

# Hinduja Global Solution Q1 FY2014 Earnings Conference Call

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**Management: Mr. Partha De Sarkar – CEO, Hinduja Global Solutions**

**Mr. Srinivas Palakodeti – CFO, Hinduja Global Solutions**

**Moderator**

Ladies and gentlemen good day and welcome to the Hinduja Global Solutions Q1 FY2014 earnings conference call. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference, please signal an operator by pressing \* and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Bijay Sharma from Churchgate Partners. Thank you and over to you sir.

**Bijay Sharma**

Thank you Moshin. Good afternoon and welcome everyone to Hinduja Global Solutions Q1 FY2014 earnings conference call. Joining us today on this call are Mr. Partha De Sarkar, CEO and Mr. Srinivas Palakodeti, CFO. Before we begin, I would like to mention that some of the statements made in today's conference call may be forward looking in nature and may involve risks and uncertainties. For the list of such considerations, please refer to our earnings presentation. Now I would like to invite Mr. Partha to provide his perspective on the performance for this quarter. Over to you sir.

**Partha De Sarkar**

Thank you Bijay. Good evening and welcome everyone. Thank you for joining us today to discuss HGS' financial results for the first quarter of FY2014. I assume that you had a chance to review our presentation which is also available on our website. I would discuss the overall operational highlight across the geographies and will pass on the proceedings to our CFO, Mr. Srinivas Palakodeti to take you through the financial performances in more detail. We will follow this up with an interactive Q&A session.

We are delighted to announce that for the third consecutive quarter we crossed the Rs. 5,000 million mark in terms of quarterly revenues. Although the first quarter is generally the slowest for us, we managed to deliver a consolidated revenue growth of 20% year-on-year to reach close to Rs. 5,600 million. This strong growth was driven by an increase in volumes from our existing clients, addition of new logos, favorable exchange rate for the US dollar compared to the Indian rupee and the Philippines Peso and benefits of the EBOS acquisition that we did last year.

Regions such as Canada, Philippines and India performed better than expected. Our consolidated EBITDA for the quarter was Rs. 634 million registering a growth of about 41.9% compared to the same period last year. EBITDA margins improved year-over-year as most of the facilities have started to operate at optimum utilization level and various cost control measures have been taken during the last year have started yielding results. EBITDA margins have increased by 177 basis points to 11.3%. Profit after tax for the quarter was Rs. 376 million, a growth of 94.2%. This growth was primarily due to higher operating profits, favorable exchange rate movement and a decline in interest expenses. The growth was offset to some extent by higher tax payable during Q1 FY2014. PAT margins for the quarter were 6.7%, an improvement of 258 basis points compared to the same period last year.

To sum up, the major drivers of the better performance in Q1, has been the fact that we have not seen the seasonal drop that typically happens in our business in first quarter. Fresh volumes have replaced the runoff volumes of the seasonal business and this lead to better utilization in almost all the geographies especially Philippines. Philippines had a drag on the profitability over the last 2 years because of under utilization of the seats that we built. We are expecting more ramp ups happening in second quarter and the full revenues from these ramp-ups are expected to kick in third and fourth quarter. So, the second half of the year is likely to be very strong for us. We have also been aided by the fact that in our India domestic business we have exited from some unprofitable businesses and we have also managed to get a price increase from one of our key clients. So, the India domestic business has actually shrunk in terms of total revenues, but it has improved in profitability and of course obvious strengthening of the US dollar as opposed to the Indian rupee and the Peso both. So these are the factors that majorly contributed to the improvement in Q1 FY2014.

Our US operations continued to strengthen its sales and marketing team by hiring experienced and talented individuals. We are in the process of setting up a global sales strategy and sales operation organization. This will provide impetus to our efforts for selling a global delivery model , one HGS experience and deepening our

engagement with existing clients to new service lines. We are now focusing on large multiple geography delivery relationships as compared to our earlier focus on small single geography deals. Our continued focus on sales and marketing efforts have started yielding results as evident from the strong sales pipeline from US onshore and offshore delivery. Further, we have been receiving traction from clients for additional volumes and new service lines.

As I mentioned during the previous earning call, our sales team had won a large customer in the telecom segment during the last quarter. It started servicing this telecom client from our El Paso centre from Q1 FY2014. We also expect to start servicing two new clients in the consumer goods and technology sector during Q2 FY2014. We remain focused on increasing scalability and achieve the growth target for this operation and are also undertaking an ongoing assessment of profitability of the existing clients.

Our Jamaica facility continues to service the domestic bank and has been receiving strong traction from new clients. Our US and Jamaica operations are well placed to capitalize on any business opportunity arising during the year.

Our Canadian operation continues to perform in line with our expectation and is building on strong growth demonstrated during the second half of the last fiscal year. Despite first quarter being the slowest quarter, most of the clients have retained their volumes and in fact some of them have even increased their demand. This trend reinforces the quality of service that we provide to our customers and the trust that they place on us. Our latest site in Barrie (Ontario, Canada) started operations from early July 2013. This centre has the capacity of around 350 seats and it is expected to operate with 400 FTEs by the next quarter. Benefits from the operations of Barrie site are expected to accrue from the second half of the fiscal year. We expect volumes from clients to increase during Q2 FY2014 and we have also taken proactive steps to invest in additional infrastructure and hiring employees to capitalize on this opportunity. The sales pipeline of our Canadian operation continues to grow as we expect revenues from new clients to contribute from Q4 FY2014.

