“eClerx Services Limited Q4FY15 Earnings Conference Call”

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Moderator: Ladies and gentlemen good day and welcome to the eClerx Services Limited Q4FY15 earnings conference call. Joining us on the call today from eClerx are Mr. PD Mundhra – Executive Director, Mr. Anjan Malik – Director, 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 the conference, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded.

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

Rohitash Gupta: Good evening everyone. Welcome to the eClerx earnings call for quarter four and the full year. This has been an excellent quarter on growth front with the sequential constant currency growth of 6.3%. This is the highest constant currency growth we ever had in the last 10 quarters. The sequential dollar growth was 5% with dollar revenue crossing $40 million mark for the first time standing at $40.7 million. The operating INR revenue crossed Rs 250 crores mark for the first time in this quarter as well. Total revenue for the full year was about Rs 975 crores and operating revenue was Rs 942 crores which are 14% and 12% respectively higher than the last year. Total dollar revenue was about $154 million which is 11% higher than the last year. The most interesting aspect of the growth this year has been that almost all of it has come from our emerging portfolio, most notably from CTS which has had some bearings on the margins as well.

This was also a year of changes for us, some due to regulatory changes, some due to policy changes and some other to align ourselves better with the changing environment. We have announced acquisition of CLX Europe which is a creative services firm headquartered out of Italy. The results of CLX will be consolidated in our Q1FY16 results and that will span a period from 22nd April, 2015 till 30th June, 2015. Due to all this reasons, all the profitability metrcis for this quarter as well as for the full year were lower than corresponding previous period. For example our net income for Q4FY15 is Rs 53 crores which is almost same as what we had in Q1FY15. However we expect that our operating margin for native business excluding CLX will remain around 30% in near term. We are also proposing a dividend same as last year of about Rs. 35 per share, which essentially means 56% of net earnings when you add the dividend distribution tax.

On the other income front, the currency impact was net favorable for us this year as a strong hedge gain more than offset reduction in the valuation gains. We also had very healthy investment income of about Rs. 21 crores due to build-up of cash throughout the year. We had $114 million worth of forward hedges as at year end, out of which about $94 million worth of hedges we realized at Rs. 68 to a dollar and they will go into the operating revenue line over the next year or two giving support to our operating margin. Further about $20 million worth of pre AS-30 hedges will mature at Rs. 71.5 to a dollar over next few quarters giving support to our other income line as well. Overall, this is the best ever hedge rate we ever had in last many years. If you look at the year-over-year operating margin bridge slide, we have had almost 10% drop in percentage terms which was proportionately distributed across all major cost heads. Out of that 10% or 1000 bps, roughly 410 bps is contributed by delivery cost or employee cost increases which in turn are contributed by the disproportionate share of growth of cable business and general utilization drop across the businesses and disproportionate salary and benefit increases throughout the year due to some policy changes as well. The 220 bps dropped contributed by sales and distribution cost heads is almost equally distributed between travel and onshore remuneration including contingent payment increases. The onshore remuneration increase is primarily due to strong exit as a quarter as well as due to higher contingent payment attributable to emerging growth which we always want.

On the G&A front, half of the gains is attributable to the CLX acquisition related cost, an increased CSR budget while remaining general and administrative cost increase is basically due to disproportionate increase in facility related cost also contributed by our Mumbai facility consolidation initiative. 140 bps of depreciation drop is almost entirely attributable to the changes in useful life prescribed in the Companies Act which has a charge of about Rs 13 crores in this full year.

We have cash and cash equivalent balance of Rs 440 crores at that year end which is the best we ever had at eClerx. Out of this, roughly Rs 180 crores has been spent on CLX acquisition cost. Further about Rs 130 crores has been earmarked for the proposed dividend. Further, our Mumbai consolidation plans have more or less completed satisfactory as of date, after significant gross addition of seats throughout the year. We have leased already enough spaces in prior quarters across three cities which will go live over H1 of FY16 and provide us enough capacity for near term growth.

On the CSR front we have been able to successfully spend 2% of our standalone profits towards the planned programs of child education and health.

