"eClerx Services Limited Q3 FY20 Earnings Conference Call"

January 30, 2020





MANAGEMENT: MR. PD MUNDHRA – COFOUNDER AND EXECUTIVE

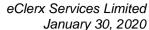
DIRECTOR, ECLERX SERVICES LIMITED

MR. ANJAN MALIK - COFOUNDER AND DIRECTOR,

ECLERX SERVICES LIMITED

MR. ROHITASH GUPTA - CHIEF FINANCIAL OFFICER,

ECLERX SERVICES LIMITED





Moderator:

Good day ladies and gentlemen and welcome to the Q3 FY20 earnings conference call of eClerx Services Limited. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touch-tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Rohitash Gupta – Chief Financial Officer, eClerx Services Limited. Thank you and over to you, Mr. Gupta.

Rohitash Gupta:

Thank you Margreth. Good evening! I welcome you all to eClerx earning call for the third fiscal quarter of FY20 ending December 2019.

eClerx completed Q3 with US\$ 51.8 million in revenue at constant currency growth of about 3% both on sequential as well as on YoY basis. Our onshore business grew strongly at 15.8% constant currency YoY whereas offshore business dipped marginally by 0.1% YoY and that was despite the uptick in FTE pricing during the year.

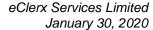
Analytics and managed services have maintained double-digit growth on year-over-year basis. The offshore roll off continued in line with the past trends; however, they were concentrated towards the calendar year end resulting in better Q3 growth but also posing additional pressure on Q4 revenues.

Further, we were benefited in Q3 with short-term demand for holiday season in our CLX business and also certain large milestone approvals in our fixed-price contracts. Growth in managed services was supported by recovery in volumes in Q3 against a rather subdued level of transaction volume in Q2. We are seeing some delay in ramp up of projects that were previously won and awaiting outcomes on several RFPs that we participated over the last 6 months. Overall, we expect Q4 to be very soft quarter of this year. Lastly, we do not have any adverse news as yet on SEIS front. So, we will reassess the certainty of FY20 SEIS during our FY results.

We made great progress on margin improvement this quarter. This was the result of relentless efforts on aligning our cost base to decreasing offshore work by leveraging RPA and machine learning to reduce bench in FTE business and to improve productivity in managed services projects, reduction in the discretionary travel, reduction in recruitment related costs due to lower attrition, favorable pricing and favorable hedges. Although some of these levers will sustain through the softer Q4, our margins will remain highly influenced by offshore revenue trend.

EBIT and PAT in Q3 stood at INR 971 million and INR 699 million respectively, which is the highest level in trailing 8 quarters. We expect our FY20 effective tax rate to be between 26% to 27%. We are very pleased with the all-round outcome of this quarter as our margin improvement initiatives are increasing profits and cash balances and attrition is showing early signs of moderation as we continue to put efforts to revive offshore growth in FY21 by focusing on our core strength areas.

With this, I will open up the call for questions & answers.



Moderator:

We will now begin the question & answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Sandip Agarwal from Edelweiss Securities. Please go ahead.

Sandip Agarwal:

Congratulations to the team for excellent execution and margin improvement. Rohitash, just wanted to know that on the margin front, we have done excellent progress in this quarter. How much more progress we can expect? I'm not asking for a guidance but the trajectory whether a sharp northward movement is still possible from here or we are like 60% to 70% done in that journey? Number two, on the growth front, is the worst growth almost behind us or we are still seeing some challenges? Again, here, the idea is not to get any number, but just trying to understand the trajectory.

Rohitash Gupta:

Sandip, I will take the first and ask PD to take the second one about growth. If you see in my comments also, a large portion of margin expansion in this quarter was contributed by the one off revenues that came in. Some portion of that expansion will continue to accrue to us. I think, generally, at flat revenues, we'll be better than probably where we were in Q2 and Q1, but Q3 performance repetition looks very - very difficult in near term.

