"KPIT Technologies Limited Q2 FY19 Results Call"

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MANAGEMENT:	**MR. KISHOR PATIL – CEO AND MD, KPIT TECHNOLOGIES LIMITED** **MR. SACHIN TIKEKAR - PRESIDENT & BOARD MEMBER, KPIT TECHNOLOGIES LIMITED** **MR. VINIT TEREDESAI – CFO, KPIT TECHNOLOGIES LIMITED** **MR. SUNIL PHANSALKAR - HEAD (IR AND AVP M&A), KPIT TECHNOLOGIES LIMITED**
MODERATORS:	**MR. RAHUL JAIN - EMKAY GLOBAL**

Moderator: Ladies and gentlemen, welcome to the Q2 FY19 Results Call for KPIT Technologies hosted by Emkay Global Financial Services. As a reminder, all participants 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 call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Rahul Jain of Emkay Global. Thank you and over to you, sir.

Rahul Jain: Thank you Kris. Good evening, everyone. On behalf of Emkay Global, I would like to thank KPIT for giving us the opportunity to host this call. And now I would like to hand the conference over to Mr. Sunil Phansalkar- Head of IR and AVP (M&A) at KPIT to do the management introduction. Thank you over to you, Sunil.

Sunil Phansalkar: Thanks Rahul. Wish all families a very happy Diwali and a prosperous new year ahead. I hope all of you have got our investor update and have been able to go through it to look at the performance of the quarter. On the call today, we have Mr. Kishor Patil – CEO and MD, Sachin Tikekar - President & Board Member, Vinit Teredesai – CFO and yours truly from the Investor Relations function. As always, we will have the opening remarks by Kishor on the performance of the quarter and the balance remainder year as we see it today and then we can have the floor open for questions. So, once again a very warm welcome and now I will hand this over to Mr. Kishor Patil.

Kishor Patil: So, good afternoon. I am very happy to take you through the highlights of Q2. So, on the first, the growth it is at 2.9% in constant currency on quarter-on-quarter. On the last year H1 to this year H1 the growth is 9.8%. This is mainly driven by PES, which in this quarter has shown 7% in constant currency. Engineering overall has shown 9.8% in constant currency and DT has shown 5% growth, DT plus PLM, the way we have reorganized has shown 3% quarter-on-quarter. IES and SAP have shown a de-growth in this quarter and specifically and in terms of industry verticals, auto has shown growth while manufacturing has shown de-growth during this quarter. Now both in case of IES and SAP specifically we had completed few large projects, significant projects very successfully which were some of the largest projects we had. And there is a little bit of a gap in terms of new projects starting which has impacted us during this quarter and will also have some impact next quarter. Otherwise, if we really look at from the geography perspective Europe has led the growth which is very strong growth. Asia has also being doing well.

During this quarter overall on Engineering it has actually grown quite well. And in products and services there was a de-growth in Asia while it was compensated by growth in Europe. That is how the overall P&P growth has come up. If you go to the profitability, overall EBITDA margin has improved by 1.5% during this quarter over last quarter. If you look at year-on-year the EBITDA has increased 62% year-on-year in absolute terms. So, it is a very strong growth and I think we have worked over the last year absolutely in terms of operational efficiency, improving the mix of services and it is showing some fruits. As you would have recollected that all last 6 quarter, every quarter we have improved our profitability. So, it is in continuing that we have been in a position to do this in this quarter where we had a wage hike, which had an negative impact of 2.2% in this quarter. We were also supported by currency benefits which were 1.25% but at the same time growth as well as mix has given us improvement of more than 2% during this quarter. So, we are very happy with this basically because in spite of a challenging quarter from the profitability perspective we have been in a position to show growth and continued on our momentum. PAT has grown 37% year-on-year and 6% in this quarter.