Moving to Europe, UK economy remains under pressure, although there are signs of positive future indicators. They have also experienced extended outsourcing decision making cycle from customers primarily in the private sector. However, our UK and European businesses performed well driven by better than anticipated volume from existing clients. We are delighted to share that our Preston site in UK has won a gold medal for the Best Mid-sized Contact Centre in the prestigious Contact Centre World Award for 2013. The sales pipeline of the UK operations remained strong mainly due to the exciting opportunities in the public sector vertical. You may recall that we were recently selected as one of the four approved government outsources by the government procurement service. The management remains focused on developing a 'transformation' proposition which is essential for market competitiveness in the UK market. We are also evaluating inorganic growth opportunities primarily in mainland Europe.

Our Philippines operations continue to demonstrate strong growth momentum driven by addition of new clients and higher volumes from existing clients. During the quarter, we started voice based clinical service for US based healthcare client. The domestic operations also continue to gather momentum with addition of new clients.

The overall growth of volume in the Philippines operations has addressed the issues of excess capacity which have been impacting our performance for the last couple of years. We also expect to start servicing our first Canadian offshore clients on Philippines delivery centre during Q2 FY2014. We remain focused to build upon the growth momentum of this operation. Strong interest from customers for Philippines delivery proposition has led us to contemplate opening our fifth centre in Philippines in the near future.

Our India international operation has continued to demonstrate a strong performance. Normally the first quarter experiences lower volumes compared to the fourth quarter. However, during Q1 FY2014 volumes actually increased both year-on-year and on sequential basis. Our third SEZ in Bangalore with capacity of around 550 seats is being established. The first stage with 170 seats will start

operation during August 2013 and the remaining seats are expected to be complete by Q2 FY2014. In addition, we are also planning to expand capacity of our growing healthcare business with approximately 450 seats being expected to be added towards the end of the calendar year. The EBOS business which was acquired last October continues to perform in line with our expectation and we plan to start a new service line of medical coding during the fiscal year.

During Q1 2014, our efforts to expand into Middle East had started yielding results and we have started Urdu language support for a Middle Eastern telecom company from our Hyderabad centre. We also expanded our non-voice offering of chat and e-mail support for a leading consumer electronics client which was earlier serviced from Philippines.

The performance of our India domestic operations has been better than expected primarily due to the increase in volume across clients. The management continues to undertake an ongoing assessment of client wise profitability to ensure internal resources are deployed optimally. With regards to our existing clients, we are ensuring requisite steps to ensure improvement in the contractual terms and de-risking of short fall in volumes.

We continue to remain focused on diversifying our client base across verticals. Our emerging market vertical has had several new logo wins and the benefits from these new client wins are expected to accrue from the next quarter. Our HRO business that is HGS' Business Services continues to perform well and has added clients across all sectors.

In a nutshell, we delivered a strong quarter with significant improvement in performance across all geographies. Despite first quarter being the slowest quarter, we managed a strong performance driven by volume growth across existing clients and some major client wins. Moreover, most of our facilities are operating at optimum utilization level which has aided our margins.

We are also pleased to report that HGS was ranked 42<sup>nd</sup> in the 2013 global outsourcing 100 list compiled annually by the International Association of

Outsourcing Professionals (IAOP). This is a significant improvement in comparison to HGS' 71<sup>st</sup> position in 2011. We were also named runner-up in the Best Outsource Provider category in the 14<sup>th</sup> Annual Call Centre Week 2013. All these accolades demonstrate our capability to service our clients globally with the highest possible standards.

We are focused on diversifying our customer base, strengthening our presence in new verticals and expanding marketing activities to build a strong sales pipeline going forward. Our strong sales pipeline gives us confidence to demonstrate strong growth along with improvement in profitability and margins going forward.

I would now like to hand over to Pala who will walk us through the financials in greater detail. Over to you Pala and thank you all for being with us on this call today.

**Srinivas Palakodeti**

Thank you Partha. Good afternoon everyone. I would like to welcome you all once again and thank you for joining us on our Q1 FY2014 earnings call. As mentioned by Partha earlier, we have crossed the Rs. 5,000 million quarterly revenue mark for the third quarter in a row. Our consolidated revenues for the quarter were Rs. 5,592 million, a growth of nearly 20% compared to the same quarter last year.

In terms of the exchange rate, the US dollar to the rupee for the quarter ended June 2013 was Rs. 56.57 as compared to Rs. 54.82 for the same period last year. The dollar to Peso has changed from PHP 42.47 for the quarter ended June 2012 to PHP 42.20 for the quarter ended June 2013. As on 30th June 2013, the dollar to rupee rate was 59.50 for the rupee and 43.09 for the dollar to Peso rate. So the growth has been driven by a combination of increasing volumes from existing clients coupled with favorable exchange rate as well as the acquisition of EBOS. So out of the growth of approximately 20%, around 14% is due to organic growth. The EBOS acquisition made in October 2012 contributed to around 3.6% and around 2.3% came due to the exchange rate variation taking into account the basket of currencies which contribute to our revenue.