P D Mundhra:

Sandip, on your question on outlook for growth, to be completely honest, I think we have had a strong Q3, but I wouldn't say that the environment has changed dramatically. I think we will continue to see some volatility in revenue. We will have some strong quarters up. We may have some softness in Q4. But the outlook is still the same, I would say. Nothing much has changed. Some of our quarters in the past were pretty bad. This one was relatively good. So, it's natural volatility.

Sandip Agarwal:

Thanks for clarification. My last question is on onsite utilization numbers, I'm assuming, they have gone up significantly. Is there still more scope for that improvement?

P D Mundhra:

Sandip, I am not sure exactly where you are drawing that inference from, but I will say that most parts of our onshore business were already margin accretive. The one area where we had some challenges from a financial perspective was our center in Fayetteville. And it's true that with increasing utilization of that center, we've been able to amortize the fixed costs a lot better. So, that center is now EBITDA positive for us and we hope that over the course of this year, it will become positive even at the EBIT and maybe net income level.

Moderator:

The next question is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja:

This question essentially is with regards to your opening remarks. You were suggesting that Q4 is expected to be soft. When I look at the past trends, Q4 typically tends to be much better than Q3. Any particular reason why you are suggesting that Q4 will be soft and does that imply that we could essentially be looking at sequential decline in revenues in Q4? And the second question, once again, to prod you a little bit further on margins. You said some of the one-time revenues that you have accrued in the current quarter could sustain with us. If you could delve deeper into that?



Rohitash Gupta:

Manik, the second question I will take first because I did not say about the revenue, I said some of the margins may sustain. A small portion of margin expansion may sustain through Q4 irrespective of the revenue, but a large portion of that expansion was revenue dependent. So, to the first question, if revenue were to be soft in Q4, that part of expansion will not be available to us in Q4. But it will still, hopefully, be better than where we were in Q1 and Q2. That was my comment. Sorry, what was your first question?

Manik Taneja:

My first question was around Q4 being soft. How should we be reading that given the fact that, historically, our Q4 is when we see some one-time projects. At least, that's what we have seen in the past?

Rohitash Gupta:

So, it is a mix of 3 - 4 factors which I alluded to in my comments. One is that it depends on when the roll-offs which were happening anyway in the quarter, actually end up happening. And luckily, they were at the year-end, which benefited us in this quarter. But that poses additional pressure on the Q4 because some unexpected roll-offs will further happen plus whatever ended in 31st December will also add up to that downfall. The second one was that there was some milestone approvals, etc., in fixed pricing contract that got bunched up in the quarter. And the third is CLX seasonality, which we were beneficiaries of and it comes time to time. You are right that in some times, it would have been in Q4. In some times, it would be in the holiday season. But this time, this year, we saw it in Q3. This is pertaining to CLX seasonality. So, these were the 3 factors and as you can imagine, many of these will not come in Q4 anymore.

Manik Taneja:

How should we be reading into your comments saying that some of the deals that we have won in the past, there is some delays in terms of those project starts? Is there some vertical, some segment specific? If you could talk a little bit about it?

Rohitash Gupta:

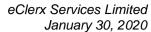
Yes. One specific example I can talk about which actually we talked about in 2 or 3 calls back. So, it was a large customer operation's new client, offshore business. And there were several phases of that ramp-up. The first phase, we ramped successfully, and it was running perfectly well in the H2, it started in September-October; however, the phase 2 ramp-up is likely getting delayed and is not as per our original plans. That is just one example, but my comment was more broad.

Manik Taneja:

How should we be reading into our employee headcount trends, given the fact that headcount essentially has been coming off on a quarter-to-quarter basis for the last several quarters now? When do we essentially see this trend reversing?

P D Mundhra:

I'm not sure, Manik. I'll tell you a couple of things that have happened. One is, as in the past, we have experienced roll-offs. It takes some time for the delivery headcount to adjust to that because basically you have to wait for attrition to run its course. Therefore, some of the reduction in headcount that you have seen is because of that. Other factors that are driving lower headcount is broadly automation, the effects of automating the lower end or lower skill set jobs. Therefore, what left tends to be the more complex, higher-end skill set type works which also typically





comes at higher revenue per FTE for the same revenue base. As you know, we've largely been flat in revenues for the last 2-3 years. For revenue base, you have fewer billed FTEs and fewer deployed FTEs because of the nature of work that you are doing. So, I think we'll see our headcount numbers increase systematically once we see that revenue growth also kicking in on a sustained basis. I think if you have small revenue growth of 1% or 2% a year, you may not see the headcount increase because that basically is just realization increase because of higher-end work. I mean if you have revenue increase of 8% to 10%, then, obviously, that can't all be just pricing.

