

## MPHASIS LIMITED

### Q1 FY09 EARNINGS CALL

28 JULY 2008

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**Moderator:** Ladies and gentlemen, good morning and welcome to the Mphasis Q1 FY'09 conference call, hosted by Batliwala & Karani Securities India Pvt Ltd. For the duration of this presentation, all participant 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. I would now like to hand the conference over to Ms. Shradha Agarwal of B&K Securities, thank you and over to you Ms. Agarwal.

**Shradha Agarwal:** Thanks Rochelle, hello everybody. On behalf of Batliwala & Karani Securities, I would like to welcome you all on the call to discuss the results for the quarter ending June 2008 of Mphasis Ltd. Representing Mphasis on the call are Mr. Jeya Kumar – CEO and Mr. Susanto Banerjee – Interim CFO of the company, with that introduction I would like to now invite Mr. Jeya Kumar

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to take the discussion forward. Thanks and over to you Mr. Jeya Kumar.

**Jeya Kumar:**

Thank you and good morning to all. I appreciate everybody taking their time to join in for this call. In all this has been a very solid quarter, the Mphasis Group consolidated revenues were at 742 Crores. During the same period, net profit increased by 54% from 51.3 Crores to 79 Crores, operating profit grew 24.2% from 67.3 Crores to 83.5 Crores in the same period.

On a sequential quarter basis revenues grew 12.9% from 657 Crores in the quarter-ended 31<sup>st</sup> March, 2008. Net profit grew by 10.6% by 71.4 Crores to 79 Crores. The operating margin during the quarter increased by 11% to 11.2% on consolidated revenues.

Cash and bank balance stood at 116.5 Crores with 43 days of debtors outstanding. Profits during the quarter-ended June 30<sup>th</sup> were impacted by acceleration of our research cost, amounting to 9.3 Crores. The net margin and operating margin impacted were about 1.3% on consolidated revenues due to the change of our accounting treatment. Excluding the accelerated charges, net profit during the quarter would have increased by 72.1% year-on-year and 23.6% quarter-on-quarter.

Now, let's look at our lines of business. Our core apps business continues to grow from strength to strength with solid growth of 13.1% quarter-on-quarter representing 63% of our total revenues. We continue our transformation and shift from being highly BFSI dependant and are positioning capabilities around verticals like manufacturing, healthcare and Telecom, retail, and government industries. Our growth from verticals other than BFSI was about 11%. We are seeing good traction from client across these diverse industries.

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I want to point out that it is a tough time for the Applications business globally with contracts taking time to mature and margins shrinking. Through this all teams have succeeded in keeping our existing clients satisfied while we continue to aggressively pursue new business.

ITO business, like we pointed out at last quarter is our growth story. We saw very strong growth to the tune of 90.5% quarter-on-quarter growth. Encouraged by good response from our clients we further expanded our capacity and capability in this service line. We have over 3900 employees working in the ITO business. This quarter we launched our Enterprise Labs providing high-end virtualization services to our clients. ITO now represents nearly 15% of our revenue. Going forward, we envisage our complete set of Remote Data Center Management Services expanding both globally as well as in the domestic Indian market.

BPO growth was 8.3% quarter-on-quarter, now representing about 22% of our revenues. We continue our path to transformation moving from voice to KPO-based services and we will also be launching what we call an E-BPO Service later in this quarter.

We have about 49% of our BPO revenues coming from non-voice, mainly from the F&A, HR, credit card processing, and claims processing. We are organizing teams to work on platform based services, basically helping us move up the value chain.

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Keeping our focus on operational excellence we continue our efforts to improve efficiency. These include high usage of productivity tools, processes, which will help crunch time on projects. We are building a team around innovative and destructive technologies; such as autonomic computing. The brightest of brains will work in collaboration with research institutes to leverage technology and automation helping solve complex business challenges of our clients. There is a need for us to bring back the technology focus in our approach to solutioning and this initiative will help us to achieve our goals.

We continue to extend our people numbers, we have added 1200 people in this quarter, and have a headcount of over 28,000 currently.

