"eClerx Services Limited Q3FY13 Earnings Conference Call"

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MR. ANJAN MALIK – DIRECTOR
MR. ROHITASH GUPTA – CHIEF FINANCIAL OFFICER

Moderator Ladies and gentlemen, good evening and welcome to the eClerx Services Limited, Third Quarter FY13 Earnings Conference Call. Joining us on the call today from eClerx are Mr. PD Mundhra – Executive Director, Mr. Anjan Malik – Director, and Mr. Rohitash Gupta – Chief Financial Officer. As a reminder all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal the operator by pressing '*' followed by '0' on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand over conference to Mr. PD Mundhra. Thank you and over to you, Sir.

PD Mundhra Thank you so much. Let us spend a few minutes just going through the highlights of this quarter and then we will take the questions afterwards. So, on slide #1 of the investor presentation you will see the key financial numbers for this quarter. Our top line came in at $31.3 million in Q3 which was up about 4.5% over the preceding quarter in constant currency terms. Some of this lift was helped by short term projects but on the whole, we felt that this was a very strong quarter for us given the environment that we find ourselves in.

Operating margin for the quarter was about 35% slightly higher than the last quarter and for the year-to-date, our operating margin stands at about 34% which is within our target goal of low to mid-30s. On an earnings per share basis, this quarter we did Rs. 16.2 fully diluted and about Rs. 41 for YTD FY13. On the next slide, you will see an analysis of our other income. So, the three components that are there and we have included this basically because this has been a source of a fair amount of fluctuation on a quarter-on-quarter basis, so we thought it is helpful to have this analysis. The first component is income from investment, which has been averaging about INR 2 crores a quarter. This quarter was slightly lower because we paid out our dividend in September and therefore the corpus available for investment was lower.

The second component is hedge gain or loss, so we have had an average hedge maturity of between $15 and $20 million a quarter and given that those hedges were usually at about INR 48 to INR 50 versus a prevailing spot of INR 53-54, we have lost money on the hedge maturity. This quarter was about INR 9 crores compared to INR 12 crores last quarter.

On the revaluation gain or loss, I think this has been the most volatile component in Q1 because the rupee depreciated, we had significant gains. Q2, the rupee appreciated so we had sizeable losses. Q3 again, there was a modest appreciation in the rupee so we had about INR 6.5 million of revaluation gain. All put together, the other income was a negative INR 1 crore for the quarter. In terms of hedges, our total hedge book outstanding now is about $63.7 million at an average of INR 53.3, $17.5 million will mature in Q4 and the rest is for FY14. This number represents basically two times last quarter revenue so definitely our hedge book is lighter than it has been at periods in the past and we will continue to layer in hedges as we get opportunities.

Slide #4 has some excerpts from our balance sheet so our total cash balance is now about INR 189 crores. This excludes the $9 million that we have an escrow against the acquisition payments and the book value per share is now about Rs. 162. In terms of an update on facilities as we had shared last quarter, we have taken on additional space in Chandigarh for our cable business and that fit-out is underway. We expect that facility to become operational within this quarter, Q4. However the equalized rent and a part of the maintenance charges have started being accrued in our P&L from Q3 so that cost is largely reflected there. Similarly our New York office we signed a lease a few months ago and that fit-out is underway. We expect to move in next month. But again on an equalized basis we have started accruing for rent from Q3. So our Q3 numbers reflect those costs. Slide #5 has our P&L.

I would not spend too much time on this because there is a graphical representation of this on the next page, so we will go straight away there to slide #6. If you see the operating margin we had a 32.4% operating margin in Q2. The two or three key moves, one was on goodwill amortization. In Q2, we provided for five months of amortization of goodwill as a catch-up from May and in Q3 we had the regular three months of amortization so there was a lower amount of amortization that happened in Q3. The other element is employee cost. Employee cost decreased as a percentage of sales because we were able to slightly improve utilization this quarter. You will see the details on the next slide. Exchange rate, we got some tailwind because the rupee was on an average about INR 0.50 weaker in Q3 versus Q2. So, those are two or three sort of big sources for the improvement in margins to 34.8%.

Slide #7 has some usual cuts of our revenue. Not too much has moved on the currency or geographic concentration and the DSOs continue to be in the 30 to 50-day band which we are very comfortable with. I think the two things to call out here, one is the client concentration, so we have seen a trend of a decrease in our top-5 client concentration and it is now down to 78%, which we are actually pretty pleased about because we think that is a good step forward and the other area is staff utilization. So this quarter we were at about 69%, which is sort of our stated goal of 68 to 70%. So, that was a slight improvement from the previous quarter. In terms of our client demographics, we did a count of our 60 clients and we found that more than 2/3^{rds} of these are companies that have more than a billion dollars in revenues and 98% of our revenues in Q3 came from billion dollar companies. So, it should just give you a flavor of the nature of client base that we are working with.

Slide #8 has a comparison of our growth rates top-5 versus non-top-5, so again top-5 growth rates have been exceeded by non-top-5 growth rates for six out of the preceding eight quarters and our non-top-5 business is now almost at a run-rate of about $7 million on a quarterly basis. So, that again is something that as some of you will know has been a long-term imperative for us. So, it is good for us to be able to make progress against that.

