

## "eClerx Services Limited Q3 FY2015 Earnings Conference Call"

**January 30, 2015** 





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**SERVICES LIMITED** 

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LIMITED

MR. ROHITASH GUPTA - CHIEF FINANCIAL OFFICER,

**ECLERX SERVICES LIMITED** 



**Moderator:** 

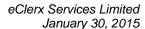
Ladies and gentlemen, good day and welcome to the eClerx Services Limited Q3 FY2015 earnings conference call. Joining us on the call today from eClerx are Mr. P.D. Mundhra – Executive Director, Mr. Anjan Malik – Director and Mr. Rohitash Gupta – Chief Financial Officer. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing \* and then 0 on your touchtone phone. Please note that this conference is being recorded. The call will begin with a presentation providing an overview of business and then open for questions and answers.

Before starting, the company would like to remind all participants that anything said on this call which reflects the company's outlook for the future or which would be construed as a forward looking statement by the management must be reviewed in conjunction with the uncertainties and risks that eClerx faces and which may cause the actual results to differ materially from those expected. eClerx does not undertake any obligations to update the forward looking statements to reflect events or circumstances. The same is highlighted on the last page of the investor presentation available on eClerx website. I now hand the conference over to Mr. Rohitash Gupta. Thank you and over to you sir.

**Rohitash Gupta:** 

Good evening everyone and thank you for joining us for Q3 FY2015 update. This quarter we had 3.1% sequential growth in constant currency terms which was about 2.1% in dollar terms. This was the first quarter when company crossed Rs 250 crores in terms of total revenue. Our operating margin for the quarter came at 28.3%. The PAT for the quarter was Rs 61 crores and for 9 months ending December, it was Rs 177 crores. In terms of other income; in Q1 we had about Rs 9 crores, in Q2 we had about Rs 10 crores and in this quarter Q3 we had about Rs 11.4 crores of other income. The constitution of this Rs 11.4 crores was largely in terms of revaluation and realized gain which was almost half of it and other half was our investment income. We have total outstanding hedges worth of \$106 million at an average strike rate of Rs. 67.5 to a dollar. Of all the hedges, constitute of forwards, this turns out to about 2.7 times our last quarter's revenue. We have also provided a breakup of hedges by pre AS-30 and post AS-30 adoption hedges. So if you see that breakup, the pre AS-30 hedges in the \$106 million book is about \$35 million and the hedges taken post 1st April 2014 are about \$71 million. A large portion of this \$35 million hedges will mature by March which means that our book going into next financial year will largely constitute of hedges taken after adoption of AS-30 which essentially means that on maturity, those hedges will go into operating revenue line item at the strike rate mentioned here.

On slide 4, we have a breakup of our P&L going up to operating margin level. The major items for change this time were not employee cost which has remained largely flat as a proportion of operating revenue. The major changes were in terms of SG&A which has increased by almost 160 bps. The major contributors in that increase on a sequential basis were rent, legal and professional fees and conveyance and travel.





In terms of balance sheet update, the cash on the books at the quarter end was about Rs 417 crores which is significantly up since Q2 FY15 end. The trailing 12-month EPS stood at about Rs. 80 in basic terms and Rs. 78 in diluted terms. In terms of new facility updates, we plan to complete our Mumbai consolidation completely by H1 of next financial year. We are on track of towards that. We have also taken one additional small lease in Pune to have city specific demand catered to. In terms of our expenditure towards CSR, we have spent about Rs 3.5 crores as of 9 months of the year which is roughly about 70% of our whole year allocation. We have covered the areas of health and child education primarily and the total number of lives we have touched towards health and child education programs are about 15,000 people.

In terms of key business metrics – the currency contribution as well as geographic contribution has shifted towards America more to do with what happened with the Euro and GBP because these figures are computed in INR terms. On the DSO front, we have a significant drop in this quarter at about 70 days compared to 82 days that we had in Q2 FY15. Just to remind you, this number also includes now unbilled revenue. In terms of clients billed, the total number of clients still remained at 74, same as last quarter whereas the top 5 contribution has dropped to probably the lowest we have ever had at about 66%. The new clients added in this quarter were 7. The staff utilization has notched up in a very minor way at about 65% now compared to 64% last quarter. In terms of client buckets which we have started disclosing from last quarter, we had one new addition in the 5 million plus bucket whereas total number of clients which are above half million has increased from 18 to 20 now.