If you really look at from the guidance perspective, 8% to 10% we have given the guidance in terms of growth and H1 this year on H1 last year, we are already close to 10%. If you really look at profitability guidance, we had given 11.5% to 12.5%. Our operational profit for the H1 is 14% plus and we will continue to do better for the year. So, overall for the year we will have 14% plus operational profit. If you really look at the remainder of the year we are looking forward to sometime during this quarter when there will be a split in our two businesses, which is engineering and IT. Overall, the next quarter is a seasonably weak quarter. However, we believe engineering will continue to show some growth, may not be as strong but will continue to show growth while IT will have a soft quarter. We believe IES and SAP which have little bit struggle this quarter as well as may have some impact in the next quarter and will come back to profitable growth in the quarter 4. As you might have all seen today BMW announced that KPIT as a technology partner for autonomous driving. It is a very proud moment for us because BMW is recognized for its thought leadership and really cutting edge technology. It is one of the few platforms in autonomous which are being built with the consortium of OEM led by BMW.

We are involved in the development as well as later on adaptation and other parts of this going forward. It is at least the 3 year plus engagement but it is a very pretty strategic engagement. And typically, it is hard for this kind of people to go beyond Europe for this kind of say transformational projects. So, we are very happy that BMW has recognized us as the global leader in this technology and chosen us for that. So, this naturally will have positive impact on engineering growth going forward. In terms of otherwise operational data DSO we have 4 days more than what we had last time. 2.5% of this impact is because of the Forex. So, operationally we have slipped by 1.5 days during this quarter. Overall on the merger as I mentioned we expect by December we will have NCLT approval and hence there is a good possibility that this split would happen before the end of this quarter. These are the few highlights and will be very happy to take any further questions.

Moderator: Thank you very much, sir. We will now begin the question and answer session. Our first question is from Daidik Sarkaar of Unify Capital. Please go ahead.

Daidik Sarkaar: Could you help us break that up into PES and non-PES. I wanted to understand which way the margins were respective entities have moved?

Kishor Patil: So margins, we will be in a position to show it only on a topline. We will be in a position to give this from the next quarter once the demerger happens. So, right now as I mentioned PES has grown by 7% in constant currency in engineering by 9.8% while IT overall had a 2% of de-growth mainly because of the ERP drop.

Daidik Sarkaar: Could you please help us understand if the margins for the non-PES business grew as well?

Kishor Patil: Yes, absolutely the margins in IT has grown up. So, typically margins are similar right now if I have to say at broad level. But we will be in a position to share it with you next quarter.

Daidik Sarkaar: I just wanted to understand your opening comments with better. Did you say the engineering growth might be softer in Q3 but then pick up in Q4? Is that what you meant?

Sunil Phansalkar: That is correct. What we mentioned is that typically the IT business has holiday season. So, to that extent it will be a soft. However, our engineering growth will continue to be on a better side, do not as robust probably as Q2.

Daidik Sarkaar: So, just of the context of your great deal with the BMW and the conversation you are having with other clients, could you help us understand in some degree of granularity. What is spending environment obviously, over last 2-3 quarters you have guided for growth of about 15% to 20% that is a great number going forward? But some more color on kind of conversations you having and what is it in those conversations that are giving you this kind of visibility perhaps the order book number or anything else that you can quantify for us?

Kishor Patil: Yes, so I think I am on the engineering front what you might be knowing, we have been in this phase for last 20 years. We have invested in this for last 20 years. So, for us it is a very strategic and that is why we are actually going for the demerger for really focusing on this part of the business and making those investments and to give the management bandwidth for this business. So, this has not been a favor of season for us. So, we have been working it on strategically. So, we have invested ahead of time in lot of areas such as autonomous, electrification, connected diagnostics in vehicle networks. So, multiple areas we had invested and fortunately these are the areas which will account for 90% of the spend for engineering for most of the OEMs going forward. So, what has happened is, we have become kind of a port of first call in the global scenario, again in these areas there are 2-3 kind of areas. One is the kind of areas for development of these technologies and then there is a testing and validation and then there is an integration and testing. So, what has happened is in the first and third areas, which is most complex, we have almost become the port of most preferred kind of a player in this area globally. So, we are seeing a very significant traction in this area and we see a very strong demand going forward and specifically as the companies are looking for autonomous and electrification over next 5 years, I would say these are the areas of spend for the leaders in the industry. There will be laggards in the industry who would like to spend few years down the line in different parts of the world. And that time they would like to really work with somebody who has those kinds of IP and experience. So we believe this is a very strong environment currently in this space.