The US concentration matrix on the business matrix slide has increased to the highest level we ever had simply because of cable business growth which is US concentrated as well as due to substantial Euro weakening against INR. Our DSO historically have been in the 70 to 80 days range and this year end is no exception. Our DSO stood at about 81 days including unbilled revenue. With the clarity emerging about consolidation among our cable clients or rather lack of it, our top 5 concentration are expected to be in low 60’s next year for organic business excluding CLX, similar to the Q4 number of 64%. Our staff utilization for the year was tad lower than the last year and our SEZ contribution is expected to be in low to mid 70% range due to our Mumbai consolidation effort. We have very strong client addition of 24 client logos this year with total clients getting billed increasing to 90 clients. This count is expected to increase significantly next quarter due to addition of CLX. As of Q4FY15 we have now 7 clients each in $ half million plus, $1 million plus and $5 million plus bucket which is addition of one client each in each of the buckets over the last year. Our emerging client growth has been increasing steadily from 8% Y-o-Y 3 - 4 years back to 44% now, whereas our top five mature accounts have been largely flat this year. Our people count increased by more than 18% Y-o-Y to end at 8100. Our onshore business development staff count has largely remained constant in last 2-3 quarters ending at 89 although the Y-o-Y increase in business development headcount has been around 17%. The attrition has reduced by almost 200 bps while the industry has seen an increase of more than 300 bps in the same period of last 4 quarters. We are pleased that our efforts to change our people practices and reset the pay has held us swim against the industry trend of increasing attrition this year.

Lastly, we mentioned about applicability of IND AS for eClerx starting 1st April, 2016 in our last call and we also said that we will start aligning our accounting policies with that new standard across the globe including CLX. We will give a more definite impact of that in Q1FY16 if any and also inform you about any changes in the treatment of goodwill due to that. With this, I will like to hand over back to Inba for Q&A.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from Manik Taneja of Emkay Global. Please go ahead.

Manik Taneja: Just wanted to get your thoughts in terms of how do you see business within your top customers? That's question number one. Second question was with regards to another top client in the cable and media business where we have seen some development related to their inorganic move. How do you see that impacting our revenue performance in that segment? And thirdly, if you could also talk about what you are seeing on the emerging side of the business?

Anjan Malik: Let me take the second question first, which is around cable and telecom. So it is no secret that the merger that was being discussed would ultimately have impacted us in a large way because it would have taken two customers and made them one in some way it should perform and obviously created a phenomenal amount of distraction and I found that distraction we had already started seeing 6 or 7 months back when this merger was first announced and we are suddenly seeing that now those discussion have stopped. People going back to focusing on business and that has reflected through buildup of pipeline and more advanced stage discussions over the last few weeks. So, on the whole we feel good about the outcome and we also keep saying that in that discussion we were introduced to other players in the market place which I think is also helping us start conversations that perhaps would never have happened in the absence of the M&A discussions that were continuing. Performance of our top clients have continued to be muted, so whilst we see a fair amount of what I would call gross sales where we are selling in new services, we see attrition in all services partly because of change in business focus, partly because of obsolescence of technology. So overall we managed to what I would call tread water in terms of our growth percentages, which takes us nearly point 3 which is emerging and if you actually look at our business performance in merging it, it has been very strong and if you actually look at measures of things like gross sales, there has been a disproportionate amount of growth in emerging and that is the area where we can feel quite bullish, particularly on the back of what I would call our productization effort, so the product as we have discussed many times and emerging is where we have seen the biggest benefits of that focus.

Manik Taneja: And if you could give us some sense of in terms of you had very healthy client addition in the current year. If you could give us some sense in terms of which segments would these client additions largely be and the second question was for Rohitash. If you could give some sense in terms of the wage hikes that you planned for FY16 and how should we think about margins in the near term?

Anjan Malik: So, the answer on question regarding logo addition, CTS and FS tend to be what I would call larger ticket programs. So we tend to win larger engagements from fewer clients. So by definition, the logo additions tend to be in DMS. So out of the 24 that we have disclosed, most of them have happened in DMS, a couple of them would have be in CTS and FS by the number of logos.

Rohitash Gupta: Manik, your second question was about the sustainable operating margins right?

Manik Taneja: Sure. I am looking for your outlook in terms of margins for the next couple of quarters and if you could give us some sense in terms of what was the cost that you had incurred related to acquisition expenses in the current quarter and should we see some of that cost come through even in Q1FY16?

Rohitash Gupta: Right. So I would say that roughly 70 bps of margin decline in the full year can be attributed to CLX related costs. So that makes your restated FY15 operating margin at about 29% right. Now coming to next year or near term, we expect that we will be closer to 30% operating margin, may be 29% to 30% range simply because we will further get support from our hedged rates under the AS-30 regime.

PD Mundhra: And Manik, this is P D. Just to clarify one point. I believe the numbers Rohitash is stating are without CLX.

