Mindtree Limited

(NSE: MINDTREE, BSE: 532819)

Transcript of analyst call

Third quarter ended December 31, 2012 (Q3 FY2013)

January 18, 2013

Welcome to possible

Moderator Ladies and gentlemen, good day and welcome to the Earnings Conference Call to discuss the results of Mindtree Limited for the third quarter ended 31st December, 2012. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Sushanth Pai. Thank you and over to you, sir.

Sushanth Pai Welcome to this conference call to discuss the financial results for Mindtree Limited for the third quarter ended 31 December, 2012. I am Sushanth from the Investor Relations team in Bangalore. On this call we have with us senior management team including N. Krishnakumar – CEO & Managing Director; Janakiraman S – President and Chief Technology Officer; Anjan Lahiri – President, IT Services; Parthasarathy N.S. – President and COO; Rostow Ravanan – CFO.

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

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

N. Krishnakumar Thanks, Sushanth.

Our revenue growth has been satisfactory this quarter despite a seasonally weak quarter. Quarter 3 revenues were $109.9 million, representing a quarter-on-quarter growth of 2.5% and a year-on-year growth of 6%. Our IT Services Business reported a healthy growth of 4.8% quarter-on-quarter and the Product Engineering Business had a decline of 2.5% quarter-on-quarter. We have seen secular all-round growth in all the verticals of IT Services. The Product Engineering Services decline is mainly due to the shutdown which was declared by many of our key clients in the Product Engineering Business. We had earlier in the year indicated that we anticipate half year two to be better than half year one. We are happy to share with you that we are on track to achieve this.

Regarding the next quarter, we expect to maintain a growth in a similar range as Quarter 3. Some of the other highlights of our Quarter 3 results are, we have 245 active customers. What has been heartening is the improvement in the quality of our customers. Our $5-million customers have increased by 4 to 21. Our $10-million customers have increased by 1 to 9 and all this is a result of our better client mining efforts.

Some of the significant wins in this quarter are as follows,

- An existing customer who is the leading superannuation and pension administration specialist based in Asia Pacific. Mindtree will provide development and testing services for its core applications.
- An existing Product Engineering Services company that provides a cloud platform for collaboration and document sharing, Mindtree will provide product development and test automation services for its product.
- A high-tech company in the area of designing integrated circuits based in Asia Pacific, Mindtree will license its Bluetooth low-energy solutions.

On the people front, the attrition on a trailing 12-month basis has come down to 15.1% compared to 16.3% at the end of Quarter 2. Quarterly annualized attrition has also come down to 13.7% from 14.7% last quarter. We have 10,952 Mindtree minds reflecting a gross addition of 443 people in the current quarter.

Now let me turn onto how we see FY14. We are constantly engaged with our key clients to understand their priorities and we have started our planning for FY14. What we are clearly seeing is that there is a stronger momentum in the demand environment and we expect FY14 to be better than FY13. We are very optimistic of the future demand scenario and hence have significantly enhanced our sales force in our major markets which is US and Europe during the current quarter, which is Quarter 3. Consequently we are also seeing an expansion in the funnel and opportunities both new and from existing customers which we are pursuing and we expect the better funnel will certainly have a greater bearing on our revenues in FY14.

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

Rostow Ravanan Thank you, KK. In Quarter 3 our fee revenue growth was 2.6%. That breaks down to a volume decline of 0.7% and price realization increase of 3.3%. Like KK highlighted, the volume decline was predominantly in our engineering services business which was mainly due to the seasonal factors that affect our businesses in December quarter every year. Some of these are customer shutdown, leave, lower billing days etc. If it was not for the seasonal factors, our volume growth for the quarter would have been a positive 1.8%. The price increase was due to increases in some of our IP licensing revenues and higher realizations on our fixed price projects effectively because of the lower billing days within this quarter. Contracted pricing continues to remain stable in the quarter. EBITDA margins for Quarter 3 was 20.4% compared to 22.1% in the previous quarter, a decline of 170 basis points mainly because the rupee appreciation in this quarter was 3.4%. If you compare the EBITDA for this quarter compared to the same quarter previous year we had a year-over-year EBITDA improvement of more than 300 basis points.

SG&A for this quarter has gone up from 18.5% to 19.9%. Part of the reason for this increase was as mentioned by KK, we added new field force in our main markets. This we believe will create greater revenue momentum for us next year.

Forex gain in this quarter was $2.6 million arising as a result of mark to market gain of 0.6 million and a normal Forex gain of 2 million. Rupee had a peculiar trend this quarter where the rupee depreciated at the quarter end to 55 at 31st December compared to 52.86 as of 30th September. However for the quarter the rupee appreciated on an average to 53.69 in this quarter compared to 55.59 in the previous quarter. Effective tax rate for this quarter was 21.8% compared to 11.4% in the previous quarter, mainly because last quarter we had a reversal of some of our income tax provision.

