MindTree Limited Q2 FY 2010-2011 Earnings Conference Call

October 19, 2010

Moderator Ladies and gentleman good day and welcome to the MindTree conference call to discuss the results for the second quarter of financial year 2010-11. As a reminder for the duration of this conference, all the participants' lines will be in the listen-only mode and this conference is being recorded. After the presentation, there will be an opportunity for you to ask questions. Should anyone need assistance during the conference call they may signal an operator by pressing * and then 0 on their touch phone telephones. At this time, I would like to hand the proceedings over to Mr. Sushanth Pai of MindTree Limited. Thank you and over to you sir.

Sushanth Pai Thanks Melissa. Welcome to this conference call to discuss the financial results of MindTree limited for the 2nd quarter ended 30th September 2010. I am Sushanth from the Investor Relations team in Bangalore.

We have with us, senior management team including Ashok Soota, Executive Chairman; N. Krishnakumar, CEO and Managing Director; Janakiraman S., President & Group CEO - Product Engineering Services; Ashok Krishnamoorthy President and CEO, Software Product Engineering; Vinod Deshmukh, President and CEO, R&D Services, Samartha Nagabhushanam, President and CEO NIW; Anjan Lahiri, President and CEO, IT Services; Rostow Ravanan – CFO; Babuji Abraham, Global Head, People Function; Salil Godika, Chief Strategy Officer; and Kamran Ozair, Chief Technology Officer.

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

Before I handover, let me begin with 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 carried risk in terms of uncertainty because of which the actual results could be different. We do not undertake to update the statements periodically. I now pass it on to Ashok.

Ashok Soota Thanks Sushanth, I am happy to state that Q2 has been a good quarter in terms of revenue growth with a Q-O-Q growth of 7.7% on a standalone basis. This has been the highest Q-O-Q growth since 7 quarters on a standalone basis and it gives us the confidence of showing a good growth in FY11 as indicated earlier. The update on our products business is as follows.

Just to refresh MindTree acquired Kyocera's India R&D center in October 2009. This unit is now called MindTree Wireless Private Limited. This unit was working on creating IP in the 4G LTE wireless infrastructure area as well as the 3G enabled smartphones. MindTree now intends to convert MindTree Wireless into a services company. MindTree believes this approach will be in the best interest of MindTree stake holders. The financial implications of the change in approach are being evaluated and will be communicated in due course. I now pass on to KK for further highlights on the Q2 results.

N. Krishnakumar Thank you Ashok. Some highlights of our Q2 results are as follows:

For MindTree standalone Q2 revenues were $78.23 million, representing a quarter-on-quarter growth of 7.7% and a year on year growth of 19.8%. On a consolidated basis, Q2 revenues were $82.4 million, representing a quarter-on-quarter growth of 7% and a year on year growth of 26.2%.

In terms of our businesses, IT services of the was the star with a strong quarter-on-quarter growth of 12.9%, which is the highest quarter-on-quarter growth in IT services over the last 11 quarters. Most industry groups have in IT services have shown a double digit growth. Software product engineering had a quarter-on-quarter growth of 3.5%, and R&D services has shown a decline of 5.3%. Our R&D services business is showing a bit of softness. However, we are seeing positive signs and we expect our R&D services to pick up in the coming quarters and overall R&D services will show positive growth for FY11. NIW had $4.2 million of services revenues and this declined by 3% quarter-on-quarter.

During this quarter, we added 21 new customers. Today MindTree has 261 active customers, of these, 64 are $1 million accounts, which is an increase of 2 over the previous quarter, 14 are $5 million accounts, which is an increase of 1 over the previous quarter and 5 are $10 million accounts. Also, we have added 6 new fortune 500 clients, taking the total count of fortune 500 clients to 45. On the people front, the attrition on a trailing 12 month basis is 21.9% and this compares to 17.8% in quarter 1. On a consolidated basis we have 9584 MindTree Minds, reflecting a headcount net addition of 572 Minds in this quarter. Now let me pass on to my colleague Rostow to share a few financial highlights.

Rostow Ravanan Thank you KK. Good evening and welcome to everybody on this call. Like KK mentioned on a standalone basis our fee revenue grew 7.9%, this is attributable to a solid volume growth of 9.4%, which is being the highest that you had since the last 9 quarters. There is marginal fall in the realized rate by 1.5% in Q2 mainly due to the fact that our India share of revenue in the overall revenues have increased.

On a consolidated basis, fee revenue grew 7.4%, which breaks up into a volume growth of 8.2% and a price realization decline of 0.8.%. Overall, our pricing has been stable as we had indicated earlier. Coming to margins, on a standalone basis, EBITDA margin improved from 14.2% to 15.4%. The reasons for the margin improvement are benefit from the rupee depreciation 1.5%, cost reduction 3%, which was off set a little bit because of wage increases. Roughly ¼th of the people got their salary increase effective 1st July, so that was a negative factor, all the 3 taken together we had an EBITDA improvement of 1.2%.

