"eClerx Services Limited Q1 FY 2015 Earnings Conference Call"

July 31, 2014

eClerx Services Limited
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Moderator: Ladies and gentlemen, good evening and welcome to the eClerx Services Limited Q1 FY 2015 Earnings Conference Call. Joining us on the call today from eClerx are Mr. P. D. Mundhra – Executive Director, Mr. Anjan Mallik Director and Mr. Rohitash Gupta – Chief Financial Officer. As a reminder all participant 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 this 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 the presentation providing an overview of the business and then open for question and answers. Before starting the company would like to remind all the participants that anything said on this call which reflects the company's outlook for the future of 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 statement to reflect the 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: Welcome to eClerx Q1 Earning Results Call. It was an eventful quarter, first of all we returned to a modest amount of sequential growth after having seen a flat Q4 and secondly this was the first quarter in the new financial year before which lot of changes in the regulations as well as environment has happened and we have reflected some or most of it in our accounting treatment. Coming to numbers, this quarter we had a sequential Dollar terms growth of about 2% which was roughly 1.9% in constant currency terms. The Y-o-Y growth in Dollar terms was about 10% which is roughly in-line with our broader commentary about the full year outlook. The operating margin and net profit were at 32% and about 24.5% respectively and this is significantly lower than previous quarters on account of higher salary cost, sales and marketing cost and higher depreciation charge. In addition as I was mentioning, we have done a couple of accounting treatment changes so for example we have adopted principles of AS30 for our hedge accounting starting April 1st this year, which has created an additional impact at PBT level of about 86 Million Rupees and similarly we have started following schedule II of the new Companies Act which prescribes the different kind of depreciation rates and useful life and that has a incremental charge of 26 Million Rupees on depreciation. So if these two changes were not done our PBT would have been higher by about 11.2 Crores than what it is reported.

Coming to next slide, slide #2 our investment and other income grew sequentially; it stood at about 6 Crores this quarter. The hedge gain and loss was 4.3 Crores in negative and this also reflects some of the treatment that we have done for adoption of AS30. The revaluation and realized gain was about Rs.6.2 Million rupees as opposed to Rs.4 Crores negative in Q4. Our total hedge book stood at about 86 Million US Dollar equivalent with the average strike rate of Rs.65.5 to a Dollar. This comes to be about 2.4 times this quarter's revenue. As I was mentioning we have adopted AS30 for hedge accounting starting 1st April and we hope that this will pave our way to adopt IND-AS and IFRS as announced by government recently and we hope that this will reduce some amount of P&L volatility as we go forward and transition completely on to AS30 which will take few more quarters. So the total impact of AS30 adoption was around 5.4 Crores of net loss and this was due to booking the MTM of the hedges taken prior to adoption of AS30 into P&L. The breakup of this 5.4 Crores is given in slide #3 further and we anticipate that some additional MTM changes which will happen on this hedge book which was of period prior to 1st April of 2014 will still continue to flow in P&L but in a very small quantity.

Our cash and cash equivalent was around 380 Crores as of June end but keep in mind that this is a pre-dividend number, this turns out to be about Rs.125 a share and about Rs.84 if you consider the dividend impact. We have also made operational the Airoli spaces - couple of them that we announced earlier, we have appointed S.R. Batliboi & Associates for our statutory audit starting 1st April this year and we have also tried to follow the new provisions of the Companies Act including the depreciation, useful life that I was mentioning earlier and we are also trying to align to CSR spend norms that have been prescribed.

Slide #5 gives a little more detailed breakup on the P&L quarter on quarter. As you can see, one of the major increases was in salary. If you think in terms of as a percentage of operating revenue so we had about 600 basis points of increase and we will talk a little bit more about this. On the other items I think only communication expenses and other expenses had some amount of flux in this quarter. Another major increase was in selling and distribution which was primarily on the account of increased travel this quarter.

