



“eClerx Services Limited Q1 FY18  
Earnings Conference Call”

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**Moderator:** Ladies and gentlemen, good day and welcome to the eClerx Services Limited Q1 FY18 Earnings Conference Call. As a reminder, all participants' 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 call, please signal an operator by pressing '\*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like hand the conference over to Mr. Rohitash Gupta – CFO, eClerx Services Limited. Thank you and over to you, Mr. Gupta.

**Rohitash Gupta:** Thank you for joining eClerx's earnings call for the first fiscal quarter of FY18.

We saw 1.9% USD and 1.4% CC growth in Q1 on sequential basis with Q1 USD revenues coming at 48.8 million. Q1 revenue growth was largely contributed by healthy deal wins in financial markets vertical during FY17. At a service line level, Campaign operations and Digital Analytics in Digital, Work Order Accuracy in Customer operations and Regulatory work in Financial Markets have shown highest \$ YoY growth in Q1. Markets and Digital consulting practice has also grown phenomenally on YoY basis from a small base in line with our objective of getting closer to customers. Further, about half of new business won during Q1 came from Digital.

As you would recall that the last amongst the 3 large Client rollofs was due in Q1 end and it has been completed as we speak. Hence, the full impact of the revenue decline due to this will show up in Q2 where we expect company's \$ revenue to drop somewhere between 2 and 4% sequentially.

Similar to trend seen in Q4, our pipeline has continued to grow on YoY basis and 50% of Pipeline as at Q1 end belonged to Digital, most notably from CGI service capability of CLX. We expect pricing to be flattish in FY18 as expected price increases in few large clients are likely to get offset by decreases in others. Average new deal sizes which saw substantial dip during FY17 have now reverted to historical sizes in Q1.

During Q1, we expanded revenue footprint on YoY basis with seven out of our top 10 clients, and our most notable new logo wins this quarter were one of the top3 global automotive companies and a multi-billion \$ furniture retailer in USA. To give you flavor of our client needs and eclerx solutions I will highlight a few significant types of work that went live in Q1.

- 1) First, eClerx has started working for an existing US cable client to effectively meet newly issued FCC guidelines of taking explicit customer approvals before making any changes to subscriber's account. eClerx's role will involve quality, compliance and governance to ensure that Client's call centers adhere to new guidelines.
- 2) Second, eClerx has started work on its largest ever Analytics engagement from an existing enterprise software product client. The project will utilize eclerx's global delivery model and include consulting, tag implementation, A/B testing and reporting to solve client's website performance and reporting accuracy issues.

- 3) 3rd, eClerx has started a large program to support an existing Canadian banking client with their AML operations. eClerx will be preparing thousands of case files every month by utilizing transactional data across disparate systems thus helping client improve its AML compliance.

Subsequent to the quarter close, we have signed a definitive agreement to purchase certain assets of a US based Financial markets consulting firm named TwoFour Holdings LLC and its subsidiaries. We hope to close the purchase at the end of Q2, and subject to timely closing, this may give us about 1% additional revenue for FY18. The Fortune 100 league client relationships of TwoFour, several of which are new to eClerx, coupled with its ability to quickly staff for client site consulting projects is likely to help our Markets business to move upstream and capture change budgets of Global Banks.

Moving on to supply side updates, our new delivery center in North Carolina has started live operations for an existing large cable client. We anticipate that much of FY18 will go in ensuring delivery quality and we expect 50-100 bps impact on FY18 OPM due to our investments in the center. In line with the near term pipeline in CGI, we have also strengthened our creative production delivery capacity by augmenting offshore delivery teams in India and Thailand.

We have trained over 5000 employees on using eClerx's proprietary Robotics platform and have entered into formal partnerships with three 3rd party robotics platforms. We now have over 300 SME level certified implementers across all platforms. Robotics has seen most traction in Financial Markets with implementation currently in progress with 5 large clients. Further, a dedicated team is developing use cases on Supervised and Unsupervised learning with a focus on NLP and Image Matching algorithms. We anticipate that several eClerx tools will soon have embedded cognitive automation components.