Our best employer initiatives are on course and have been appreciated by our employees. We have worked tirelessly to put in place new training structures focusing on individual growth and development. Additionally, we have deployed programs around job rotation, career advancement, re-skilling, which has been very much appreciated by our employees. We continue to undertake activities to enhance employee morale and for the current quarter our attrition dropped by 2.1%.

Our client concentration improved this quarter. During the quarter the group added 28 new clients, including relationship through EDS. This includes clients in multiple sectors as in BFSI, Telecom, Manufacturing, Government, Logistics, and Healthcare covering all business lines of Apps, BPO, and ITO services.

In terms of geography we are seeing a surge in client interest in UK and EMEA regions. Revenues from US markets are coming through, but in slow and delayed manner. We continue to actively engage with clients in new geographies.

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We are very satisfied with the successful quarter. We believe that we are undertaking several innovative initiatives to invigorate our business prospects and are bullish about the fiscal ahead. I would like to now open up to questions.

**Moderator:** Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. At this time, if you would like to ask a question, please press \*1 on your phone. The first question is from the line of Divya Nagarajan from JM Financial, please go ahead.

**Divya Nagarajan:** Hi congrats on a good quarter. My question relates to the overall demand environment that we are seeing for your services at present. What is the environment currently?

**MphasiS:** If you look at the current quarter, client and services on revenue terms grew 16%. We don't see client cancellations, which I think is very positive, but we see delays in terms of the decision-making process. Going forward, we don't expect the trend to change, given the scenario in the US, but at the same time we are seeing our growth continuing at this pace. Vendor consolidation is a new trend and will impact the industry as a whole.

**Divya Nagarajan:** Right, you have also had you know stable pricing during the quarter, what is your outlook on pricing growing for the full year?

**MphasiS:** Essentially we had steady billing rates for this particular quarter. Though New contracts are being signed at prices that are higher than the old contracts there are pressures on billing rates because vendor consolidation programs undertaken by some of our customers.

**Divya Nagarajan:** If you could separate out for me, how much of the growth this quarter came through the EDS route and how much came through the MphasiS channel?

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**Mphasis:** The EDS share of revenue this quarter is 41% of the total revenues. The Mphasis market facing channel grew faster than the EDS channel.

**Moderator:** Thank you Ms. Nagarajan. The next question is from the line of Mr. Pratesh Krishnan from DSP Merrill Lynch, please go ahead.

**Pratesh Krishnan:** If you can just tell me what is the volume growth this quarter?

**Mphasis:** Volume Growth is at about 7%.

**Pratesh Krishnan:** In which segments did you give a salary hike in this quarter? Also has the impact of the salary hike has been factored in the margins that you saw in this quarter?

**Mphasis:** We announced a salary hike in all segments across all lines of business. Yes, we have factored the impact of the salary hike. However in our case not the entire employee population get salary increases in one quarter, it is spread over the year.

**Pratesh Krishnan:** Secondly in terms of the VISA cost, what do you see as the policy there?

**Mphasis:** Before we used to amortize the VISA cost for over the period of the VISA, . We have changed the accounting treatment this quarter to bring it in line with the industry practice. We took a hit of INR 9.3 Crores which is about 1.3% of the consolidated revenues. Excluding that, our profit growth would have been over 24% quarter-on-quarter.

**Pratesh Krishnan:** In terms of the BPO side, despite the rupee depreciating, what is the kind of outlook you see there?

**Mphasis:** There maybe some business ramp down although we do have reasonable pipeline.

**Moderator:** Thank you Mr. Krishnan. The next question is from the line of Mr. Sandeep Shah of ICICI Securities, please go ahead.

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**Sandeep Shah:** This quarter as you mentioned that non-EDS market channel has grown faster than the EDS channel. So how can one read the growth expectation in terms of MphasiS. Is the future growth likely to be more driven through EDS or do you believe that the current growth rates are sustainable despite EDS not growing in the short-term?

**MphasiS:** I don't think growth is binary i.e. EDS versus MphasiS. The EDS growth is typically backhanded, while for MphasiS it is more likely to grow faster than EDS on a quarter-on-quarter basis. If you look at last year, the EDS channel contributed to about 43% to 46% of our total revenues. From an EDS standpoint we may see the EDS channel bounce back 45% - 46% in the later quarters.

