MindTree Limited Q3 FY 2010-2011 Earnings Conference Call

January 18, 2011

Moderator Ladies and gentlemen good day and welcome to the MindTree conference call to discuss the results for the third quarter of financial year 2010-11. As a reminder for the duration of this presentation, all participant 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 this conference call, they may signal an operator by pressing * and then 0 on their touchtone telephones. I would now like to hand the proceedings over to Mr. Sushanth Pai of MindTree Limited, thank you and over to you Mr. Pai.

Sushanth Pai Thanks Rochelle. Welcome to this conference call to discuss the financial results for MindTree Limited for the third quarter ended 31st December, 2010. I am Sushanth from the Investor Relations Team in Bangalore.

Before we start the proceedings, I would like to wish you all a happy and prosperous new year. We have with us senior management team including Ashok Soota – Executive Chairman; N. Krishnakumar – CEO & Managing Director; Anjan Lahiri – President and CEO, IT Services; Rostow Ravanan – CFO; Babuji Abraham – Global Head, People Function. The agenda for this session is as follows. Ashok, Krishnakumar, and Rostow will begin with a brief overview of the company's performance. After which, we will open the floor for the Q&A session.

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 Ashok.

Ashok Soota Thanks Sushanth. Let me also add my good wishes to all of you for a very happy, healthy and successful 2011. The latter half of 2010 has shown a very positive momentum in our overall business environment and this is reflected in our Q-over-Q numbers. After a downturn, the recovery process varies from business to business.

Our ITS business has shown strong Q-over-Q volume growth and we are beginning to see a growth trend in product engineering services also. These are good signs for 2011-12.

The update on MindTree Wireless - significant developments. We have received the approval to merge MindTree Wireless with MindTree. The amalgamation is effective from 1st April, 2010. Consequently, the results of MindTree include that of MindTree Wireless.

Recently, we also announced the completion of the restructuring exercise to convert the product business into a design services business. The design services business will now be an important service offering for us and the skill sets and capabilities we have in this area have a good market demand. We are seeing positive traction and already have an international consumer electronics company as our first customer. The restructuring cost is about $3.7 million which is within the range indicated recently and significantly lower than the original estimate of $12 to $14 million.

There have been some tax benefits also because of the merger. Rostow will discuss this later. Given that the acquisition cost was only $6 million, I would like to state that the acquisition in itself has yielded favorable results. Kyocera services revenues since October 2009 till date has been $22 million. We have also added a new business segment as part of our service offerings and acquired state-of-the art facilities. Now I would like to pass it on to KK for further highlights on our Q3 results.

Krishnakumar Thank you Ashok. Some highlights of our quarter 3 results are as follows:

Q3 revenues were $85.25 million and this represents a quarter-on-quarter growth of 3.5% and a year-on-year growth of 21%. In terms of our businesses; IT services continues its good traction with a quarter-on-quarter growth of 7.6%, R&D services has shown a growth of 5.6%, software product engineering had a decline of 4.9% mainly due to clients' year end budget constraint and lower billing days due to holidays. MindTree Wireless with $4 million of services revenues declined by 4.7% quarter-on-quarter.

We added 30 new customers during this quarter. With this, we have 269 active customers. We also added 3 new Fortune 500 clients taking the total count of Fortune 500 clients to 48. Some of the significant wins during quarter 3 were:

- a leading Fortune 500 retail chain based in U.S. MindTree will provide services in the area of digital business, infrastructure management, and testing.
- A Global CPG company, MindTree will provide business consulting services in the area of business transformation to improve customer's distribution competitiveness.
- A large semiconductor company based in Japan, MindTree has partnered to build lifestyle accessory products using low energy Bluetooth technology.

On the people front, the attrition on a trailing 12-month basis is 24.2% compared to 21.9% in quarter 2. Attrition for the quarter annualized is 25.6% which is lower than the 26.8% the previous quarter.

On a consolidated basis, we have 9671 MindTree Minds reflecting a headcount net addition of 87 minds in this quarter. If we exclude the people separated in MindTree Wireless, then the net addition is about 180.

Now let me pass on to my colleague Rostow to share a few other financial highlights.

Rostow Ravanan Thank you KK. Good evening and wish everybody a healthy, happy, and prosperous 2011. The financial highlights for the quarter were as follows:

Fee revenue grew 3.6% wholly driven by price realization increase. Volumes were largely flat in the current quarter due to higher leave as well as lower number of working days and holidays in the current quarter. Part of the price realization increase was because of our IP licensing revenue in our product engineering services business. MindTree including the wireless business, EBITDA margins have been stable at 11.7% from previous quarter to this quarter in spite of the revenue pressure like I mentioned due to lower billing days as well as the restructuring cost we incurred on the wireless products what we previously used to call the NIW business as well as the impact of the rupee appreciation. During the current quarter, rupee appreciated approximately 3.5% which led to 1.7% impact to margins. In spite of these headwinds, margins were flat from previous quarter to this quarter.