At a net margin level, if we exclude the one time income in the previous quarter in the standalone results, PAT margins has actually improved from 8.5% to 10.7%. In Q2, the rupee depreciated during the quarter, but appreciated at the quarter end compared to the closing rate on 30th June, which therefore led to a gain on mark to market of our forex hedges. The net forex gain for the quarter is $466,000. Effective tax rate for quarter is 14% and we expect it to be broadly stable for the rest of year. The NIW business contributed a loss of $3.3 million in the current quarter added to the $1.2 million loss in the previous quarter, so the YTD loss of NIW business is $4.5 million. One area of operational parameter, which did not go well was our DSO has increased from 68 days to 76 days. Specific actions items are being implemented to bring this back on track. Utilization for the quarter has broadly been stable at 70%. The board has recommended an interim dividend of 12.5% or Rs 1.25 per share for the half year ended 30th September 2010, with that I pass it back to the operator for questions and answers.

Moderator Thank you. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Mr. Rishi Maheshwari from Enam Asset Management. Please go ahead.

Rishi Maheshwari Thanks and congrats on the good revenue performance. My question was regarding seeking an explanation on the MindTree Wireless as a services company. Could you explain, what exactly would you mean by this and can you also elaborate on what is happening at the NIW front, the product story, the protocol being acceptance by the clients. I would like to have a detailed explanation on that if you do not mind. Thanks.

Ashok Soota Jani you go ahead and then I will add to this.

Janakiraman S On the NIW other than the Kyocera account where we were doing services for both the phones as well the infrastructure, building our own IP in the fourth generation wireless arena and planning to license that and in addition to that on the phone side, we were building a complete phone and then we wanted to take it as a white label product in the market. We have now decided to move away from doing a complete product for phone on a white label basis and instead of that, the skill sets that are available and the capability and then the equipment and infrastructure will be much more leveraged on providing services related to phone design for our customers. Similarly, on the IP front, surely we will continue to pursue our IP program on the fourth generation wireless arena but we will be much more focusing on few services as well services around IP and that will be our future focus.

Rishi Maheshwari You had earlier mentioned that you would be spending about $10-$11 million on the product development, so does this imply that that spend will be curtailed, how do we see this?

Ashok Soota Yeah, the product development cost will be curtailed and that is a black and white answer unless you have any other follow-on on that. There will be no further product developments.

Rishi Maheshwari Yes. Just in case the other follow-on was more towards your excess spend which has happened towards the SG&A also, but primarily I want to understand more on the NIW front, the product front.

Ashok Soota So just to clarify I am going to go back to the beginning If you see this grand total, we have given, I think the year to date loss of 4.5 million and there will be cost associated with stopping the product line. You see that there will be including the one time charge we expect a maximum of $12 to $14 million loss in the second half which we will try to minimize through the higher service revenue and upside in service revenue on the areas that Jani has already talked about.

Rishi Maheshwari Okay. Alright, and the increase in the SG&A what is that attributable to?

N. Krishnakumar See, primarily if you look at the SG&A, there are two elements of it, one like we said part of our non-billable people, 25% of our people had their compensation increased during this quarter which is the July quarter and if you have seen the very substantive growth in terms of both volumes as well as revenues, that certainly resulted in increased pre-sales and sales related cost. Both of which led to an increase in SG&A.

Rishi Maheshwari Okay. Thanks. I will come back for followup.

Moderator Thank you. The next question is from the line of Anand Basavaraj from Spark Capital. Please go ahead.

Anand Basavaraj Yeah. Just wanted to understand the nature of the $12 to $14 million of expenses you would see on the products business for the second half?

Ashok Soota Well, it will include the mix of the fact that there will be some people who are now not available in the system to the extent that they are absorbed within our R&D services business we will consider that possibility, but if there isn't then there will be a one-time sort of a lay off cost out there and there will also be obviously materials which could have been in the prototype stage, etc., had we gone on to the final product would have been used. At this stage, they may be useful in the design element but we will write them off.

Anand Basavaraj Would there be any asset write-off also, does it include any asset write-off which you would have got for testing or something?

Ashok Soota All the assets are essentially needed even in the design business.

Anand Basavaraj Okay. Sure. Just wanted to get an update on what is the kind of outlook you are having on the margin you said ex of the product investment you will be looking at close to a flat margin on

FY11 vis-a-vis FY10 just wanted to know if we are holding onto a similar outlook at this point of time.

N. Krishnakumar Anand, if you see in terms of the standalone EBITDA margins, this quarter we had a 120 basis points improvement on the EBITDA margin which like Rostow pointed out it is due to the strong revenue momentum. It is due to some level of rupee depreciation which has been partly offset by the wage increase which we had. Going forward we clearly continue to see reasonable momentum on the growth which is revenue front and we do have adequate levers, the utilization has been at 70%. We do have scope for marginally improving utilization. There have been because of the very strong growth in the revenue some level of subcontracting cost which have incurred, which can be reduced. So, as we see the outlook for the balance of the year, we do anticipate that for the half year 2, there will be an expansion in margin.

Anand Basavaraj Sure, I will come back later. Thank you.

Moderator Thank you. The next question is from the line of Mohit Jain from Alchemy. Please go ahead.

Mohit Jain Hi, I have 3 questions. The first is on the spend which you mentioned 12 to 14 million in the second half and the margin guidance which you have given, does that include the spend or should be treated as one-off and second going forward into FY12 should we expect any further expenditure on the handset or on the 4G wireless investment side?

