



“eClerx Services Limited Second Quarter FY13 Earnings Conference Call”

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**MANAGEMENT: MR. PD MUNDHRA – EXECUTIVE DIRECTOR
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MR. ROHITASH GUPTA – CHIEF FINANCIAL OFFICER**

Moderator

Ladies and gentlemen good evening and welcome to the eClerx Services Limited's Second Quarter FY13 Earnings Conference Call. Joining us on the call today from eClerx are Mr. PD Mundhra – Executive Director, Mr. Anjan Malik – Director, and Mr. Rohitash Gupta – Chief Financial Officer. As a reminder all participant lines will be in a listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. PD Mundhra. Thank you and over to you sir.

PD Mundhra

Good evening folks and thank you for joining our Q2 call. As we do every quarter, I would like to just take a few minutes for Anjan and I to walk you through the few slides on the presentation and then open it for questions. If you look at Slide #1, our total revenue for the quarter in US Dollar terms was up about 6% quarter over quarter. Total revenue for this quarter was just under \$30 million. Of that 6% sequential growth, roughly 4.5% is basically because of the inorganic contribution for a full quarter consolidation of Agilyst numbers compared to the two months that we took in Q1. The remaining 1.5% or so is the organic growth across the business. Clearly there is a big swing in the profit numbers on a Q-o-Q basis so if you look at it in a couple of different ways at the EBITDA level which includes other income, there was a reduction of about 22 crores in EBITDA quarter on quarter. Almost all of that was largely due to a swing in other income and we have a slide that provides details on that front. On an operating margin front, which is sort of our preferred measure of profitability, we came in at 32% for Q2 compared to 36% for Q1. Of that gap of about 4%, 2% was the impact of the goodwill amortization that we have elected to perform from this quarter onwards. So really on an operating basis I would say that there was a 2% delta and again we have a bridge for that later on in this presentation. These numbers, both in terms of top-line and bottom-line now reflect the full quarter impact of the pricing adjustments that we had made in Q1. Obviously some of these adjustments happened at different points during the quarter in Q1, so Q1 had a partial impact, Q2 has the full quarter impact.

Moving onto Slide #2, we have chosen to include a detailed breakup of the other income both in Q1 and Q2 to explain the swing. So other income for us is basically a summation of three different components. The first is interest and dividend income from our cash-surplus investments, which roughly is about 2 crores a quarter, not much has changed across the quarters. The second component is loss or gain on maturity of hedges. In Q1 we had \$14 million worth of hedges that matured versus Q2 where we had \$19 million and there was an approximate difference of about Rs. 6 per dollar between the hedge rate and spot rate. The hedges were at 48-49, the spot was at 54-55 for most of the quarter. So we had a 12 crore loss in Q2 versus 8 crores in Q1. The third item was actually where the bulk of the swing happened, which is revaluation, gains on our foreign currency assets which are primarily composed of foreign exchange bank balances as well as debtors. Included in the bank balances is the \$9 million that we have in escrow against the Agilyst acquisition. So in total we had a base of about \$25 million of foreign exchange, foreign currency denominated assets and the

translation loss was about Rs. 3-3.5 on that which came to a 9 crore loss this quarter compared to a 10 crore gain in Q1. Really speaking on that line item we had a 19-crore swing in profitability and cumulatively on other income as a whole we had about a 22-crore swing between Q1 and Q2.

The next slide, on slide #3 has snapshot of our outstanding hedges now. We have about \$67 million of hedges outstanding at an average of Rs. 51.4 over the next four quarters or so. Our hedge book is very light compared to a historic level, mostly because of the suspension in our hedging program while we were waiting for RBI clarification. We have now started resuming our hedging activity so we put on a little bit of hedges towards the end of Q2 and we will now look to slowly build back our hedge book to its normal level of three to four quarters' worth of revenues over the next few months.

Slide #4 has some highlights from our balance sheet. Total cash balances at quarter end were about 124 crores. This excludes once again the \$9 million that is in the escrow account. You have the EPS and book value numbers also on this slide. In terms of facilities it has been a somewhat busy period for us. In the second quarter we have commissioned our second facility in Pune which has just about 700 seats and total capex there was about 12 crores, so in Bombay and Pune we now have seat capacity of about 4600 seats cumulatively. Also we have signed a lease in Chandigarh to take on another 22,000 sq. ft. in which we expect to house roughly 450 seats. Total capacity in Chandigarh therefore will now become 1200 seats once this goes live. Therefore across Bombay, Pune and Chandigarh we will have about 5800 seats which should house about 6500 people. So that gives us a fair amount of head room from where we are. As our onsite teams have ramped, we have also run out of space in our sales offices abroad. So this quarter we moved into a slightly larger office in London. We have set up an office in Philadelphia for our cable business and we have signed a lease in New York to move to a larger office which will happen probably in Q4 this year.