In Q3, we had a mark-to-market gain of $1.5 million. Other Forex related movements gave us a gain of $200,000 leading to an overall Forex gain of $1.7 million. Effective tax rate for Q3 was 9.6%. Part of the reason for fall in the effective tax rate is because the NIW restructuring cost got completed as well as the merger got complete in the current quarter. So therefore the loss from the NIW business led to a lower tax rate for the current quarter. Excluding these, our average tax rate is again in the region of approximately 15-16% effective tax rate.

Our DSO improved from 76 days in the previous quarter to 68 days in the current quarter. Utilization including trainees declined a small amount and now it is at 69.3%. Part of the utilization dip was because of the restructuring of the NIW business. I now pass it on to the moderator for question and answers.

Moderator Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Pratyush Rastogi of Sabre Capital. Please go ahead.

Pratyush Rastogi Thanks for taking my question. My question regards to, few times in the press you mentioned that you are targeting to become a billion dollar company by 2014 and I just wanted to basically get your thoughts on whether or not, how you are doing with that goal and your thoughts on it?

Ashok Soota Thank you for that question. Pratyush when we articulated this vision, it was just before in effect the global recession suddenly broke out, so you might say it certainly did come in at a time when markets were growing at different pace and there was always going to be a challenge. We had in 2009-10 one flat year due to also now the decision to convert the mobile product business into a design services business, I would say that the target date certainly needs review, not the billion dollar goal in itself it will remain. We are taking a look at this and it will need to shift but by how much, may hopefully not too much and that we will in due course of time articulate. We are in the middle of our planning cycle and I think it is during that plan cycle that the revised date we want to set will become clear.

Pratyush Rastogi Okay thank you.

Moderator Thank you Mr. Rastogi. Our next question is from the line of Anurag Purohit of Alchemy. Please go ahead.

Mohit This is Mohit from Alchemy. I have two questions. The first is on the impact of lower number of working days on volume growth. Sir if you could help us understand why the volume growth was flat. The second is on price realization. If you could give us a breakup of price realization which happened because of contribution from IP based revenue?

Krishnakumar Mohit if you look at the number of working days, quarter 3 had 61 working days compared to Q2 which had 63. So the impact in terms of revenue was approximately 2% because of the lower number of working days. In terms of the pricing realization of 3.6% like Rostow shared, it's really come in terms of a one-time IP deal which was roughly about $600,000 which could have cost about a percentage of increase. The other two key factors being of our own increase in terms of few contracts where we have been able to negotiate better prices, those really have contributed to the pricing increase.

Mohit Just as a followup, is it safe to assume that barring seasonality, the volume growth was like 2%?

Krishnakumar Barring seasonality yes. If you see our IT services business in spite of the seasonality, we had a volume growth of about 3.9%.

Mohit And can you help us understand or can you throw some light on what is happening in the product engineering services side because we have seen that segment declining for last couple of quarters and so what kind of growth or what kind of trend should we expect going forward?

Krishnakumar Mohit like I think in our opening remarks we shared and Ashok alluded to it saying that we are seeing a growth momentum catching up also on the product engineering services. There were really two major components of the product engineering services. The R&D services where you see after 2 quarters of decline, we had a 5.6% quarter-on-quarter growth during the current quarter. In the software product engineering where you see a decline for the first time that is certainly more seasonal because clearly I think there were few clients who had year end budget pressures as well as some of the technology companies adopt what they call the golden week where they have a closure including for their own employees which led to a reduced volume during the current quarter. Going forward clearly I think we would have growth in volumes in the product engineering business also.

Mohit Okay thank you and all the best.

Moderator Thank you Mr. Purohit. The next question is from the line of Madhu Babu of Systematix. Please go ahead.

Madhu Babu Sir BFSI has seen a strong traction during this quarter and over the last 2 quarters, what is the kind of deals we are winning and what is the size of the deals?

Krishnakumar Madhu I am going to ask Anjan who is the President and CEO of our IT services business to take this.

Anjan Lahiri In terms of BFSI deals, there are two trends here. One is the largest BFSI companies who were really not our customers in our first 6, 7, 8 years of existence, but now going into the second round of offshoring or multisourcing shall I say and they are looking to augment their current partners by another partner and we are coming across quite strongly as a credible alternative and we are seeing a trend there. Otherwise our traditional strength has been in the more smaller or more mid-sized BFSI companies and we are becoming quite significant partners to them. In the last year and year and a half, we are seeing the companies, our customers themselves really ramp up some of their expenditures and we are seeing growth from both of these sectors.

