



“CMC Limited Q4FY2009 Earnings Conference Call”

April 15, 2009

Participants: **Mr. Ramanathan Ramanan** - Managing Director and Chief Executive Officer, CMC Limited
Mr. J. K. Gupta - Chief Financial Officer, CMC Limited.
Mr. Prashant Shukla – Chief Operating Officer, CMC Limited.

- Moderator:** Ladies and gentlemen good afternoon and welcome to the CMC Limited's Q4FY09 Earnings Conference Call, hosted by Standard Chartered - STCI Capital Markets Limited. As a reminder 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. Should you need assistance during the conference, please signal an operator by pressing * and then 0 on your touch-tone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Mehul Mehta of Standard Chartered, thank you and over to you Mr. Mehta.
- Mehul Mehta:** Thank you Melissa, good afternoon everyone. We have with us today Mr. R. Ramanan Managing Director and Chief Executive Officer, Mr. JK Gupta - CFO and Mr. Prashant Shukla COO from CMC Limited. We will start with Mr. JK Gupta briefing us on financials and then Mr. Ramanan will give us outline about growth strategy and will be followed by Q&A session, over to you Mr. JK Gupta.
- JK Gupta:** Thank you Mehul and very warm welcome to all the participants in this call. I know it is a busy day for all the participants because of some other results being out in the market and right now the market is on, so I am really thankful on behalf of the management sitting over here including Mr. Ramanan Managing Director and CEO, and Prashant Shukla, the Chief Operating Officer. We are thankful to you all for taking your time and coming onto this call. I will briefly take you through the financial performance highlights of the company for the quarter and the year before handing over to Mr. Ramanan.
- Company had operating revenue of Rs.237.75 Crore during this quarter, a growth of 11% on Q-on-Q basis, but a decline of 9% on a YOY basis due to 46% decline in low margin equipment business, which is part of our strategy. Equipments were restricted to about 48 Crore in Q4. Consolidated operating profit that is EBITDA is at Rs.39.50 Crore which grew 18% Q-on-Q and 33% YOY. Company had an EBITDA margin of 16.6%, best ever achieved by the company so far and which is an expansion of over 90 basis point on Q-on-Q basis. Other income during the quarter has been Rs.13.32 Crore, which includes one time extraordinary write back of an old liability amounting to Rs.8.17 Crore. PBT excluding this extraordinary item is Rs.41.10 Crore, which is an increase of healthy 20% on a Q-on-Q basis and 28% on YOY basis.
- Company earned their consolidated Profit After Tax of Rs.38.45 Crore, which is an increase of 43% Q-on-Q and 60% on a YOY basis. The average effective tax rate of the company during Q4 was 22.0%, compare to 25.5% last year and 21.4% in the previous quarter. A slight increase in average effective tax rate on a Q-on-Q basis is largely because the write back of liability of 8.17 Crore is fully taxable. Margin expansion in this quarter is led by operating cost efficiency and improvement in quality of revenue. Our services revenue grew 3% on a Q-on-Q basis and 10% on YOY basis. Services revenue share in total revenue from sales and services is 80% compare to 66% in the same quarter last year

and 86% in the previous quarter. Similarly, international revenue grew 3% on a Q-on-Q basis and 10% on YOY basis. International revenue share in total revenue from sales and services improved to 43% compare to 36% in the same quarter last year and 47% in the previous quarter.

Our American subsidiary, CMC Americas, grew 28% on YOY basis. Total client addition for the company has been 16 during this quarter. Six clients were added in Americas in the areas of embedded system, ITES, and software solution & services. One client was added in UK in the areas of e-governance and nine clients were added in India in the areas of BFSI, Energy, and Cooperative Sector. Company had an income of Rs.1.23 Crore from mutual funds investment and net foreign exchanges gain of Rs.1.70 Crore during the quarter.

Company was able to reduce manpower attrition by 5 percentage point during the quarter on Q-on-Q basis. Manpower productivity measured as net value added per person month improved 9% in Q4 compare to Q3. Company ended the quarter with a total consolidated cash and cash equivalent balance of Rs.162 Crore, which is an increase of Rs.54 Crore during the quarter.

