

## Mphasis Limited

### Earnings Conference Call

November 27, 2008

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Moderator: Good morning ladies and gentlemen. I am Manjula, the moderator for this conference. Welcome to the Mphasis Earnings Call. I would like to hand over to Mr. Jeya Kumar, CEO, Mphasis. Thank you and over to you sir.

Mr. Jeya Kumar: Good morning. Thank you and welcome to the call. I really appreciate everybody taking the time to join this call. This call is occasioned by the change in the quarter end financial year from November to October with effect from 1<sup>st</sup> November 2008 to align with the financial year of HP consequent to the merger of EDS with HP. Accordingly, the results for the current year is for the 7-month period ending October 2008. The Mphasis consolidated revenues were 1,907 crores in the 7 months ending October 31, recording a 41% growth over the same period last year. During the same period, net profit grew a 111% from 140 crores to 295 crores. EPS increased to 14.6 rupees from 6.72 over the same period, recording a growth of a 111%. The EPS recorded is the highest in the history of the company. Operating profit during the 7 month period ending 31<sup>st</sup> October was 288 crores compared with a 167 for the same period a year ago. That represents a growth of 72%. Operating margins recorded a 2.7% growth and the net margin grew by 5.1%. For the month of October 08, revenues grew 17.8%. Operating margins and net margins for the month of October 08 grew by 6.1% to 22% and 23% respectively over the quarter ending September 08. EPS for the month was at 3.61 per share. The Board has recommended a final dividend of 2 rupees per share for the 7 month period. During the 7 month period ending

October 31, 2008, the group added 47 new clients including 38 through EDS relationship. This included clients in manufacturing and retail, technology, banking, and financial services. The group now has 96 clients with an annualized run rate of more than a million dollars including 9 clients in excess of US 20 million dollars. The billing rates remained steady. Manpower utilization improved significantly across all businesses. The group net headcount grew by 1,700 during the period taking the total manpower to 28,800. All lines of business have registered impressive growth for the 7 month ending October 08 relative to 07. Applications business grew top line by 36%, BPO by 33% and ITO by a whopping 83%. The ITO share in business for this period is now up at 15% from 11.5% a year ago. All core verticals have registered increases for the above period. In terms of geographic composition, it has been similar in the 7 month ending October 08 as compared to last year. North America and Europe registered 41% growth and India grew 56%. You will find the analysis of the same in our management discussion section. To sum it up, strong financial performance with a record EPS and EPS growth and further improvement in our operating metrics has been the highlight for this period. And now, I would like to open up for any questions.

Moderator: Thank you very much sir. We will now begin the Q&A interactive session. First in line, we have Mr. Sandeep Shah. Please go ahead with your questions.

Mr. Sandeep Shah: Congrats on the good set of numbers. Sir, just some of the key metrics, like number of clients with more than 20 million dollar run rate has declined from 9 to 7. Any particular reason for this? Any loss of clients or any ramp down from any top clients?

MphasiS: It is not a question of certain clients have gone out of our client portfolio. Every period that we report we annualise based on the revenues of that particular period, so there may be certain ups and downs in the revenues from those clients which has moved the client from 20 million dollar client to 10 million dollar client.

Mr. Sandeep Shah: Okay. And secondly even manufacturing contribution has gone down by 200 basis point over Q2. Any particular reason, which vertical you are feeling a pressure at this point in time?

MphasiS: It is a result of projects closing during this period. It should not be a trend.

Mr. Sandeep Shah: The employee addition, even last quarter we said that for the full financial year April to March it would be around 7000 to 8,000, but if you look at the first 7 months, what we have added is roughly around 1,700 employees or 1,750 employees. So, what would be your guidance for the same and how you are looking at the utilization rate going forward.

MphasiS: We are going to hold the number. I think our initial guidance was 6000 to 8,000. We feel pretty confident by April timeframe we will get to the same number. One thing Sandeep, you are right, we added about 1,700. Our utilization improvement has actually reduced the need for close to about 1,500 people. Over the last 7 months, if you like, our utilization has actually gone up by 11%.

Mr. Sandeep Shah: Right.

MphasiS: That is offsetting that, but otherwise we are still looking...we are getting the space ready and we are looking to hire to get to close to another 3000 to 3,500 by March.

Mr. Sandeep Shah: This would be the net addition right?

MphasiS: Yes, it is all net addition.