Madhu Babu Okay sir and sir larger companies like TCS on a revenue base of $2 billion per quarter, they are showing a sequential growth of 7% and the industry is looking at 25% growth in revenues for that companies on such a high revenue base. So we being a mid-sized company, what is the ideal growth rate we would be targeting for FY12 assuming the scenario is going to be good?

Ashok Soota The one phenomenon I would like to highlight that as markets recover and grow, you will see that our growth will become higher than the industry and more so which has really been our objective and our stated goal even in the current year. I will just take you back to the period 2004-2009, 5 years in a row MindTree grew significantly above the industry as a whole and significantly higher than the larger players. 2009-2010 we were all flat. This year, our year-over-year growth may be in the same ballpark. Our stated objective, we will not give guidance is that we will grow faster than the industry and that will remain our aim and goal for the years ahead also.

Madhu Babu Okay sir and attrition has picked up quite to an extent, is that a concern for smaller companies and are we being squeezed out because we are a mid-sized player on the HR front?

Babuji Abraham Even though we have recorded a higher attrition for the last 12 months that is predominantly because of the lower attrition month getting replaced by higher attrition months and on quarter-on-quarter attrition, we have seen a slight improvement, if you see the data.

Krishnakumar Madhu again here like Babuji rightly pointed out that for the quarter 3, we have seen a declining trend in terms of attrition and again I think the right way I think you also alluded to the question saying are mid-sized companies getting squeezed out. I think we track the data in terms of people whom we attract from the larger companies, I must tell you that in the last 9 months, we have attracted more people from the larger companies. For every 1%, we used to lose to the larger companies, we used to gain 4 and that has become 1:6.5 now. So clearly people are wanting rather than being a nameless, faceless entity in a larger company, they want to work for the mid-sizes where they can make an impact which is clearly one trend which we are seeing. The second aspect is I know that lots of press thing comparing attrition of the larger players and the mid-sized players, but what that note did not really sort of take into account is the large number of freshers which the larger companies recruit where there is no attrition practically for the first one year. So if you take the freshers out of the denominator and then calculate the attrition percentage, it is no different in fact probably a company like MindTree might be comparable with any of the larger companies or even may be fractionally lower than the larger companies on attrition.

Madhu Babu Okay sir thanks a lot.

Moderator Thank you Mr. Babu. Our next question is from the line of Sandeep Muthangi of IIFL, please go ahead.

Sandeep Muthangi Good evening, Can you give me a breakdown of the EBITDA margins Q-o-Q. I wanted to understand how much the restructuring expenses have impacted you and how much the pricing has impacted you during the quarter?

Rostow Ravanan Sure, Sandeep this is Rostow. Of the $3.7 million of restructuring costs that we booked in this quarter, approximately $3.2 million is pre EBITDA which is largely people cost which will be part of direct cost or part of the SG&A. Approximately $500,000 is the goodwill write-off, so that will be post EBITDA.

Sandeep Muthangi And just a breakdown of other elements also?

Rostow Ravanan Yes the other elements largely there are 1.7% impact because of currency appreciation. Approximately 2.5 to 3% impact to revenues because of lower billing days.

Sandeep Muthangi And the earlier Android development expenses which would have been happening and obviously I think there was also involuntary attrition in that area during the quarter. Has it related in any cost benefits?

Rostow Ravanan To the extent that there were involuntary attrition and cost incurred on that front have been recorded in the quarter. It will be part of direct cost for the quarter. So whatever severance cost we incurred for those people have already been recorded.

Ashok Soota So the relative benefits is what you will see in the next quarter, taken all costs into account this quarter and literally in the next quarter, you will see the benefit of the fact that as we talked about, whether it is the involuntary separations, etc., and to the extent that obviously and it takes time for design services revenues to pick up as we begin to get the benefit of those.

Sandeep Muthangi And I was going through your comments and where it was mentioned that the contingent consideration payable to Kyocera is now lesser because of a lesser expectation on future revenues. What is this related to?

Rostow Ravanan When we did the acquisition in 2009, Kyocera had two elements of contingent consideration linked to revenues. About $1.5 million linked to 2010-11 revenues and another $1.5 million linked to 2011-12 revenues. From an accounting perspective, we reevaluated the likelihood of the customers meeting of revenue targets and we found that revenue traction was falling and therefore that amount of contingent consideration was reduced, but that was not a P&L impact. So the cost of investment and the liability to Kyocera correspondingly got reduced to that extent. So there is no P&L gain or loss because of that adjustment.

Sandeep Muthangi Fair enough. I will come back for more questions later.