When we come to see the picture for the year as a whole, Company achieved significant improvement in revenue mix, healthy improvement in margins and Profit After Tax. The total operating revenue of the company for the year was Rs.939.83 Crore, which is a decline of 12% over last year primarily due to 40% decline in low margin equipment business in line with the company strategy. Services revenue share increased to 75% compare to 64% last years. Similarly international revenue share increased to 40% compare to 35% last year. International business growth was driven by America, which grew 15% in Dollar terms for full year and 33% in Rupee terms. Company had an EBITDA of Rs.126.68 Crore, which is a growth of 6% over last year and resulting in an EBITDA margin expansion of 230 basis points to 13.5%. Profit After Tax of the company was Rs.143.82 Crore, a growth of 17% over last year, resulting into PBT margin expansion of 340 basis point to 14.9%. Profit After Tax of the company was 116.15 Crore, a growth of 26% over last year resulting into a PAT margin expansion of 340 basis points to 12.0%.

So this was a brief snapshot of financial performance of the company for the quarter and for the year and with this I will hand you over to Mr. Ramanan to take you through some of the key elements of the strategies that company pursued during the year and what we are going to pursue in the year to come, Mr. Ramanan.

R. Ramanan:

Yeah thanks JK and thanks everybody who have logged on to the call. As JK mentioned we truly appreciate your being on the call in spite of it being a very busy day. As JK has given the financial numbers, what I would like to share with you is the focus that CMC had during the last year and the focus that we are going to continue to have during the next year. Our focus during the last year was to move away from low margin traditional box

selling businesses into more value adding solutions & services businesses, into changing our business mix, so that business mix would enable us higher margin growth and would also enable us to improve our cash flows because some of the businesses that we were in were causing pressures on cash flow in terms of the type of projects that we were involved in or the nature of customers that we were involved with. So, all of these strategies had a very positive effect on the company during the course of a year. So, even though our revenues did dip because of our moving away from equipment sale business, how we were able to end the year with very good growth both in EBITDA margins, EBITDA as well as in profitability. Our Profit After Tax also grew quite handsomely as JK had mentioned especially in the last quarter. It was a consistent performance in terms of growth quarter-on-quarter, which also was very encouraging in terms of the sustainability of what we can do in the coming year.

Our focus in services and solutions really found very good expression in this year, in SI and ITES, which are strategies for this company and for which CMC has been well-known for. System integration business grew not only in India but also in the international market and our ITES and digitization services business also grew well in international market. Our synergies with TCS enabled us win some very large projects, which will find expression in terms of revenues and profitability during the coming year. These include projects like the "Passport Seva" or the "CBEC Project" that we have been executing. Our focus on niche solutions of CMC in ports and cargo and insurance also found expression in terms of new clients that we gained during the course of this year. In fact in insurance, in the domestic market we are probably the leading player in the private insurance sector today. A business, which has just come up during the last couple of years in India and which have very aggressive growth potential not only for the insurance companies who are in the sector, but also for potentially new insurance companies that are coming up in the sector. So, we have today customers like ICICI Lombard, SOMPO, Chola, Reliance Insurance, and General Insurance and also in addition to that we of course have retained our relationship to the New India, United, and National Insurance and so on.

In the ports and cargo, we had some good international wins, but also we have been able to win two major port projects within India and that has enabled the growth in the ports and cargo section.

In terms of education and training we had a flat year primarily because our franchise revenue actually went down. However, we were encouraged by two new initiatives that we had started last year and actually towards the end of the previous year and this was a "CJET" initiative, which was Job Enabling Training programs, and the job enabling training program-yielded us for almost 7 to 8 Crore of revenue during the last year, which was completely new stream of business that we started. We do see aggressive growth potential for this during the coming year. We also had encouraging results in corporate training programs, which are conducted for corporates in a dedicated manner and even that business has grown well. We are revamping our offerings for the retail sector, in addition

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to having new strategies for vocational training as well as application rollout training, which is becoming quite common as applications get rolled out with the growth of infrastructure in the country.

