

Transcript

KPIT Cummins Infosystems Q1FY06 Earnings Call on 20th July, 2005

Hosted by Fortis Securities

Participants: Chairman & Group CEO - Mr. S.B. Ravi Pandit
CEO & Managing Director - Mr. Kishor Patil
GM (Finance) - Mr. Anil Patwardhan
President & ED - Mr. Girish Wardadkar
Head of IR - Mr. Sanjay Sinha
Manager of IR - Mr. Vikas Jadhav

Deepa: Good evening everybody. This is Deepa from Fortis Securities. I welcome you all to the first quarter earnings call of KPIT Cummins Infosystems. Today we have with us Mr. S.B. Ravi Pandit, Chairman and Group CEO, Mr. Kishor Patil, CEO and the Managing Director, Mr. Anil Patwardhan, GM (Finance), Mr. Girish Wardadkar, President and Executive Director and Mr. Sanjay Sinha, Head of Investor Relations. Mr. Pandit would be discussing with us the company's performance for the quarter ending June, 2005, following which we will have a Q&A session for the participants. I would now request Mr. Pandit to discuss the company's performance for the quarter. Over to you Mr. Pandit

Pandit: Thank you Deepa. I would like to add that apart from the team that you mentioned, we also have here with us Mr. Vikas Jadhav, who is our Manager of Investor Relations.

Vikas: Hi, good evening everybody.

Pandit: Deepa, what I would like to do is to talk very briefly about the quarter that went by and about the guidance that we have given for the year. I don't think I need to go through all the details of the performance because I am sure that all the people would have read our press note as well as our investor update. So I will try to go beyond what is written there and tell about, what are the things that are happening and what are the issues that we are actually looking at as you all know that our consolidated revenues during this quarter give 4% sequentially and they grew 15% on a year-to-year basis. Although we have had this growth, of 4% on a sequential basis, there has been slight change in the composition of this growth, our onsite revenues have gone up slightly more and our offshore have not grown up as much. That is because of the phase of the project in which various assignments have been. Now although this is a small variation but it has had its rather relatively large impact on our bottomline, because as we all know the profitability of onsite and offshore revenues are different. So that is on the revenue side. On the revenue side we have added a few customers. There are two customers whom we have moved to the star customer category and there are three more customers who are added to our general customer list. These customers have been more for advanced technology solutions and they have been from Europe. So we are seeing some traction over there. However, we have not seen the traction that we have anticipated when we went in for the year and therefore our revenues for this quarter have been lower than the revenues that we had

initially projected. Two of our customers have had the deferral of or postponement of their IT expenditure and that has hit us. Now that is on the revenue side.

If you look at the operational side, we have added significantly to the number of people. We have added about 190 people during this quarter. We have also had our annual increases in the staff compensation and the result of both of that has been our salary levels have gone up, both on account of increase in numbers as well as on account of increase in the rates. And our resource utilization has come down almost 3% point. We have during this period taken a lot of freshers and we expect that when these freshers become operative or when they become fully productive in Q3-Q4, the current per head salary levels would come out little more within the reach, because there will be a larger proportion of fresher people going in. Now that is as far as our staff per se is concerned.

In addition to this, what we have done is, we have continued to pursue our initiatives for improving our systems and processes and we have talked about that in our note and we have also continued to invest in our chief practice areas and that is the kind of an investment that we have continued to make. We have moved completely to the new premises and now we have this quarter when the entire expenses on the current new premises has come in and that the capacity creation that we have done. These capacity creation have been done not only in Pune, but also in Bangalore, where we have 240-seat facility on which we have incurred expenses during this quarter and the facility will be fully operational during the next quarter. We had as we mentioned to earlier we had passed a resolution for formation of a separate company for process of outsourcing. We have now finally got the incorporation for that. During this quarter we have invested money into building a team. The total team size that we had towards the end of the quarter was about 40 people. We have also some visibility of growth in our BPO operations. We believe our operations would be in one of the 3 areas, namely finance and accounts, HR or on technical support for software and we see some growth happening in this area. So we expect that we might be able to hit a number of about 100 people at which point in time BPO operation become profitable towards the end of this year. So there has been a change in that area as far as our earlier working was concerned. During this period, we have also finalized in the last quarter we have got the sanction from the IFC for funding of our new facility and it is a funding for \$11 million, it is a 7½ year loan with over 3½ year moratorium and we should be drawing on that amount during the current quarter. So we have already started construction of our additional facility. This is really like a really quick recap of the last quarter.

We have given a revised guidance. We have brought down our revenue guidance by about 5% and based on the cost structure that we have, we have brought down our bottom-line guidance about 12½%. This guidance has been brought down predominantly on account of the deferral revenues that we faced in the first quarter. This was actually the additional anticipated revenues that we were looking at during the first quarter. We believe that whatever has been deferred in this quarter, would ultimately result in a deferral of revenues for the whole year as such and that is why we have revised our timing. We are quite certain that with the kind of action that we are taking in terms of adding to our customers, adding to our practice lines, adding to our

geographies, we would be in a position to meet the guidance that we have now given. We will be ofcourse will be looking at better numbers at that internally. I think this is like a broad background of what has happened during the last quarter. We will be happy to take questions now.

Moderator: Ladies and gentlemen, we will now begin the question-and-answer session. If you have a question please press '*1' on your push-button phone and await your turn to ask the question when guided by the facilitator. If your question has been answered before your turn and you wish to withdraw your request, you may do so by pressing the '#' key. We have our first question from Mr. Sandeep Shah of Tower Capital. Please go ahead Mr. Shah.