From a revenue breakup perspective, performance of all geographies improved during the quarter. US accounted for around 60% of the consolidated revenues, Canada accounted for 22%, UK and Europe 10% and the remaining around 9% was contributed by India domestic. As our India domestic business has shrunk, its share has come down from about 12% earlier to about 9%.

In terms of revenue by verticals, the EBOS acquisition combined with increased volumes from existing clients has led to the share of the healthcare vertical increased from 24% in quarter ended June 2012 to 28% for the quarter ended June 2013. Our key verticals; healthcare, telecom and technology and consumers electronics jointly accounted for nearly more than 75% of our total revenues.

Our consolidated EBITDA for the quarter increased by nearly 42% to Rs. 634 million compared to the same period last year. Our consolidated EBITDA margins stood at 11.3%, an improvement of 177 basis points compared to the quarter ended June 2012. The improvement in EBITDA is attributable to optimum level of utilization of facilities across geographies, exit from accounts with low profitability as well as the benefits from the cost control measures undertaken during the year.

Employee benefits during the quarter increased from Rs. 3,151 million to Rs. 3,833 million. This increase is on account of addition of headcount of around 1,350 mainly in Philippines, USA and Canada. Additions made to our team for strengthening sales and marketing function also led to higher employee cost while depreciation has shown a year-on-year growth of 6%. The strong revenue growth has led to depreciation for the quarter dropping from 3.9% of the total revenues for the quarter ended June 2012 to around 3.5% of the total revenues for the quarter ended June 2013.

During the quarter, we recorded other income of Rs. 183 million compared to Rs. 138 million for the quarter ended June 2012. This is mainly on account of gains due to foreign exchange variation.

Our consolidated profit after tax for the quarter was Rs. 376 million. Our PAT has registered a growth of 94% driven by higher operating profits, favorable exchange



rate movements as well as decline in interest expense. This growth was partly offset due to higher tax incidence. Our consolidated PAT margins have improved by 258 basis points to 6.7% compared to the quarter ended June 2012.

The decline in interest expense during the quarter was due to the reduction in the interest rates. In quarter ended June 2013, our interest expense accounted for 1.6% of the total revenues as compared to 2.1% for the quarter ended June 2012.

At this point, we are comfortable with our capital structure. During the quarter, we repaid debt of about Rs. 222 million and our total debt stood at Rs. 5,561 million as compared to Rs. 5,470 million for the quarter ended March 2013. The impact of repayment of debt has to some extent has been offset by an increase in foreign currency denominated debt being restated in Indian rupees at higher exchange rates. Our cash and treasury surplus at the end of the quarter stood at Rs. 5,477 million resulting in a net debt of Rs. 84 million and a net worth of Rs. 13,314 million. As of 30<sup>th</sup> June, HGS has a conservative leverage of total debt to equity of 0.42x and there has been a significant improvement in the net debt to EBITDA ratio which has improved from 0.32x to 0.03x.

The total headcount as of 30<sup>th</sup> June 2013 stands at 24,433. Of which, 61% were based in India, 16% in Philippines, 9% in US, 10% Canada and the remaining in Europe and the UK.

The total number of seats as at the end of June 2013 was 23,920, an increase of 884 seats over March 2013. The increase in volume from customers has led to near peak capacity utilization in Philippines and we are contemplating opening a new centre based on the business outlook.

With this, I would like to open the session for any question and answers. Thank you very much.

**Moderator:**

Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Dhaval Mehta from Ventura Securities. Please go ahead.

**Dhaval Mehta:** As you had mentioned earlier that you are basically working at peak utilization right, so if you see right now the margins at 11.3%. So do we expect that margins have almost peaked out for the year, so for FY2014 the margins will be at the same level?

**Partha De Sarkar:** When I say the capacity is at peak utilization, what it means is some of the ramp ups have not got converted into revenues. Ramp-ups have taken up all this space that has not resulted in revenue stream which we are expecting to happen in the second half. So with the second half, the profitability will actually improve further beyond what it is today.

**Srinivas Palakodeti:** And second to clarify, the peak capacity is primarily for Philippines which had an overhang of excess seats for about last 12 to 15 months. As we have said earlier, we are starting a new centre which is an SEZ center, we are also adding the center in Barrie and looking at adding extra seats to deal with the healthcare sector. So the peak utilization capacity was more specific for Philippines plus as we said earlier we are also focusing on the Philippines local domestic market which would mean daytime services as opposed to the night time services for the offshore business.

**Dhaval Mehta:** So what we can expect from margins to be for FY2014 like for FY2013, it was 11.3% for the whole year. So can we take at least 100 bps increment from FY2013?

**Srinivas Palakodeti :** We do not give specific guidance, but all I can see at this stage is looking at the overall numbers, FY2014 would definitely have better EBITDA margins than what we have seen of 11.3% in FY2013.

**Moderator:** Thank you. The next question is from the line of Amitabh Sonthalia from SKS Capital & Research. Please go ahead.