Slide #9 has an HR update, so we are now at 5,837 people. Attrition this year has been soft at 26.5% so it is very similar to the levels we saw in FY09. We think that it might pick up a little bit but we still expect that as a year, whole attrition will remain soft. With that I, will hand over to Anjan to talk about the outlook.

Anjan Malik So, one of the consistencies that remains across all our businesses is cost reduction. I think you only have to read the newspapers I guess and I am sure as we have talked to all the other folks in our industry and you listen to their commentaries about client business, the one thing that is pretty consistent is that people are looking to save money in whichever way they can and exit businesses that do not meet basic ROI targets. What we are finding is that the demand for our services is being triggered basically on these three parameters. One is of course low cost execution which is given, the other two which I think are becoming very important for companies like us are, specialization and speed and specifically the combination because there are a lot of what we see short term engagements or medium term engagements that are ramping up to meet business needs and that has been a driver of demand for us. If you look at our three businesses, we see interesting demographic trends across the three of them. The one that is the most interesting and perhaps the most surprising to us has been, I guess the growth that we are seeing in the Cable and Telco business which is the erstwhile Agilyst acquisition effectively. We see that as having a lot of tailwind in the medium term, an interesting trend in that business is that they really have not looked at outsourcing other than really call center work. What this industry is now facing is tremendous pressure on subscriber revenue growth with guys cutting cables, try and save money and increasing competition as market faces more deregulation from some of the big guys like Google in fact. And what that is doing is forcing our customers to start looking at cost pretty much the same way as some of our more established players, for example the BFSI space has started thinking about cost. Add to that, the high ROI nature of the services that we today provide which is really focused on reducing the cost of servicing customers and increasing customer satisfaction revenue assurance. We are finding that there is a tremendously high adoption rate. So we have been very excited about the growth rates that we have seen there. We see a tremendous pipeline growing in that business. The sales and marketing services especially I guess with the focus on digital continues to have demographic demand. I think we have mentioned this quarter-on-quarter, for many years now and we continue to see that trend. It is a combination of two things. You can either see a lot of what I would call re-platforming, so guys moving from online data in a particular format onto more consolidated platforms which needs a certain amount of data remediation upfront and then ongoing maintenance and operation. We have been picked for those kinds of activities and obviously for more established players where they are already online and have more complicated footprints. There is tremendous demand for our services. So we continue to see that. And if you look at emerging client portfolio growth, that is the business that had the most traction in the last six months.

However, I guess it has been in the press, some of the industries would be serviced today, are subject to large secular trends and potentially event risk and as our customer base goes through that, we have to see how that impacts our service portfolio and the services we will be providing them.

Financial Services of course continues to be the most interesting and in some ways the most challenging businesses as you can all imagine. I am sure you have heard this from your other investments as well. Regulation is given. I think what it has done is many of our customers, that are in the investment banking industry, are fundamentally questioning whether they should stay in the investment banking industry because of the return reasons. Regulation has made it much more expensive and ponderous for these guys to continue in the business. So it has to be seen what happens on that front. In the shorter term, we are seeing a lot of demand for remediation work.

There is a lot of project work, risk reduction activities. In the longer term one of the goals that we have set ourselves obviously is a reduction in OTC business. It is given of course and has been brought up in a number of quarterly calls that as our business matures and as the financial services industry moves to its more low risk-return businesses that the structured/over-the-counter business will become a smaller percentage of the portfolio. Although we expect overall volumes to explode over the next couple of years, our reliance on that portfolio is the lowest that it has ever been. We continue to increase our portfolio of services so we are pretty confident that we are well positioned to meet the changes that are coming about. There are challenges and headwinds to that industry, for example cheaper INR in the last couple of years have strengthened captive positions and actually one of the big themes that we see in the last six months and regulatory fundamentally questioning by the banks today have too much India risk in aggregate across vendors and captives. So I think a lot of moving parts we continue to invest in the marketplace and we see demand but we also see a lot of challenges. What does that mean net-net for us, we anticipate organic growth to remain soft and we actually expect quarter-on-quarter volatility to increase given some of these things that we have seen. For example, PD mentioned some of the short term project work contribution to Q3 revenues. I mean we would expect those kinds of volatility events to continue. We do feel more sanguine about pricing because we feel that we are not competitive to the price in the market.

Our customers are demanding so we expect that over the next year the way you would provide service changes. You have to give more for the money that they pay you so I think that is the part of service evolution. And the onshore team which we have always maintained is a very important part of our client centricity and industry relevance, we feel is now right sized and a lot of the focus over the next 12 months is ensuring that we get maximum return for the investment that we made on that front. With that I will hand over to questions to the folks.

Moderator Thank you sir. Participants, we will now begin with the question-and answer session. We have the first question from the line of Ravi Menon from Equirus Securities. Please go ahead.

Ravi Menon I am surprised to see that the Cable and Telco sectors are gaining are lot of traction. It would be great if we could separate out exactly how much loss is due to this particular line and how much is of Sales and Marketing services?

PD Mundhra Typically, we have not sort of broken out segment-wise numbers for our three businesses because ultimately they are all very similar. They are all data processing businesses. In this quarter actually though I would say that growth in our native business was higher than for Cable and Telco but our statement on the last slide is more about pipeline and what we see in the forthcoming quarters.

