renewals are happening? I just want to get some clarity on this one aspect.

Rostow Ravanan: Thanks, Sandeep. You are right, there is an impact that is affecting us from two different directions. One is when contracts are renewed, customers are obviously putting a lot of pressure on pricing and that is one impact. The second impact is some of the newer opportunities that are in the pipeline, those are not closing as fast as we anticipated given the political and the economic environment affecting our clients in the major markets and clients are delaying decisions on some of the newer opportunities. So there are two headwinds that some of our large clients are going through right now.

Sandeep Muthangi: Right and in terms of the outlook because of the situation, do you have any hope of a recovery in the second half probably in third quarter or do you think that the situation is still pretty volatile and the revenue headwinds will continue well into second half?

Rostow Ravanan: There is definitely some uncertainty and obviously we have seen some of these events as they progress week-after-week, month-after-month and have led to obviously faster picture that is evolving. So we definitely do not see anything that has happened in the recent past that make life a little bit more confident; however, we think the picture should at least improve from where we are, for example we do not think Q3 will be a decline. So I think the decline was one-off in Q2 and hopefully more positive momentum should start happening from Q4.

Sandeep Muthangi: Right, thanks and just one question if I may. See, this pricing pressure issue has been going on for some time for the sector, I am sure Mindtree also has seen earlier in the past 1-1/2 years contracts coming up for renewal and there being some sort of pricing pressure, but I am somehow getting a feeling that this is a lot more intense than what has happened in the past one year for you guys. Is that correct that this time the pricing demands when the renewals are happening is more intense than what has happened in the past one year?

Rostow Ravanan: Has the situation become tougher in the recent past, absolutely yes. However, our impressions based on customer conversations, I do not think it is unique to Mindtree. In many of our cases, we are obviously competing along with other both domestic and MNC vendors. So to that extent I think it is uniform across the industry. Historically, we have been able to balance it to some extent by having newer wins and the absence of new wins especially in some of the emerging technologies is obviously impacting. We are also taking newer offerings to market nowadays. For example, we have created a new offering called integrated services which we showcased to the investment community in August when we did the investor briefing. Some of those are obviously generating a very high degree of traction with customers. So we believe the cost pressures of the customers is translating to two things, delay of new decisions or cancelling of projects at one end and obviously price compression on renewals on the other end that has to be balanced by new wins coming in as soon as the market recovers and customers feel a little bit more confident about their businesses.

Moderator: Thank you. The next question is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: My first question was to get some sense in terms of what was the contribution of Bluefin and Relational Solutions in the current quarter? The second question was to understand from you the outlook on the digital business. That is a piece where you have done historically very well and some of the peers have now talked about some slowdown in terms of discretionary spending which includes even digital-related projects. Are you also seeing something along similar lines?

Rostow Ravanan: I will ask Sushanth to give you the data about Bluefin and then I will give you some commentary on the second question.

Sushanth Pai: Manik, Sushanth here. Our Bluefin contribution for the quarter was approximately $8.4 million.

Manik Taneja: And how about Relational Solutions?

Sushanth Pai: Relational is approximately 700K.

Rostow Ravanan: So on the second part of your question which is outlook for digital, I think definitely market validation both by customer as well as other participants like industry analysts etc. that Mindtree's digital story is probably very comprehensive and has a lot of value. So I do not think that has changed in anyway, but customer confidence in terms of signed deals is volatile and for example we have a few things in the pipeline which did not close in Q2 and have got shifted into Q3. So that volatility of that uncertainty continues.

Manik Taneja: Sure and if I can prod you further on the margin outlook. You started this year with an outlook saying that we should essentially be able to expand margins and then we have seen some of these revenue headwinds impact margins apart from pricing pressure. So, is there any sort of medium-term outlook on margins that you can share with us that you aspire to because our margins have actually been under pressure for quite some time now?