**Amitabh Sonthalia:** So it seems like after several quarters, some earnings momentum is back in terms of the performance and some of the earlier acquisitions are finally yielding some results. You did make some comments in your opening remarks, so just thought

some further assurance in terms of what is the kind of visibility we see in terms of revenue growth going forward and in terms of the ramp up in businesses because in the past we have sort of blamed the ramp up cost and that is one of the reasons why performance has been subdued. So if you can just throw some more light on what is happening in terms of the overall business and some of the key subsidiaries?

**Partha De Sarkar:**

I think the key to improve profitability has been actually three factors. One is improved exchange rates that we obtained from our offshore services which are currently at about 32% of our revenues. So the dollar has strengthened both against the rupee and the Peso. So that is point number one. Point number two and this is a vital point. We have actually reduced our exposure to India domestic market. We have exited a lot of clients whose businesses were not profitable and even our headcount has shrunk. This has actually improved our profitability. That is going to be a focus going forward. Also, if you look at contracts and wherever we are not being profitable – we exit from client relationships if we are not able to turn them around. The good news is wherever we were not able to turn the contracts around, we have exited those contracts and for our largest clients, we are actually managed to get a good price increase which in today's day and time is actually very difficult to do. So the ramp ups are already in as I was saying the capacity utilization is at a high number today because we have lots of people who are in training and the revenues actually will materialize in the second half of the year. So the profitability will actually improve in the second half of the year and the sales pipeline is also very strong. If you look at organic revenue growth this year, it is fantastic. We have got almost high teens of organic revenue growth which given that this is first quarter- it is actually very different from the trend that we had in the past where, Amitabh, as you are familiar with our business, first quarter always used to be lower in revenues from fourth quarter. So, I think this is the second time that our first quarter revenues are higher than fourth quarter and is a very good indicator of the sales pipeline that we have ahead of us. Based on these factors our assessment is that this will be a good strong year for the business.

**Amitabh Sonthalia:** Another quick one, you mentioned something about the exchange benefits in your presentation as well as in your remarks. So earlier we would typically have some hedging losses whenever the currency moved in our favor. I do not have the line items in front of me, but what I recall is that they are not any hedging losses that we have reported if you can just clarify on your hedging policy and in terms of both the policy as well as the reported numbers?

**Srinivas Palakodeti:** Amitabh, it is Pala here. There are two parts. One is as far as the revenues are concerned, we continue to take hedges. These tend to typically be on a rolling basis for about 12 months and this is somewhere typically in the range of 65-75%. So that is as far as the hedging policy is concerned in India. We do also take forward covers in Philippines, but there some of the movements are being a little surprising. Right now the exposure is a little less, it is somewhere in the 30% range. As far as the mark-to-market (MTM) loss is concerned, what we have done is effective October 2011, we have adopted accounting standard, AS-30 for cash flow hedges which is what we take. So essentially any mark-to-market gain or loss essentially flows into the balance sheet and we have what is called a hedging reserve. So the hedging reserve would show pluses and minuses as depending on how the MTM shapes up. So that is one reason you no longer see, but this has been from October 2011.

**Amitabh Sonthalia:** So essentially what you are saying is currency translation benefits flows in through directly, but to the extent there are some potential hedging losses, the gains may be overstated to some extent in the short run on a quarterly basis. What I mean to ask is that in simplistic terms let us say if you hedged part of your last quarter's revenue at 55, you actually realize 60 on the spot basis, but you have let us say Rs. 5 of hedging losses which has flown through the balance sheet. Is that possible, just hypothetically not to, just for me to understand how this whole concept works?

**Srinivas Palakodeti:** Let me explain. Let us say I have taken forward covers that about 53-54 for 75% of my revenue. During the quarter, what would happen is for each month I would get, let us say for 75%, I will take at the hedge rate of 54 and if the rate at the end

of the month actual spot rate is 56-57, I will get the spot rate on that amount. So to the extent it has been unhedged and the rupee has depreciated that comes into my P&L directly. So that as far as the impact of hedging and non-hedging is concerned. The mark-to-market is basically whatever were the hedges which were taken prior to for the period starting from beyond 30<sup>th</sup> June, so which is 1st July onwards to 30th June 2014. Since for each forward cover which I take, there is a fair value given by the bank and if the fair value has decreased, it translates into a mark-to-market loss. If the fair value has increased, then it is a mark-to-market gain. So for this portion, the hedges which go beyond 30<sup>th</sup> June, those because of our policy which we have taken from October 2011 will go into the balance sheet. The problem with the standard which the AS-11 which we are following earlier that any mark-to-market loss had to be shown into the P&L, any mark-to-market gain on the grounds of being conservative, you could not report it. So in that sense it was unfair and there was a big disincentive to take any hedges. So we are out of it. Now, that we have adopted AS-30 from October 2011. The third part is whatever are the revenues for April-May have to be restated at the exchange rate as prevailing in the end of June. So since there was a movement of the rupee towards the end of the quarter and which ended at around 59, so whatever was the receivables for April and May which get restated at the rates prevailing for June, that flows into other income. So whatever is the hedge-unhedged weighted average goes into my P&L, anything on the MTM loss, gain for hedges taken beyond 30<sup>th</sup> June went into the hedge reserve and any restatement of receivables from pure accounting reporting perspective that goes into other income as exchange gain. So that is how three components get reflected simply in the P&L and balance sheet.