Moderator Thank you Mr. Muthangi. Our next question is from the line of Anurag Purohit of Alchemy. Please go ahead.

Anurag Purohit Thanks for taking our question again. Sir this quarter, there is a goodwill which is zero in the balance sheet as compared to previous quarter. If you could highlight what led to goodwill being zero?

Rostow Ravanan Like I mentioned in the beginning as well as a response to the previous question from Sandeep, we have goodwill arising out of the Kyocera acquisition, given the changes we have made to the business that goodwill was found no longer carriable and therefore goodwill was written-off as part of the restructuring that we did. Amount involved is approximately $500,000.

Anurag Purohit Fair, so this $500,000 would have been routed through P&L, but if I am not wrong; last quarter, the goodwill amount was close to Rs. 130 million.

Rostow Ravanan Correct. So the difference was because see like I explained in the previous amount the goodwill was calculated including the contingent consideration till the previous quarter. Now when the overall amount payable to Kyocera was reevaluated, now that number reduced on its own, so therefore the goodwill itself reduced and whatever goodwill remained got written-off.

Anurag Purohit Thanks and all the best. Thank you very much.

Moderator Thank you Mr. Purohit. Our next question is from the line of Rishi Maheshwari of Enam. Please go ahead.

Rishi Maheshwari Thanks and I would like to know one of your larger players had indicated that there has been normal growth which has come back to the industry and he described normal growth was between 18-20%. Now you mentioned in your call earlier that you would certainly beat that industry growth. So I am just trying to understand your internal estimates whether it is looking at growth beyond 18-20%?

Krishnakumar We do not give a guidance in terms of what our revenue growth is going to be, but certainly we provide qualitatives. What we clearly see in terms of conversations which we have particularly with our larger clients is that they are far more positive than what it was 12 months back. We do see discretionary spending starting to happen or being planned. We do see some of the strategic work which had stopped being put back on tracks. So overall I think the conversation which we have with our larger clients is on a positive track. Many of them are in the final stages in terms of facing their budgets and we would have a far more concrete idea in terms of what it looks like in the next 4 to 6 weeks, but at this point in time I think we are optimistic in terms of how the demand scene is looking.

Rishi Maheshwari Sure and given that the restructuring cost is over, what shall we look at as your steady state margins for the future?

Rostow Ravanan We do not want to give a comment on our specific percentage, but we believe there are two margin upsides for us for Q4. One is revenue growth momentum continues and up to that extent that will be a margin positive and the fact that there will be no further cost incurred on the wireless product business and that will also been a margin positive. The factor outside our control is currency. So all the three need to be seen together, but if you were to look at the factor within our control, we expect margin outlook to be positive going forward.

Rishi Maheshwari Fair enough, but given the margin erosion that has happened over the last 3 quarters, you usually were around 18-20% range. So even if I had to take away about $3.5 million of cost that has incurred in this quarter and build a steady state growth, is it fair to assume that the margin jump will be in the excess of 500-600 bps from next quarter onwards?

Rostow Ravanan We do not want to comment on a specific percentage. Like I said there are some positives and there is also the impact of factors outside our control like currency. Our ambition is to keep increasing margins as we grow.

Rishi Maheshwari Okay sure and just a couple of bookkeeping ones, what was the NIW losses in this quarter?

Rostow Ravanan NIW losses in this quarter were approximately $1.5 million.

Rishi Maheshwari Okay and what would be your effective tax rate for this year as well as FY12?

Rostow Ravanan My guess is it will be somewhere as of 15 to 17% of upper range excluding the impact of that one-time gain we got in Q1 through the winding up of the US subsidiaries of Aztec because that led to a benefit of $4 million in other income on which we paid a tax of approximately $1.6

million. If you exclude that as a one-time item on an operational basis, my guess is it will be somewhere in a 15%-17% range.

Rishi Maheshwari And next year this will be?

Rostow Ravanan We have to plan for that. Like Ashok mentioned, we are in the middle of our planning cycle. We will have to see overall revenue growth as well as distribution between STPI-SEZ, etc. So that number we will probably update you when we will give the commentary for next year.

Rishi Maheshwari Any plans that you have made for hiring next year?

Babuji Abraham We are in the middle of the planning cycle and we will firm up these numbers by the end of March.

Rishi Maheshwari Sure I understand. Thank you so much and all the best.

Krishnakumar Just one addition, clearly since the campus cycle has started, we are targeting close to adding about 2000 campus minds.

Rishi Maheshwari Okay thank you so much.

Moderator Thank you Mr. Maheshwari. Our next question is from the line of Rahul Jain of Dolat Capital. Please go ahead.

Rahul Jain Good afternoon everybody. My question is if you can share some perspective in terms of the reconciliation from $12 to 14 million of early estimate to $3.7 million actually?

