

Hinduja Global Solution Q2 FY2013 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 Earnings Conference Call. As a reminder, for the duration of this conference all participants' lines will be in a listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference please signal an operator by pressing '*' followed by '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Bijay Kumar Sharma from Churchgate Partners. Thank you and over to you sir

Bijay Kumar Sharma Thank you Melissa. Good afternoon and welcome to the Hinduja Global Q2 FY2013 Earnings Conference Call. Joining us today on the call today are Mr. Partha De Sarkar – CEO and Mr. Srinivas – CFO. Before we begin I would like to mention that some of the statements made in today's call may be forward looking in nature and may involve risks and uncertainties. For list of such considerations please refer to our earnings presentation. I would now like to invite Mr. Partha to provide us his perspective on the performance of this quarter. Over to you sir

Partha De Sarkar Good afternoon to all of you and thank you for joining our second quarter earnings call. You may have already had a chance to review our results presentation; but I would like to start by summarizing the financials of the quarter quickly and followed by key strategic and operational highlights. After that I will request Mr. Srinivas Palakodeti, our CFO, to discuss the financial performance in greater detail. We then look forward to an interactive Q&A session with all of you.

We start with the financial summary and the corporate highlights. The overall second quarter financial results reflect a globally strong operational performance. Our consolidated revenue for the quarter is at Rs.4,692 million which is an increase of 31.2% on a year-on-year basis. This top-line growth profile was driven by the acquisitions made in Canada and of the payroll business in August 2011 as well as pure organic growth.

The increase in the revenues also factors the rupee depreciation for the quarter as compared to the quarter ended 30th September, 2011. Overall, we benefitted from increased volumes and new service offering delivered to our existing clients. This was further enhanced by strengthened client relationships. Clients contributing revenues of more than Rs 100 million for the quarter increased from 9 to 11 when we compare it to Q2 of FY12.

Our consolidated EBITDA for the quarter was Rs.499 million, an increase of 30.7% on a year-on-year basis. This was after accounting for ramp up cost for the new delivering center in UK and site expansion and re-organization in Canada. Our margins were maintained on a year-on-year basis and improved by 100 basis points sequentially.

Consolidated PAT was negatively impacted by Rs.53.2 million on account of foreign exchange re-measurement loss due to the appreciation of the rupee towards the end of September.

At the end of the quarter we had 521 active clients. We also added two high profile healthcare clients extending market coverage to 5 out of the Top 12 Healthcare Companies in the US. Emerging market and HGS Business Services benefitted from a large number of client additions to them.

Wanted to make a few points about our acquisition of the Revenue Cycle Management Business, in September we announced that we had entered into an agreement with Deloitte Consulting to acquire Revenue Cycle Management Business in the healthcare space. This transaction closed in early October and is expected to result into incremental revenue of over US\$ 11 million per annum. This business deals with accounts receivables processing services and insurance and eligibility verification services. It caters to several US hospitals and strengthens our presence in the Provider segment of the Healthcare sector which accounts for close to 24% of our revenues.

Now getting to specifics about geography and industry observations, let's talk about USA first.

Revenues for Quarter 1 and Quarter 2 were soft due to a slower ramp up of a telecom client. Revenues for Quarter 2 were better than Quarter 1 leading to better efficiency in pricing. The second quarter also benefitted from increased volumes from other existing logos leading to an overall improvement in financial performance of US. For the remaining quarters, revenue –and EBITDA from existing customers should increase, as the seasonal effects of our consumer product customers expand during the upcoming holiday season along with addition of new logos. Focus on improving efficiency and streamlining business processes will continue. The sales pipeline looks strong and we expect to create additional opportunities going forward. The acquisition of the revenue cycle management business from Deloitte Consulting will contribute additional revenues for the remaining part of the year.

In early October, we appointed Kathy Hamburger to the HGS Global Executive Team in the role of President of HGS, USA. Kathy will be responsible for strategic planning business growth initiatives and in enhancing profitability of that operation.

Our recent EBOS acquisition and the strengthening of our US Leadership Team demonstrate our focus on North America.

Talking about Central and South America, as we mentioned earlier we continue to look for opportunities and locations in South and Central America to keep pace with the client's demands. These initiatives will help us to serve the clients who believe that they can have much more control if their delivery centers are located close to countries of their operations.

