

Hinduja Global Solution Q2 FY2014 Earnings Conference Call

November 12, 2013

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

Mr. Srinivas Palakodeti – CFO, Hinduja Global Solutions



Moderator Ladies and gentlemen, good day and welcome to the Hinduja Global Solutions' Q2 FY2014 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 this conference, please signal an operator by pressing "*" then "0" on your touch tone telephone. Please note that this conference is being recorded. I will now hand the conference call over to Mr. Bijay Sharma of Churchgate Partners. Thank you and over to you, sir.

Bijay Sharma Thank you Inba. Good afternoon and welcome everyone to Hinduja Global Solutions Q2 FY2014 Earnings Conference Call. Joining us today on this call are Mr. Partha De Sarkar – CEO, and Mr. Srinivas Palakodeti – CFO. Before we begin, I will like to mention that some of the statements made in today's conference call may be forward looking in nature and may involve risks and uncertainties. For the list of such considerations please refer to our earnings presentation. Now I would like to invite Mr. Partha to provide his perspective on performance for this quarter. Over to you, sir.

Partha De Sarkar Welcome everyone to the Hinduja Global Solutions' Earnings Call to discuss our results for the second quarter of fiscal year 2014. I hope you have had a chance to review our presentation and financials which are available under the investors section of our website. I will start with providing an overview of the quarter financials followed by highlights of our key strategic and operational performance across the geography. Post that, I will hand over the call to our CFO, Mr. Srinivas Palakodeti, to take us through the financial performance in greater detail. We will then open up the call for an interactive Q&A session.

We are very excited to announce that we continue to build on our growth momentum, and have achieved new milestones during this quarter. In Q2 FY2014, we have recorded our highest ever quarterly revenue, EBITDA and PAT altogether. Our revenues increased by 38% on a y-o-y basis and 16% sequentially, to reach Rs. 6,473 million. This robust growth has been driven by a combination of enhanced volumes across the existing clients, addition of new

logos, better demand scenario and favorable exchange rates. In terms of geography, regions such as Canada, Philippines, India and the US contributed to the strong growth.

Our EBITDA for the quarter was at Rs. 814 million, registering a growth of 63% y-o-y and 28% sequentially. This improvement in EBITDA was driven by strong organic growth resulting in optimal capacity utilization levels across most of our delivery centers. Our EBITDA margins for the quarter were at 12.6%, which is an increase of 193 basis points, compared to the same period last year. Our initiative on an ongoing assessment of profitability and corrective actions undertaken has resulted in enhancement of margins.

During the quarter we recorded a profit after tax of Rs. 429 million, an increase of 288% compared to Q2 FY2013 and 14% sequentially. This growth was primarily due to higher operating profits and lower interest expense, as a result of repayment of debt and lower working capital requirement due to better utilization. PAT margin for the quarter was 6.6% representing an improvement of 427 basis points compared to Q2 FY2013.

Given the robust financial performance, the boards of directors have decided to declare an interim dividend of Rs. 5 per share. The declaration of an interim dividend by us is a reflection of managements' confidence in the performance of the business going forward.

Another significant milestone achieved this quarter was the 40th Anniversary with our very first client, the consumer electronics giant Sharp. Very few in our peer group can boast of a 40 year old client but we have many such clients, and also employees who have been with us for many decades. They had their own choices of going to somewhere else, to our competitors but they chose to remain with us for 30 to 40 years and this speaks volumes of our happy people and happy clients.

Before moving onto an update on various geographies, I would like to touch upon the healthcare sector as it is a very important vertical for our business. The

recent development in the US healthcare reforms starting October 2013 has opened up new opportunities for us and we are optimally positioned to capitalize on them. The immediate opportunity arising from the reform is supporting peers on the exchanges and we are already servicing a healthcare client in the USA and Philippines on this process. In the long term, there is a significant opportunity for medical cost management and overall care management. There is an abundant supply of nurses in Philippines and coding professionals in India. We expect good growth from these two segments going forward, for the healthcare sector.

Moving onto the update on geographies we operate in, the performance of our US operations was in line with our expectations. The financial performance of the US operations improved, compared to the same period last year as well as sequentially. Our efforts to strengthen the sales team have started yielding positive results and have helped us to build a strong pipeline. This will start to translate in our performance in the coming quarters. During Q2 FY2014, we added three new clients in the consumer vertical and based on the response for our sales effort, we are expected to add few more logos by the end of this fiscal year.

During the quarter we also initiated various operational measures for margin management. Our operations team in the US has now been centralized under Senior Vice President of Operations; this will help us generating better synergies and accountability. We also started an ongoing assessment of client-wise profitability and are taking corrective actions for exiting any unprofitable business, whenever it is necessary. Some cost control measures have also been initiated to optimize general and administrative expenses. All these steps are expected to result in better profitability and improved margins by the end of this fiscal year.

Our Canadian operation continued its growth momentum and has demonstrated strong financial performance. The last two months of the quarter achieved the highest ever monthly revenues, thus driving better profitability. During the quarter, our new site at Barrie in Ontario, Canada started operations with 350

FTEs. We received a new line of business from an existing telecom client, which is expected to be fully operational by Q4 FY2014. This service is currently in a ramp up mode with around 40 seats and has potential to reach around 200 seats.

We expect the ramp up of the Barrie and Dartmouth sites will be completed in coming quarters and they will operate at optimal utilization levels. HGS Canada remains focused on acquiring new clients and generating additional lines of business from existing clients. Also, more offshoring opportunities are anticipated to arise from these operations and there are plans for site expansion to address domestic growth opportunities by Q4 FY2014.