PAT for this quarter is 16.7% compared to 12.1% in the previous quarter which is a growth of approximately 43% on a sequential basis. It is also very heartening to note that our EPS for the nine months this year is approximately Rs. 63, which is more than the full year EPS of last year.

Cash generation for this quarter has been very good. We generated about $20 million of operating cash flow in this quarter translating to about 90% of our EBITDA for the quarter. Net cash position in this quarter has further improved to about $84 million. Based on the improvement and profitability ROCE for the quarter has also increased to 41% this quarter compared to 28.6% in the second quarter of this year, also compared to 34.1% in Q3 of last year. So this is a very heartening factor.

Utilization for this quarter is 71.4% including trainees compared to 71.7% in the previous quarter so utilization broadly remains stable from the previous quarter. Coming to our hedge position, as of 31st December we have $39 million of hedges for FY13 at an average rate of 52.32 and 91 million of hedges for FY14 at an average rate of 57.37. In all we have $130 million worth of hedges of which the old leverage option have now become very-very negligible at $3 million and they expire by March 2013.

Capex spend this quarter was muted at $4.6 million mainly because of delay in regulatory approvals for some of our new facilities. Full year Capex is expected to be in the region of $16 to 18 million.

Coming to the outlook on margins for the coming quarter, if currency remains at the current level we expect margins to be stable in the coming quarter. With this we would like to turn this over for questions.

Moderator Thank you very much sir. Ladies and gentlemen, we will now begin the question-and answer session. Our first question is from Srivatsan Ramachandran of Spark Capital. Please go ahead.

Srivatsan Ramachandran Just wanted your comments on one specific point. You did mention in your initial comments that you substantially strengthened the sales reach and we have also been in a series of letting go of the long tail we had. So when do you think in your opinion we should start seeing benefits of some of these initiatives and what should be the metrics that we should watch out for to see if this is playing about as you are planning or not playing?

N. Krishnakumar Srivatsan I think it is always a question in terms of both the market demand and what is the confidence with which you are seeing some of the initiatives which will pan in terms of better growth, clearly to that extent when we really shared our impression that FY14 is going to be better than FY13. It was said with confidence that in the major markets we have enhanced clearly the hunting capability. So to that extent like you said the matrices should be in terms of not just new client acquisition but clients who are of a high quality who can potentially be built into may be $5-$10 million clients. And the other thing which I would just like to leave is many of this is not something which is going to deliver results in 90 days. I think clearly the impact of this could be over 3-4 quarters. So at this point in time we feel confident in terms of the investments we are making and that it will definitely result in terms of giving us the ability to improve the profile of our customer.

Moderator Thank you very much. Our next question is from Manik Taneja of Emkay Global, please go ahead.

Manik Taneja You did mention that our volume growth in the current quarter was impacted by shutdowns on the PES segment, if you could give us a sense on what's the volume growth in the IT services side and also talk about what you are seeing within your top clients and then finally carrying on with the question that the earlier participant asked, if you could indicate that most for us in the last 1-1.5 years a lot of growth initially has been driven by mining of our top customers. So would it mean that most of the low-hanging fruits with regards to mining have been plugged and now it would be more about hunting growth?

Rostow Ravanan We do not disclose the breakup of the impact or shutdown etc. between the two businesses but if you look at our apex level the IT services business revenue grew 4.8% in this quarter. The PES (Product Engineering Services) business sequentially has a decline of 2.5% that led to an overall growth of 2.6% for Mindtree. So the IT services growth was very-very healthy in the quarter. On an overall basis the impact because of one lower working day in this quarter contributed about 1.4% negative impact to volume growth. Impact of customer shutdown and leave in the quarter resulted in a 1.1% negative impact on volume growth. So excluding those two, it has been an almost 1.8% volume growth for Mindtree as a whole. We do not break that down between the two businesses.

Manik Taneja Sir just to broaden that point further, our PES business eventually is all offshore delivery or there is some onsite element even in the PES business?

Rostow Ravanan Predominantly offshore, I would say almost 90% plus would be offshore.

Manik Taneja I thought it was completely 100% offshore.

Rostow Ravanan Predominantly. There is small amount of onsite but that’s relatively small.

Manik Taneja Sure sir.

Rostow Ravanan Second part of Manik’s question was on demand.

N. Krishnakumar See Manik clearly if you see I think you rightly pointed out that we have done good job on client mining which is really reflecting in terms of the improvement in our client profile, both on the improvement of the $5-million customers and the $10-million customers. But the key element is I think the nature of these clients is such that we do not think we have reached where there is no headroom. Honestly I think there is more available in terms of work which we can do and what is also important is many of these customers have large budgets and they have consciously now adopted a multi-sourcing type of approach which in fact is beneficial for us. So clearly we will continue to invest on that. Also, as we get focused in terms of a few domains, we have got a set of what we think our must-win customers and we have identified those and we have added in frontline selling capabilities from some of the best organizations to help us get these must-win accounts. So clearly in terms of trying to get into those must-win accounts and build them over a period of time to sizeable customers is really the next thrust.