Slide #6 gives a better picture of where our operating margin stood in Q1 in relation to Q4 so if you strip out the exchange rate impact the 600 basis points impact shown in the previous slide results into about 530 basis points and the breakup of that 530 basis points is the regular wage hike of 10%-11% that has resulted into 270 basis points of impact, the special hikes due to certain HR policy and program changes that we announced in Q4 Earnings call those impact was around 150 basis points and as we will discuss little later also we had a significant dip in utilization this quarter and that caused us 110 basis points of additional margin impact.

On the selling and distribution side, bulk of the 210 basis points negative down side that you see was due to travel, most of it is not likely to be repeated in the next quarter, so the S & D will trend to our normal historical averages with minimal amount of growth, that you used to see. In terms of currency contribution this quarter was 81% USD, the geographic concentration on North America (primarily US) was around 73%, the debtor days was 41 days. On top five contributions, this is probably our lowest figure in last three to four years at about 71%; we added four new clients this quarter and the total client billed count stood at 65 clients. And bulk of our revenues continue to come from SEZ and based on FTE billing model.

If you see the major drop is in utilization which was at 61% as compared to 64% in Q4 and this is primarily due to large ramp ups that we were doing in over the Q1 for our cable businesses and as you know that the processes there are quite chunky and the ramp up or training times are significantly high for a large batch and hence we had a good amount of staff buildup during Q1 and these revenues are likely to come starting Q2.

Slide #8 tells you the top five versus non top five Y-o-Y growth. On non top five, we continue to see a modest uptick so it was a 37% Y-o-Y growth quarter on non top five front, non top five now contribute almost 11 Millions in a quarter in revenue terms;, on the downside on top five you see growth rate further slowing down so it was 1% Y-o-Y on the top five clients put together. The total head count for organization was about 7600 people, the onsite head count stood at 82 people and the attrition in this quarter was 25% which is lower than what we see on average in the last year. Thank you and I will handover now to question and answer session.

Moderator: Thank you very much Sir. We will now begin the question answer session. We have the first question from the line of Pankaj Kapoor from Standard Chartered Securities. Please go ahead.

Pankaj Kapoor: PD if you can give some update on the outlook for the full year, in the past like you have been talking about FY'15 playing out to be similar to FY'14 or marginally below that any update on that?

P.D. Mundra: Hi Pankaj, I would say you know the outlook is broadly unchanged, we will have lumpy quarters you know where one quarter might be better or worse than others but for the year as a whole you know I don't think that we see anything that would cause us to revise our expectations substantially so last year was 10-12%growth in Dollar terms and I think this year you know best case is something similar.

Pankaj Kapoor: Okay so last year we had roughly about 14 odd% growth so which essentially means that we will be doing or we should be looking at something around 3.5 to 5-odd% growth in the next three quarters is that right way of looking at it or you see that that the number actually could be slightly lower than this?

P. D. Mundra: Pankaj I will start out by saying that you know we don't really even ourselves have that much visibility to be able to forecast to that degree of precision .I think broadly speaking if I had to get I would say somewhere between 10% and 15% is where we end up.

Pankaj Kapoor: So just wanted to understand this head count addition that you have done in the last couple of quarters I believe this is for a client in the cable business can you give some sense of this, is it outside of the large account that is undergoing some Corporate action and does it in anyway changes our view on the cable business which we expected to be softer this year?

P. D. Mundra: The head count addition that we have done is I would say on account of two main drivers; one is that you know typically Q2 is our highest attrition quarter of the year as it comes after a bonus payouts and also it coincides with the start of the new academic years for people wanting to undertake masters programs so generally we thought of do some preemptive hiring and anticipation of attrition that we expect in Q2 and you are right, the other part of this of the ramp up in head count is because of programs that are ramping some have ramped towards the end of Q1 some will ramp in Q2. Also you know I think its pertinent to state that on the cable side of our house utilization tends to be somewhat lower because attrition is higher and therefore bench requirement tends to be higher given more BPO types skill sets involved, so that is sort of the reason for the ramp up. Sorry what was your other question you were asking? I missed that.