Coming to our detailed Q1 results, our INR Operating revenues remained flat sequentially at 3.33 Billion INR, and decreased 2% on YoY basis. Our OPM was at ~27% and is likely to move closer to 30% levels in H2 once the effect of revenue decline and wage increases subsides. The Profit after tax at 794 million INR increased by 6% sequentially while declining 17% on YoY basis. The PAT percentage in Q1 was same as Q4 at 23%.

Other income was 82 million INR gain in Q1 vs a loss of 73 million INR in Q4. This was mainly due to depreciation of Euro vs INR resulting in revaluation gains on our euro debtors and bank balances. Our forward hedge book of about \$140 mm was at 2.9 times the quarterly revenue. The average strike rate of these hedges is 71 Rs/\$ which has worsened by 110 paisa to a \$ since Q4 due to unfavorable USD/INR movement. Based on hedges booked till now, we expect that ~83 mm worth of inflows will convert into operating revenues at 71.4 Rs / \$ during rest of FY18.

The Operating margin percentage dropped by ~260bps in Q1 vs Q4, 2/3rd of the drop was due to salary hikes and rest was contributed by increase in delivery team headcount both offshore and onshore. SG&A remained largely flat on QoQ basis and depreciation came down to 3.3% due to the usual new FY effect and lower capex in last few qtrs.

We had about 6.43 billion INR of cash and cash equivalent at the end Q1 which is about 370 million INR more than FY17 end. Our Q1 Net operating cash flow stood at 387 million INR in Q1 vs 649 mm in Q4 mainly because of adverse working capital movement such as debtors.

While we have booked capex of around 85 million INR in Q1, FY18 Capex is likely to remain at FY17 level. We have spent 3.8 million INR on various CSR activities during Q1 and spend is likely to increase in remaining quarters resulting in G&A increase.

Our USD and North American concentration have remained fairly steady at 84% and 68% respectively. The DSO was at a high of 88 days in Q1 due to one off issues in few large clients and our DSO range is likely to be within 75-85 days in near term. Our staff utilization based on direct production staff including trainees in Q1 saw a minor improvement sequentially at 76.8%. The utilization is likely to remain lower on YoY basis in next few quarters till the impact of last roll off subsides.

The client counts in 5mm and 0.5mm buckets have remained same as in Q4, while we saw a net decline of one in 1-5mm bucket due to completion of a large legal docs remediation project for a Bank last year. While emerging clients have been flat on YoY basis, we have seen 2.6% CC decline in top 10 clients.

The company employee strength has increased by 3.6% during the quarter to cross 9000. Our sales and Business Development staff count has remained steady at 78. The India attrition stood at a high of 41% with some of the increase being unavoidable attrition in line with the roll offs. Our Current taxes have slightly increased from FY17 levels to 24% in Q1 however due to deferred taxes the effective tax rate for Q1 was still around 19% and we expect Full Year rate to marginally inch up from Q1 levels.

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

**Moderator:** Thank you very much, sir. Ladies and gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Madhu Babu from Prabhudas Lilladher. Please go ahead.

**Madhu Babu:** Could you talk about the ramp-down in 2Q... what is the proportion of work which is going to ramp-down from this client?

**Rohitash Gupta:** Madhu, as I told, we expect 2-4% decline at a company level. The clients overall revenue were around 5% when it was fully accruing. Obviously, we are not losing the client, we are losing substantial portion of this client.

**Madhu Babu:** So would there be any backfill from financials which can surprise because QoQ decline appears to be a bit steep, at least at the higher end which is 4% if at all?