Ashok Soota Let me take the FY12 side, I do not think even I got the question for the first part may be Rostow if you got it you can respond. Clearly by the time we get into FY12, we will be a pure services company, there are certain investments that you see typically in a product type of entity will not exist. The IPs we are talking of are really essentially ready, in all we would really need is expenses to marginally customize them and then realize revenues around those IPs. So, it will be a pure service model. Rostow you may want to take the first half and I never understood the question

Rostow Ravanan Thank you Ashok. To answer the first question, no, the margin outlook that we gave that we expect the next two quarters to be on a margin improvement trend does not factor in the cost of $12 to 14 million. Those would be accounted for as a one-time cost for restructuring the business.

Mohit Jain Okay. As a follow up can you please repeat the break-up of margin impact for this quarter?

Rostow Ravana In the current quarter there was a net improvement in EBITDA by 1.2%. Breakup for that is a positive impact of 1.5% due to rupee depreciation, impact of 3% positive cost control and negative impact of 3.3% to wage increases.

Mohit Jain And should we expect any further wage increases because you mentioned that one fourth got wage hike last quarters.

Rostow Ravanan No. This point I made was three-fourth of our people have got their wage increase effective 1st April so that is Q1 itself. The balance one-fourth got their wage increase effective 1st July. So, therefore by now the entire company has been covered and we are not planning any further revisions of salary other than what happens to people in the normal course through career progression, etc as of now.

Mohit Jain So I should not expect any further wage inflation due to promotions or wage hike in FY11

Rostow Ravanan Like I said, promotions happen in different cycles and you know to the people who are covered by those cycles, there would be a wage revision. There are no across the company wage revisions planned for the rest of this year

Mohit Jain Okay and can you please help me understand the product engineering side of the business. I noticed that there was a fall in margin in this quarter. So if you could throw some light on that business.

Janakiraman S I do not know where you have picked up that number, the gross margin we had a 0.4% increase and the revenue if you take on a quarter-to-quarter basis, we had at a product engineering services which excludes the NIW part which is the R&D services and then the software product engineering together we have 0.8% increase.

Mohit Jain Okay, I will check this and will come back to you. Thank you.

Moderator Thank you. The next question is from the line of Amar Mourya from Indianivesh. Please go ahead.

Amar Mourya Alright. Good morning. Congratulations for the good quarters and just a followup question. First I just wanted to know what are the main reasons for this software development expenditure going up, by 100 basis point, that is primarily because of the wage hike or is there any other reason behind that?

Rostow Ravanan The biggest component within that is people cost increase due to both the salary revision as well as new joinees, like KK mentioned in the beginning of this call, net addition has gone up by appropriately 600 from Q2 to Q1. So, the increase in number of people also led to the increase in the software development cost, other related costs include, for example, increases in subcontractor, usage of subcontractor because in the current quarter given the fact that we are a strong revenue momentum, we had to use a little bit of a third party resources to meet that demand. Lastly, some increase in travel as well.

Amar Mourya Now, see the 66% of the total revenue, that is, for the software development expenditure going forward, what is your take and I believe, additions are going to be at the normal level. So, is it expected to go down or is it still going to remain at the same level for second half?

Rostow Ravanan We expect margins to improve going forward mainly driven by the fact that there is a very strong revenue traction that we see and like I said some one off cases where we use subcontractor etc to start the project will get replaced by own people going forward, both of those will lead to a margin improvement going forward.

Amar Mourya So, margin improvement going forward.

Rostow Ravanan Correct.

Amar Mourya So, what could be the range 13% to. Sir, right now, EBIT margins are 13%. So it is expected to reach to the historical level?

Rostow Ravanan Right now, we are not making any specific comments on what target margins we are looking at. But like we have shown from Q1 to Q2 there has been an approximately 1.2% improvement in margins. We expect a similar trend to continue even going forward where the margins will go up. But we are not making any comments on the exact number at this point of time. Because we do not give guidance either on quarter-to-quarter basis or on a year-end basis.

Amar Mourya Okay. Sir, the second question is on the SG&A front. Now, the SG&A front is 22% of the total revenue. How far like, it is expected to decline going forward?

Management Again, we are not calling out on specific trends on SG&A per se, but we expect overall EBITDA to improve both in Q3 and in Q4.

Amar Mourya Okay. Secondly, attrition rate is pretty high in this quarter. So is the trend expected to continue?

Babuji Abraham We have implemented, like Rostow said two wage revisions in Q1 and Q2 and we have started seeing the results of that and we expect the attritions to taper down in the coming quarters.

Amar Mourya Okay. Now, I missed this thing the expenditure on this product development that is $10 to $11 million, right?

Rostow Ravanan The comment which Ashok made was the cost of restructuring the business, net of any gains we make from the services profit is expected to be in the region of $12 to $14 million for the second half of this year.

Amar Mourya Now, the handset business which you were talking about like, is it actually coming out with mobile phones or it is serving to mobile companies**?**

Rostow Ravanan Like we mentioned that's business which we are exiting, we wanted to operate that on a product basis. Now we have exited that business…

Janakiraman S And it is the mobile phones actually a white label product providing to service providers or the OEM's, that's the business we are exiting

Ashok Soota That was the business but now we are converting that into design services

Amar Mourya Thanks a lot and surely if I will have some followup question, I will come back.