Pankaj Kapoor: So my question was that given the ramp ups which are happening in the cable business does it change in anyway the outlook that we had an earlier of this year being soft for this part of the business?

P. D. Mundra: I would say that you know the latest we have heard is that the merger between the large cable players in the US is expected to close in the first quarter of calendar 2015 that's the best case that we are hearing so I don't think it will really change our outlook for our FY'15 because we think it will happen too late for it to have a material impact for our FY'15 but we are still seeing growth on the cable business perhaps not as much as we would have seen at these head wins not been there but we still seeing growth which is why we are having these ramp up.

Pankaj Kapoor: Coming on the sales and marketing data I think Rohitash spoke of increase in travel which will not be coming in the later quarters so again looking it from a model perspective should we expect it to be around the 14 odd% kind of a level for the full year which is the range which you broadly have been talking about or you think that this year it could be slightly higher?

Rohitash Gupta: I think that would be a fair estimate although I would say the bias will be for it to increase slightly because if we continue to see growth in one part of business we may do bit more hiring on the onsite front so that is one impact and the second is that nature of business is changing and that some of it requires you know little bit more travel, more engagement upfront for the process setup which requires more travel. So because of these two factors you can take base line as FY'14 but with slight uptick I would say.

Pankaj Kapoor: Okay and we also see an increase in the sales head count, so again should we take this as a build out of you know our continued effort to diversify the client base or is it something more in terms of building out new service lines etc.?

P. D. Mundra: It's a combination but Anjan perhaps you might want to chime in on this and share some perspective.

Anjan Malik: Yes I think it's a continuation of our investment onshore in both those things Pankaj one is as you can see our growth rates in a top five has slowed down dramatically and most if not all of our growth has come from emerging accounts, so we are making three pronged investments in the business; one is in effectively domain leadership which is we have identified particular lines of business that we want to double down on because we see a lot of demand in our emerging clients and across the industry in those areas. We want to increase technology investments over there to give us more productized services and thirdly we want to have more door openers and more senior people of the industry for relationships so I think its combination those three things.

Pankaj Kapoor: Okay thank you. And just one last question to Rohitash on the depreciation so we have made the adjustment for the one time charge in the quarter so should I take that normalized for this as the level for the full year?

Rohitash Gupta: Yes so this quarter I think we had 7.5Crores of depreciation which includes the new treatment and you can anticipate that this will remain at this absolute level if there is no further asset growth or retiring but obviously you know as Airoli ramps up we will have addition of more assets which will add to this charge.

Pankaj Kapoor: So like it will be at the normalized level for the first quarter and that will be the level it will continue.

Rohitash Gupta: Yes it will continue so there was a one-time impact which has gone to general reserves in balance sheet of 1.6 Crores but this 7.5 is I think you can take as a run rate.

Pankaj Kapoor: Sure. Okay thank you and all the best.

Moderator: Thank you very much Sir. The next question is from the line of Aishwaria K from Spark Capital. Please go ahead.

Srivatsan: Yes Hi! Srivatsan here, I just wanted to get your comments on the non top five clients we have been seeing healthy growth for the last few quarters, it will be helpful if you can just dwell a bit deeper in terms of which offerings offer that we are seeing good traction how long these clients have been and then as there any chance of any large deal related to a size that is floating around these clients which you could potentially garner and could bump up this growth even higher may not be in FY'15 but in FY'16?

Anjan Malik: Hi Srivatsan. The answer I mean we can't give a definitive answer to that question but I think you know as I alluded to earlier our focus is, imagine a world in which our client base is essentially seeing reduced demand in their own business so none of them have had very substantial increases in sequential revenue across the industries, so in a world where there isn't a naturally native demand what we are finding is that we are succeeding by taking some of the services that we have established differentiation in and converting them in to more productized offerings, now some of the services have small footprints, some of them have large footprints depending on a combination of the industry and the service line, so we are in discussion in advance stages of a number of deals, I mean some of them are small and some of them are large, but I think there is a focus to be much more of what I would call productized service lead as opposed to service quality and capability lead which may have in the past you know worldwide there was lot of demand from let say our top 5 or top 6 guys.