Moderator I will move onto our next question. Our next question is from Ajay Vora of Enam Asset Management. Please go ahead.

Ajay Vora When you say that the volume growth was negative 0.7 and pricing is 3.3 positive, and that was primarily because of all these problems of one-day leave and shutdown otherwise it would have been 1.8 volume growth. So can we except similar numbers for Q4 also because these headwinds would not be there in Q4, right?

Rostow Ravanan Volume growth in Q4 will definitely be better because we have greater number of billing days in Q4. Q4 is approximately three billing days higher offshore and I think one billing day higher onsite as well compared to Q3. So that should definitely lead to better volume growths in Q4 compared to Q3.

Ajay Vora And on the pricing side?

Rostow Ravanan Pricing side should remain stable because little bit of the pricing increase, like I mentioned, was because some of our fixed price project led to a higher realization in this quarter because the same revenue is coming with a lower effort. So that to some extent normalizes the next quarter. Contractually we have not seen any major improvement in pricing. The last open issue to some extent will be some of our IP licensing revenues. We will have to see how that plays out but all other things being equal, we expect volume growth for the next quarter to be better, pricing to remain stable.

Ajay Vora And how do you see the product engineering division for next year as in FY14?

N. Krishnakumar See clearly if you look at the Product Engineering Services, in some segments clearly the demand momentum is picking up, particularly in the independent software vendor segment. What we talked to you in terms of semiconductor slowing down, clearly we are starting to see demand picking up there also. There are some elements particularly on the consumer electronics and the communication part of the business which still is challenging but overall we do think there is a good momentum which is starting to come up even in the Product Engineering Services.

Ajay Vora So can we expect growth in FY14 or FY13 and to what extent?

N. Krishnakumar To a large extent like I mentioned I think as of now we are starting to have conversations with our top-50 clients, which is across both our IT services and the Product Engineering Services business and except one client who certainly is going to have challenge on his budget. The rest of the clients have not indicated any negative sentiments. So at this point in time certainly it looks promising.

Ajay Vora And lastly on the utilization, where do you see utilization rates moving in FY14?

Parthasarthy NS If you look at our current utilization rates we have been hovering between 71% and 73%. We expect it probably to be at the same level in the coming fiscal year as well.

Ajay Vora At the same levels?

Parthasarthy NS Yes.

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

Sandeep Muthangi I had a question on your comment on FY14 that you are seeing a pickup in some of these areas. KK, could you give me more insight on what kind of industries you are seeing a pickup and what kind of services you are expecting a pickup?

Anjan Lahiri Yes, in terms of industries, as KK said this quarter it is been across the board and particularly in retail, CPG and in BFSI we have had a fairly strong growth and we see that continuing in the future also.

Sandeep Muthangi I was just trying to get more color on within these industries what is driving the growth. We have highlighted BFSI, CPG etc. Is that the traditional services where they are trying to reduce the cost on offshore more or the discretionary services? What is the kind of insight that we can get?

Anjan Lahiri At a macro level obviously all of those continue but we see that our largest customers are actually getting into fairly committed discretionary spend particularly to expand their own operations in the developing market which is in APAC. So across the board, across industries we are seeing that trend and we are engaging in that quite successfully. In terms of service lines, again, obviously mobile is big, data warehousing continues to be very important, ADM is important, our normal maintenance is increasing so no specific information there except that it is fairly robust.

N. Krishnakumar Sandeep from the service lines I will be able to just add one. I think the approach which we took on infrastructure management is to really build it through a platform based approach and we are clearly seeing strong traction on that. In fact, this quarter the infrastructure service line has had a strong growth and if we look at the compounded quarter-on-quarter growth rate, in the last 7 quarters infrastructure has had at least in excess of 7%, 7.3% compounded quarter-on-quarter growth and we continue to see a very strong momentum on that.

Sandeep Muthangi Some of these other companies that have reported a very good result this quarter have also seen very strong pickup in discretionary package implementation, ERP kind of services. I am just wondering that we had a very weak first half for these services. In fact, even for Mindtree the first half in fact the past three quarters have been very-very bad. We have seen pressures on these kind of services and suddenly we are seeing a very strong pickup. I just wanted to get your thoughts on do you think there is any element of a budget flush in this kind of a demand or is this more sustainable throughout the year?