Rostow Ravanan: Like Jagan outlined in his comments, we are conscious of the fact that our margins need to be better than where they are and two types of activities are being implemented, one is cost control measures, wherever we are looking, wherever there is possibility and operational efficiency improvements wherever it is possible etc. For example, that time you saw an improvement in utilization or like Jagan explained here doing a few things to restructure the business in Bluefin that will help nurse that business back to profitability faster. So from a management discretion implementation perspective, multiple measures are being put in place to help improve profitability. The second part obviously is getting revenue traction on a faster mode and multiple initiatives on that front as well to be able to get deal closure, get closer to customers, understand their concerns etc. So that piece is also being actively worked up on.

Manik Taneja: Sure. Sir any number that you can share from a medium term perspective?

Rostow Ravanan: Unfortunately, we do not give a guidance on margin per se, but conscious of the fact that more needs to be done and we are working on it.

Manik Taneja: And finally one more bookkeeping question. If you could help us with the contribution of Magnet 360 as well during the quarter?

Jagannathan C Narasimhan: On the revenue front, they have contributed around $ 7.6 million, Manik.

Moderator: Thank you. The next question is from the line of Madhu Babu from Centrum Broking. Please go ahead.

Madhu Babu: Sir, onsite is increasing continuously I think and that is one big headwind for the margins. So, is there any possibility of moving offshore because considering that we are strong in digital, would that be a lever for H2?

Rostow Ravanan: Yes, we have recognized it, but you have to see it in the context of the fact that some amount of the onsite increase is also because of the acquired entities which are 100% onsite. I do not think the onsite ratio will change immediately in the next 1 or 2 quarters, but on a medium term basis absolutely yes. If you look at the kind of efforts we are taking to skill even higher end sort of technology like salesforce and be able to do more offshore manner, so that clearly is the action that we are taking, but it will take a little bit of time. Again just to correct the impression, in the quarter our onsite revenue in percentage has not increased. It is stable over the previous quarter.

Madhu Babu: And second how is the top level churn impacting on client specific growth?

Rostow Ravanan: Absolutely zero. The leadership exits that we had, haven’t made any impact from a business perspective. Many of our clients have multiple touch points within Mindtree. So therefore whether it is in existing customers or existing prospects, all those customer conversations have been handled seamlessly. Teams have picked up the threads and they are handling all those threads and people like me, KK, Partha, Scott etc. are also pitching in to pick up additional sort of load on those fronts. No more impact to customers or business because of the two leaders who have exited Mindtree a few weeks ago.

Madhu Babu: Can we look at an exit margin of 15% for this year?

Rostow Ravanan: Not making any comments at the moment, but like I mentioned before there are things that we are doing to help address the situation that we are seeing in front of us at the moment.

Moderator: Thank you. The next question is from the line of Vinita Kumari from Narnolia Securities. Please go ahead.

Vinita Kumari: My question is about Bluefin business. From last two quarters, it has been declining. It will be helpful if you give some color on it regarding what number you're expecting going ahead? Are the uncertainties in UK over or it will continue to affect the numbers?

Rostow Ravanan: I think it is difficult to make any prediction at the moment because the uncertainty is partly driven by external factors like Brexit which is obviously impacting customer decisions at the moment. So it is difficult to say whether the problems are behind us and things will be better in future or not. I am monitoring it very closely. We are changing a lot of approaches at our end, changing the way we are doing the integration, changing for example incentive schemes, doing some other kind of restructuring to be able to react quickly and more efficiently, but given the sort of external uncertainties unable to make a confident prediction at the moment.

Moderator: Thank you. The next question is from the line of Anurag Purohit from Anived PMS. Please go ahead.

Anurag Purohit: My question is regarding the headwinds that you are facing right now both on pricing front as well as the new deals. In terms of new deals, how much of the structural change in the kind of deals that has happened in last few quarters for you? And in terms of pricing in the traditional services, by what time do you expect some of these pricing headwinds to moderate or are they getting worse?