Moving onto UK and Europe, the macroeconomic scenario in the UK and Europe continues to remain challenging. Particularly in the UK, there are only a few new scale CRM outsourcing opportunities available. We remain focused on actively pursuing public sector clients and are better placed to capitalize on any opportunities arising in this sector. We were recently selected as one of the four approved government outsourcers by the government procurement service, and this is the testimony of our credentials of servicing public sector clients.

Our continued focus on building strong relationships has resulted in a new line of business from an existing telecom client. We have also added two new clients in the consumer and auto sectors.

Moving onto Philippines, the financial performance of our Philippines centers improved significantly due to robust growth and volumes from healthcare and consumer electronics sector. It was also supported to a certain extent by the weakening of the Philippines Peso. During the quarter the Philippines operations added a new line of business such as payer data management for a healthcare client and the service center back office and social media management for a consumer electronics client. We also started servicing our first offshoring work for the Canadian telecom client.

Our focus on acquiring new clients is gathering momentum and has shown favorable results, particularly towards Philippines. As the sales pipeline of HGS

Philippines remains strong and all the facilities are operating at an optimum utilization level, we are planning to open our 5th center in Philippines. The site for this expansion has been identified and operations are expected to start by the end of this fiscal year.

Moving to India operations, we recently completed the 10th anniversary for a telecom client and our largest healthcare client. This long relationship clearly demonstrates the strong customer relationship that HGS maintains with its clients which has been achieved through superior quality of services delivered.

Our first SEZ in the global village of Mysore Road which started operations in January 2011 has reached peak capacity. Our Hyderabad SEZ is handling our EBOS operations and our third SEZ in Bangalore, commissioned in August 2013, is currently servicing an international consumer electronics client. We are expecting strong demand in the healthcare sector primarily due to healthcare reforms in the US. To capitalize on this growing demand, we plan to add another 526 seats in Bangalore.

For our India domestic operations, the initiative of an ongoing assessment of client profitability and corrective actions undertaken have started yielding results. We have also received rate increases from various clients who continue to do business with us. This is expected to result in better margin contribution in the second half of the fiscal year. Also we are focusing on selective and profitable client acquisitions across sectors, to improve profitability. We also want to offer our India delivery capabilities for our international clients, who have services in India.

To summarize, we have been able to consistently deliver robust performance for the past four quarters with our focused strategy and quality of service delivery. We have delivered strong top line growth and have also been able to improve our margins gradually, which has been an area of concern for us in the last fiscal year. During the quarter all our geographies demonstrated strong performance except Europe, which continues to be under pressure. However, we are

comfortable, given the fact that it accounts for only about 10 to 12% of our annual revenues. Also the situation is expected to turn around in the next 6 to 9 months.

Overall, HGS has been able to build a strong sales pipeline broad based across its verticals and its geographies. We remain very optimistic about the upcoming quarters based on our strong sales pipeline and the traction we are receiving from clients. The management expects to continue the growth momentum and also continue to focus on improvement in our margins.

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

Srinivas Palakodeti

Good afternoon everyone. I would like to thank you all for joining our Q2 FY2014 earnings conference call.

After crossing the quarterly revenue mark of Rs. 5,000 million for three quarters in a row, our consolidated revenues for the quarter reached Rs. 6,473 million, a growth of 38% compared to the same quarter last year.

In terms of exchange rates, the US dollar to the rupee for the quarter ended September 2013 was Rs. 63.05 as compared to Rs. 54.67 for the same period last year. PHP to the US dollar changed from 41.89 for the quarter ended September 2012 to 43.92 for the quarter ended September 2013. As of September 2013, the US dollar rupee rate stood at Rs 62.91, while the US dollar to PHP rate stood at Rs. 43.67.

Of the total growth of 38%, around 22% of the growth was on account of growth in volumes from existing clients as well as new client additions. Around 4.5% came from the EBOS acquisition, which we had made in October 2012, and the remaining 11.5% came from exchange rate variations. Overall, our revenue growth has been driven by a combination of enhanced volumes across clients, new logos and better capacity utilization at all centers. In addition the favorable

exchange rates, has a significant impact on the offshore business which contributes around 30% to our revenues.

From a revenue breakdown perspective, the performance of all the geographies has been as per management expectations. US accounted for approximately 60% of the total consolidated revenues, Canada accounted for 23%, UK and Europe accounted for 9% and the remaining 8% was contributed by the India domestic business. If we exclude the revenues from our payroll business, which is HGS Business Services, the remaining India domestic operations declined by around 4% compared to the same period last year. This decline is primarily on account of an ongoing assessment of client-wise profitability and corrective actions undertaken.

For the quarter ended September 2013, the contribution of the healthcare vertical increased by around 3%, compared to the same period last year. This is on account of EBOS business growth in volumes as well as increased opportunities as a result of the healthcare reforms in the US. For the quarter ended September 2013, telecom contributed 33% of the revenues, consumer sector 17%, banking and financial services 8% and media 7%.

Our consolidated EBITDA for the quarter increased by 63% to Rs. 814 million compared to the same period last year. Our consolidated EBITDA margins stand at 12.6%, an improvement of 193 basis points compared to quarter ended September 2012.

Employee benefit expenses for the quarter increased from Rs. 3,293 million in quarter ended September 2012 to Rs. 4,378 million for the quarter ended September 2013 and stand at 67.6% of the total revenues. Depreciation for the quarter ended September 2013 has increased around 15% over the depreciation amount for the period ended September 2012. Depreciation as a percentage of sales has declined significantly from 4.4% of revenues to 3.6% of total revenues.

During the quarter we recorded other income of Rs. 103 million comprising Rs. 33 million of income from treasury surplus, and the balance on account of gains due to exchange rates variations.