Anjan Lahiri There are two aspects to it, as we have said earlier ERP was an area of relative softness for us internally and we have done a lot of things to bolster that and those results are showing. So irrespective of the industry, I think we are doing better in getting our fair share on the ERP market. We had some key hires and key structural changes. But on the balance in terms of discretionary spending on ERP, I think as I said there is discretionary spending particularly to expand services of companies in let us say the APAC area and most of those are around packages and around ERP, which continues to be a fairly strong fulcrum around which companies are spending.

Moderator We will take our next question in the meanwhile. It is from Sagar Rastogi of Credit Suisse. Please go ahead.

Anantha This is Anantha. KK in your opening comments where you gave us some idea of your outlook for the next quarter and FY14, is it possible to just break that separately for IT services and product engineering?

N. Krishnakumar I think like I said Anantha, overall we are clearly saying the demand environment to be far more positive and like Anjan articulated earlier in this call, we are starting to see customers start conversations about discretionary spends, starting to talk in terms of initiating strategic projects and clearly I think we are preparing the ground to sort of leverage on this opportunity where we shared that we have significantly enhanced our hunting sales capability both in US and Europe. If we are to sort of breakup like Anjan said across all verticals and IT services we are seeing demand, be it manufacturing, retail, consumer products, BFSI and so on. In the Product Engineering Services if you really take the independent software vendor segment, particularly with services relating to cloud engineering we are seeing very strong traction and that is something which I think will continue to grow and it is demonstrating strong growth. Particularly on the software product segment we see demand. Semicon which continued to be challenged over several quarters, for the first time Quarter 3 has started looking good and a funnel is building up there. So we are confident that the demand momentum there is coming back. Where in the Product Engineering Services we would continue to see softness is really in the consumer electronics as well the communication segments.

Anantha So basically if just like to put all this together, would it imply that next year is likely to be more equally driven by both these business lines rather than one segment driving overall growth?

N. Krishnakumar See there will be a marginal difference in terms of growth rate, but you are right, I think we are certainly seeing that both engines will start firing next year.

Anantha So what we have seen historically KK is that during periods of downturn or an uptake in demand, the smaller companies typically tend to be more highly leveraged. So in the downturn they get squeezed more and in uptick they bounce back a lot more. This time however, given the slightly weak environment we see in the past year or so the smaller companies have not done really that badly, Mindtree included and clearly I think may be smaller project size or whatever have been the dynamics that have prevented them from getting hurt too much. My question is if demand environment does turn a lot more positive going forward, do you think the smaller size companies will be more highly leveraged or do you think it will be the same for the bigger ones and the smaller ones?

N. Krishnakumar See essentially I think Anantha what we are seeing is if we look at the earlier cycles where demand started coming back like the 2008 and so on, we consciously saw the large enterprises at that time being a little more risk aversive but this time around we are clearly seeing customers focusing a lot more on expertise and what is the value which a specific company can bring into the game. To that extent we do believe in this cycle of demand we do things that in the segments in which you are focusing and where we can bring in adequate or better values than any of the larger players, we have a chance to compete and win our share of business. The second key thing which we are seeing is particularly on large enterprises the whole notion of multi-sourcing is becoming more a reality, which again sort of opens up the opportunity for you. So I do think that clearly it is becoming a far more level playing field and scale alone is not necessarily the reason why people win.

Moderator Thank you. Our next question is from Pinku Pappan of Nomura. Please go ahead.

Pinku Pappan KK could you talk about the kind of deals you are getting invited to,sizes what you are seeing in the pipeline and what is your outlook on your win rate going forward? I mean could you just talk about how it has been in the past year and what you expect it to be going forward?

N. Krishnakumar I would try to really break it up into few things because if you were to look at it as new opportunities like both Anjan and me shared earlier in the call, I think we are clearly getting into more focused approach of focusing on a few segments and within that clearly identifying which are the clients with whom we want to work with to the extent a lot of our both sales and marketing efforts are targeted on these clients. Again, if you just were to do a comparison of how this opportunity, funnel of new opportunities looks compared to December 2011 to what it is in December 2012 clearly we are seeing far more stronger funnel in the new opportunities. Similarly with respect to our existing clients Anjan did share earlier in the call saying that we are seeing return back in terms of discretionary spending for customers to really start running their businesses far more in a competitive manner. So in the existing customers the funnel is also starting to look good. The third aspect which is important is you recollect that about two quarters back we shared that, we feel that the market is moving to more smaller deals and customers are wanting to really breakup deals into typically deals of $25 million plus. So we did invest in a large deals team which really had a tremendous level of knowledge and capability to handle as well as compete in large deals. In that team clearly, yes we have been starting to get calls for these large deals. At this point in time in the range between $20 to 100 million we are in the fray in about 8 opportunities. The fact is that we have also been called to a few till now where decisions have been made. It is about 2 or 3 where we have not won it but again what we have understood and this is I think getting called to these deals is important but this is again not something within one or two quarters, there would be results which will come. I think we have done the right step ahead in terms of forming this team, investing in making it happen but we are very clear in the future quarters, we will get our results in the large deals also.