**Moderator:**

Thank you. The next question is from the line of Ranjeet Singh from Arc Capital. Please go ahead.

**Ranjeet Singh:**

I have two questions. One is with regards to the hedging policy. So if I understand correctly what we are saying is any hedges that fall due in the quarter sort of which we are reporting, those are recognized in the P&L in that quarter and for future quarters they have taken to the balance sheet and as those quarters

keep coming up, those whatever the accumulated amount is recognized in the P&L for that particular quarter. Is that correct?

**Srinivas Palakodeti:** Yes, that is correct.

**Ranjeet Singh:** And the second aspect of that is as regards just a translation aspect of hedges, not the cash flow hedges. Those if we have translation gains or losses even for the current quarter, are those taken in the balance sheet directly?

**Srinivas Palakodeti:** No. When you say for the current quarter, there are no un-matured hedges right because whatever is hedged which I have taken in the quarter, those have already been realized and would flow through the P&L for what you described a little earlier.

**Ranjeet Singh:** That I understand, what I am referring to is for example the rupee value of a foreign currency get increases right and so for various balance sheet items on a rupee basis either the liability is higher or lower and I am just trying to understand where that adjustment goes?

**Srinivas Palakodeti:** So let me explain to you. Fortunately, for us in India on the India balance sheet, we do not have any foreign denominated debt. So the exchange rate variation does not make any difference to the P&L because if I had a dollar denominated debt, there would have been an increase in the value of the liability and that would flow into the P&L. My debt which is in dollar or pound or Canadian dollar denominated, those are all lying outside India. So any changes in those values will flow into the balance sheet as a foreign currency translation reserve.

**Ranjeet Singh:** And just to confirm if you were drawing your consolidated balance sheet as of today, what would have been, it would be the same, right?

**Srinivas Palakodeti:** I have not understood that question, but let me try to explain. For instance let us say that I had 60 million of debt in different geographies as of 31<sup>st</sup> of March, the rate used there was 55 and if nothing has changed and if the rate used for the end of June is 60, so Rs. 5 is extra liability which will get created as a foreign

translation reserve on the liability. That Rs. 5 adds into the 60 million and similarly if I have treasury surplus sitting abroad that will also get restated at value. So both the asset side and liability side get inflated by whatever is the rate applicable on 30<sup>th</sup> of June whereas if I had a liability in India on dollar denominated, then I would have had a hit in my P&L because of the restatement, if it is a current liability, it will get restated at a higher value.

**Ranjeet Singh:**

The other question I have is going back a few years, we are talking about 11.5% EBITDA margin, may be an improvement on that. If we go back a few years, our margins on the EBITDA side and consequently on the net profit side were substantially higher and then when we went through this period of declining margins in India sort of acquisitions, trying to ramp up etc., but now we are back at a situation where capacity utilization has improved. We are rationalizing kind of business we wanted to do. When you look at your business now versus going back to FY2008 and high teen margins we had there, it is not 20% in one of the years. Where will our steady state margins be? I am not talking about this year specifically, but where do you see steady state margins for the business in the environment we operate today and what will it take to get there?

**Partha De Sarkar:**

So this is a medium-to-long term question obviously from the way you have asked this. It is a mix of businesses right. So as we increase our footprint globally, our mix of onshore and offshore businesses changes. Now when you are talking about the high margin of 18 % our offshore revenues were close to 40%. Thus we acquired a lot of businesses onshore right and because the onshore businesses are lower profitability than the offshore businesses, the weighted average EBITDA declines to the low numbers that you talked about. As we improve the businesses, offshore businesses actually improved, it went down to as low as 30%, now this year is back to 32%. So there is always a balance between what you have onshore and what you have offshore. The reason we acquired businesses onshore was those act as a funnel to send business offshore. If we were pure offshore players, then our growth would not have happened at all. In fact we would have been in pretty severe jam because of all the legislation that is coming and we would have been in the wrong books of the government.

So we do believe that the strategic decision to increase our footprint onshore was a right decision and therefore it did go through a temporary blip in operating profitability as the sales pipeline ramps up and we are able to sell offshore more than onshore and this is what we hope to do in the medium term because our incentive structures are designed in a way to push offshore more than onshore. Then over a medium to long-term period, we will again have an improvement in our EBITDA numbers.

**Ranjeet Singh:** Right, but is there a specific number you target over the medium term?

**Partha De Sarkar:** We would like to be back in the middle teen number. That is obviously aspirational or many things have to fall in place for that to happen, but that is what we are aspiring for.

**Ranjeet Singh:** And then with regards to the use of sort of net debt flat company more or less, obviously it is a capital structure decision, what is the strategy with regards to the cash we have on the balance sheet. What is our plan?

**Partha De Sarkar:** The cash that we have in our balance sheet has been deployed very wisely to fund some of the acquisitions that we have done. Over a period of time, we may have refinanced some of these acquisitions through bank debt because it provides a tax shelter for us. So the cash is meant to be deployed for acquisitions and as and when we get the right opportunity, we deploy this cash.