Our center in Jamaica has gone live and has started servicing a bank in Jamaica. We have started seeing interest from our clients to have Jamaica as a delivery center.

In Canada, Quarter 1 and Quarter 2 experienced a number of market impacts within our installed base of clients leading to lower volumes. Combined with this, the Canadian operation were impacted by the costs associated with the ramp

up of our newest delivery Site in Bellville for Apple Computers as well as the consolidation process of shutting down the Antigonish site.

Towards the end of Quarter 2, we have started seeing an upward trend in all our clients volumes as well as market conditions and our telecom clients are seeing an increasing trend in the subscriber growth. Combined with the increase in the existing client volumes, we have started getting new lines of businesses from our installed clients, which would lead to overall improvement in financial performance in Quarter 3 and Quarter 4. Encouragingly, interest amongst our clients for offshoring continues to remain strong and we are optimistic about starting Canadian offshoring revenues in the current fiscal year. We are also building a substantial sales pipeline within the banking and the finance industry in Canada and are looking for this investment to produce new logos with new revenues added to our run rate in 2014.

Moving to Philippines, clients from our US and Canada operations and from a variety of verticals continue to show strong interest offshore to Philippines. While the outlook on the consumer electronics sector is cautious, we are confident that new clients along with additional lines of business from the existing clients, will help fill up the current excess capacity. There is a strong dependency on seasonal volumes on our Philippines Quarter 3 and Quarter 4. We are keeping our fingers crossed, hoping for a strong holiday season consumer spending on durables. That will drive volumes in our Philippines center.

Moving to UK, our UK business continues to perform well in the face of a depressed market. During the quarter, we have started a new site in Preston for a significant contract for a large telecom client. In a short period we have exceeded the delivery expectations which have also confirmed Preston's long-term potential as an ideal contact center to support the future growth of the business. The Preston ramp resulted in certain onetime costs, that we will recover in full as the contract reaches a critical mass. We continue to invest in sales, marketing and people, process, infrastructure for providing the foundation to support aggressive organic growth and increase complexity and scale of service delivery. We are

investing just ahead of the curve in order to ensure continued service excellence and client revenue optimization. We expect improvement in financial performance, as our new logo sales initiatives in existing client relationships deliver results.

Moving to our India domestic business, while volumes on telecom segment continue to remain soft, the emerging market segment is performing well and continues to act fine. HGS business services, our HR service delivery arm has won a large number of clients -such as Tata Starbucks, JP Morgan US, and CIMB. We also launched a chat support for Telco in November 2012 and expect to ramp significantly in FY13.

US Healthcare, The healthcare business in the first half of FY13 showed good organic growth. We have three significant wins in the second quarter for non-voice and voice work to be done from India and Philippines. While the revenues from these contracts will start in Q3, these are expected to reach significant size in FY 2014.

In August 2012 we opened a new center in Bangalore to service offshore businesses. For servicing the business acquired from Deloitte in USA, we are setting up a SEZ delivery center in Hyderabad.

A few words about the economic environment, Major economic regions across the world have recently experienced a deceleration particularly in India and China. These effects have been more severe across the Euro-zone where GDP in countries like Spain continues to contract. UK has recently technically emerged from recession but like the US with difficult job market, resulting in continuous pressure on consumer spending. The continued economic un-certainty in the US has affected corporate client budget by this and resulted in a general decline in discretionary IT based project. However, long-term partnership discussions to help clients permanently reduce the cost base remain the priority for the management. Strong demand for smaller outsourcing deals remain will select large opportunities available across industrial sectors. With Obama's win in the

recent election the healthcare reforms that started earlier are likely to continue.. Most of the healthcare peers continue their push to reduce the administrative costs and find ways to redesign their organization to be more consumers oriented in order to compete in the new era. Similarly, providers are continuing their drive to reduce the overall cost and better manage their healthcare receivables. The likely emergent for the Accountable Care Organizations (which are also called as ACOs) and other models that are focused on delivering better healthcare outcomes at lower cost, are expected to throw a new set of opportunities to services organizations like us. Our vast experience in US healthcare and newly added capabilities, position us to compete effectively in this market.

