



## “Hinduja Global Solutions Q2 FY19 and First Half FY19 Post Results Conference Call”

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**Moderator:** Ladies and gentlemen, good day and welcome to Hinduja Global Solutions Q2 FY19 and first half FY19 post results conference call. As a reminder, all participants' 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 assistance during the conference call, please signal an operator by pressing '\*' then '0' on your touchtone telephone. Please note this conference is being recorded. I now hand the conference over to Mr. R. Ravi – Vice President, Investor Relations, thank you and over to you Sir.

**R. Ravi:** Thank you Aman, Ladies and Gentlemen, I, R. Ravi, Head of Investor Relations and Vice President at HGS, wish you all a very good evening and a warm welcome to the second quarter FY19 and first half FY19 Post-Results Conference Call. To discuss the quarterly and half yearly results, I am joined by Mr. Partha DeSarkar, Global Chief Executive Officer and Mr. Srinivas Palakodeti, Chief Financial Officer of HGS.

Before we begin the conference call, I would like to mention that some of the statements made in today's conference call may be forward looking in nature, including those related to the future financial and operating results, benefits and synergies of the company's strategies, future opportunities and the growth of the marked of the company's service and solutions. Further, I would like to mention that, some of the statements made in today's conference call maybe 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 half year under review. Thank you and over to Partha.

**Partha DeSarkar:** Thank you Ravi. A very good afternoon and thank you all for joining us on the call today to discuss our second quarter and first half FY 2019 financials and business' performance. We hope that you have had an opportunity to review our earnings press release and attendant fact sheets of the reported financials which are available under the investors section on our website as well as uploaded on both the Stock Exchanges.



I would like to start the conference call with a brief overview of the financials for the quarter 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 of the quarter under review in detail. We will then open up the call for the Q&A session.

Led by the ramping up of some very big logos that we had won in the second half of the last fiscal and in Quarter 1 FY19, we have posted a very strong growth performance. If you recall, in Q1FY19, we had reported a revenue growth of 18.7% year-on-year, and in Q2FY19, we further improved our performance by reporting 22.9% year-on-year growth. For the third quarter in a row, our revenues decisively breached the Rs 10,000 million mark to register revenues of Rs 11,596 million.

To give a breakdown of the 22.9% year-on-year revenue growth for Quarter 2, 7.4% was through organic growth, 7.9% was on account of foreign exchange gains and the balance 7.6% came from the twin acquisitions of AxisPoint and Element Solutions that we made in the month of April 2018. For the first half of the year, HGS reported revenue growth of 20.8% year-on-year at Rs. 22,595 million; this is significantly more than what we achieved in terms of growth rates in the last two years.

From an EBITDA margin perspective, performance of the legacy business was in line with our expectations. The EBITDA margins, excluding the acquisitions, were at 10.2% in Q2FY19, an improvement of 66 basis points sequentially, despite the impact of wage revisions which I am going to come later. If we include the acquisitions, the EBITDA margins were at 6.7% in Quarter 2 FY19. Once we are able to stabilize the cost structure of the AxisPoint acquisition, we expect to return to the normative profitability in terms of the EBITDA margin.

One of the factors impacting EBITDA has been the revision of minimum wages in some of the States that we operate in India, especially in Karnataka. The issue related to Karnataka is currently sub judice; we have taken a conservative view and have made provisions for minimum wages pending the final order of The Karnataka High Court.



Our efforts to grow profitable revenues and turn around specific geographies, which have been operating sub-optimally, have now started to show results. In Quarter 2, performance of the Indian operations, which includes the India International of business, from a revenue standpoint is muted primarily because of the India CRM business. But from an EBITDA margin perspective, it has expanded by about 150 basis points sequentially. Similarly, revenues from Philippines were flat in Philippines Peso terms but the EBITDA margins were up by about 80 basis points sequentially. Revenues from Canada operations in Canadian dollar terms were up by 27.7% sequentially in Q2FY19, while revenues from the UK operations in GBP terms were up by about 11.5% sequentially in Quarter 2 FY19. Both operations have turned EBITDA positive in the Quarter.