Shah: Yeah Sir, good afternoon. Just wanted to know what has changed in the last or two months which has taken to revise our sales guidance and our significant downward revision in the PAT guidance? What has changed, why this is not been looked into before?

Pandit: Sandeep, as I mentioned the change in the guidance is of 5% of topline. On knowing the cost structure any change in the topline can mean relatively higher change in our bottomline. Now the question is what are changes as far as this 5% are concerned. We have had situations with two of our major customers, our star customers, where they put their IT investments on hold. Now, this came on account of their global scenario and this has resulted in they saying almost, like instantaneously saying that these are the projects that we want to defer from this quarter to next and there is going to be a slight freeze on that. And this was something which we couldn't have predicted.

Shah: But are we confident that these projects will start from Q2 onwards?

Pandit: The extent to which they will get deferred, we are provided for in our revised guidance.

Shah: So it is nothing like that projects has been gone to some other vendors or...?

Pandit: No, we haven't lost the customer, we haven't lost the project.

Shah: Okay, the revised guidance, does it include the BPO revenue?

Pandit: It does.

Shah: So what could be the quantum out of that, because...?

Pandit: No, let me go back, revenues which we have not got a commitment for we have not included. Currently, as I said we are doing work for about 36-40 people. Currently, we are doing work in the area of financial accounts, etc. Those are the works that we have taken in. We are likely to do some larger amount of work which we don't have on hand and we have not put it as a part of our revised guidance.

Shah: So the current guidance only includes the work for the current 40 employees?

Pandit: That is true.

Shah: Okay, so that means that the actual downward revision in the sales for the IT services is higher than the actual deference in the sales what we have given.

Pandit: No, I would put it like that, the downward revision is extensively is on account of IT, because these are our earlier guidance not the current guidance, includes any potential growth in the BPO business.

Shah: That is true, but the earlier guidance was not including any revenue from the BPO, but now...

Pandit: I think even the revised one doesn't include any significant growth in the BPO business, as I said today right now we have very small number of people.

Shah: Okay, and you mentioned that BPO by end of Q4 will start giving some profits?

Pandit: We expect it to break even by that time.

Shah: Okay, and the investment which you have mentioned of 4.5 crores, will it be on operational level or it will affect our P/L?

Pandit: No, actually first is that the total investment at we are looking at, it may not necessarily be completely during this year, okay, and it would not affect our P/L for the current year.

Shah: And Sir just looking at some mathematics, if we take the higher end of the revised guidance our compounded quarter-on-quarter growth rate in the sales will be 8.4% and if you take a lower end of the part guidance our compounded profit growth quarter-on-quarter will be 15.1%. So that means there will be a significant up move in the margin expected from the coming quarters, and how confident are this double-digit Q-on-Q growth in the bottomline will be achieved in the coming quarters?

Anil: Sandeep, this is Anil here. We have revised guidance, we have taken into account about next three quarters revenue as well (**not clear**) prior to this financial year on our practices as well as the revenue mix, there is onsite and offshore — financial year. We are confident to achieve the bottomline...

Shah: Sir, sorry to disturb you, your voice is breaking, it is not coming clearly.

Anil: Yeah, Sandeep, basically what I was informing you is the revised guidance we have taken into account in the next 3 quarters, revenue mix as well as the structure, as well as the practices which we are operating. And based on these 3 factors, achieving the bottom-line for the remaining 3 quarters to meet our revised guidance. After taking

into account the (not clear) which have taken place in the past, in the quarter one and the ramp up which have also taken place in the quarter one.

Shah: Sir, that means the margin will move up going forward. That is what we are expecting?

Pandit: Actually, Sandeep, if you as you see when we put our topline guidance down by 5% we have brought our profit guidance down by 12%. So obviously when the revenue goes up, the profits will go up disproportionately because of the fix nature of certain Costs

Shah: Okay, and Sir our target of \$100 million by end of 2007, any change in that?

Pandit: No.

Shah: Okay, so that means that we are in the '07 we have to grow by 35-40% on the sales front?

Pandit: Yes.

Shah: Okay, so we have a visibility in terms of that.

Pandit: I wouldn't say visibility, but we are sure we will get there.

Shah: Okay, Sir just coming to the Cummins account, it is very good growth of Q-on-Q, if I am not wrong the Q-on-Q is close to around 27% and if it doesn't grow, if the Cummins revenue is flattest in the coming quarters, then we will achieve close to around 27-28 millions from Cummins. So my question is will the future dilution will happen on account of the conditions which will be applied in the June 2007?

Pandit: See, the landmarks for future options of being converted are...

Anil: The level of the 48% is the remaining options of earlier part and the last two options is perhaps really exercised then we have to achieve little above 52% and 55%. That's the new KPIT Cummins precise here.

Shah: Very true Sir, this quarter I think the number was 43-44%.

Pandit: We still have and as you know Sandeep, the other issue that as I mentioned is quarter's revenue drop has been on account of freeze of our deferral of IT expenses by some of our customers, okay, whereas Cummins has continued to grow. We don't expect the deferral of IT investment by our customers to be permanent. So, I think finally our composition of Cummins and non-Cummins will kind of revert to what it was earlier.

Kishor: The other thing is this call has to be taken after March '07 in June '07 at point of which we are looking to have revenues in excess of 100 million. So in case this has to happen, the Cummins' revenues have to go beyond 48 million.

Shah: So, last quarter you said that Cummins revenue will grow in '06 by around 25-30%, so we still mention the same stuff?

Pandit: Yes we are still certain about the same level of growth.

Shah: Okay, and I think the other star customers mainly in the Europe have declined, that is what geographical mix mentions Sir?

