



“Hinduja Global Solutions Q4 & FY2019 Earnings Conference Call”

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Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Hinduja Global Solutions Q4 FY 2019 and Full Year FY 2019 Post Results Earnings Conference Call. As a reminder, all the participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need any assistance during the conference call, please signal an operator by entering “*” then “0” on your touchtone telephone. Please note this conference is being recorded.

I now like to hand the conference over to Mr. R. Ravi -- Vice President, Head of Investor Relations. Thank you and over to you, Sir!

R. Ravi:

Thank you Melissa. Thank you. Ladies and Gentlemen, I, R. Ravi -- Head of Investor Relations at HGS, wish all a very good evening and a very warm welcome to the Fourth Quarter FY 2019 and Full Year FY 2019 Post-Results Conference Call.

To discuss the quarterly and the full year results, I am joined by Mr. Partha DeSarkar -- the CEO and Mr. Srinivas Palakodeti -- the CFO.

Before we begin the conference call, I would like to mention that some of the statements made by the speakers in today’s conference call may be forward looking in nature, including those related to the future financial and operating results, benefits and synergies of the company’s future strategies, future opportunities, and growth of the 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 by the speakers may be forward looking in nature and may involve risks and uncertainties.

Now, I would like to invite Mr. Partha DeSarkar to provide his perspective on the performance for this quarter and for the full year under review. Over to you, Partha.

Partha DeSarkar: Thank you, Ravi. Good Afternoon and thank you all for joining us on the call today to discuss the Fourth Quarter and Full Year FY 2019 financials and business performance.

I hope you have had an opportunity to review our earnings press release and the attendant fact sheets of the reported financials, which are available under the Investors Section on our website, www.teamhgs.com.

I would like to start the conference call with a brief overview of the financials for the quarter under review and for the year gone by, followed by strategic initiatives and operational outcomes. After that, I will hand over the call to our CFO, Mr. Srinivas Palakodeti, to discuss the financial performance in greater detail. We will then open the conference call for the Q&A session.

HGS has traditionally reported a strong fourth quarter over the years and this year was no different, led by robust performance in most geographies, ramp ups and a solid healthcare open enrollment session.

Top line in Q4 FY 2019 was Rs. 12,846 million, a growth of 28% year-on-year and 0.9% sequentially. This comes on the back of double-digit growth rates posted in the previous three quarters, reiterating a growing demand for our BPM services.

In constant currency terms, the growth was 22.5%. Of the total growth of 28% over Q4 FY 2018, 6.6% growth came from AxisPoint Health and Element acquisition, 5.5% is due to foreign exchange fluctuations and 15.9% from organic growth. Q3 FY 2019 had revenues of Rs. 311 million from the sale of GuidePoint contracts. Excluding this transaction, the revenues have grown by 3.5% on a sequential basis.

You are aware that the initial part of FY 2019 was challenging due to significantly higher than anticipated losses in AxisPoint Health, the drop in India CRM telecom revenues, rise in minimum wages as well as adverse circumstances faced by our UK business due to uncertainties on account of

Brexit. As a result of these factors, our EBITDA margins were under intense pressures during the first half of the year.

As we have shared with you during our earlier call, we have taken several measures to improve our profitability. For AxisPoint Health, in end December 2018, we sold several subscale contracts of the GuidePoint business focused on Nurse Advice Line services. Most of the cost synergies were in place by Q3 FY 2019.

In addition, we implemented several other measures, including focusing on non-linear growth, getting increased rates from clients, consolidation of centers and moving to an OPEX model, diversifying into non-telecom verticals in India domestic, driving Work@Home in Canada and the U S, etc.

I am happy to say that the impact of these measures is showing up as can be seen from our Q4 results.

The EBITDA for Q4 was Rs. 1,488 million, up by 43.3% year-on-year and 7.4% sequentially. More importantly, EBITDA margins were higher at 11.6% for the quarter.

Q4 PAT stood at Rs. 545 million, up 6.1% year-on-year and 48.8% sequentially. So, these numbers demonstrate that Q4 of this year has really been a spectacular quarter.

Now moving to an update on the Karnataka minimum wages. You will recall that the government of Karnataka had mandated a steep increase in minimum wages, effective 30th December, 2017. HGS, along with other companies, have filed a writ petition challenging the order of the Karnataka government. Pending the appeal, the company had made conservative provisions for the increase in minimum wages from Q4 FY2018 and through the first 3 quarters of FY 2019. Towards the end of March 2019, the Karnataka High Court upheld the Karnataka government order on minimum wage increase. In light of the above and keeping in view various other court orders, the company

has paid the arrears on May 22, 2019. We also had some excess provision, which have been reversed and are reflecting in this quarter.

