"Hinduja Global Solutions Limited Q1 FY2018 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Hinduja Global Solutions Limited Q1 FY2018 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ravi Ramalingam – Head of Investor Relations. Thank you and over to you, sir.

Ravi Ramalingam: Thank you Tanvi. Ladies and gentlemen, I, R. Ravi - Head of Investor Relations at Hinduja Global Solutions, wish you all a very good evening and a warm welcome to the first quarter of FY2018 post results conference call. To discuss the quarterly results, I am joined by Partha De Sarkar, the CEO and Srinivas Palakodeti, the CFO.

Before we begin the conference call, I would like to mention that some of the statements made in today's conference call may be forward-looking in nature, including those related to the future financial and operating results, benefits in synergies of the company strategy, future opportunities and the growth of market of the company's services and solutions. Further, 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 a list of such considerations, please refer to our earnings presentation page two.

Now, I would like to invite Mr. Partha De Sarkar to provide his perspective on the performance for this quarter. Thank you and over to you, Partha.

Partha DeSarkar: Thank you, Ravi. Good afternoon everyone and thank you for joining us on the call today to discuss our first quarter FY2018 financials and business performance. We hope that you have had an opportunity to review our presentation and the reported financials, which are available under the investor section on our website as well as in the stock exchanges. As always, I would like to start with an overview of the financials for the quarter followed by operational highlights. After that, I will hand over the call to our CFO - Mr. Srinivas Palakodeti to discuss the financial performance of the quarter in review in detail. We will then open up the call for the Q&A session.

Traditionally, quarter one and the first-half has been soft for HGS, Q1 of FY2018 has been no different and the overall performance has been in line with our expectations and to what was indicated during our last earnings call in May 2017.

In Q1FY2018, HGS recorded revenue growth of 6.4% in constant currency terms over Q1 FY2017. Due to the significant strengthening of the Rupee against the Dollar and other currencies, the Rupee revenue growth has been reported as 1.9% on a year-on-year basis. The revenues for the quarter stood at Rs. 9,272 million. On a year-on-year basis, the revenue growth has been driven 10.3% by the health care vertical and 17.4% by the India CRM businesses.

We had a reasonably strong EBITDA for Q1 FY2018, excluding the impact of the FX losses at Rs. 1,002 million. The EBITDA margin was at 10.8% as compared to the 11.7% for Q1 FY2017. The drop-in margin is on account of the strengthening of the Indian Rupee and the lower profitability of the India CRM business. Coming after a strong quarter four 2017, the cash flow from operations remains strong and came in at 1,269 million. Cash flow on CAPEX for the quarter stood at Rs. 395 million excluding items such as tax refund while the EBITDA to free cash flow for the quarter stood at 75%. The strong cash flow has helped us reduce debt level by Rs. 594million during the quarter ended 30th June 2017.

Coming to business highlights, we signed seven new clients in the year to date across Healthcare, Airline, Retail and Consumer Electronics verticals. Two of the accounts have already started generating revenues while the rest will flow in during the year. The total number of active clients is 187 BPM clients and 618 payroll processing and HRO clients. We also expanded engagements with

19 existing clients and signed five digital related deals across new and existing clients in quarter one. The employee headcount was 44,877 as on 30th June 2017, a net addition of 640 people in the quarter.

Moving to the markets we serve and our delivery locations, we will cover North America first. In Q1 FY2018, the revenue performance from US onshore and Canadian operations was stable. We won new business from existing as well as new clients in the region. To give a flavour, we signed contracts to provide customer support services with a consumer electronics firm, an automotive retailer, a food and beverage giant and a health care insurance player. The healthcare regulatory changes in the US are still going through the legislative process. Meanwhile, for us it is business as usual. In fact we are expanding our footprint onshore as well. The outlook for Q2 sales pipeline has been encouraging for North America.

Jamaica continues to be a very good near-shore delivery location for us, primarily due to proximity to the US and the talent availability pool. We doubled our revenue in Q1 FY2018 over Q1 FY2017, led by significant ramp ups from our healthcare clients. Though the revenue base is small, we are witnessing strong profitability in the business. During the quarter, we won an engagement to provide customer support for a consumer electronics firms covering the Canadian region. We also started providing digital services from this operation through an engagement for chat services for a healthcare client.

UK operations: Revenues reported in Q1 FY2018 in GBP terms were stable. As mentioned in earlier calls though, we are still a few quarters away from a full turn-around. We continue to have profitability challenges in the UK. In July 2017, we announced a new CEO for the region Adam Foster. With extensive experience in outsourcing and offshoring businesses, he will primarily work on driving growth in the region. In Q2 FY2018, we expect to begin a seasonal ramp up for a key government client in the UK.