Slide #8 gives the trend of Y-o-Y revenue growth in dollar terms for our top 5 versus emerging clients. The emerging clients have grown to contribute \$13.2 million in Q3 FY15 revenue which is about 42% Y-o-Y growth on emerging base whereas our top 5 clients which have remained flattish for last few quarters has seen a modest decline of -3% this time. A large portion of that decline is also due to the fact that one of those top 5 clients is denominated in Euro currency.

In terms of people, we have 7,751 people as at quarter end as delivery resources. This is about 300 people addition since last quarter. Our onsite headcount has remained roughly at 90 similar to last quarter's number. On attrition front, this is the third sequential quarter where we are having a Y-o-Y decline. So overall number for this quarter was 29%. Thank you and over to you for Q&A.

Moderator:

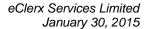
Thank you sir. We will now begin the question and answer session. The first question is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja:

Just a question with regards to your outlook in terms of business from the three segments and if you could also talk about how some of your top clients are indicating to you in terms of business over the next few quarters?

Anjan Malik:

So there are some of the things that we have been talking about in the past which have continued which is vendor consolidation on one hand and our buyers being again more and





more thoughtful and how they approach the market for services. The BFSI sector obviously is undergoing a tremendous amount of change, you said right. So there is a secular decline in revenues on our customer side as you have probably seen and there is a large change in business model. So we continue to see that there is a lot of demand but it is of a shorter term nature. So although we have grown in that business and we had a lot of growth in that business, a lot of it has been offset by effective rolling off of existing programs or short-term programs. So we are seeing more volatility and churn in that business, but we continue to see demand and is mostly being driven by projects and large infrastructure spends and sort of business analyst work associated with the large infrastructure spend. In the digital business, again demographic demand continues but as more and more businesses continued, we are seeing a lot of re-platforming work but again that demand does not drive a lot of manual activity which is the reason why people want to re-platform. So although we had a lot of bumps in taking over these large re-platforming initiatives where the projects are beginning at the end of it tend to be smaller in size but underlying demand continues to be strong. In the cable-telecom business, obviously that business has been our strongest performer this year again and that is partly a function of the fact that industry is sort of new to keep you work, right. So I think they have been first movers in the call center world but not as much in the kind of services that we provide. I think we are catching the early part of that move on those services. So I think demand in the cable business has been strongest to and that is also the area where we have had the least attrition in terms of business. So I think that is broadly what we are saying.

Manik Taneja: Just trying to understand your plan to increase capacity in Pune, if you could give us sense on

what kind of capacity addition are we looking at in from our Pune facility?

**Rohitash Gupta:** So this will be a very small in size, roughly around 350 to 400 seats.

Manik Taneja: And when do we expect this to get functional?

**Rohitash Gupta:** This will be functional only towards start of Q2 FY16.

Manik Taneja: And if you could give us some sense on what would be the mix of the three businesses

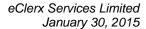
currently and how do you see margins more over medium term ahead?

**P.D. Mundhra:** So I think the mix would be now - Cable would be just over 20% of our mix, somewhere

between 20% - 21% and the balance 80% would be more or less evenly split with financial services being slightly larger, so may be 41:39 or 42:38 kind of split. In terms of margins going forward, I think it will continue to be a function of the split. So obviously we have seen some decline in our margins as the cable business has become a larger proportion of overall firm revenue growing from 12% - 13% now to the 20 odd percent that it is but we continue to think that we can keep margins around the 30% level. That is the expectation, give or take a

little bit.

**Manik Taneja:** Sure and any progress on inorganic initiatives?





P.D. Mundhra:

Yes Manik, in the sense that we keep seeing a lot of deal flow. As always we remain in active discussions with potential companies at different stages in that pipeline but until there is something definitive to share, there is really nothing more I can say at this stage.

**Moderator:** 

Thank you. The next question is from the line of Madhu Babu from HDFC Securities. Please go ahead.

Madhu Babu:

Sir currently in our tail accounts, what is the kind of deal sizes you are doing and how can we contain attrition in those accounts?