In terms of customer services, our focus mainly was to move away from the equipment sale business and to increase our cost efficiencies in the services business and ensure rationalization of cost. So, we see now, this year we will be focusing on growth in the international sector in infrastructure business as well as we are looking at new area such as security and surveillance system, deployment of the solutions or managing infrastructure rollout in the country on a larger scale as some of the retail organizations or even some of the banks and insurance organizations have launched large computerization initiatives, which are spanning the breadth of the country. So, overall our focus on solutions and services in the private sector, in the international sector and in the specific areas that CMC has been traditionally strong and have yielded us good results and we will continue on these strategies in the coming year.

In the international sector, we are increasingly synergizing the TCS both on Embedded System as well as on digitization services and in niche areas of SI, such as ports and cargo and other solutions that CMC has developed. These we see having increasing potential during the coming year and we will be focusing strongly on enhancing our synergies with TCS in these areas. In India, we are synergizing the TCS on large mission mode projects, which are of the types of projects like Passport Seva or CBEC and so on and we do see with the growth of the power sector or the investments that are happening with the power sector in India, there will be opportunities for us to tap that sector because it has been a traditional area where CMC has done well, not only in billing system for the power sector but also for SCADA and Real Time Systems, which we have developed and implemented in India in number of areas. So, with these I would like to really take your questions and both JK and Prashant will help me in answering any questions that you may have and we look forward to an interaction with you.

Moderator:

Thank you sir. Ladies and gentlemen we will now begin with a question and answer session. At this time, if you would like to ask a question please press * and then 1 on your touch-tone phone. Please use only handsets while asking your question. Anyone who has a question may press * and 1 at this time. We have the first question that has come up from Mr. Ruchit Mehta of HSBC Asset Management, please go ahead Mr. Mehta.

Ruchit Mehta:

Yeah hi sir congratulations on the numbers. I just wanted to get a sense from you in terms of the business outlook going into fiscal 2010, what is the kind of mix that you are seeing between the different business segments, what is the growth profile of these businesses?

R. Ramanan:

We have today as you can see 75% of our revenue is coming through solutions and services and about 25% during the course of the years came through equipment sale, which is a great improvement from the previous years. We will continue strengthening our

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preference in solution and services, however there are some large projects there may be an equipment sale component unless that is directly linked with a good margin or in down stream solutions and services; we will not be picking up these orders. So, in absolute numbers, we will try to enhance our solution services business and in terms of the mix, it could, we would like to maintain or improve upon this, based upon the type of business that is coming to us. In terms of specific segments, we do see for SI and ITES to grow and Embedded Systems to grow more during the coming year. We are also, the growth in infrastructure services, we are going to be focusing on the private sector as well as in international markets, but the larger growth, we are looking forward to come from SI, Embedded Systems in ITES. Educational training, that is an opportunity here in terms of demand for training and the need for advance training programs, which will enable people to be able to get jobs and so the Job Enabling Training program and advance training program that would be a differentiator for students, something that we are going to focus on and hopefully we will see some growth in that sector. But may not be to the same levels that we maybe aspiring for an SI and ITES here and Embedded System.

Ruchit Mehta:

And just to get a sense on in terms of initial segment growth outlook, how do you see customer segments per se is behaving in the current year, I mean we were down almost 30% to 35% in the current fiscal, what would be the budget in terms of going forward and similarly for system integration you know 10%-12% growth, how much of that actually came in from because of the currency appreciation and how much do you think you are budgeting in terms of the growth for the next year?

R. Ramanan:

I would like JK to answer on the impacts of foreign exchange and so on.

JK Gupta:

Yeah Ruchit, when we try to compare growth in SI segment, we have to just keep in mind that this year we had renegotiated one large contract from onsite rate basis to a net offshore rate basis. I had probably shared with you earlier also, impact of that is about Rs.13 Crore per quarter that way these numbers are slightly not comparable. Last year numbers have got about Rs.52 Crore of that additional revenue which is not reflected in this year. So, that way the growth will be more, so out of these Rs.13 Crore almost Rs.9 Crore pertains to SI segment and the other to CS segments. So, I can say that you have to reduce almost 36 Crore from the last year number to make it comparable. So, reported growth of 12% will be very healthy. This is what you have to see from our international business growth perspective also. Then on reported number when we see, our international growth looks at around 1% or so, but when I adjust for this Rs.52 Crore of last year, our international business growth this year is about 17%. So, that is one perspective that I have on this.