In Q4, HGS added seven new clients and expanded 11 existing relationships. Three of the new wins are significant in size, one is from a public sector organization in the UK while the other two are from the logistics vertical, a new area of focus for us. We have recently set up a Center of Excellence for logistics in Jacksonville, Florida to support the latter. Another positive development was both APH and Element signing new engagements.

We continue to see good momentum in both healthcare and CES (consumer engagement services) businesses. The healthcare revenues grew by 29.9% year-on-year in INR terms in the quarter. For FY 2019, the vertical accounted for 52% of the overall HGS revenues. As mentioned earlier, we had a solid open enrollment session during the month of December to mid-March for multiple clients across India, Philippines, Jamaica and the US.

In the last few quarters, we have focused on growing specific verticals such as retail, consumer, telecom, and technology outside India, BFSI, government and logistics. Many of our new wins and expansion with existing clients in Q3 and Q4 are from these verticals, which is a healthy sign and a consequence of investing in strengthening our sales team and beefing up our capabilities.

Coming to the acquisitions made in FY 2019, the acquisition of Element Solutions has helped HGS foray into the area of digital marketing and cloud services. While HGS has traditionally been in customer care, the acquisition of Element helps to support our clients in the area of customer acquisition, too. For the year ended 31st of March, 2019, Element had revenues of US\$ 15.5 million and EBITDA of 10.3%.

HGS has a strong portfolio of services in healthcare and revenues from this vertical accounts for over 50% of HGS revenues. The services offered by HGS

have traditionally been in the administrative spend of the healthcare sector. The acquisition of AxisPoint Health has enabled HGS to offer services in medical spend, which is around 4x larger than the administrative spend.

For the year ended 31st March, 2019, AxisPoint Health recorded revenues of US\$ 30.8 million and EBITDA loss of US\$ 10.3 million. The strategic rationale for AxisPoint Health acquisition remains strong and the sales pipeline is robust. We expect AxisPoint to be EBITDA breakeven during the second half of FY 2020.

We have seen a good traction building up in the two businesses led by cross selling of these services, along with our traditional services, especially with existing clients. The solutions are adding to the value-added services we are taking to the market and helping to be seen as a high-value partner. For example, Element's foray into cloud segment in Q 3 helped us expand our engagement with a US based healthcare client.

Moving onto the full year performance, I am pleased with the progress we have made, especially in the second half. From a top line perspective, overall revenue stood at Rs. 48,167 million, a strong increase of 25.1% year-on-year. Of this, organic growth accounted for a very healthy 11.3%. forex was 5.4% and inorganic growth was 8.4%. The double-digit organic growth reflects the broad-based positive traction across our regions and the service offerings as well as the work we are putting to drive operational efficiencies.

The EBITDA for the fiscal increased by 8.6% year-on-year to Rs. 4,411 million. However, EBITDA margins at 9.2% were lower than the previous year. PAT was impacted by one-time consolidation that we did in our India business. Because of which, our accelerated depreciation went up. We also wrote down some software that we have built for the Canadian business. Our PAT was down by about 11.8% year-on-year to Rs. 1,755 million. The drop in full year FY2019 PAT was primarily due to the earlier losses seen in APH, UK and India domestic businesses, with these businesses showing significant improvement as we close the year, we believe that the coming fiscal will show better numbers.

The other thing worth mentioning for the year is that after two consecutive years of struggling with our India domestic CRM business, we are finally seeing some green shoots of positivity. We have shrunk our footprint by shutting down many of our Tier-II centers. Our headcount, unfortunately, had to be rationalized as well.

At the end of this consolidation exercise, the telecom concentration of our India domestic business has now decreased considerably. We have also deliberately increased our financial services footprint. Today, as a percentage of revenue, our financial services revenues in India domestic has doubled. We see this as a big positive going into FY 2020. This is likely to reduce our headwinds in this business.

To share some color on the fiscal performance, HGS has had one of its best years in terms of clientele. We added about 21 new clients across verticals for core BPM services and 20 for HRO/payroll processing. We expanded or renewed our relationship with 23 existing clients.

During the year, we saw an increase in digital and business transformation deals. In fact, many of our recent contracts, especially with existing clients, have some component of transformation services embedded. In terms of new logos, we have signed several social care engagements, including from an India-based media company, a telecom service provider in India and a large retailer in the US. We are also deploying RPA as a Service for three new clients in the Middle East to be supported from Bengaluru.