Moderator Thank you. The next question is from the line of Rahul Jain from Dolat capital. Please go ahead.

Rahul Jain Yeah, good evening, Sir. Just to understand, what we were guiding was some 10 odd million of expenditure if we were going through the product business. Now the restructuring cost is to the extent of 12 which is similar or a little higher? So can you explain that?

Rostow Ravanan The $12 to $14 million like we mentioned would be a one time cost because certain investments were made in people and everything else and now we see how we have to restructure the business. Certain amount of separation of people, other write offs equipment already procured or components already procured, etc, will now need to be incurred. So, that's the reason. So we wanted to take an approach; now that approach is changing and our change in approach requires certain amount of cost. So, that is the way it has to be seen.

Rahul Jain So now, the change stance in terms of getting into a service business. So what we are looking is basically to help different OEMs in the designing of the phones. Is it what we are looking?

Samartha Nagabhushanam Actually going forward we will be doing design services for the OEM where we will be helping them to realize the product little faster and we will also help some of the silicon vendors to make some reference designs and those kind of stuff.

Rahul Jain Just to, come up from what you guided earlier was that you guys are having some good response in terms of whatever displays or the road show we went through and now once we are coming off from this particular business, how does it help, us gaining some business on the similar account when we are actually dropping our own idea of coming with a white label product.

Samartha Nagabhushanam Actually in terms of the user experience, the team has developed a significant user experience. Now, we know the real capability of the user experience team. The skills will be really utilized for the phone OEMs because they are good designers. They will be able to make significant contribution to the Phone OEMs user experience. They can enhance the user experience of the phone OEMs. So, we will be utilizing those skills as design services going forward, but we have gained reasonable amount of confidence in the team in terms of the capabilities. So, that is a happy thing to know.

Rahul Jain You may find it a little persisting, the confidence which we are talking of, is it because of some response we might have got from the OEMs?

Samartha Nagabhushanam Yeah, actually it is the response from the operators that we have talked to. There are some focus group studies we had done. Okay, there were good responses from them and the eco system partners that you were showing the product to. So, we got good response from them in terms of the user experience. What we will be selling now is not user experience per se, but their skills will be utilized in the other OEMs to make the design better.

Rahul Jain Okay. How do we see, monetizing all this efforts going forward?

Janakiraman S In addition to Samartha, let me add little more Rahul we are already in the R&D services arena we are servicing several semiconductor clients like ST Micro**,** Texas Instruments, NXP or several of them and who are in the phone related arena where they make chipsets and they look for realizing a product for their customers and in addition to that we are servicing several semiconductor rather the communication equipment client be it Alcatel, or Huawei, CISCO or any of them any of them and they again are the ones who will be looking for the skills. So between the NIW and R&D services, we will be able to absorb most of the people into the services business of ours.

Rahul Jain Just to understand, all the service capability which we will be providing to these players, what could be, kind of a bench mark percentage of the total cost of a product?

Janakiraman S See if you take any of the customers in the 4G wireless arena or in the phone arena, they spend somewhere around 10% to 15% towards the R&D cost and they would like to keep as much as possible that cost as the variable cost and that is where we provide the design services to our client and we feel there is enough traction in the market rather there are several clients who were looking for such services in the phone arena previously and we did not take it up because we were building our own product. Today, we will be able to service them better because we are not in the product business and we will be deploying them into the services business.

Rahul Jain Okay. Thanks a lot. That is it from my side.

Moderator Thank you. The next question is from the line of Kawaljeet Saluja from Kotak. Please go ahead.

Kawaljeet Saluja Hi. My question is that, what drove a change in heart on the entire product strategy and at what point in time did you realize that, the product business or the handset business would not be your cup of tea?

Ashok Soota Sure. Kawaljeet this is Ashok here, let me just take a first stab at that, you know, I think the change is come very largely because of two reasons. One is that literally as we began to see traction with our customers which was positive so they actually seen the design and have been keen on it and looking and beginning to test it already but this is the changes in market conditions we clearly are seeing these contracts in the larger global players require more commitments on areas like for example inventories than the model required in previous years and these have been changes in market conditions which are really built up. Arising out of that we do realize that the business like this does have to be capitalized at a much higher level, may be somewhere between $50 to $75 million and you might say when did we get our first real realization that this was in effect going to be sort of the investment levels needed. You might see anomaly or uniquely it would have happened when we actually got into the door with larger operators and they gave us access to their contracts and we began to see that those contracts required inventory commitments which we have assumed were not going to be available or required in white label phones and that used to be the position in the market until the previous year when we actually kicked off and launched our business model.

Kawaljeet Saluja Thanks. Second, I am not able to understand just one thing that if the total investment in the product business has been $1 or $2 million then, you know, what is this $12 million write off for and where does it sit in your balance sheet?

Ashok Soota May be, I will just give one quick overview then may be Rostow you can add more to that. Essentially, as you go through the process of developing a phone you are making a lot of commitments for people to do upfront engineering work for you so those are commitments which you may say would be in the pipeline because commitments were made and those were to be amortized when we began to supply the product and the very fact that they we are now going to stop that. Those people have got to be reimbursed and also there are prototypes because you go through various stages of building and those prototypes are fairly large in their quantities because you have to do so much testing. So I would say that these two become the single largest areas of cost, which should have been really work-in-progress you might say and now because we are discontinuing the product we end up writing them off as a one-choice basis. Rostow, would you like to add further?