- Rohitash Gupta:** Like I said, the client was a substantial one with contributing almost 5% of total revenue of the company, so substantial portion of that has gone. Our range factors the possible growth in other areas.
- Madhu Babu:** In terms of the acquisition we have done, could you just give us more detail and how we are going to look into the front end consulting part in the Financial Services side?
- Anjan Malik:** These guys have been very active in the space of staffing and augmentation and consulting work for KYC technology projects, implementation of training systems. Their work heads are being much higher end than the work that we do. In fact, lot of the guys that they start to progress the services that they provide are then used to determine whether or not services that you can outsource. I think for us it is an opportunity to come higher up the decision cycle. We have already started seeing that in plain because we have been sort of doing partnership work with them over the past six months. That is opening up new project opportunities for us.
- Madhu Babu:** Sir, we are talking of more of digital deals and all that. So would we need to open more of onsite centers maybe more in Europe, we already opened one in North Carolina for Cable. So would that rise and how that should shape up for the margin at least on a two year perspective?
- Rohitash Gupta:** Madhu, if you recall, we have already told I think in the last call that we have opened Austin center, which will be hub of our Digital Analytics activity. Since the primary growth and client concentration is in US, I think Austin suffices the needs of US. It is a small center simply because we expect most of the consultants to be billed out and working hopefully from the client site. So it will act as a permanent place for analytics center of excellence within eClerx. At this point, we do not see any need of opening European centers for this purpose.
- Moderator:** Thank you. The next question is from the line of Vishal Desai from Axis Capital. Please go ahead.
- Vishal Desai:** A quick recheck on the delivery center in North Carolina. You said one of the clients has already started delivered from there. Is that correct?
- Rohitash Gupta:** That is right.
- Vishal Desai:** The impact also that you all mentioned was close to around 50-100 bps impact on OPM on a full year basis, right?
- Rohitash Gupta:** Right.
- Vishal Desai:** So this means that a commentary which we had given earlier of around maintaining our EBIT margins at around 30%, if I am not mistaken at the end of the Q4 earnings call stands down to around 29% or so?
- Rohitash Gupta:** It is possible, Vishal, as you know, last three-four months have been fairly active even on the currency front and coupled with the North Carolina center, I think your estimate could be right.

**Vishal Desai:** Quickly, just to understand from a demand perspective. We said that Q2 will see our final impact of the roll-off kicking in at around (-) 2% to 4% QoQ. So post that assuming that roll-off is the last that we have seen off in the client side, we expect revenue growth to ramp up because that is what was commented even at the end of Q4. So how are we seeing growth post that going into the second half of the year?

**PD Mundhra:** Vishal, this is PD. I would think that the second half of the year should be stronger for us than the first half because to the comments that Rohitash made we do not have visibility to any further large roll-offs beyond this one that has just finished. The pipeline continues to look as strong as it has been at any time in the last 18-months. So if I put those two things together, we hope to maintain the momentum on the new sales side. Once the roll-offs slowdown, then I think we can again start reporting net growth numbers from Q3 onwards, at least that is our expectation right now.

**Vishal Desai:** From a demand commentary perspective across our three verticals that we work in, if you could throw some light in terms of I believe in FS you mentioned something about the automation bid where of the top-5 I think top-3 are already seeing some amount of automation work being done by us. Is that correct?

**PD Mundhra:** Actually, from an automation perspective, that factor is pretty universal across the board. The degree might vary a little bit but clients across all three businesses are adopting enthusiastically. Technologies like Robotics or in some cases Machine Learning when appropriate. So as we maintained in prior calls in the near-term these things are revenue headwinds for us because in our model where effectively we charge for people's time, if those people become more productive, because of automation, then you require a fewer people to do the same amount of work. So some of the muted growth that we have experienced is partly because of that along with the roll-off effect. So in the future I think that automation trend will continue, I do not see changing.

**Vishal Desai:** Just keeping automation obviously on the side in terms of an overall demand perspective, if you could just paint a picture in terms of the three verticals, that would be helpful?

**PD Mundhra:** Overall demand I would say is actually surprisingly good, across all three businesses, the pipeline that we have today is probably as healthy as it has been in the last year and a half in markets I guess clients have been helped by good trading performances and good results. Digital also, I guess, is an area of focus for our clients. The capabilities that we have developed through CLX around digital asset creation and CGI in particular are seeing good demand as is analytics. So I think across all the three businesses we are seeing fairly healthy demand.

**Moderator:** Thank you. The next question is from the line of Ankur Rudra from CLSA. Please go ahead.

**Ankur Rudra:** First question on hiring. I was just wondering the hiring uptick that happened this time, is that because there is a mismatch of the staff that are being released from the roll-offs in the current quarter versus the business you won recently?

**Rohitash Gupta:** Ankur, I think you have captured one of the main reasons right. So the timing of new growth even within the same vertical and the roll-off was quite odd for us and it is not easy for us to repurpose resources with overlapping demand, #1 and #2, the shifts of different types of work within each vertical are different. So the growth maybe in different shift and the roll-off could be in different shifts. Not many people would like to change their shift because it changes lifestyle and pattern, right. And, that is also the reason why attrition has also gone up by the way.