Ravi Menon So may I assume that the inorganic revenue of this quarter was more or less the same as what it was last quarter, that is what I assume at the Cable and Telco business, right?

PD Mundhra Yeah I mean I think from the way we look at it everything is organic now because in Q2 we had a full quarter of Cable revenue so whatever growth we had on a sequential basis is on that base.

Ravi Menon And then if I have heard right you were saying that pricing is expected to remain stable but you expect to pass on some productivity benefit. Is that right?

PD Mundhra I think that is right and it has been so because as we will also see elsewhere in the presentation about 90% plus of our client contracts are structured on an FTE basis and the implication of that structure is that to the extent we are able to become more productive and that same FTE is able to produce more units of output in a 40-hour work week that benefit does get passed onto the clients and one of the reasons they come to us is because we are able to increase productivity over time. So yes, I mean that is sort of the standard structure.

Ravi Menon Was that part of the SLA in these contracts or you are guaranteeing productivity benefits?

PD Mundhra It varies from case to case. In certain cases where we have very good visibility about the process and also we have good controls in terms of automation levers and things like that, we are happy to commit to a certain level of productivity improvement. In other cases where we are working largely on client systems and therefore we have less control over the operating environment it is more on a best efforts basis. In either case we will very transparently share with clients what the average handle time and productivity numbers are but the commitment may only usually be in cases where we see we have more control.

Moderator Thank you. We have the next question from the line of Nitin Jain from Ambit Capital. Please go ahead.

Nitin Jain I see there is a decline in all cost items except sales despite having a stable pricing. You have explained that you had some productivity gains. But can you give some more reasons for this?

PD Mundhra Okay so if I flip over to slide #5 of our presentation which has the P&L you will see rent actually went up quarter-on-quarter by about INR 1.2 crores because of the inclusion of the Chandigarh expansion and the New York office. Employee cost went down because of the increase in utilization. Legal and professional fees came down because I think in Q2, we had a lot of recruitment charges as we were ramping up the onsite team and because that team is now stable therefore in Q3 we did not have that surge in cost. Electricity went up a little bit quarter-on-quarter. Communication went down, sort of these things, there is always a little bit of quarterly flux on them. So there was not that much of a change in G&A. I think what helped us of course is the fact that we had a strong revenue growth for this quarter and therefore we were able to scale that expense base better.

Nitin Jain And the next question is on as you mentioned in the presentation that half of the growth came from short term projects and all of them have completed this quarter. So what is the sustainability? Will we see the same types of projects next quarter or in coming quarters?

PD Mundhra I think that is the point we were also trying to make on the last slide about quarter-on-quarter volatility. We are a very small business. It is a $30 million P&L if you look at it, so you will never have very smooth quarterly outcomes. This quarter sort of our normal volume growth was helped by the infusion of the short term project which will not be there every quarter. So I think the fair expectation would be that you will get sort of volatile quarter on quarter outcome. Some quarters will look very strong as this quarter did, others will look not so strong.

Nitin Jain Is there any relation between margins and these short term contracts? Are these more profitable?

PD Mundhra Yes, I think short term contracts usually tend to be more profitable because you tend to service them using your bench staff or people like that so you do not really end up hiring a lot of new people but you get the revenue benefit.

Nitin Jain Okay, so utilization increase might be a consequence of these short term contracts?

PD Mundhra Profit is linked with that but I think on the margin front if you take any four-quarter period our goal is low to mid-30s and I am pretty sure and hopeful that even for FY13 as a whole we will be able to stay within that band.

Nitin Jain Last question on Agilyst business coming. Can you give me revenue numbers for last quarter and this quarter?

PD Mundhra As I mentioned in response to the previous question we do not break out numbers by business on a quarterly basis but when we acquired the business they were about $15 million in revenue run-rate and they have grown since then.

Nitin Jain $15 million per quarter, right?

PD Mundhra No, $15 million annualized revenue run-rate.

Nitin Jain And the 30% margin range you said is the EBITDA margin, right?

PD Mundhra Operating margin, so more I think closer to EBIT before other income.

Nitin Jain Okay.

Moderator Thank you. We have the next question from the line of Dhaval Mehta from Edelweiss Securities. Please go ahead.

Sandeep Sandeep here. I continuously see every quarter that we have done a very good job on the top-5 clients and I understand that the model is around that but the non-top-5, I think we have not been able to make much progress and we are trying our level best. But can PD or Anjan throw some light on this, how it will happen going forward and we still have a strategy in place to target because the concentration otherwise will not come down significantly. That is part one. And part two which I have is that how you are seeing that demand environment now, although I am very optimistic on FY14 demand environment but just wanted to check whether you share the same positivism or optimism on the demand side?