So, you would understand from all the statements that I have made that the organic business has actually turned very healthy in the first half of this year. Average revenue per employee is a good indicator of non-linear growth for a services company such as ours. If you look at our Quarter 2 fact sheet, you would notice that we have seen a steady improvement in the average revenue per employee matrix in the last five quarters even as we posted almost nil or flat growth in head count including decrease in India where we have a majority of our work force. These have been the impact of specific initiatives across geographies to drive more profitable growth; in fact our average revenue per employee in Quarter 2 increased by 4.6% sequentially on top of the 11.5% sequential growth achieved in the previous Quarter.

Both the healthcare and the CET that is basically Consumer, eCommerce & Telecom and Technology clubbed out together, verticals did well in Quarter 2 FY19 led by volume growth, ramp ups in onshore and offshore.

Healthcare grew by 20.1% year-on-year in dollar terms in Quarter 2 and contributed to 51 % of overall revenue. This trend of over 50% contribution has been sustained for the past four quarters. A significant driver of growth in the Quarter was the Provider segment, which grew by 52.9% year-on-year in dollar terms in Quarter 2. We do have a healthy pipeline and some good wins in recent weeks, and we are ramping up in almost all the accounts for Open Enrollment season across US, India, Philippines and Jamaica.



The other vertical - the CET vertical has also seen a good traction led by ramp up in recently won accounts, especially in Canada, US and UK. Our Telecom clients actually grew their businesses onshore by 11.4% sequentially in rupee terms, led by higher volumes in Canada. We have brought in an experienced leader Tom Hricik as President & Head of Business Development, North America. He will be working with both the existing CET accounts as well as with the new logo team to build a healthy pipeline and win new business that is profitable and sustainable.

The Jacksonville Centre, which is our newest center, is expected to go live end of Quarter 3 or early Quarter 4 with both healthcare and CET clients.

The challenge in the India CRM business however continues due to the domestic mobile operators facing pressure. Our volumes were down as a result of which our utilization is down. We therefore have fixed costs of operating some centers, which are bleeding.

We talked about the steep hike in minimum wages; While we have challenged the decision in Court, we have provided for this increase wage cost in our books as contingency in case the decision goes against us. It is a substantial amount and is also one of the reasons why our numbers in the first half of the year are quite depressed.

We have earlier spoken about reducing the dependency on the Telecom vertical in India. We have been pretty successful in this although it will take a few more quarters for volumes from other verticals to counter the drop in current volumes from Telecom. The BFS vertical has been doing extremely well in the last four quarters, having more than doubled its revenues for H1 FY19 compared to H1 FY18. This vertical now accounts for 14.2% of India domestic revenues while Telecom is down to 66.7%. We will continue to focus on BFS consumer and media segments going forward. While focused on revenue growth, we are also looking to improve EBITDA. HGS is currently negotiating price increases with our domestic clients while focusing on premium LOBs and consolidating some of our existing footprint.

Coming to acquisitions, the acquisition of Element Solutions has provided HGS deeper capabilities to support consumers across the digital customers' life



cycle, including new areas such as cloud migration. We have also gained an onshore team of digital experts. We are expecting strong revenue growth from cloud services, which is expected to account for a third in H2 and around 50% next year of Element Solutions' revenues. The profitability in Q2 was slightly muted because of the training cost incurred for our new cloud services. In the second quarter of FY19, Element's performance was as per expectation reporting revenues of US \$3.42 million, the pipeline looks strong and we expect significant revenue growth especially in the cloud migration segments from Quarter 3 onwards.

Healthcare as you know continues to be the choice of verticals for us, contributing over 50% of our revenues. It is a market worth trillions of dollars in the US and growing. HGS has traditionally supported clients in these processes related to administrative cost management segment, which accounts for 15% of the overall healthcare spend, the rest 85% is spent in the area of clinical services, which includes areas such as population health management, care management, patient outreach, etc.

We acquired AxisPoint about six months ago to deepen our capabilities in the clinical services segment. While HGS has had offshore capabilities in some of these areas, AxisPoint brings in an onshore presence of highly skilled specialists, coders and US registered nurses as well as high end analytics and medical directors. The strategic rationale for this acquisition continues to be strong though there have been some challenges to the EBITDA. We knew the acquisition would be margin dilutive initially and this was factored into the price we paid for the acquisition. Though I would say it has been higher than expected mainly due to the exit of a significant client much earlier than scheduled.