**Ankur Rudra:** I am guessing this will only stabilize in a few quarters once you rolled off completely?

**Rohitash Gupta:** Our expectation at this point is that Q3 will be much stable for many metrics, not only these two.

**Ankur Rudra:** Wanted to understand your commentary on the margins a bit better if I could. One, you said there is 50-100 basis points impact on margins because of the North Carolina center. But I am assuming this is not something which is not unplanned. So you must have had this in your plan anyway at the end of FY17 when you said you expect margins to be 30%. So I am just trying to understand is your change in commentary because the ramp up in the center being lower than you thought at the time or is that because of currency, what has changed from then to now?

**Rohitash Gupta:** The main reason actually is currency and hopefully it will move favorably from here on at least. But the second reason is more around the timing of this roll-off which change from Q1 to Q2 and hence the Q2 number will be telling us the real low in terms of margin and revenue both. From then on, as PD mentioned, revenue should start hopefully uptick and as I just mentioned our staff count and attrition should also stabilize which will lead us to closer to the targeted attrition.

**Ankur Rudra:** A question was on margins, Rohitash. I think in the last call you did say that the roll-off will be felt completely in Q2 and not so much in Q1. So to that extent, I do not think your commentary has changed on revenues, but your commentary on margins has changed. I was wondering if that was because of the lack of ramp up you see in the North Carolina center or there is something else I am missing.

**Rohitash Gupta:** The North Carolina center is still not fully occupied as I mentioned, #1, although we will be doing proactive hiring and training of people which will be doing parallel work with our India teams on the same kind of projects. So there is a little bit of upfront investment I would say which shows up in OPEX which is here and revenue is somewhat unpredictable for the full team that we have hired or we will hire there at least from this year perspective. So that is one reason. The second as I mainly said is currency expectation that how long it will last at this level is not really known and hence we expect that H2 we may still meet our targeted margin percentage but H1 will be what it is.

**Ankur Rudra:** I just wanted to understand the currency side. You have been reporting relatively strong realization on the USD front, thanks to hedging program. So given that you know your hedge book and you shared that with us also, so what should we assume the average dollar realization for this year and next year...should this year be very close to what you have achieved in 1Q and next year that is going to spot, how should we think about this?

- Rohitash Gupta:** As you can see the outstanding hedge effective rate is going down continuously; we had seen 110 paise drop just in three months. This is because as you layer in hedges at the new spot which is much lower, you tend to decrease the average rate. In Q1, our realization counting everything was Rs.68/dollar effectively because of the hedge support primarily, but it will go down as we proceed at these spot levels.
- Ankur Rudra:** The investment on the North Carolina center is 50 to 100 basis points. I am assuming that there should be element of that, that is a permanent reduction, right, if your delivery mix changes towards onsite/offshore from largely offshore, should we not assume in the long-term your margins would be lower?
- Rohitash Gupta:** You capture one other reason correctly, Ankur. I was mentioning our Consulting in general, has seen phenomenal growth; obviously it is still very small footprint. Coupled with that Consulting and Global Delivery model they bring additional cost because some of the work is done onshore or close to client site, right. That mix change also has some minor impact I would say on this number.
- PD Mundhra:** If I can add one point to Rohitash's comment, I think we try to always convey that as a management team, the numbers we are trying to optimize is total EBIT dollar and not an EBIT percentage. I think that is what most important to us. So if we get good work opportunities with clients, which are lower margins and what we do, but we think are accretive, because business are sticky restated, so we rather on 20 points or 25 points on INR350 million and 30 points on INR225 million.
- Ankur Rudra:** But that we will see that optimization on the EBIT dollar level perhaps in FY19, right given that this year is slower growth?
- PD Mundhra:** Yes.
- Moderator:** Thank you. As there are no further questions from the participants, I would now like to hand over the floor back to Mr. Gupta for his closing comments. Over to you, sir.
- Rohitash Gupta:** Thank you, Karuna. Thank you all for joining in Q1. Look forward to talking to you next quarter.
- Moderator:** Thank you very much, sir. 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.