Manik Taneja: Yes, I understand that.

Moderator: Thank you. Our next question is from Utsav Mehta of Ambit Capital. Please go ahead.

Utsav Mehta: My first one is, if you do not mind sharing, could you tell us what the AS-30 hedge benefits for this quarter were?

Rohitash Gupta: So Utsav, I do not have those numbers handy. Roughly if you look at what is there in terms of the next 1-2 years, those numbers are $94 million of hedges. That will mature over next maybe 6-7 quarters from now at about Rs. 68. So even if you equally divide that revenue per year to maybe $50 million at Rs. 68, we should expect $50 million in next year to come at Rs. 68.

Utsav Mehta: Ok I understood. My second question was to do with margins again. Just wanted to understand since you are saying that margins will be in the low 30% range, so wanted to understand how the build up from the current 23%-24% that was reported in this quarter would be towards 30%. So where would the benefits come from? I understand the acquisition bit was one off. So that would add approximately…?

Rohitash Gupta: I will encourage you to look at full year because the changes that have happened throughout this year, it will be very inaccurate to build a bridge from Q4 onwards. For example, you take any change. For example, we did pay resets at the start of the year. Now only Q4 impact may be understating the full impact because the full impact comes in Q1 for that initiative right and so and so forth. So I would say, you should look at the bridge from 28.2% or 28.3% for the full year operating margin onwards and as I stated roughly 70 bps of that is purely due to CLX related acquisition cost. So you stand at about 29% right.

Moderator: Thank you. Our next question is from Srivatsan Ramachandran from Spark Capital. Please go ahead.

Srivatsan Ramachandran: Just wanted to get the break for the difference between dollar revenue growth and constant currency revenue growth is slightly larger than what I was modeling. So just wanted to know if there is any change that is leading to slightly higher mix change between constant currency and dollar?

Rohitash Gupta: So Srivatsan, constant currency versus dollar growth you are asking right which is about (+90) bps and as you know roughly 15% of our revenue is in Euros and maybe 3%-5% is in GBP and I hope that will help you work out the numbers, but this entire plus is attributable to these two currency changes versus dollar.

Srivatsan Ramachandran: And second is in terms of the integration timelines of CLX in terms of, given that now you have been looking at asset for long. So just wanted your commentary on EBITDA in terms of margins or profitability. Do you think in the first year or 18 months, that would be necessary to invest more to ensure you can take it across to your service offerings to existing clients or do you think you will continue to operate it where existing margins of CLX is at its early 20's?

PD Mundhra: I think the prudent assumption for now would be that the margin of CLX will continue to remain in the ballpark where they have been. I think it's important to keep in mind that this asset has a very different operating model from the rest of our business in terms of where its delivery is located, the nature of its client base and so on. So I would presume that integration will may not be as comprehensive as what we did with our cable business and therefore I think at least when we have looked at this asset and considered a partnership with them, we have always assumed that operating margins will continue to remain more or less in a similar range as they are for the time being, so which is why I think all the statements we have made about margin outlook for FY16 have been ex-CLX and I think once you had a quarter or two of working closely with them and including their results and ours, we will be in a better position to provide some guidance of how we see that margin shaping over time. So for now I think safest course of action would be to assume that margins will stay roughly where they are for CLX.

Srivatsan Ramachandran: My last question is from the Financial Services practice. We have seen a lot of talk or rather a lot of action from the captives also on ramping up in India especially on the risk and compliance area and I just wanted to get your thoughts in terms of, are there work which is currently being done by us for whatever reasons some of the clients are migrating to captives. Is that a conversation you are seeing from some of your clients?

Anjan Malik: So I think it is a fact in life that there is a coexistence of three types of entities in most of our large clients. So there will be a large IT vendor, there will be a captive organization and then there will be a guy like us who is providing some element of niche or solution-oriented services. So at any given point in time, there are always things that go to a captive or go to the big IT guy who come to us and we have seen a two-way traffic between a captive and third parties like ourselves. So there may be for example places and it is not limited to banking. For certain activities that we were carrying out might end up in a captive and there instances where things that would be done in a captives may end up coming to the vendor because of a more holistic service stereotype solution. So I think conversations are continuing and they always are. I think the bigger trend actually which we see more and more in the BFSI sector is sort of more, there has been a much more focus on what I would call utilities, so non-linearity in terms of cost. So I do not think it is much BPO or third party versus captive as much as looking at how can we create more industry utilities where we can reduce or we can create multi-tenancy where the same function is being provided to multiple banking clients. So we have seen those kind of conversations to take on much more traction.