In summary, HGS has performed in line with management expectations from both the top-line and the profitability perspective. This is despite the global backdrop which has been challenging at the best of times. Our consistent strategy of building a diversified geographic industry and services platform has enabled us to create value and deliver for our shareholders. Although profitable organic growth is our highest priority, we retain full financial flexibility to evaluate selective acquisitions and explore new markets such as Latin America and East.

As you are already aware, the first half of the fiscal year is relatively slow for us because of the seasonality and we expect the performance in the remaining half to be robust. The company continues to invest in sales, marketing and infrastructure to support its organic growth plan, increased complexity and the scale of service delivered by its clients. The HGS Global Leadership team continues to explore ways to improve, internal operating efficiencies while retaining full customer focus. I would now like to hand over to Mr. Pala who will walk us through the financials. Over to you Pala, and thank you.

Srinivas Palakodeti

Thank you Partha and welcome everyone once again for joining to this call and thank you for taking time out to go through this presentation and the financials. As Partha mentioned earlier, the acquisition of the revenue cycle business was closed in the month of October so the financials for the quarter ending September

do not reflect whatever the impact of revenue and other financials. The acquired business will start generating revenues from this quarter onwards.

So coming back to the results for the quarter ended September. Our revenues were Rs 469.2 crores, an increase of 31% over revenues of Rs 357.5 crores for the quarter ended September 2011. You may recall that the acquisitions of HGS, Canada (earlier known as OLS) and HGS Business Services (earlier known as HCCA) were completed in August 2011. So the numbers of the current quarter are not directly comparable to the revenue and profits of Quarter ended September 2011. Out of the total growth of 31%, around 8% is on account of acquisitions, around 8% is on account of organic growth and the balance is on account of the exchange rate variation. The average dollar to rupee rate for the quarter ended September 2012 was Rs.54.67 as compared to the rate of Rs.46.36 to the dollar for the quarter ended September 2011. On a sequential quarter basis, revenues were marginally higher at Rs.469.2 crore as compared to Rs 466.7 crores for the quarter ended June 2012. Average exchange rate for the quarter ending June 2012 and September 2012 were roughly in the same range of 54.6 to 54.8.

EBITDA for the quarter ended September 12 was Rs.49.9 crore and this has increased by 30.7% from the EBITDA of 38.2 crores for the quarter ended September 2011. On a year-on-year basis the EBITDA margins have remained in the range of 10.6% to 10.7%. Compared to the quarter ended 30th June 2012 the EBITDA margins have improved by 100 basis points.

This improvement in the EBITDA margins has been achieved after absorbing the startup and ramp up costs of the new site at Preston in UK and Bellville in Canada, the cost of consolidation of Antigonish center in Canada and absorbing the cost of empty seats in Philippines. We expect the EBITDA margins to improve during the second half of the year, which typically sees business and revenue uplift.

On a sequential basis, other income in this quarter was substantially lower due to exchange rate variation. The average rate for the quarter ended September 2012 for the P&L purposes was Rs 54.67 to the dollar, but the closing exchange rate was substantially lower. Along with that, the Cross reference rate of the Indian rupee versus the Peso was from 1.33 as of 30th June 2012 to 1.27 as on 30th September, 2012. The adverse quarter end movement led to foreign exchange re-measurement loss of 5.32 crores as compared to gain of Rs 6.2 crores in June 2012.

On a sequential quarter basis, the interest costs have increased from Rs 9.6 crores to Rs 12 crores. This increase is primarily due to dividend outflow during the quarter. Depreciation has increased in line with increase in capacities. Profit before tax and other income for the quarter ended September 2012 stood at Rs.17.4 crores as compared to Rs.17.9 crores for the quarter ended September 2011 and Rs 16.8 crores for the quarter ended June 2012. That has been a 4% increase in profit before tax and other income compared to the quarter ended June 2012.

Moving onto revenue analysis, there has been growth in revenues from all geographies on a year-on-year basis. We are well diversified and from revenue origination perspective, US accounts for 58% of the revenues, followed by Canada at 19%, 12% from UK and Europe and balance 11% from India. The revenues split geography-wise were the same for the quarter ended June 2012.