As of 31st of March, 2019, HGS had 237 core BPM clients and 656 HRO/Payroll processing clients.

The increased demand from clients has been broad-based, both in terms of services and regions. We expanded our presence to cater to the demand. Apart from gaining five new centers in Chicago (Illinois), Austin (Texas), Denver (Colorado), San Juan

(Puerto Rico) and Vishakhapatnam, through acquisitions, we have opened four new centers in Pune and Bengaluru (Bangalore) in India, Jacksonville in US and Iloilo in the Philippines.

Our headcount decreased by over 2,300 people on a net basis to 42,190 at the end of the year, largely due to consolidation of some centers mentioned above and ramp down of unprofitable telecom related processes in India. Do note that our revenues have grown significantly despite the de-growth in headcount.

Total number of seats is 42,345. OPEX led seats have increased to 22.1% from 16.9% in quarter 4 FY 2018. Utilization rate, which was 81.7% in Q1 FY 2019 has improved to 84.5% in Q4.

HGS is evolving as a company “to make our clients more competitive”. We continue to invest in building new solutions and capabilities in our chosen verticals and geographic markets. This includes two acquisitions made in April 2018 and a go-to-market partnership with key industry product leaders in RPA, social and analytics, etc. Technology partnerships is our new value story, tying up with platform providers in the customer experience transformation space with product companies like Oracle, Salesforce, Sprinklr, etc. HGS has strengthened our client-facing team. We have bought in a senior leader, Tom Hricik to lead business development and help build a healthy and sustainable pipeline for our non-healthcare, CET businesses. The **beefed-up** hunter strategy is showing results.

We have also created a CIO office, led by the new Chief Innovation Officer, Natarajan Radhakrishnan. He joined us in Q4. This will bring all our external facing and internal business transformation platform services and IT teams, including the automation Center of Excellence, Colibrium and Element Solutions under one banner to collaborate, transform and drive better outcomes for clients through end-to-end domain-led services. The focus is to help us leverage technology to open up opportunities in new segments and markets. An example is the Middle East where we have won several new contracts for RPA as a service.

As mentioned earlier, we have started the Center of Excellence in Jacksonville, Florida for logistics and roadside support. The nature of this line of business is dependent on some external agencies that is vehicle towing, vehicle retrieval, etc. Costs charged by external agencies are billed back to the client with a markup.

Going forward, any analysis of revenue growth and profitability margins must be done keeping in view the pass-through nature of some of these revenues. The logistic support business is currently going through a ramp up stage and we expect operations and profitability to stabilize starting Q2 FY 2020. This will therefore create some pressures on our Q1 margins.

To sum it up, the overall state of our core business continues to be reasonably strong. Most of our businesses are doing much better than how we started in FY 2019. We are exiting the fiscal with a reasonable confidence as our internal deliberations with clients suggest that we would be able to report strong revenue growth FY 2019.

Our endeavor would be to expand EBITDA margins, both of the legacy business as well as the acquired entities. We expect further improvements on various measures we have undertaken across the business in geographies, including a turnaround of the India domestic CRM business.

I will now hand over the call to Pala to walk us through Q4 FY 2019 and full year FY 2019 financials in greater detail. Thank you all once again for being with us on the call today. Over to you, Pala.

Srinivas Palakodeti: Thank you, Partha. A very good afternoon to everyone on the call and thank you for joining us on our Q4 FY 2019 and FY 2019 earnings discussion.

As we have said in the past, we would like to repeat that for the purpose of this discussion, EBITDA and EBITDA margins have been computed excluding FOREX losses and gains, which have been taken as part of other income. This is being done so that we have a better comparison of financials on a like-to-like basis.

Coming to Q4 of FY 2019, revenue growth on a year-on-year basis was 28% and in constant currency terms, the growth works out to 22.5%. If we break up the revenue growth of 28%, 5.9% was organic growth and 5.5% came from forex gain and 6.6% came from the acquisitions of AxisPoint and Element Solutions. The 15.9% year-on-year growth in organic revenues achieved should be seen in the context of the India domestic CRM business, reducing by around 7% over Q4 of FY 2018. On a sequential quarter basis, the reported revenues appear were up by 0.9%. You may recall that HGS sold off some subscale contracts of GuidePoint business of AxisPoint in December of 2018. Excluding this transaction and on a like-to-like basis, sequential revenue growth was 3.5%.