**Ranjeet Singh:** Finally our dividend in absolute numbers has been static for the last few years, understand the company went through a situation, now that we are on back on the growth part, earnings momentum has come back to some extent. What is the outlook for dividend as far as the dividend policy of the company is concerned?

**Partha De Sarkar:** I think the fact that we have held onto strong dividend despite the fact that our profitability had declined, has a story to tell in itself. I would not be able to talk about the dividend policy of the company. We do not really have a stated dividend policy and it is again premature to talk about it as to what is going to be the dividend for next year as that is the Board's decision. We have a good



visibility on the fact that profitability is on its way back. So we the board has taken the decision of retaining our dividend payout despite declining profitability. I think that is our track record. I would not like to comment anything about what we want to do in the future because I think it is premature. It is just the first quarter. It is the change that the board contemplates is essential for the business. I think we will have sufficient communication ahead to be able to deal with expectations of investors.

**Moderator:** Thank you. The next question is from the line of Anirudh Mohta from Ginni Finance Limited. Please go ahead.

**Anirudh Mohta:** I just had a quick question. Your gross debt stand at around 561 crores, so could you give us the breakup in terms of the foreign currency loan and rupee loan?

**Partha De Sarkar:** If I look at my total debt in India books that is roughly about 150 crores, rest of it is all abroad.

**Anirudh Mohta:** So abroad, it must be spread across geographies, you must be having some borrowing in the US and Europe?

**Partha De Sarkar:** Primarily in the books of the US subsidiary, HGS Inc. and it includes the loan taken for the Canadian acquisition.

**Anirudh Mohta:** So as Ranjeet was saying earlier that how you plan to utilize the cash and you said that you might use them to be may be acquire a more assets going forward. So may be going forward we will see the net debt to be increasing?

**Srinivas Palakodeti:** There is some seasonality in our business. Fourth quarter typically tends to be a strong quarter. So then you realize all those receivables. Cash may look higher at end of June, but as we ramp up and for instance there is outgo which would happen for dividend. So you could see some increase in debt in the shorter term, but also some of the repayments would happen as we go through the rest of the year, but there could be some blips during the year.

- Anirudh Mohta:** So you plan to repay debt in upcoming quarters as well?
- Srinivas Palakodeti:** Yes. We have term loans. So those term loans have a set repayment. So those repayments would continue, but especially on the working capital side, as topline increases, as you incur some expenditure upfront to finance the revenues, you would have increased working capital utilizations during the year.
- Anirudh Mohta:** And what is the interest cost we are incurring for our overall debt?
- Srinivas Palakodeti:** It varies. The rupee portion, again we had a fair amount as commercial paper that was running at 9%, but rates have gone up. So you can see that on an average the India debt is somewhere in the 10 to 11% and in the US, ones which are abroad those are typically in the range of Libor plus 3 to 4%.
- Anirudh Mohta:** And what is the debtor position?
- Srinivas Palakodeti:** It has been in that range of 78-79 days.
- Anirudh Mohta:** And could you tell us more about the medical coding business in your EBOS business which you have just acquired?
- Partha De Sarkar:** So medical coding, I do not know how to explain this. Depending upon how familiar you are with the US healthcare system there is a diagnosis code, there is a procedural code for every treatment that patient goes through in facility right whether it is a physician facility or a hospital facility. When we acquired EBOS they were working for providers like mostly hospital chains, but they were not doing any coding work. They were working on eligibility verification. They were working on claims processing and those kinds of things. That was because of their internal constraints, their previous owners did not want to get into coding, though they had a capability of doing coding work. So after we acquired them, we clearly have identified coding as one of the most important and growing areas for EBOS and we have won a coding pilot from one of our oldest clients in the EBOS business. That is a very encouraging start for us because that basically is a very attractive line of business to get into.

- Anirudh Mohta:** So are you guys looking forward for this Obama care code changes, the ICD9-10 changes that is why you are....
- Partha De Sarkar:** Part of it, yes absolutely. It has also the Obama care changes bring in about 39 million people in the insured category. So it is bringing more people in the insurance space. What it also targets is it sets a limit on administrative costs. So of the total premium collected, you have to have a certain limit which you can manage your margins and operating costs which means that if you have to improve your margins, you have to increase your operating costs and therefore offshoring will become a very strong play in that. So we are very bullish with how we are seeing this thing play out.
- Anirudh Mohta:** So right now the EBOS business contributes about 3.5% of your business if I am not wrong, right. So going forward in 2 year's time, we will see a significant expansion from the contribution from the EBOS business?
- Partha De Sarkar:** Yes, because we do believe that it is a strategic acquisition for us and we believe that it is very well-positioned to leverage the opportunities that have been thrown up in front of us, which is coming to us in the US healthcare business.
- Anirudh Mohta:** And just last question. Could you tell me how well your top client has grown from last year to this year?
- Srinivas Palakodeti:** The top clients, it varies from quarter-to-quarter, but typically they would account for about 12-13% of our revenues.
- Anirudh Mohta:** So they come from the telecom segment or the healthcare segment, your top client?
- Partha De Sarkar:** It varies quarter-to-quarter. This quarter happens to be healthcare, but it is just about at the same level as the telecom client, but it is marginally higher.
- Moderator:** Thank you. The next question is from the line of an individual investor, Mr. Manish Gupta. Over to you.

