"eClerx Services Limited Q3 FY18 Earnings Conference Call"

January 30, 2018





MANAGEMENT: Mr. PD MUNDHRA - EXECUTIVE DIRECTOR, ECLERX

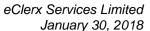
SERVICES LIMITED

MR. ANJAN MALIK - DIRECTOR, ECLERX SERVICES

LIMITED

MR. ROHITASH GUPTA - CHIEF FINANCIAL OFFICER,

ECLERX SERVICES LIMITED





Moderator:

Ladies and gentlemen, good day and welcome to the eClerx Services Limited Q3 FY'18 Earnings Conference Call. 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 entering '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Rohitash Gupta. Thank you and over to you, sir.

Rohitash Gupta:

Thank you for joining eClerx's earnings call for the Third fiscal quarter of FY18.

We saw Q3 Dollar revenues increasing sequentially by 1.2% in USD and 1.1% in CC terms with Q3 USD revenues coming at 48.9mln, which is our highest reported revenue in last 5 qtrs. We have made substantial progress across our four strategic initiatives during Q3 as well as in YTD. (1) Our Onshore revenues have increased by more than 50% YoY in Q3. Consulting, major portion of which is onshore has grown 2.5 times over same period. Our Fayetteville center has now started generating revenues at US billing rates. (2) Analytics business, after lower growth for last few quarters has grown significantly YoY in Q3. (3) We have made substantial progress in Managed services deals with revenue from such deals increasing by 26% YoY in Q3. Further, more than one third of new deals sold this YTD have been managed services deals. (4) IT or advanced automation services revenue has grown by more than 50% YoY out of which RPA revenues have doubled every qtr this year.

We have announced a Share Buyback of 2580 INR mm at price of INR 2000 and is now subject to regulatory approval and is expected to close by March end. We have now also recognized incentives under Software Exports from India scheme of INR 65 mm for 9 months of this year in Q3 under INR Operating revenue, while the similar incentives amounting to INR 204 million for prior years were accounted as exceptional item in Q2. So including SEIS incentives in Q3, the INR Operating revenue grew sequentially by 3%.

On the margin front, our Operating margins came down by 230 bps sequentially. The main reason for decline over last few qtrs is sharp change in business mix towards onshore, consulting, managed services and Robotics. So while the offshore BPO revenue has declined lately due to roll off of legacy offshore business, growth in onshore, consulting and Advanced automation revenues have more than made up for the decline. We now expect that redeployment of excess staff resulting from client roll offs during H1 will be completed by March. Similarly, our project for setting up 3rd Offshore site for Customer Operations will complete soon. Although some of our YTD investments in Fayetteville staff will accrue revenue in Q4, but we anticipate that investments towards future ramp up of the center will continue to precede the corresponding revenues. All these mix changes and trends have contributed to 60 bps of OPM decline. Secondly, we have done substantial investment in Business development team this quarter to promote onshore consulting sales, which was the single largest reason of OPM decline in Q3. Further, legal and professional fee has impacted OPM by 70 bps because of Twofour asset purchase, recruitment fee for new senior talent and SEIS incentive related fee. We expect that majority of Buyback costs in Q4 will be adjusted against retained earnings and not affect G&A further.



So while we have achieved reversal of declining revenue trajectory in Q3, we hope that both USD revenues and OPM pool will grow sequentially from Q4, which will put us in better position for FY19.

Similar to trend seen in last 5 quarters, our pipeline has continued to grow on YoY basis and at the end of Q3 the high probability pipeline size was 2.5 times that of corresponding number at Q3 end of last year. The largest share of current pipeline is from Financial markets, closely followed by Digital and followed by Customer operations. At a service line level, campaign operations in Digital and regulatory services in Financial Markets have shown highest \$ YoY revenue growth in Q3. Entry deal sizes for new logos have more than tripled in Q3 on YoY basis due to onshore delivery and consulting lead sales focus. On pricing, although pricing for offshore FTE business has remained flat over last few qtrs, however managed services deals tend to have lower equivalent pricing in earlier years the share of which has been increasing.

During Q3, we expanded revenue footprint on YoY basis with six out of our current top 10 clients. We added 4 new client logos in F500 league this quarter with 2 being in Markets and 2 in Digital.