Rostow Ravanan: I will take the second question and I will ask you to restate your first question because I am not sure I understood correctly. On the second question, the pricing pressures have definitely not become worse. I think it is probably remained at the same level for the last few months and I think it will probably be difficult for us to say whether it will peak at some stage and start improving in the future etc. IT teams across clients by and large have some flat budgets granted to them by their business and they have to get savings out of their traditional services and use it to fund the innovation agenda. So therefore I think even now if I have to look at the next 2 or 3 quarters, I think that trend is likely to continue, do not see any major changes right now, but at least the good part is I do not see the customer conversations indicating pricing pressure becoming worse than the past. I think it more or less remains the same level over the last few months. If you would then restate your first question once again and then I will be happy to answer that.

Anurag Purohit: So, my question was regarding is the structure of deals in the traditional services now much different than what it used to be probably a couple of years back, especially in last 6 months to one year, has the traditional services deal structure changed?

Rostow Ravanan: I think it is difficult to say, but what we are beginning to see is the customer confidence in younger specialized companies like Mindtree is becoming much higher. So today for example multiple tens or millions of dollars and multiple years kind of contracts are in the pipeline right now. So we have been taken seriously and being considered for much larger longer term kind of opportunity than what we saw 3 or 4 years ago. So, to that extent yes there is a progression, but again like I said it is difficult to extrapolate that and say if it is a trend line or not. But as of today that is the change we are seeing compared to the past.

Moderator: Thank you. The next question is from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Rostow, in the business update that we had put out a month back, we were expecting at least for the full year to still hit the NASSCOM numbers. So now with the outlook, you think the situation has worsened in the last one month incrementally and we may not be able to achieve these numbers? That's my first question.

Rostow Ravanan: Yes. The updated assessment we have for the second half of this year is showing a softer picture than what we saw a month ago. So to that extent yes, there has been a change in the assessment, but is the change across two dimensions. Clearly obviously our conversation with our customers' prospects etc. is to some extent indicating a slightly softer picture, but also to some extent things have changed at an industry level. So to that extent, this update is definitely not unique to Mindtree.

Pankaj Kapoor: Sure and given that the pricing now is still probably not at the bottom and you still may have some incremental headwind on the pricing front, what is giving you the confidence that the next quarter may not see a decline? Are we expecting a very significant volume increase to happen, which can give us a push up? I am just asking this question in the context that third quarter normally is softer from the volume side.

Rostow Ravanan: The picture that we have is obviously that we think that revenue decline should get arrested in Q3. To that extent, it was obviously a one-off issue. So what I meant was the decline that we saw in Q2 should not continue again. So I think Q3 we will arrest that decline. Given the fact that it was client specific factors, some sort of project level cancellations etc., so that is what gives us confidence that we will probably not have a same situation in Q3. So we do not see that as a continuing trend to the same extent that we saw in Q3 from an operational perspective. The one factor outside our control is obviously cross currency. So close to half the revenue decline in this quarter was because of the cross currency. So obviously I cannot comment on that piece, but from an operational piece or from a business piece, we think we will arrest the revenue decline in Q3.

Pankaj Kapoor: So, basically what you're saying is that in constant currency terms we should have at least an increase and which will be net of decline in pricing possibly, but a volume correction will be better. That's the picture you're saying for the third quarter.

Rostow Ravanan: You said this a little bit more than what I mentioned. So, my point was we don't think Q3 will be a revenue decline. I think we will arrest the revenue decline in Q3.

It will obviously be a combination of factors. But to the extent that there are operational things in our control in terms of business and so on and so forth, I think we should have a stable Q3. Cross currency is obviously outside our control.

Pankaj Kapoor: But my question was largely coming from the fact that pricing pressures typically don't get arrested in one quarter. So, we probably on the conservative side should be building in a continued softness in the pricing? That's where I was trying to come from. And in terms of margins then, does it mean that you think we have probably hit the bottom in the second quarter? You see there are incremental headwinds going forward as well on the margin side.

Rostow Ravanan: At this point of time, we don't think any incremental headwinds to affect us in Q3, but we are watching it closely. And like I said from our point of view, there is a consciousness that we need to do a lot more compared to where we are on margins and all our focus and efforts are taking in that direction.