Anjan Malik:

So I think there is no secret that our top 5 represents something in the region of two-thirds of our revenues. So I think it is easy to figure out what the average size of our remaining 70 odd customers is. So that gives you some sense of the size of these relationships. I think the scene that we highlighted in the last few quarterly calls which was of productization and service specialization has continued. So we are trying to be much more, what I would call, vertically integrated in the services that we are providing from everywhere from onshore consulting, onshore engagement to project work, to BPO in those areas and what we are finding is that in the areas that we are investing it in that way is where we are winning both in our co-customers and also in our new and emerging customers. So in brief, our strategy for increasing the size of those relationships is to focus much more in these, what I would call, large productized buckets.

Madhu Babu:

In the platforms in the financial services, are we seeing any revenue leakage because of all this automation in platforms?

Anjan Malik:

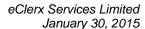
No, I think we are not seeing. So I think revenue leakage, I am not sure what do you mean? We are definitely seeing consolidation of demand, so you are right. We are seeing a lot of deals that happened in the industry today where customers are looking to effectively get rid of back office to prevent this, who are willing to take on effective technology platforms and manage them. So we are in discussions and some of those discussions were effectively providing a solution which is platform like and in some cases very effectively partnering with a platform provider to provide a combined service. So at the moment we have not seen work being taken away, it is usually being replaced to do something else in those areas but it is too early to say but certainly there is a lot of activity right now given a lot of the banks are looking to shed large amounts of costs and of course the easiest thing for them to do is to have do effectively what looks like sale leaseback agreements but I think that is an area that we have to watch carefully.

Madhu Babu:

Sir lastly just on the margins, I think this is the third quarter where you are seeing a downtrend and missing our expectations. So can we say that going forward also margins we have to start looking just at a lower level compared to our historic levels?

P.D. Mundhra:

It depends what you are comparing again. So you are right. I think if we say our historic margins have been in the low to mid 30s as for operating margins, I think as we go forward a





level of give or take 30% is a more reasonable expectation because there is a higher proportion of the cable business that we have in our books and also I think it would be wise to remember that these operating margins are after providing for amortization of goodwill which also has an effect of more than 1% point on that. But give or take, I think yes if the past was 33% - 35%, future looks closer to 30%.

**Moderator:** 

Thank you. The next question is from the line of Utsav Mehta from Ambit Capital. Please go ahead.

Utsav Mehta:

My first question is more specific to do with the financial services segment. We have been reading a lot about OTC derivatives and continuing automation over there plus regulatory issues means that they are moving towards exchanges, is there any specific impact of this trend on your business?

Anjan Malik:

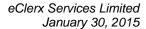
Well, I think there is. So we are probably one of the largest processors of, what I would call, non-cleared derivatives on the street today. So clearly any kind of activity which will lead to a complete reduction in non-cleared derivatives or very large regulatory capital charges that make the full stop trading those activities, those kind of transactions will obviously have an impact on the book of business that we have. Having said that, two things, one is we are not necessarily seeing the volume decline that we would have expected in fact in many cases where I am just seeing a volume increase. Secondly, we are seeing an increase in complexity of the services that are being provided which is actually leading to an uptake off in terms of the number and the sizes what they are providing. And I said there were only two things, this is the third thing, we are seeing a lot of demand for change type work which is what I was alluding to. So there is a lot of project work and project initiatives which are about moving businesses to these new areas. So in this case it would be for example work moving from let us say derivative conformations looking of margin and collateral which is the next big initiative for the bank as they look at managing liquidity or they move from OTC to clear and OTC cleared activities, working with people like DTCC who are the central hub for cleared activity today. So we are finding that a lot of the demand is shifting to these new areas and new books because what people are looking for ultimately is domain expertise across that whole operations and operation change area. So we are seeing a shift in demand as opposed to reduction in demand.

**Utsav Mehta:** 

Okay and when you say shift in demand, it means that these are comparable volumes or would volumes be lower in these new segments?

Anjan Malik:

Well, remember I think we talked about this in the past that ultimately while there is a correlation, there is some correlation between revenue and volume from our customers. A lot of the work that we do in digital and in financial services driven by complexity and the path of the value chain that we own, so even though in some cases volumes change, the work is driven more by the complexity and the path of the supply chain of the services that you provide today. So actually in many instances, volumes are going to the roof, right. So for example, when stuff moves from OTC to cleared, you would expect volumes to go up 10x because there is not





much restriction, so work reduces, but you may take on larger parts of the supply chain that we did not do before.