India operations: The India international business experience good revenue growth and sustained volumes in healthcare from existing and new clients. The outlook for the business looks good and we expect a strong growth in FY 2018, led by Healthcare clients both at offshore and near-shore. HGS is seeing a lot of interest for robotics process automation especially from health care clients. We have been working with several of them and these transformation initiatives have resulted in tangible savings, which have been passed on to client via a gain-share model.

The India CRM business continues to grow stronger, driven by verticals like telecom and e-commerce. EBITDA margins saw a slight dip due to lower volumes from a telecom client. The business is seeing diversification of portfolio through new clients in segments like travel and mobile payment companies. Through these clients we hope to add about 150 FTE by quarter 3 of FY2018. We have set up a new delivery center in Indore, our second in the city with 700 seats. In Q2, we would be consolidating our existing operations from two small centres in Durgapur to a new and bigger facility in the city. Payroll and HRO businesses added four new clients to take the total client base to 618.

Philippines Operations: Coming to Philippines, the Philippines' operation saw good business expansion on an overall basis, adding new LoBs worth 100 FTEs across healthcare and retail clients in Q 1. We continue to look at offering new kinds of services from the geo. We recently launched a speech analytics project for a US-based healthcare client, focused on enhancing customer experience. In terms of Q2 outlook, we see a healthy pipeline in Healthcare and financial services in Philippines.

HGS recognises the ongoing transformation happening in the business world and is committed to making our clients more competitive. In line with helping clients create higher value, we continue to invest in building capabilities in technology solutions, people and most importantly domain expertise through the HGS innovation network.

We are partnering with some of the technology firms in RPA, digital and analytics as a key go-to-market strategy. Our solutions leverage our domain expertise built on top of their platform to deliver impact to our client. In Q1 FY2018, we announced a strategic partnership with Conversable, a leader in artificial intelligence and customer experience. The tie-up will enhance HGS' service offerings to transform customer experience through intelligent integration of Bots and Brains.

Looking ahead, we expect the second half of FY2018 to be better than the first half.

There are some areas of concern which we would like you to keep in mind. The Rupee continues to be strong and is trading around 64 against the US Dollar as compared to 66.75 around a year ago. A substantial part of the India CRM business is from the telecom sector. Given the intense competition in the Indian telecom business, there may be drop in volumes and cost pressures.

There has been a tendency for state governments to increase minimum wages. We have seen an increase in minimum wages in several states in India and there is also a possibility that some of the provinces in Canada may increase minimum wages in Q4 FY 2018. While we would attempt to renegotiate rate increases with clients to factor in these increases in minimum wages, it may not be possible to pass on the entire impact. We are reviewing the situation and taking necessary cost containment measures to reduce the impact of the likely cost increases.

In conclusion, we are encouraged by the start we have seen in the new fiscal. The pipeline looks promising with several ramp ups planned, especially in the Healthcare business for the forthcoming Open Enrolment season to cater to the US market.

I would now hand over the call to Pala, to walk us through the financials in greater detail. Thank you all once again for being with us on the call today.

Srinivas Palakodeti: Thank you Partha. Good afternoon to everyone on the call and thank you for joining us on our Q1 FY2018 earnings call.

Let me start by clarifying and repeating the way the results have been presented. The results for Q1 published are as per SEBI guidelines and as per Schedule 3 of the Companies Act 2013. As per Schedule 3 of the Companies Act, if a company has FX gains, then that should be added to the other income, and if there are FX losses, those should be added to the other expenses. We have disclosed in the notes to the consolidated results, the FX losses which form part of our other expenses.

As you may have seen: In Q4 of FY2017, we had a FX loss of Rs. 22.67 crores while in Q1 of FY2018, we had a FX loss of Rs. 88 lakh. That is how the EBITDA margin of Q1 of FY2018 of 10.8% should be seen in comparison with 13.3% in Q4 of FY2017.

During Q1 of FY 2018, we had a revenue growth of 6.4% in constant currency terms on year-on-year basis and at about 1.9% in Rupee terms. The average rate of the USD to INR for the quarter was 64.47 as compared to 67.04 in Q1 of FY2017, an appreciation of 3.8%. The average exchange rate of the USD to the Philippine Peso for Q1 FY 2018 was 50.15 as compared to 46.96 for Q1 FY2017 i.e., a change of 6.8%. Compared to Q1 of last year, Indian Rupee has appreciated 7.4% against the Canadian Dollar and nearly 12% against the British Pound. We hope that this helps to get a better picture of the soft Rupee revenue growth which has been reported.