Earlier Partha mentioned about the pass-through nature of revenues related to the logistic business. For the quarter ended March 2019 and FY 2019, the pass-through revenues stood at around USD3.9million or Rs. 273 million. Like always, revenues from healthcare and insurance continued to show strong momentum, growing by about 29.7% in Q4 FY 2019 over last year fourth quarter. This strong growth includes revenues of Rs. 338 million of AxisPoint, which is all healthcare, and around 60% of Element revenues of Rs. 320 million, which also is from healthcare.

If we exclude the acquisitions, healthcare revenues grew by about 25.8% on a year-on-year basis. For Q4 FY 2019, healthcare revenues accounted for 51.7% of total revenues as compared to 52.3% in Q3 FY 2018. On a sequential quarterly basis, healthcare vertical reported decent growth rates, aided by the just concluded enrolment season.

In Q4 FY 2019, revenues from telecom and technology vertical grew by around 21% on a year-on-year basis, though there has been a decline on a sequential basis. This growth has been achieved despite decline in India domestic revenues, where the telecom vertical revenues accounted for about 61% of the India domestic CRM revenues. The strong performance of the telecom and technology vertical is due to the growth which we have achieved in Canada, US and UK, which have significant telecom and media revenues, especially in Canada.

In Q4 FY 2019, revenues from the consumer and retail segment grew by about 16% on a year-on-year basis. A part of the strong growth is due to revenues from one of the largest retailers in the world. The strong growth from this vertical has ensured that this vertical accounts for 12% to 13% of total revenues.

In Q4 FY 2019, revenues originating in USD continued to perform well and grew by about 35% in INR terms over Q4 FY 2018 and 5.1% sequentially. USD revenues accounted for 73.1% of total revenues as against 72% in the previous quarter. In Canada, the revision in commercials from clients achieved during the year, coupled with increase in wages, has helped HGS to be better positioned despite labour shortages and meet client requirements adequately. Consequently, revenues from Canada have grown by about 41% and now account for about 10.8%.

In Q4 FY 2019, if you look at revenue by delivery centers, USA and Jamaica grew by about 6.4% sequentially and the last year fourth quarter was around 66.4%. Though on a sequential basis, India domestic revenues in Q4 made a recovery. As the dependence on India telecom sector reduces and gets rebalanced with revenues from other verticals coming at better price points, the shift in vertical mix in the India domestic CRM business is expected to continue.

In Q4 FY 2019, the onshore revenues, which include India domestic revenue, stood at 56% of total revenues, which is about 400 basis points higher than what it was in Q4 of FY 2018. This increase is primarily coming out of acquisitions and growth in business in US and Canada.

Coming to the acquisitions: During FY 2019, HGS had made two acquisitions, and we would like to present to you an analysis of the revenue, the performance of the core business and the acquired businesses.

In FY 2019, revenues of the core business grew by 16.7% and EBITDA grew significantly higher by about 24%. EBITDA margins of the core business expanded by 70 basis points from 10.5% in FY 2018 to 11.2% in FY 2019. Clearly, the core business has done very well during FY 2019. The acquired businesses have a total revenue of Rs. 3,243 million but had EBITDA losses

of Rs. 607 million. For FY 2019, AxisPoint Health had revenues of Rs. 2,151 million and an EBITDA loss of Rs. 721 million. During Q4 FY 2019, EBITDA losses of AxisPoint Health were Rs. 70.6 million.

The other acquisition, Element Solutions has performed well, generating an EBITDA of Rs. 114 million on revenues of Rs. 1,091 million. For Q4 FY 2019, EBITDA of Element was Rs. 34 million. So on an overall basis, after factoring into account the impact of acquisitions, revenues grew by 25.1% and EBITDA grew by 8.6%.

You would have noticed compared to FY 2018, depreciation for FY 2019 grew by 39%. Of the increase of Rs. 555 million, around Rs. 55 million was due to accelerated depreciation related to the sites of the India domestic CRM business, which were either closed or consolidated. Around Rs. 223 million was on account of accelerated depreciation for Colibrium healthcare platform, which are in the nature of software that was internally developed. This has been done reassessing the life of the software that had been capitalized and also keeping in view new developments and new products being launched by Colibrium. Rs. 201 million of increase in depreciation is on account of the acquisitions which we have made. So a total of Rs. 479 million of increase in depreciation came from these items and the balance is due to CAPEX incurred during the year.

Interest costs during FY 2019 rose by around 17.3%. Of the increase of around Rs. 60 million, Rs. 11.3 million is due to interest costs for minimum wage payment as per the Karnataka High Court order, around Rs. 23 million is on account of deferred compensation for acquisition of balance 43% stake in Element Solutions. The balance increase is also on account of increase in borrowings for funding the loss-making business.