Pankaj Kapoor: And lastly, Rostow, about 40% of our revenues now are from digital which I would presume that may not have so much of pricing pressure. So, correct me if I'm wrong there because in case if there is no pressure on the digital business, then that means the pricing pressure on the non-digital business seems to be far higher or is it that you're seeing pricing pressure on the digital business as well?

Rostow Ravanan: Less pressure on the digital business purchases. Obviously, all deals are competitive so there is clearly Mindtree is positioning itself along with other companies for every opportunity in the marketplace at the moment. However, we are able to defend the value proposition and in many cases lead with sort of innovative ideas to the customer etc. on digital. So, we are not seeing a pricing pressure to that extent on the digital services.

Moderator: Thank you. The next question is from the line of Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah: Just again the question is on pricing. Rostow, if I look at our offshore pricing, I think it is one of the lowest in the industry or close to at the bottom versus peers. So why we are not able to defend the pricing in the renewal? Is it more a client specific issue which is leading to this or is it more a competitive scenario which is leading to this and is there any client where we have lost the wallet share?

Rostow Ravanan: Multiple questions in that so let me start with the last of your question. We have not lost wallet share in any of our customers. All our customers, we are continuing to maintain the relationship and in some cases even grow the relationship. And when I look at feedbacks from senior management for many of our customers, actually they say that the revenue decline that they have with other partners in their landscapes are even higher than Mindtree. So, definitely we don't have the feeling that we have lost wallet share against any of our competitors in our existing customers. On pricing, difficult to say whether we are the bottom or not compared to other offshore vendors. In our case, I think the Q2 offshore pricing actually increased marginally compared to Q1. So, I also think that it was a combination of issues like pricing pressure, like client mix, geography mix, etc. that led to our pricing situation and that is beginning to sort of moderate at the moment.

Sandeep Shah: Rostow, I think some of the peers are being able to defend the pricing pressure through some automation technologies at the backend. So, what is the progress here? What is the status of Mindtree on that side?

Rostow Ravanan: So, I think our efforts whereby which we can innovatively create a value proposition for customers in traditional services is probably as good as the best in the industry. Some of this we even showcase to the investment community in our investor meeting in August. So, I do not think we are lagging behind on any of those. And the measures we are taking is not just automation, it is a range of different approaches, partly technology like automation, artificial intelligence, etc. but partly also process improvements like you have LEAN, full lifecycle management. So multiple steps are being taken and I do not think we are lagging behind the rest of the industry. So, therefore the issue for us is less from a pure pricing pressure perspective. Combination of issues including obviously the revenue decline are the reasons for our margin picture at the moment and therefore series of initiatives, both revenue increase as well as cost reduction are being pursued aggressively to help improve our margins.

Sandeep Shah: And just last question on the pricing. Most of the renegotiations are fully reflected in this quarterly results or you believe that there could be some extended impact of the same in the coming quarters?

Rostow Ravanan: Like I said, I think we are reasonably okay for Q3, but at the end of the day, it is not as though all contract renewals just happen in one quarter, so we obviously need to monitor it quarter after quarter. However, I think the issue at one level obviously about the renewals and the pricing pressure for renewals etc. but on another level made of external environment, customer sentiment etc. improving and therefore growth coming back. So, the balance that will be there is that some of the projects, opportunities in the pipeline need to get converted to revenues and therefore once that comes back, then that growth will offset some of the headwinds we are seeing on the traditional business.

Sandeep Shah: And just on the cost initiatives, we have spoken couple of initiatives. Can you actually elaborate where are we and where do we see that this will help us by what FY18 or you believe that those are temporary measures and FY18 right now the impact on the margins may continue because of what has happened in FY17?

Rostow Ravanan: I will ask Jagan to answer this. However, the only comment that I want to make before passing on to Jagan, I think we are not looking at this point of time in terms of any comments into FY18. Jagan will give you a little bit of highlights as to what we are doing for the rest of this financial year.