Slide #5 has our P&L comparison quarter on quarter. I would not spend too much time on this Slide because effectively the same data is represented in a visual fashion on the bridge so let us move onto that slide, which is slide #6. As you can see our operating margin in Q1 was 35.9% and we came in at 32.4% in Q2. The big elements there were basically a 2% reduction in margin because of increased expenses on selling and distribution. Our onsite headcount was roughly 52 people at the end of Q4 last year and it is now 59. Much of that incremental headcount came on board at various points in Q1 and therefore in Q2 we see a full quarter impact of that expansion in team. The 2% item is basically the goodwill amortization for the Agilyst acquisition which we are writing off over a 10-year period so that will be a continuing charge but it is really a non-cash charge. India employee cost went up because we had the full 3-month inclusion of Agilyst and Agilyst has a slightly higher proportion of employee cost than our native business in online and in banking, so therefore on a blended basis India employee cost went up. Exchange rates, our average effective realization for the quarter was about Rs. 54 as compared to Rs. 55 in Q1. So there was a 2% appreciation of the Rupee for revenue recognition purposes which had a 1% impact in operating margin, against this G&A

decline because we had 4.5 crores of non-recurring expenses in Q1. So therefore there was a reduction in G&A expenses in Q2. So that is sort of the net-net. Q2 operating margins to summarize that 32.4, I think the right way to look at that would be 34.4 after adding back the goodwill amortization.

On slide #7 there is a quick update on the cable and telecom business. A lot of our energy has been utilized in doing the integration of that business over the last few months. There were two or three large initiatives that we were running. The first was senior level hiring, both in the U.S. and in India because that business has experienced quite rapid growth over the last 12 months and the management team hasn't kept pace with that so we were trying to remedy for that. And also creating capacity for the future as some of the founders transition out of the business. That is largely done. Some of the managers are yet to join and they will join over the next 4 or 6 weeks. We expect by the end of Q3 the team will be fully on board. The second big initiative was HR integration, so aligning pay, benefits, titles, perquisites, policies to eClerx's standards. This was a fairly consuming exercise because we had to do it at a name by name level. This is now been completed both in the U.S. and in India as of September 30th and all elements of HR are now aligned with eClerx's standards. The third and ongoing initiative is around operational integration. So we have conducted a detailed benchmarking of all operational processes between Agilyst and eClerx and we are aligning some of those processes which will happen by June next year. These items will add some cost to the business as we add people and as we align HR policies. Now having seen performance of the business for five months and with some estimation of what these additional costs will be, we think operating margin for our cable business will be in the low-20s in the near term and mid-20s in the medium term. Also to provide an update on total consideration for the transaction based on H1 performance and likely outcomes for H2, we expect the total consideration to be between \$19 million and \$24 million and most of this will be capitalized. About \$600,000 of this will go through the P&L in the second half of the next financial year. On the goodwill front we are amortizing the goodwill over a 10-year period so there is a 2.1 crore quarterly charge that we are taking currently. This quarter was more because we took the charge for five months from May till September but in Q3 it will be a 2.1 crore charge. Once the earn-out payment happens in the middle of the next financial year then the goodwill charge will obviously increase commensurately to reflect that.

Slide #8 has our revenue metrics – not much has changed here with the exception of geographical concentration, North America is up slightly. This reflects a change in some budget ownerships with some of our clients from Europe and Asia to North America. So it basically reflects now where that budget is controlled from. We added four new clients in Q2 and had a total of 54 active clients for the quarter.

Slide #9 has a report out on the performance of our emerging business. This has been a key area of focus for us as a management team and results are somewhat encouraging. In the last three of the four quarters emerging business has grown faster than our top five businesses and is now almost a \$25 million revenue run-rate business for us. For the first time in almost three

years our non-top-five business has exceeded 20% of our total mix. So that for us is a good sign. On the HR front we ended the quarter with about 5760 people. Attrition in Q2 was slightly higher as expected because this was the quarter just after our bonus payments. But it is still lower than the same period last year because it was about 39% in the Q2 last year versus 30% this year. So overall attrition in FY13 continues to be softer than FY12.