Our top three verticals – telecom, healthcare and consumer contributed around 73% of the revenues in Q2. Employee count for the quarter ended September 2012 was 22,883 as compared to 23,865 for the quarter ended June 2012.

The head count is expected to increase as we go into the busy season and we hire for the Hyderabad SEZ which is being set up to service the business acquired by HGS Inc. in USA from Deloitte. As on 30th September the number of seats stood at 22,444 as compared to 22,286 at end June 2012.

As on 30th September the debt position was 608 crores as compared to 571 crores as on 30th June 2012. This debt includes US \$5 million which is approximately Rs 26.4 crores of loans taken against fixed deposits. The higher debt level is on account of capital expenditure and enhanced working capital requirements. Cash and cash equivalents of our Mauritius subsidiary remained at US \$ 88 million which is same as in June 2012. Due to variation of closing exchange rate from Rs/US\$ 55.63 (as on 30th June 2012) to Rs/US\$ 52.85 (as on 30th September 2012) , in rupee terms, there is a decline in the cash balance but the dollar amount remains the same.

Taking into account the other geographies, the cash and cash equivalents stand at Rs. 580 crores as compared to Rs.635 crores as on 30th June, 2012. Out of this variation of Rs 55 crores, Rs 14 crores is on account of the exchange rate variations and the balance is due to funds deployed for ramp up of new sites CAPEX and gearing up for the peak season. That's all from my side. We can now move into the question and answer session. Thank you.

Moderator

Thank you. Ladies and gentlemen we will now begin with the question and answer session. We have the first question from the line of Anil Trivedi from Enam Securities. Please go ahead.

Anil Trivedi

My question is with regards to the Hyderabad SEZ. You said that the headcount is going to increase on account of Hyderabad SEZ so could you roughly quantify the number and also with regards to the CAPEX at Hyderabad any number on the figure that you want to be spent?

Srinivas Palakodeti

To clarify we have applied to set up an SEZ. The approvals are in the process of being approved so we expect that to come through in the next few weeks. So as intent we don't have any SEZ in place I just want to make that clear upfront.

In terms of the number of employees what we are looking to have, is somewhere in the range of 450 to 500 and we have already identified space which happens to be built up in terms of the interiors, etc. Our estimate for the CAPEX will be somewhere in the range of Rs 5 to Rs 6 crores for the Hyderabad SEZ.

Moderator Thank you. We have the next question from the line of Prateek Gandhi from IDBI Capital. Please go ahead.

Prateek Gandhi I have three questions. Firstly, on the disclosure part, if I look at your press release this time around, I find only your top-line margins and basic EBITDA margins impact number. I don't see the remaining items so is it that I haven't received that or it's the new disclosure going forward will follow the same pattern.

Secondly, if you can update us on the acquisitions which you did in the past? Basically how are we in terms of the top-line and how the margin profiles of those acquisitions and lastly tax rate for FY2013 and '14?

Srinivas Palakodeti Apart from the press release you should have got a detailed investor presentation apart from the results which are already published. In case you do not have that we can send them across to you.

Prateek Gandhi Basically the last 2 to 3 acquisitions for example we have HCCA which we have overlay so how are we in terms of the revenue and the margins and what do you expect for the current year as well as next year. So if you can throw some light?

Srinivas Palakodeti We have done in the last two years about 3 acquisitions. We acquired a business called Careline in UK which is now called HGS, UK. That contributes about 11 to 12% of our total revenues. Whatever we show under UK is coming out of the Careline acquisition. Then we have the OLS acquisition, the Canadian acquisition. That accounts for about 20% of our revenues. This was about 19 % for this quarter, but in the last few quarters 19% to 20% is the contribution from Canada. And HGS business services commonly known as HCCA contribute on an average of about Rs. 9 crores per quarter so that accounts about 2% of the total revenues. Margins have been as expected on a long-term basis across all the geographies. As Partha mentioned earlier in the call there was some soft volumes in the earlier part of the year in Canada but things are pretty much looking up and from September onwards we are seeing an upswing in the volumes. So the things are pretty much performing as expected.

Prateek Gandhi But if you can just share some light in terms of at the time when we acquired these businesses what kind of margins they were operating and what is the current margins? So I just want to understand whether we are able to leverage on the offshoring part which I think Partha mentioned earlier but with this kind of part we expect that offshoring will continue to be higher so just to get the reference and trying to get some numbers on those.

