



“eClerx Services Ltd. Q4-FY10 Earnings Conference Call”

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**MODERATORS: MR. P D MUNDHRA-EXECUTIVE DIRECTOR, ECLERX
MR. ANJAN MALIK-DIRECTOR, ECLERX
MR. SACHIN RASTOGI-CFO, ECLERX**

Moderator

Ladies and gentlemen, good morning, good evening and welcome to the eClerx Services Ltd. conference call to discuss the results for Q4 FY2010. Joining us on the call today are Mr. P D Mundhra – Executive Director, Mr. Anjan Malik – Director and Mr. Sachin Rastogi – Associate Principal. This is Rochelle, the Chorus Call Conference Operator. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Mundhra of eClerx Services Ltd. Thank you and over to you Mr. Mundhra.

P D Mundhra

Thanks Rochelle. Good evening everyone and thanks for joining our FY10 conference call. Without further ado let me begin to the presentation so that we can run through that quickly and leave time for some questions at the end.

On Slide #1 you can find the key financial numbers for the quarter and the year:

We ended the year with \$55 million of operating revenue which was up 30% over the previous year. Revenue for the 4th Quarter was just under \$16 million, up 6% quarter-over-quarter in dollar terms. Total revenue for the year came in at 246 crores, up 28% year-over-year. On the margin front we were largely able to maintain margins in our target range. Operating margin for the year was 36% and for the quarter was 34% and net margin for the year was 30% so very much within the range that we were targeting. EPS for the year came in at just over Rs. 38 on a basic basis and Rs. 37 on a diluted basis. The board has recommended a dividend of Rs. 10 per share along with the interim dividend that we had paid after the half year of Rs. 7.50. The full year dividend cumulates to Rs. 17.5 per share which equates to more than a 50% payout ratio of net income.

Slide #2 has some of the highlights for the year:

We believe we have now achieved true scale in our business. For the first time we crossed \$50 million in revenue this year and we are close to 3000 employees. On a corporate development front we set up a subsidiary in Singapore this year and now have a direct presence in five countries with operations in India and sales and marketing presences in the US, UK, Ireland, and Singapore. Through the year, we continued to increase our wallet share with our large and strategic clients, in fact that business grew faster than the overall 30% growth in revenue that we experienced across the firm and even qualitatively the nature of services continues to become more core and critical for our clients, which we believe is positive as a sign of quality of revenue. Of course the other connotation is that this resulted in higher concentration for the year, with now 82% of our revenues coming from our top five clients which is something that we have anticipated when we spoke on the subject about 12 months ago.

On another note we are very pleased to see that some of our 2nd Tier clients are on the verge of reaching inflexion points and we feel confident that we should be able to manage our concentration matrix down over the next year and two as a result.

On the operation side – We continued our investment in people and infrastructure. We have brought on a number of senior hires both in India and in our overseas client markets during the last financial year. Although attrition is picking up as the talent markets in India are tough, but we have largely been able to successfully retain our senior management talent and attrition is contained to more of the entry level positions in the firm.

On the infrastructure side – We started the build out of our Airoli facility and that is proceeding on progress and we expect to start operations in late June.

Slide #3 has a status of our hedges as of the end of the year on March 31st. We had about \$46 million US\$ in hedges across the combination of forward and option at an average around 48. This is obviously a more favorable hedge position than we had the previous year. So we expect that the FX losses that we had in FY10 should not be the case in FY11.

Slide #4 has key snapshots from our balance sheet – We had 125 crores in cash at the end of the year. Of our IPO proceeds, we have used 35 out of the 66 crores and we plan to take shareholder approval to defer the utilization of the remaining amounts against tax positions and additional facilities till FY12 to give us time to use that money more productively.

Slide #5 has the P&L compare FY10 versus FY09 – Without spending too much time on this slide, I think the message is more graphically represented in Slide #6 on the operating margin bridge. Operating margin for FY09 was 37.2 and it declined 90 basis points to 36.3 in FY10. The big change was increased investment in employee cost of about 4% which was a very conscious decision on our part as we brought on more senior hires in both India and overseas. The headroom for this was created by better scaling on our operating expenditure side. As we ramped operations in our Pune facility and improved utilization levels, G&A and other OPEX as a percentage of revenue declined to allow us to make those investments without really impacting our P&L too much.

On the net margin slide on Slide #7 – The key item to call out is the foreign exchange losses last year because the hedges were at more unfavorable rates. Again, as I mentioned previously we believe that we are much better positioned for FY11 and beyond.