Mr. Sandeep Shah: This would be in anticipation of some confirmed ramp-up from the clients or this is based on just the expectation built on.

Both MphasiS: It is actually both Sandeep.

We get space and people first to service the pipeline and then we look at what else that we need to build for future as well. So, if you look at, you know, our utilization, we are almost running close to 80%.

Mr. Sandeep Shah: Okay.

MphasiS: And I would like to maintain that at, plus/minus 1% range.

Mr. Sandeep Shah: Okay. And just on the EBITDA margin, I think there is a stellar performance which is happening in the last four months. Even this month, our improvement over Q2 base is around 530 basis point, but if you look at, there is no much improvement in the utilization except in the onsite front and apart from the rupee depreciation. So, can you elaborate how we are able to get such a significant improvement even in this month?

MphasiS: You are absolutely right. Onsite utilization, has improved over the quarter ended September and the rupee depreciation has definitely helped the numbers up. But together with that, we did have small improvement in our billing rates as well and which is not showing up in our MD&A because we don't give it in decimals. Also fresher induction program that we had launched about close to a year back ...now we are getting them to bill.

Mr. Sandeep Shah: Right. And sir just on the overall demand trends looking at the macro challenges, what is the experience of MphasiS both looking at the revenue coming through EDS and HP channel as well as outside this channel, especially because our contribution from verticals like BFSI is as high as around 45% and even within the manufacturing, we also work with some of the clients in the auto verticals, so what is the current experience in terms of ramp-ups, the IT budgets for CY08, whether they have been fulfilled versus what has been committed as well as any clue in terms of next year's budgets?

MphasiS: In terms of the trend that we see, our pipeline is holding steady. Customers are taking a lot longer time to make any decisions. The clear positive trend is - the deal sizes are getting much bigger. Two reasons, one I think is industry consolidation and the other one is vendor consolidation. A lot of stuff that was in BFSI at least I think moves out of the uncertain stage into more... a consolidating stage. Manufacturing and retail, I think we are just getting started, so we will have to wait and watch what is going to happen there.

Mr. Sandeep Shah: Lastly, on the billing rate, are we still maintaining a flattish trend going forward or we believe that now maintaining rates would be a challenge going forward?

MphasiS: We hope that we will be able to maintain the rates and may be the rates will tend to move a little bit towards north, especially because of the new contracts, when they come into the revenue stream, we see a slight movement in the needle. There will not be any drastic improvement in the billing rates.

There are two changes that are going on in the business model, like I say the deal sizes are getting bigger, but the deals are also getting more and more to be outcome based,. So which, one, in terms of, you know, in terms of the opportunity to grow your margins are much better at least in the short term. So, this is what we look at our pipeline, this is what is showing up in the deals that we are bidding for and lastly becoming more as to what customers also want.

Mr. Sandeep Shah: Okay. Thanks and all the best.

MphasiS: Thank you.

Moderator: Thank you very much sir. Next in line, we have Mr. Ashwin Mehta from Mangal Keshav Securities. Please go ahead.

Mr. Ashwin Mehta: Yes sir. One question in terms of our BFSI growth. We seem to be seeing a significantly higher growth than what even the large cap companies are seeing in BFSI. What is different at MphasiS compared to these companies?

MphasiS: Difficult to answer that question because I don't know what they all do and the details behind their BFSI number. All I can tell you for what is happening in MphasiS is the customers that we serve are currently the winners in all this credit consolidation that is going on, so I think that is what is giving us, one, growth and two, I think stability and like I said, the project that is coming out in BFSI, one, is getting to be more in terms of managed work outcome base and two they tend to be much larger than the deal sizes that we have seen over the last 18 months.

Mr. Ashwin Mehta: Okay. One more, in terms of currency impact on revenues, what would have been the currency impact on revenues in this particular month?

MphasiS: It will be roughly about...on the revenues, it will be about 10- 11%.

Mr. Ashwin Mehta: Okay. In terms of taxes, why has the tax been quite low in this particular quarter?

MphasiS: The deferred tax plays a role in the net tax provision. Deferred tax depends on the amount of capitalization that we do.

Mr. Ashwin Mehta: Okay. And in terms of our rentals, we seem to have jumped significantly in this particular month. So on a normalized basis, it is almost 60-70% higher than what it was last quarter. What has caused these two to go up?