On year-on-year basis, revenues from the Healthcare vertical grew 10.3%, media and entertainment grew 25.2% while banking and financial services grew 14.4%. There has been a drop in revenues from technology and telecom sector by about 9.1%, reflecting softness in volumes in some markets as well as the Rupee appreciation. On year-on-year basis, US-originated revenues grew 5.2%, while India originated revenues grew 23.7%. A substantial portion of the growth of the India-originated business came from the India HRO and

Payroll business, which grew by nearly 54%. For Q1 FY2018, Healthcare revenues accounted for 46.9% as compared to 43% in Q1 of FY2017. For Q1 FY 2018, telecom and technology accounted for 21.9% of the revenues, consumer and retail 12.7%, banking and financial services 8.3%, media and entertainment 3.9% and others 6.4%. Near- and off-shore revenues accounted for 47.5% of the total revenues in Q1 FY2018 as compared to 44.5% in the same quarter last financial year.

Moving to revenue origination by various geographies, USA accounted for 65% of the total revenues. Share of Canada-originated revenues for the quarter stood at 11% as compared to 11.9% for Q1 FY2017. Business originating from the UK for the quarter stood at 8% as compared to 10.3% for Q1 FY2017. This decline is on account of an exit of an European client, which we have spoken about in the last financial year and the depreciation of GBP against the INR post the Brexit announcement in June 2016. Contribution of the India-originated business for the quarter stood at 16.1% as compared to 13.2% during Q1 of FY2017.

Employee expenses as a percentage of total revenue stood at 67.4% of revenues for Q1 FY2018 as compared to 66.4% for Q1 FY2017. Other expenses excluding FX loses remained at 22% of the total revenues. Interest expenses for Q1 FY2018 stood at Rs. 91.8 million, around 22% lower than Q1 FY2017 and around 5% lower than Q4 FY2017. This reduction in interest cost has been brought about by paying down debt during Q1 FY2018. Debt came down by Rs. 594 million and in the 12 months ended 30th June 2017, debt was reduced by Rs. 2,032 million. As at 30th June, the company has total debt of Rs. 5,961 million, of which around 33% is through term loans and the balance is through working capital loans. While we expect debt to reduce by end of FY2018, given the seasonal nature of our business, working capital in debt may increase during the course of the year. As a result of the repayment, net debt to equity now stands at 0.09 times as against 0.5 times in terms of Q4 of FY2017. As at

30th June 2017 net debt to EBITDA has come down to 0.29 times and net debt to 12 months EBITDA ended 30th June 2017 has come down to 0.27x.

Our cash in treasury surplus at the end of the quarter was Rs. 4,774 million, resulting in net debt of 1,187 million. Net debt to equity stood at 0.085x and gross debt to equity stood at 0.43x. Cash flow from operations and after working capital changes stood at Rs. 1,269 million and cash flows for CAPEX payments for the quarter were around Rs. 395 million. During the quarter ended 30th June, the company received income tax refunds of approximately Rs. 51 million. After factoring items such as tax refunds, EBITDA to free cash flow conversion stood at 75%. The business return on capital employed. i.e., return on capital employed excluding treasury and cash surplus for the quarter came at 15.4% on an annualized basis.

At the end of the quarter, we had a total headcount of 44,877, an increase of 3,138 over 30th June 2016 and an increase of 640 over 31st March 2017. 67.1% of the total employees are based in India, 16.1% in Philippines, 4.7% in US, 4.4% in Jamaica, 5% in Canada and the remaining in UK. Of the total employed in India, around 59% are for the India domestic CRM business. 30% are for the India International Business and around 11% for the HRO business. As of 30th June, the total number of seats stood at 42,050 as compared to 40,960 on 31st March, 2017 and 38,350 as on 30th June, 2016. We had mentioned through last financial year that we are trying to take increasing number of seats on an OPEX basis as compared to the provisional CAPEX basis. We wish to share that we continue to make progress and as of 30th June, we had about 15.2% of the total seats on OPEX basis as compared to 10% of the total seats being on OPEX basis about a year ago.

With this, I would like to end my remarks and open the call for the Q&A session. Thank you very much.

Moderator: Thank you. We will now begin the question and answer session. The first question is from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: My first question pertains to the Colibrium performance. Can you highlight how was that for the quarter and generally how is the outlook, especially for Healthcare in North America looking. I am more interested in terms of from a demand perspective?