Slide #8 has key cuts of our revenue demographics – The big changes I think are on the currency concentration front. With increased penetration in Europe, our Euro concentration has gone from 18 to 23 which obviously might be slightly negative in the short term as the Euro depreciates but we believe in the longer term, the most important thing for us is to have a balanced look of business across currencies.

Geographic concentration remains roughly the same as before. Our client concentration has gone up in FY10 for the reasons we spoke about previously but again we anticipate that that should improve over the next 12 to 18 months.

On the billing mix – Our SEZ revenue has gone up from 28% share to 42% in FY10, which has the happy effect of reducing our effective tax rate in FY10 even though the minimum alternative tax went up from 10% to 15%. So we were able to more than mitigate the entire impact of the tax increase by having the SEZ contribute a higher share for revenues for us for that year.

Slide #9 has a quick snapshot on staff details – We ended the year with just under 3000 employees and attrition for FY10 came in at around 30%. We expect FY11 to look more similar to FY07-FY08 on an attrition basis and the software conditions we saw in FY09-FY10.

With that I hand over to my colleague Anjan to talk about FY11.

Anjan Malik

Well I will probably use this as an opportunity to give you some sense of kind of things that we are seeing in our current markets more than setting up a stage for what expectations should be for fiscal 2011.

I think one of the continuing themes is continued focus on cost reduction from our clients which clearly is broadly positive for the outsourcing and off-shoring business. The other key thing that we see is that the cost benefits of third party versus captives seemed very well understood. Since you get much lesser debates from our clients and other clients and the advice is that you drive them on these matters on what the cost benefits are and that is again probably positive for third party BPOs/KPO providers in the industry.

What is interesting is we had mentioned in the last quarter's review that we were seeing IT and consulting budgets have opened up and I think that trend continues to accelerate. It is both a response to our third and fourth bullet points which is on regulation that as transparency requirements and over site increase our customers are investing more and more in IT and in consulting projects to do change management activities that put them in a better place, to be more efficient and to have less risk in the business. And that is obviously very good for the consulting firms, the IT firms and parts of our business that cater to risk management.

On the 5th slide clearly as has been seen most vividly by the fiscal situation layout – There are clearly large deficits in 2008 as government took over more and more corporate debt. The response to it has been high taxes, more bureaucracy, and clearly more protectionism. We are seeing a rise of consumers and employee protectionism from the state and that is obviously impacting our customers in European and US markets and we anticipate that this will continue to affect the margins in the short-to-medium term. So if it looks back to the first point of why we think that there is a greater focus on cost reduction but that is an important fact that we keep in mind. Our customers are also seeing much more hostile government not just for

example abroad I mean we have seen what has been happening in Dubai and the likes some place like China and always has been the case in Asian markets but now those governments are hostile in the local markets, so for example in UK or in Europe or in the US I think that is when your customers are under pressure, more regulatory pressure and more cost pressure and we are going to continue to see the fall out of that both positive and negative.

And of course we think our business come back with a vengeance, volatility in the marketplace has begun now and that is clearly reflecting itself in any export business and will continue to do so we think over next 12 months.

And in the subset of what has been happening on a government pressure basis obviously you have seen finance act that has been passed by the various countries like Germany, US, UK over the last couple of months. There is now a move towards more aggressive product and process complexity in financial markets and there is a much-much greater drive towards transparency and capital requirements. Again, all these things will force sort of our customers to be less aggressive in the business portfolios, invest more in technology, invest more in efficiency and risk management and overall we anticipate this will be good for business because in the longer run this will imply, this will be the stronger banking system and will bring back volume much more aggressively. So with that we hand over for any questions that folks may have.

Moderator Thank you very much. Ladies and gentlemen we will now begin the question and answer session. Our first question is from the line of Madhu Babu of Systematix Shares & Stocks, please go ahead.

Madhu Babu What is the revenue size of our largest engagement with the client and how much of our revenues are annuity based?

Anjan Malik We do not disclose revenue by customer. It varies from time-to-time. I think we have been pretty clear that our top five customers are about 80% of our booker business currently. A very large percentage of our booker business is annuity, so 90% of our booker business is basically rolling business or ongoing business.

Madhu Babu Okay. How much is from the BSFI part, you have shown some new clients, so is the 90% from the banking side and just....

Anjan Malik No, I think business is almost exactly split 50% between capital markets and marketing operations.

Madhu Babu Okay sir. Thanks. That is it from my side.

Moderator Thank you. Our next question is from the line of Manik Taneja of Emkay Global, please go ahead.

Manik Taneja Given that last year most of the growth was actually led by financial services client for us, what are you seeing on the manufacturing side which is the other vertical focus for us and I understand that there are certain one-off elements in our cost in this quarter, if you could elaborate on that. Thank you.