**Sandeep Shah:** How do you read the situation of HP coming into MphasiS parentage? HP also has its own arm HP India, so how do you read this in terms of short to long-term ramp ups as well as HP adding to business to your the portfolio?

**MphasiS:** I think it is going to be positive, both in terms of the delivery coverage and client coverage. There is no overlap and that is going to be a huge up side creating greater value for HP and for MphasiS.

**Sandeep Shah:** Can you throw some light in terms of HP India's business portfolio?

**MphasiS:** I don't have clear view on their business or clients. I think that it would be appropriate for HP India to respond.

**Sandeep Shah:** This time verticals like manufacturing and retail have seen some decline - any specific reasons?

**MphasiS:** If you look carefully, growth from manufacturing quarter-on-quarter was up to nearly 28%.

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**Sandeep Shah:** What about Telecom and the other verticals like logistics?

**Mphasis:** There is a marginal slow down in Telecom. This was because of one of our client, where the work has slowed down

**Sandeep Shah:** Do you believe that the slowdown in the BFSI has been spread to the other verticals?

**Mphasis:** BFSI grew quarter-on-quarter by 16% and manufacturing we grew 28%. The challenge that we had in the last quarter, continues. Clients are not canceling orders but taking longer to make decisions. Additionally a lot of clients across different verticals including BFSI are moving towards vendor consolidation.

**Sandeep Shah:** On the order book, can you share the details like?

**Mphasis:** We normally don't share order book details. Based on our current visibility, our pipeline continues to be strong.

**Sandeep Shah:** Barring the last quarter, we have been growing higher than the market rates, so based on the pipeline, you believe such your performance is likely to continue in the near term?

**Mphasis:** Like I said we will continue to see our growth story flourish.

**Moderator:** Thank you Mr. Shah. The next question is from the line of Mr. Hitesh Shah from Citi Group, please go ahead.

**Hitesh Shah:** On the hiring plans, how many do we plan to have for the rest of the year and what is the share of the freshers that are likely to join?

**Mphasis:** As we stated at the last quarter we are looking to hire between 7000 to 9000 people for this year. We are looking to hire about 1500 to 2000 freshers.

**Hitesh Shah:** How many of this would be in IT services?

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**MphasiS:** They will be in IT services in our Apps business and our ITO business.

**Hitesh Shah:** What was the Forex trade realized during this quarter?

**MphasiS:** It is close to Rs.42 to a dollar .

**Hitesh Shah:** In terms of the hedging strategy, do we continue to hedge only the balance sheet exposure or have we set in hedging our cash flows?

**MphasiS:** We had been hedging against OUR balance sheet. We have now embarked on a structured program for future cash flow hedging also.

**Moderator:** Thank you Mr. Shah. The next question is from the line of Mr. Ashwin Mehta from Mangal Keshav Securities, please go ahead.

**Ashwin Mehta:** Our applications business has seen a substantial increase in our onsite revenues, the offshore has been relatively flat, do we start to see the transitioning happening on offshore for these projects going forward or there is some aberration here?

**MphasiS:** Well, that is the model in the Apps businesses, essentially new projects which are being signed up will see initial revenues on site. Then the work moves off shore. As mentioned, we see that budgets are under pressure for the customers in US, so obviously you would see more off shoring on those business in the future.

**Ashwin Mehta:** In terms of our facilities consolidation we are planning to reduce our facilities from around 33 to 16 odd, how is that progressing?

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**Mphasis:** We are looking at our growth for the next three years and we may take other avenues to grow in terms of space, particularly in the tier II and tier III cities.

**Moderator:** Thank you Mr. Mehta. The next question is from the line of Mr. Ruchit Mehta from HSBC AMC, please go ahead.

**Ruchit Mehta:** In sense of billing that you mentioned that there was some pressure that you have seen because vendor consolidation. Do you actually see customers asking for price cuts in return for higher volumes? How are you approaching this?

**Mphasis:** Yes, that's what the vendor consolidation process is all about. Essentially what this entails is that instead of 10 vendors, clients want to operate with 4 vendors and request for discounts. It is del/ customer specific.

Price is one way of approaching it, the other way of approaching it is, solutioning. We always try to provide innovative solutions in order to bring down the spend of our customers which in turn relaxes the pressure on billing rates.