Srinivas Palakodeti Well. As a policy we don't disclose our line of business margins geography-wise. When we did the Canadian acquisition we had two or three elements, one our dependence in US was at one stage close to 90% or even 100%. Through acquisition and growth of India domestic business we have actually reduced the business from US to about 58%. The other part was Canadian business environment was much better and much more stable. The regulators have been far more conservative than what we have seen in US right through the crisis of 2008 – 2009 the Canadian Banks, etc., continued their robust performance despite Canada as an economy being highly dependent on US. And we also realized that the Canadian market was new to offshoring and from our timing perspective, we think it is perfectly well timed. The clients we have in Canada have shown lot of interest in offshoring into geographies like India and Philippines. There have been number of interactions, client visits, etc and as we mentioned earlier in the call we are optimistic that before the end of the financial year we should have beginnings of the offshoring revenue from Canada and Philippines. So to that extent apart from whatever we can see the visibility of the business in Canada from existing clients as well as new clients, the offshoring element has come in pretty quickly for a market which is fairly new to offshoring.

Prateek Gandhi Just on the Deloitte one which we have acquired recently we expect around Rs.11 million of revenue coming for the full year, right?

Srinivas Palakodeti Yeah that's the expectation that the total revenues will be in the range at least US \$ 11 million on a full year basis.

- Prateek Gandhi** Basically since two quarters have already gone I think we should expect half of that in for FY13, right?
- Srinivas Palakodeti** Yeah roughly. it started sometime in October and it will take a little bit of time to build up since we are recruiting people but on a full year basis on October-to-October we expect to have more than US \$ 11 million of revenue.
- Prateek Gandhi** If I recollect your earlier commentary I think you are saying that margins will improve in H2 so I think from the current around 10.7% I think you expect margins to slightly improve by around 150 basis points, right? Is that a fair assumption?
- Srinivas Palakodeti** Yeah if you look at it going back by past two year experiences the first two quarters tend to be flat and the subsequent margins for performance in these quarter 3 and quarter 4 improves in EBITDA margins perspective substantially.
- Prateek Gandhi** And what would be the tax rate for full year FY13 and 14?
- Srinivas Palakodeti** On a broad basis our tax rate on an aggregate basis is about somewhere in the 25% range but the dimensions vary because we operate in different geographies. If I take SEZ the MAT is 20%. If I look at India, it is 30%. Philippines is a little more complicated because we have some units going out of SEZ benefits and Canada and UK, etc., have but on the overall basis we expect to be somewhere in the range of 24% - 25%.
- Prateek Gandhi** This quarter was fairly high, right?
- Srinivas Palakodeti** Yes because in this quarter, a lot of it is because of that exchange rate re-measurement. Those don't constitute as taxable losses so you still end up paying tax so to that extent it will always look a little higher.
- Prateek Gandhi** And, lastly on the dividend payout. I think with the few acquisitions which you have already did it and probably since we are now a net debt company so any change in the payout policy?

Srinivas Palakodeti Let me put this way. If you look at past three years our profits have been in the range of Rs 106 to Rs 130 crores on a full year basis and we have maintained dividend rate of Rs.20 per share so it is for the Board to decide as we complete the financial year to take an overall view but historically at least for the last two years it has been Rs.20 per share irrespective of the variation and the profit between Rs 106 to Rs 130 crores..

Prateek Gandhi So you expect that to be continued, right?

Srinivas Palakodeti I don't want to necessarily say that, but I can only talk of what has been done on the past and it is for the Board to take a final decision at the end of the year.

Moderator Thank you. As we have no further questions I would like to hand the floor back to the Management for closing comments. Please go ahead sir.

Partha De Sarkar Ladies and gentlemen thank you for joining us on this call. We look forward to building up on our success and look forward to having you with us again. In case if you have any further questions or queries, please feel free to get in touch with Mr. Palakodeti or our Investor Relations Team. Thank you.

Moderator Thank you, gentlemen of the Management. Ladies and gentlemen that concludes your conference call. Thank you for joining us and you may now disconnect your lines. Thank you.