Pandit: Yes, deferral has happened within European clients.

Shah: Okay, Sir I have some more queries, I will come will later on. Thank you very much.

Pandit: Certainly Sandeep.

Moderator: Thank you very much Mr. Shah. We have our next question from Mr. Dipen Shah of Kotak Securities. Please go ahead M. Shah.

Dipen: Good evening Dipen here. Sir just wanted to know one thing, this client deferral or the project deferral which has happened during the quarter, have their projects actually started in this quarter or if it is not, when do you think this should start?

Pandit: They should start in Q3 most probably.

Dipen: Okay, so maybe would you say that Q2 could also remain impacted and then we can see significant scale up from Q3?

Pandit: It's not only a single project, now there are some projects which we expect to come in Q2, there are some other revenues which we expect to see come in on Q2 and what we are saying is by Q3, we would have the same projects come back in.

Dipen: Okay, thanks very much.

Moderator: Thank you very much Mr. Shah. We have our next question from Mr. Hitesh Zaveri of Edelweiss Capital. Please go ahead Mr. Zaveri.

Zaveri: My question is with regard to the client additions that you have in the current quarter. If you could just characterize this to what kind of clients that you added in the current quarter? Second is with regard to your VLSI facility in Bangalore, whether you already have few clients working from there and outlook please?

Kishor: Yeah sure. The clients which we have added during this quarter are mainly European customers and they belong to manufacturing and ATS services. These are typically a billion-dollar plus customers and our engagements are either for embedded soft mainly in the area of embedded and VLSI. The center which we have set up in Bangalore is already had start well and we have already engagements started with more than 2 customers. We expect this center to be pretty occupied in terms of utilization by third quarter.

Zaveri: I would also appreciate if you could give me some colour on the pipeline of the clients that you have in the discussion and also if you

could share some remarks on the visit that you are saying at this time and overall how do you see the environment?

Pandit: Can you repeat the last question please?

Zaveri: What is the environment you are looking at the client visit that you are experiencing it this time and how is your overall client pipeline?

Kishor: See generally we have seen that the client acquisition has been reasonably good. There are enough opportunities on the table, the progress has been well. In the areas in which typically the client attraction is happening more strongly is area of embedded software and VLSI and accordingly the manufacturing sector. The initial engagements are little smaller and customer generally waits for a couple of assignments to get over to get confidence in the overall offshore delivery model and scale up happens little later. So the reason we are confident about some of the things which we mentioned about is the client acquisition or the client traction is reasonably good. The pilot projects are going well and that is the reason that we believe that the scale up will happen a little later. These are all customers which are pretty much leaders either in their geographies or in their industries, where they are and these are typically a billion dollar plus customers.

Zaveri: Sir, the last question actually I didn't quite follow about the BPO business as you said you mentioned that there will be no hit on the P/L account because of this. Most companies in the recent past in last 2-3 years have had to take some hit on account of initiating their BPO business at least in the first year. So have I understood correctly that there will be zero loss on account of your BPO business that you are initiating in the current year, and why is that?

Pandit: During the quarter, we have invested in the BPO business. We expect the investments to continue for the next 2-3 quarters till we hit a stage of that business being fully set up. And what we have right now is some income coming on account of our existing customers and what we also see is some incoming coming on account of the future customers with the one which I have referred to earlier. But this will be completely separately kept and we expect that to be completely operational and profitable from next year onwards.

Zaveri: Sir, I am sorry I am still not clear. So in a separate if I was to draw a P/L for the BPO business, for the whole year it will break even?

Pandit: During this year, we will continue to make investments and as our note say we will invest upto Rs.45 million in that and we will keep that aside as a separate investment.

Zaveri: Okay, so where will they reflect in your P/L and balance sheet?

Pandit: This will reflect in our balance sheet as of this time and whatever revenues we will get from that business till we reach the set up stage, we will also take it to our balance sheet. We will adjust it against our expenses.

Zaveri: Right, thank you.

Moderator: Thank you very much Mr. Zaveri. We have our next question from Mr. Mahesh Vaze of Brics Securities. Please go ahead Mr. Vaze.

Vaze: Hi Sir, there was a question earlier on the arithmetic of your guidance, I will labour a bit more on that. If one looks at your profit guidance the next 3 quarters you have to grow by 25.3% each quarter sequentially to meet the top-end and around 23% to meet the bottom-end, which seems very tall order. So the gap, if you look at just the 3 quarters, in the topline for the high-end you will have to go by 8.3% and bottomline by 25.3%. What is going to cause such a big jump in the profits?

Pandit: What is the topline growth you are saying, 8% per quarter?

Vaze: 8.3% and bottomline 25.3%.

Pandit: Per quarter? I think we need to re-look at those figures. Anil, can you re-look at those figures?

Vaze: Okay, see the figures are right in front of me. I could just read it out to you. 64 million is your profit this quarter? Okay, and 370 million is what your guiding at the top-end, right? 37 crores, you are guiding?

Anil: Yeah.

Vaze: Okay, so this 64 million, I will just talk in crore, so this will be simpler. This 6.4 crores will have to go to 8 crore in next quarters 10 crores and ...

Anil: Sorry to interrupt you. 370 million was my earlier guidance.

Vaze: So what is the latest guidance?

Anil: Revised guidance are, they must be 320-350.

Vaze: Okay, so for 320 you will have to go by 23%.

Pandit: I think you might want to kind of..

Vaze: No, that is what, I just did that, it will be about 23% for 350. The 25.3% comes down to 23%.