MphasiS: We had taken up space in anticipation of the growth and then with utilization needle moving up we have deferred the built-outs there. The rentals during the period when built outs were held back were charged to P&L in October. It is a one-time charge that we have taken.

Mr. Ashwin Mehta: Okay. And one more thing, in terms of our onsite contribution and onsite growth on a normalized basis, that has been almost near 30% sequentially plus the contribution has gone up significantly. Do we see in the future project transitioning happening offshore and possible pushing offshore rates going forward?

MphasiS: I don't know where you got that onsite contribution, I think you are referring to the onsite billing rates.

Mr. Ashwin Mehta: Onsite revenue contribution that has gone up.

MphasiS: Yes, that is correct because of the project transition, so the projects which were there in the pipeline, for example in the first quarter, (first quarter means January-February-March quarter) they all got signed off in the subsequent quarters which triggered onsite transition and increased onsite revenue contribution.

Mr. Ashwin Mehta: Okay. So, the trickledown effect of that onsite transitioning would be seen on our offshore revenues going forward.

MphasiS: Again, it all depends on what new deals again are going to come and what is the transition work involved in those new deals.

Mr. Ashwin Mehta: Okay. And in terms of HP, post HP, what is the progress on the restructuring in terms of your discussions with HP?

MphasiS: We have had no discussion on any restructuring.

Mr. Ashwin Mehta: Okay.

MphasiS: There is no open offer from HP.

Mr. Ashwin Mehta: No, in terms of the business side, has there been any changes since HP happened?

MphasiS: Okay, so the discussions on the business side is more in terms of go to market. What we can bring to HP as a complete portfolio services company and how do we get our go-to-market plans together in India and everywhere around the world.

Mr. Ashwin Mehta: Okay. Thanks a lot.

MphasiS: Thank you.

Moderator: Thank you very much sir next in line, we have Mr. Pratheesh Krishna. Please go ahead with your questions.

Mr. Pratheesh Krishna: Yes, this is Pratheesh here from DSP Merrill Lynch. You know, what could have been your realized rupee rate for this quarter?

MphasiS: Average exchange rate is about...close to about 49 rupees.

Mr. Pratheesh Krishna: Okay. And, you know, the kind of growth that we are seeing in this particular quarter, I mean like how would you really attribute this to, I mean it is a more that you are saying lot of, you know, offshore push from your existing clients or these are like new deals being signed.

MphasiS: Yes, so it is a combination of both, the new deals, the existing deals which is ramped up.

So, yes, the one trend that you might want to watch is the growth rate in the onshore volumes because that is typically a precursor for pipeline buildup for us.

Mr. Pratheesh Krishna: Okay. And, you know, lastly, I mean last quarter we had said, you know, probably in a month or so, HP will, you know, decide on your offshoring strategy. This is, you know, vis-à-vis MphasiS, with, you know, their own subsidiary in India which is Digital. I mean any progress on that front I mean in terms of, you know, their offshoring strategy.

MphasiS: I think that is just an ongoing discussion. I think what is critical for us is to resolve or get to a correct plan on the go to market plan and I think that is getting very clear for all of us and then in terms of the next course and in terms of delivery, like I said, there is no over-lag there. So, as long as you drive the go-to-market strategy and your top line grows...

Mr. Pratheesh Krishna: Okay.

MphasiS: The work that is supposed to come will come.

Mr. Pratheesh Krishna: Okay fine. Thanks a lot sir.

MphasiS: Thank you.

Moderator: Thank you very much sir. Next in line, we have Mr. Sumit Poddar. Please go ahead with your questions.

Mr. Sumit Poddar: Yes, gentlemen, congratulations on great set of numbers. As we see, in the last two months, actually the world has changed globally as such. So, how would you see this, the overall environment for IT spends and then for offshoring for the IT sector as such?

MphasiS: I think Sumit the world has been changing for us for quite a while, but I think I don't see a significant change in the track.

Mr. Sumit Poddar: Okay.

MphasiS: I think, you know, pick any industry right now or anywhere in the globe, industry is consolidating.

Mr. Sumit Poddar: Right.

MphasiS: So, what you would expect with all your clients as the industry consolidates, people will look to optimize infrastructure. Everybody would want to spend less, a lot percent less than they did before. So, what I think this would be like a good opportunity and, you know, depending on the length and the depth of whatever this economic phenomenon that we want to call, whether it is, I don't know, recession or depression or whatever names people choose, I think the length and the depth will actually change the landscape for IT services industry.