Srivatsan: So on productized services a bit, in terms of capabilities are there any specific areas where you have gone ahead built out these platforms that would be require for us to drive productized services any test marketing or proof of concepts which being developed which segments if any color would be useful.

Anjan Malik: Effectively every one of the three areas, CTS, DMS or Digital marketing services and financial services we always have some applet being built, in many instances what we are doing is we are trying to create larger platforms yet they are not of the style or size of a large product play but we see these exclusive things enable us to have this productized services so the answer is yes we have prototypes, we have enablers in place and many instances we find that is an entry point for our client.

Srivatsan: Sure and then just wanted to get your comments in terms of you have been predominately offshore heavy any delivery capabilities either new shore or onsite any thoughts on that front?

Anjan Malik: We continue to look at different option I think this year we saw a fair amount of demand for us to provide services in our client locations which is done by combination of delivery and expert delivery from India so we have seen more and more work being done in local market but I wouldn't say its best, I would say it is much more sort of higher end process reengineering kind of work which then leads on to potentially reengineering and BPO opportunities.

Srivatsan: Sure my last question in terms of with wage hikes and on the higher investments in sales and marketing done with on a constant currency basis will it be fair to assume that margins would inch up from here on?

P. D. Mundhra: I think yes that's a reasonable assumption that on account because I would expect that some of the more one off items we saw this quarter for example relating to travel and for example relating to the unusually low utilization some of those will definitely you know get reduced as the year progresses so yes I think its fair to say that on constant currency basis I would expect margins would move up a little bit from here on for rest of the year.

Srivatsan: Sure thank you.

Moderator: Thank you. The next question is from the line of Ravi Menon from Centrum Broking. Please go ahead.

Ravi Menon: Hi two questions from me, first around reduction and trading and the prop book activity of financial services and the increased regulation I mean on balance how do you see that demand playing out for you guys?

Anjan Malik: So I think you can look at what drives work along a number of axes. One of the axis by definition is volume, the other axis is complexity I guess the product is business change and which has been driven to some extent by regulation so we are seeing a big change in things like clearing houses. On the other side of the coin we are seeing there is a tremendous amount of demand increasing in activities like collateral management and margin management and in managing documentation for moving people from one end to the next, so what we are seeing is that whilst volume is a reducing in one area volumes are increasing in other area there is a substantial amount of change so I think because of the change the complexity of environment is much greater

Ravi Menon: The second question was about the growth from the non top five I mean you know could we assume that this quarter's non-top five growth was mainly from the four new clients you said you add up this quarter?

P. D. Mundra: Not really actually because you know as you might have seen as per in the presentation the invoice about 65 clients in the quarter the non top five bucket is actually an amalgamation of 60 names, so the growth that you see is across those, mostly I would say on average what happens is when we acquire a new client its typically with the smallish deal, so the bulk of the Dollar additions that happened in any given quarter are with existing client.

Ravi Menon: Right and the new cable customers that you are looking at could be fair that's a different region or is it a completely different operator itself within the US?

P. D. Mundra: So when we talk about new clients it would be a different corporate entity, if you are working with the new division of the same customers we wouldn't call that a new account in our terminology.

Ravi Menon: Great alright thank you. Best of luck.

Moderator: We have the next question from the line of Mr. Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: Hi this question is regards to the new policy that we were opted with regards to a hedges just trying to understand from Rohitash how do we estimate the forex losses or the gains going forward as part of our quarterly earnings?