Kishor: See, if you really look at our topline growth or the growth which we need to have, first quarter revenues are about 22% of our topline guidance, the second quarter revenues are 24%. So the growth are in the topline is not that significant and as we mentioned earlier the growth in the topline is not compensated fully by, I mean there will be additional growth in terms of bottomline with the growth in the topline.

Vaze: The additional growth requirement seems to be quite high is the point I am trying to make, because at the high-end earlier number I was talking of first 25.3% is now actually coming to 22%, I have modified

the number for the high-end of the guidance I am talking about, both topline and bottomline.

Pandit: The only thing that one needs to look at is that we are at a stage where all our investments are already in the company. The investments in terms of number of people that we need, they are there. The investments in our facilities are there. So except when we need to have onsite work to be done as a part of our growth. In all other cases whatever is the growth in the topline will completely fall into the growth into the bottomline. And our cost structure being significantly fixed, it makes the disproportionate difference between the topline and the bottomline. And as I mentioned earlier, our downward revision on the guidance also shows that.

Vaze: Yeah, the second thing is, you must have also seen results of some of the competitors, okay. And this quarter almost everyone, some of the large guys from whom you always expect good growth, the volumes are not grown for them and some of the smaller companies have seen a downward revision in the guidance. So while we have attended quite a few calls and almost everyone seems to attribute it to some sort of one-off event, some slow down in some client, all of them happening coincidentally. To your mind do you think that there is some problem in the system, not specific to say, KPIT or X or Y.

Pandit: No, the way I would look at that is that I would ask the following question. Are the IT budgets of companies in general going down?

Vaze: I wouldn't know that Sir, that is what I want to understand.

Pandit: This is the way I think of it. I just want to share my thought with you.

Vaze: Okay.

Pandit: Are the companies bringing down their overall IT budgets in general or are there deferrals in IT budget? That is the first question I would ask. The second question that I would ask is that, are the days of outsourcing over? Only if the answer to both of them are 'yes', then one can say that ongoing basis on a secular trend there would be a reduction in the revenue of the Indian software companies. And to me I don't see that the answer to both the questions or either of them are 'no'.

Vaze: Sir, I am not talking of reduction in revenues, okay. Essentially there seems to be some loss of growth momentum. Even now all across, it is just that the growth rate seems to have come down. What I wanted to understand is when you go in market, do you see the difference today compared to say one year ago when you were growing very nicely. Compared to that the growth has slowed down, not just for you, for everyone else. So do you see some difference, is what I wanted to understand?

Kishor: Basically, there are 2 categories of customers. Some customers who have been doing outsourcing are for a few years. I think in many such cases now, there are taking stock and looking at larger issues and

I think that they are taking more time for concluding such deals. The other type of customers are which are like a first-time kind of a companies who are doing offshoring, where I think the scaling up is taking more time than required. I think even if you look at what most of the companies have said and that is our experience and that is what we experienced in the market as well. The client acquisition has been reasonable. So I don't think there is a situation where the new clients are being acquired and I think I also read the reports from other companies. That seems to be across.

Vaze: Okay, one last small clarification. What is the kind of tax rate one should be looking at going forward? There are some write-backs, it had been a bit volatile over last 3 quarters.

Anil: Mahesh, can you just repeat your question?

Vaze: Yeah, what would be the tax rate going forward? 6.7 was what it was this quarter. Last year there was some write-back and it was 9.3% in third quarter.

Anil: For the year as a whole in the range of 8-8½% of our total PBT.

Vaze: Okay, and the depreciation has seen a significant jump. So would one assume that this is the level at which it should remain or is there some more addition that could happen to depreciation?

Anil: In fact what has happened is, we had capitalized the whole project, that investment which we have made in the last financial year and this depreciation is mainly the first quarter's impact of that depreciation. There is a normal capital expenditure which will happen during the year based on the people growth and I don't think there is significant increase in the depreciation quarter-on-quarter.

Vaze: Okay, fine enough. Thanks a lot and all the best.

Moderator: Thank you very much Mr. Vaze. We have our next question from Mr. Sudanshu Rajpal of BK Securities. Please go ahead Mr. Rajpal.

Rajpal: Good evening Sir. First of all I wanted to understand, number one, has the profitability in Panex gone down a bit? Has it gone into losses? What is happening in Panex, because I don't see Panex numbers coming in?

Pandit: Yeah actually, Sudanshu as you would recollect, last year was the first year in which Panex has come in. We didn't have Panex the year before that and we were giving separate Panex numbers to make the two years comparable. During this year, now we have fully integrated Panex and Panex is a normal part of operation and so during this year we don't intend to report separately on Panex, because neither for comparison purposes nor for integration purposes, there is a separate need now to look at Panex. So we internally also look at Panex as a part of the division of the company which is having certain onsite and certain offshore revenues, much the same way our UK subsidiary has or other US subsidiaries has.

Rajpal: But has it gone into losses or has the profit...?

Pandit: No, Panex has not gone into losses. As we had explained last time, Panex has continued to be a good deal.

Rajpal: Okay, so offshoring is continuing there?

Pandit: Yes.

Rajpal: Okay, fair enough. Secondly, as far as Cummins is concerned, could you just tell, I mean the growth has been really great this quarter, almost 30% and you are saying for the entire year you maintained that the growth for Cummins as an account is going to be 25-26% now. If I just annualize the current quarter's number I am getting a 37% year-on-year growth. So are you seeing some kind of volatility in Cummins revenue over the next 3 quarters?

Kishor: No, not really. We are looking at steady revenue and some growth in Cummins account in the next few quarters.

Rajpal: No, let me re-phrase it. From this level over the next 3 quarters on a sequential or a quarter-on-quarter basis, are you expecting a decline to come or are you expecting only a growth to come?