PBT declined from INR 1179 mm in Q2 to INR 784 mm in Q3. Three almost equal contributors for this decline are (1) SEIS incentive delta of ~INR 140mm, (2) Other income decline of ~134mm due to INR appreciation and (3) reasons attributable to OPM decline explained earlier. Our PAT in Q3 has declined slightly more than PBT to INR 575mm, as effective tax rate for YTD has moved towards previously guided FY range of 24% with Q3 coming at more than 28%. We do not expect US tax rate changes to have any material impact this year. Our forward hedge book remained constant at \$142 mm was at 2.9 times the quarterly revenue. The average strike rate of these hedges is 69.3 rs/\$ which has further worsened by 0.7 INR to a \$ since Q2 due to unfavorable movement in spot and due to continued slide in forward premiums. Based on hedges booked till now, we expect that ~31 mm worth of inflows will convert into operating revenues at 70 rs / \$ during Q4.

We had about 7.8 billion INR of cash and cash equivalent at the end. Our YTD Net operating cash flow stood at 2.32 billion INR and has decreased by INR 150 million YoY. The EBITDA to Net OCF conversion rate has increased from 65% to 70% in YTD on YoY basis.

While we have booked lower capex of around 54 million INR in Q3, we expect Q4 to be higher depending upon ramp up plan of Fayetteville facility.

Our USD and North American concentration have remained largely unchanged at 83% and 65% respectively. The DSO has remained constant at 81 days in Q3. Our staff utilization based on direct production staff including trainees in Q3 further dropped to 72.9% due to decline in offshore BPO revenue creating excess staff. The utilization is likely to improve to the extent of future BPO revenue growth resulting in redeployment of excess staff.





The client counts in all revenue buckets have remained largely same as in Q2 but for one new entry of 0.5mm Financial Markets client and downward movement of one digital client within the buckets. While the YoY growth of top 10 strategic client continue to show YoY degrowth primarily due to the loss of a key client in H1, we have been able to grow our emerging target clients consistently in double digits. Further, substantial portion of this emerging growth is due to existing client mining.

The company employee strength has decreased marginally by 130 employees during the quarter to be at 9,091 and we expect it to decline further in Q4 on constant offshore BPO revenue basis. Our sales and Business Development staff count has increased by 3 to be at 85 now, with additions across the 3 verticals. Our attrition has marginally increased to 38% in Q3, which is likely to move to stable levels once the staff redeployment completes.

With this, I will hand over the call back for Q&A.

Moderator: Thank you. Ladies and gentlemen, we will now begin the "Question-and-Answer Session." We

will take the first question from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: My first question is on the top-five accounts. What is your outlook there, I mean, how do you see

that portfolio?

P.D. Mundhra: Hi! This is PD. I think as we discussed even in the last earnings call, the headwinds on the top-five

hopefully are largely behind us because sort of the large roll-off that we had visibility into have now been completed, so from that perspective, I think as we go ahead on QoQ basis we would

expect the top-five to be stable and perhaps grow a little bit.

Apurva Prasad: Also, the margins if you can talk about how should we see that from slightly medium term

perceptive considering the investments that we are making Onsite?

P.D. Mundhra: If you look at where we have been this year, it has been about 25% operating margin on an average

will be business mix. So obviously it is no secret that the Offshore BPO work will typically be higher margin than Onshore work or some of the Managed Services work at least initially. Secondly, I think the other big factor is the exchange rate. So the margin levels that we are at today are also partly a function of the rupee having appreciated against the dollar over the last two to three years period. As the management team, as we shared in prior calls, our intention is to grow the absolute OPM pool as opposed to focusing on the percentage margin. Clearly, where we are this quarter, we think it is a trough, and hopefully from here onwards in terms of absolute OPM

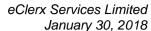
rupees or dollars it should increase starting Q4. But in terms of a percentage range, where we are

over the nine months period. There will be two things that drive the margin performance - One

25%, where that goes in future will be more a function of business mix.

Moderator: Thank you. We will take the next question from the line of Vishal Desai from Axis Capital. Please

go ahead.



Vishal Desai:

P.D., just if you could help me in terms of understanding what is the outlook between our three segments and possibly if you could give us a rough breakup in terms of what it is currently versus a year back? Second, a follow up question is again on margins in terms of what the levers are going forward from here on?

P.D. Mundhra:

In response to your first question, I think overall the mix has not changed that much because while growth rates have been a little variable, it is not enough to really change the broad revenue mix across the three businesses. So as we shared in the past, that mix is approximately 40:40:20 and it stays around that level, maybe a percentage point up or down, but that sort of the broad mix of the three businesses. In response to your other question of margin levers, I would say the biggest one that is in our hand is business mix. Obviously, exchange rates are another big lever but that is something we have any influence over. The third lever is obviously utilization also. So again this quarter if you look at the utilization numbers on the metric slide, it was somewhat low. So hopefully as the utilization also improve it will reduce cost of delivering sales and therefore improve margins. I think those would be the two or three main levers of which exchange rate is out of our hand.