Jagannathan C Narasimhan: Sandeep, as mentioned by me earlier, we have taken quite a lot of steps to improve our operational efficiency. This is not only on the cost control measures, We are also taking steps to manage the efficiency and the way we are able to reduce the cost per unit of whatever the service consumption that is happening for us and for this, we are utilizing the negotiation point with the contractor. We are taking steps to arrest the ad hoc unplanned incurrence of the expenditure, close monitoring of the planning and also we have taken some steps to effectively partner with our service providers to get the best benefit across the globe. This is going to be a long-term measure, which we have started a journey in this quarter. It is going to continuously help us mange the costs over a period of time. The benefits will be starting to flowing now. It has already started flowing in this quarter. We are seeing some positive results, for example our subcontractor costs have come down by 1% this quarter. So, this is going to be a continued impact. However as mentioned by me earlier, this was not sufficient enough to cover the salary increase cost and the revenue drops in this quarter that was the impact on the margin. We hope this cost management and operational efficiency improvement will help us in the coming quarters.

Moderator: Thank you. The next question is from the line of Akshen Thakkar from Fidelity. Please go ahead.

Akshen Thakkar: First I wanted to compliment the consistency with which you put out the profit warnings, recently it's been warnings, but otherwise I think it's best practice irrespective of how the things have gone for you guys, I just wanted to congratulate you on that practice. The second was a slightly medium-term question. If you see the margin history right now and I don't want to engage on this question on the next three months or six months, but maybe over the next two or three years. The range for margins for you guys have been fairly wide. Peak margins were over 18% last seven, eight years; the bottom margins were about 8%; currently maybe somewhere in the middle or maybe lower than that. While near-term margins are hard to call because there are too many moving parts, just generally over next two- to three-year period, how are we thinking about margins? What are the right sort of margin levels for a company your size with the growth aspirations that you guys have? Just some sense around that would be great. Thank you.

Rostow Ravanan: Thanks Akshen**,** I think our view is that given the various factors that are affecting our business right now, may be somewhere in the region of I would say 18%-19% at an EBITDA level would be a near to medium term target we would like to set for ourselves. Getting there would require a series of actions, obviously not one single silver bullet that we can fire to get there. It will for example include greater offshoring, faster revenue traction, revenue synergies and cost synergies with our acquired entities, operational efficiencies within the business, etc. and also defending prices and helping rebalance portfolios with customers. So we have a combination of both higher value added and traditional services in a very efficient way with many of our customers. So I would say our medium term sort of margin aspirations will be 18 to 19. It will take us a little bit of time and a little bit of hard work for us to get there and that is what we are focused on. Once we get there and execute that consistently for may be a year or 2, then we will probably set our aspirations on the next orbit for ourselves.

Akshen Thakkar: Just a quick follow-up over there. You've seen onsite presence for you increase over the last 3 to 4 years and if higher offshoring is a key margin driver for you, very dumb question, but doesn't that also then pose a growth challenge for you?

Rostow Ravanan: Not necessarily because if the revenue momentum is able to come back, then for us to be able to convince our customer and do more things on a distributed basis should not be a challenge. Second, that will also happen when you see the nature of deal shifting. One of the reason for higher onsite over the last I would say 2 or 3 years is the early wave of newer emerging technology conversations with our customers require more of the interactions to help closer to the customer. Over time some of those should lead to larger multi-year kind of opportunities and therefore large portions of those could also then be done in a distributed way. So, part of it is business evolution and that is a sort of push that we are taking there and part of it is also changing nature of business as some of these become more mainstream.

Akshen Thakkar: Would it be fair to broadly conclude that to get to aspirations of smoother and higher growth for you and better margins, you would need some of these smaller digital projects that you've done to scale and the constraint to that at this point in time seems to be macro or client unwillingness. So until unless that doesn't change, both your goals on whether it's topline or margins, it won't be a smooth journey. You could have quarters of good performance and quarters of bad performance, but if you have to take a one, two, three-year view till that variable doesn't change; you're going to have lumpy rides. Is it a fair conclusion?