On slide #11 for the outlook I will hand over to Anjan and then we can take questions.

Anjan Malik

Thanks PD. It has been a challenging quarter from an organic front and when we talk to our clients we continue to see a lot of decisions on the client spend. Clearly there is a lot of focus on outsourcing; there is a lot of focus on off-shoring. But we get mixed reviews and mixed feedback from our clients based on pressure from regulators, from oversight committees, and also from really uncertainty around future business prospects for the companies themselves. So while we have fairly extensive discussions going on and I would say some pretty chunky things being discussed in the pipeline, I would say that we have less confidence about the timeline of closing those things that happened in the past, simply given the variations that we have seen from decision makers over the last 12 months broadly across our business. The good news of course is that pricing has stabilized. On the back of a weaker Rupee in the last six months as you know we have got a negotiation with some of our large clients to reduce pricing. I am happy to say that most of efforts like all of that has now flown through our P&L and we do not anticipate anything else in the medium term. On the build-up of the organization we have made significant progress on building our onshore SME and client engagement teams to the points that we are now, about just under 60 FTEs across locations. And as PD was mentioning we now have our office in Philadelphia up and running which is a great outcome for us, and helps us stabilize our footprint in the cable and telecom business. The integration of cable and telecom has gone well and continues to go well. We are seeing very positive signs from that customer base as we have gone up and met those franchisees and those franchise owners. We get very positive feedback from the work that Agilyst does and about the work that Agilyst does not. We are very bullish on certain features of that business so all hands are right now on making sure that we go through with a successful integration. PD also mentioned that the emerging business continues to show us growth signs and I think it always has done. We are very cognizant of the fact that at this time, given an uncertainty in spend patterns, we have to be very, very focused in making sure that we are differentiated in product offering, we are differentiated in our approach, and people recognize this for our domain niche offering. I think we are making good progress on that front. We are seeing some of the early signs of success. In the medium term as we have always maintained we remain very bullish in our business. In all the conversations that we continue to have with our clients show that the services and the skill sets that we have, the products that we have to offer have very high resonance and have high demand. So we do think it is just a matter of time before this starts converting into Dollars and we are confident that the new team and the new investments that we put into place will get us the right place in the medium term. With that we will hand over the questions and I am sure there must be quite a few this quarter.

Moderator Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from Hitesh Shah of IDFC Securities, please go ahead.

Hitesh Shah Just wanted to understand when you said that organic growth of about 1.5 percentage point, I was looking at standalone financials which were down by about 1 crore in Rupee terms and if you convert into the realized exchange rates were flat in dollar terms. So is it that some of the organic business has been moved to Agilyst or how are you calculating the organic growth there? If you could help me understand that it would be great.

PD Mundhra So the organic growth is growth in both cable, online and banking across that quarter, so when we are measuring organic growth we are looking at what the revenue accrued or run-rate was in Q1 vs. Q2 for each of those three businesses and that organic growth of about 1.5% is split roughly equally between the cable business and our other businesses. For the eClerx's native business, I think we had like of that 1.5% I think roughly half came from the eClerx business. As you saw in rupee terms revenue went down because the currency move was much more than that, the currency move was 2% of thereabouts.

Hitesh Shah And secondly when you said that this Agilyst would grow much faster, so is the growth possible in the cable and telecom business upwards of 20-25% or one should build in more kind of a softer growth in there and also if you could throw some light on what is happening on our financial services business. Is the pricing behind and do we see any kind of a volume discount kicking in next year onwards?

PD Mundhra So let me take the first part of that question and I will request Anjan to respond to the second part. We have tried to stay away from giving quantitative guidance on any of our businesses but I think here on the cable business we benefit from having a very small base and I think we also benefit from having the potential of larger deal sizes, individual ticket sizes for deals are larger. Therefore we think that there is a possibility for that business to have a good growth outcome over the next 12 to 18 months. Having said that it is a very concentrated business because there are 3 or 4 clients that we work with so it would be very lumpy, it would not be a smooth sort of quarterly outcome but from whatever we can see the pipeline looks really strong for that business. With that I guess Anjan can respond to the question on financial services specifically.