Rostow Ravanan Broadly we have significant savings on two fronts. One is the amount payable to vendors who had supplied us or who we are contracted with to procure materials or services. We were able to close those contracts significantly lower amount than what we originally anticipated. That was one benefit. Second benefit was the assets that we had in the business, we were not sure how much of it will be reusable given the change in the strategy, but given that we have already started winning business on a services mode using pretty much the same capabilities and the infrastructure, the write-off of the assets were also significantly lower. Those were the two reasons why we had a lower restructuring cost than the original estimate which was made on a more conservative basis.

Rahul Jain And as the write-offs in assets are lower, does that mean the blended margins should be lower compared to considering the higher asset utilization now?

Rostow Ravanan No the assets in both the businesses are broadly similar. So the profile of the assets does not make a significant difference to the margins between our design services business compared to the remaining software services business.

Rahul Jain And just to understand what could have been our learning curve over the last 4 quarters?

Ashok Soota Learning curve on what aspect, on all our business or on this part of the business?

Rahul Jain Considering NIW.

Ashok Soota Well, for a start we did take, you might say a calculated risk and clearly we knew that there were different risk reward ratios in the product business and to that extent, I would say that we took a call we believe at the right time. We had the satisfaction of knowing that we could produce the product, then it went under testing with one of the largest operators in the world and yet at that time, the learning was that we found changes in the business and those changes included the fact that white label was no longer equal to zero inventory which is what we had assumed and we also found that even though the window had been open in terms of testing, there was going to be a few months delay in terms of being able to launch the product and we know how sensitive the market is. So I think realizing the nature of the change I think what we have clearly realized is that it is very difficult to combine a product business in its rhythms with the service business. The other plus is, that we have also learned though that the skills that we have can be used end-to-end for our range of customers in the services mode which is what is receiving a very good market traction already. So yes, there has been an interim period where as we have had these write offs on the product part of the business, if we still look at the acquisition from a holistic point of view, then of course, we have had a pretty low cost acquisition which is already yielded good revenues, given us a good skill base and also given us a good state of the art facility.

Rahul Jain Okay that was insightful. Thanks a lot and best of the luck for the coming quarters.

Moderator Thank you Mr. Jain. Our next question is from the line of Ankit Pandey of SBI Cap Securities. Please go ahead.

Ankit Pandey Yeah hi everyone. Well actually focusing on the verticals, PE Services, IT services and Wireless at the nascent stages. Could you give some idea into each of these verticals specially what drives the margins there. As I see it from the data that you have, IT services have improved with the margins so is that going to be a focus for you guys from now on?

Krishnakumar I think we will talk about both. I am going to ask Anjan to give a view in terms of how he sees the IT services market and margins in particular and since Jani is not there I will sort of speak for him. Anjan you want to go first?

Anjan Lahiri Yeah, IT services as I talked about the banking industry which is, of course, a very large part of the overall IT services spend from an industry standpoint which is doing well. We are also seeing significant traction and growth in our manufacturing industry group which was, of course, very severely hit during the recession but they seemed to have come back quite strongly. We are also seeing good traction in the other industry groups, retail, media, etc. In terms of margins as KK had mentioned earlier, clearly margins are really a huge function about predictable growth and we are seeing reasonable growth as we have announced over the last three quarters in IT services. We hope that growth momentum will continue with continued improvement in margins.

Krishnakumar Let me now chime-in in terms of the product engineering as well as some of our, what we see as high growth service lines. First to touch up on the high growth service lines, we clearly see fairly sustainable and decent growth in our infrastructure management business. We have got a few large wins there and we see those accounts expanding and certainly for the next couple of quarters we see strong growth momentum and consequently margin expansion in the infrastructure management business. Coming specifically in terms of product engineering services after two quarters of decline, in our R&D services business, had a 5.6% quarter-on-quarter growth, looking ahead we are starting to see companies investing in new products, in variations, and looking at replacing end-of-life products. And one of the wins which we announced was a large semiconductor company where our intellectual property in low energy Bluetooth, they are going to build a series of products. So clearly, margin expansion in the R&D services business will get driven by the ability to sort of configure newer solutions using our intellectual property which will deliver both time to market as well as better quality end products to our customers. In the software engineering space, yes, there has been a seasonal volume decline in Quarter 3 largely due to year-end budget constraints but clearly we see a large growth opportunity there primarily for product vendors who have a on-premise license application being converted to SAAS model. Already about 30% of our software product engineering comes from that space. We are probably one of the largest vendors doing product engineering work on the Azure computing platform. So the whole move towards SAAS model is clearly going to drive both our revenue growth as well as margin expansion in that business.