Compared to the quarter ended September 2012, our interest cost has declined by around 19%. This decline in interest cost during the quarter is due to debt repayments as well as use of commercial paper to reduce interest, as well as better profitability leading to lower working capital requirement. Interest expense accounted for 1.5% of total revenues for the quarter ended September 2013, compared to 2.6% for the same period last year.

Our consolidated PAT for the quarter was Rs. 429 million. Our PAT has registered a growth of 288% driven by higher operating profits, favorable exchange rate movements and decline in interest expense. PAT margin for the quarter was 6.6%, an improvement of 427 basis points compared to quarter ended September 2012.

Our effective tax rate stands at 26%, compared to 39% for the quarter ended September 2012. This is due to increase of business in the SEZ units as well as in Philippines units, which are under a tax holiday.

We have a strong balance sheet to support our future growth. Our total debt as of 30th September 2013 stands at Rs. 6,110 million after factoring the restatement of foreign currency denominated in rupees at higher exchange rates. Our cash and treasury surplus at the end of the quarter stood at Rs. 5,700 million, resulting in net debt of Rs. 410 million. Our net worth stands at Rs. 14,364 million and based on a debt of Rs. 6,110 million, we have a very conservative leverage position with debt to equity of 0.43x and net debt to annualized EBITDA of 0.14x.

Our total headcount as of 30th September 2013 was 24,669, an increase of about 250 employees compared to the last quarter on a net basis due to commissioning of our site at Barrie Canada and Bangalore. This offsets the decrease in the headcount on the India domestic side. Of the total headcount, 60% are based in

India, 15% in Philippines, 10% in US, 11% in Canada and the remaining 4% in UK and Europe.

The total number of seats at the end of September 2013 was 24,827, an increase of 907 seats over quarter ended June 2013. This increase was mainly in India for the offshore business and the new site which we have opened in Canada at Barrie in Ontario province. The increasing volumes have led to near optimum utilization in Philippines. We are planning to add around 800 seats in Manila and 526 seats in Bangalore to address the growing demand.

We would like to add that the High Court of Mumbai has approved the merger of HGS Business Services with our SEZ subsidiaries at HGS International Services with the appointed date of 1st July 2013. The merger will become effective once the filing with the Registrar of Companies has been done and other formalities are completed. This merger is expected to lead to operational synergies and cost savings. The effect of the merged financials will be reflected in the quarter ended December 2013.

With this I would like to open the call for a Q&A session. Thank you very much.

Moderator Ladies and gentlemen, we will now begin the question and answer session. Our first question is from Mahesh Bendre of Quantum Securities. Please go ahead.

Mahesh Bendre The second quarter volume growth has been around 22% organically and historically if you see the pattern of our company, the second half has always been better compared to first, so this trend will be followed this year also?

Partha De Sarkar Whatever visibility that we have of our Q3 and Q4, we believe that Q3 and Q4 numbers will be better than Q2.

Mahesh Bendre What is actual growth driver, we have seen the growth across all the geographies has been very strong, so what has been driving this particular growth?

Partha De Sarkar Let me correct you; our growth has been good across most geographies, except UK and Europe. UK and Europe is kind of steady and is not growing that much. Our India domestic business is also not growing that much, so you should exclude those two geographies. North America has actually delivered most of the growth and North America means both US and Canada. These businesses have grown in both onshore US and Canada, and in offshore India and Philippines. So as a result of that, our capacity utilization has improved both in Philippines and India. Philippines operation is operating at peak level and we don't have any seats left at all. In India also, we have maxed out. We are building additional seats in response to demand. We are in a situation wherein we have actually oversold the seats that we have. The business is waiting for us to add seats so that we can start delivery. That is the situation that we are in today. What is delivering that, I think, over the last 18 months if you have been following us, we have invested a lot in front-line sales leadership in the US. We have hired at least four very high caliber sales professionals from various companies like 3i InfoTech, Sutherland Global Services and Wipro. The combination of all of these has actually helped us in developing a pipeline which is converting at the rate that you are seeing today. The interesting thing is that what you're seeing is in the pipeline still constitutes of 90% of growth is from our existing clients and about 10% from new logos. What will end up happening is as the pipeline is so robust, contribution from new logos will increase in the fiscal year, as the pipeline converts itself. So that is the long answer to your question, the fact is that the organic growth is driving better margins and organic growth is coming because we invested in sales. Also, pipeline is actually converting itself quicker than it used to be historically.

Mahesh Bendre Given such a strong volume growth organically and since in most of our factories we are operating at peak of the utilization if you want to continue with this growth, I think, we need a substantial increase in our number of seats and even the employees strength. Do you agree with this?

Partha De Sarkar Yes, so growth will come by addition of seats and employees, without that growth will not come.

Mahesh Bendre Do you think by FY2015, the number could be much higher because employee strength has been very stable for the last few quarters and even the seats are have not grown organically in a great way. But since now we are operating at peak level, at this kind of volume growth, the thing there could be a jump up in both the numbers in terms of seats and employee strength next year?

Partha De Sarkar As I told you, we have a good pipeline that will convert itself fairly well. So growth will come from organic business and the reason you were seeing the flatness in our headcount is because we are churning our portfolio of businesses. We are exiting some businesses which were unprofitable for which the headcount was going down and we are adding headcount in more profitable businesses. So at the net level, the headcount growth may not be dramatic. But as we continue to rationalize, you will find that our business growth will happen across all the geographies. We need seats and we need more people. Revenue rates are different in different geographies so you should not assume that it is a linear model that if I have to grow my business x% then it would mean I would need equivalent growth in headcount that is not the way it works. Since our revenue rates are different in different geographies, our growth is non-linear.