P D Mundhra Thanks Manik. As we look out to FY11 you know we feel very positive about our pipeline on both side of the business. I think it is becoming much more evenly balanced and you know on our sales and marketing business our key focus or concentration is around online support and I think broadly speaking there are lots of tailwinds and clients as the main theme to more aggressively leverage online because it is a lowest cost distribution channel for many-many businesses. So we expect the benefits on that and I think in FY11 we will see growth will be more evenly balanced across both of our businesses. In terms of your second question on cost, we gave our annual wage hike every year effective April 1 and we did the same this year so the effect of those wage hikes would play out in our 1st Quarter numbers. The wage hike that we have given this year range between 11% and 12% on average compared to I think around 8% or so last year which was a much softer year. But again, we expect that to even out during the year and we do not expect a substantial impact on profitability for year. So we expect to be able to absorb the cost of those hikes over the year.

Manik Taneja Okay and how would our salaries compare versus competition?

P D Mundhra So we run a Hewitt Survey every year where we basically ask them to benchmark our wages against select competitors and our goal is to be median or better so all of the salary adjustments that we have done this year has been done in light of that surveys so in select areas where we compared unfavorably, we made proofread corrections and in other areas where we are well-positioned we have done sort of a more average type hike.

Manik Taneja Sure and the other question would be for Sachin, just wanted him to give us an idea on the tax rate front for FY11.

Sachin Rastogi So for FY11 we expect our tax rates to remain in the same ballpark range, as in the current year which was around 11.2%. In spite the margin increase in MAT now 15 to 18% that mainly goes of the fact that we expect most of the new growths to hit base out of our SEZ facility in Pune and a new facility that we have taken up in Airoli. So the exact status there will be no impact or slight change in the effective tax rate.

Manik Taneja: Sure, and the depreciation cost with regards to the Airoli facility that should start from second quarter almost.

Sachin Rastogi I think It will depend upon the commencement date but I think it is fair to say it is will start towards the end of the first quarter or early second quarter.

Manik Taneja Sure. Thank you.

- Moderator:** Thank you Mr. Taneja. Our next question is from the line Madhu Babu of Systematic Shares & Stocks, please go ahead.
- Madhu Babu** Could you talk more about the sales pipeline, how many new clients you are likely to be added in FY11?
- Anjan Malik** Again I think we do not really provide that kind of information on the pipeline by granularity of number of clients but all I can say is the way we see the confidence of good growth in 2011. We see a strong pipeline both from existing customers and from new customers.
- P D Mundhra** And just to add one more point you know we are less focused on the total number of net new customers added and much more focused on diversifying away our share of business amongst our client base, so we already have 40 plus clients so even if we stay in that range but we are able to bring down our top five contribution. I think that is a good outcome for us so in turn it will be just that is the number we focus on more then just per se on net new client additions.
- Madhu Babu** Who are our major competitors?
- Anjan Malik** I think it can be very right, so for example, so some of the large opportunities you tend to come across people like Cognizant, Wipro, TCS and the likes. For onshore engagements we will meet with some of the large specialist consulting companies like Sapient and Accenture every once in a while. In some parts of the business we will compete with guys like CapeGemini and in other areas we will compete for example with small software companies where we might be selling a service which is in productized by local software company in the US or Europe. So it depends on which part of the business we are focused on.
- Madhu Babu** Select IT companies have been talking of IT and BPO being an integrated offering so would that be a lost proposition for us or.....
- Anjan Malik** I think we certainly are aware that a lot of the large IT companies sell IT and BPO together. Some of our customers have mentioned that and that is an attractive proposition but none of our customers have actually seen that in reality so we do not believe that these skill sets are necessarily deliverable from the same house. I think a lot of people who hire people like us or people who are looking for specialists in the specific areas that will be good at and those specialist skills do not necessarily come from the large IT houses and similarly companies like ourselves would provide the special skills and other companies that will be providing broad IT services. So we are aware that that marketing pitch is used but we are also aware that it is not really worked out in reality for most of our customers.
- Madhu Babu** Okay sir. Thanks a lot.
- Moderator** Thank you. Our next question is from the line of Saurabh Penkar an individual investor, please go ahead.

Saurabh Penkar I just wanted to get details on the Airoli facility, what is the seat addition there and what is the overall seat capacity that eClerx has right now and what is the utilization level?

P D Mundhra So today we have a total seat capacity of about 4000 seats across all of our facilities before Airoli and given that we have about 2900 people on staff that works out to about 1.4 times utilization. In Airoli the first floor that we are currently fitting out will have about 500 to 550 seats. We also have an option on more floor. If we choose to exercise that option at some point in the near future then that could give us another 750 to 800 seats but at the moment we are fitting out is give us between 500 and 550 seats.