Hitesh Shah Just wanted to understand what is the pricing discount given in financial services? Do we expect any kind of a volume based discount in the financial services business going forward as well and when would we see the volume growth returning there?

Anjan Malik Well, I wish I had a crystal ball because if I could answer that question then I would be making a lot of money doing something else, because that is the question, to be honest, a lot of analysts, and I think a lot of people in our seats are asking in our competitor organizations. I think as we probably figured out the financial services industry is going through a secular change. There is a lot of change in the business structure, there is a lot of focus from regulators and I think a lot of guys are asking themselves a question about what their business is going to

be like. Now all I can tell you is like we do not have any eminent price reductions in play. Whatever volume based reductions are going to happen are going to be on the back of increasing volumes but in the financial services space we also have what I would call some large element of non-FTE contracts which allow us to mitigate somewhat the effect that volume based price reductions were they to happen but we do not have anything substantial in the way of price reduction planned or in the pipeline. In terms of volume growth, I would say the industry is about as focused as any industry on cost reduction and I would say that they are very, very focused on offshoring and outsourcing. So we have been having lots of discussions. As I mentioned with lots of size opportunities but again I do not know if that is a next month thing or it is an 18-month thing but we do know that there is a lot of focus and interest in doing more in India.

Moderator

Our next question is from Srivatsan Ramachandran of Spark Capital, please go ahead.

Srivatsan Ramachandran

Just wanted your thoughts given that there is some amount of pressure in terms of new deal flow or closure of these deals. Just wanted to understand, are you using this opportunity to kind of invest in some of eClerx's own technology platforms for the online or financial services markets so that when the market recovers we would be better positioned than where we were?

Anjan Malik

I mean I think that is exactly what we are doing. I made the point that one of the most important things about the businesses like us is to continue to differentiate and distinguish ourselves from our competitors or the large scale players. And we are very cognizant of the fact that we do not want to get trapped in that neither skill nor scale bucket which ultimately is a fatal place for small & medium sized companies for us to be at. I think we have historically been very, very good at being able to differentiate ourselves with our focus on products. And I think as we have had this sort of geared up consolidation, I think we have a great opportunity on doing this all over again with a much larger portfolio of services obviously than we had at a younger stage in our evolution. And a lot of our focus this year is going to be about exactly that. It is about fine-tuning our product solutions, our product-based services, our domain-led service offerings to make sure that we continue to differentiate. Now are those going to be technology platforms? I am not sure they are going to be in direct technology platforms but they will have some element of what I would call product based service characteristics, which means there will be things that there are things which customers find easy to understand and buy and sign off on as opposed to very large diffused capability pitches, which is the large consulting all the IT companies would make.

Srivatsan Ramachandran

Just continuing on that thought process, would the outcome of some of these initiatives would position us in a better way to offer non-linear pricing models to our customer like I may not per FTE-based more per transaction or whatever way you want to define, basically pay per train kind of models?

Anjan Malik

So I think there is a very high correlation in your ability to sell non-FTE, I would not say non-linear, I would say non-FTE contracts and doing that service to multiple clients. So as you

become expert a particular space then clearly your ability to convert that IP into different pricing models is exponentially higher and that is certainly a focus area for us. Is it non-linear in the way the market expects it to be, I am not sure. Is it better than pure FTE sort of backsides on seats kind of pricing approach? It definitely is and we have already shown some success in that so I think if you look at our book, we certainly have contracts into existing customers or in fact even if it is new customer where it is per transaction basis or the fixed-fee contracts where we take productivity benefits and do not give it back to our clients so that you would expect in a pure FTE contracts. So, yes is the answer.

Srivatsan Ramachandran Given the profitability prognosis for the cable and media business, just wanted to know how should we look at profitability for the overall blended business so it could kind of stay of an assuming rupee, stays constant at current margins over near term at least for the next 6 to 8-12 months kind of timeframe?

PD Mundhra I think for our native business we have always targeted low to mid-30s as operating margins and we think that it is definitely sustainable certainly at current rupee levels. For the cable business we have sort of shared with you what we think is the likely margin outlook so at some point it becomes a question of what the mix is of the total business but I think even if you assume sort of most likely outcomes I would say we will be in the low-30s on our blended average across all put together.

Moderator Thank you very much. Our next question is from Ravi Menon of Equirus Securities, please go ahead.