Pinku Pappan My next question is on, as you build your large deal sales team and increase your investments on the sales side, do you think you also perhaps will have to start looking at creating your bench, especially once discretionary spending improves? So may be you are looking at slightly lower utilization rates so as to capture when the demand uptick happens?

Parthasarthy NS Our utilization levels if you look at it we are operating at a 71% to 73% range and I think that will give us enough capacity to be able to take care of any new deals that come because of the increased discretionary spends as we see going forward. There is no reason why we should drop our utilization levels below the current levels.

N. Krishnakumar There would be specific things we can sort of do like Anjan articulated. I think we are putting in lot of efforts into increasing our package application business and in the next phase our large enterprises are moving to roll out these package applications in the APAC type of region. We will work probably on a basis that yes we will create enough bench to really try and maximize our leverage on the demand which you see in that space.

Pinku Pappan And the next question is you had very strong growth in BFSI in the last two quarters and this quarter it has kind of slowed down. Is it a function of may be the shutdowns at clients or is it something structurally you are seeing here? And you also have a larger exposure to some of the mid-sized banks, so could you talk about the outlook that you see in FY14 around these clients?

Anjan Lahiri Yes quickly the mid-sized banks continue to be fairly strong in technology spending so we are quite positive. BFSI was muted. One is because it was such a strong growth so a little bit of breather was required. At the same time while ITS was not affected by the Golden Week Holiday, if it was it was in BFSI but it was not very large impact but there was an impact and it was only in BFSI.

Moderator Thank you. Our next question is from Madhu Babu of HDFC Securities. Please go ahead.

Madhu Babu Sir what is the outlook on hiring for next year?

Parthasarathy NS If you look at our hiring and you have to split it as lateral hiring and campus hiring, for FY13 by the end of fiscal year, as far as campus onboarding is concerned we would have on-boarded about 800 people. Next for FY14 we expect the campus onboarding to be closer to 2000 levels. As far as lateral hiring is concerned, obviously we will do it on a just-in-time basis as we see deal pipeline improving.

Madhu Babu Sir and currently now the cash balance is improving. So would we look at increasing the dividend policy, I mean dividend payout ratio?

Rostow Ravanan Sure, like we explained in our IPO and subsequent communication with our investors our dividend payout policy is linked to profitability. As we become more profitable we will keep increasing our dividend payout.

Moderator Thank you very much. Our next question is from Pankaj Kapoor of Standard Chartered Securities. Please go ahead.

Pankaj Kapoor Just trying to get a sense more on your outlook for FY14. When you see things improving are you looking at a more second half kind of a growth coming back or you see this is coming in even at the beginning of the fiscal itself? If so, if I look at our bench and that was the earlier portion also was referring to, though we have a space for utilization to improve and can give them substance in terms of if sudden growth comes in, it still does not give much confidence in case a very sharp recovery happens. So putting it together are you looking at a growth which is more back-ended next year or you see that coming in much more quickly?

N. Krishnakumar See at this point in time like I shared earlier, we have just started and been in consultations with our customers. In terms of the specifics of how they are going to plan out initiatives will be far more firm in the next 6 to 8 weeks but at this point in time we are saying that it is going to be a secular trend and like Partha said earlier we are confident that with the current capacity we have and our ability to sort of create additional capacity, both on infrastructure and people we would be able to meet these demands.

Pankaj Kapoor If I look at my deal flow or in terms of where you are probably close to completing the transactions, is it something that which is giving also some confidence that we may have a pickup in the deal momentum in the coming couple of quarters?

N. Krishnakumar See like I said many of these large deals have their own sort of sales cycles but clearly some of the ones which we are talking are right now in discussions with our existing clients gives us a confidence that it is going to be a fairly even paced growth in FY14.

Moderator Thank you. Our next question is from Kawaljeet Saluja of Kotak, please go ahead.

Kawaljeet Saluja You know if I look at FY13 revenue growth for Mindtree, it is going to be materially below the fastest growing companies in this sector or may be below the industry levels as well. Now I understand the Product Engineering Services would not grow as much but I guess every company has a certain portfolio challenges. My question is that what are we going to do differently to ensure that the growth rates are materially better than the faster growing peer and to do justice to the breadth of management team of Mindtree?

N. Krishnakumar What I would like to sort of present as a perspective is if you look at FY13, one of the other key decisions which we took was to try and rationalize the portfolio in our Product Engineering Services business. So a lot of the tail which we got out in the business was really in the Product Engineering Services. So if we really even break that business up into our independent software and cloud engineering business and the communications and consumer product business clearly the independent software vendor business is at a growth rate which is comparable with the industry growth rate. I think a major part of the transition in terms of pruning as well as changing the portfolio in our consumer and the communication part has got completed. And that certainly last year had an impact in terms of actually having a negative year-on-year growth for the Product Engineering Services business. As we have completed this transition clearly we believe we have a good set of marquee customers in the ISV Business which will help us grow in line with comparable specialist players in that space.