Rostow Ravanan: I think the uncertain external environment is obviously hurting customer sentiments and therefore it is hurting both the smaller and emerging technology kind of projects as well as larger traditional services kind of projects. So, the weak environment is actually affecting both pieces of our pipeline whether it is in terms of outright cancellations or delayed decisions etc. So to that extent, a little bit of the business improvement at our end will come when at least one or two of the external headwinds abate a little bit there.

Moderator: Thank you. The next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: Firstly, you talked about arresting decline in revenues in 3Q. Could you help us understand why you think 2Q decline is a one-off and what are the various factors which is giving confidence for 3Q because pipeline possibly was strong even getting into 2Q and pipeline even now is strong. So, what are the various conversations or factors which is helping you to think that 3Q will be not a decline?

Rostow Ravanan: So, the short answer to your question is obviously it is like an evolving picture and even between July and August, things were evolving. So now our ability to have, more deeper insight more probing conversations with our customers etc. are the reason for us to say we probably will arrest the decline for recognizing the revenues in Q3.

Gaurav Rateria: Have you seen that trend like a month-on-month improvement in September, which kind of also gives you some more confidence?

Rostow Ravanan: So, I think some of the headwinds were hitting us till September and obviously definitely become a little bit more positive in October, but it is only 20 days of October. So, let's watch a little bit more. But our current impression is that in a sense that a sequential quarter decline was a one-off in Q2 and we should probably not have the same picture in Q3.

Gaurav Rateria: Secondly, you have on-boarded quite a lot of people from campus while the outlook has kind of worsened from your earlier stand. So, any reason why you did not think about deferring them? Is it because the utilization is already running at peak and you could not have done any kind of volume growth in 3Q and hence you are kind of taking the freshers now?

Rostow Ravanan: Two reasons, one is tactical and one is more sort of strategic and the tactical reason is there is a conscious effort to try and correct the pyramid and to the extent wherever we can as and when attrition happens amongst the tenured employees, the focus has been obviously to broad base the pyramid and replace them with the younger talent. So, that is one push from a margin improvement kind of a perspective. The second is a little bit more strategic, which is that managing inflow of campus is as much a function of branding from an employer branding etc. perspective. So, we definitely would like to whether short-term quarterly storms and continue to do some campus recruits. Lastly, the kind of sort of projects as well, some of the younger talents come with more brighter, more digital natives that are coming into the workforce with some of the talent. So therefore for the kind of work that we are getting, we also believe that some of this younger talent can make a big impact of those. Overall obviously the people addition plan continues being fine-tuned along with the business, but for Q2 and to some extent our outlook for Q3, we want to continue the momentum and with our plan for campus additions.

Gaurav Rateria: Last question from my side, could you help us understand what's the incremental impact because of Bluefin not doing too well in the quarter on margins, is it like a change in the compensation structure? What are the restructuring initiatives you have taken for the Bluefin?

Rostow Ravanan: I will take the second part, which is the restructuring initiatives, and I will hand it over to Jagan to give you some more details. Restructuring initiatives, I would say are broadly of two categories. One is headcount restructuring. You look at some of the talent, look at some of the opportunities and where we see either for performance reasons or for pipeline and opportunity reasons where things are not aligned to the business outlook, we have initiated steps to restructure some of the teams, team sizes, people counts, etc. So that is the restructuring that we have done at one level. The second restructuring is the way we were going about integration like cost rationalization etc. some of those we have also changed our track and approaching it in a more aggressive way. So, those are the kind of restructurings that we have started to undertake. I will give it to Jagan to give you some more details on Q2 revenue and margin impact.

Jagannathan C Narasimhan: In Bluefin, this quarter the revenue dropped to 8.4 million compared to 9.5 million last quarter. This was a combination of business impact, Brexit impact, as well as currency impact. As you know, the GBP has depreciated by more than 12%-15% during this quarter. This had a major impact in Bluefin's revenue. However, on the margin front, they have worked out some of the operational improvements and some improvements on their efficiencies. So, their losses remain the same level at around $450,000 as it was in the last quarter. So, it did not add up to the additional impact to Mindtree in this quarter.