**Utsav Mehta:** 

Okay, that is one and the second one is a bit more on to the margins question. There has been an increase in sales and marketing expenses if I am not mistaken in the quarter. Could you just elaborate as to, I mean any initiatives specifically that you are taking in terms of boosting sales or increasing deal wins etc.?

Anjan Malik:

So I think P. D. maybe you can take the question on margins and maybe I can talk about the sales.

P.D. Mundhra:

Sorry, can you repeat the question on margin?

Utsav Mehta:

Yes. My question on margins was more to do with the sales and marketing. This is another quarter where we have seen an increase in sales and marketing expenses, so just wanted to know what this increased expenditure is going towards?

**Rohitash Gupta:** 

So if you look at only sequentially, yes there has been an increase even in percentage terms as well as absolute terms and I think there has been a slight increase in all three major components of sales and marketing expenditure. One is the onshore salary cost which is towards the staff that we have for business development purpose; second is for the bonus and commission payouts that has also increased sequentially and third is towards travel which sequentially has increased but to be honest on travel, I think it is on the average of what we had in H1 FY15.

**Utsav Mehta:** 

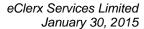
Okay and the second part of the question more towards the initiatives on sales and marketing?

Anjan Malik:

I think, yes. So there it is a continuation of I think the messaging that I passed on to the gentleman who had asked this question earlier about how we increased deal size? So I think there are two initiatives, one is what we sell which is addressed by productization. As I mentioned before, we will focus much more on looking at areas of our business where there is natural resonance and we feel we have a USP. And in those areas, we are investing in people, technology and process improvement and training and knowledge development. So in those areas we are winning and we are winning bigger deals. So that is one thing. The second part of it is augmenting the salesforce not in number but in type and I think this is going to focus our shift towards more senior, more networked individuals. So I think that is a more gradual change that we might see the profile of our staff change over the next year or so but not necessarily the number. So I think it is a combination of both increased networking and a more resonant and well defined set of products.

**Moderator:** 

Thank you. The next question is from the line of Karan Uppal from Equirus Securities. Please go ahead.





**Karan Uppal:** My question is specifically for the new SEZ in Pune. So is that for the cable seat and the hiring

which is done for this quarter, is that primarily for the cable business?

Rohitash Gupta: The second part is largely correct. Yes, cable business has contributed for the most of the

headcount addition. On your first question of Pune SEZ, our Pune footprint is primarily for our

two native businesses. So that is not related to the cable work.

Karan Uppal: Okay and the next question is in the constant currency terms, how has been the growth of the

top 5 clients?

P.D. Mundhra: In constant currency terms, I think top 5 would be close to flat quarter-on-quarter because the

3% decline that you see, almost all of that is attributable to Euro depreciation. We have not done that maths specifically so it is not an authoritative answer but the feeling is it will be

more or less flat.

**Karan Uppal:** Okay and just one more if I could squeeze. So we have had a quite some time since the top 5

clients have remained muted while the non-top 5 have grown. So how much more time before one of the non-top 5 replaces the stagnant top 5 names or is it that even the best non-top 5

clients is quite small in size?

**P.D. Mundhra:** That is a hard question to answer but I think there is a possibility that basically you are asking

is when the number 6 becomes number 5, correct?

Karan Uppal: Yes, correct.

**P.D. Mundhra:** So I think that there is some possibility of that happening maybe in the next 12 months.

Moderator: Thank you. The next question is from the line of Nitish Chawla from Banyan Capital. Please

go ahead.

Nitish Chawla: As Anjan was saying earlier that you are focusing more on the onshore opportunity like

consulting type of project, so any chances of opening an onshore center?

Anjan Malik: We have had lot of discussions with clients. At the moment, we are looking at different options

but more likely it is going to be something that is going to be a client location seed as opposed to a new onshore center by itself because it is impossible to figure out exactly where the client demand because the client demand is very footloose. It is across different geographies because

in many instances, you have to provide global support. So on shore center not yet.

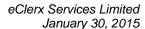
Nitish Chawla: Okay and secondly the geographic concentration which have moved 78% for North America,

so what is the reason for that? Is it just the Euro depreciation or something else also?