Kawaljeet Saluja Is your process of setting targets for the management team for FY14 going to be any different from FY13 in the sense that let us say you set targets for Product Engineering Services and for whatever reason the external environment is not good then perhaps basically the allocation or the shortfall goes to Anjan and perhaps he is asked to do or pull up the growth rates for the organization and vice versa. Is this going to be any fundamental change in the way you set targets for your team in FY14?

N. Krishnakumar So clearly we have just started the process of our plan for FY14 and the intention is like we said based on what we sense of our customer, we think there is a unique opportunity for us to really deliver what we think is reasonable growth.

Rostow Ravanan I will also add in a certain sense if you look at the previous 5 years 2007 to 2012, we have been amongst the fastest growing companies probably in percentage terms may be top one or two in growth. This year had some peculiar challenges, partly because like you said on the PES Business and partly because some of the deals that we are pursuing this year have got delayed or when we won it the customer reduced it in terms of the project scope. Some of those things that we believe are sort of tactical for this year and therefore our feeling is if we continue to do what we are doing and do it well, that should be enough for us to get to better growth next year. I do not think as of now we are required to do anything very-very differently.

Moderator Thank you very much. Our next question is from Dipesh Mehta of SBI Cap Securities. Please go ahead.

Dipesh Mehta Only two data points, one is what was the margin movement in constant currency sequentially and secondly clarification on margins, you said you want to maintain margins, so at Q3 level or at what level?

Rostow Ravanan We believe if the rupee remains at the same level where it is as of now where the margins for the next quarter will be stable i.e. operationally we are not seeing anything to majorly swing profitability from Q3 to Q4. On the first question, the impact on profitability because of currency in this quarter was 1.7%. EBITDA for the last quarter was 22.1% that has become 20.4%, that 1.7% was largely because of currency movement. Rupee appreciated by 3.4% for us in this quarter.

Moderator Thank you very much. Our next question is from Vishal Agarwal of Jefferies. Please go ahead.

Vishal Agarwal My question was on the margin side. Now in this quarter despite the currency appreciation of 3.5% or so, the gross margin has actually improved whereas we have seen a meaningful decline in the EBIT margin, most of that possibly could be explained by currency. Just wanted to understand you have already kind of referred to it that the SG&A expenses moved up sharply because of the hiring that you have seen, but is there any reclassification? That is point #1 and secondly where do you see the SG&A settling?

Rostow Ravanan There are two parts to your question. The gross margin improvement was partly because of our increase in our realized rates. Like I explained a little bit of it was because of the non-linear revenues that came in this quarter which is a small contribution and the fact that you had higher price realization because on your fixed price and fixed monthly contract you got a better realization on the basis of the lower number of billing days. That is why you had an increase in your gross margin level. SG&A, I do not think is going to have a major swing from where we are right now. We expect it to broadly remain at these levels in absolute terms. So as revenues grow it will start falling in percentage terms. If you look at over the previous 2 or 3 quarters, every quarter SG&A has fallen as a percentage of sales. This is the first time it has gone up and after the last 2 or 3 quarters it will start trending down again in a quarter or two when revenue momentum comes back.

Vishal Agarwal If you could just give a sense on the effective tax rates may be for the next few quarters? Do we expect more of an operational basis, the 23-24% that we are realizing currently, do we expect that to sustain or come down over a period of time as more businesses kind of move to the SEZ?

Rostow Ravanan Our SEZ proportion is amongst the highest already. I think almost 55% of our revenue is coming from SEZ. Over the last 3 or 4 years all our incremental growth is coming out of SEZ. So our current working show that there will be a small increase in effective tax rates over the next 2-3 years, may be a 1 or 2 percentage point increase from every year over the next 2-3 years as some of our older SEZ complete their full tax holiday and start becoming partially tax paying. So we think that the 22% or so where we are right now on an average will probably become 24 or 25% in the next 1 or 2 years.

Moderator Thank you. Our next question is from Hardik Shah of KR Choksey. Please go ahead.

Hardik Shah In the last quarter we have mentioned like we were working on the six large deals, any update on that?

Rostow Ravanan Like KK explained in his comments, we won one or two of those but by the time we won the customer reduced the project scope. We lost about I think two or three and one or two are still continuing in the pipeline.

Hardik Shah Sir like the two deals that you have won, like what is the total contract value of those deals?

Rostow Ravanan As of now they have started as pilot projects and they are more in 1-million, 2-million range for the time being. If all goes well hopefully we will get the follow on work which will be much larger.