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

Dipesh Mehta: I think partly my question was answered. I just want to understand the margin. Just now you suggested about Bluefin absolute loss remained more or less stable, so it seems to be the organic business where we are seeing weakness in terms of margin performance. So, if you can provide some detail apart from pricing decline we have seen, what areas is hurting in terms of margin performance?

Jagannathan C Narasimhan: Dipesh, this is Jagan here. I will talk about the margin impact, what created the margin impact for this current quarter for Mindtree. The salary increase had an impact of around 2.3% on margin this quarter plus the restructuring cost of Bluefin had an impact of around 0.3% in this on EBITDA. However, we have brought in a lot of operational efficiency improvement measures, which has shown a positive result for us in this quarter. This helped us in EBITDA by about 40 basis points. So, the net impact was around 2.2% on our margin.

Dipesh Mehta: But absence of visa, which we earlier at the time of Q1-end we suggested which can partly negate our salary hike? Now because of visa if I look travel expenses where we generally club our visa related costs, it is showing some kind of improvement quarter-on-quarter. Even if we adjust for that visa absence and then salary hike this quarter, the number seems to be weak in terms of margin performance. So, how one should look at? If you can provide some additional detail apart than what you already provided?

Jagannathan C Narasimhan: Dipesh, actually as I mentioned, the margin is also dependent on the revenue performance for the company. We have taken various steps to manage some of the cost and increase the operational efficiencies. However, it depends, this will continue to give us an impact in the coming quarter and however, the rate also depends on the revenue performance and how fast the revenue growth happens for us in the coming quarter. So, we are keeping a close watch on that and see what best we can do to improve the margin.

Dipesh Mehta: And last thing is about the fresher. We are maintaining our fresher intake target for the full year or we may defer it?

Parthasarathy NS: This is Partha here. We had a plan to add 1400 people for the full year. We have slightly moderated it, probably we will do close to about 1100.

Dipesh Mehta: But till now in H1, how much we have already done?

Parthasarathy NS: We have already added about 440 in Q2. We will be adding about 150 in Q3 and the remaining in Q4. End of Q4 last year, we have added about 400 and then another 400 in Q2 and about 150 in Q3.

Dipesh Mehta: In H1 put together, we added around 890 that's what you're suggesting?

Rostow Ravanan: No, H1 is just 440 people.

Dipesh Mehta: 440 and so remaining roughly around 1000 we will add in H2?

Parthasarathy NS: About 700, we will add in H2.

Moderator: Thank you. The next question is from the line of Ashish Chopra from Motilal Oswal Securities. Please go ahead.

Ashish Chopra: Rostow, I was just looking at the renewal number in the deals count and it seems to be the lowest in the last six to seven quarters. So, I was just wanting to understand from you as to the pricing pressure that is prevailing in the market. Is it actually leading you to also take decisions in terms of letting some of it go or let it be on the table and probably move towards or pick and choose the deals in terms of where you can still protect the margin band?

Rostow Ravanan: Of course yes, we have been conscious about what kind of business you pick up whether it make sense, overall economics and relationships etc. So you are right, we will be careful about what kind of business we pick up. However, what happened in Q2 was less due to Mindtree walking away from deals because of pricing or anything like that. I would say more of the reasons for the softer picture in Q3 were client related issues, sentiment, external environment. Those kind of things have led to delays in decision making. None of those deals have been lost either because Mindtree walked away or because competition in some form or fashion did a better job and then therefore won the deal. I would say the weaker picture in Q2 was more because of clients delaying decisions.

Ashish Chopra: And just one question on the margins front was that so if 3Q is a flattish kind of revenue and followed by growth in 4Q, then is this a case for a fairly substantial margin expansion over the second half or would you also foresee some headwinds despite the scenario playing out maybe from pricing or any other factor? Thanks.

Rostow Ravanan: We are not currently predicting any further headwinds on margins and therefore from a directional point of view when revenue starts becoming a little bit more stronger, our margin should begin to trend up.