Anjan Malik I think the second part of your question which was around demand optimism. As we have mentioned in the last slide we feel somewhat sanguine about sort of the medium-term. We do feel that there is a significant amount of event risk that sits out there in the marketplace. So may be we are a little more sanguine than some of the IT majors in how we look at demand. So we sort of went through each of our three businesses and we explained to you that look in financial services lot of regulation, there may be change in business models but at the same time there clearly is a focus to do things at lower cost. We do feel that there is a captive bias right now because of regulatory pressure and we also do feel that over the next couple of years these banks will be forced to look at markets other than India, simply because of regulation saying that look there is just too much India concentration risk. So as we mentioned in the medium term a lot of the success would come with what I would call product or specialization driven strategies, of which we have some and we are investing in more. In the digital space there is clearly demand and that demand will continue. But as I think PD has mentioned in a call a few quarters back, demand and its impact on people like us in terms of revenue is non-linear. So for example, because by definition those are automation initiatives so when you have a large re-platforming exercise that is going on there will be a certain amount of content migration which is a large amount of project but then the ongoing work does not necessarily need as many people. But there are lot of companies out there that are going through re-platforming exercises that need help in the online existence business and clearly we are quite bullish about that space. And cable as we mentioned earlier, we think over the next couple of years there is a tremendous amount of demand because that business is going through an inflection where it is a business that has never really thought of outsourcing or offshoring in any significant way and it is now being forced to because it is in a way becoming deregulated in facing some of the same challenges that some of our more mature customers are facing. So that would be my point on the demand. Your first question was about diversification, again I think it is a point that we have addressed, I feel on this call prior and in previous quarters. I think it is given that a business like ours is really built on mining customers, so I think once you get in with master services agreement and then you take your services to as many stakeholders in concentric circles around the services which you provide and that is the way to grow because you are an established vendor. In the last four years we have mentioned that there has been a significant amount of vendor consolidation and we have seen that where you win you tend to win big and where you don't you effectively do at some point that gets marginalized. That happened to us to some extent in 2008 and I think over the last three years we have basically been climbing back up that wall. So today although it does not look like we are making a lot of progress in the emerging world, I would say that a lot of the growth that you are seeing in the last year has actually been driven by the emerging business but because it drives a much smaller base, its overall impact on top-line is not as significant as you would see of course if you were getting the same growth rates on the top-5 or top-6 customers. So I would say on a percentage basis we feel very bullish because a lot of the absolute growth has come from that business anyway. So I think that we are making progress but clearly it will take some time before that business is of a scale where growth rates will make a very dramatic impact on top-line.

Moderator Thank you. We have the next question from the line of Pratik Gandhi from IDBI Capital. Please go ahead.

Pratik Gandhi If you can just elaborate more on the nature of these short term projects. So what kind of service offerings were there, whether it was more on a financial services side or more on a sales and marketing side and how should one look at that in Q4 and was it a one-off in the current quarter?

PD Mundhra The short term projects I would say were mostly driven by two factors. On the online business these were sort of projects which were helping our clients get ready for the holiday season because as you know for the online retailers the Thanksgiving to Christmas period is their high sales period for the whole year. And on the banking business there are some deadlines under Dodd Frank that are coming into effect in January this year or have come into effect and so there were some remediation and cleanup exercises that we were able to participate in for our clients. So that is basically the driver for these short term projects. In terms of how that impacts Q4 is that to the extent there was 500K or 600K of short term revenue that was in our Q3 number, it leaves that much of a hole in Q4 for us to resell in terms of revenue growth.

Pratik Gandhi Secondly, what kind of utilization rate are we targeting? So I think for example if I look at the utilization rate it has improved marginally by 100 bps. My sense is a bulk of that would be from Agilyst, so just want to know when can we expect that utilization rate can move to again 70-72% kind of level or that will be difficult on an overall basis?

PD Mundhra I think after the inclusion of the Agilyst business we are targeting 68-70% for utilization. So I think that when we are more efficient maybe we can get up to 70 but 68 to 70 is the range sort of that we see for the combined business.

Pratik Gandhi And just last one on the margins to fall of Agilyst, how it has been over the last two quarters? Are we able to improve that largely on account of improvement in the utilization rate or how do we see that on the last two quarter basis?

PD Mundhra Pratik as you might recall with our Q2 earnings call we had shared an outlook on Agilyst margin saying that we expect short term 20% and medium term mid-20s. So we still hold with that. We think that is an accurate estimation for that business. In fact, if I was to stick my neck out I would say that in Q4 itself we should be somewhere close to mid-20s for that business.

Pratik Gandhi And just last one on your standalone numbers, if I see your sales and marketing, sales and distribution cost has gone down so it is basically the contract for services cost has gone down significantly there on 25% on a QoQ basis. So just wanted to know what is that regarding?

PD Mundhra Pratik can I ask Rohitash to take that with you offline?

Pratik Gandhi Fair enough, no issues.

Moderator Thank you. We have the next question from the line of Madhu Babu from HDFC Securities. Please go ahead.

Madhu Babu Hiring has been very soft this quarter, so is it an outlook that we are looking for a slower growth trajectory or nothing to read into that?

PD Mundhra No, I think we are definitely looking at a period of slow growth. I think FY13 YTD has been slow organically and as we have shared earlier in this conversation we do not really see a change in the environment. Hiring has been slow because we sort of hire as and when our pipeline converts. So we have been sort of hiring I guess between 50 and 100 people net a quarter this year and Q3 has sort of been in that same range.

Madhu Babu And the onsite sales headcount, what is the current count and is there any additional reduction there?

PD Mundhra 61.