Daidik Sarkaar: And given the impendent demerger, is it fair to assume that the current management has kind of taken that foot off the pedal in investing in the non-PES space?

Vinit Teredesai: To be fair our investments on both sides, whether it is the IT side as well as engineering side are balanced. In IT we continue to make investments in the digital technologies across the industries.

So, we have not taken our foot off of the pedal when it comes to the investments. Kishor just talked about the investments that we have been making on the engineering side and will continue to make those investments.

Kishor Patil: Actually that was the reason why we wanted to do the demerger because I think that is what exactly I was mentioning that it is difficult for us to make the investment in both the sides which are going through a transformation. But I think as the IT part will merge with Birlasoft they have enough funds and appetite for making further investments. So, I think that will allow this part of the business to grow further.

Daidik Sarkaar: But my question was bit short term in nature like for instance, over the next coming quarters is it fair to assume that there will be some slowdown in the business given obviously the transition from your end and it might take some type of Birla to really come in and start making investment it is very short term question in nature.

Kishor Patil: No, that is not true. Actually the whole part of the business, the IT part of the business we have transformed last year if you look at the profitability has really gone up. We have gone after some very large deals. We have really build on digital capabilities and you can see the growth in the digital areas also. So, we have achieved that. I think these are some of the parts which we are facing right now for not that reason and the other part is already for the last 8-9 months we have already involved the Birlasoft team in order to understand the business. He wants to get familiarized them with our business, people, customers. The significant part of the leadership is also going in the new company in the merge IT company from KPIT. So, it will hit running the ground. So that is not, it will not take significant time to really build on what we have built. There is just one point I want to say that there are certain IT spent scenarios which are coming and one of the thing they think is from next year onwards ERP will show a stronger growth. So, I think we have some of the world class capabilities build in this. I think we should be in a position to leverage it.

Daidik Sarkaar: My last question, so obviously your demerger expenses of 17 crores, 7 crores, could you help me understand apart from your regulatory and your legal costs it is very bulk amount 29 crores. What is that constitutes?

Sunil Phansalkar: So, it does include costs of investment bankers, lawyers, compliance etc. so, those cost are inculded.

Daidik Sarkaar: Have we completely expense that out or is Q3 and 4 expected to see some more hit from this?

Sunil Phansalkar: I think so, we have made significantly we have covered up most of the expenses. We do not anticipate in the coming quarter any material expenses to come into that.

Daidik Sarkaar: So, the marginal guidance going forward will be at 14%, whereas our operating EBITDA this quarter were 15%. So, do we anticipate increasing our SG&A spends or which is building in cushion for the future?

Sunil Phansalkar: I think**,** we have said that if you look at H1 we were at 14% plus and the next quarter is going to be a little bit softer and Q4 will see growth coming back. So, right now what we are saying basis what we see today, a 14% plus number for the whole year in terms of operational profitability is what we should look at.

Daidik Sarkaar: And anyway these operational expenses are added back for, this kind of deal expenses are added back to work out 14% number operational.

Moderator: Thank you very much. The next question is from Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: The only question I have is on DSO. If you include unbilled that number has gone up a little compared to 4Q and in the first half like in the last 6 months. Is there a change in the trade receivable pattern for us from an FY19 perspective?

Vinit Teredesai: So, Mohit the DSO is always calculated based on the billed revenue because that is only when you go to the customer and demand for any payment. So, we do not look at unbilled revenue. Unbilled revenue is pretty much in line with what has been there for the last couple of quarters. So, I will not take the unbilled revenue in the calculation. As Kishore already said the 4 days calculation, two and half days Forex effect and the balance is now given our revenue basis on a higher side. We continue to maintain our cash collections on a stronger note.