Mahesh Bendre My last question is on the margin front, the margins in this quarter are around 12.6%, and there has been improvement over the last few quarters. So are we on a path to come back to the margins that we used to enjoy in 2008-09 when these were 13% to 15%. So are we seeing that kind of stuff or do you think margins could be stabilized at current levels?

Partha De Sarkar I think margins will improve because of two things one is we continue our efforts to improve profitability of our current clients. While a lot of work has been done, there is still some more work to be done. So far, as cleaning up of the portfolio of some unprofitable accounts is concerned and the reason we are not able to accelerate on that is because some parts of business are profitable and some parts are not. So it is not that easy to go to a client and say listen give us the price increase otherwise we will exit because the other part of the business is doing very well. So we need to do that and it is taking longer than we had

thought. The process is an ongoing process of improving profitability of our portfolio and that's the reason our margins will improve. The other thing that is going to improve margin is the fact that we are seeing strong growth of offshore. You will recall during our peak margin days our offshore used to contribute about 38% of our revenues and that had gone down to about 30%. So now we are back to about 32%, and next year, given the way offshore is going to grow, we are going to see an increasing percentage coming from offshore. That is also one of the reasons why margins will improve.

Moderator The next question is from Dhawal Mehta of Ventura Securities. Please go ahead.

Dhawal Mehta I have two set of questions, the first one is that if you see, our net debt has increased from Rs. 8.4 crores last quarter to Rs. 41 crores this quarter. Is there any specific reason for the increase in debt as our working capital requirement has decreased too, so why there was a need to raise money?

Srinivas Palakodeti As I said earlier, the debt numbers which come out are based on the translation in the rupee rates so even if I have repaid some debt because of the way the rupee has depreciated between September 2012 and September 2013, all that gets re-translated into numbers that are reinstated numbers at a higher level. So from a rupee level the debt numbers would increase. Also, while we are growing we would also need larger working capital so there is an impact of that as well.

Dhawal Mehta Can you just give us the percentage of foreign debt and debt in INR?

Srinivas Palakodeti Of the total debt, about Rs. 420 crores is basically debt which is taken by our overseas subsidiaries. Money which was taken primarily for the Canadian acquisition, so while there is restatement, there is no exchange loss gain for us when we report in India. But if I had US \$10 million as of 30th June 2013, that is reported at a higher exchange rate based on the exchange rate as on 30th September 2013.

Dhawal Mehta Second question is that if you see our Europe operation is not doing well and it was expected to be a bit sluggish in this financial year but the number of

headcounts have increased in Europe so is there any specific reason for that? Are we seeing a good traction in the coming quarters? Why have the headcounts increased?

Partha De Sarkar I would say that UK and Europe situation is just a timing issue, we expect a reversal in situation in next 6 to 9 months, and growth back to our normal days. Also I'm not sure where are you picking up the numbers from of the headcount increase.

Dhawal Mehta If you see employee metrics, for this quarter around 4% of our employees is from UK, compared to 3% last quarter. So considering that, even the total number of employees has increased; the total strength of UK will be more?

Srinivas Palakodeti The difference is primarily due to rounding-off. In absolute amounts the number has actually decreased marginally between June and quarter ended September.

Dhawal Mehta So are we expected to clock around £25 million from the Europe operations this fiscal year because last year in FY2013 we did around £27.4 million?

Srinivas Palakodeti If you just annualize the first half earnings, we will be in the £25 million mark.

Moderator Our next question is from Pranav Tendulkar of Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar This Philippines new center is there a CAPEX or are you going to take it on lease that is first question? Second thing is how you see peak utilization across various geographies in terms of man hours and if you're saying that we are lacking spare capacity, will it affect our revenue trajectory in next year?

Partha De Sarkar When you say CAPEX, in Philippines we don't own any of our facilities all of them are leased. Could you repeat your second question?

Pranav Tendulkar We have said that we have order book suggesting that we should have more people and have more capacity. So is that going to be a constraint in revenue growth for next year?

Partha De Sarkar What I meant was we are in a good situation where we have oversold capacity. If you look at our profitability in the last two years, one of the factors our profitability took a dip was we had undersold capacity. The capacity was built ahead of demand and that is why the cost of that unutilized capacity impacted our profitability in the last two years. Currently the situation is the reverse. We have oversold capacity that means there is order book that we are sitting on right now for which we do not have delivery capabilities unless we build seats. As we have also grown wiser, given the last two years experience, these days we don't add capacity much ahead of demand because that takes a lot of margin points away, we wait till the last moment to add capacity, which is actually a much better situation to be in.

Pranav Tendulkar Is it safe to assume that this margin trajectory will continue with your just-in-time hiring model and you will be successful in hiring manpower just-in-time when you see a contract visibility. Is that a fair assumption?

Partha De Sarkar In terms of manpower hiring, we don't carry any bench we only hire people when we have a business. When I say capacity, it is basically physical infrastructure like seats and buildings, etc. If we build infrastructure ahead of demand rentals, depreciations and of all of that actually eats into your margins, so that is what we are avoiding. We are doing just-in-time capacity building. Hiring is always the just-in-time.

Moderator Our next question is from Ankit Pande of Quant Capital. Please go ahead.

Ankit Pande My question is around the India business reduction which sectors and areas have been targeted. Also, if you can just highlight the sectors where we got increase in rates from some of the Indian clients?