Ruchit Mehta:

And sir, on this 17% growth how much is because of the rupee depreciation and how much is because of actual volume growth?

JK Gupta:

In this let me tell you, we have got an exchange gain of about 9.44 Crore in this year, which is not a part of operating revenue. So, that has not been reflected and other impacts

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are due to the value embedded into the transaction that I really do not have an absolutely separate number available. But we have grown in dollar terms also, as you see that in America we grew almost 15% in dollar terms, so it is not only exchange which has delivered a growth in international revenue, it is also dollar itself which has helped us growing our international revenue.

Ruchit Mehta: Okay and this SI business, how do you see growing into next year into fiscal 10, what sort of growth is that you are looking at?

R. Ramanan: Yeah, we do not give forward looking projections for these types of numbers, as this has not been traditionally followed in the company. However, the SI, ITES, and Embedded Systems we have a healthy pipeline of opportunities that we are pursuing, both in the international market as well as in the domestic market.

Ruchit Mehta: Okay. And just to getting a sense of the ITES because it grew almost very sharply in the current quarter from 18 Crore to 22.5 Crore in this current quarter. What helped to growth, I mean was there any specific new contract within the quarter or?

R. Ramanan: Yeah, it is a combination of some new contracts in this quarter, as well as existing contracts which grew in terms of scope and new sources of revenue for that. So, it was a combination of both.

Ruchit Mehta: And just finally sir, in terms of the CAPEX for current year, what do we spend in fiscal 09' and what are we looking for spend in fiscal 2010 and you mentioned cash 162 Crore, but what is the debt?

JK Gupta: Our fiscal 09' expenditure is about 21 Crore that we spent. In fiscal 2010, we have planned for CAPEX of around Rs.20 Crore of general CAPEX, plus there will be additional CAPEX required for SEZ in Hyderabad. Our SEZ phase 1 is almost over with all the three ODCs being operational. We are still developing a plan for phase 2 that phase 2 plan may require a CAPEX of anywhere between 40 Crore to 60 Crore to be spent in the current financial year, that is fiscal 2010. When you talk of our cash balance, we do have a cash balance of 162 Crore against, which is a consolidated cash balance.

Ruchit Mehta: And debt correspondent to that?

JK Gupta: Consolidated debt correspondent to that is about 50 Crore.

Ruchit Mehta: And sir, you mentioned CAPEX of 21 Crore of fiscal 2009, but this is including the SEZ CAPEX or?

JK Gupta: Yes it includes, it is the total CAPEX.

Ruchit Mehta: Total of 21 Crore?

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- JK Gupta:** That is right.
- Ruchit Mehta:** Okay thank you.
- Moderator:** Thank you Mr. Mehta. The next question is from the line of Mr. Neerav Dalal of Capital Market, please go ahead.
- Neerav Dalal:** I wanted to know the rental income for quarter end of the year?
- JK Gupta:** For the year it is 8.4 Crore, yeah.
- Neerav Dalal:** Sir, the ITES margins have shot up this quarter, any take on that?
- JK Gupta:** Yeah basically, you know if you look at our ITES business in the fiscal 2007, we were having almost similar kind of margins. We have got most of the ITES revenue growth in this quarter through international business and international business delivers us very high profitability. So, frankly speaking our margin of last year of 11.6% was unduly low, so this is what is the representative one. We have been sharing with people that more sustainable margin in this within the range of 24%- 25%. For the year, our margin is about 21.1% because our first few quarters margin has been low, but I see 25% margin is something, which is sustainable given our business mix, for domestic and international.
- Neerav Dalal:** Sir and what about the margin outlook for the other System Integration business?
- JK Gupta:** In fact if you look at SI margins for the quarter has been about 30% and for the year has been about 28%. Here, two things have happened number 1, our share of international revenue has gone up and also we have been able to improve profitability on domestic business significantly this year. So, this 28% margin now is I think comparable to any peer company. We have been delivering these margins earlier also last year same quarter, itself it was about 28%, so here will I say again about the current level of margin is around 28%, which is something which is in line with the business mix that we have got and that should be taken as sustainable.
- Neerav Dalal:** Sir, what was the headcount at the end of the quarter?
- JK Gupta:** About 5400, I can give you the precise number, I think it is 5383.
- Neerav Dalal:** 5383, so it is down slightly.
- JK Gupta:** Yes it is down almost 26 in the quarter.
- Neerav Dalal:** Okay, sir and what is the contribution of TCS in the revenues?
- JK Gupta:** For the year it is about 45%.