We are taking various corrective measures including cost management and exploring offshoring options. We are also restructuring the business significantly by reviewing contracts and may also look at exiting some of the unprofitable engagements. The losses on AxisPoint are expected to taper down in the second half of this year. By the next fiscal, we are looking at cleaning up the business completely and growing the revenues with more profitable contracts. With those initiatives in play and the full year of cost synergies



coming in next fiscal, we expect it to reach breakeven by the second half of the next fiscal. To repeat, these losses are not a cause of big concern, they may be looked upon as investments to build a new capability in our healthcare services, which will be an asset for us in the future.

Touching a bit on business transformation, HGS continues to invest in leveraging technology both internally and for clients to deliver a better impact – be it RPA, DigiCX, analytics and platform-based services. The focus on these technology-led solutions is helping us open up opportunities in new segments and markets. HGS is now supporting clients who are among the top brands in the world and include segments we have not traditionally been in such as media and broadcasting and education. We have also had wins in regions like Middle East and India for these services, demonstrating a demand for new age services irrespective of regions. We are looking to forge strategic partnership in segments like digital analytics, robotics and machine learning. This will add value to our businesses; this is also where our stake in Elements Solutions comes in very handy. Our platform-based revenues would approximately be 10% of our revenues today.

We want to talk about what we have done new in Canada; we have tweaked our hiring strategy last year by focusing on the Work@Home program. That program has scaled up wonderfully well. It is a technology platform that we leverage to deliver services to our clients through remote agents in North America. It provides us access to a wider geographical talent pool and helps us deal with labor challenges in this market as well as deliver more number of hours to drive revenue. In the last four quarters, HGS has increased from 168 Work@Home agents to 719 in September, 2018 in Canada. In the US, we have about 140+ such agents. This model has led to significant improvement in performance... as mentioned earlier we have turned EBITDA positive in Canada.

To sum it all, the overall state of our legacy business continues to be strong and with the exception of India domestic, all other businesses are doing much better than what we were doing in FY18. Our internal deliberations with the clients suggests that we would be able to report better revenue growth in the second half of the current financial year. The focus is now on expanding the



EBITDA margins, both of the legacy business and the acquisitions. We expect improvement from the various measures we have undertaken with Canada and UK on the turnaround path as well.

I would now hand over the call to Pala to walk us through Q2 FY19 and first half FY19 financials in greater detail. Thank you once again for being with us on the call today.

**Srinivas Palakodeti:** Thank you Partha, a very good afternoon to everyone on this call and thank you once again for joining us on our Q2 FY earnings discussion. As we have said in the past, our results for Q2 FY19 have been published as per SEBI guidelines and as per schedule 3 of the Company's Act, if the Company has FOREX gains, these are to be added to the other income as you could see in Q2 FY19 results. On the other hand, if there are FOREX losses, the losses are to be added as other expenses. The EBITDA margin expansion or contraction on sequential basis or on year on year on basis should be seen keeping in line with this requirement. For the purposes 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 can have comparison of financials on a like to like basis.

Coming to the financials for the quarter, revenue growth on a year-on-year basis was 22.9%. If we break up the growth of 22.9%, 7.4% was organic growth, 7.6% came from AxisPoint and Element Solutions acquisitions, and 7.9% is on account of FOREX gains. The FOREX gain of 7.9% is a combined result of variation of various currencies of the rupee versus the dollar. For instance, the dollar has gained 9.6% against the rupee while the Canadian dollar has gained 5.3% against the rupee and the GBP stands in by about 8.6%. So, the 7.9% number I spoke about, is a combination of all the exchange rates looking at our mix of revenues.

The growth of 7.4% needs to be appreciated in the light of the drop in the India CRM business, which accounted for 12% of Q2FY18 revenues. The India CRM revenues have dropped by about 24% during Q2 of FY19. On a year to date basis, revenues have grown 20.8%, of which around 8.3% is due to acquisitions and volume growth is of 6.2%. As in the past, revenues from





healthcare vertical continue to show strong momentum and have grown by 31% over second quarter of last year.

The strong growth on healthcare revenues is partly being driven by the AxisPoint business, which had revenues of Rs 469 million or (USD6.6 million) which has several healthcare clients as well as Element Solutions. Around 75% of Element Solutions' revenues of USD3.4 million or Rs243 million is from the healthcare vertical. Excluding the impact of acquisitions, healthcare revenues have grown by about 15.8% on a year-on-year basis. Excluding the acquisitions, the share of healthcare vertical is at around 48% of total revenues of Q2 FY 19... around the same level as it was at Q2 FY18.