Mr. Sumit Poddar: So, I mean in what manner or what changes could we see to the IT, I mean services, could we see a kind of a dip and then again restructuring or how would we see the whole industry to pan out?

MphasiS: Yes, it depends, right, it depends like I said the length and the depth. If the length is long, that means as in 18 months, and the depth is low, I don't think there will be any significant restructuring of the industry except very I guess extended pricing pressure. If the recession is long...sorry, if this, whatever it is, is long and deep, then I think the industry will have to restructure. I think the industry will have to move more and more into technology-based solutions, which the modus operandi will be more in terms of having products and solutions which will have a much lower to almost zero marginal cost of delivery.

Mr. Sumit Poddar: Okay. So...and as you said that clients are taking longer to decide. So I mean is it like that they are already in discussions with the vendors or is it that they are not at all letting the vendors know what their demands are or what their requirements are going ahead as such?

MphasiS: So, this is a trend I think that has been going on since last year November timeframe, if you like, and now, you know, it sort of accelerates now with all the industry consolidation, particularly in the BFSI sector. We see the first step that customers do is, one, to consolidate the vendors and then start reviewing based on what their internal needs to consolidate their infrastructure and rationalize their work, if you like.

Mr. Sumit Poddar: Okay.

MphasiS: So, the picture becomes clear once the customer makes up his mind.

Mr. Sumit Poddar: Sure. So, I mean they may also restructure their requirements if it need be. I mean, the point I am trying to gauge is, is it that they are holding up on their requirements or is it that those things would never come up.

MphasiS: No, I don't think they are holding out or...it will come out right, otherwise the work won't get done. But if you are looking at, you know, I mean look at the size of companies that got integrated.

Mr. Sumit Poddar: Right.

MphasiS: Right. It is massive.

Mr. Sumit Poddar: Right.

MphasiS: So, it will take time for them to consolidate...

Mr. Sumit Poddar: Okay.

MphasiS: In terms of, you know, I think rationalizing two departments in a company, we can take a quarter, can you imagine the two brands of that size.

Mr. Sumit Poddar: Surely. And there have been lot of job cuts that have been announced, I mean, in the developed nation. So how would you put it. Is it beneficial for IT offshoring companies or I mean even IT offshore companies would at least get impacted from these kind of job cuts?

MphasiS: I think it is positive, you know, we got to look at whether the job cuts that is being announced. Produce net productivity growth or is that in terms of lowering your operating costs. So, if it is the former, then, you know, there is no benefit for offshoring. If it is the latter, yes. So, even if you look at the last two recessions, 91 and 2001 recession, the peak unemployment in US only happens one year after the recession ended. Right and that is the time that I guess offshoring really started taking off big time.

Mr. Sumit Poddar: Sure. Right and great, thanks a lot and all the best.

MphasiS: Thank you.

Moderator: Thank you very much sir. Next, we have a follow up question from Mr. Ashwin Mehta. Please go ahead.

Mr. Ashwin Mehta: Sir, one data point in terms of what was the contribution from EDS channel in the 7 months?

MphasiS: It is about 40%.

MphasiS: It is really flat.

Mr. Ashwin Mehta: And one more thing, in terms of receivables from EDS information services, that seemed to be almost 53% of the revenues booked in the 7 months. What are the terms with EDS information services in terms of payments?

MphasiS: Various towers have different payment structures with EDS and it ranges between 30 days to 60 days.

Mr. Ashwin Mehta: Okay. Because this appears to be almost 50% of our revenues for the 7 months 2008.

MphasiS: There is an approval process which may take a longer time thereby pushing the over all days of outstandings.

Mr. Ashwin Mehta: Okay. Thanks a lot.

MphasiS: Thank you.

Moderator: Thank you very much sir. At this moment, there are no further questions from participants. I would like to hand over the floor back to Mr. Jeya Kumar for final remarks.

Mr. Jeya Kumar: To reiterate, we are very satisfied with the year. We believe that we are undertaking several initiatives to ensure growth despite a very

difficult business environment. Thank you all for taking the time and talk to you all again next quarter.

MphasiS: Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen, thank you for choosing WebEx Conferencing Service. That concludes this earnings call. Thank you for your participation. You may now disconnect your lines. Thank you and have a nice day.

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