Between 31st March, 2018 and 31st December, 2018, DSOs stood in the range of about 73 days to 74 days. As of 31st March, 2019, DSO days stood at 83 days due to increase in receivables by about Rs. 1,470 million between 31st December, 2018 and 31st March, 2019.

To explain this increase, we want to highlight that HGS had negotiated revised commercials, especially for the Canadian business and the India domestic CRM business. Specific to India domestic CRM business, we have negotiated rate increases from clients' consequent to the increase in minimum wages out of the Karnataka High Court order. So, the contracting process for revision in commercials took time and collections, which could have happened before 31st March, 2019, spilt over to FY 20, to post the signing of the contract.

The increase in receivables is also on account of large contract billing from Jacksonville site, Florida in USA where billing started in mid-February 2019. Adjusted for these developments, EBITDA to free cash flow conversion for Q4 FY 2019 would be around 30% as compared to 21% for YTD December FY 2019.

On an overall reported basis, on account of increase in receivables and higher CAPEX outflow, EBITDA to free cash flow conversion for Q4 FY 2019 was minus 37%.

On a full year basis, EBITDA to cash flow conversion was around 2%, after factoring CAPEX of around Rs. 1,930 million. CAPEX outflows in Q4 were higher on account of the new site at Jacksonville, CAPEX made in AxisPoint Health to reduce operating costs and also for technology refresh.

During the quarter under review, gross debt increased to the tune of Rs. 470 million, but on an overall year-on-year basis, debt increase was about Rs. 142 million. The increase in debt was primarily on account of funding the loss-making businesses. It may be noted while the debt increase is about Rs. 142 million, the losses on account of the acquired businesses was significantly higher by about Rs. 607 million. This clearly demonstrates that the core business is generating adequate cash. The gross debt at the end of Q4 FY 2019 was Rs. 5,996 million. Of this total debt, around 72.2% of the debt is foreign currency denominated. The capital expenditure incurred in Q4FY19 was Rs 780 million and in FY2019, it was Rs 1980 million.

Coming to return on capital employed, the ROCE for the core business stood at 19%, and including the acquisition, it came in at around 14.2%. Our endeavor to take more seats on OPEX basis continues; at the end of Q4 FY 2019, OPEX seats accounted for 22.1% of total seats, up from 16.9% at the end of Q4 FY 2018.

Our endeavor to increase revenue productivity continues and at the end of Q4 FY 2019, our average monthly revenue per employee was Rs. 98,711, up from Rs. 95,141 in Q3 of FY 2019. In Q4 FY 2018, average revenue per employee was at Rs. 73,811. This increase is part of our consistent improvement to increase our average monthly revenue per employee over many quarters.

At the end of Q4 FY 2019, the total headcount stood at 42,910 as compared to 44,567 in Q3 FY 2019. If we compare the headcount of the India operations, it has seen reduction of around 3,500 over Q4 FY 2018, primarily on account of the reduction in headcount of the India domestic CRM business. During the last 12 months, headcount has increased across all other businesses except for UK, and as I mentioned, the India domestic CRM business. While at one level, the headcount of the India domestic CRM business has declined over the last 12 months, headcount for the India offshore business and our payroll business has continued to increase.

We ended Q4 and FY 2019 on a high note, and our endeavor is to improve margins across geographies, operations of the acquired entities as well as increase our EBITDA to free cash flow conversion.

Before I conclude, I wanted to highlight, and this is something which you may have heard, starting from Q1 of FY 2020, we will have to factor into account the impact of the new accounting standard of IndAS 116 on the way leases are to be treated. And as we report results, we will also call out separately the impact of IndAS 116 when we present our results starting Q1 of FY 2020.

I would like to now conclude my portion and throw the floor open for Question-and-Answer. Thank you very much.