Partha De Sarkar Large part of our India business was centered around the telecom sector, so a large part of the rationalization has also happened in the telecom vertical. We have exited a quite a few relationships which were not profitable that is already done. We continue to do business with our profitable clients and those are across telecom, financial services and some NGOs. India, therefore, will continue to be

smaller percentage of our revenues because we are not focusing on the market as of now. The addition of business, if we were to do in India geography, would be for our international clients who have operations in India. We just won an order from large Japanese consumer electronics client who is our international client and who wants us to service them from India and also possibly in the Middle East. Those are the kind of the businesses that we are chasing. We are not chasing any other businesses in India domestic.

Ankit Pande

Can you just discuss something about the billing especially with the exchange rate moving so much, are we under pressure in certain areas to rationalize and pass on some of the benefits?

Partha De Sarkar

Our business is a little different from IT. We don't do project based billing or T&M billing. What we do is long-term contracts generally, which has cost adjustment built-in which is annual cost of living adjustment. So every time an exchange rate moves, we don't get into pressure of changing or the re-pricing models. Please also understand that while exchange rates are moving, our inflation is also high. So on an annualized basis today our CPI is at 9% to 10%, Then, I need to have that leeway on the exchange rate for us to be able to maintain our margins. We don't necessarily go to clients saying give us a break in pricing because the exchange rate has gone down. We go back to them saying that cost of living has also increased and that is also a part of our contractual adjustments and therefore we are able to hold on to our prices. Generally, if we ever have to give a price discount to our clients, it could be on volume based.

Ankit Pande

So by and large the cost of living adjustments have come through from foreign clients?

Partha De Sarkar

Yes, that is contractual in most cases therefore we don't need to go back to our clients and our clients don't have an ability to come back to us saying that, okay the exchange rate is deteriorated now give us a discount.

Ankit Pande One final question on the Healthcare sector the demand that we are seeing how much share of revenue or what kind of traction are we seeing due to the ACA (Obama Care) particularly in the US?

Partha De Sarkar Today Healthcare is about 28% of our revenues and with healthcare reform coming in that adds about 30-35 million more members who need to be insured. We believe that volumes overall will go up. The accountable care also means that you have to be responsible for outcomes. It is not just enough to bill for services which means that most insurance companies will have to manage their SG&A and the margins within 20%. They can't charge more for SG&A or margins, which means if they have to retain their margins or to increase their margins they have to reduce their SG&A. They don't have the ability to charge higher premiums and if they have to improve their SG&A, the only way to improve SG&A is to outsource and offshore, so I think it means quite a lot to our business.

Ankit Pande I think you mentioned healthcare and insurance is likely to go up to about 30% by the end of next year because of increase?

Partha De Sarkar I mentioned that because of healthcare reforms about 39 million people are uninsured today in the US. I'm assuming that affordable care will bring them into the fold of insurance also which means 39 million will convert let's say to about 30 million new subscribers.

Moderator Our next question is from Amish Kanani of JM Financials. Please go ahead.

Amish Kanani What I wanted to know is if you observe the q-o-q versus y-o-y growth, the health insurance business on y-o-y basis has grown at 55% but on a q-o-q basis your telecom and technology space has grown much higher at a 20% q-o-q growth. So my question is, 1) how do you see these two verticals on a medium term basis on the growth outlook side whether Obama healthcare related opportunity will mean higher growth from health insurance? And 2) give some sense whether this high rate of growth which you are saying is likely to be maintained second half of this year whether you see this kind of high growth rate

to sustain over a medium term on a three-year outlook? Also, in that context, my observation was that on an employee base of 24,500 odd, your seat capacity addition is 5%. So how do you see that vis-à-vis volume growth which is a very high number at least for this quarter?

Partha De Sarkar

So you have asked a fairly long question so let me see if I can answer all of it. I think the part on healthcare I have already answered, I think your question was why has the telecom grown higher than healthcare is that the first part of your question?

Amish Kanani

Yes, so is that an aberration or is that more of a trend as well in terms of telecom and technology ones?

Partha De Sarkar

Telecom continues to be the largest outsourcers so if anybody is in our business then it is very difficult to avoid telecom. The telecom growth has happened in mostly onshore where the billing rates are almost double of that for offshore. The telecom business is growing onshore, and also is very profitable even onshore. As revenue rate onshore is higher, it will show a higher growth from the telecom vertical whereas most healthcare business is offshore so even if healthcare grows, the revenue rate is half of the onshore rate. So, even if in headcount terms it grows, the contribution to revenue will appear to be slower. Having said that, we are trying to increase our healthcare footprint even onshore. That is a medium term project and it is not going to be visible immediately but we made some right moves in those directions and that continues to be a strategic priority for us. You will see onshore revenues from healthcare and that will boost the percentage of revenues from the healthcare vertical. That is the other lever why we think healthcare continues to sustain at the growth of three years I have answered that question in the previous question.

Amish Kanani

So my question was whether the visibility that you have in health insurance do you have the similar visibility even in the telecom and technology space?

- Partha De Sarkar** Yes, our pipeline is at a very encouraging number today and it is across many verticals, so we have fairly good confidence in what Q3 and Q4 and even going forward is going to be like.
- Amish Kanani** In that context how do you view this seat capacity additions of you mentioned 800 seats in Manila and 526 odd seats in Bangalore which is say about 1,326 seats. I take that as an indicator of growth for you as what you said, you oversold seats that would mean 5% on your current employee base. So I don't know what is the current seating capacity and how do you view that whether you will need to continue to add the seating capacity on an every quarterly or half yearly basis given the growth?
- Partha De Sarkar** So it is an interesting question. What happens typically on telecom your seat to employee ratio is about 1:1.25 whereas on a healthcare basis it is 1:2, so that is why it is not a linear model. Depending upon what is the mixture of the business coming, the seat requirement will be higher for a CRM business and lower for a healthcare back office business which also explains the reason why the healthcare back office is more profitable because it's got lower seat requirement. Our growth will also come onshore which means that apart from the 1,300 seats that I talked to, is spread across Philippines and India, we will also see growth in Canada and possibly in the US as well.
- Amish Kanani** As and when the telecom business grows which is more onshore you have to add seats there whereas as and when the healthcare business scales up at a much lower requirement because of the better seat to employee ratio, you will be adding more at Bangalore and Manila?
- Partha De Sarkar** I need to correct you there. If the revenue comes in onshore, then the revenue rate will be higher but the seat utilization is more or less the same whether it is offshore or onshore. Whereas the revenues of healthcare that is more offshore and the seat utilization is 2:1 but that is offshore so the revenues will be half but the seats will also be half.