Ravi Menon I have a couple of questions – training and transition. How long is your training period and is it the same across all the businesses? Second, do you have a permanent team on client engagement or do people fly in and out and if they do how is that accounted under what head?

PD Mundhra On training I would say there is a slightly different approach across our businesses, so in our native businesses of online and financial services there is more of just-in-time approach to hiring and training people because we have sort of engineered our knowledge management processes to be micro-scale. Typical training periods range from 4 to 6 weeks from the time you hire someone to the time you can deploy them on the floor. For our cable business the approach is traditionally been to hire and train in batches in classrooms and again I would say sort of similar training periods of 4 to 6 weeks with the difference being that that training is delivered more in a batch fashion. On your second question about client coverage the 59 sort of account managers / sales reps number that we shared is all full-time staff who are employees of our subsidiaries in the U.S., U.K. and Singapore. And they are full-time based either in our offices or in client locations, engaged in client coverage. Their cost for the purposes of the investor presentation shows up under selling and distribution cost.

Moderator Our next question is from Pranav Mehta of Value Quest Research, please go ahead.

Ravi Dharamshi

This is regarding Agilyst – earlier in our last quarter interaction we were mentioning that margins would be in higher 20s and now we are saying that it is going to be in lower 20s so we just want to understand what happened over there. And second, is it fair to assume that earlier you were saying that the maximum earn out could be 28 million and now you have downgraded to 19 to 24 million. So are there growth issues over there as well? Can you just elaborate on that?

PD Mundhra

On the margin front actually if you look at their H1 operating margins, it is in the low 30s currently. But we have done a number of things from an integration perspective that will add cost to that business because we think that the way sort of when you have three or four founders involved there is a lot of subsidy provided to that business, because they are doing a lot of things on their own and their true cost is not loaded on the business. Once they transition out and you have to replace that effort with sort of an arm's length transaction by hiring professional managers from the marketplace, there is obviously a cost to that business. So that is why we are saying that those costs will bring down the margin for some period of time and again it is a very small business. So if you hire four or five senior guys particularly in the US it has a meaningful impact in percentage terms. Of course if you are able to grow that business to its potential and convert that let us say to a \$25-30 million business overtime then I think again you have the potential of having a 30% sort of an operating margin. In terms of your question on the earn-out I would say that the \$28 million number was a cap and the \$16 million number was a floor and there was a potential for the outcome to be somewhere in between based on business outcomes. So the range that we are projecting now is based on current revenue performance and outlook which is I would say sort of slightly above the midpoint of that range. So I am sorry if we miscommunicated but the intention was never to say that we expect to pay 28 million, the intention was the earn-out could be up to 28 million. So now that we have six months of information about FY13, we thought it would be helpful to share a narrower range than 1628.

Ravi Dharamsingh

So what is the arrangement with the top management of Agilyst? When will the transition happen?

PD Mundhra

The arrangement is that they are expected to be around that minimum till the end of the earn-outs which would be sort of mid-calendar next year. After that really it is sort of based on mutual interest, it is a purely a voluntary arrangement between them and us. So it is hard to predict what happens at that time but if you look around and see what is customary in transactions like these I would say in the majority of instances for transactions of this size typically some of the founders leave. So we want to make sure that we have redundancy and that we have a transition team that can take over if they leave.

Moderator

Our next question is from Madhu Babu of HDFC Securities, please go ahead.

Madhu Babu

What is the depreciation run-rate we have to take from here on quarterly for next quarter onwards?

PD Mundhra I would say the depreciation would be a sum of two components. One is a regular depreciation based on capex which should not be different than what it has been in the past. A new component is the amortization of goodwill which at least in Q3 and Q4 will be 2.1 crores a quarter.

Madhu Babu And sir how is the sales force traction happening? I mean we had substantial people onsite, so currently it is around 59 people. So what are the results we are seeing, I mean how is the business traction from this new sales addition?

PD Mundhra Well I think one of the things that we have to look at is growth in our emerging business which is more effort intensive than our top-five business because you do not have the same benefits of scale when you cover. That was one of the objectives for us increasing our investment in the sales force a year and half ago and I would say broadly speaking results are encouraging. Again the velocity of progress is nowhere near what we would have liked but at least it is all moving in the right direction. I think the other way to think about that sales force is also an investment in keeping our domain knowledge current because ultimately domain knowledge for our businesses resides primarily in client's markets and that team is the link between our clients and our delivery organization in India. So I think on that objective also the team has been helpful. Clearly in terms of growing an overall revenue this will mean a soft year so there is some disappointment. Some of it is a function of the environment, some of it is a function of what we are seeing with our clients. Some of it is a function of the traction we have in our own pipeline but let us see when things improve.