Mohit Jain: Do you have this number on unbilled which is up, it shows like 23%-24% up in the last 6 months? I mean which is not part of your receivable day calculation but in the …

Kishor Patil: See, we do not look at it from the numbers but I do think it is not abnormally any high. This unbilled revenue number is absolutely in the line with the industry. There is no abnormal increase in that number. So, actually the way we do it is, it is completely based on a specific projects. So, if any project is hitting a milestone it can go up a little bit in other case it can go down. So, it is based on that. But I do not think at overall basis it is any abnormal.

Mohit Jain: And sir second is I missed your initial remark, is there an impact in third quarter? Did you mention something like that in the initial remark?

Sunil Phansalkar: So, what we have said is third quarter is seasonally it is a quarter where you have less number of billing days. So, obviously we will have some impact of it on the revenues for the next quarter. IT would be impacted more than engineering. So, IT will be soft and engineering will show some growth. Obviously it will not be as high as this quarter but we will be able to show some growth there.

Mohit Jain: But nothing apart from the usual seasonality which you have witnessed in the last 2 years.

Sunil Phansalkar: Nothing.

Moderator: Thank you very much. Our next question is from Abhsihek S from Equirus Capital. Please go ahead.

Abhsihek S: You made an interesting comment about acceleration in ERP next year. Could you elaborate what you have seeing on the ground and leading to this comment, thank you.

Kishor Patil: No, I just mentioned that this is what the IT analysts have come up in terms of how they see IT spend next year and you might have seen those reports. So, relatively if you can look at there is a ERP spend is relatively stronger and specifically different kind of ERPs including Oracle, SAP as well as the other products which are there specifically cloud driven. Next year, they see a stronger adoption of that. I had to also say that last month we have also spent some time with some of these people. Very interestingly they are seeing the growth on on-premise as well as the cloud and specifically in Asia Pacific. So, there are both these opportunities. Now this is what is the market as well as what we see from our partners, alliance partners like Oracle, SAP.

Abhsihek S: And secondly this quarter manufacturing was a little short. So, any color on that that would be helpful.

Kishor Patil: So, I mention in the original comment that there were 2-3 projects which were significant in size came to closure. So, there is always a little bit of gap in starting new projects at this time of the year, including some of the support and maintenance contracts to start. So, that is what is impacting us for this year and for this quarter and little bit of next quarter.

Moderator: Thank you very much. The next question is from Saumitra Chatterjee of Spark Capital. Please go ahead.

Saumitra Chatterjee: My question is you mentioned that the margins are similar for both the segments. Can I get capital employed also for both the segments separately that is the IT and the PES business?

Vinit Teredesai: Not right now. I think when we will have the demerge companies I think we will share some of those numbers.

Saumitra Chatterjee: And my next question is on this BMW partnership and what is the typical size if you can give us something some indication on how big the engagement can get over a 3 year period, 3 to 5 years period?

Kishor Patil: No, we will not put any numbers right now. But it is, I can only say it is a significant opportunity and it is for at least next 3 years if not 5 years and the way it will work is there is an opportunity to work in 2-3 areas. One area is basically actually we are working started working on platform which is the main thing. The second thing is when this platform get adopted by the other partners of the BMW is a significant part of the work which we needs to do on their part as well as the integration part. I think that opportunity is there and later on when the third party work starts there will be a maintenance opportunity. So, all these 3 opportunities are there.

Moderator: Thank you very much. Our next question is from Manish Shah from Revelation Portfolio. Please go ahead.

Manish Shah: Sir, can you throw some light on the shareholding pattern in the promoter holding post the demerger of both the companies?

Sunil Phansalkar: So, as we have said in the filings made to the exchange currently if you look at the promoter holding in KPIT is just under 19%. When the merger will happen as a consideration for the merger equity will be issued to the Biralsoft promoters that would be in the range of about 28% and after the demerger of engineering business happens and the listing is done over a period of time, the IT shareholding of KPIT promoters will be sold to Birlasoft promoters and the engineering shareholding of Birlasoft promoters will be bought by the KPIT promoters. So, once these transactions are over then it could roughly be a 40% shareholding for KPIT promoters in engineering and a similar shareholding for Birlasoft promoters in the IT company.