- Amish Kanani** Whether more of the healthcare business is addressed at India versus Manila how is it there and whether you see Manila being more competitive vis-à-vis India now?
- Partha De Sarkar** It is interesting you are asking that question, India continues to be very strong in healthcare because our clients prefer to do the voice business from Philippines and non-voice business from India. So the growth in healthcare is happening both in Philippines and in India.
- Amish Kanani** You did mention about the coders from India and nurses from Philippines?
- Partha De Sarkar** Yes, that is right.
- Moderator** Our next question is from Amitabh Sonthalia of SKS Capital. Please go ahead.
- Amitabh Sonthalia** You mentioned something in the beginning about seat additions 800 in Manila and 500 in India. Is this in line with our stated asset light model going forward?
- Partha De Sarkar** Yes, so this is asset light model means we don't necessarily go and add technology or buy technology any more so that's our asset light model. These are leased spaces on which we do leasehold improvements, so the leasehold improvements and the fit outs will be there as a part of the CAPEX, the leases is a lease rent so that is an OPEX. What we used to do earlier it used to be the technology also that we used to buy. Large part of the technology used to sit in our books we are moving away from that model and we are saying that okay we are going to move to an OPEX model to the extent possibly on technology by buying license per seat on an OPEX model base.
- Amitabh Sonthalia** So just if you could give some flavor of what has the difference been in the earlier CAPEX vs. the OPEX as per this new model per seat roughly or in percentage terms, how much are we actually saving by this shift in strategy?
- Srinivas Palakodeti** I will give you a sense, if I do a seat in India the typical cost is about Rs. 2 lakh out of which about the IT part is roughly about Rs. 60,000-70,000 may be a little

more. That is the total which is the IT side and rest goes into furniture, fixtures, etc., so this is the part which we are trying to move progressively into through the cloud or an asset light models those numbers are still being worked out so I don't have a specific number but that gives you a sense of where the numbers are.

Amitabh Sonthalia Only about 20% odd is the difference actually, it is not a huge difference compared to the earlier cost in terms of OPEX and CAPEX combined?

Srinivas Palakodeti Yes 30% to 35% can go into IT.

Amitabh Sonthalia You mentioned something about the affordable healthcare in the US, etc., I missed that part, so how big is that opportunity for us again and what is the outlook on the healthcare vertical for the second half of the year or beyond? And, is the implementation on track because we see numbers which are not so big the reported numbers which are coming out here and there on the people switching to that maybe it is based on my limited understanding of what is happening on that front?

Partha De Sarkar At a very fundamental level, affordable care is supposed to make healthcare more affordable. Earlier the model used to work like this a patient becomes sick and goes to the hospital or a healthcare service provider for treatment the revenue model was that the healthcare provider would get paid for the service and the system had an inherent contradiction that the healthcare provider was not paid on outcome. He was paid on providing the services whether it provided with the right outcome or not. So the incentive was skewed towards providing more service as opposed to cure. So the more number of visits that a patient makes to the hospital the hospital actually gets paid more. It is almost a conflict built in the revenue model itself, and that is what the Affordable and Accountable Care is all about. Accountable care is all about being responsible for outcomes. At a very fundamental level that is what healthcare reform is all about. So now the ability of a provider to pass on all its cost in the form of higher premiums is slowly being taken away, therefore its ability to charge SG&A and margins out

of premiums is now restricted to a certain number let's say the number is 20% that is what affordable care is, so you can't load your premium beyond 20% for your own margins and your SG&A cost. So if you have to retain margins or improve your margins it will come at the cost of reducing your SG&A and which means that it has to be offshore or outsource so therefore that is going to drive and increase volumes. Also what is happening is, Affordable and Accountable Care is bringing about 39 million people who are currently uninsured into the fold of insurance which is where the healthcare exchange thing is all about. Now why these numbers do not seem very encouraging because the exchange website is not working it is not able to enlist more people. There is a complete log jam there and that's why the numbers are not looking good because people are trying to enlist, they are trying to buy insurance, the website is just crashing.

Amitabh Sonthalia So how big is this revenue opportunity for the outsourcing industry, a guess estimate as per you?

Partha De Sarkar See I would not know the exact visibility of the healthcare spend as a percentage of the total GDP but it is a huge number, the number is in several trillions. That is the size of the total spends on the healthcare as a percentage of GDP that is very high.

Amitabh Sonthalia Just a quick one what kind of synergy benefits are we deriving from our overseas acquisitions now, since the number reflects that we are deriving some and you mentioned that there is. You have done your first outsourcing contract out of Philippines for the Canada onshore unit so could you throw some light on that and what is the outlook on that front?

Partha De Sarkar This is really the first to win so about 160 seats to start with, and potential to go to 500 or even 800 seats if we do well, just from Canada and from one client.

Amitabh Sonthalia Are to be seeing any more visibility on that front in the second half or beyond that?