Madhu Babu Sir second thing, now you are saying margins will come down further, so would that push the earn-out further lower because I am unable to figure out because the new professional managers will be added to the cost and that will bring down the margins?

PD Mundhra I think the earn-out is structured keeping in mind or the consideration for the transaction is keeping in mind this performance. So if you walk through the numbers, even if you assume that the purchase price ends up being at the top-end of that 19 to 24 million band ,let us say 24 million, for what was a \$15-16 million revenue run-rate business, it is about 1.4-1.5x revenue. If you assume an operating margin of low to mid-20s it is about 6 to 7x operating margin. So those were thought of the metrics we had in mind as we pursued this transaction and we think that for a business of that quality and that potential 1.5x revenue and 6 or 7x operating margin is a fair price.

Madhu Babu And just on the tax rate sir, what is it because it has gone up this quarter?

PD Mundhra Tax rates will be some blended average of our tax rates and the tax rates for Agilyst. Our tax rates will be effectively continue to be based on MAT so about 20% or thereabouts. The Agilyst tax rates will be, since the parent company, the U.S. company about 33% or so. So blended average I would assume maybe 22% or so would be the tax rate but Rohitash can probably give you better guidance offline.

- Rohitash Gupta** Madhu, the jump in this quarter primarily is because the amortization of goodwill is not a tax-deductible expense so to that extent yes, there is a jump. But I think we will still maintain that for FY13 22-23% overall effective tax rate will be there.
- Moderator** Thank you very much. Our next question is from Rajat Budhiraja of Banyan Capital, please go ahead.
- Rajat Budhiraja** My question would be floating around margins. I am just trying to get the understanding because on Page-1 you are giving EBITDA margins and operating profit margins. EBITDA margins are excluding the effect of FOREX and operating margins is little including that. And you are giving the guidance that your operating margin would be in the range of 29%. So I just want to have a fair idea that what are the enable margins in your business apart from FX or any one-time expenses?
- PD Mundhra** The metric for margin that we focus on is operating margins because as you mentioned in your question, the EBITDA number includes the FX fluctuations which tend to be fairly volatile. So we look at operating margins for our business and we think for this quarter as you can see operating margin came in at 32% and we target low to mid-30s for operating margin for our business. At current FX levels 53-53.5 we are confident that we can maintain operating margins in that band.
- Rajat Budhiraja** And if I take out amortization which is 2%, so your margins would be improving by 2% and again your G&A expenses which last time were onetime expenses. So if we take out that also the margins should be in the range of more than 35%. So are these like sustainable margins because integration cost is going to be there going forward with the Agilyst or if any other cost that you foresee is going to be for one-time for the next one year or two years?
- PD Mundhra** No, I think the one cost that we can see at this time is the \$600,000 for the transaction consideration that will go through the P&L in the second half of next year. So that will sort of be a non-recurring expense but apart from that there should not really be any other non-recurring expense and we think that for FY13 as a whole barring any very large scale fluctuations in foreign exchange we should have an operating margin of certainly low to mid-30s for our native business and for Agilyst as a whole for this year at least it should be mid-20s because for the first half we were at low 30s and for the second half I expect we will be in the low 20s. So if you average that, I think for the cable business we will be in mid-20s and for our native business, we will be in mid to low-30s.
- Rajat Budhiraja** And if I remember in the last conference call you had mentioned that we have ramped down the own shore employees to 60 and in the current conversation we have mentioned that it has gone from 52 to 59 which has increased your SLB expenses. So the affect of 52 to 59 has already been priced and it is going to be there in the next quarter also?
- PD Mundhra** So our onsite headcount was 52 at the end of Q4 that is in March. In Q1 that went up to 59 which is at the end of June but those people came on board at various points in the quarter so

the full quarter impact of that team is there in these numbers now. There will be a marginal uptick in Q3 because for our cable business some of the new hires have not yet joined and they will join in October but again as I mentioned, sort of keeping all of that in mind we think that the margin targets that we have are achievable.

Rajat Budhiraja

And what about the integration cost with Agilyst going forward?