Madhu Babu And sir we are talking of diversification of clients beyond India, so would we as a player look to set up a centre outside India just to tap that or what you would do to get into that?

PD Mundhra I think if we continue to meet our growth aspirations then it is quite possible that in a 2 or 3 year timeframe we may end up creating some delivery capabilities outside India. I would say the primary driver for that is two-fold. One is diversifying country risk because there is small section of clients who are starting to get worried about India concentration and the other reason is to create additional language capabilities, so it expands our addressable market because as you might know in India to source foreign language skills other than English is pretty difficult. So we have looked at some of these proposals in the past in terms of Northern China or may be even near shore in the US, nothing has worked out so far but I would say that over the next 2-3 years it is not unlikely that we end up doing something.

Moderator Thank you. We have the next question is from the line of Neha Kaushik from Banyan Capital Advisor. Please go ahead.

V P Rajesh V P Rajesh here. First one is you guys said that the organic growth is going to remain soft. I was just curious if it is true for all the three verticals you have or that was more relevant to the financial services area?

Anjan Malik Yeah I think we meant it at the top-line level and I think it is a mathematical outcome of the fact that out of five customers which obviously make up a very large majority of our revenue is where we see some slowdown in growth. If you look at it by verticals then again as we have mentioned, we expect growth to continue to be strong in the cable business. So by definition the slowdown that we anticipate would be in SMS less and probably financial services I would argue is where we expect most volatility in the short term. But I would say we have taken a very conservative stance in what we have told you about our expectations. So yes you are right, so I would say in terms of expectations of growth we would probably put cable where we are most optimistic, SMS where we feel there is a lot of tailwind and assess Financial Services where we see event risk and at the same time there are opportunities. So I would say it is volatile.

V P Rajesh And you mentioned that Dodd-Frank was one of the reasons that you had some short term projects in the last quarter, do you see any other catalyst like that which could result in more short term projects over the next couple of quarters?

Anjan Malik If you talk about financial services specifically there are a number of different deadlines that are coming up over the next year. So for example the Dodd-Frank protocol, the Dodd-Frank thing is a big overarching method statement almost. There are a bunch of underlying regulations that are put into place by different regulatory bodies and I think a lot of the OTC stuff has been spearheaded by guys like CSTC. And the CSTC initiatives coming in tranches through 2013 into 2014, there is stuff around Basel, there is the stuff on capital adequacy. There are obviously these new initiatives on anti-money laundering. There is the European Directive equivalent of Dodd-Frank just called EMIR which comes in towards the middle of next year. We anticipate that will get delayed. So Dodd-Frank and EMIR and a bunch of these other sort of what I would call overarching method statements, they create a spider web of regulatory activity really pretty much across the banking community. And depending on your reach we anticipate that we will have the ability to participate in a number of them. So it is not like Dodd-Frank is one act and December 31, 2012, it ended. I mean it is the beginning. It is a number of different work streams.

V P Rajesh And on the competitive side are you seeing your competitors gaining more share in your top-5 clients or how is the competitive activity that you see there?

Anjan Malik Is the question, have they grown in our customer bases or have they grown at the expense of our business?

V P Rajesh I mean the latter part.

Anjan Malik I would say the latter is definitely not the case. I would say that in specific instances it has actually gone the other way, where we have migrated stuff away from existing large vendors because of specialization and skill set that the other vendor may not have. Net-net has worked on to some of the large vendors. We are seeing for example, more consolidation amongst the players of a particular class. So for example, if you take TCS, Infosys, Cognizant and Wipro we have seen in some of the large customers that we have worked with that more and more work will start going to one of them as opposed to being across a bunch of them. But we have not had a situation where it works has been directly taken away from us. But we are seeing them, for example in RFP situations, we do compete with them on engagements simply because of proximity. Many instances we are talking to same stakeholders. We will have a different value proposition, they will have a different value proposition and when a customer wants to take off they will usually pick us, pick them and they may look at a captive.

V P Rajesh Just one quick housekeeping question, in terms of the earn-out that is due to Agilyst, how that trending in terms of the amount that has to be paid out?

PD Mundhra Again I think with our Q2 numbers we had shared a range of a total consideration between $19 and $23 odd million across all trenches put together and we still hold to that range. Against that $16 million was paid at the time of closing. So I think the incremental money that will get paid will be somewhere between $3 and $7 million.

Moderator Thank you. We have the next question from the line of Vaibhav Agarwal from Motilal Oswal Asset Management. Please go ahead.

Vaibhav Agarwal I know that 98% of your clients are billion dollar plus but what is the average size of contracts that you have with them?

PD Mundhra An average contract would be around $250,000 to $300,000 per contract. Of course with our large client we will have multiple such contracts, which is why we get to the $10 or $15 million account sized but the average SOW (Statement of Work) would be of that size.

Vaibhav Agarwal But average accounts would be about in the line of what $300K?

PD Mundhra Average contract, single contract.

Vaibhav Agarwal Yeah but average account size would be how much?

PD Mundhra We have about 60 accounts and give or take $120 million. So, if you do a straight arithmetical average it comes to $2 million but it is not a perfectly distributed $2 million because our top-5 are 80 odd per cent of revenue.

Vaibhav Agarwal And in terms of employee mix between onsite and offshore, how much would that be?