Manik Taneja:

Sure. And if I can prod you a little bit further with regard to the Q4 outlook. When you essentially suggest that Q4 will be soft, are we suggesting that we could essentially see a sequential decline? Or growth may be soft?

P D Mundhra:

Manik, if I knew the exact answer to that, I would have told you. So yes, I still don't have that much visibility, but it could be either of those 2 outcomes.

Manik Taneja:

You have been talking about getting some price increases with your top customers. Are we done with that phase or some more tailwind from that effect to follow through?

Rohitash Gupta:

Manik, it's a continuous process because for some clients it happens in one quarter, for others subsequently. I would say a large portion of it is already done, but we are expecting 1 or 2 more to come in the next 3 to 6 months. But again, every year, there'll be some discussion on this, and results could be upwards or downwards, as you can imagine, right. In the current cycle, I think we are largely there.

Moderator:

 $The \ next \ question \ is \ from \ the \ line \ of \ V \ P \ Rajesh \ from \ Banyan \ Capital \ Advisors. \ Please \ go \ ahead.$

V P Rajesh:

With the cash building up on the balance sheet, could you comment on capital allocation side?

P D Mundhra:

As we have disclosed in the past, our general thought process around this is to endeavor to return at least 50% of net income back to shareholders every year, and I think that hasn't changed. Now, the mix of instruments we used to do that in terms of dividend, buybacks, etc., a lot of it also is a function of regulatory changes. Let's see how the tax legislation shapes up and then we can take a call as to what is the best mix of instruments to achieve that goal.

V P Rajesh:

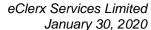
Relatedly, what are you seeing on the acquisition side? Are there any plans to buy business to augment one of the business lines or go in a different direction?

P D Mundhra:

I'll ask Anjan to respond to that question on what acquisition opportunities we are seeing and what the thought process around that is.

Anjan Malik:

We continue to be opportunistic around acquisitions. We continue to see assets being shown to us, as they have been for the last few years. And we investigate them until we can bring them to





some logical conclusion. So, at any given time and in any given quarter, we have quotations and the due diligence continuing and that's what's happening right now.

Moderator: The next question is from the line of Akshay Ramnani from Access Capital. Please go ahead.

Akshay Ramnani: I just have one question. You mentioned that our margin was supported by some one-off

revenues. If you can quantify what was the impact on margins by these one-off revenues and if they were not accrued in this quarter, what our margins would have been, a qualitative sense on

that?

Rohitash Gupta: I will probably be repeating myself because I can't be more specific, not because I don't want to

tell. It's just that we are also not as clear on what Q4 PAT will be, right? So, all I'm saying is that even if revenues remain flat at Q1 and Q2 level, our margins in Q4 should be better than what

we achieved in Q1 and Q2. That's all kind of direction I can give.

To your other question about quantification of one-off effects in the revenue in Q3; again, as I

largely said, the 3 factors I talked about, whether it was CLX or milestone-related things or delay in roll-offs, I would say that substantial portion of 3% sequential growth came from those 3

factors.

Akshay Ramnani: Again, were these one-off revenues in your top 10 clients because I see a strong growth there as

well?

Rohitash Gupta: There are 2 things. I don't know from where you are picking the data because the YoY growth

is actually still

Akshay Ramnani: I'm speaking about the QOQ number over here.

Rohitash Gupta: As I was talking about earlier, there has been price movement upwards. And as you can imagine,

this is largely in the top 10 clients, right? So, some of it could be that effect. But one-off project

which I talked about, was from our CLX business which is outside of top 10 typically.

Moderator: The next question is from the line of Ruchi Burde from Bank of Baroda Capital Markets. Please

go ahead.