Moderator: Thank you. Our next question is from Ankur Rudra of CLSA. Please go ahead.

Ankur Rudra: Just wanted to understand the margin one-offs, is that only 70 basis points because of CLX on the G&A?

Rohitash Gupta: Ankur that is largely true although there might be a small one-offs in some other items but I would say that, that is not material or quantifiable event for us. So lastly that is the only one-off that we can identify because other things like regulatory changes or be it the pay resets, most of it actually happens to take over time.

Ankur Rudra: I appreciate that because even on SG&A as an overall basis has gone up somewhat sharply in this quarter. So just wanted to understand what is the reasonable number for that for the rest of the year, FY16?

PD Mundhra: Rohitash, it might be useful to share also what the margin impact was for Q4 because the 70 bps is for FY15 as a whole right?

Rohitash Gupta: Right. So Ankur, your specific question on the selling and marketing cost right? So as you know the backdrop of this is that we had a strong growth on account of primarily emerging clients and that too CTS. Now in emerging because that is part of our strategy to grow emerging given that mature accounts are not showing too much growth. We tend to incentivize people slightly higher and that has impacted the sharp increase in selling and marketing cost for large part. Now whether that trend will continue or not will depend on what the competition of net growth next year happens to be. As of now we are contemplating it will be slightly more balanced than it has been in the last year towards emerging and top five but it has to be seen yet. So it is very difficult to model but I would say that what you have seen this year is probably on the higher side.

Ankur Rudra: Are these growth incentives led bonuses paid out in Q4 which is why you have seen a bit more of a lump in the last quarter?

Rohitash Gupta: Right. So our contingent payment largely track towards the exit which is to say Q4 revenue, so you are right.

Ankur Rudra: Fair enough. Just moving on. On growth, clearly a very strong boost this time from smaller emerging clients, etc., given the trajectory appears to be a bit better, even your commentary around your largest cable account seems to be a lot better. Is it time to revisit your medium-to long-term growth expectation that you have spoken about last quarter if I believe it was low-to mid-double digits in teens?

PD Mundhra: Ankur, I would say that overall growth assumptions outlook probably remains the same because to the point Anjan was making, I think in our core accounts which are still two-thirds of our business, we continue to see some headwinds because some of our services are sort of either becoming obsolete or getting to chase the automation. So we would not want to sort of take up the growth expectation from the current levels right now. But to Rohitash’s point, hopefully on the margin front we will see some improvement next year.

Ankur Rudra: Lastly on your larger accounts, are you expecting a reasonable amount of billing rates support from cost of living expenses this year?

PD Mundhra: Sorry. Is your question about increases in billing rates?

Ankur Rudra: Yes. Billing rates resets based on cost of living expenses for larger accounts?

PD Mundhra: Yes. I think we should see some modest increases more in line with usual years. So I would say somewhere between one and two percent maybe on a portfolio basis through the course of the year. Also keeping in mind that the currency has been relatively stable and therefore I think that sort of mix is reasonable to assume that there will be modest increases in pricing.

Moderator: Thank you. Our next question is from Hardik Verma of ICICI Direct. Please go ahead.

Abhishek: Sir the question is regarding the growth especially for the revenue. Could you highlight what was the growth rate for Agilyst this quarter versus the rest of the business?

PD Mundhra: You know we do not really provide that breakup because we do not sort of disclose segment level numbers but yes I think it is fair to say that the majority of the growth in FY15, a very large chunk of net growth came from the cable business and you see that reflected also in the fact that our people expenses as a percentage of revenue went up because that business does have a lower margin profile in terms of gross margin than our other businesses.

Abhishek: Fair enough. Just as a follow up to that, why I was coming to that in the Q4 is because out of the Rs 10 crores incremental number sequentially, our estimates suggest Rs 6 crores have come from Agilyst. Is that a fair analysis or there is incremental data point to it?

PD Mundhra: I do not have that exact number with me but certainly I think it would be true that the majority of the growth as I said earlier would have come from Agilyst. So whether it takes Rs 7 crores or Rs 5 crores I am not sure but yes more than 50% for sure.

Abhishek: And the second question is regarding the growth especially in the top five and specific to those two large customers where you know the merger process has been on. Is it sufficient to say that FY16 would see at least a double digit growth or at least in the top five could see company average growth for FY16?