PD Mundhra We have about 60 people abroad so roughly 1% of total headcount and we have 5,800 odd people in India, so 99%.

Vaibhav Agarwal And I think one of the larger trends in data analytics is now towards like Big Data and Hadoop and all of that, so are you guys in any way being beneficiaries of that trend?

PD Mundhra I think Big Data is a very hot term, which means different things to different people. But generally speaking I think we are beneficiaries from the trend that companies are creating and having access to large streams of data and they themselves may not have the bandwidth to process all of it and they may not have their systems automated to a degree where manual intervention is no longer required. So in other words manual intervention is required to process this data and they may not have the bandwidth which is why they come to people like us.

Vaibhav Agarwal And are there any plans may be to invest in cloud computing or any of those platforms at this point of time for data processing and all of that?

PD Mundhra I would say our business really exists because of cloud computing, so almost across the board the way we deliver services is our staff sitting in India, logs into our client's system in the US or in Europe, accesses data from there, processes transactions there, and creates reports there. So it is like a private cloud virtually. It is not a public cloud. It is not available on the public internet. So these are private circuits between our facilities and our clients. So I think that technology was available on the corporate side for a number of years and which is why businesses like ours exist. The difference is today that technology is now available to the small consumer who can pay $10 for a DropBox account or whatever. So I think that is a distinction.

Vaibhav Agarwal Obviously it is very impressive margin of around 34-35%, but your larger players obviously have slightly lower margins in the vicinity of 27% to 28%. So what do you think would help you sustain this pricing advantage over other competitors of your sort of same contacts?

PD Mundhra First of all I would say we do not have a pricing advantage. We exist in an intensely competed marketplace and we have to rise in line with our competition. When you benchmark margins I think the 25-27% that you are reporting for our peers is a blended average of their onshore and offshore work and their onshore work is typically lower margin, the offshore work is higher margin. So higher work is 100% offshore as you can tell from our employee mix, 99% of our employees are in India. And therefore our offshore margins are very comparable to their offshore margins. So I do not think that we have a margin profile that is very different for others for the same kind of work.

Moderator Thank you. We have the next question from the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain The first question is we said that we could possibly move out for more delivery center outside India. So what basically would actually trigger such a decision because that would actually change the overall margin aspect and also what could be the challenges once we do it in terms of say cost impact, second on the transition time?

PD Mundhra I think for us the main trigger to setting up an overseas center would be line of sight to a very concrete pool of demand. So if you are able to line up an anchor client who commits a certain volume of work to us then it makes our decision much easier because otherwise you are making a long-term commitment and incurring cost without having good visibility into end demand. So I think that is sort of what would be the trigger for us to do something abroad. On your second question about impact on margins to be completely honest, we are not very focused or hung up on an absolute level of margins. As a proof point we decided to acquire Agilyst even though that business has a much lower charge out and a slightly lower margin profile than our native business. I think what is more important to us is on an incremental basis that risk reward makes sense, so if you for example, set up a center in Latin America and your charge outs increase a little bit, your margins go down a little bit but you are still making a similar amount of contribution in terms of dollars per employee. That may still be interesting to us and it also gives us additional capabilities. So I think we have a more flexible evaluation criteria when we look at these decisions because the thinking is more about what will strengthen the positioning of the business over the medium term.

Rahul Jain And just from the prospect of it as you said pooling up of demand. So is it like right now we are losing our some of the opportunity today because it is not sizeable enough to consider such a thing and how one could actually quantify such a thing because it could be remain a perennial issue because that pool up of demand may not be accumulated at any one given point of time.

PD Mundhra I think that is a very insightful observation. So I would say today specific inquiries that we have may be 5 or 10 headcounts for somebody speaking Spanish or somebody speaking Chinese and that by itself is not enough to warrant setting up a delivery center because as you need a certain minimum economic scale. So I would say that we need to have line of sight to at least 50 to 100 FTE to make this decision. But I think it is not impossible to get that demand because we have had conversations with clients where they have an evinced interest. So it is now a matter of closing one of those opportunities when they next come along.

Rahul Jain Okay but this would not be more of a proactive effort that okay we can put up people around possibly if you could get an incremental business for that. It would be more driven by client not driven by you.

PD Mundhra No, I think it is driven both ways but all we are trying to say is that before we pull the trigger we would want to have a certain level of comfort that that demand exists and it is a sustainable level of demand. That is all we are saying.

Rahul Jain Do you see if you have to say, if there are five steps what level you would have probably reached today to sort of make such a decision?

PD Mundhra Well I would say we evaluated a number of different locations, we have used consultants and teams of people to look at different sites, understand what incentives might be available for job creation in those areas, look at the legal and tax framework, look at sort of how we would have to may be set up a subsidiary, etc. and also shopped the proposal around to a couple of clients. So we have done all of that, so I would say we have gone past the exploration stage, may be to the pitching stage. We have had some indications of interest back from client but nothing concrete. So the moment we decide to do something, we will share it with all of you guys.

Rahul Jain That gives lot of comfort because otherwise to start from zero from a new onsite kind of a delivery will look a little tough from a 100% offshore kind of a model. And secondly as you said $3 to $7 million of payouts, so what is the total period for this on Agilyst?