Partha De Sarkar Yes, we will probably see more coming in Q4 and Q1 of next year.

- Moderator** Our next question is from Manish Gupta of Rare Enterprises. Please go ahead.
- Manish Gupta** How much cash did we generate in the 1st half of this fiscal year?
- Srinivas Palakodeti** Cash flow from operations roughly would be about Rs. 85 crores.
- Manish Gupta** And how much CAPEX have we done?
- Srinivas Palakodeti** That would be about Rs. 55 crores.
- Manish Gupta** So net cash generation is about Rs. 35 crores?
- Srinivas Palakodeti** Yes, but you have to also factor in debt repayment as well as the servicing which we have done so the CAPEX is roughly about Rs.55 crores.
- Manish Gupta** I was asking about the free cash flow. So this is before debt repayments?
- Srinivas Palakodeti** Yes, before debt repayments and before dividends.
- Manish Gupta** So, that is then Rs. 30 crores, Rs. 85 crores cash from operations and Rs. 55 crores CAPEX?
- Srinivas Palakodeti** Yes.
- Manish Gupta** Could you also tell us about your hedges outstanding as of now?
- Srinivas Palakodeti** We have about Rs. 43 million outstanding as of September.
- Manish Gupta** This is in Philippine Peso and INR, or only INR?
- Srinivas Palakodeti** Dollar to Rupee.
- Manish Gupta** Do we hedge any other currency?
- Srinivas Palakodeti** We do a little bit of hedging in dollar versus the peso.
- Manish Gupta** But the bulk of it is dollar rupee about \$43 million?

Srinivas Palakodeti Yes, as of September 2013.

Manish Gupta And roughly how many months of revenue would that be?

Srinivas Palakodeti That would cover roughly about 60% - 70% of our next 12 months revenue, and, let me put it this way India revenues.

Manish Gupta Of revenue executed from India?

Srinivas Palakodeti Yes.

Manish Gupta Could you also just explain the other income thing once again the specific question is that that is the difference I've read through the transcript of Q1 where you had explained the other income calculation. So maybe I will give an example to state my question more clearly let us say that you have booked revenue at the end of each month April-May-June for example, and, let us say you have booked revenue at the end of April at Rs. 60 to a dollar. As I understood from your transcript in the last call when you draw up your financial statements for the period ending June the receivables of the revenue which are not yet collected will show in your balance sheet as of the dollar rate of the end of June is the right?

Srinivas Palakodeti That is correct.

Manish Gupta And this difference i.e. presumed that the dollar was Rs. 62 at the end of June and let us assume that all the money is uncollected so Rs. 62 minus Rs. 60 that is reflected in our books as other income is that right?

Srinivas Palakodeti That is correct.

Manish Gupta And therefore the other income will really be a sum total of this accounting entry as well as the difference in what is the value of the dollar when you finally collect the receivables vis-à-vis what the value was when you book the revenue?

- Srinivas Palakodeti** The first part is correct. As we have a large treasury surplus so whatever that money comes in that goes into other income so that is a pure treasury income. The second part is as you explained the exchange gain on account of restatement of receivables. Now, the third part what we'll do in accounting treatment is what you explained correctly is that you would restate the receivables as of 30th of June and that is irrespective of whether you have hedged or you have not hedged. Now, what you would do technically is on 1st of July you would actually reverse all this restatement and recalculate at the end of the month. Suppose you have 1 million of receivables in your books you take as of 30th June say at the rate of Rs. 62 which was your closing rate but a month of July when the money comes in 15th of July, to the extent that the hedged rate would come, if it is a hedge cash flow, it would take the hedged rate and whatever is the difference between the closing amount and the hedged amount will come again as a gain or loss in the next quarter.
- Manish Gupta** So again maybe I do not understand you very well. Let us say you have booked your revenue in April say at Rs. 60 to the dollar but let us say you have hedged at Rs. 62 so effectively in your P&L line will you recognize the revenue at Rs. 60 or at Rs. 62?
- Srinivas Palakodeti** For P&L purposes, I will take a weighted average of the amount hedged and the amount not hedged, so that will be a weighted average rate for the month of April.
- Manish Gupta** So assuming, Pala, that you hedged 70% of your revenue, the P&L line will be 70% weighted with the rate at which you have hedged your receivables and 30% at the rate at which you finally raised your invoice the dollar rate the day on which you raised your invoice?
- Srinivas Palakodeti** Right.
- Manish Gupta** Q-o-Q, your growth rate is roughly 15.8%. Can you break that up as well how much of that is currency and how much of that is real growth?

- Partha De Sarkar** That is about 16%, 6% and 10%.
- Manish Gupta** 10% from volumes and 6% from currency?
- Partha De Sarkar** That's correct, 9.8% is volume and 6% is currency.
- Manish Gupta** And the last question is have we added any new customer in the healthcare vertical this quarter?
- Partha De Sarkar** One client is going to come who is the existing Philippines client expected to start in India over Q3 and Q4.
- Manish Gupta** So you're just moving it from Philippines to India, is it? Or is the expansion happening in India?
- Partha De Sarkar** This is a different line of business this is a non-voice piece coming.
- Moderator** Our next question is from the line from Senthil of IDBI. Please go ahead.
- Senthil** Couple of things, I want to know if we are back to the FY2011 cut end of EBITDA margins one. Point number two is what are these Philippines hedging losses taken into the hedge reserve account? Could you give some clarity on that, and, with the numbers. So, bring on the optimistic side and when things are moving around what sort of debt repayment we can look at, going forward?
- Srinivas Palakodeti** So as far as the margins are concerned we will continue to work towards improving the margins. As far as the Philippines, we had AS-30 basically adoption of AS30 means any market loss or gain goes directly into the balance sheet. This is something which we have been doing for India and we have now extended that to Philippines as well, starting from April 2013. This was there for the first quarter as well.
- Senthil** So the mark to mark will be hedged down, and post that period it will be brought back into the P&L as a FOREX loss or gain, am I right?