Vishal Desai:

More from a vertical perspective I was trying to get some color in terms of what kind of demand environment are you seeing amongst the three verticals of financial discipline and so on?

P.D. Mundhra:

Anjan, do you want to respond to that?

Anjan Malik:

Demand is stronger than we have seen over the last few years. So to the point that Rohitash is making, we feel more confident in the medium-term that there is an uptick. Part of it is sort of made it from our customers budgets, part of it also comes from the changing of business mix that we are now offering to our customers which is much more a combination of Technology, Consulting, Analytics and Business Services as opposed to BPO.

Vishal Desai:

Within the Digital space and Financial Services space, if you could break out in terms of where demand is coming from?

Anjan Malik:

I can talk very quickly about the markets; as Rohitash alluded to demand is coming from front office as in the business side and also from regulatory and compliance. I guess on the digital it will be the marketing organizations right, PD.

P.D. Mundhra:

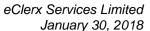
I would say two areas where we continue to see good demand -- one is around creative asset production and the second area is all kinds of Marketing Analytics including Digital Analytics.

Moderator:

Thank you. We will take the next question from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal:

P.D., just to stretch a little bit on the demand environment question once again and also on the margin which you said. So I clearly remember you have been highlighting that your focus is on the absolute operating profit and not on the margin so much. So what I wanted to understand is that can we reasonably assume that the bottom of the absolute profit is close by or it is almost behind...





and I understand you already answered this question sometime back, but just wanted to understand what gives you this confidence, is it because the margins have fallen and your onshore has gone up significantly or you have some other levers which you think will play out going forward? Question #2 which Anjan and you can probably jointly reply is, on the demand side what are the fundamental changes when you say that demand is looking better. Is it you have spoken about the client budgets or you are seeing some kind of traction on a particular stream of days which are coming or what is giving you that confidence to say that the demand environment is better than what it was last year at the same time?

P.D. Mundhra:

Let me take the first question and I will ask Anjan to respond to the second. As Rohitash said in his opening remarks, we had almost Rs.40 crores dip in pretax profit QoQ. Of that Rs.40 crores, two-thirds were due to factors beyond our control, one being quarter ending exchange rates adjustment, one was the SEIS recognition. Saying that obviously hopefully will not repeat again in the next quarter. From a purely operating performance standpoint, you already shared that in Q4 we should continue to see some uptick in dollar revenue, #1; #2 I think we should see some uptick in utilization compared to where we were this quarter. So combining both of those things, it would lead me to believe that we should start seeing some growth in absolute OPM on QoQ basis in Q4 and that is the basis behind my statement. On the demand environment, I will hand it over to Anjan perhaps who can talk a little bit about why we feel better on that front.

Anjan Malik:

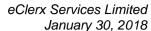
I will start where again on the point that I was making earlier; we are certainly seeing more combined budgets from our customers, by that I mean, so while customers may now be looking for pure play offshore opportunity, I think they are looking for vendors who can solve business problems by using combinations of Artificial Intelligence, Robotics, Business Consulting and Offshoring, where we do combination of onshore and offshore. I think what PD was referring to earlier as Managed Service I think so was Rohitash. So for those kinds of opportunities, we are seeing some sort of consolidation phase where for example what has been done in a particular way, a lot of it being done offshore, some of it being done in low cost centers, some of it being done in high cost centers and customers are looking for ways to run them much more efficiently and in a much more holistic manner where you are not just looking to get offshore arbitrage but you are looking to automate away some things and reengineer some parts and maybe some parts of the offshore. So we have seen a number of those opportunities come up for the last six months, that give us confidence that it is a combination of increasing customer demand and also for a particular type of solution offering, that we are now increasing providing the combination of those two we are seeing more uptick from.

Moderator:

Thank you. We will take the next question from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra:

Maybe a question for Rohitash. Given that you are transitioning now to a more of traditional onsite/offshore model, are you considering maybe sharing a bit more metrics to understand us in a bit more detail going forward, may not be for this year but maybe for next year onwards?



Rohitash Gupta:

Ankur, if you recollect we have provided a little more breakup at least on the headcount side which gives the traction on the onshore delivery guys and that I think will be the key metric as far as our Fayetteville center is concerned because most of the growth in future at least in onshore delivery is likely to come from that center. So that growth you can track from there. In terms of financials, frankly, we have not thought about it. We will be review our disclosures at the start of next year, but take your point.

Ankur Rudra:

In terms of the top 10-20 big customers and top-10 within emerging, I am not taking the entire emerging clients, do you feel a bit more confident about where the spending is going, I am not talking about margins but overall basis do you feel that there is a bit more visibility the kind of lack of clarity you had before is most of that behind you?