PD Mundhra Payout will happen in two trenches. One will get paid in May or June 2013 and the final trench will get paid in November-December 2013.

Moderator Thank you. We have the next question from the line of Sahil Shah from HSBC. Please go ahead.

Sahil Shah It was much more to do with the cable business, you spoke about a higher adoption rate going ahead. What I wanted to get a better clarity was (a) what is the level of penetration within the cable business especially the one that Agilyst looks at. The second one was what are the potential number of clients because I think at some point you had mentioned that you would not look at the smaller clients?

PD Mundhra On the first question I would say that the level of penetration is still low. I mean if you look at how these cable companies are typically organized in the US is that they are run on a regional or division basis. So a large company may have different units for each of the major metropolitan markets that it serves in the US and Agilyst is only working with two or three markets with each of its clients. So from that perspective penetration is low. In terms of number of clients I think Agilyst has about four clients right now and I would say that total universe for that company might be anywhere from six to 10 clients of any size. But I think the difference there is that they have the potential to convert each of those accounts to very meaningful revenue sizes.

Sahil Shah I just wanted to understand what are the geographies that are currently being addressed and are we looking at any expansion in terms of potential geographies?

PD Mundhra See the geographies right now are primarily North America, which is the United States and the UK. Again, I think because delivery is based in India a binding constraint becomes English language speaking geographies. So from that perspective I would say in the near term the UK, the US, may be Canada is sort of the low hanging fruit. I do not know if markets like Australia have enough size to warrant dedicated marketing effort but certainly the US, Canada and the UK would be our primary focus.

Sahil Shah My second question was on the depreciation for this quarter, I just wanted to get a little more clarity, clearly the run-rate seems to be about INR 4 crores, which was in first quarter. There is another INR 2.1 amortisation that happens on the quarterly basis. It will continue for the next 10 years based on Agilyst. What would the delta be on that INR 7.4 crores that was reported in third quarter 2013?

Rohitash Gupta As you might recall we have operationalized the Pune-2 facility fully sometime in July-August, and there was some asset addition due to that. Also as part of integration of Agilyst, we have put a lot of infrastructure to align it with eClerx IT infrastructure and policies so that asset base also got added. So, all of this has come for depreciation in this quarter giving you some incremental amount.

Sahil Shah Is this the number I should be looking at on an ongoing basis?

Rohitash Gupta Currently if you look it is about 3%of operating revenue. I think that should be the case in near term.

Moderator Thank you. We have the next question from the line of Kunal Sanghoi from Birla Sun Life Insurance. Please go ahead.

Kunal Sanghoi Actually my question is on some of the cautions that we have placed on, Anjan you did highlight these significant amount of inventories essentially because of some of the changes in the regulations. Last quarter we had spoken about changes in the business sponsors in some of the Financial Services clients which was actually providing some gap in terms of project flows. Is that stable now?

Anjan Malik I would say the Investment Banking industry is anything but stable at the moment. So if you look around you can look at the very large institutions like Barclays and Citi, you can look at HSBC, you can look at all the really big banks and every one of them is going through some wholesale change, right. And they have been doing what they call reduction enforced pretty much every quarter. I think Barclays has just announced they are going to be cutting 6000 people primarily all from Investment Banking. Citi announced that a little while ago that they are going to cut some 6000-7000 people from their Institutional Client group. So there is a fair amount of event risk I would say. There is even more career risk right now and certainly we are seeing in addition to that sort of risks that are going on, we are seeing compensation being driven down very aggressively especially in the support staff for our client base. It is now I guess increasing recognition that the money that people have been paid in support functions from Investment Banks are probably unjustified. So, all of those are leaning to people also voluntarily deciding to leave the industry. So I think you will see over the next couple of years the industry will look very different. So I would say that I do not think we are at the beginning of the cycle, I certainly do not think we are at the end of the cycle. I think we are somewhat in the middle right now. So this is going to work its way through and I think that event risk will stay for a while.

Kunal Sanghoi Is there a caution also from the Sales Marketing Business unit as well where you have some of your large accounts are may be involved in a LBO or so?

Anjan Malik I would say that at this stage that is one of the event risks that is out there certainly. We know that there are discussions about large LBOs in the marketplace. I would say that there is also a fair amount of risk that certain number of our clients may merge. There is a risk that some of the businesses that we today support may get jettisoned because they no longer provide the margins that those businesses want and I do think that over the next three years some of our customers would not be around. I think they will be filing for Chapter 11 because their business models will be affected by some of the trends that are happening in the marketplace. There is absolutely large amount of event risk in the marketplace right now.

Kunal Sanghoi On the short term project you did indicate there is a lot of demand which involved remediation work. So what could be the magnitude of these projects in terms of FTEs?

Anjan Malik To be honest Kunal when that demand comes usually it comes to you because the captives of the internal teams cannot flex to meet those demands. So if it was in the range of 10 to 20 people, usually it is not considered to be a short-term project. So I think guys will come to you if it is a sizeable track of remediation that needs to be done in a very short period of time and they will come to a vendor because you have the ability to scale up a very large team that is trained in a very short period of time. So without putting any exact number to it I think it is certainly bigger than the numbers that you were mentioning.