**Manish Gupta:** The question I had was you said very rightly that since your business is a blend of onshore and offshore, it is perhaps hard to predict the EBITDA margin because it depends on the mix, but what is your plan to enhance the return on capital deployed in the business because as long as you keep holding a lot of cash, just may be a personal concern, but typically lot of companies just go wrong on acquisitions and when you have a stable earning profile and there is a huge risk that one does an acquisition, it does not integrate very well and so the margins collapse as we have seen with some other Indian companies who have been acquisitive. So I guess two questions in one. One is how do you plan to increase the return on capital and what risks our investors carrying off any integration that could go wrong?

**Partha De Sarkar:** It is a very good question and you are right. I think there are companies in our peer group who have not handled the acquisition very well. We have been very conservative in the way we have acquired and thankfully touchwood all our acquisitions have been well integrated and we have gone about it in a very slow and steady fashion. We have not acquired four companies in one year, different parts of the geographies and all of that. All our acquisitions have been at a very reasonable size making sure that the right payback mechanisms are in place and it takes time to integrate our businesses. So our track record of the acquisitions if you look in the last 6 years, we have integrated 5 acquisitions and they are all well integrated and all has been bottom line accretive. So that is going to continue to remain channels through which we will grow and the fact that we have a track record of doing this thing well gives us the confidence that, even in the next few that we do we will continue to be the same cautious approach towards doing this, making sure that return on capital employed and it is profitability accretive.

**Manish Gupta:** But as long as you continue to keep a lot of the cash on your balance sheet, your return on capital will always remain subdued and if that remains subdued despite a lot of the spectacular results you are delivering, one would find it hard to believe that you would get a massive PE rerating which you deserve because at the end of the day I have just recently invested, but I was reading your transcripts

from a prior call and I think you had a little bit of debate with some other investors on, you asked them whether you want stock price appreciation or you want dividend and I think the gentleman on the other side argued that your dividend payout is also helping your stock price, but just a suggestion is that if you can drive return on capital employed higher which in some sense would only come as you reduced the amount of cash your holding, you could see quite a massive rerating of the stock and if you ever needed to do an acquisition and your stock price was healthy, you could always dilute at that point in time to raise funds for the acquisition. So here I think you are sitting on boat loads of cash, I would imagine planning for an acquisition which may or may not happen.

**Partha De Sarkar:**

So that is what I wanted to just give you that information that we have done 5 in 6 years , we have not done 10 in 6 years , not have we done 1 in 6 years . So I think 10 in 6 years is hugely impressive, but we do not want to go down that path nor have we done 1 in 6 years which means it is a highly conservative approach towards this and therefore we have not been in that league as well. We trade the middle path which is a cautious approach to make sure that we are choosing the right target and deploying your funds to make sure that it gives the right return to the investors. So the fact that we have cash in our books enables us to grow because we are able to deploy those funds in the manner that we want, in the kind of target that we are looking for. So your point is valid. We definitely do not want to continue to be this cash forever. Whatever cash we have had in our balance sheet has historically been deployed to part pay for some of the acquisition proceeds. In some of the acquisitions in the interest of speed, we completely deployed the cash to pay for that to refinance that later once we lined up financing for that. So the cash has come back to the extent that for example if I were to give you an example of the acquisition that we do it for the Canadian bid, that is how which we paid about CA\$75 million. The initial payment that we did was full from our cash and then we refinance that loan through another bank and our end cash investment in that was about CA\$25 million. So we got about CA\$50 million back from refinancing with the bank. It is tax efficient because it is an interesting profitable company. So to that extent the loan acts as a tax shield for us and it allows us to expand the cash more because we have not then

deploying all the cash in we have in just doing one deal and then sit tight with it. We are able to acquire more with the amount of cash that we have.

**Manish Gupta:** Sir just a question to you as the CEO is given the healthcare opportunity in the US is so humongous. If you were to do an acquisition, would that not be distracting for the senior management team. So, i.e. if we are buying growth vis-à-vis pursuing growth organically. Do you see any compromise between the two?

**Partha De Sarkar:** That is again a very interesting question. If you look at our last acquisition that was in the healthcare space in the US, so we bought provider type of the business from Deloitte in October of last year. So that is the strategy we have followed. It is always a question which is make or buy. Make is a slower route to the same end objective. If you have a suite of offerings which is selling in the market place, you may choose to build all the capabilities in-house which is a very slow way to capitalize on the opportunity that presents itself and guys who already have that capability would be way ahead in the game and therefore you will miss out. So what we do is typically in such situation when we realize that the opportunity exists, but the capability does not exist, we do not really take a long time to build that capability organically. We will go and acquire and make it a niche, tuck-in acquisition that will give us the capability to sell. So it is a pure make or buy decision and your time to market decision.

**Manish Gupta:** Perhaps I can meet you offline and debate this little more.

**Partha De Sarkar:** Sure.

**Moderator:** Thank you. The next question is from the line of Amitabh Sonthalia from SKS Capital & Research. Thank you.

**Amitabh Sonthalia:** Just a couple of quick follow-ups. One is did you receive any dividend from your overseas subsidiaries in the India business this year to pay out dividends which to manage the cash flows for the dividend payouts?