PD Mundhra: I'll ask Anjan to step in on this but very quickly, I am not sure that would be a good expectation because, yes we will see some growth from our large cable customers but elsewhere I think to grow than 10% on the sort of sizeable base the that we are now, all top five clients are collectively around $100 million or so in revenues for us. So I am not sure that we will see a 10%-12% growth on the entire book. But Anjan I do not know if you have any further.

Anjan Malik: No. I think that is accurate.

Moderator: Thank you. Our next question is from Kunal Sangoi of Birla Sun Life Asset Management. Please go ahead.

Kunal Sanghoi: PD, my question is with regards to the Digital business. It is with regard to the top accounts. You did mention that there are some headwinds but with regards to the customers on the Digital front, how do you see the outlook there?

PD Mundhra: You know I think the Digital business in general has been doing well for us in the sense that a lot of customers continue to want to increase their spends in that area. Of course that spend gets divided between technology, platform suppliers, and also providers like us. I think though we do also face some headwinds from our large accounts, you mention the top account in that area. So in environments like that I think growth opportunities continue to be very limited but away from that, more broadly I think yes, the Digital business has done well in FY15 and we hope it will do the same in FY16.

Kunal Sangoi: Right and Anjan, with regards to Financial Services, all your top accounts, you did say that there is co-existence and multiple ways of working with a client. But would you say that 6 months back the kind of outlook that you had on Financial Services clients versus now is improving?

Anjan Malik: You know it is hard to say it is improving or worsening because I would say we are in a period of incredible churn. So one thing that has changed if you look at specific data points, let us say there is two. So, the demand side we have seen the revenue has come back in investment banking after a long time, the guys have had good quarter right. So mainly the expectations and assets have been marked down pretty dramatically in the last period. So that is one. The second data point from the demand side is around rates, so all the expectations about rate rises and, etc., have gone away. So cheap money is around for a while which ultimately does benefit the business. So the demand side we think is looking healthier. The flip side of it is that as I mentioned they are the most consolidated buyers and it is the most advanced set of highest vendor managers if you think about it given how some of the experiences we have had on buying low cost. So I think their expectations of what a vendor can be able to provide and what the market will provide is somewhat different now. So as I said, there is a lot more focus on utility, there is a lot of more focus on platform and non-linear, I am missing some very interesting news that we got. It is to be seen over the next 18-24 months whether this represents the seismic shift or paradigm shift in the demand from those clients or if it is just temporary. So I would say we do see a lot of demand but it does not have the same long term tenure as it has been may be five years ago because a lot of the budgets we getting is change the bank budget as opposed to run the bank budget. But there is no single trend that I can say that this a better way except the demand side revenue being up.

Kunal Sangoi: Ok. So that being the case, we as a company are we looking at any kind of platform investments, growing some platform in-house or acquiring within that space to try and cater to the changing demand?

Anjan Malik: So we have been saying many times on our quarterly calls, we have this thing called a primitive product which is the focus on a few service lines where we want to augment with onshore capability and technology investments right and technology investments in middle base is effectively looking at what platform type services we can develop. I think Syntech is probably one of the hottest areas to invest, so I am not sure that company is of our culture and nature are necessarily going to look to buy assets in that area. So I do not think buying in

Syntech is a sensible opportunity at this stage. However, here is a lot of focus in the product area that we have developed. How can we garner together many of the applications that we have already developed to create more of a product as offering and I think a lot of the growth which you have seen in the emerging is driven by those investments and I would say that we are already doing it. I think we are doing it in multiple parts of our business, not just in Financial Services.

Kunal Sangoi: Last question to Rohitash. Rohitash, did I hear you correctly with regards to the hedges, $94 million Rs 68 and $20 million which are non-AS30 hedges at Rs 71.5?

Rohitash Gupta: Yes. $94 million at Rs 68 and $20 million at Rs 71.6.That is right.

Kunal Sangoi: Given that these hedges are significantly in the money, what kind of costs you incur to take these kind of hedges?

Rohitash Gupta: These are plain forward. So there is no upfront cost.

Kunal Sangoi: But the cost of hedging if you have to look at that?

Rohitash Gupta: Cost of hedging in terms of what? In terms of our investment to plan more hedges or the charges that bank…?

Kunal Sangoi: Banking charges and all.

Rohitash Gupta: No, there is none. There are no bank charges.

Moderator: Thank you. As I have no further questions from the participants, I now hand the floor back to the management for closing comments. Off to you sir.

PD Mundhra: Yes. Thank you gentlemen for joining our Q4 call and we look forward to sharing our Q1 results with you at the end of the quarter. Thank you.

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