PD Mundhra

So that is why we are saying that for the cable business in the near term we expect margins to come down to the low 20s because that integration cost will involve the cost of this senior team onsite will involve the increase in HR cost or payroll cost in India once we have done the alignment with eClerx, etc., and will also involve high depreciation on the new facility once it goes live in Q4. So all those things will come so we will see a decline in operating margins for the cable business in the near term but as we get a little bit of growth in that business and we are able to amortize these costs which are largely fixed in nature over a larger revenue base, we think that mid-20s is certainly very achievable for that business.

Rajat Budhiraja

And it would be great if you can quantify some number on a consolidated basis.

PD Mundhra

Well I think that depends on the mix, right so may be Rohitash can give you more detail offline.

Rajat Budhiraja

And just want to understand, I am looking at the Slide #6 and in this Slide there is a 1% affect of the exchange rate. I just want to understand what exactly if we are comparing the same number for the two quarters.

PD Mundhra

If you go back to the previous slide, Slide #5, when you look at the footnotes you will see that FY13-Q2 average exchange rate was 53.98 and just below that you will see Q1 average exchange rate was 55.01. So there is a 2% appreciation in the rupee for our revenue recognition purposes between Q1 and Q2 and for every 1% increase in the currency, it has a margin impact of between 50 and 55 basis points for us. So the 2% increase in the currency translated into a 1% drop in margins. That is the effect that you see.

Rajat Budhiraja

Okay and where exactly this 1% is reflecting in the expenses? It is spread all across the revenues.

PD Mundhra

Yeah, so the bridge is done in constant currency and that is why the exchange rate affect is delineated. I would suggest that if you would like to understand this better you can have a follow-up call with Rohitash.

Rajat Budhiraja

And just want to understand your DSO went up to 41 days. What is the primary reason behind it?

PD Mundhra

I think DSO will be somewhat volatile. Actually this is not a large move, if you take a 5-quarter view it has ranged from 29 days at the low to 76 days at the high. So I think that sort of

average DSOs for us will be somewhere around 50-55 days and it will swing in some range around that. So I would not put too much talk in that DSO number because there will always be some swing.

Moderator Our next question is from Abhishek Shindadkar of ICICI Securities, please go ahead.

Abhishek Shindadkar Sir could you break the 1.5% constant currency growth into volume and pricing?

PD Mundhra We shared with our Q1 results that the total pricing adjustment across the portfolio was between 3% and 4%. Now this was obviously across multiple clients and therefore at multiple points for time in Q1. So just for the sake of simplicity if you assume that those pricing cuts happened in a normal distribution throughout Q1, we would have got half quarter impact in Q1 and the remaining half quarter impact in Q2. So we have 1.5% organic growth, you can assume somewhere between 1.5-2% of pricing headwind incremental in Q2 so about 3-3.5% of volume growth in Q2.

Abhishek Shindadkar The reason I asked this question is in the first quarter if I remember it correctly the volume growth was between 3% to 4% and this time it is between 3% to 3.5%. Our primary reason of giving discounts on the pricing was to get incremental volume. So on the organic side are we getting the volumes which are being committed against the pricing?

PD Mundhra There were two reasons for performing the pricing adjustments. The first scenario was situations where with clients we have an agreement which says if over a 2-year period or over some period of time you substantially increase the amount of work you do with us by 50%, 75%, 100% then you will get the benefit of reduced pricing. What we had shared was that in Q1 a couple of our clients tipped over those thresholds because they have on a cumulative basis reached that relationship size or slab and therefore became eligible for a lower price. So that was the first scenario. The second scenario was in a couple of other instances given the sharp move in the rupee we felt that we were at the risk of not being very competitive against other alternatives our clients might have whether it be captives or third parties and therefore we have engaged in discussions with clients and taken pricing adjustments in those situations as well. So efficacy on pricing is a net outcome of both of those triggers and across the portfolio had an impact of between 3% and 4%.

Abhishek Shindadkar So could we assume that the incremental volume should flow in the Q3 and the Q4 and the second part of the question is obviously the Q3 will have a lesser number of working days. I know you do not guide but Q3 volumes would be a little tepid related to Q2?

P D Mundhra Again to clarify the rates resets were done on the basis of volumes already achieved. So if the client gets the benefit of a lower price once they reach a certain slab. So it is not an anticipation of future work. It is more as a reward or as an eligibility for having reached a certain point. So the fact that rates went down in Q1 does not mean that necessarily that there is additional work to come as a result. On the second part of your question we do not really bill in terms of days, etc., So more or less holidays to that degree does not have an impact on

revenues for us because we bill on a man-month or man-quarter sort of unit. So that really should not have an impact.