Rostow Ravanan Some of these costs are currently not incurred like Ashok mentioned a decision of this nature would lead to a certain amount of employee separation. So, then the cost of separation is one large component within this overall $12 to $14 million worth of restructuring cost. Other costs include current outstanding purchase orders which are now not cancellable like Ashok mentioned, the decision has been taken at a time when we already had some level of feedback from customers so certain components and certain services have been ordered, etc. Those now have to be cancelled but those will still require cost to be incurred as of now and some of the things that we have currently incurred, like Ashok mentioned in terms of prototype development, some parts that have been ordered, etc., will all now need to be written-off. So all of those constitute the cost that add up to $12 to $14 million that I said before.

Kawaljeet Saluja Rostow, is there any cost right now which is residing or which is sitting in the balance sheet which has to be expensed off? Any line item which I can look at which would just give me an indication of what is the liability sitting on the balance sheet and what is contingent or may come in over next 6 months?

Rostow Ravanan Very small amount on the asset side. Firstly no liabilities are being written-off. It is a very small amount on the asset side. I could send that to you subsequently in terms of cost that we have incurred on tooling and equipment and stuff like that. But the bulk of the costs are the costs that we need to recognize from now on because we are restructuring our business.

Kawaljeet Saluja You know, Rostow, help me. My understanding may be somewhat limited. From what I understood is that, unless and until you show a prototype, you do not need to source too much of equipments, or give out too much of purchase orders so if there is no cost in sitting the balance sheet then where would this $12 million write-off accrue from or essentially come from?

Ashok Soota May be we can put this question in to two parts, regarding an understanding on how the business work in terms of commitments may be Samartha can answer that and regarding the most specific thing on where it sits whether in the balance sheet or wherever Rostow can give you that.

Samartha Nagabhushanam So, in terms of the product development cycle, before showing it to the operators we will have to do enough and more testing and for that essentially we will have to do a lot of technology based testing and we will have to see whether all the parts of the technology that is all the parts of connectivity that is put on the mobile phone is completely working. So, there is enough amount of testing that has to be done and to that extent there is some investment into the capital equipment to do the testing. So that is one part of the thing and the second thing is before getting the design version which is built to show to the operator, we will also go through some kind of engineering versions and prototypes. So there again, we incur some raw material and some kind of at least one manufacturing spin to that extent we will be spending some thing on the prototype development. So these are largely the components that we will be incurring before really maturing the product to show it to the operators. So that is what we have done until now.

Rostow Ravanan The same answer Kawaljeet, some of them are, assets that we have probably distributed between both current assets as well as fixed asset which is now have to restructure because you no longer being in this business. So somehow those would need to be written-off, which is one part of what is already in our balance sheet that needs to be written-off. But the larger components are like I said, people separation cost as well as currently outstanding purchase order for services or components, etc., which, because we are no longer going to execute that purchase order, exiting that purchase order will require us to incur some cost.

Kawaljeet Saluja Okay. Just a final question from my side. You know, Rostow if I look at a stand alone financial statement, your PBT is 46 crores and in consolidated your PBT is 31 crores; however, when I look at the direct tax provision, it is higher in consolidated and lower in stand alone. So effectively in subsidiaries you are making losses and there are some extra tax expenses as well, I mean, that is only the limited thing that I can understand. Can you just help me with this particular anomaly?

Rostow Ravanan Sure. The biggest reason for the distortion Kawaljeet is because if you can remember in Q1, we had to book an accounting gain which only appears in the standalone results. Because when the two Aztec US subsidiaries were wound up and those accumulated profits and the capital of that entity was taken in, then that typically required an accounting gain but the tax had to be paid because it was treated as evidence received from a subsidiary upon winding up in India. So that is the reason why there was a distortion between the gain and the tax between the two. This gain for example, the gain does not appear in the consolidated. Only the gain appears in standalone, but since the tax outflow is an actual outflow. The tax outflow appears in the consolidated and in the standalone. It is sort of accounting wise that is what the accounting requires you to do. But that is what is causing the distortion.

Kawaljeet Saluja This is heavy. May be I will just try and understand offline. Thank you.

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

Sandeep Shah Sir, just to follow up to what Kawaljeet asked, I think the earlier estimate on the expense was close to around from $10 to $11 million and now if you look at the first half is 4.5 and now we are saying incremental is 12 to 14. So that 10 to 11 for the full year is increasing by almost to $17 to 19 million and we are saying that the increase is largely people related cost. So is that a severance pay is significant which we are incurring or the earlier figure of $10 to $11 million was under estimated.

Rostow Ravanan The earlier 10 to 11 was not an under estimation. That was the estimate we had that point of time, but coming to where we are as of today and the change in approach that we have decided as of today requires us to incur something like that $12 to 14 million right now. Ashok also did mention that we will try and minimize it if any of our efforts to realize some value of the IP we have created or any other services, revenues if it comes faster than anticipated it could lead to an upside but where we stand as of now, we do realize that possibly we will need to do like a $12 to $14 million cost to restructure the business.