Hardik Shah Sir like the ERP space we just saw a significant growth. Any one-time license-fee kind of thing in that segment?

Rostow Ravanan No our ERP does not include any license fee. Our deals are more of the services parts so we do not do any license sales on ERP.

Hardik Shah So we can expect the 4% of the revenues to continue in the coming quarters also.

Rostow Ravanan We have to see because to some extent that part of spend is also discretionary from the customer so there will be a cycle that it goes through but it is one of the areas where we are building capacity based on the fact that we are seeing demand for that service in that market.

Hardik Shah And sir final question, sir in the beginning you have mentioned that we expect the same growth for the Q4 in line with Q3. So we expect 5% growth in IT services and around 2% in Product Engineering?

Rostow Ravanan At this point we are not breaking down the growth between the two businesses. Overall Mindtree growth will be similar to the growth rate we saw in Q3.

Hardik Shah So it will be around 2.5-3% in Q4?

Rostow Ravanan Yes we are not giving a specific number but we think it should be in similar comparison to Q3.

Hardik Shah We almost lost significantly on account of lower number of working days and furloughs, so would that support the higher growth rate in Q4 compared to Q3?

Rostow Ravanan Sure like we explained to one of the earlier questions, Q4 volume growth will definitely be better.

Hardik Shah But sir like already like 2.5% we are seeing a significant growth from that level, right?

Rostow Ravanan Overall, we are expecting a revenue growth to be similar in Q4 compared to what we have in Q3.

Moderator Thank you very much. Our next question is from Abhishek Shindadkar of ICICI Securities. Please go ahead.

Abhishek Shindadkar Sir the question is regarding the revenue growth. The growth which we achieved in the Q3 was that growth in line with what we anticipated at the start of Q3?

Rostow Ravanan Yes, like we explained when we announced the September quarter results we expected Q3 to be better than Q2, which is what it has turned out to be and also if you look at in the beginning of the year we expected second half of the year to be much better than the first half of the year, on both counts – what we saw on the beginning of the year as well as what we saw on the beginning of the quarter, we are currently sort of broadly tracking to what we expected.

Abhishek Shindadkar Sir why I am coming on this question is basically at the end of Q2 we said that we would achieve the lower end of the NASSCOM guidance which was more closer to 11% or more closer to the 10% and that necessitated roughly a 5% plus growth in the Q3 and Q4 and the commentary what we are making right now suggests that the growth would be more slower than what we had said. So now coming back to the question #1, did we still do more than what we had anticipated at the start of Q3?

Rostow Ravanan No, just to correct the picture there, what we said at the end of the September quarter result was that the growth rate for this year will be lower than the NASSCOM estimate. At that time NASSCOM had lowered the estimate to 11% to 14%, and we said we will be lower than the lower end of the NASSCOM range. We did not give a specific number for the year.

Abhishek Shindadkar And last question on the EBITDA margins, sir this quarter it seems that the IT services margins were down roughly to 33% basis points sequentially. Could you help us understand the breakup of that into loss of days in the quarter and then some of the other variables that go into that number?

Rostow Ravanan Sure out of the business unit level the main impact to profitability was because of currency. Mindtree has a whole loss about 170 basis points due to the exchange rate, the same rule applies to the business units as well.

Moderator Thank you. Our next question is from Ankit Pande of Quant Broking, please go ahead.

Ankit Pande My question is around the new deals and I am a little sceptical as to whether the environment is really improving as a lot of reports are suggesting. So really in your conversations with clients, what are the decision timelines like? Is it quick enough? Is it inside 2 or 3 quarters which is the conventional way because this might just be the December seasonality effect?

N. Krishnakumar See clearly like we shared earlier in the call, this is really the time when we have fairly intense conversations with our key clients on how is it that they are planning the budgets next year and like we shared earlier, except for one client who is certainly anticipating challenges and could probably have a reduction in budget, we are not having any negative conversations with the top 30 clients. Again if we were to look at really the way in which the funnel appears, clearly in Quarter 3 the number of new opportunities which we saw coming in is higher than the opportunity numbers as well as value, both in the first quarter as well as the second quarter of the year. So to that extent these data points in terms of what you could call us qualitative conversation with key clients as well as what we see in terms of quantitative numbers in our funnel, both sort of point out to the fact that we anticipate the demand scenario to be better in FY14 than FY13.

Ankit Pande And this is another point in that so how many of our deals are really in the rebid market or may be are replacing existing vendors? How many are our opportunities really?

N. Krishnakumar See again this is a fairly large thing like I talked about earlier particularly a number of large enterprises which are mature users of off-shoring are adopting the multi-sourcing model far more aggressively which means if earlier they had a team of 2 or 3 preferred vendors they are enlarging that list may be by 1 or 2. So to that extent, each one of those could be a competitive sort of bid but clearly within a selective set of four, or whatever may be the number of preferred sort of clients.