Partha DeSarkar: That is a very good question, Apurva and let me answer about Colibrium in specific and then I will approach Healthcare in boarder perspective. You would have been reading in the press or on TV about the fact that the change in Healthcare Act that was being proposed still has to go some distance before it becomes a reality. And therefore it is business as usual for us in the interim. But because of the uncertainty, we do believe that the Colibrium business performance is going to be muted this year and in quarter one, it was slightly negative. I think over the full year, we will see the business making some money because we will catch up in quarter three and quarter four, which is the typical open enrolment period during which the Colibrium platform becomes more useful.

As far as the overall Healthcare business is concerned, it is completely business as usual. We operate in an area which does not get impacted that much by whatever changes are being thought of from a regulatory perspective. The basic premise on which we work is to reduce the cost of Healthcare services in US, which is about 18% of the GDP and in several trillions of Dollars. And that problem remains the same today as it was in the previous government's regime, and therefore our basic premise of providing higher value-added services to our Healthcare clients continue. We have actually grown it quite substantially this quarter; you do not see the actual effects of that because of the Rupee appreciation.

The growth in the Healthcare business for this quarter is actually in middle-teens and we continue to believe that we will see a strong growth for this business going forward, combined with the fact that we are also adding new logos in this space and opening up the mid-market segment. We are quite significantly penetrated in the top-end of the market, I believe the next opportunity lies in the mid-market and that is what we are trying to attack. We have strengthened our sales and marketing team in the US with new additions to the team and we are quite confident about Healthcare.

Apurva Prasad: My second question pertains to the margins side of it. I mean, we know the headwinds that are there, you talked about the Canadian wage as well as the currencies. So, what levers do we really have to sort of maintain margins that where they are?

Partha DeSarkar: See, the Canadian thing has not happened yet. It is expected to happen in January of 2018. There are two-three levers, one is going to the client and asking for a commensurate rate increase. So, we are working on that. Two is, as of now this wage increase is in a particular province only and not all over Canada. We are trying to see what will it take for us to relocate some of our work force to a different province and we are also implementing the technology solution work@home, which enables employees to work from anywhere in the country and therefore we are able to spread our workforce out from this province to the other provinces, which have not enacted this. We may be able to counter part of the impact. And third is working with the government, trying to educate them about the impact of this change on the overall job market for that particular province, the cost of living for that particular province and all of that. So, it is a three-pronged approach. Thankfully we have visibility of this way ahead of time and we trying to pull all these three levers to see which one works best.

Srinivas Palakodeti: And also if there is an opportunity to offshore, that is the other option to mitigate some of the rate increase.

Moderator: Thank you. Next question is from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: Sir, what is the overall growth outlook in constant currency and Rupee terms for FY2018 in terms of both revenues and margin?

Partha DeSarkar If you look at this quarter, the constant currency growth for this quarter is 6.4%, which is very healthy. Unfortunately, it is getting camouflaged by the fact that Rupee has strengthened so much. We do believe that at a constant currency level, we may be able to maintain high single-digit growth. However, what it will convert to in Rupee terms is a little bit of conjecture; we do not have a view as to where the Rupee will end in the fiscal and it has a significant impact on what the reported numbers are going to be.

Sarvesh Gupta: Excluding the effect of Rupee appreciation, the EBITDA margin?

Srinivas Palakodeti: No, we talked about it right? If you look at our revenues, the dollar part of it, about 3.8% has been the Rupee appreciation compared to the same period last year. So you could say that bulk of that could flow down to the bottom line in this year has exchange rate remained at where they were last year.

Sarvesh Gupta: Sir, so what is the transmissions, let's say 3.8% is the appreciation that would impact your revenues but overall you are also hedged because part of your OPEX is in dollar itself. So, overall what is the transmission to EBITDA?

Srinivas Palakodeti: So, it is like this. As we said about 65% of our revenues are originated in the US but if you look at it from a delivery perspective, the near shore component is roughly about 47% and of which, about roughly half would come to India. At a very high level, about 20% of our revenues would come down to India.

Sarvesh Gupta: And sir, this quarter we also saw there was this special postal ballot on employee stock appreciation rights, which got defeated because of promoters voting against it. Can you shed some light on that?

Partha DeSarkar: We are not commenting on this; We are working on an alternate plan is the max that we can say on that because that instrument was quite complicated and would not have helped our overseas employees. So, we have gone back to the drawing board to work on an alternate plan. Beyond that, we are not commenting on this.

Sarvesh Gupta: Did the management not take the promoters group into confidence before floating this resolution because it is a very rare case that promoters act against such a postal ballot.

Partha DeSarkar: Beyond this, we will not be commenting on it.