Sandeep Shah Can you break down this into CAPEX write-offs and OPEX write-offs?

Rostow Ravanan We will share that subsequently. We do not have that information readily available at this point of time.

Sandeep Shah Because Sir, this $18 million as a write-off with no revenues in FY2010 is a write-off of 10% to 15% to the networth which we have reported in March 2010. So I think this is like significant erosion to the shareholder value through book value as well as through the market price.

Rostow Ravanan That is true if you look at it from that perspective, but if you look at it, we had certain expectations from this business and then we attempted it but when you realize that the reality is different from your expectations exiting it at this point of time, turned out to be a better choice for us. If we persevered with it and had to incur a higher loss or had to commit to much more higher amount of capital to make it a success would have been an even worse proposition. If I knew what I knew as of 19th October, as you know, I had obviously acted differently for the business as a whole on 1st April as well, but I do not know what I know today on that day. So we attempted something, it did not workout. So, at least we are pragmatic enough to realize that our bets did not go well and taking corrective steps as of now. So while obviously at a certain extent the loss could have been avoided if we did not do it, but you would not have known it unless you did it.

N Krishnakumar Sandeep again here I think Ashok had mentioned this earlier. Primarily, I think there has been a very significant change in the market in terms of business models, which has necessitated a substantively higher capital requirement for this business. Again, what we built had good traction in the market with some of the leading players and operators and like Rostow rightly said, in the changed scenario of the market with the changed business model if we had to go ahead it would have involved substantive capital investment as well as commitments from MindTree. So, in the context and in the interest of protecting as well as enhancing stakeholder value, we have taken a more pragmatic and practical decision to see how we can enhance the value of the capability and competence that the team has built, to build a designed services business to build an IP based services business which will in turn generate revenues for the company.

Sandeep Shah But is it like a second option also, where we can monetize the IP buy just selling it upfront?

Rostow Ravanan Absolutely, any opportunity to take this work that you have already done both on the cellular infrastructure as well as on the handset segment, anything that we can take to customers and realize value clearly will be attempted and if in any efforts prove successful that would lead to a lower loss than the $12 to $14 million that we explained but since we want to be conservative we have taken the cost at the gross basis as if now.

Moderator Thank you. The next question is from the line of Mr. Sandeep Muthangi from IIFL.

Sandeep Muthangi Ya, if I recollect the Kyocera acquisition there were two so called units as you directly highlighted one was supposed to be the handset development at the platform front and the other was about this IP, which was related to the 4G services and the LTE part? Have the plans of the IP development also been shelved?

Janakiraman S See as far the IP development is concerned previously we were looking at making a complete base station and then offering it as a kind of the IP with multiple stacks in it and then now we will be taking an approach in terms of whatever are the efforts that we have put in and they are something which are functional and that will be a value in terms of componentizing that IP and then selling it in the market and in addition to that providing services around those IP also as an opportunity.

Sandeep Muthangi Okay, fair enough. I was looking at your attrition rates and a bit surprised because most of the salary hikes have already happened in the last quarter and if I look at a compatible metric like a quarterly annualized figure it's fairly high at about 35-36%. I was just wondering as to whether some of the cost-cutting or the attrition related to the discontinuation of the Android platform front has already started happening or is it completely voluntary attrition that we are seeing during the quarter?

N. Krishnakumar No, this is completely voluntary, Sandeep. I am not sure how you got that 35%. This is Krishnakumar here. The key thing which you really find I think is during the period July and August, is the time when the number of IT professionals who opt to go for higher education either abroad or for their business school tend to leave. So, it is a fact that during that time the attrition peaks and even if you look at segmented data of attrition you certainly had a reduction in September. You are right that overall for the quarter the trailing 12 months numbers have increased to 21.9% but certainly if we segment into things and again just to give you a very specific quarter-2 number alone it is 26.8%.

Sandeep Muthangi Okay, fair enough, thanks.

Moderator Thank you, the next question is from the line of Mr. Nitin Padmanaban from Indiabulls Securities. Please go ahead.

Nitin Padmanaban Hi thanks for taking my question and congrats on a great revenue momentum. Just with regard to the cost of revenue, if I look at the salary and allowances it has gone up by 15% quarter-on-quarter versus where we have probably added just 6.5% incremental employees. Where you look at the previous quarter where bulk of the actual hikes were given, the cost has not moved up as much so just wanted to figure what was there in the quarter?

N. Krishnakumar Nitin, I think you if you look at what we had explained in the last quarter was that 77% of MindTree Minds who had an increase were the people in the C1-to C4 as we call it, the programmers, tech leads and up to the level of a module lead. So, people with a higher compensation were covered in July which is why you will find the wage revision actually impacting. The other reasons for the wage revision is typically, your campus recruits - significant number of them have come in to the pool in July, that again adds to the addition in manpower cost without adequate sort of revenue numbers coming in in this quarter itself.

Nitin Padmanaban Sir if you could just give us a break-up in terms of the overall wage bill what percentage would it be for 1Q and what percentage would be for 2Q?