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

Vishal Desai: Quickly on the digital wins which stood at around 64 million this quarter. From your commentary, it sounded like while pricing pressure does exist on the digital front not so much so versus on the traditional business, would you say that there has been some amount of push out in these deals as well because if you compare it on a Q-o-Q or even a year-on-year basis, we're significantly lower on momentum in the digital front if you could just throw some light on that?

Rostow Ravanan: Yes, Vishal you are right. Some of the delays in decision making affect both traditional services as well as emerging technologies like digital.

Vishal Desai: So, any sense that you all are getting from clients in terms of Q3, Q4, H2 because given the nature of these deals which are short term in nature, there ideally would have been some amount of clarity coming in whether they're likely to be pushed out further or not?

Rostow Ravanan: Continue to engage with customers obviously whether it is a very large traction of customer visits to India plus customer interactions even in their own locations, but difficult to sort of explicitly make a prediction at this stage.

Moderator: Thank you. The next question is from the line of Darshan Seth from Riddhi Investments. Please go ahead.

Darshan Seth: I just had one small question. So as rightly pointed out by Jagan that the net margin is affected 2.3% because of the employee expenditure or salary increase and I've also come to know that there's going to be an increased hiring of at least 600 to 700 people in the next two quarters. So, do you feel that there will be enough amount of revenue to offset the increased cost on account of additional hiring?

Rostow Ravanan: So, like the comment that came from a previous question, more of the recent increases have been campus graduate and therefore obviously from a cost point of view it create much lesser of a headwind and therefore from an overall perspective, do not see any new incremental margin headwinds for the second half of this year and to that extent therefore, when revenue traction comes back that should help the margins as well.

Darshan Seth: So just following up on that because the amount in Q2 was significantly higher than the amount shown in Q1 FY17 or Q2 FY16, so I hope this issue doesn't occur again. Thank you.

Rostow Ravanan: So, the big reason for difference between Q2 versus Q1, and obviously also Q2 versus the previous year same quarter was the salary increase in this quarter, which is a one-time for this year and therefore it should get built into the P&L for next quarter and the quarter after that.

Moderator: Thank you. The next question is from the line of Mohil Loonker, he is an individual investor. Please go ahead.

Mohil Loonker: Just wanted to understand process of a new joinee. Whenever a fresher joins Mindtree, what is the time of training that has been given to the new joinee in Bhubaneswar training center. What is the cost that is being incurred on that new trainee and what is the average bench period of that new trainee? Is he being immediately given a project or he has to wait as per the availability or business requirement? And if you break up the attrition, what is the attrition at the junior level?

Parthasarathy NS: You asked multiple questions, I will try to attempt to answer some of them. All campus people join through in our global learning center in Bhubaneswar and the training program there, is a fixed 90 days. Couple of people may come little earlier but it is closer to 90 days, between 85-90 days. The duration of time they take after that to get into the project varies depending on the skills that which they are trained. On an average, they will probably take about 60 days, after that we able to get on to project in a billable mode. They may be staffed as a shadow little earlier, but in terms of earning revenue, they take about 60 days after that.

Mohil Loonker: Can you break up the attrition. What is the attrition at junior level? And if we are moving towards new growth of orbit say around after a year or two year or so. So, are we ready with the infrastructure in terms of new development center or are we planning for any new development center as of now?

Rostow Ravanan: I don’t have the split of the attrition by the level, but I can share it with you, but normally our attrition at the junior level is almost zero. Attrition starts typically between 3 and 5 years.

Parthasarathy NS: And sufficient infrastructure available between all the 4 India locations as well as some of the additional physical capacity we are creating in Bhubaneswar as well. So, across all the offices, we have sufficient capacity for growth from a physical infrastructure perspective.

Moderator: Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to the management for closing comments.

Sushanth Pai: Thank you, Margreth. Thank you everyone for joining this call and we look forward to speaking with you in the coming days. Thank you and good night.

Moderator: Thank you, on behalf of Mindtree Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.