Ankit Pandey Okay great. And some information on the wireless side of things?

Krishnakumar See on the business front, like Ashok talked about, I think the design services is clearly sort of taken off to a good start. We think we have excellent depth in terms of both competency and skill and we have already started servicing a large global consumer product company for a phone design opportunity and we continue to see strong traction there. Apart from that in the whole wireless space we will also focus on what we call mobile applications because apart from designing the phone we have capability in building applications as well as Ashok talked about excellent infrastructure we have got in place which we will use to drive testing of mobile devices. And particularly we see this as a very interesting opportunity because increasingly we are seeing high convergence of devices not just in terms of smart phones but those extending on to newer devices like tablets. And with the number of newer products coming into the market the demand for independent testing, the demand for applications on those devices will only continue to expand. So together if we look at, I think, we will have a substantive market addressability which is really based on three core components which is designing mobile devices, building applications for mobile devices as well as testing mobile devices.

Ankit Pandey Okay great, thanks.

Moderator Thank you Mr. Pandey. Our next question is from the line of Anup Upadhayay of SBI Mutual Fund, please go ahead.

Anup Upadhayay Good evening sir. If we look at the services-wise trend in sequential growth then we seem to have seen a decline in development services which does not seem to tie in with your commentary that we are seeing a pick-up in discretionary services so where could….

Krishnakumar Like I said the decrease in development services is more seasonal because of the drop in our software product engineering particularly clearly they were some year end budget issues because of which there was a decline of about 5% in our software product engineering and that has led to the decline of our development services.

Anup Upadhayay Okay. And secondly if I have understood correctly you said that of the total $3.7 million of expense related to the Wireless venture $3.2 million has been taken as part of the software development expenses. Am I right in understanding that?

Rostow Ravanan Correct. $3.2 million will come partly between direct cost and partly in SG&A and $500,000 will come part of depreciation.

Anup Upadhayay Okay sir. Great, thanks a lot for that.

Moderator Thank you Mr. Upadhayay. Our next question is from the line of Sandeep Muthangi of IIFL. Please go ahead.

Sandeep Muthangi Hi, thanks for taking my question again. Rostow just can you give me a clarification on the licensing income from the IP? I am primarily looking at its nature and is it fair to assume it to be non-recurring?

Rostow Ravanan Sandeep, the second part is easier, yes, it is non-recurring with this customer. I think there is a small amount of follow-on revenue that will come in Q4 but it is the licensing revenue as you know in some quarters it comes and some quarters it does not come. The nature of the licensing, in fact, we license our Bluetooth intellectual property to our customers as they deploy it in their devices they pay us royalty. By and large it is about $600,000 which we got in Q3 and a small amount will continue in Q4 as well.

Sandeep Muthangi So it was just $0.6 million but your pricing improved by close to 3.5%.

Rostow Ravanan Correct.

Sandeep Muthangi Rest of the improvement in pricing is it like-to-like organic or is it primarily led to change in the business mix?

Rostow Ravanan The rest is largely organic but there are two sub-divisions to that as well. Part of it is real price increases in a few of our customers, part of it is a small portion of our customers who have fixed monthly contract because the number of billing days were lower in Q3 that led to a higher realized price as well.

Sandeep Muthangi Okay got it. And just a question with respect to your manufacturing business. This year it has been a superb performer. It will be very helpful if you can give us some insights into the nature of growth that you are witnessing primarily maybe the micro verticals and the other things that are growing within manufacturing.

Krishnakumar Sandeep, I am going to ask Anjan to answer this.

Sandeep Muthangi Sure.

Anjan Lahiri Yeah in terms of overall IT services as I said, banking particularly the large banking is working. In terms of micro verticals we are seeing a pick-up in a CPG side consumer package goods side. We are also seeing some good growth in the process manufacturing side and auto which has been quite a hit and had been a very large segment for us, is also seeing good signs of revival. So overall with good growth you are seeing growth in pretty much all the verticals within manufacturing and the other areas that I mentioned.

Sandeep Muthangi And is this primarily ERP led?

Anjan Lahiri This is actually not ERP led but as you see on a package side our overall revenue is relatively muted as a company. It is more led towards transformational large projects, non-ERP led but around ERP infrastructure.

Krishnakumar Sandeep, just to give two data points I think Anjan gave the highlight in terms of CPG being a growth segment. I think today, 8 of the top 10 consumer product companies in the world work with MindTree and a lot of the current growth is also getting driven post-ERP because many of these people have completed the ERP rollout so they are getting to the next stage. Digital business which is really a sweet spot for MindTree is becoming a key priority for consumer product companies. So number of this is relating to transformation from their current way of managing brands to more digital brands and present strategy which is driving growth.