Kishor: That is exactly, I mean we are not looking at any decline from the current level of revenues, we are actually looking forward to some growth in the Cummins account in next quarters.

Rajpal: Sir, then Cummins in itself grows 37% y-o-y then why are we holding on to the position that Cummins will grow only 26%? I mean, you annualize 28.6 odd crores which Cummins has done in the current quarter, you get 115 crores, you will already grow Cummins account by 37%. So I was just coming from there, you know.

Pandit: Yeah, but Sudanshu you know there are always sometimes when some projects get over within a quarter, in some quarter the delivery gets beyond the end of the quarter. So there can be some ups and downs that might happen on a quarter-to-quarter frame. What Kishor was mentioning was that on annualized basis, our current run-rate of Cummins should continue to be healthy. That doesn't mean that next quarter we will continue to grow at a higher rate or a lower rate, we might have some small variations, ups and downs. You know Sudanshu, you have been following KPIT Cummins very well and you would recollect even in the last year and the early part of, you know in the first quarter of last year, we had a quarter when Cummins suddenly shot up and in the next quarter it didn't go up. And I explained at that time to you that sometimes the project deliveries don't necessarily get at the end of the quarter. So I would now extrapolate completely on the basis of a single customer's performance in a single quarter.

Rajpal: Sure I understand, and secondly is the shot-up which has happened in Cummins account, is it because of a lot of new projects start onsite? What is the nature of the incremental business coming in Cummins?

Kishor: There are a couple of projects. One is in the area of risk and control compliance that is Sox compliance, so that is one part of the

project. And the second parts of the projects are in terms of their global implementations of some of the global manufacturing systems.

Rajpal: Okay, and so maybe these are onsite projects which have come because of cross-selling strategy within Cummins account.

Pandit: We would see some impact of that in our relative proportion of onsite and offshore, Sudanshu.

Rajpal: Right, also there has been certain kind of news in the market that as far as Cummins is concerned it might be having a strategy to go on its own in India within two segments, one is BPO and the second is engineering design services. How far is that true?

Pandit: Cummins has declared that they have an intention of doing BPO in India that is as far as BPO is concerned. As far as engineering services are concerned, they already have their own for almost 2 years now. Many of these facts are unplanned for as far as our own performance is concerned.

Rajpal: Sir, as far as the BPO is concerned, we don't get any part of the BPO, the BPO business goes to its own captor?

Pandit: That is what they are planning. We are not banking on that business as far as our own working is concerned.

Rajpal: Okay, fair enough. Sir just wanted to get the understanding again, when you said BPO will be consolidated in the balance sheet and not in the P/L, why not?

Pandit: First we have to reach a certain setup size. We anticipate that we will reach the setup size by the end of the year. And at that point in time, while we consolidate the subsidiaries both in the balance sheet and the P/L, up to the stage of its full setting up, we will capitalize, subsequently we will recognize.

Rajpal: Sir, then won't it reflect that in 2007. If we start making profits, only the profits show. There is no comparable loss in 2006 numbers in BPO business?

Pandit: No, but as you know, when there is any setup cost, you amortize the cost.

Rajpal: Sir, but that is only in case of product and in case of BPO...

Pandit: In case of any new business that you start-up, you account in the same way.

Rajpal: And is the BPO subsidiary 100% owned?

Pandit: Yes, atleast now it is 100% owned.

Rajpal: Okay Sir, as far as the deferral of the projects which has happened, correct me if I am wrong, it is as you said close to 5% downgrade. So 5% of revenues effecting bottomline by a multiple, so if we have at all downgraded our guidance, doesn't that also reflect that

we are not very sure we will be able to replace that offshore piece of business. And if not then how are we factoring in for an increase in margins moving forward?

Pandit: I think we need to look at these two things separately. We are looking at a certain revenue reduction till the end of the year, which we are stating to be in the region of 5%. Sequence of that would be reduction in the bottomline to the extent of 12½% because of the fix nature of a substantial part of our revenues. Going forward, as we increase our revenues on a quarter-to-quarter basis in order to reach the guidance that we have given, obviously the increase in our profitability on a quarter-to-quarter basis will be higher than the proportion of the increase that we will have in sale, again on account of the fixity of our expenses.

Rajpal: Sir, if you are saying that you will have GNA leverage, if I understand correctly, or ...

Pandit: Not only GNA, but also software development expenses, because our basic staff is already now in place. As our note mentions, our utilization is actually in the region of 69% onsite. So it is actually leveraging not only of just GNA, but it is also the leveraging of our basic software expenses.

Kishor: Just to clarify on one more thing is during this quarter many of campus joining come on board and many of these will become productive in next quarters.

Rajpal: So, how do you see offshore utilization improving moving forward? Ravi, could you please explain...?

Pandit: Yeah, that is what I will try to do. Revenues that come towards on account of any offshore delivery, of course adds to be income. The corresponding expense can only be in the form of our delivery expenses which is our software people cost and the rest being our infrastructure cost. We have already invested in the offshore delivery people and that expense is already being booked during the current year, as our regular normal revenue expense.

Rajpal: But as far as the replacement of this particular 5% of revenue is concerned, don't we have visibility enough to replace this 5%.

Pandit: Sudanshu, I think we are looking at 2-3 different things; I am talking about the cost structure. What I am saying is that when we have additional revenues, offshore revenues, we don't have to incur any additional cost at all because the people are in place, infrastructure is in place.

Rajpal: Sir, I appreciate your point.

Pandit: Now, going to the second issue, your second issue was that if there was a drop in revenue during the current quarter, why could we not see it earlier? And as I mentioned earlier that this was a case where there were really sudden changes in the client's IT budget.