- Moderator:** Thank you. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. We have the first question from Anand Rathi. Please go ahead.
- Mohit:** Hi sir, this is Mohit from Anand Rathi. First is on employee costs, there was a sequential decline. So is this a recurring item or is there a one-off in the fourth quarter related to some provisioning or reversal, etc.?
- Srinivas Palakodeti:** Hi Mohit, Pala here. So this is a combination of both. So one is, as you noticed, there is been reduction in headcount, especially on the India domestic business. And second is due to the High Court order from Karnataka High Court. So, we paid out the minimum wages as per the order since there were some provisions which were made earlier on and excess provisions were reversed.
- Mohit:** So now this is the recurring number? Or I mean the High Court challenge is still on or is this the new number without any contingent liabilities?
- Srinivas Palakodeti:** No, there is no contingent liabilities. So now we have fully applied the minimum wage increase as per the order. So it should be fine. It would not be a 62% of total revenues. There will be some increase. That is all I can say right now.
- Mohit:** Okay. Sir, second is on receivables. You mentioned there was some renegotiation in commercials. So structurally you are moving to a higher working capital or the renegotiation was only related to pricing and it still reverts back to the original receivable days?
- Srinivas Palakodeti:** We expect it to reverse. The commercial negotiations were not about the DSO days or the credit period. It is more about the process of completing the negotiation. Just to give you an example, we had agreed with our clients that if we are forced to implement the increase in minimum wage for the India domestic business, especially in Karnataka, then they had agreed for us to rebill them with the higher rates. The High Court order came on 28th or 29th

of March. The process of completing the documentation and negotiation obviously took time. So we had revenues recognized, receivables done. But collections obviously could happen only after the new contract got signed. Same thing in Canada, where we had agreement on change in rates. We mentioned this earlier. We had negotiated higher rate so that we could give our employees better wage rates and then be in a position to recruit more people and deliver revenues and volumes. But while it is agreed, the process of documentation took time and the collections happened post 31st March. So it is more about the rate negotiation rather than extending credit period to clients.

Mohit: So by Q1, this should automatically reverse itself, is it?

Srinivas Palakodeti: Yes. The money has, obviously, started coming in April and May. So we expect this to go back to that 73 days - 74 days by June.

Mohit: And you gave depreciation break up... Rs. 5 crore accelerated on account of closures. That is for the quarter or for the...

Srinivas Palakodeti: No, on a full year basis.

Mohit: So what will be the recurring D&A rates for next year?

Srinivas Palakodeti: If you take Rs. 196 crores, roughly about Rs. 5.5 crores plus that accelerated depreciation of about Rs. 22 crores, so Rs. 27 crores has clearly the one-off component in that. But as we are looking at our India domestic business and doing some re-jigging, moving from telecom to non-telecom, there would also be some impact going forward during FY 2020, which we would call depreciation but one-off in nature.

Mohit: So this will continue or some part will happen in FY 2020 itself?

Srinivas Palakodeti: Yes. Because if volumes shrink on telecom and volumes get picked up in a different location, then we will need to provide for accelerated depreciation as we close down sites.

- Mohit:** Okay. And sir, any color on margins for next year, see, I think on my calculation, we have already paid Rs. 180 crores to it and therefore, it is expected that Rs. 20 crores - Rs. 25 crore EBITDA should be a reasonable number for next year from M&A?
- Srinivas Palakodeti:** You mean from the acquired businesses?
- Mohit:** AxisPoint Health and Element Solutions?
- Srinivas Palakodeti:** Yes. So clearly, we expect that business to do much better going forward.
- Mohit:** But given that we will assume cost of capital of 15%, is the quantum correct, like you guys are also expecting it or it could be very slow like Rs. 5 crores kind of a EBITDA and then moving up after three years?
- Srinivas Palakodeti:** See Element is profitable, so that is not the issue.
- Mohit:** No, I am looking at the combined number.
- Srinivas Palakodeti:** Yes. The challenge has been on AxisPoint and as we said, all the cost corrections have been done either by negotiating contracts or moving from an OPEX model to a CAPEX model by investing where required, so all the cost corrections have been completed. You would notice there has been reduction in EBITDA loss in Q4. So as we go through FY 2020, now the focus is on adding new revenues because the cost structure has been optimized. We need to now add revenues which can absorb the extra overheads. Our pipeline is looking strong. So, we expect losses in AxisPoint to reduce significantly on a full year basis.
- Mohit:** And what are the likely growth rates there in AxisPoint? Could it be like 15% plus from a Q4 number perspective?
- Srinivas Palakodeti:** Yes. We are looking fairly strong growth on AxisPoint for FY 2020.
- Mohit:** And Q4 annualized would be the right number, right, from base perspective?