Saurabh Penkar The cash balances are increasing with the company and may be that is why you have increased the payout ratio also this year. So how do you see utilization of the cash? I understand we have increased IPO funds utilization timeframe, so do you see any acquisition coming up or any details on that front?

P D Mundhra Well I think the cash is there either for acquisition or for distribution and we continue to look for appropriate acquisition opportunities and if we find the correct fit then the primary use of that cash would be to do an acquisition that would be accretive to all the shareholders. If we do not find the right transaction then you would see us continue to set up distributions because we do not believe in accumulating exerted cash in the company. So the cash would be used one of the two objectives.

Saurabh Penkar Okay. Thank you. That is it from me.

Moderator Thank you. We have a question from the line of Nitish Pandey, an individual investor, please go ahead.

Nitish Pandey I would like to get a sense on our key clients, the top five clients, is it the case that eClerx happens to be the sole service provider or as a backup policy they also are replicating these services from some other companies. So this would give us a sense of what is the criticality of eClerx to them?

P D Mundhra Yes, the question is clear. Nitish I would say that you know these are all very large organizations with tens of thousands of people on payroll worldwide Fortune-500 type companies so obviously they would like to maintain balance in their partner base and from a risk mitigation standpoint they would be hesitant to commit to one provider. So they all have relationships with multiple providers both for IT and for outsourcing and they all have I think without exception our products pipelines have their own captive in India and in other countries as well. So they are mature in their usage of off-shoring partners to decide what types of activity can be best performed by what type of partner, either their own captive or by some third party provider. And certainly we would not be the only provider of services to any of those clients. They have multiple other providers.

- Nitish Pandey** So that means the specific services that we are providing they are being outsourced to somebody else as well, right.
- P D Mundhra** Well usually for specific services they may not choose to split that because then they do not get efficiency to scale but they may give certain set of services to us and they may give a similar, not identical set of services to somebody else.
- Nitish Pandey** Okay, as the new facility rolls in June, is it coinciding with the new process rollout or is it that you would be migrating capacity from Mumbai to that new facility.
- P D Mundhra** No, this would be for incremental business. I think the SEZ regulation in India very clearly states that the new unit must be set up only for new activity and that is the goal for setting up their Airoli business to take care of growth.
- Nitish Pandey** Okay, thank you.
- Moderator** Thank you Mr. Pandey. We have a question from the line of Abhir Pandit of Parag Parikh Financial Advisory Services, please go ahead.
- Abhir Pandit** What would you believe would be your sales growth that you see in the next three years and do you believe that the current margins are sustainable due to the competition in sales?
- P D Mundhra** Well we do not really give guidance but what I could share with you is that our next aspiration is to be a \$100 million in revenue and that is the outcome that we are very focused on. Although I would not want to put a specific timeframe on that. On the margin front I do believe they are sustainable, you can think about it in a couple of different ways. One is if you look at the large IT companies, they all earn margin in the same range as a stronger offshore businesses and those are businesses that are much more mature and have achieved much larger scale, have been around for a longer period of time and they still maintain those margins. So for our activity which I would argue is somewhat more specialized, and also newer, preferably be able to maintain those margins. Secondly, from a pricing standpoint I think the economic environment has now been tough for more than two years and over a period of time there has been intense competition and intense scrutiny on prices and all of our clients have benchmarked their providers in terms of pricing strategy. So I think the prices that we have today are reflective of that pressure and so I do not believe that there is too much room for those prices to move down further. So again I think from that standpoint I would say margins are more or less maintainable.
- Abhir Pandit** Okay. Since you have a good cash balance, acquisitions would be in which area?
- P D Mundhra** Ideally we want to look at businesses that create new streams of opportunities for us because when you spend the cash and you pay a multiple for a business you want it to expand our addressable market within that construct I think we have a pretty broad outlook. We have looked at businesses in the travel arena. We have looked at businesses in the marketing

analytics arena. We have looked at businesses in content management and publishing so I think we are pretty agnostic from our sector standpoint as long as we believe that the industry is attractive and as long as we believe that we have the skills to integrate and manage that business.

Abhir Pandit

Okay, that is it. Thank you sir.

Moderator

There are no further questions. Would you like to add closing comments at this time?

P D Mundhra

Nothing, except to thank everybody for showing up. I know it is been a very volatile and turbulent day in the market. So thank you for making the time to attend the call.

Moderator

Thank you. Ladies and gentlemen on behalf of eClerx Services Limited that concludes this conference call. Thank you for joining us on the chorus call conferencing service and you may now disconnect your lines. Thank you.