**Srinivas Palakodeti:** As of now all the surplus continues to remain abroad. So we have not received anything so far.

**Amitabh Sonthalia:** So is that still expected during the course of the year or do you have sufficient cash flows in your standalone entities in India to make the dividend payouts? Would you have to resort to borrowing as you did in the past for that?

**Srinivas Palakodeti:** In short term, there would be a borrowing. Long-term, there is definitely a possibility that the money could come here given that there is some tax benefit available as of now till 31<sup>st</sup> of March.

**Amitabh Sonthalia:** By long term do you mean within this financial year?

**Srinivas Palakodeti:** Yes, that is what I meant because what is visible on a tax benefit side of bringing money from overseas is only limited till March 2014 under the present Income Tax act.

**Amitabh Sonthalia:** So would you not like to take advantage of that and bring in as much as you can to sort of deleverage yourself here in the standalone entity?

**Srinivas Palakodeti:** That is a possibility. It is also a question of timing and also where the exchange rate is. So that is definitely possibility.

**Amitabh Sonthalia:** Pala sorry to harp on this point. Why is that a possibility and not a high probability and what stopping us from doing that because we have been talking about that as people have expressed as well. That is one of the key things where the reason why this is depressing our valuations and you are failing to create shareholder value despite performing well from time to time, you are potentially trading at 3x current year's earnings even Firstsource which is highly leveraged and it is far more liquid and trades at much more premium valuation than you despite you are having a much stronger balance sheet. So just wondering why is that such a reluctance on part of the management and the senior management on the board to bring in the money which is supposed to be sitting idle outside?

**Srinivas Palakodeti:** I said it is definitely possible. I was not really differentiating between possible and probable. So this is something which can happen and it is something which we need necessary approvals at different levels and complete whatever is the paperwork required to bring in the dividend. So that is the only point.

**Amitabh Sonthalia:** And coming back to your India business where you have 61% of your headcount is in India and you mentioned somewhere that I think you expanding seats in India, you got SEZ investment which is being commissioned etc. So what is the rationale behind that despite having unutilized seat capacity for a while in India and your constant de-growth and pricing pressure that you face in India and your reduction in the management tend to reduce the India centric business. So just finding that a bit of a contradiction there to increase the seat capacities in India?

**Partha De Sarkar:** So these are two different businesses Amitabh. What we are de-growing is our India domestic business. So that does not make seats available for the India international business because that for tax purpose needs to be in SEZ. So that is why we are building out on the SEZ.

**Amitabh Sonthalia:** So what is the breakup in terms of our India headcount between those focused on the India business and those focused on outsource business?

**Srinivas Palakodeti:** Roughly we have about close to 15,000 people in India. There are about close to 1,000 people who are on the payroll processing business. The India offshore business would probably have somewhere around 4,000-5,000 people, closer to about 5,000 people and then rest are all on the India domestic side. On the India domestic side what has been happening is we are reducing our telecom exposure, but adding on the non-telecom side. So there are number of things which are moving there. So the broad drive is to reduce the headcount on the non-profitable, low profitable businesses and increase headcount where there is growth with adequate margins. So let me put it that way. So the overall number is misleading. You should look at the combination of the people who are there.



**Amitabh Sonthalia:** And the seats which are there for as I think Partha mentioned that the seats which are there for the domestic business versus the offshore are not fungible. So you got to have dedicated facilities for which are segregated for both. Is that correct?

**Partha De Sarkar:** Because the international seats are going to be an SEZ, right Amitabh.

**Srinivas Palakodeti:** Just to clarify while the SEZ is one part, there are those non-SEZ seats. So seats are one aspect, but CAPEX, etc., computers those are all can be reused which is what we are doing.

**Amitabh Sonthalia:** So you are able to reuse some of those assets and this SEZ facility, the first time we are moving to an SEZ facility or we already had presence there?

**Partha De Sarkar:** No, this is our third SEZ and the first one that we had has already maxed out. Our second one was opened in Hyderabad sometime earlier this year. That is where we service the business that we acquired from Deloitte so that may have some seats left who have been not maxed out, may be 50 to 100 seats may be left there and the third one is 550 seats that were taking in Bangalore. Out of which, 170 seats are already sold. So building out about 170 seats only, we are not building up the whole thing. As and when we have better visibility of pipeline conversion that is when we add the rest of the seats.

**Srinivas Palakodeti:** And Amitabh just to go back to your point the India domestic part was purely doing domestic in terms of number of employees that is only at 8,500. Remaining are all people working on either the India international side or the payroll businesses side. So the mix is changing.

**Moderator:** Thank you. As there are no further questions, I would like to hand the floor back to Mr. Partha De Sarkar for closing comments. Over to you sir.

**Partha De Sarkar:** Thank you very much to all of you for having taking the time to participate in the Q&A session and listening to our comments on our Q1 FY2014 Earnings performance. We look forward to getting back with you again for next quarter's discussion sometime in the month of October.

**Moderator:** Thank you. On behalf of Hinduja Global Solutions that concludes this conference. Thank you for joining us and you may now disconnect your lines.

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*Note: This document has been edited to improve readability*

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