Rohitash Gupta: I think from Q2 onwards we will start disclosing probably little bit more as we go through the transition period, by transition period I mean that it will be period when the hedges which were taken prior to AS30 adoption are yet to mature and the new hedges which are being taken from 1st April onwards are building up. As you can imagine this will be a transition period of almost may be five – six quarters or so; having said that at the start of it AS30 hedges volume will be very less, so for example in Q1 quarter we will take may be 10-15Million Dollar worth of hedges let say, with only that much amount to start with. Having said that as we build up and as we go through the quarters we will start disclosing probably little bit more in terms of break up of AS30 versus non AS30 hedges and you will be able to model it at that point of time.

P. D. Mundra: Manik this is P.D., just to add points effectively on the hedges that have been taken post 1st April one would expect much less volatility in the P&L because the mark to market at the end of the each quarter will be taken directly to the Balance Sheet and basically what will happen is our revenues will get realized at close to hedged rate and the volatility will come in our P&L on account of the hedges existing prior to March 31st.

Manik Taneja: I understand the intent to regards to the new policy but just trying to understand how that will impact our P&L in greater detail so for example as of this quarter end your total hedges is about 45 Million Dollars of US Dollar hedges for FY'15 out of that about 19 Million Dollars hedges are about 63.4 for Q2 FY'15 so should one essentially as part of our revenue assume that 19Million Dollars of Q2 revenues will be booked at 63.4 and the balance would come in at the spot rate will that be the right way to model?

Rohitash Gupta: No actually this won't happen this way so only the hedges which are maturing and were taken after AS30 adoption will get realized at hedged rate and as I was telling it will be very small proportion in this quarter as well as next quarter, so that is why I am saying that you can probably wait for one quarter we will work through it and provide little bit better disclosure so that you can appropriately model it.

Manik Taneja: Sure. Thanks and look forward to your details on this. Thank you.

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

Karan Uppal: Sir just a question on utilization front, looking at the utilization it dropped from 64% to 61% so what is the target number you are targeting for full year?

P. D. Mundra: Well I think, so our belief is that our current mix of business should lend itself to utilization rate of let us say somewhere between 63 and 65 which is where is been for the preceding three four quarters, so we would see 61 has definitely an aberration on the lower of that range. So I think we would expect some improvement in Q2 and hopefully towards the end of the year we should be back closer to 63-64.

Karan Uppal: And another question is on the Capex front what is the target number for FY'15 or if you can share the average number which you targeting for FY'15?

Rohitash Gupta: See in first quarter roughly around last three or four months we have spent around 20Crores on fixed assets and this was primarily on the fit outs as well as the lease holding improvement that we have done across the facilities specially with the new Airoli facilities. And you can assume that roughly similar amount will be a spend on same Capex item through the remainder of the year because bulk of the expenditure is already done in terms of IT purchases for majority of the space that we have taken, but some pieces of it will continue and hence I am expecting probably you know 20 Crores more will come through in the next three quarters.

Karan Uppal: So the total amount would be around 40 Crores if I assume it correctly?

Rohitash Gupta: Yes.

Karan Uppal: Okay fine thank you.

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

Madhubabu: Sir the new clients attrition can you give detail where the attrition because the clients billed has been steady at 65 for the last four quarters?

Rohitash Gupta: So attrition typically happens at the tail end and it is more of a phenomenon in digital marketing services segment because that is where the bulk of the client base comes from, so roughly you know 45 plus clients come from DMS and the tail end of it attrites because either those projects are won as Pilot or paid Pilot or they are very short term project by definition.

Madhubabu: Okay and second thing on how are you seeing the attrition currently are we seeing a steep spike or for the next quarter are we expecting a very strong attrition because of the arising demand environment?

Rohitash Gupta: So Q2 has always been highest in our history and we expect that Q1 numbers which are roughly 25% or thereabouts will obviously increase in Q2. Having said that we don't have a very good feel whether last year's trend of Q2 will prevail in this Q2 simply because we have done certain HR policy changes which we discussed earlier and how the results of those will pan out we are not very sure but we anticipate that if all things go well the attrition in Q2 this year should be slightly lesser than last year.