Revenues from the Telecom and Technology vertical grew by 11.5% on a year-on-year basis and 10.7% on sequential basis. This growth has been achieved despite close to 24% drop in the India Domestic CRM revenues, which are significantly based on Telecom clients. We are seeing strong growth in US, Canada and UK, which have significant Telecom revenues, resulting in share of Telecom revenues increasing from about 17% to 18% on a sequential basis. Revenues from the consumer and retail segment have grown 14% on year-on-year basis and nearly 23% on a sequential basis. A part of the strong growth is due to some of the wins we have had in the last few months and this strong growth has led to this share of consumer and retail vertical to go up from 12% to 13%.

Revenues originating in US currency grew around 26.5% and accounted for 69% of total revenues. Canada revenues grew close to 50% on year on basis and nearly 28% on sequential basis. As a result, share of Canada revenues has increased from 10% in Q1 FY19 to 13% in Q2 of FY19. UK revenues have grown by around 21.5% in rupee terms on a year-on-year basis. Looking at revenues by delivery centers of US and Jamaica, they have grown 5.2% sequentially and around 48% over last year.

Onshore revenues, which include India domestic, accounted for 53.4% of total revenues, which is about 70 basis points higher than what was in Q2 of FY18. This increase is on account of strong growth in US, UK and Canada as well as the acquisitions, which have primarily onshore revenues. As Partha mentioned earlier, EBITDA margins of the legacy business have increased from 9.5% in



Q1 FY19 to around 10.2% for Q2 FY19, around a 66-basis points improvement on a sequential basis. EBITDA margins for Q2 FY18 was 11.1% and this drop is primarily on account of decline in revenues of the India CRM business, along with the provisions made for minimum wages, especially the increase in Karnataka. For the quarter ended June '18, we had a provision Rs129 million and we made an additional provision of Rs. 110 million for Q2 of FY19. As the increase in minimum wages were effective 30<sup>th</sup> of December 2017, we also made provisions for the quarter ended March 2018 and on a cumulative basis, we are carrying provisions of Rs383 million as of end-September. As mentioned earlier, the matter is pending before Karnataka High Court.

During the 12-month period, our gross debt reduced by Rs 302 million and by about Rs 168 million between 30<sup>th</sup> June'18 and 30<sup>th</sup> September'18.

As we had announced in April 2018, HGS has acquired 57% of Element Solutions and the balance 43% will be bought out from the existing shareholders in a phased manner. The estimated amount, which is payable is shown as a deferred compensation and a liability, and as per IndAS, these have to be fair valued and interest costs must be accrued for the deferred consideration. As a result of this, a sum of Rs7 million has been added as under Interest costs. So, while we have seen reduction in debt, there is an increase in the interest costs due to the notional interest costs, which need to be provided on deferred compensation as per IndAS.

Depreciation for the quarter included around Rs20 million on account of amortization of intangibles arising out of the acquisitions made.

CAPEX in Q1 was Rs395 million and CAPEX for Q2 was Rs369 million. CAPEX in Q2 included Rs29 million for the purchase of the building housing our Selkirk center in Scotland. Typically our centers operate from leased premises and we do not invest in property; however an exception was made given the strong economics and a payback of around 3.5 years. The investment in the building also helps demonstrate HGS' commitment to local community and we believe this would go a long way in helping source talent in the region.



Our EBITDA to cash flow remains strong during the six months ended 30<sup>th</sup> September 2018; our EBITDA to free cash conversion from the core business, excluding acquisitions and one-offs, was around 31%. The one-offs include provisions made for increase in minimum wages in Karnataka, purchase of the Selkirk center and some tax refunds. Including the AxisPoint and Element acquisitions, EBITDA to free cash flow conversion comes to around 19.6%.

From Return on Capital Employed basis, our legacy business as a return on capital employed of 23.9% and after factoring the acquired businesses, the ROCE is roughly 14.6%.

Our endeavor to take more seats on CAPEX continues... As of 30<sup>th</sup> September, OPEX seats account for 21% of total seats, up from 19.8% as at June 2018 and significantly higher than 16% at the end of September 2017.