Ankit Pande So I mean we are in there, right, I mean that is my conclusion.

Rostow Ravanan Yes. We are in the active shortlist on consideration by many of these customers.

Ankit Pande In the replacement market, right?

Rostow Ravanan Correct. Predominantly all of these are existing works that customers do. So if maintenance enhancement kinds of opportunities are the large part of the RFP so that will be done by somebody else right now.

Moderator Thank you. Our next question is from Kunal Sangoi of Birla Sun Life Asset Management, please go ahead.

Kunal Sangoi Rostow I wanted a data point, with regards to the gross could you give us a figure of gross capitalized value of asset YTD?

Rostow Ravanan During the quarter we spent $4.6 million. YTD was $13.7 million.

Kunal Sangoi And that whole $14 million is capitalized?

Rostow Ravanan Yes, the whole $14 million is capitalized.

Kunal Sangoi I was just wondering at the depreciation number. Over the last 6-7 quarters depreciation has been coming down. Could you just explain the reason?

Rostow Ravanan Sure, the predominant reason for that is many of these assets that we have are older assets. In the last couple of years we have not added any major new capacity in terms of new facilities there, so that is why depreciation is not trending up. Two of our largest projects are still under implementation. So it will probably start reflecting as new assets and therefore changes to the depreciation numbers may be by next year.

Kunal Sangoi Second question is that with regards to your top five clients, large part of the growth in the first three quarters has been driven among the top five clients. Could you share what would have been the churn within the top-five? Any new entrants in the fiscal 2013 versus a year before, what would have been the churned number of clients?

Rostow Ravanan Overall the top-five haven't changed but within the top-five some customers keep changing their ranks but the five which were in the top-five still are in the top-five even today from whatever, even a year or two ago.

Kunal Sangoi And last question, KK you mentioned that you are focusing on or at least you had conversation with your top-50 clients. Could you give us some idea with regards to how do you look at account management in your top accounts? What will be the focus account, number of accounts and how would you approach them?

N. Krishnakumar Amongst this 50 we have about 24 accounts which form a part of what we call our key accounts, of which five are platinum accounts where clearly the intent is building up to much larger scale. Then we have the category 'A' accounts which are about 14 of them and the balance is what we call category 'B' accounts which is within the whole key account structure itself. And each one of these 24 have a dedicated account management structure which means there are may be one or two dedicated account managers with their own support infrastructure for us to both expand the number of services within those clients as well as participate and mine those accounts far more deeply. One of the key, as a part of our plan we are debating is how would we really expand it to probably may be our top 40 accounts which is really being discussed as a part of our plan.

Moderator Thank you. Our next question is from, it is a follow-up question from Manik Taneja of Emkay Global. Please go ahead.

Manik Taneja Hi sir, could you just repeat the hedge figure for both FY13 and FY14 along with their averages?

Sushanth Pai For FY13 we have about $39 million of hedges outstanding. That is at an average rate of 52.32 and for FY14 it is $91 million at an average rate of 57.37. So overall we have $130 million of hedges.

Moderator Thank you very much. Our next question is from Sagar Rastogi of Credit Suisse. Please go ahead.

Sagar Rastogi Sir your ROCE as per your press release has improved from 28.6% in the previous quarter to 41% in the December quarter. So could you just explain how this is calculated and the reason for this sharp increase?

Rostow Ravanan Sure the reason for the increase is for improvement and profitability because our PAT for example went up from 12.7% to 16% mainly because in Q2 we had a Forex loss of $7.5 million, there has been a Forex gain of $2.5 million in this quarter. The formulae we have used for ROCE is EBIT divided by the Average Capital Employed and the ROCE of 41% is annualized for the quarter.

Sagar Rastogi I mean you referred to the net profit margin number, which has gone up, but the ROCE formula if it uses EBIT then the EBIT should have actually come down if the margin has dropped, right from Q3 to Q4.

Rostow Ravanan Sure, the EBIT calculation includes Forex. So you take PAT, add back taxes, there is pretty much no interest for us, so therefore that does not make any difference.

Sagar Rastogi So essentially it is the Forex swing I guess.

Rostow Ravanan Yes, Forex swing was the contribution to the improvement and profitability and to ROCE.

Moderator Thank you. Ladies and gentlemen, due to time constraints that was the last question. I now hand the conference back to Mr. Sushanth Pai for closing comments.

Sushanth Pai Thanks, Inba. Thank you all for joining this conference call. If you have any questions, any further questions please reach out to us. We look forward to speaking with you in the coming months.

Moderator Thank you very much Mr. Pai. Ladies and gentlemen, on behalf of Mindtree Limited that concludes this conference call.