Sandeep Muthangi Okay. Thank you, all the best for the future.

Moderator Thank you Mr. Muthangi. Our next question is from the line of Nitin Padmanabhan of India Bulls Securities. Please go ahead.

Nitin Padmanabhan If you look at the 4^{th} Quarter traditionally has a lower number of working days, am I right because I see that volumes in the 4^{th} Quarter in the previous two years were also relatively lower, negative rather. So just on the perspective do you see volumes really going up in the 4^{th} Quarter per se?

Nitin Padmanabhan What I meant is the 4^{th} Quarter, traditionally if I look at our history we basically have lower number of working days, am I right?

Rostow Ravanan You are right. The number of working days probably are slightly lower in Q4 compared to Q3 but we will still have volume growth in Q4 because the number of leaves taken in Q4 typically tends to be lesser than Q3 both in terms of our own people taking leaves and also what happens in Q3 is like KK mentioned, where December typically onsite billing customers tend to shut down their offices to be what they call a golden week. So those things don't happen in Q4 so that will make up for the little bit of the lower number of billing days in Q4.

Nitin Padmanabhan But as a percentage what would that be on a quarter-on-quarter basis?

Rostow Ravanan It is only one. Q3 had 63 billing days, Q4 has 62 billing days. So there is only one day difference in Q4 compared to Q3.

Krishnakumar One other thing which Rostow alluded to because the leave cycle is January to December and this being also the time period when schools were closed, the billable employees taking leave is higher, like we had an impact of almost little over 1000 days of additional incremental leave which was taken in Q3 which did impact available hours which will not be there in Q4.

Nitin Padmanabhan Sure. And from a NIW perspective seems that the goodwill has been taken off, would that be right to assume that the overall run rate that we are seeing for Kyocera on an annual basis, would that be down going forward?

Rostow Ravanan As of now yes, Kyocera lost one of their major customers for whom we were developing engineering services, so yes, the current picture for the Kyocera account is a declining trend.

Nitin Padmanabhan Any sense when that could stabilize?

Rostow Ravanan Not right now Kyocera typically follows a July to June financial year so maybe by Q1 or Q2 we will get a little more picture where the account is going next year.

Nitin Padmanabhan Despite the Kyocera decline we should be able to show an overall volume growth, am I right?

Krishnakumar That's right, yes. Nitin you asked about Q4 right?

Nitin Padmanabhan Right.

Krishnakumar Yeah.

Nitin Padmanabhan Which segment are you more bullish on?

Krishnakumar See clearly like Anjan alluded in the IT services we are seeing strong momentum will continue both in BSFI and the manufacturing segment. In our product engineering services we are starting to see growth momentum both in our software product engineering and R&D services.

Nitin Padmanabhan So the volume decline we saw in this quarter should not be there next quarter?

Rostow Ravanan We are tracking that. We expect our customers who have budgets pressures in Q3 should not have the same problem in Q4 but we will give you an update maybe by the end of the quarter.

Nitin Padmanabhan Sure, perfect. Thank you. All the best.

Moderator Thank you Mr. Padmanabhan. Our next question is from the line of Anand Bhaskaran of Spark Capital. Please go ahead.

Anand Bhaskaran I wanted to understand especially the pricing movements the kind of budgets you are seeing for your clients in SPE and R&D services because some of the tech bell weathers have been giving some really good sets of numbers. Just wanted to know what kind of projects are typically coming up. Are they actually opening their purse strings and spending more on R&D be it on the hardware side or the software side, what kind of pricing trends you are seeing there?

Krishnakumar I think there are two parts of it as I see your question, one is on the pricing front we are seeing a lot more stable environment with a marginal positive bias. Clearly we are not seeing pressures for reduction. In a few cases we have been able to negotiate an increase in prices wherever contracts have come up for renewal. So overall both in our IT services and product engineering services we see the pricing environment as being stable with a marginal positive bias. In terms of the budgets I think clearly there is a lot more positive conversations we have in our IT services which in turn has got reflected even in the current quarter-on-quarter growth and also the outlook forward is positive than what we had sort of envisaged 12 months back. But we see in the product engineering services the first signs of customers wanting to invest in new products or enhance features functionalities of existing products, we would have a better handle on it in the next four to six weeks but overall we are starting to see a more positive environment for demand even in the product engineering services.

Anand Bhaskaran Okay sure. On the margins front, even if you have to kind of adjust for the NIW loss or for the re-structuring cost what we had, just wanted to know other than the restructuring cost of $3.7 million were there any other cost related to this that were on in this quarter maybe some of the people who were asked to go or who voluntarily left were they in some form billable in the first period of the quarter so that more inflated cost was sitting in the P&L this quarter?