**Ruchit Mehta:** Can you comment a bit on your tax rate, it's actually come off this quarter compare, so what's likely tax that we are going to see for full year and probably also if you could also comment on tax rate for the fiscal as well?

**Mphasis :** These tax rates should be in the region of 8% to 10% of the PBT for the fiscal.

**Ruchit Mehta:** What is our next year outlook, considering the STPI environment?

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**Mphasis:** We don't have an outlook that we can give for the next year, but it will be highert as some of the units will come out of the tax holiday status.

**Moderator:** Thank you. The next question is from the line of Srivatsan Ramachandran from Spark Capital, please go ahead.

**Srivatsan Ramachandran:** Could you please update us on SEZ plan that we have this point of time?

**Mphasis:** We have 2 facilities in India which are SEZ, and we will be looking at more SEZs going forward..

**Srivatsan Ramachandran:** Please provide an update on the Forex; typically most of the contracts are just forward contracts, or do you have any options?

**Mphasis:** No, currently we don't have any options, they are all forward contracts.

**Moderator:** Thank you Mr. Ramachandran, the next question is from the line of Mr. Hiten Sampat from Parag Parikh Financial Advisory Services, please go ahead.

**Hiten Sampat:** I would like to know, if we can get some breakup of your sales for the current quarter, which is new business, renegotiated contracts, and the continuing business sir?

**Mphasis:** We don't disclose it.

**Hiten Sampat:** Regarding HP-EDS, exactly, what is the transaction going to happen there, is it going to be a takeover by HP of EDS? What about an open offer from HP?

**Mphasis:** Let me reiterate, and we had sent out a note to the Stock Exchange, it is going to be a merger not a takeover. Thereby it is not mandatory for HP to come with a open offer to the shareholders.

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**Moderator:** Thank you Mr. Sampat. The next question is from the line of Mr. Abhijeet Kumar from Equity Masters, please go ahead.

**Abhijeet Kumar:** Could you throw some light in EBPO, what is it exactly and how it is going to impact revenue going forward?

**Mphasis:** EBPO we talked about is a service we will roll out this quarter. EBPO leverages application solutions focused more on business process optimization as opposed to outsourcing. This is a service in the accounts payable domain which we are rolling out this quarter. This will help our clients to drastically reduce head count and cost of transaction. We have piloted the EBPO solutions internally and found that the reduction capabilities are huge. We estimate that about 75% to 80% of existing cost per transaction would go down.

**Moderator:** Thank you. The next question is from the line of Hitesh Shah from Citi Group, please go ahead.

**Hitesh Shah:** The revenue from the EDS channel, till last quarter we had been saying upwards of 50% and this quarter we said something like 41% is that right?

**Mphasis:** Last quarter EDS contribution was over 43%. The share of revenues has dropped from 43% to 41%. You may see Mphasis channel grew much faster than the EDS channel. In the later quarters we may see the EDS channel contribution growing.

**Moderator:** Thank you Mr. Shah. The next question is from the line of Mr. Jigar Walia from Parag Parikh Financial Advisory Services, please go ahead.

**Jigar Walia:** My question pertains to your innovative, disruptive technology you intend to launch regarding automatic computing. As I believe it has small segment in small area of operation, but going ahead, how do you and other companies plan to leverage

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this particular technology or service line? Will this impact your existing business?

**Mphasis:** We are only getting started right now and the focus is more in terms for us to build out what is required for autonomic computing. The bulk of our business is in application space. We have strong ITO heritage and what autonomic computing does is to bring that Application and ITO services together in a much seamless way for the customers.

This will serve a unique group of customers and over time, this is probably what's going to grow into about, 10% to 20% of our revenue stream. But to get there it is going to take us two to three years. For the current year we are making the investment, pulling out the best and brightest of our people to be a part of this team and building out our future.

**Moderator:** Thank you Mr. Walia. The next question is from the line of Mr. Vikram Aditya from Credit Suisse, please go ahead.

**Vikram Aditya:** I just wanted to know if you could give us a better guidance on the revenues across your verticals, how are you expecting them to be for the year?