Rajpal: So you are saying those particular changes in the client's budget, why do you see that happening? Is it happening because of some problem of its own internal? Is it happening because maybe another larger vendor has come, or he has thought that he will de-risk his business and go out to a multi-vendor strategy?

Pandit: As I mentioned earlier, wherever there have been deferral of our incomes, in none of the cases either we have lost of the client or we have lost the market-share in that client.

Rajpal: Okay, let me put it in other way, as far as this client is concerned, beyond this deferral do you see him growing or do you see the client stagnating?

Pandit: We don't see the client stagnating nor do we see our share of his business stagnating.

Rajpal: Okay, and what is our targeted onsite/offshore mix by the end of the year and which will be the areas which will contribute to the improvement in the offshore mix and does the utilization?

Anil: Sudhanshu, we are looking at the onsite-offshore mix currently is at 65:35. Going forward, we are looking at it at couple of percentage point, improvement in offshore revenues. Basically, the loss of revenues what we have seen is at a client level and it is not at whether it is an onsite revenue or an offshore revenue. Depending upon projects, it would be really decided whether the offshore revenue is going down or whether onsite revenue, but as far as the year is concerned, we are certainly looking at 37-38% offshore and remaining onsite.

Rajpal: And improve utilization also?

Anil: Yeah, basic driver would be improvement in utilization, because we already have the people on board and as you have seen the utilization for Quarter 1, it has been at a level of 69-69½, so that will improve going forward.

Rajpal: Have you reduced our client for the entire year, we had initially announced that we would be aiming at taking around 1000 people. Have you reduced that, what is the stand right now?

Girish: This is Girish here. I would come to this question, second I will extend the answer that Anil was providing on the offshore/onsite mix. As you have heard before from both Kishor and Ravi, our focus on the embedded tools and VLSI is also one more factor helping us increase our offshore revenues because all these projects have most of these engagements rendered themselves easily for offshore activities. So that is because the continuance of the first part of the question. And the second part, our addition of about 1000 people that we had kind of talked about, finalize would remain at the similar levels. If at all it could see a marginal kind of a hit, based upon how we are able to reach our higher-end of the newer guidance.

Rajpal: But if remains in the similar level, then achieving utilization improvement seems a little ambitious, doesn't it?

Girish: Yeah, but the qualifier is increasingly the offshore content and that where the head count increase will actually be happening. As you heard from Kishor in the beginning, we are seeing a good ramp up on our Bangalore activities and that is also helping us do both the things. One is better our offshore/onsite mix and also get into newer areas and newer customer engagements from additional business perspective.

Rajpal: Last two questions very quickly. What would be the contributions of the ATS practice to the revenues to this quarter as against last quarter? How has that grown?

Anil: Sudhanshu, I will just come back to you on this question in next few minutes.

Rajpal: Sure, last question. Again something on the map of the revenue guidance. See we had given the lower end around 308 crores of guidance and if you see Cummins and star customer's combines have physically contributed 80% to our overall revenue mix. This quarter also it's not much different. Now if this quarter's revenues of Cummins and Stars, if you actually annualized both of them, I appreciate your point Ravi, that in Cummins there could be some variability. But overall my point is that within Cummins and Stars, do you see in the future, especially in the Star customers any kind of a dip coming in further as far as revenues are concerned?

Pandit: Yeah, I think the first thing that Sudhanshu, we need to recognize is that we have increased the number of our Star customers by 2.

Rajpal: Okay, so you are not expecting a dip coming in there?

Pandit: Yeah, that is true.

Rajpal: Okay, thanks a lot.

Moderator: Thank you very much Mr. Rajpal. We have our next question from Mr. Sanjeev Kapoor of SSKI. Please go ahead Mr. Kapoor.

Kapoor: Yeah, I just wanted to know, where you see the most traction coming from, which particular segment? When you are giving a guidance, which particular segment is giving you visibility the most?

Pandit: I didn't understand the question? Can you please repeat it?

Kapoor: Yeah, I am saying in which particular segment, the service offering which you have, you are saying the most visibility, when you are giving your guidance?

Kishor: Yeah, that's mainly in the case of embedded and VLSI service offerings, that is ATS offerings we have, we see a clearer visibility both in terms of client acquisition and the future engagements, apart from some star customers.

Kapoor: Okay, thanks a lot.

Moderator: We have our next question comes from Mr. Jyothi Roy from Mata Securities. Please go ahead Mr. Roy.

Roy: Good afternoon Sir, my question is regarding the, you have divided the company into basically three business units, embedded tools, VLSI, and the other SAP practice and information risk management and compliance. My question pertains to the SAP practice where this is basically in the Panex. So, how was the client ramp up and traction in your SAP business. How much of growth rate are you expecting and last year you offered around \$1.50 million worth of revenues. So, this year how much are you expecting to offshore?

Pandit: I think I need to clarify something. Our SAP practice is not necessarily our earlier Panex business, and all the Panex business is not necessarily SAP practice. Some of the work that we have been doing from offshoring, and offshoring from Panex had not been necessarily only on SAP.

Roy: Okay Sir, thanks a lot.

Pandit: Thank you very much.

Moderator: Thank you very much Mr. Roy. We have a next question from Mr. Shiv Puri of Voyager. Please go ahead Mr. Puri.

Puri: My question is just stepping back from just second, the revenue base of the company is still pretty small, \$15-16 million a quarter. As I understand the penetration at the star customer is very small ex Cummins. In would have though irrelevant of what's happening in the bigger scenario non- Cummins revenue is \$6-7 million which is as a percent of budget is extremely small. And as I said earlier I thought the company was in track to take shares so that near terms movements would not have any impact. Could you tell me what's happening in some of these accounts, why is it hard to go from single digit million record revenue in some of these customers which have substantially bigger budgets, to a bigger number sequentially irrespective of what happens on a macro environment.