Rostow Ravanan No, the $3.7 million of re-structuring cost includes the whole amount of the people separation and all the other cost related to NIW business..

Anand Bhaskaran Okay. One last question on the update on the hedge book?

Rostow Ravanan Sure. As of 31st December we have an outstanding hedge of approximately $157 million at a weighted average at the rate of approximately 45.

Anand Bhaskaran Okay and this includes old leveraged options?

Rostow Ravanan Yeah it includes the old leveraged options. The old leveraged options which continue are approximately $75.7 million out of the $156 million.

Anand Bhaskaran Okay sure, thanks a lot.

Moderator Thank you. Our next question is from the line of Anup Upadhayay of SBI Mutual Fund. Please go ahead.

Anup Upadhayay Sir on the attrition front if we look at the quarter annualized numbers then that attrition seems to have moved up in the Q3. So that does not seem to tie with your comment that attrition has come down. And secondly are you looking at any interim wage hike for a part of the work force or the entire work force?

Babuji Abraham In fact attrition has shown a slight improvement in this quarter compared to the previous quarter. It is 25.6% for the quarter ending December compared to 26.8% for September of 2010.

Krishnakumar Maybe Anup I think you are talking about the LTM increasing. That is because I think one quarter of low attrition has moved out which is getting substituted by a quarter where the attrition is fairly high which is why you find that there is a increase in the LTM attrition numbers….

Anup Upadhayay No, I am not referring to LTM numbers I am referring to only the quarterly annualized number. That is if I calculate it based on the gross addition of 1021 employees and the numbers for the last two quarters. So maybe I will take it up with you offline.

Krishnakumar Yeah sure.

Rostow Ravanan The difference is because of the involuntary attrition.

Anup Upadhayay Okay and can you also comment on any plans for interim wage hike for a part of the work force or the entire work force.

Rostow Ravanan Currently no plans for any interim wage hike. Our wage hikes are largely in April and July because we run two cycles. Some groups get it in April, some groups get it in July, so the next cycle will happen in April 2011.

Anup Upadhayay Okay thanks a lot.

Moderator Thank you Mr. Upadhayay. Our next question is from the line of Biplab Chakraborty of B&K Securities. Please go ahead.

Biplab Chakraborty Hello sir, most of my questions have been answered. Just a quick question, one of your largest peers has seen a tax demand based on onshore sale, I am just curious if you have seen something similar?

Rostow Ravanan At this point of time we have not got any demand notices. The fact pattern of MindTree is also significantly different from the rest of the industry unlike the larger peers who have approximately 50% of the revenues coming from on site billing, for us it is less than 30%. Less than 10% of our headcount is on site. The nature of work that we do is also significantly different. But irrespective of that the industry position is that this notice that has been received is the merits of that notice are not very strong. So the industry across us as well as the larger companies believe that we should be able to defend our position.

Biplab Chakraborty Thank you sir. Good luck for the remainder of the year, thanks.

Moderator Thank you Mr. Chakraborty. Our next question is from the line of Hardik Shah of K.R Choksey. Please go ahead.

Hardik Shah Hi good evening sir. Sir if we look at the number of employees in training its just 1.8%. So are we following the policy of just-in-time hiring?

Rostow Ravanan Its not a question of just-in-time hiring Hardik, its more the fact that we build capacity in the first half of the year and our utilization currently is running at 69% so there is sufficient capacity at this point of time to meet our immediate growth need so that is why hiring has tapered off, which is balancing between the high addition in Q1 and Q2 to more muted addition in Q3.

Hardik Shah Sir what is our utilization target including trainees going forward?

Rostow Ravanan Typically our business model runs at somewhere between 72% to 73% sort of utilization, given the fact that we have more project oriented business, so we have the need to keep sufficient capacity for growth so we are about 2 to 3 percentage points below our desired state.

Hardik Shah Sir, number of our $1 million clients has come down by 1, so what is the reason for that in spite of having like 30 clients addition and fortune 100 are increasing from 45 to 48?

Rostow Ravanan Anecdotal, it is just a one-off customer for whom a particular project ended. No great trend line behind that.

Hardik Shah And sir final question. Can you give us the break-up of IT services 7.6% quarter-on-quarter in USD, what is the volume growth and what is the billing rate growth in that?

Rostow Ravanan IT services in the quarter had a 3.9% volume growth.

Hardik Shah Okay sir, thank you, that's it from my side.

Moderator Thank you Mr. Shah. Ladies and gentlemen, there are no further questions from participants at this time. I now hand the conference over to Mr. Sushanth Pai and the management to add closing comments.

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

Krishnakumar Thank you.

Moderator Thank you members of the management team. Ladies and gentlemen on behalf of MindTree Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.