Manish Shah: So, you said sir between 40 and 50?

Sunil Phansalkar: It will be around 40% more closer to 40%.

Manish Shah: So, that transactions will happen over a period of time that means is it planned or it will happen the way the prices at that point of time?

Sunil Phansalkar: No, it is a part of the agreement.

Manish Shah: Is it made public?

Sunil Phansalkar: No.

Moderator: Thank you. The next question is from Latin Padmanan of Investec. Please go ahead.

Latin Padmanan: There been a couple of, let us say, automakers and off-road equipment providers manufacturing companies who have been suggesting that there were potential hit on earnings for the year because of these trade wars. I think one case in point being Ford, Caterpillar and so on and forth. So, just wanted your thoughts in terms of what you are seeing on the ground and anything that you see from an impact perspective or we are sort of inflated considering the area of spends that we play with.

Kishore Patil: So, you are very correct. I think, it is not only for trade war, there are other reasons while there will be a, if I have to say some strain on profitability for OEMs and naturally than Tier-1s. We work largely with OEM and there are few Tier-1. That is how we work with. It is basically because of not as much as on the trade wars right now. I mean, it has a possible impact because of the taxes they may levy. But the more impact is on technology spend because they have to really move very quickly in terms of their commitment to the regulators, moving from the protecting their market shares once the electric car comes in and more and more adoption happens in autonomous and other areas. So, I think it will be more and more from that perspective. So, this will happen but as this is very important from their perspective to make this technology come into production programs in next 3 to 4 years, this is the area which will not get comprised. But naturally we have to be productive, we have to be efficient. But this is not the area which will get comprised. Not only that, they will require a partner who has the relevant understanding as well as competency so that it does not fail, so both are very important for me.

Latin Padmanan: So, what you are saying is they will not, it is sort of a spend, it is a must-do spend. So, it will continue and it is a sort of a multiyear kind of thing.

Kishore Patil: Largely for European and Asian.

Latin Padmanan: So, do you think that considering the situation, let us say, the financial situation these companies are in, do you think that there will be a pressure on pricing or things like that?

Kishore Patil: There will be pressure on globalization model actually basically for example, it is very important for us to and we have made those investments into global centers. At the same time there is a very clear importance to really leverage it in India. Some of these technologies are pretty complex, the programs are very pretty complex. So, I think it will be at a cost of some of the high price vendors.

Latin Padmanan: So, just to understand the broader competitive landscape, if you look at the cost-to-serve an automotive client on the R&D side of things. How many players do you see who can sort of in the technologies where there is a lot of demand, who you think would be able to scale or sort of basically provide the similar cost to serve as you would and not the names of these people but at least if you could quantify the number of people at least.

Kishore Patil: So, there are 2-3 trends in this. Number one is, all the OEMs know that this is a significant investment for one company to do. So, that is why they are forming consortiums. So, typically 2-3 people or 3-4 companies are coming together to make this spends. They basically form consortiums for the obvious reasons, so that they can share cost. They can share infrastructure standardization, infrastructure cost, all those kind of things. So, there are 3-4 consortiums which are forming**,** so that is one trend. And if we look globally there will be naturally in every market there are few but I do not see there are more than 5-6 players globally who have this competency what I am talking about and not many of them are global players.

Moderator: Thank you very much. Next question is from Ashish Kacholia of Lucky Investment Managers. Please go ahead.

Ashish Kacholia: My question pertains to our business trends in the US market for our automotive services. So, could you comment a little bit obviously we are doing very well in Europe? Can you throw some light on how when we are position in the US markets?