Pandit: See, what happens is that the project that one is targeting are decided at certain level within the organization and sometime some of those projects as it happened in this quarter get postponed. And at precisely at the scale at which we are, those projects can sometimes make a larger than normal impact on our topline and therefore on profitability. So, I take your point that the customers are large, I take your point that the customers on projects are large, but not all the budgets and not all the projects come your way. And you are targeting with the certain service offering to certain customer and if the project that is in line with those offering in that customer gets delayed, we have a problem. And that is what has happened during this quarter.

Puri: Yeah, I mean I also thought that there would be a differentiator or if there is, you know typically in a company of the size you don't see that sort of a slow down at all, assuming there is a real differentiator.

Pandit: No, but in the case of some companies there is significant deferral in their whole IT budgets and you have seen across the whole industry.

Puri: No, I understand, but you know with the budgets with tens and hundreds of millions of dollars for their star customers, you obviously represent very small proportion of their spend. So if that gets curtailed 2% or pushed out by 1% or few percent or whatever the number is, I am surprised to see the sort of an impact down the line. May I ask another question, which is on your two star customers, both either in manufacturing or BFSI sector?

Pandit: They are both BFSI clients.

Puri: Okay, you know obviously that BFSI has gone from 21% of revenue last quarter to 14-15% of revenues. Where do you see that going forward, is it going to be in 15% range or go backup based on these two new customers.

Pandit: As I mentioned there has been deferral during this quarter, that doesn't mean that there is deferral completely during the whole of the year. So the change in the proportion, if not necessarily secular, it could vary from quarter to quarter. Our own guidance for the current year shows that we will recover some of that percentage.

Puri: So, the other things, if I have the numbers correctly, outside of the Cummins, the business did not grow, right? The client a little bit sequentially, is that's correct?

Kishor: If you really look at it there has been a growth other than Cummins also, may be moderate but there has been a growth in non-Cummins business.

Puri: How much is that been?

Pandit: Anil will come back to you in two minutes, you know that kind of data is readily available here.

Puri: Okay, that's all the questions I had.

Pandit: He would talk about the star customers excluding Cummins contributed to about 41% this time and 44% last time.

Puri: I was just asking non-Cummins star or not, just non-Cummins because you obviously has been an expert in the Cummins business but not that there doesn't seems to be growth right now. Assuming you added to new star customers and if you are saying Cummins generally going to grow, there have you should meet your guidance.

Pandit: As I mentioned to one of the earlier question, I think it is a little dangerous to extrapolate on a customer by customer revenues on the basis of a single quarter. The nature of our business is such that in some quarters certain project deliveries happen and revenues go up, in some quarters may come down. And we have seen the effect of these up and downs in the past quarters as well. What has happened in our case

we report Cummins revenues separately because of its implications on our merger agreement etc. That's why the ups and downs get seen and magnified. If you have to look at the industry as a whole nobody talks about the customer's revenue, that variability from quarter-to-quarter very much exist. I think that is the feature of the industry and I would not possibly extrapolate so much single quarter to the whole year.

Puri: Okay, thanks.

Moderator: Thank you, very much Mr. Puri. We have our next question from Mr. Rahul Chhada of Standard Chartered. Please go ahead Mr. Chhada.

Rahul: Sir, could you tell us in detail that these two customers who deferred their projects, were all the projects deferred and when did this happen because mid-April was the time when you gave us the guidance for the year. So wasn't there any inkling at that point of time that the deferred was going to happen?

Kishor: Both these cases actually went through a major reorganization and almost like within few weeks projects were cancelled.

Rahul: Okay, so when did it happened, it was in the month of May or when did the postpone happened?

Kishor: The postpone happened in the later part of May.

Rahul: Okay, and my second question is how confident are you achieving of this guidance the current guidance is given? Have you gone back to your customer, check with them on the traction, is there any likelihood of any further deferral happening and further revision either which way?

Kishor: In last year we revised our guidance upwards in the middle of the year. This time when we took a call on going back, and revising it downward, I think we have taken adequate care in duplicating our numbers. So, I think we are always careful in taking our calls which based on all the facts that point of time, we are very comfortable of meeting this guidance.

Rahul: Okay, and also taking queue of the question which was asked before, we talked before all these lines of the star customers, and actually big persons, and we are dealing with them in niche areas and we have worked there for quite sometime. Why isn't this ramp up happening in non-Cummins accounts so quickly? I mean the base is really small, it's not a large base.

Pandit: The base is small, that's why we grew 100% last year, it didn't happen in this quarter.

Rahul: But you think the traction going to continue in coming quarter, coming year?

Pandit: Yes, in terms of the guidance that we have given, it will be.

Rahul: Okay, thank you Sir.

Moderator: Thank you very much Mr.Chhada. Our next question comes from Mr. Sandip Shah of Tower Capital. Please go ahead Mr. Shah.

Shah: Coming to the non-Cummins star customers, the growth in the last two years was phenomenal close to around anywhere between 75-100%, and what that number will look like in 2006 in terms of growth in the non-Cummins star customers?

Pandit: Sandeep, we are looking at total of about \$72 million, we had about \$20 million of Cummins last year. We had anticipated about 30% of growth, so we are looking at about \$26 million from Cummins. So we are looking at other than Cummins some things like \$54 million. And as you know a lot of substantial part of for non-Cummins would come from non-Cummins star customers, I am sorry \$44 million.