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- Neerav Dalal:** Okay sir, thank you.
- Moderator:** Thank you Mr. Dalal. We have one last question that has come up from Mr. Ruchit Mehta from HSBC Asset Management, please go ahead.
- Ruchit Mehta:** Yes sir, in terms of the margin profile obviously there is business, mix your margins will tend to improve. From an individual business perspective do you think that we will now hit that sort of stable steady state margin or do you think there is further improvement possible? And specifically on your ITES margins you know they have improved very sharply in the current quarter, what would be steady state margins in this business going forward?
- JK Gupta:** I think I just answered about ITES steady state margins. We should consider about 25% as a steady state margin and the scope for improvement is there in E&T. E&T margin for the year has been only 11% compare to 22% last year. E&T is a business, where the margin sharply depends on the volume of business being done. Here, our guess is that last year kind of margin of about 21%- 22% is something that can be reasonably targeted. In case of CS business, our current year margin has been 5.5%, last year margin was 8.3%, current year margin of CS has been impacted because of exchange, hitting CS because of increase in hardware cost on imports. So, my guess is that 5.5% has a scope for improvement going forward.
- Ruchit Mehta:** And what would be the SI business?
- JK Gupta:** In SI business, our current margin is about 28%, something which looks reasonable maybe a percentage point here and there, we should be able to sustain that.
- Ruchit Mehta:** And in terms of the growth outlook, you know across most of the IT business trying to get volume in this market in a current environment and what is the kind of pressure that you are seeing in terms of customer demand so far as you know rate reductions or reducing the overall cost or you know increase competition from other players, typically who would not have probably bid it for projects that you would have focused on?
- R. Ramanan:** Yeah, I am reasonably optimistic about CMC's chances in this year, even though there is a lot of pressure due to the economic downturn and the global meltdown and all that. But there is an opportunity for CMC because of two reasons, one we do not have as big an international base of customers as some of the largest companies have and so there is an opportunity for growth even if there is a decline overall in the economic areas. And our growth will be driven by replication of what we have been able to achieve during this year and the scope for such replication is quite high. The second part is the India story is also an encouraging story, because the Indian economy has been slightly more resilient than the global economy and there is committed IT spend in India in certain areas for example. There is going to be a lot of spend on infrastructure management, security and surveillance. There is going to be increase in defense and military, which is again a

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traditional area that CMC has been strong in. And there is going to be an increase spend in e-governance related projects across the country and there is an opportunity in power sector and the energy sector. So, these are positive indicators for us because these are traditionally areas in which CMC has build competencies as well as has a Pan India infrastructure capability to service our customers on a countrywide basis. And the third part is yes there is going to be pressure on pricing and margins overall both in India as well as abroad. But that is again an area which CMC may fair, can have or have the opportunity to fair better than the others because of his inherent cost structures being lower than the traditional players in this space. And at the same time, you know in terms of quality or in terms of reliability and reach, CMC has you know proved itself time and again in very large projects, in mission projects like Railway Reservation or Bombay Stock Exchange or the defense, military and so on. So, these three factors are promising for this company and I do not want to make it sound very rosy, but these are the value differentiators that we are trying to bring to the fore and that is resulting in actually even few customers who were traditionally operating with some of the largest players looking at CMC as an alternative.