- Srinivas Palakodeti** Yes so any mark to market whether it is loss or gain goes into the balance sheet as a reserve.
- Senthil** So the reserve will be set off against that?
- Srinivas Palakodeti** Yes.
- Vijay Sarda** One in terms of the client contribution there was a sudden improvement in the client in Rs. 10 crores bracket from 12 to 16. So is the function of ramp up of few of the clients from the existing? Or basically, what is it?
- Srinivas Palakodeti** As we said, we have been seeing there has been a 22% volume growth as the clients are growing. The number of clients crossing that mark is also increasing.
- Vijay Sarda** And, second is a very quick question in terms of India business from servicing out of India. We are seeing last two quarters of good numbers so is it reasonable to understand that India part of the business will see good amount of traction now not India domestic, but business out of India on the international saw year-on-year quite sharp improvement is quarter-on-quarter again (+10%) compared to last quarter, so will that trend continue from here onwards?
- Srinivas Palakodeti** As we said we are focusing on India delivery especially for the healthcare sector and we are also adding seats. We have opened an SEZ in August 2013 and we are also planning some non-SEZ seats in the current quarter.
- Vijay Sarda** And last thing on this consumer electronics piece which has shown a good improvement this quarter is it a blip or is it one-off or some client has started ramping up. So, is that a function of that?
- Srinivas Palakodeti** We are seeing good growth. It is not consumer electronics only, it is all consumer electronics package goods sectors, so we are seeing volume group there as well.
- Vijay Sarda** This is majorly service out of Canada?

- Srinivas Palakodeti** Bulk of it is Philippines. Some of it is also Canada.
- Senthil** On the debt repayment thing so with the things going back into green, can we see some stringent repayment of debt across?
- Srinivas Palakodeti** There is no stringent repayment; we have an agreed repayment schedule. Now we have to see whether it makes sense to prepay because sometimes these prepayments come with penalty.
- Moderator** Our next question is follow-up from Pranav Tendulkar of Canara Robeco. Please go ahead.
- Pranav Tendulkar** As you said telecom is onsite heavy and you are visualizing that healthcare demand will come offshore so could you just elaborate how it is for other verticals that is the first question. And, how is demand panning out, or how was your pipeline looking onsite heavy or offshore for other verticals that are one. Second, how are your onsite and offshore margins on the incremental business?
- Partha De Sarkar** If you look at it right now our revenues are about 57% onshore, 32% offshore and the balance is India to India. In the pipeline also we are seeing a greater proportion coming offshore so that is the change in the pipeline. Since it is a pipeline, I would not be able to give you an accurate number because pipeline at the end of the day is what you'll have to predict how much we convert into actual business. So I cannot give you an accurate number. I can only tell you in percentage terms, when I look at the pipeline I see that the percentage offshore is improving.
- Pranav Tendulkar** Margin-wise, how is it placed in the sense, even existing business. Or, how is pipeline margin for onsite and offshore. So basically my concern is that change to offshore will it impact margin negatively?
- Partha De Sarkar** If it is offshore, it will actually improve margins, so that is why I'm confident that our margins will improve because the pipeline is skewed towards offshore.

- Moderator** Our next question is from Ankit Pande of Quant Capital. Please go ahead.
- Ankit Pande** Can you just give me the capacity utilization level?
- Srinivas Palakodeti** On a broad-level, we would say around 85% is in optimum capacity utilization, because balance we need for shared services, support services and training. So we are pretty much close to that level but we opened a center in Barrie, which is ramping up. We have opened a center a SEZ center and there are some seats empty essentially in India arising from the India domestic business, because right now we are reviewing the whole portfolio and if it does not make sense we are either looking for a rate increase or walking out of such contracts. So there are some empty seats in India but outside, all others are at optimum capacity utilization.
- Ankit Pande** Can you give me the utilization figures y-o-y as well?
- Srinivas Palakodeti** Can I give it to you separately? I'm looking for it. Is there any other question? I will come back to you.
- Ankit Pande** The offshoring levels that are the compatible figure required there as well; and if you can give me the debt repayment figure as well this quarter?
- Srinivas Palakodeti** The offshore revenues as a percentage of the total revenues are in the 32%-33% range. Our debt repayment would roughly be close to about Rs. 20 crores per quarter.
- Ankit Pande** And this run rate of prepayment is not material? Is likely to change over the next couple of years or so?
- Srinivas Palakodeti** No, these are all contracted repayment.
- Ankit Pande** Can you just also give our rough breakup of the voice and the non-voice mix?
- Srinivas Palakodeti** Roughly about 82% to 83% would be voice, balance is non-voice.

- Ankit Pande** And offshoring, the y-o-y comparable figure if you can give me that?
- Srinivas Palakodeti** It would have been around 29% to 30% if you go back to September 2012.
- Moderator** I would now like to hand the floor back to Mr. Partha De Sarkar, for closing comments.
- Partha De Sarkar** Thank you very much for taking your time to listen to us and hear our explanation for the Q2. We are looking forward to you joining us again when we do our Q3 FY2014 results sometime in mid-February.
- Moderator** Ladies and gentlemen, on behalf of Hinduja Global Solutions, that concludes this conference. Thank you for joining us. You may now disconnect your lines.

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Note: This document has been edited to improve readability

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