Abhishek Shindadkar Rohitash were we anticipating this higher quantum of FX related loss during the quarter? I know you would have done M-to-M at the end but in the quarter were you anticipating a significant loss on the FX side?

Rohitash Gupta Broadly yes, we were anticipating FX losses to this scheme.

PD Mundhra But you know as you will appreciate the Rupee appreciated very sharply towards the end of September but as you can see our average rate for realization was about Rs. 54 during the quarter and the quarter end rate was 52.50 where all of our assets got remarked. So to some degree these likely outcomes become clearer in the last two weeks of the quarter. And as you start getting a better sense of where the exchange rate will settle.

Moderator Thank you very much. Our next question is from Pranav Mehta of Value Quest Research, please go ahead.

Pranav Mehta I was just wondering what your lead indicators of the growth are suggesting especially your ramp up in employee addition and especially your non-top-5 and non-Agilyst clients?

PD Mundhra On the ramp up and employee additions a large part of that ramp up is in our cable business and there we have this scenario of hiring people in batches and training them in batches. So I would not sort of take that to be very indicative of a sharp jump in the near term revenue. I think in general the scenario has not changed too much between the end of Q1 and now in terms of outlook on organic growth, etc. Our non-top-5 and non-Agilyst growth – I think that generally speaking has been stronger than our top-5 performance and we hope that that should continue in the future as well. Having said that it is still on a very small base, right because as you will see from the numbers it is now a \$25 million business in an aggregate across cable online and banking. So there will be some volatility associated with quarter-on-quarter numbers but broadly speaking at least if you look at the last six quarters and five out of six quarters I think non-top-5 growth has been better.

Pranav Mehta Actually yeah, that is what I wanted to ask. I mean non-top-5 growth looks good but if we were to take out the top-Agilyst client does it still look that good?

PD Mundhra Actually the top Agilyst client is not there because they are now part of our top-5.

Pranav Mehta That is part of the top-5. But you have top-6 clients which are big right.

PD Mundhra Well at some point we hope that will become top-7 and top-8.

Pranav Mehta And what is the breakup between Retail and BFSI in revenue?

- PD Mundhra** It still continues to be roughly equal. There has not been a huge change. So both of those businesses in coincidence seem to grow or otherwise at the same pace.
- Pranav Mehta** And what is the growth outlook for Retail?
- Anjan Malik** We continue to be bullish because we do not have a business which is Retail. We have a business which is primarily Digital or Online Services and that is multi-industry. So in the online space we continue to see a lot of demand for our services. I think we mentioned the point a little while ago that there is a lot of migration activity for platforms to move online. So we continue to get a lot of interest in those services. And I would say a lot of reverse increment. We find people moving from company to company calling us up to provide similar or the same services that you are providing to them in the previous company. So on the whole there is demand.
- Pranav Mehta** Are there any RFPs coming up right now and when does the investment in the sales and marketing end?
- Anjan Malik** I think we mentioned sometime ago that a large part of our business is not RFP-led because usually if you are in the business of RFPs you tend to be in what I would call the liquid portion of services and our service portfolio is not tough but typically guys would go out in RFP. So our book is typically things that we would propose as ideas or things that our clients would ask us to take on as an effective concentric area that you are already working in. So that is continuing.
- Pranav Mehta** When does the investment phase and sales & marketing end?
- Anjan Malik** Well I would say that and I think this is the point that PD had made earlier in the presentation. I would say that we are right-scaled for the size of the business that we are today. I think what we would like to do now is look at the size of the business that we have, look at what I would say restructuring we can do in the way we run that business and the roles and responsibilities that people have to make sure that we are maximizing the ROI of the investment that we are making in that business. So I would say we are right sized but we would have incremental changes from here as opposed to large step changes that we have seen in the last 18 months.
- Moderator** Thank you very much. As there are no further questions from the participants I would now like to hand the floor back to Mr. P D Mundhra for closing comments.
- PD Mundhra** Thank you folks for joining this call and we look forward to speaking with you in January with our Q3 numbers.
- Moderator** Thank you very much sir. On behalf of eClerx Services Limited that concludes this conference call.