



India Infoline - Columns

Leader Speak

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Speaking to **Rajiv Mehta** of **India Infoline**, **Mr. Ramanathan** says that the company hopes to maintain the 50% yoy growth momentum of the first half in the forthcoming quarters.

What are the reasons behind strong volume growth witnessed by the sectoral companies in Q2 FY06? What has been the company's experience with respect to it? What is your outlook towards the same from company's and sectoral point of view?

At the industry level, the US global companies are coming out of the trauma and shock caused by the 9/11 attacks. Post the attacks, major companies had gone into a conservative mode with respect to IT outsourcing which led to suppressed demand for offshore IT services. With these companies now becoming more open and comfortable with the idea of offshoring non-core IT processes, the Indian IT services industry has been witnessing strong volume growth.

Our experience in terms of volume growth has been in line with the industry. We witnessed ~50% volume growth in the first half of the current fiscal.

Recent trends in prices (billing rates) witnessed by the company? How successful has been the company in securing rate hikes from existing and new clients? What is the price negotiating power of the company considering high client dependence?

We have been able to secure higher rates in the range of 5-10% over the company average rate from our new clients. However, this has not altered our overall average billing rate, as new business's contribution to the overall revenues is low. On the other hand, on existing contracts, we have not been able to win any major rate hikes but the pressure for rate reduction has disappeared which was evident last year.

The company only operates in the highly crowded and competitive space of BFSI and provides plain vanilla services (ADM, Testing, BI&DW). So what is the USP or key differentiator of the company?

Right from the start, our aim has always been of not becoming a run-of-the-mill software company just converting customer specifications into core applications. Our differentiating point is that we always go a step further by asking the customers about the problems they face and then structuring the applications along with them. This acts as an easy entry point for us. This apart our BFSI domain knowledge and capability of our people with regards to developing a solution jointly with the users acts as a differentiator. Our domain knowledge comes from the banking professionals we recruit who act as business analyst on various projects along with our technical team. With respect to increasing competition in the BFSI domain, we feel the space is big enough for all the players to survive and grow.

Could you name some industry players who are your main competitors (in terms of fighting for the same business pie)?

We have come across Cognizant, Hexaware, Polaris, Thinksoft (mainly in testing) and some other small and mid-sized IT companies. We don't compete with the bigger players like Infosys, Wipro,

etc as we focus on the sub million dollar accounts. The average size of our orders is less than US\$1 mn. Most of orders we win are either through relationships or direct contacts but not through RFPs or any other shortlisting process. We normally start our relationship by advising and consulting clients regularly, which typically translates into project wins at a later stage of the relationship.

What is the current service-line composition of revenues and trends expected in the same? What is the ~operating margin earned in each of the service line?

Application development currently contributes ~40% of our revenues, testing constitutes ~30%, support and maintenance contributes 12%, augmentation services accounts 15% and other services make up for the balance revenues. Business Intelligence/Data Warehousing (BI/DW) is a sub set of application development segment constituting ~40% of the segmental revenues ie ~16% of our total revenues. The augmentation services comprise supplying necessary tools and resources (testers) on time & material basis to the customers, which are managed by them, as against normal contracts executed by us, where we manage our resources and are responsible for the quality of the delivery. At the current junction, we anticipate all the our service lines to grow at a similar pace of 40-50% thereby leading to more or less balanced growth over the next two years. We do not foresee any significant change in our current business composition going ahead.

As far as margins are concerned, application development, testing and support earn gross margin in the range of 38-42% whereas augmentation services command gross margin of 25-30%.

What is the current geographic break-up of revenues and trends expected in the same and why?

Currently, US contributes 65-70%, India 10%, Asia Pacific (ex-India) 12% and the balance ~10% of our revenues comes from Europe. In the next one year, we expect US contribution to decline a bit with the corresponding increase in the Europe's share.

What about the company's plans of foraying into other verticals and broad basing service lines? What are the steps taken towards it?

We do not foresee ourselves foraying into any other vertical for a year at least. In case of service line expansion, we are thinking for expansions like product implementation services to extend our support services portfolio.

Top 5 clients contribute more than 75% of the company revenues. What is your take on this and trends expected in the same? What are the steps taken to reduce the high client concentration?

We have been expanding our active client base over the past many quarters to reduce the client concentration levels. Further, with the help of our conscious efforts, the growth in top accounts like Citibank has started declining recently.

Could you just elaborate on the kind of work done, arrangements in place and maturity of the relationships you share with your top clients?

To Citibank, we provide our entire portfolio of services right from application development to augmentation services whereas to Truelink we provide relatively less of augmentation and testing work and more of development and support services. We have been providing services to Citibank since last 5 years, Truelink since last 3 years and Amber since last one year. We don't have multi-year contracts with our customers.

What is the current and targeted onsite:offshore revenue mix? How would the company achieve this target? What are the margins on both fronts?

The current onsite:offshore revenue mix stands at 68:32, which we target to bring at the industry level of 60:40 within couple of years. Generally, gross margins onsite are between 30-32% and offshore are between 45-55%.

The company had set aside Rs50mn for acquisitions from the IPO proceeds of Rs75mn. What is the progress status on this initiative? Could you elaborate more details about it such as rationale, timeframe, targeted geography, service line and domain?

We are looking for inorganic growth that complements our organic growth. We have been scouting for acquisitions since then. We came close to clinching a couple of deals but couldn't. At present, we are in talks with couple of companies but it would be premature to disclose details. We should be able to close a deal in the next 6-8 months. We plan to acquire a company preferably in BFSI domain and complimenting us in some way, may it be strengthening or adding service line, geography, client base, etc.

Your OPM has varied between 19-24% in the first two quarters. Where do you see it sustaining in the future? What is the OPM target for FY07 and FY08 and the levers available?

We anticipate OPM to come off from the level earned in Q2 FY06 in the next two quarters. The second quarter of the current fiscal was very carefully managed in terms of efficiency and productivity, which we feel would be difficult to maintain in the remaining two quarters. Overall, we expect our OPM to stabilize in the range of 21-23% in FY06 and FY07.

Your outlook on Rupee/Dollar rate and comments on recent sharp Rupee depreciation? What has been the hedging policy of the company? What is the current forex cover and the average rate at which it has been taken?

Compared to the industry, we hedge only a small portion of our dollar inflows.

What is the current manpower strength and ramp up plans in the next two years? What would be the experience mix (freshers:laterals) of the new recruits?

Our employee base currently stands at ~300 people after adding ~80 employees in the first two quarters of the fiscal. We plan to add further 75-100 people in the remaining quarters and ~175 people in the next fiscal. Of the new additions in the future, we target to add 20-22% freshers.

What is the current utilization and attrition rate and steps taken to improve the same?

We are operating at a high employee utilization level of 85%. The attrition rate in the company is in the range of 20-24%.

What was the capex incurred in the H1 FY06 and plans for H2 FY06, FY07 and FY08? How would fund the intended capexes?

The capex incurred in the first two quarters was not significant. We plan to spend more in second half of the year. For FY07, we don't have more details of the capex but we will be incurring the expenses as and when required along the lines of what we had planned and stated during IPO.

What is the topline and bottomline growth expected in FY06, FY07 and FY08?

We have grown 50% in the first half of FY06 in top line & bottom line and we hope to maintain the momentum.