**Mphasis:** We don't give forward guidance on the revenues, but all I can say is that our growth story should continue.

**Moderator:** Thank you Sir. The next question is from the line of Mr. Sumit Poddar from Birla Sunlife Insurance, please go ahead.

**Sumit Poddar:** I wanted to know how do you see the overall environment for your business, and how do you see it going forward?

**Mphasis:** The environment is getting challenging, but I think it's no different from the years before. There is more delay in terms of decision-making by our clients. While we don't see cancellations, vendor consolidation is more becoming the norm

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for our bigger clients. However we are positive, if you look at our top ten clients, this quarter, on quarter on quarter basis, we grew 7.5%. I think we are very strong with our clients and they value the services that we deliver.

**Sumit Poddar:** So what are the winning strategies in such a scenario like?

**Mphasis:** We are focusing and investing quite heavily in client solutioning leveraging technology. Price itself is a low entry barrier in these markets, but providing clients with the solutions, which will help them to achieve their cost objectives, is the way to win and that's where we are focused on.

**Moderator:** Thank you Mr. Poddar. The next question is from the line of Mr. Pratesh Krishnan from DSP Merrill Lynch, please go ahead.

**Pratesh Krishnan:** This is for the ITO business. What are the key drivers for its revenue growth?

**Mphasis:** The ITO business is the heritage that we picked up during the Mphasis EDS merger. Clients are moving more of their work into manage work versus FTE-base and that's what it is translating to a much stronger revenue growth. We grew headcount by about 7% and maximized our utilization.

**Moderator:** Thank you Mr. Shah. The next question is from the line of Mr. Nimish Mistry from MF Global, please go ahead.

**Nimish Mistry:** Your mix improved, - on site revenue grew by 2%, is this a trend? Secondly in terms of the EDS government business, do you get some business offshore from that?

**Mphasis:** For the first question, yes the onsite revenue share grew by about 2%. Essentially on new projects on-site revenues grow faster than the offshore revenues before work is transitioned offshore. So, you will see the ratio stabilizing back to offshore, in the quarters ahead. The other question that you asked

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regarding the EDS government work, we do a little bit of EDS government work .

**Moderator:** Thank you Mr. Mistry. The next question is from the line of Mr. Hiten Sampat from Parag Parikh Financial Advisory Services, please go ahead.

**Hiten Sampat:** Your sales and distribution expenses in the last two quarters have moved up significantly from around 24 Crores to 27 Crores, is that trend likely to go up just because Mphasis channel is growing faster than the EDS business?

**Mphasis:** Selling expenses are incurred in dollars. Higher INR expenses is a result of higher rupee conversion rate. We are also investing in our sales force for the future growth..

**Moderator:** Thank you Mr. Sampat. The next question is from the line of Mr. Jigar Walia of Parag Parikh Financial Advisory Services, please go ahead.

**Jigar Walia:** What is the expected CAPEX for FY'09?

**Mphasis :** It's about \$60-\$70 million.

**Moderator:** Thank you Mr. Walia. The next question is from the line of Mr. Ram Prasad from Sundram BNP Paribas, please go ahead.

**Ram Prasad:** Just a couple of questions on the US Financial Services. What is that driving the growth there?

**Mphasis:** If you look at Mphasis' history, we have always been strong in the BFSI sector. We continue to grow with our existing clients. Some of the early investments we made, last quarter particularly in the US and some in Europe especially in the BFSI sector are accruing early returns.

**Ram Prasad:** Due to the kind of bad market scenario globally you will have a discretionary spending cut down. So, what are the projects you

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are handling and how does it protect from this kind of cut down in this discretionary spending?

**MphasiS:** What we had done was to look at what we spend and why and we rationalize on that perspective. Every dollar we spent is not an expense, they should be investments with clear cut business ends.

**Moderator:** Thank you Mr. Ram Prasad. At this time there are no further questions in the question queue. I would now like to hand the conference over to Ms. Agarwal to add a few closing comments.

**Shradha Agarwal:** Thank you. On behalf of Batliwala & Karani Securities, I would like to thank the MphasiS management as well as participants. I would now like to hand over to MphasiS Management for closing remarks

**MpahsiS:** One again, thank you. This has been a great quarter for us and looking forward to getting you all back again with this quarter's results. Thank you.

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