Shah: Okay Sir, current guidance, what is the margin of safety to take the future shocks in such kind of nature like deference of projects and all that?

Pandit: As we mentioned earlier, we have taken adequate care at this point in time, we are normally conservative in our guidance. Last year when we gave the guidance, we have to actually increase it during the year, we don't want to go through guidance reductions, that is not what we have been doing. So we have been careful, we have factored in the account all the facts that we know as of now in giving this guidance.

Shah: Okay, such small shocks will be now observed in the new guidance. That's what I just wanted to know what is the margin of safety now going forward? Just one more question, these star customers what we have mentioned the non-Cummins star customers contribution in this quarter, does it include the revenue from two new star customers also?

Pandit: Yes, it does. These are the customers which has just, as you know we call somebody as star customer when we have worked in for a period of time, may be like two or three quarters, that point in time we have gone beyond our initial pilot projects as well as some of the major commercial projects. So at this point of time the volumes are not very high, and the volumes are included in the star customer numbers that we have given.

Shah: What is the Bangalore facilities current occupation at this point of time in terms of number of employees?

Kishor: We have about 65 employees in Bangalore.

Shah: And what that number by end of 2006?

Kishor: We are looking at around 100 people at the end of the year.

Shah: And this new facility will be operational by Q2, FY-06, what we have mentioned earlier.

Moderator: Thank you very much Mr. Shah. We have our next question from Mr. Sanjeev Kapoor of SSKI. Please go ahead Mr. Kapoor.

Kapoor: I wanted to ask, you spoke on this two clients on star, if I am getting correct, it is basically shift of rather from the other clients to the star clients.

Pandit: Yes, that's right. What we do is, we have talked about two client numbers during this guidance, we talked about 3 new customers being added and we have talked about 2 of the existing customers now being recognized as star customers.

Kapoor: Okay, and added 3 new, that's what you said, know?

Pandit: That is true.

Kapoor: Okay, thanks a lot.

Moderator: Thank you very much Mr.Kapoor

Kapoor: I have one more please. Just wanted to know the Panex shift to the offshore, is there any delay which has happened?

Pandit: Sorry?

Kapoor: The shift of the business of Panex to offshore, has it being going slow as what were earlier expected?

Pandit: No.

Kapoor: Okay, because I see that the offshore has not changed much, the offshore declining.

Pandit: No, I think (not clear) with Panex offshore movement.

Kapoor: Okay, what is the attrition level?

Girish: Between 14-15%.

Kapoor: Okay, thanks a lot.

Moderator: Thank you very much Mr.Kapoor. We have our next question from Mr. Sudhanshu Rajpal of BNK Securities Please go ahead Mr. Rajpal.

Sudhanshu: Sir, as far as our manufacturing pattern is concerned we have taken several steps to leverage in the right footage taking Cummins's star customer. What is happening in BFSI, I mean what are the initiatives being taken there to prove differentiation, if you could just elaborate on that Sir?

Kishor: Yeah, in case of BFSI, some of the areas which are targeting are into areas such as risk management because what we have seen is compliance and risk management contributes some major parts of the projects for many banks. And in order to leverage some of the practice areas we have, we are looking at BFSI more from this aspect. The second

is in some of the areas in terms of equities and I think that's another area where we are developing our practices.

Sudhanshu: And what about the existing work which we are doing in BFSI, which are the areas and which we do work within BFSI today, as of things stand right now?

Kishor: That's mainly in the area of investment banking.

Sudhanshu: Yeah, investment banking would be an area, I am saying as per the technology of the services concerned what we do.

Kishor: The technology areas are across.

Sudhanshu: And how do you see growth rates within BFSI, manufacturing obviously is doing good but...?

Kishor: We had temporary as..., besides that they did not grow as much as we wanted in BFSI sector before that. But I am sure we will pick it up latter this year.

Sudhanshu: How many of our non-Cummins star customers are actually in the BFSI segment today?

Pandit: Three of them.

Sudhanshu: 3 of now 8.

Pandit: 9 now.

Sudhanshu: Okay, my final question is in regards to Cummins itself again, as we get closer and closure to the 35 million mark which is really the total offshoring target achieved might have Cummins price adjusted. Number one, are there any indications which you are getting from Cummins that he might want to de-risk his vendors in India and he might look at another vendor. And number two, beyond that what is the kind of growth rate which will you actually look at within Cummins?

Pandit: We don't see any move from Cummins to de-risk us and we believe that currently we are looking at 30 million by end of next year and I think we would keep our sight fixed on that as of now.

Sudhanshu: Okay, by the end of 2007 you are looking at a 30 million mark.

Pandit: That is the rough number we have been looking at.

Sudhanshu: But you don't think that Cummins would derisk itself and...?

Pandit: Actually that is not the indication that we get from them, as you they are our partners.

Sudhanshu: Okay great, thanks so much.

Moderator: Thank you very much Mr. Rajpal. Participants who wish to ask any question are requested to press '*1' on your push-button phone. Ladies and gentlemen, you are requested to press '*1' to ask any question. As there are no more questions I would now like to hand over the conference to Deepa Arora. Please go ahead Madam.

Deepa: I would like to thank Mr. Pandit, Mr. Patil, Mr. Patwardhan, and Mr. Wardadkar, Mr. Sanjay, Mr. Jadhav and all the participants for attending the call, thanks a lot and have a nice day.

Pandit: Thank you very much.

Moderator: Ladies and gentleman, this concludes your conference for today. We thank you for your participation and for using TATA Indicom conferencing services. You may please disconnect your lines now and have a great evening, thank you.