Ruchi Burde: Rohitash, my question is regarding our North Carolina delivery center. Could you highlight what

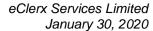
is the utilization that we are running today? And going ahead, what all factors would come into

play for margins or profitability there to improve?

Rohitash Gupta: I think we have to understand the utilization in the sense of its margin impact in two ways. One

is, how much of the facility is filled up, and the second is, what is the productivity of current team there. On the first, as we explained even last time, we are nearly 80% full on the single shift basis seat capacity. That's the similar position even in the Q3 end. On the second factor, I

think it's a little hard to say because you can't do people math simply because some of these





projects as well as costs are hourly, and they get matched more or less. So, I think the second factor is not very relevant or clear in terms of its margin impact. But yes, there is some bit of training cost, etc., which is there, but that's more of a function of attrition out there rather than utilization or skill set level.

Ruchi Burde:

So, I mean not near term but over the medium term, what would be your strategy to improve profitability at this on-site operation? Would it largely be based on change in the billing rates or do you see that there is some leeway? 80% utilization, so you still have some leeway. Or is there anything else that you think would matter over medium-term for the on-site business to show a decent profitability?

Rohitash Gupta:

Ruchi, just for context, out of about \$50 million to \$55 million onshore business in an year, roughly half or more than that is CLX. That business works a little differently, a little more project nature and things like that. What you are talking about is probably only Carolina kind of a number. So, you have to see in that context, number one. Number two, as part of our overall approach, we are seeing offshore and onshore business and customer operations segment as more and more linked and interrelated in the sense that some of the onshore work rubs off on offshore, some programs are co-delivered and things like that. So, our first objective since we started our Fayetteville center was to get into positive territory. And as PD mentioned, we are almost there through this year, at least. So, we don't see too much materiality in going from 0% to 2% or 3% because it won't really show up. I think what's more important is can there be more co-delivered programs wherein whatever we have in Fayetteville actually is closely interlinked and protects the offshore business related to that. And we are seeing some of that. So, I think that's more important part of it rather than margin expansion purely in Fayetteville by itself.

Ruchi Burde:

Understood, that is helpful. Secondly, could you share your comments regarding the health of your top 10 clients?

P D Mundhra:

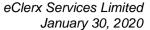
I think top 10 clients obviously are a more mature client set for us. As you would have seen from the revenue growth numbers, we have had more success in growing our emerging portfolios than growing the top 10 clients, but they continue to be very important for us because basically we have to broaden our relationship and trust with them that they allow us to experiment with them in terms of developing new services collaboratively. I think that's the general environment. We don't really see a big pickup in revenue in the top 10, but the hope continues to be that as we can build out the emerging business, it becomes a more stable and diversified revenue base. And also, as it becomes a larger and larger part of the business, hopefully it starts having more of a contribution to overall revenue outcome.

Moderator:

The next question is from the line of Umang Shah from Asian Market Securities. Please go ahead.

Umang Shah:

With respect to your top 10 clients, they form 65% of revenues right now. Would you be able to give a breakup of onshore and offshore revenue in your top 10 clients?





Rohitash Gupta: Umang, thanks for the question. Actually, we don't disclose it in that kind of granularity. But if

you look at our top 10, they are roughly two-thirds of the company. Again, at the company level, 25% is offshore. I think if you apply the same metric for top 10, you won't be too wrong. Just one sort of correction or caveat. Keep in mind, as I previously said, CLX business is almost \$25

million or thereabouts, and that's outside of top 10.

Umang Shah: Great, quite helpful. And sir, on profitability front, is CLX profitable now? And if yes, what

would be its margins?

P D Mundhra: On the CLX front, we have been seeing fairly good performance through this year. The business

is profitable. As we indicated, when we bought the business, EBITDA profitability was in the high teens. It continues to be in and around that benchmark. Actually, it has been higher than

that in the last quarter. But on a sustainable basis, I would say mid to high teens.

Umang Shah: A bit similar to what I think was at March '19 level also at the financial year close.

Rohitash Gupta: Yes, you are right. But I think you are picking from the subsidiary performance, right?