Kishore Patil: So Ashish, we are very cognizant about which customers we will work with while what we are doing right now. And we have be very selected because number one, while we have good expertise, I think we know that ultimately there is a finite capacity in which we have to work and how much we can build every year. And the second thing is also we have to ensure that during this pressures in automotive world there are companies who will survive and thrive and they can manage themselves well and continue with this spend and the programs. So, I think the reality is US there are 3 OEMs and there are one naturally I am taking out Tesla for now, but because Tesla does most of the work inside. There are 3 companies and few startups which are there as against double-digit number in Europe and Asia. So, that is one part. There is some other ecosystem in US which is also in the commercial area which is our target as well but it is our target which we are building on that. And they will be little slow in adaptation but we believe they will be stronger also in some areas. So, that is the segment we will pursue little down the line if I have to say. So, from that perspective, Europe will continue to be the strongest and then Asia and then followed by US. The second part is also the adaptation of certain technologies like electrification where the fuel prices are very cheap in US as compared to pretty 3-4x in Europe as well as Asia. So, some of this technologies become more cost effective in this part of the world.

Ashish Kacholia: Can you explain this last electricity cost bit, Kishor?

Kishor Patil: So, fuel prices right, US the gallon prices per liter in US are the cheapest and they are multiple times in Europe as well as in Asia. And that makes electrification viable in this market as compared to US. In US that is why in spite of all whatever, I mean, in US people are driving at only from the government regulation and there some of the emission controls point of view. But largely in this part of the market it becomes little more affordable as well as there are government is again demanding certain compliances. As compared in US if you look at last year still their one of the hottest selling vehicle is the trucks, which are for individual mobility. So, people care less for fuel efficiency as compared to the Europe.

Ashish Kacholia: And any thoughts on Asia and China?

Kishor Patil: Absolutely, Asia will be a big market. There are many OEMs there. Other OEMs are also emerging. China is an important market. We believe that in this little bit of, if I were to say face-off, one first is the China anyway is the largest market. Second it is also ahead in the shared mobility market and electrification. Also in this certain dynamics which are working out within different countries, I think China will become important and we are working with some leading Chinese players.

Ashish Kacholia: So, you do not see any intellectual property problems, etc., which kind of other players are afraid of?

Kishor Patil: Not much, I mean, I think ultimately they need help actually to go to the other markets as well.

Ashish Kacholia: And our position with the Japanese and Korean OEM, Kishore?

Kishor Patil: Ashish, our position with Japanese is very well. Japan sees some of the key OEMs there. They think that they are slightly behind the Europeans and they want to play the catch up games and they have realized that the Tier-1 system in Japan is not helping them to get there at a faster rate. So, they are depending more and more on companies like us to do more of their AD, ADAS or electrification works. So, we see really good opportunities for growth in Japan.

Ashish Kacholia: And Korea?

Kishor Patil: Korea is just one to speak-off. We have had a relationship with them in the past. We are trying to see how we can transform that relationship. There are a couple of areas that we have identified and the discussions. Essentially it is AD, ADAS work. ADAS for developing countries AD work for developed countries and they also want to look at some of our stacks like the AUTOSAR that is going through transformation.

Sachin Tikekar: So, yes there would be opportunities we are just trying, As Kishor mentioned earlier on we really want to work with handful of OEs across the globe and make sure that the relationships are deep and wide and we are in a really good position to service them well. So, will have to pick and choose our battles.

Ashish Kacholia: So, as of now is it safe to say that we pretty much have all the relationships that we want in place and we look to kind of do more work with the existing relationship or we are not happy with the or there is still some work to be done in getting the additional relationships on board.

Sachin Tikekar: So, Ashish on the commercial vehicle, so Kishor talked about the passenger cars and passenger cars we work mostly with the OEs. I think over there 80% of the relationships are in place, right. I think, there are 2-3 companies we are actually considering at this point in time but we feel good about passenger car segment. The Tier-1 also I think we have really good relationships for passenger cars and we actually have to make choices there, right because we cannot work with all of that. So, we feel very good about our relationships with the passenger car segment. I think, there are 2 areas where we need to get some more solid relationships in place. One is the commercial vehicles part where there are couples of relationships that are very strong and these are leaders in those fields but we would like to have 1 or 2 more and the whole new mobility space. We have couple of relationships now. We would like to build some more going forward that is the shared mobility. It is the shared mobility space. So, those are the areas where we would want to have more relationships but only a handful of them not too many.

Ashish Kacholia: What is the meaning of shared mobility when you say something like? Does it mean the equivalent of Uber, Ola equivalents or what?