Our endeavour to increase revenue productivity continues and our revenue per employee has been gone up from 82,349 to 86,146 on a sequential basis and has increased by about Rs. 17,000 compared to the quarter ended September, 2017. As at 30<sup>th</sup> September, the total headcount was 44,528 as compared to 44,854 as at end of June, 2018 and 45,926 as at September, 2017. During the last 12 months, headcount has increased across all geographies except India, which is a mixed bag. The drop in India domestic revenues has led to India headcount dropping from 30,354 at end of September 2017 to 27,148 at end of June, 2018 and 26,365 at end of September, 2018. During the last 12 months, while there has been a decrease of around 6,000 for the reduction of the India CRM business. India offshore business has grown by about 1,300 and another 400 for the HRO business.

As we have mentioned earlier, we had a subsidiary by the name HGS International Services. This wholly-owned subsidiary has been merged into HGSL and all the formalities have been completed as of 1<sup>st</sup> of August, 2018. The appointed date of this merger was 1<sup>st</sup> April, 2017 and hence the published financials have been recast to give effect to this merger and necessary disclosures have been made in the publishing page.



Before we conclude, we wish to add that we have our annual Investors and Analysts Day on December 06, 2018 at the Four Seasons Hotel in Mumbai. There will be presentations by the senior leadership team. Invites for the event will be sent to you shortly and we look forward to your participation at the event. With this, I conclude my portion and now throw the floor open for question and answers. Thank you.

**Moderator:** Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Amitabh Sonthalia from SKS Capital. Please go ahead.

**Subhankar:** This is Subhankar here, sir. So, just wanted to understand the profitability of AxisPoint. If you can talk about last quarter performance as well as the outlook for this newly acquired entity?

**Srinivas Palakodeti:** Coming back to your specific question, for the quarter ended September 2018, AxisPoint had revenues of around Rs 46.9 crores and an EBITDA loss of about Rs 34.25 crores.

**Subhankar:** This is for the quarter?

**Srinivas Palakodeti:** Quarter ending September, 2018.

**Subhankar:** If you can quickly give me the number for the June quarter as well, please sir?

**Srinivas Palakodeti:** So, June quarter the revenues were Rs 62.7 crores and the EBITDA loss was about Rs 26.6 crores.

**Subhankar:** Sir, is there any kind of seasonality there, I mean on a lower revenue, the loss seems to have moved up higher?

**Srinivas Palakodeti:** Yes. So clearly as Partha mentioned earlier, when we acquired the business, we had expected some losses. And we were doing this primarily for the strategic capabilities that it would build for us. But the losses were higher than what was anticipated. So, we are doing two things. One is in terms of cost controls, cost measurements – a number of them we expect to come through as we go through the remaining part of the financial year. The other part also is where we are doing a review of the portfolio and looking at some of the



contracts, which we believe do not make sense from a financial point of view. And we are looking at those very seriously to see how to improve the profitability or to look for some amicable exits from those contracts.

**Subhankar:** So on these, I mean do you expect in terms of the EBITDA loss to come down from December quarter?

**Srinivas Palakodeti:** Yes, we expect losses in H2 to be lower than what we have in H1.

**Subhankar:** And in terms of overall the legacy business has done well. The margin, I mean the EBITDA margin outlook for the legacy business continues to be similar in terms of whatever seasonality impact that we had? We are expected to do well in the H2, right?

**Srinivas Palakodeti:** Yes, traditionally H2 has been better than H1. We expect that trend to continue for the legacy business.

**Moderator:** Thank you. Ladies and gentlemen, as there are no further questions from the participants, I would now like to hand the conference over to Mr. R. Ravi for closing comments. Thank you and over to you, sir.

**R. Ravi:** Thank you to all the participants for joining us in the conference call. If there are any further questions or clarifications about the Q2 FY19 or on the first half FY2019 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 HGS Management. I would also like to remind you that our Analyst Day is on December 06, so looking forward to seeing you all there. Thank you very much.

**Partha DeSarkar:** And wish you all a Very Happy Diwali.

**Moderator:** Thank you very much, members of the management. Ladies and gentlemen, on behalf of Hinduja Global Solutions, that concludes today's conference. Thank you all 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 have certain abbreviations/abridgement of words and sentences.*