Madhubabu: Okay sir thanks.

Moderator: Thank you. There are no questions at this time sir.

P. D. Mundra: So I think we can wrap up and you know we will look forward to speaking with all of you in the next quarter results. Thank you.

Moderator: Just before that we have a question in the queue; the next question is from the line of Mr. Rajat Buddhiraj from Banyan Capital. Please go ahead.

Rajat Buddhiraj: Thanks a lot for taking my question. So my first question is on the cable business as we know that there is lot of M&A activities going on, so what is the current status and your view and how do you see this situation in terms of growth going forward?

P. D. Mundra: Yes this is P.D. , let me take a crack at that, you know everything that we have heard points to the fact that these corporate deals in the mergers have not closed before the 1st quarter of next calendar year, so 1st quarter 2015, we would be expect that for most of FY'15 we will continue to see some what slow decision making with our clients because they are still going to be caught up having the merger done, but you know we are still seeing growth some of the growth that we have seen in Q1 and that we expect in Q2 is from the cable business but hopefully once the dust settles around the mergers there will be more clarity.

Rajat Buddhiraj: Okay and from the financial services side you mentioned in the last con call that they are one or two bank who are reshaping themselves and you continue to be close to them but the picture is still unclear so by when the picture would be clear on your business association with them?

Anjan Malik: Yes I think it's not immediate, it is going to take a couple of years because in many instances people are embarking on a very long journey as they are changing the business that they make money from so we anticipate this three to five year journey from many of us in this industry.

Rajat Buddhiraj: Okay so what I understand from this situation is like that there would be another two years for transition and I assume that you will be closer to them in the transition process itself?

Anjan Malik: That is correct. I mean in fact we were working through transition, you know very closely working with industry bodies you know as utilities are being set up we are closely involved with a number of them either as supporters or as a potential utility where obviously providing a lot of consulting work, lot of BPO work and lot of change management work and many aspects of our clients businesses.

Rajat Buddhiraj: Okay and my next question is on acquisition like Agilis I understand that you will look out for different opportunities but how actively are you looking for an acquisition like Agilis that is first question and the follow up question is that do you have any size in your mind for the acquisition?

P. D. Mundra: We have a pretty good pipeline of potential companies to look at I would say you know in any for example in the last 12 months we probably looked at 25 plus companies in varying degrees of seriousness and detail. In terms of your second question was is about the size of a likely acquisition.

Rajat Buddhiraj: Yes size of the acquisition.

P. D. Mundra: I would say the majority of companies we looked at would range from 10 Million to about 40 Million in terms of annual revenue. There are a couple that might have been larger but the majority of the assets that come to us are somewhere 10 and 40 Million in revenues, the price expectations of course varies very substantially based upon profitability and growth but that should hopefully give you some sense of skill.

Rajat Buddhiraj: Okay thanks a lot. That's it from my side.

Moderator: Thank you. We have another question now from the line of Mr. Pranav Mehta from Value quest. Please go ahead.

Pranav Mehta: One question I wanted to know what has been the growth in your top client in the digital marketing division.

P. D. Mundra: You know we don't really talk about client specific data on the call but you know more generally I will say that the situation for that business remains for a roughly similar to what we have discussed in prior quarter, some of our larger clients in the technology space they obviously have their own headwinds because of the tectonic shifts and technology demand, away from that I think other segments like retail and travel are doing reasonably well for us.

Pranav Mehta: Okay so going forward you are seeing similar sort of performance as compared to FY'14?

P. D. Mundra: Yes I would think so.

Pranav Mehta: Okay thank you that's it from me.

Moderator: There are no more questions at this time sir.

P. D. Mundra: So let wrap up Mohsin.

Moderator: Thank you. On behalf of eClerx Services Limited that conclude this conference, thank you for joining us and you may now disconnect your lines.