Kishore Patil: Absolutely. That is the shared mobility today. Tomorrow some of the OEs are making investments in such companies. So in some sense the OEs will also become shared mobility's over a period of time but you are right. That is the shared mobility.

Moderator: Thank you very much. The next question is from Apruva Prasad of HDFC Securities. Please go ahead.

Apruva Prasad: Sir, my question again is on the engineering piece. If you can sort of give indicative in terms of where the margins can potentially had over the medium-to long-term as well as can you think the recent growth rates can be replicated again over that term?

Kishore Patil: So, I think we have mentioned that any growth in excess of 20% is absolutely maintainable in the engineering part. We see a very good traction as I mentioned we have to be very selective in our, basically we have to see what how quality we can build in terms of what we deliver and how we scale it up. Now last year we grew by 30%. This year will grow something between 25% and 30%. So, we have got a good numbers but I think I would at a high level, I would say we can grow in excess of 20% for sure. So, that is what I would say in terms of numbers. In terms of margin, as I mentioned the current margins are similar. Initially the margins we used to get impacted, we do still get impacted because of certain investment we made into products. We changed our strategy to make it software only and we are repositioning or we are re-architecting that part of the business so our go-to-market is only software. So, during this time but over the period we believe margin in a couple of years will be anywhere around 18%.

Apruva Prasad: And also if you can just share the sub-contracting expense number?

Sunil Phansalkar: For the quarter it was about 103 crores.

Moderator: Thank you. The next question is from Nirav Dalal of Maybank. Please go ahead.

Nirav Dalal: Couple of questions. One is have you faced any supply side issues in the US like we have heard a couple of companies facing that, so wanted your take on that?

Sachin Tikekar: I think it is getting more and more difficult last couple of years we have seen headwinds due to restrictions that different countries are putting in. So, that is one part of the issue but we have been dealing with it for the last couple of year and we believe that that is going to be our challenge going forward as well. I think the challenge is going to be bigger on the engineering side and that is why we have to be very selective about the work that we do the quality that we put in and we need to figure out ways of doing more with less. So, supply side continues to be a challenge but nothing different and what we have faced over the last couple of years.

Kishore Patil: So, I think specifically in the new technology we have to build our own talent. There is no other company, we are one of the largest in this. So, there is no other company we can go to hire and we have built in the last few years' technology centers in Europe, USA, Asia, so Munich is one of our largest center. Then we have a center in Detroit area, we have in China, we have in Bangkok, Thailand. So, we have built multiple centers to build these technologies, build the skills. So, we have our own strategy in place but the kind of programs we are servicing it they are very critical. So, it takes a bit of a time to build this case.

Nirav Dalal: And the other question was if you could give us split, geographical split for product engineering and IT services broad geographical mix for the 2….

Kishore Patil: So, any split of revenues, any split of assets we will share once the demerger happens post next quarter. But at a high level I would say that engineering is very evenly spread, largely much more evenly spread across all the 3 geographies.

Moderator: Thank you very much. Next question is from Laxmi Narshiman of Tattva Capital. Please go ahead.

Laxmi Narshiman: Sir, please correct me if I am wrong. My understanding is always been that the engineering segment has had higher margins as compared to your business IT. But earlier in the call you had mentioned that both of them are almost at similar margins levels. So, can we deduce that the engineering part of your business has higher employee cost as compare to your business IT services?

Kishore Patil: No, I think it is not true but I think as we discuss, so first what your observation is correct where I said margins are similar but on the engineering side there are 2 things which are very important. We are working in a very new technology areas. So, we are made significant investments in technology. All of the people who have been following the company no over last many years. So, we still continue to make some investments and I think that is the one part. The second is this globalization setting up centers outside has also increased some costs. So the kind of programs which we are working on really needs that. And also the third part was some of the products which we made the investments also impacted our profitability where I mentioned that we have made a clear cut decision to move to software only products and really move into a different business models. So, I would say over a period all this factors be driven out. But in the initial period as we are growing fast and we have to be leader first mover thing, these expenses will be there.