Rostow Ravanan Sorry, one more comment on the previous question. Manpower cost would include recruitment cost as well. So if you see the numbers that were given based on a gross hiring of approximately 1200 in the quarter, our recruitment cost went up for that and lastly manpower cost would include subcontractor cost as well, like KK and I mentioned in the initial briefing in the current quarter because of the revenue traction we had to use subcontractors for certain extent to fill immediate requirements at customer projects so that also lead to a overall increase in the manpower cost from last quarter to this quarter.

Nitin Padmanaban I am just looking at the salary and allowances. Subcontractor charges you have a separate line and I am looking at the break-up. So, basically it looks pretty big. So, if you could just give the percentage of the wage bill?

N Krishnakumar Yes, Nitin I think if you are looking for this number what we did in April was the wage revision for 71% of our MindTree Minds. What we did in July was for 29% of our MindTree Minds which are people in the higher end of the spectrum.

Nitin Padmanaban As a percentage of the total wage cost?

N Krishnakumar As a percentage of the total wage cost is 29% contributed to 45% of the wage cost.

Nitin Padmanaban And this 29% came in 2Q?

N Krishnakumar In-2Q that is right.

Nitin Padmanaban Okay, fair enough and just one more thing, with regard to the 12 to 14 million you highlighted that it was cost of separation and cancellation of purchase order and write off of cost, with regard to the cost of separation which you did highlight was a major cost there, what would these severance pay be, would it be for 3 months or 6 months?

Rostow Ravanan It will be as per our contractual terms to our employees.

Nitin Padmanaban Okay, what would that be on an average?

Rostow Ravanan It could vary between people at different grades.

Nitin Padmanaban Okay, that is enough, Thank you.

Moderator Thank you, the next question is from the line of Pratik Mehta from Bajaj Allianz Life Insurance. Please go ahead.

Pratik Mehta Thank you for the opportunity to ask a question. One of the large component as you mentioned of the $12 to $14 million of charges people reimbursement for committed work and now my question is with such strong volume growth and also in terms of work that we are doing, there is some overlapping in terms of designing or product development work, etc. so cant these resources be used for our services business, which can eventually reduce the $12 to $14 million charge by probably certain meaningful amount?

N Krishnakumar Pratik I think that is a very good question. What you have factored in is out of the 700 MindTree Minds in MindTree Wireless, there would be a good percentage of people who will be leveraged in our R&D service business, where we have similar services being delivered to customers. This 12 to 14 million is after taking into account what we anticipate now in terms of a good percentage of people being deployed in services and you are absolutely right as I mentioned earlier in the call, we are seeing a very positive momentum in our R&D services business and the ability as well as the capacity which this change will bring in will positively impact the revenue momentum in R&D services in the second half of the year.

Pratik Mehta Okay fair enough, that is from my side. Thank you very much.

Moderator Thank you, the next question is from the line of Mohit Jain from Alchemy. Please go ahead.

Anurag Sir, I had a question regarding coming back to the product business, because if I am not wrong till one month back management was highlighting US as the target geography with a white label phone of $300 per unit, so at what point in the quarter, the management realized that the strategy needs to be changed. Essentially, because if you look at NIW there was a recruitment of at least 74 employees on net basis in NIW in this quarter?

Rostow Ravanan Sure, this change in approach was very-very recent. Like I said till may be about 2 to 3-4 weeks back, the plan was based on the customer traction to take it to the next level but as the feedback on the instrument itself, our engineering and our design, etc., standpoint progressed favorably and we saw it getting into more detailed discussions on business model and execution approach etc… it gave the feeling that the capital required and the risks involved in this business are significantly different than what we originally anticipated. So, the thought process to change the approach was fairly recent and was finally crystallized at our board meeting today and from that perspective it is like an almost few hour old decision to change this approach.

Anurag Sure and one more thing, would not the same employees which are there into NIW have the same skill set that would be required for providing services to the operators as well. So in essence would we really be requiring to lay-off employees in that case?

S Janakiraman We will be absorbing most of the employees and as high as possible we are working out the numbers as Rostow was saying it is only a few hours back decision and whatever we have indicated in terms of $12 to 14 million is a back of the envelope calculation. We will be coming out with details much more but at this point of time we are trying to absorb as many but still we may have to lay off some of the skills which may not be deployable in other businesses?

Anurag Finally, in this quarter, goodwill has reduced on quarter-on-quarter basis and also there is significant amount of reversal in provision for bad debts, if you could throw a little bit color on that please?

Rostow Ravanan Sure, the change in the goodwill was on the basis of our reestimation of the contingent consideration payable to Kyocera. At the beginning of the acquisition in October 2009, we had paid approximately 6 million upfront and a part was linked to contingent consideration dependent on the revenue for this year and next year. The updated estimate of the revenue for this year from Kyocera is lower than the original projection. So, therefore the contingent consideration reduces correspondingly. So therefore the goodwill has reduced there. What was the second question?

Anurag The provision for bad debts

Rostow Ravanan The provision for bad debts has reduced because we have a provisioning policy that is based on age of the debtors and some of the debtors that have crossed into higher buckets subsequently got realized in the current quarter. Therefore, there is a reduction in the provision for debtors in this quarter.

Anurag Thanks and all the best.

Moderator Thank you. The next question is from the line of Ashish Agarwal from Tata Securities. Please go ahead.

Ashish Agarwal Thanks, just one question from my side, what would be the goodwill write-off which could happen because change in schedule whether there will be any write off of the goodwill?