Moderator Thank you. We have the next question from the line of Pankaj Kapoor from Standard Chartered Securities. Please go ahead.

Pankaj Kapoor Just want to get a flavor of the incremental demand that you are seeing, that you spoke of especially on the regulatory side. Is it more which is being coming-in in the form of integrated deals especially for example in the Dodd-Frank site are the clients looking at more integrated deals which means both IT as well as Processes. If you can give some flavor of that in that way and how much percentage or how much share of his would be pure-pure process oriented work where probably we will be pitching in better?

Anjan Malik I would say that if it is regulatory driven and if it is short term, and if it is a project driven exercise it is very unlikely that it is going to be a technology/process initiative. I think it is something that needs to be done yesterday. It is by definition data process. They will obviously prefer vendors that will apply some level of automation and process reengineering to the data remediation process itself so that they can gain scale and they can gain quality. So that is the kind of area where I think companies like us have an edge. I think where you see the large IT plus operations deals or where there is stability, so usually it is a bank or an organization that has some legacy tool and a legacy process and they feel that by passing on the ownership of the application along with the process, they can get benefits over some longer term period and those tend to be sort of around the more stable platforms. So I think they are almost at opposite end of the spectrum.

Pankaj Kapoor And again on this side only, are you seeing more of this going to captive that means on the regulatory side the clients are engaging more with their captives and using third party like us more from our incremental perspective only or you see standalone full stuff coming to third party people?

Anjan Malik In the last year we have definitely heard the word captive much more than we had heard in the three years prior to that and the constant refrain that we are getting from our clients is that regulators prefer for many of these activities to be done within captives. A lot of it because of client confidentiality reasons. So for example, if you are doing any work which touches the client's client, there is now all of a sudden additional nervousness about this being given about the third party vendors. So yes, a lot of the work which is also why mentioned volatility in our earnings and the volatility in the FS business because I think a lot of the chunky work that we are seeing in the short term is of sort of this additional requirement as opposed to core processing that is being thrown at vendors. We are seeing from clients what I would call more run-the-bank kind of activities but in a time like this where there is uncertainty within the banks about how end state is going to look like, I think there is generally a nervousness around sort of committing to multiyear contracts with vendors without really knowing what your business is going to look like three years from now so hence our comment about volatility.

Pankaj Kapoor So if I just try to project this out do you see from a slightly longer range perspective the captives getting more engaged on the regulatory side and more of the run-the-business kind of a work coming to third party vendors? Is it a right assessment to make on a going forward basis?

Anjan Malik I think in the medium-term you will see that the vendors will evolve their product offering. I think you will see that they will add I guess value propositions that are above and beyond what a captive is able to offer and I think you will see the vendor market becoming re-engaged in more run-the-bank activities but I think as I said at the moment the trend is to try and keep things within the captive because there is a lot of change and I think as soon as there is more stability in the marketplace we anticipate the vendor community will see more of this pipeline. Certainly I think you may start seeing stuff coming from the captives going directly to the vendors over the next couple of years.

Pankaj Kapoor And sir if I then look from the margin side at the third quarter base, what do you think can incrementally be the levers to work on if I have to take again a FY14-FY15 kind of view?

PD Mundhra Pankaj, I think we still think that low to mid-30s for operating margin is kind of where we will be because it is impossible to predict the currency but from a pricing perspective we think that prices will be where they are, may be slightly up modestly year-over-year. And on a cost basis from whatever we can see the market for talent still looks softish as you can see both from our attrition numbers as well as the attrition numbers reported by the IT industry. So I think from that perspective we should be able to manage cost and the sales and marketing expenses now we expect to more or less keep flat as a percentage of revenues. So barring very large fluctuations in currency I think low to mid-30s we should be able to maintain.

Pankaj Kapoor So PD do we need to model may be some of the incremental cost because of the non-India operations that you are evaluating. Do you see that impacting cost in any which way next year maybe?

PD Mundhra Pankaj if that happens then the revenue will also go up commensurately because I would think that in all likelihood when we pull the trigger we will have some line of sight to the associated revenue. So it will be incrementally cash flow and operating margin positive. Now the margin may not be the same as our native operations but it will contribute some margin and some cash flow, so for whatever you are baking in for our native business I think the offshore business we can maintain certainly low to mid-30s.

Pankaj Kapoor On this outside India expansion that you are evaluating, are you also looking at an inorganic angle to it in terms of acquiring a player who already has operations over there in a similar line of business?

PD Mundhra For inorganic opportunities we tend to look at a very broad spectrum of assets. Certainly now that we have this thought process if one of the targets we are evaluating has an existing and a successful setup in an attractive region that would be an additional plus factor in our mind when we look at that company. But primarily the intention is not to go out and buy something just because it has East Europe or North China or Latin American presence. When you look at inorganic opportunities it is more strategic because I think the overseas presence we can also set up on our own once we decide to.

Moderator Participants, that was the last question. I would now like to hand the floor back to Mr. P D Mundhra for closing comments. Over to you sir.

PD Mundhra Thank you so much everybody for joining this call and we look forward to chatting again in May with our full year results.

Moderator Thank you sir. Ladies and gentlemen on behalf of eClerx Services Limited that concludes this conference call.