Prashant Shukla:

To add to what Mr. Ramanan is saying from an operating perspective while the market is tough, there is no doubt about it. The reason why we feel reasonably confident is on three scores. The first point is that we have demonstrated ability and consistently shown that we can take on large projects, combined with that our focus in doing repeatable business, which improves our productivity in delivering that solution with our asset where we have considerable domain expertise enables us to demonstrate at the same time, the ability to handle complex projects and the domain experience required in these areas. An example of that is ports and cargo, where we have a very good product, which have capability not only for India, where we have won but also internationally where we have won and demonstrated capability against the best in the world so, that is one. Another example of that is insurance, Mr. Ramanan already pointed out that in insurance, in the private sector in India, we have quite a bit of presence and we have tremendous scope to increase the scope of this outside. Yet, another example is a very complicated national rollout kind of project, where we have demonstrated the capability to take a complex domain base solution and scale it with large groups and we have some good contracts in that area and we see further traction in that area because it is a skill that is niche and at the same time it is a skill that enables us to expand on a larger basis, simply because we have demonstrated the capability to cut customer cost. And last but not the least, I think our focus in improving our ability to deliver business on time and concentrated focus in doing, improving our operational skills is starting to show good results and part of it you can see in our ability to complete projects and so on which of course is seen in the cash flow situation and to some extent it is reflected in the cash flow situation. That being said, I do want to point out this is a tough market, there is no doubt about it and we are cautiously optimistic.

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- Ruchit Mehta:** And just finally on your Passport Seva Project, can you give a sense on what is the update because since the project has been delayed because of I do not know certain other vendors not probably delivering on time?
- R. Ramanan:** Yeah the Passport Seva Project that has two phases to it, one is the prototyping phase and the other is the actual service phase and the prototyping phase is going through some initial tests and so on and also because of the election situation some of these testing acceptances may have certainly got postponed. But otherwise the project is very much on track and the major portion of the revenues were estimated to actually start flowing from the current year and you know it is a seven year project, so you know the revenues will be distributed over a period of time.
- Ruchit Mehta:** Out of the total price of contract was almost 1000 odd Crore, out of that what is our share?
- R. Ramanan:** What is that, CMC's share?
- Ruchit Mehta:** Yeah.
- R. Ramanan:** I mean, we are not giving any numbers here, but we are going to be focusing on infrastructure services, digitization services, facility management services and a certain degree of SI services related to some competencies we have in biometric solutions.
- Ruchit Mehta:** So, I mean in terms of or do you actually will set up the center, initially hardware?
- R. Ramanan:** Yeah in hardware we may not take you know the hardware routing part of it, we may not be playing a very significant role there, we are trying to play more significant role in the solution and services. However, there maybe some instances where it is tied up with the solution and service and so we may still have to engage in that portion of it.
- Ruchit Mehta:** And what is your digitization over here, what exactly would you do, you do directly or you do from third party vendor also?
- R. Ramanan:** Digitization model is a combination of in-house and contracting model.
- Ruchit Mehta:** Okay, so you probably might contact third party vendor and so on.
- R. Ramanan:** Yeah because there are certain low level activities, which do not require, do not justify really us getting involved in that. But we have to manage it and we bring tools and technology and processes and methodologies, that is our expertise that we bring to the table.
- Ruchit Mehta:** Okay thank you.

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- Moderator:** Thank you Mr. Mehta. Sir, there are no further questions. Mr. Mehta would you like to add any closing comments.
- Mehul Mehta:** Thank you Mr. Ramanan, Mr. JK Gupta and Mr. Shukla for taking time out for this call and all the participants for being part of this call. Sir, any closing comments from your side, Mr. Gupta.
- JK Gupta:** Thank you Mehul. We are really grateful for people who have taken their time out. In case they have got any follow up questions, participants are requested to either forward it to Mr. Mehta or they can forward it to any three of us, who are here and we will be too pleased to answer those questions. And thank you very much for taking time out to come in the call.
- Moderator:** Thank you gentlemen of the management, thank you Mr. Mehta. Ladies and gentlemen on behalf of Standard Chartered STCI Capital Markets Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.