Rostow Ravanan We are evaluating that right now. Our current view is that it possibly should not lead to a big change in the goodwill amount because the goodwill amount is linked to the asset value of the business and as of now the bulk of the asset that we already have is unlikely to go through any major impairment at this point of time but if there is any change we will update you as soon as we have any updated information. We do not anticipate like a big write-off at this point of time?

Ashish Agarwal Okay, thanks.

Moderator The next question is from the line of Ritesh Rathod from UTI Mutual Fund. Please go ahead

Ritesh Rathod May be my question is something bit different and for a longer-term if you see historically, I believe on my sheet 3Q-2009, we had a quarterly run rate of $75 million whereas EBITDA of 30%. Today, we are at a quarterly run rate of $82 million and you said standalone EBITDA is 15%. So, the 15% point is 1500 bps difference. If I remove the rupee impact, I believe the rupee impact would be some 250 bps which would have dented the profitability, what would you explain the rest of the impact the margin decline and how do you see internally targeting what level if MindTree can come back to in terms of margin?

Rostow Ravanan Sure, Ritesh the numbers that I have is Q2 2010 was EBITDA of 20.9%

Ritesh Rathod No I am talking of 3Q-2009 where we had a $75 million run rate and 30% EBITDA with a rupee conversion of 48.73. So, if I see I believe that was the peak margin which we did and today we are at some 15% points on the standalone basis, so removing the rupee impact which was some 250 bps we are still down and if we see internally we had one salary hike and then we had several project over-runs, but everything should have been recovered given the project overruns happened in 1Q-2010. So today we have 4-5 quarters ahead of that project over-runs. So, still margin has not recovered on the underlying business, whereas the revenue run rate has recovered, so what will you attribute and where do you see?

N Krishnakumar I think this is a very good question. Clearly if you look at Q3-09 I think the market was going though a tremendous growth momentum and clearly as vendors the pricing power was there and in fact if my recollection is right during FY08-09, we probably increased our average pricing by close to about 5% off shore and 3% onsite and so on. The fact is that over the last 12 months or even 18 to 24 months, really pricing it went through a decline when there was tremendous level of pressure from customers to reduce pricing, so you went through a reduced pricing. Obviously, even now you are slowly getting back to where you were 24 months in terms of levels, but if you really see the compensation increase, which has sort of come in to the P&L during this financial year is probably the highest over the last 3 – 4 years. So, it is a factor in terms of two variables which are working in a different direction, but what we do perceive going forward like Rostow also shared, we do have some margin lever. We certainly have the growth momentum, which is catching back. Our utilization is still stable at 70%.

There is an opportunity to enhance utilization by at least a few percentage points, so that will give a margin improvement lever. Because there was a significant growth momentum, we have used some subcontracting, which we will address and sort of improve margins. So those are the various elements which have sort of and your point is absolutely valid. We do see a positive momentum in terms of the margin front. The other factor which you have to consider between Q3 of 2009 and now, is that we very consciously took in the time of even recession, to significantly expand our field force in fact, I think we have shared that in earlier quarterly sort of analyst call, that we enhanced the number of account managers and people which are client facing. (In fact even during the period of recession we honored all the campus offers which we made and particularly this investments in front-end field force at the time of recession is starting to help us because if you see our growth momentum now has been the highest, particularly in the IT services the highest in the last 11 quarters and that has happened because we invested in front customer facing position 3 to 4 quarters ahead.

Ritesh Rathod So how much would have been the price decline from the peak till today when you see 3Q-2009 as a peak and if you say at the company level how much of the offshore pricing would have declined?

N Krishnakumar See Ritesh, I do not have the numbers on the top of my head, but certainly we can get those numbers and email it to you, Sushanth, our Investor Relations persons will do that.

Ritesh Rathod What kind of margins are we targeting when you say like in the next 6 quarters or 5 quarters. Where do u see MindTree, where you want to target it internally, which level you would be more, assuming the rupee and the rupee volatility doesn't come in between at the current rupee levels where do you see margins coming in and getting stabilized or whatever inefficiency which you talked of subcontracting and all other things getting out of it and helping you out in coming quarters. So where do you see the margins stabilized?

N Krishnakumar Ritesh, again as a policy we don't give forward looking guidance, so to that extent I cannot assess what percentage of margin we will have 6 quarters from now, but what we do see is that we have adequate capability and as we look ahead on both the market and the growth momentum, which we are foreseeing, we do see quarter after quarter an expansion in margins. Clearly, I think that is the key thing and meanwhile while you have talked about, I think we would sort of get those numbers and sort of provide it to you particularly, I think there would have been impact on the realized rate in the offshore business. My guess is it is somewhere between 8 to 10%.

Ritesh Rathod Thanks, that is it from my side, thanks a lot.

Moderator Thank you. Ladies and gentleman that was the last question. I would now like to handle the floor back to the management and Mr. Sushanth Pai for closing comments. Please go ahead.

Sushanth Pai Thanks Melissa. Thank you all for joining this conference call. We look forward to speak with you in the coming quarters.

Moderator Thank you gentlemen of the management. Thank you Mr. Pai. Ladies and gentlemen, on behalf of MindTree limited that concludes this call. Thank you for joining us and you may now disconnect.