- Srinivas Palakodeti:** Yes. I mean, there could be some seasonality and if we had a new client, there could be some ramp cost. But we clearly expect losses to reduce in FY 2020.
- Mohit:** Okay. And sir, lastly, as we ask every fourth quarter, what is the capital allocation plan for next year? Currently, we are running at a very low ROE because of this CAPEX, M&A payment, etc., extremely low cash generation.
- Srinivas Palakodeti:** No If you looked on a YTD basis, the...
- Mohit:** No, I am looking at FY 2017, FY 2018 and FY 2019, last three years. So, the problem is our ROE is falling because of acquisitions, sometimes there is something else on the margin side. And this time, suddenly the CAPEX shot up to Rs. 190 crore versus Rs. 130 crore last year. So, what is the likely plan for the next year because if we do not spend on these activities, we may just turn net cash negative possibly. So are there any further acquisitions or on the dividend side, do you have a plan? Or do you think CAPEX will remain high?
- Srinivas Palakodeti:** See, if you look at FY 2017 and FY 2018, our EBITDA to free cash flow conversion was fairly good. And we achieved between the two years above Rs. 200 crore reduction in debt. FY 2019, clearly, we came across some headwinds. So obviously, we were challenged in terms of overall EBITDA to free cash flow conversion. We expect that to improve significantly between where we are in FY 2019 and how we expect to end FY 2020. Coming to the specific costs on CAPEX, there are a number of new changes that are happening. We have moved from CAPEX to an OPEX model for most of the infrastructure for the offices in India, and we are seeing a similar model coming up in Philippines as well as in other locations. The other part is a lot of telecom infrastructure used to be in our CAPEX model. Now we are looking at alternate technologies like cloud based technologies where we pay on a usage basis, per minute, per hour basis. So a lot of things which are fixed in nature could also move into a variable nature. So, it is a little difficult to put a number right now because we are clearly looking for alternatives. We recognize that we have

not generated enough cash in FY 2019. And clearly, we want to improve the ratios and reduce the CAPEX intensity of FY 2020.

Mohit: So is it safe to say, it will be less than Rs. 190 crores?

Srinivas Palakodeti: Yes. Clearly, we want to reduce it from the levels it was in FY 2019.

Mohit: And any plans for M&A? Which you have earmarked for the year?

Srinivas Palakodeti: No, I cannot give you statements like that. We will continue to look for opportunities, but those would typically be in terms of new capabilities. Unlikely we will buy “more of the same” in U S or Canada.

Mohit: Sir, anything on size, like range in which you are looking or anything on that front? Or could it be...

Srinivas Palakodeti: Nothing. Too speculative right now. It is too early and too speculative.

Moderator: Thank you. We have the next question from the line of Subhankar Ojha from SKS Capital. Please go ahead.

Subhankar Ojha: Three data keeping questions. So, can you share the Q4 numbers for the subsidiaries and for the newly acquired entities, AxisPoint and Element Solutions, only the quarter 4 numbers?

Srinivas Palakodeti: Yes. So if you look at AxisPoint, it had revenues of Rs. 33.8 crores and an EBITDA loss of Rs. 7 crores. And for Element Solutions, revenues were about Rs. 32 crores and EBITDA of Rs. 3.4 crores for the last quarter.

Subhankar Ojha: EBITDA loss?

Srinivas Palakodeti: No, profit. EBITDA profit of...

Subhankar Ojha: EBITDA profit?

Srinivas Palakodeti: Element has always been in profit.

Subhankar Ojha: And in terms of the basically EBITDA breakeven in H2. So, starting H2, you mean to say Q2 and probably this can become profitable, AxisPoint?

Srinivas Palakodeti: Yes, we definitely expect this to turn profitable during the year. I cannot pinpoint which quarter, by the time we end FY 2020, we should be positive.

Subhankar Ojha: Okay. And secondly, sir, I missed the initial remarks from Partha. There were some factors, he mentioned, Q1 2020 margin is likely to get impacted because of some factors, which I missed out clearly, which is basically the June quarter we are in.

Srinivas Palakodeti: Partha, do you want to take that?

Partha DeSarkar: What I meant was Q1 is typically a slower quarter for us.

Subhankar Ojha: That is typically more of the seasonality part.

Partha DeSarkar: Yes. There is a seasonality and also, there may be some startup cost related to expenses for our Jacksonville site where we started the roadside assistance.

Subhankar Ojha: Okay. And finally, sir, what was the provision reversal from this minimum wage that you have earlier provided for? There was some reversal, you said?

Partha DeSarkar: Yes, if you recall, the Karnataka minimum wages were increased by the government and we have challenged that order in the court. However, even though we challenged it, we did provide for it and we were very conservative enough in our provisioning. So, for Q4 of last year and the first three quarters of this year, we had actually provided much more than we eventually needed to. So that is the amount that is been written back in Q4. There was some extra provisioning made towards minimum wage.

Subhankar Ojha: Is that a significant amount that you have reversed?

Partha DeSarkar: Pala, you have it?