Rohitash Gupta:

On the emerging front, as I said, most of the growth that you are seeing in that slide is actually coming from mining of existing clients and most notably from that top few of the emerging clients actually. So we feel that trend may continue. Obviously, the logos may change because we have many more logos, many more industries, which can be mined, and the work is in progress. So most mining-led growth will come in emerging, that is our hope. Coming to top-10 which are the largest clients, there I think as PD mentioned, one of the biggest downward movement factor has been the roll-off in some of those accounts. That, we think, we do not have any further news of those event happening which means that the natural growth will take over. It has been happening in almost seven of the top-10 accounts for the last few quarters as I also mentioned in last quarter call. So we are very hopeful that as long as the downward factors are arrested, the natural slow growth will return in the top-10 as well.

Moderator:

Thank you. We will take the next question from the line of Soumitra Chatterjee from Spark Capital. Please go ahead.

Soumitra Chatterjee:

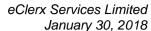
Whether you are targeting the absolute operating margin percentage or absolute profit in dollar terms because if your business is shifting towards more onsite, then the margin improvement or the levers that you currently have, will there be enough to offset this impact on the onsite mix changing?

Rohitash Gupta:

Soumitra, thank you for the question. We are focusing on the absolute number for example this quarter was about Rs.78 crores or thereabout. To your question about the onshore mix and its impact on that metric, what we are looking at least in this YTD is the buildup of our Fayetteville center, training of resources and all those things. As I mentioned, the revenue from that center will start only in Q4 as we speak. I think that will lead to some growth because it will not be only cost, but there will be some revenue offsetting that cost as well at least in Q4. So we are very hopeful that Rs.78 crores number has to grow in absolute sense because of multiple factors both in Q4 as well as onwards.

Moderator:

Thank you. We will take the next question from the line of V. P Rajesh from Banyan Capital. Please go ahead.



V.P. Rajesh:

Rohitash, looking at your selling and distribution cost this quarter, it has gone up by about Rs. 5 crores and if I heard you correctly, you only added three new people in the BD side, so that is not quite a higher number. So could you just give more color on that?

Rohitash Gupta:

Actually the number is five. The reported number is three as you correctly pointed out, but the number is five for the purpose of cost, simply because we inherited some of the BD staff from TwoFour Consulting as of 30th September. So those few numbers were already in the 82 numbers of the last quarter. So the full cost is actually of five, six resources including some very senior one, that is point #1. Point #2, there was a little increase in travel as well this quarter due to seasonality factor. Thirdly, as we are trying to build different model of Consulting and Onshore, there are a few other types of contracted resources required to support that organization, that also add to the BD cost, although they do not show up in the count because count is only for the full time employees.

V.P. Rajesh:

So should one assume that you will be at this kind of run rate for the foreseeable future or is it going to go up even from here?

Rohitash Gupta:

It will depend on the mix as we said but at the current mix of onshore revenues I think this is sufficient in near-term. The absolute number of BD cost we do not see any significant increase unless the mix further changes dramatically for onshore.

V.P. Rajesh:

The second question is on your attrition rate on Page #9. This year it seems to be significantly higher than what it has been historically and obviously your employee cost also coming down. So could you comment on that as well?

Rohitash Gupta:

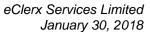
Attrition has been at the elevated level actually for quite some time now and one of the reasons is that we had the significant roll offs for large three clients over last 18-20-months and that created some bit of excess at the point of roll-off, which obviously we tried to redeploy but subject to shift and skills and other things matching. Due to that some people attrited more of those who cannot find redeployment within reasonable period of time given the demand in other companies. So I would say that attrition number is not in a very stable state what you have seen in the last few quarters including Q3 and we hope that after Q4, we can call it a steady attrition whatever it is.

V.P. Rajesh:

And then on the staff utilization, what PD was earlier commenting that the idea is to take it higher. So now you could have the two ways by reducing the number of employees just because the project has rolled off or you could have used as if there is a bench deployed on those projects. So currently in this quarter it was 73%, what do you expect it to be in Q4 or next year and what will be the driver of that given the numerator and denominator that I just talked about?

Rohitash Gupta:

It will depend on the execution and what we are able to achieve but I can give you a theoretic answer that with the current business mix and the current volume of work offshore, this number can theoretically go up to 75%, but obviously the journey from 73% to 75% will depend on what we are able to practically achieve during next few quarters.





Moderator: Thank you. As there are no further questions, I would like to hand the floor back to the management

for closing comments. Please go ahead sir.

Rohitash Gupta: Thank you very much everyone for participating in this quarter's call. Look forward to talking to

you next quarter.

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

this conference call. Thank you for joining us and you may now disconnect your lines.