Umang Shah: Yes. One last question is, when you are booking contracts, do you look at contract level

profitability? And if yes, then how much is the difference in contracts that you sign up for

offshore and onshore?

Rohitash Gupta: Yes, we do look internally at contract or engagement level profitability also. Typically, offshore

business will have 30% kind of EBITDA, give or take, or maybe more in managed services projects which mature. Onshore business, as PD explained, CLX is what we just discussed. The onshore is typically either Fayetteville where we just talked about us being breakeven. And the balance portion of onshore outside of CLX and Fayetteville is basically consulting business

which typically earns 15% to 25% gross margin on consultants that we deploy.

Moderator: The next question is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: PD, just wanted to prod you with regard to the way we have seen our S&M expenses trend.

Given some of the challenges around growth, how should we be thinking about our investments

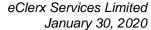
on this side because they have just been coming off for a very long time now?

PD Mundhra: Manik, I'm not sure I agree with that statement. Certainly, it's true; I think, in the last quarter to

two, they have declined a bit. I think that's just a process of adjustment of us being where we are getting return on investment in terms of different functions and different sales teams and then trying to optimize our spend. The other side to that coin is, do you feel that you would accelerate growth outcomes if you threw more dollars at the sales team and at this point, we feel 'no'. We are not convinced that we have adequate period to productively employ additional salespeople. I think it's just an exercise and optimization at some level, and I think we have taken some actions

in the near past in areas where we haven't seen appropriate return. But I'll ask Anjan also to step

in and share some perspective on this topic.



Anjan Malik:

Manik, our focus continues around a couple of axis. We have spoken about the importance of being much more focused on differentiation and specialization. Over the last year to year and a half, our focus has been in making sure that our service offering has resonance with the marketplace. And in the areas in which we are finding resonance and we have demonstrated capability and tenure; we are doubling down on outreach and sales. When you see a reduction on onshore, it's not because we are dialing down on cost as much as optimizing that cost where we feel that we will get the best return. And actually, that's working to some extent.

The second axis continues to be that we made a bet, let's say 3 years ago that we wanted to invest onshore with the following caveat that we sense that onshore would drive offshore, one; two, that onshore investments will also to some extent provide inside sales capability. And I think both of those have worked well. Even though you see classified business numbers come down, the fact is that our consulting business, our analytics business, and even our footprint in North Carolina is substantially larger than it was last year. Overall footprint is bigger.

Moderator:

The next question is from the line of Sumit Modi from Arete Investments. Please go ahead.

Sumit Modi:

Just wanted to know that excluding the one-off projects and milestone revenues, would we still have grown on a sequential basis?

Rohitash Gupta:

I think, Sumit, it's the same question being asked in a fourth different way, and I can answer only the same that all 3 factors put together led to substantially all of the 3% sequential growth that we saw. We are not fully clear whether some of these things can come, let's say in March which we don't have visibility to today, but largely, those factors don't seem to be repeatable at least till the January visibility that we have now.

Moderator:

The next quarter is from the line of V P Rajesh from Banyan Capital Advisors. Please go ahead.

V P Rajesh:

Rohitash, just looking at the EBIT bridging analysis, I just want to make sure I understand this correctly. The core revenue increase of INR 174 million, are you saying that, that came with 100% EBIT margin and that is sort of comprising of the 3 factors that you have been talking about on the call?

Rohitash Gupta:

That's right. Rajesh, just to add, as you can imagine, this has the price and FX impact also.

V P Rajesh:

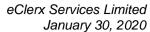
That's what I was trying to figure out that the 3 factors plus the pricing led to an increase of this INR 174 million of core revenue with 100% margin. That's the way to think about this.

Rohitash Gupta:

That is right.

Moderator:

As there are no further questions from the participants, I now hand the conference over to the management for closing comments.





Rohitash Gupta: Thank you very much for joining us for this quarter's call. Look forward to talking to you next

time, thank you.

Moderator: On behalf of eClerx Services Limited, that concludes this conference. Thank you for joining us,

and you may now disconnect your lines.