Sarvesh Gupta: Over the last many con-calls we have had the discussion on potential to buy back the shares given that the market is not valuing it. So has there been any discussion on the Board of Directors and what is the sense that you can give on that because right now?

Partha DeSarkar: That is very forward-looking. All I can say is there have been discussions but beyond that I will not be able to disclose anything more.

Sarvesh Gupta: Right now what we are doing is that we are using the money to just pay down the debt where we are also losing the tax shield. So net-on-net it is may be giving us the benefit of 5%-6%. But that is a very expensive way to spend the equity money.

Partha DeSarkar: Yes, there was a point of time when there was so much concern about the debt in our books. The fact is that we have paid down close to Rs. 200 crore in the last four quarters. So, it is always a delicate balance between how to use leverage and there was I would say a huge number of people talking about the high levels of debt and presence of cash in our books at the same time. So, you are right. I am not discounting what you just said beyond that commenting on whether there will be a buy back or anything is something that is beyond the purview of this call. If something's going to happen, you will get to hear about it is all that I can say but the questions are correct.

Moderator: Thank you. The next question is from the line of Shubhankar Oza from SKS Capital. Please go ahead.

Shubhankar Oza: Sir, in Q1 was there any one-time impact in terms of when the margin was lower. I mean apart from this currency appreciation, was there any cost element there which has impacted our margin?

Partha DeSarkar: We talked about the Rupee right and we also talked about the fact that the India domestic CRM business while it has grown, has not been as profitable as it was a year ago and primarily you know what is happening on the Indian telecom sector. So there is some impact of volume fluctuations, etc., which have led to some pressure on the profitability.

Shubhankar Oza: And so, what is the outlook of that segment the domestic part of the business, telecom?

Partha DeSarkar: There will be headwinds in the India domestic market going forward for this year. We are trying to diversify our revenue base to make sure that we are able to handle the telecom concentration but honestly, I do believe that we have some headwinds in the domestic business this year.

Shubhankar Oza: Last quarter, I mean basically 2017 we ended with a 13% kind of margin. so do you not think that in 2018 we can probably hit the similar margin in Q4?Obviously Q4 is the best quarter for us and Q1 is not so good for us seasonally. So you think we are not probably confident enough to hit the similar kind of margin?

Partha DeSarkar: If you recall, the last quarter margin was also impacted by FX.

Shubhankar Oza: Yes that is correct. So adjusting for that I think we kind of….

Partha DeSarkar: Yes, I will not be able to give you specifics about where the margin outlook is going to be. There are couple of factors that we mentioned towards the end of my comments, which are headwinds that we are seeing in the business. But in spite of that, in fact I would say that we are quite happy with our Q1 results. Traditionally it has always been a slow quarter and despite that we have still been able to produce EBITDA of Rs. 100 crore, free cash flows of about Rs. 75 crore. So we are happy with where Q1 has ended and we will have to see how we manage the headwinds right. Minimum wages is the problem. We are dealing with that trying to see if our customers will give us higher price. We talked about Canada at length. We have to see where the Rupee ends. The good thing is that while the Rupee is strengthening, the Peso is actually weakening. So it counter balances each other a little bit and even the Jamaican Dollar is weakening. So if Jamaica grows and Philippines grows more than India grows, then you may be able to offset some of the pressures caused by the Rupee appreciation but you will still have a translation impact because every other currency gets imported in the Indian Rupee term. So, it is a complex play of currency.

Shubhankar Oza: And can you also talk about the CAPEX for FY2018?

Srinivas Palakodeti: Shubhankar, we spoke about it. We had mentioned in our earlier call that CAPEX would be in the range of Rs. 160 crore to Rs. 180 crore depending on where the growth happens. So, this quarter outgo was about Rs. 39.5 crore and as I mentioned, the intensity is less in India given that we are able to get seats on an OPEX basis, which is about 15% of the total - up from 10%. We would like to have the same model in other geographies; some places it works, some places it may not work.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to Mr. Ramalingam. Thank you and over to you, sir.

Ravi Ramalingam: Thank you to all the participants for joining us on the conference call. If there are any further questions or clarifications about the Q1 FY2018 financials, please e-mail me or Pala, the CFO and we will be more than happy to get back to you with the answers. This is Ravi signing off on behalf of HGS Management. Over to you, Tanvi.

Moderator: Thank you. On behalf of Hinduja Global Solutions, we conclude this conference. Thank you for joining us and you may now disconnect your lines.

Note: This transcript has been edited to improve readability. For the sake of brevity the edited version of the above content, may have certain abbreviations/abridgements of words and sentences.