Srinivas Palakodeti: Sorry.

Partha DeSarkar: We have not disclosed that, right?

Srinivas Palakodeti: Yes, we have not.

Partha DeSarkar: Over the full year, it is normalized. So, you do not have to look at Q4. What we have for the full year as wage cost is representative of what is the new normal is going to be with the increase in minimum wages.

Moderator: Thank you. We just the next participant in queue. This is from the line of Madan Lal, an investor. Please go ahead.

Madan Lal: Sir, every time we expect something good to happen... But every time, nothing new is happening. From last 1.5 years, this is going on and even now, after making so much losses in AxisPoint, you are unable to say by when the losses will decrease. Sir, why did you make this acquisition if we are sitting on the losses?

Srinivas Palakodeti: Madan Lal Ji, it is like we have said earlier in Axis Point we had a high cost structure. -we have rectified that. We have reduced costs significantly. . If you look at Q4, losses are less compared to whole year. Now that the cost structure is optimized, we are talking about growing revenues. The pipeline is looking good; so we expect that it will be profitable in FY 2020.

Madan Lal: But sir, loss is reduced because you have sold some contracts

Srinivas Palakodeti: We sold the loss-making contracts to reduce losses, which is a good thing to do... right?

Madan Lal: That is good thing but EBITDA profit should have come before to us?

Srinivas Palakodeti: We believe that the turnaround will happen when the new revenues come. This will take some time.

Madan Lal: Sir, because of this High Court's order in fourth quarter, this excess amount which was kept for salary, is there some addition to that in the net profit?

- Srinivas Palakodeti:** Yes. If you look at the whole year, that is the representative, in that some amount of Rs. 8 crores is of last year but the remaining amount is of this year.
- Madan Lal:** Is some amount returned back? I am asking in that in profit.
- Srinivas Palakodeti:** Yes, the whole year's expenses of employee cost that is representative as the total cost to revenue, which is approximately 67%.
- Madan Lal:** Okay. And sir, I want to ask one last small thing, scrip there is no liquidity. So, because of any reason will it be thought on this?
- Srinivas Palakodeti:** Sir, how can we talk about that? Our focus is that company's performance improve, liquidity is not in our hands.
- Madan Lal:** Sir, liquidity is not there. But sir, when are we coming back on dividend sir, you guys have years of record of giving dividend of Rs. 20. And now, day by day sale is increasing profit is constant and we are not able to give dividend, when will this situation change, sir?
- Srinivas Palakodeti:** No, when dividend was more that time borrowing was also increased so leave this year in past two years we have reduced around Rs. 200 crores debt. So first, we want to make company zero Debt Company on net basis and we will discuss with board about the dividend.
- Madan Lal:** Sir, after borrowing reduction, there is no jump in net profit. Except that Hinduja Global the merger which you did, you said in that merger also that benefit will happen but because of that also no benefit is happening. Means, we watch every quarter that somewhere magic will happen and Hinduja Global Solution's result will come excellent and we are finding that every quarter.
- Srinivas Palakodeti:** No, that impact happened on tax benefit, the ISPL merger happened with GSL and operating expenses are also less. But then right now we are trying that performance will improve in future.
- Madan Lal:** That is not reflecting in profit, interest is not reduced, amount payback is done, we did merger, none of the benefit did not came to net profit, sir.

Srinivas Palakodeti: See, like I told you, if you leave the AxisPoint and Element then the revenue has increased by 17% there and EBITDA has increased by 24%. That improvement is not showing because whatever is AxisPoint's losses is there because of which the improvement is not showing. Otherwise, there is very good performance there.

Madan Lal: Sir, revenue per employee is something like 98,000. So on basis of that, if we see, our range should be improved going forward, sir.

Srinivas Palakodeti: We are trying to improve the businesses which are not doing good; if they improve then profit will also improve.

Moderator: Thank you. Ladies and Gentlemen, as we have no further questions from participants, I would like to hand the conference over to Mr. R. Ravi for closing comments. Please go ahead, Sir!

R. Ravi: Thank you, Melissa. Again, Ravi here. Thank you to all the participants for joining us in the conference call. If there are any further questions or clarifications about the Q4 FY 2019 or for the full year FY 2019 financials, please e-mail me or to Pala, the CFO, and we will be more than happy to get back to you. This is Ravi signing off on behalf of the HGS management. Thank you, once again.

Moderator: Thank you, gentlemen. Ladies and Gentlemen, on behalf of Hinduja Global Solutions, we conclude today's conference. Thank you for joining us and you may now disconnect your lines. Thank you.

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