Laxmi Narshiman: Sir, my final question could be sir, your R&D if you look at it as a percentage of sales has been around 1% for the last 2-3 years now. So, once the merger demerger happens, the auto business now would it have a higher proportion of R&D spend or how was this R&D that would get split between the 2 companies.

Kishore Patil: As I mentioned I will not give any split expenses but naturally most of us and R&D is only one part of it. I think, there is lot of investments which we make beyond that specific item which goes only to an, if I have to say we have a technology we have a CTO organization which not many companies have but large part of this do belong to engineering.

Moderator: Thank you very much. The next question is a follow up question from Abhsihek S from Equirus Capital. Please go ahead.

Abhsihek S: Sir, could you just comment about the tax rates for the H2 20 possible and the second part is share of profit from associate than number is increasing. Could you elaborate how should we look at it going ahead, thanks.

Vinit Teredesai: So, that our effective tax rates are in the range of around 22%-24% and we anticipate that will continue to remain as it is. And as far as the investment from the associate companies if you remember we have spoken about our product strategy most of that investment is in that category. We are eventually sort of working on a plan to sort of exit the hardware potion of that business and we will not see any significant amount of any pressure or anything coming from there.

Moderator: Thank you very much. We have a question from Manish Shah of Revelation Portfolio. Please go ahead.

Manish Shah: Sir, can you throw some light on the hedging strategy and the outstanding as of today?

Sunil Phansalkar: So, as a strategy we hedge for 75% of our net exposure on a 2 quarter rolling basis.

Manish Shah: 75% of the revenue?

Sunil Phansalkar: 75% of the net exposure of cash flows. And we hedge them on a 2 quarter rolling basis. We use only plain forward contracts for hedging. The total outstanding hedges as of the end of the quarter were $49 million US and the average rate for that was about Rs. 70.4 per Dollar.

Moderator: Thank you very much. Our next question is from Rahul Jain. Please go ahead.

Rahul Jain: If you could give any update on the electric vehicle side? What are the various developments in terms of different relationship and opportunity we have in this space?

Kishore Patil: So, there are 2 sets of opportunity we deal with. One is we work with many of the leading companies whoever our customers are, most of them in terms of electrification, in terms of system integration instead of developing, development of certain engineering things, battery management systems, inverters, motors, so there are multiple areas in which we work. And that is a significant and a good fast growing business for us. Now, in certain part specifically in Asia including India there are commercial vehicles where they also want a full product which is where we try and use our proprietor technology like Revolo and that we use in terms of servicing those customers to give them the holistic solution.

Rahul Jain: So, my question is more in terms of what are the developments? For example, from an India perspective as we have been mostly doing it through government, state governments and Municipal Corporation. So given the upcoming election are we seeing that there is a kind of a lower traction on this kind of thing? Or are we finding new opportunities in some other way in this space?

Kishore Patil: No, I think it is a slow as compared to what you see but there is a certainly a forward-looking or I think I must say it is improving every month. So, there are more and more people adopting it in certain way. It is not on a very large scale yet. But naturally there are many people, Indian and as well as international interested in coming to India. We are working with them in multiple way and we look at Southeast Asia as a very interesting market again which again where there is a similar kind of thing which is happening. We are working with some of the players in that.

Rahul Jain: Sir, Southeast Asia is for two wheelers or even for passenger vehicle?

Kishore Patil: Southeast Asia mostly for the commercial vehicle, busses. Electrification of busses in South East Asia some of the countries.

Rahul Jain: But overall you would not call the revenue opportunity meaningful at this point of time, potentially it is?

Sachin Tikekar: I think we have taken a long term bet on this. Most of the states and countries will get there but regulations and some of these things take time and we have to be patient.

Moderator: Thank you very much. Ladies and gentlemen there are no further questions, I would now hand the conference back to the management team for some closing comments.

Sunil Phansalkar: So, thank everybody for being on the call and hope we have been able to answer your questions. If you feel, you need to have or if you have further questions please feel free to write to me. Thank you very much.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Emkay Global Financial Services, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.