PD Mundhra: So I think as Rohitash mentioned the way these numbers are computed is by taking our

revenues in Rupees and I think what proportion is coming from America and Europe

respectively, so just given the sharp depreciation of the Euro against the Rupee, the Euro





contribution has come down. So I do not think fundamentally anything has changed too much in terms of where our buyers or services are located but it is just a currency movement.

Nitish Chawla:

And if I see this 5 million plus clients, it has increased from 6 to 7, so just wanted to understand what this client and in which business it is in? Like the earlier participant also asked, when can we see one of these next two clients becoming one of the top 5 clients?

P.D. Mundhra:

So the latest addition on that list is a client from the cable side of the house, probably does not come as a surprise given the color we shared about growth coming from that business. And as I said earlier, I think sometime in the next 12 months you could see some shuffling in the constitution of the top 5 and the next 2.

**Moderator:** 

Thank you. The next question is from the line of Hardik Thakker from AirTight Networks. Please go ahead.

Hardik Thakker:

I was looking at the attrition rates for India and they seem to be quite high and more than the industry standards, I wanted to know what are we doing to reduce the attrition rates?

P.D. Mundhra:

I think it depends what comparison you are using because our attrition rate was certainly higher than the IT companies, but if you compare to the many other parts of the BPO industry including call centers our rates are in line with that. So I think a more appropriate comparison might be to look at our own attrition rates have trended over time and what you will find is in FY15, our attrition rates have actually come down in comparison to FY14 whereas from what we have been seeing from other industry participants, attrition rates this year are actually higher. So we actually feel that this year we have been able to reduce attrition a little bit by 2% or 3% points and I think it is partly attributable to a variety of HR initiatives we have taken over the course of the year. Having said that, I think we are comfortable with attrition rates at the level that they are, because more important than the headline rate is the composition of who is leaving and as long as we are able to retain the majority of our subject matter experts and senior management talent, we think that service quality will not suffer.

**Moderator:** 

Thank you. We have a follow on question from the line of Utsav Mehta from Ambit Capital. Please go ahead.

**Utsav Mehta:** 

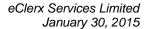
I think this is more for Rohitash. The G&A expenses this quarter, there has been an increase like you said in rent. So I am guessing this is because of duplication of cost due to the expansion in centers?

**Rohitash Gupta:** 

Yes, mostly that.

**Utsav Mehta:** 

So how long will this continue, any sense on what the G&A spends over the next 3 to 4 quarters would be like?





**Rohitash Gupta:** So the number in percentage terms has varied between 12% - 14% and even this quarter that is

very close to 14%. So we are expect it to stabilize around that range itself. Most of our facility additions and thereby some of the G&A elements which get impacted by facility additions

should be largely over by Q2 of next year.

Utsav Mehta: Okay and just one last question on the amortization of goodwill bit. I am sorry, I am not aware

but how long is this amortization costs going to last?

**Rohitash Gupta:** This is supposed to be on a 10-year schedule. So we have already completed about 2 years.

**Utsav Mehta:** And this is I am guessing it will be even across all quarters?

Rohitash Gupta: Yes, it is even about Rs 3 crores a quarter or so. It will remain at that level. It gets fluctuated a

little bit by currency movements because this goodwill is sitting in other entity but largely yes

Rs 3 crores.

Moderator: Thank you. The next question is from the line of Hussain Kagzi from Prabhudas Lilladher.

Please go ahead.

Hussain Kagzi: I just wanted your views on how do you see FY16 growth rate panning out and any comments

on the next quarter growth rate and where do we see ourselves by FY16 end?

P.D. Mundhra: So I think it is hard to comment honestly on next quarter but for FY16, I would say

environment look similar to FY15. So this year, our year-over-year growth rates are currently about 10% - 11% in dollar terms. So I would say next year also probably something similar, somewhere between 10% - 15% year-over-year dollar growth would be what we can see at this

point.

Moderator: Thank you. As there are no further questions, I now hand the floor back to Mr. P.D. Mundhra.

Over to you.

P.D. Mundhra: Just to thank you to all participants for joining the call. I know it is a busy day as we fix the

same day for our board meeting as many other companies. So thank you for joining the call.

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

conference. Thank you for joining us. You may now disconnect your lines.