“Hexaware Technologies Limited
Earnings Conference Call”

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MANAGEMENT:  

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Moderator: Ladies and gentlemen, good day, and welcome to Hexaware Technologies Limited Earnings Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Latika Gidwani. Thank you, and over to you, Madam!

Latika Gidwani: Thank you, Aman. Good afternoon all of you and thank you for joining the Hexaware call. From Hexaware, we have with us Mr. R. Srikrishna, CEO and ED; Mr. Ashok Harris, President of Global Delivery; Mr. Vikash Jain, CFO.

The safe harbor statement has already put up on the Hexaware website, and I shall take that as read.

With this, I hand over to Keech.

R. Srikrishna: Good evening, everyone, and thank you for being here. We are quite pleased with our performance for this quarter. Usually, it is a seasonally weak quarter for us, beginning of the year. Lots of clients kind of have not frozen their budgets or they have not been distributed out. So we expect to see a bunch of challenges in Q1. We had our fair share. But notwithstanding that, we had it on par or slightly better than what we had expected growth for this quarter. $180 million revenues, a growth of about 2.2% sequential. Y-on-Y growth is solid. It is actually 13% on constant currency. It is about little under 11% on reported, but 13% on constant currency.

On our EBITDA, we used to give you both pre and post ESOP and we realized most of you really do not care about pre-ESOP numbers. So we are going to focus on post ESOP. So that is at 15%. It is a small 20 BPS drop from the previous quarter, nothing that worries us. There are some good reasons behind it, which we will talk about later.

Our EPS grew robustly, 12% sequential. This is after taking out forex loss. Slightly lesser loss than last quarter, but we still took a loss. And that will actually change going forward. So we will talk about that.

We had a robust NN quarter. Actually, usually, our Q1 is not this good, but we had an outstanding start to the year on NN, continues the momentum we have built last year.
We closed at little over 16500 people, and we are continuing the dividend that we have been paying out for the last several quarters, Rs.2.5 a share.

On the revenue & I am going to double-click a little bit on the EBITDA. What were some of the big kind of puts and takes for why the changes happened. What were the drivers behind the changes, but before that, first on revenue, so for those of you that are looking at our slides, it is on Slide 6 if you are looking at it offline, there is a small cost of impact due to forex. There is a small positive impact due to calendar. Actually, there is a sequential drop due to calendar from Q4 to Q1, but we had a furlough in Q4. We had a little bit of furlough in Q1, too, so this is net of all of that. So net of all of that, there is a positive impact, and then there is a volume growth. So the volume growth accounted for more than half the absolute growth during the quarter.

EBITDA, the forex cost after the significant amount of drop. H-1B visa cost, which is cyclical every quarter, but, from a sequential perspective, was not there in Q4. So we had the visa application costs this quarter. In Q2, we will have, the actual visa costs should be higher. But for this quarter, it was about 30 BPS. For this quarter, the forex cost was 40 BPS. There were other cost increases around third-party contracting mainly, which cost us 80 BPS. And calendar made up a little bit of it, but we did a lot of margin difference for the quarter through SG&A. And this is in spite of the fact that, actually, we had a big event during the quarter, our first-ever Global Customer Week we held during February in Florida. But notwithstanding that event, we kind of knew some of these factors are coming during the quarter. So there was some defense on SG&A to ensure that our margins were largely flat.

We continue to have customer metrics that are very encouraging to us. We have, at this point, 99 million-dollar clients and our pyramid in the $1 million to $5 million bucket has grown substantially. And the $5 million to $10 million has almost doubled in the 12-month period. So if you look at the $5 million to $10 million, the LTM currently we are 19, 12 months prior to that, we had 10 in that bucket, so clearly solid kind of a growth in client profiles across the board.

What you also see is that our, actually client concentration at the top is reduced. Slowly but surely, our client concentration at the top is reducing. This is because we are doing very well in our next 5, or 6 to 10 account is doing better than top 5. Our 11 to 20 is doing as well as the 6 to 10.
You see here that there are 2 different customer relationships on the client metrics on concentration. One is that it pertains to, if the same set of accounts are there, the other is the top 5, top 10, top 20 as it stands today.

We had, like I said, a robust quarter for NN, actually better than usual Q1s on NN. More interestingly, I think while the value is good, I think the quality and the type of deals is quite different from what we do, what you see from us. Actually, there is not a single kind of outsourcing or automation-led deal on this. Virtually, all of these deals are in the customer experience transformation and our cloud area, so one other large cloud-native development project, building a data lake for a large bank to drive their analytics program, application integration using MuleSoft for a large insurance company. So all of these are very, very in the area of customer experience transformation or cloud or an intersection of cloud and the customer experience transformation, which we think will continue. This trend will continue, but while we will continue to be robust on automation-based offerings, you will see increased traction and win for our other 2 teams, which is customer experience transformation and cloud service.

Our utilization was steady. Now I told you last quarter that for the year, we see an opportunity to improve utilization from where we are. But early in the year, we are going to be making investments on skill creation. And that is exactly what you are seeing happening here. That underlying utilization has actually gone up, but there are people on training, there are people we have hired from colleges in the U.S., in Mexico, that are going through skill creation and training programs. We do see the utilization improving during the course of the year.

On attrition, there is a continued uptick, but there is actually a little bit of a change in some of the underlying dynamics. Our onsite attrition was quite an issue. I mean, I spoke of the fact that it is a very tight labor market in the U.S. We have kind of cut that a little bit under control. It is flattened out or even reduced from where it was. On the other hand, offshore attrition, we are seeing an uptick. And all of you know, seen all the hiring reports, and there is just a lot of hiring going on right now. So we are managing this very actively at this point.

I am going to talk a little bit about different crux to the numbers on growth, geographic, vertical and horizontally. So from a geographic perspective, you will see this quarter, actually, I am talking about Europe. Europe had a small dip this quarter, minus 1.2%, but
that is actually a blip. We expect they will do very well for the year. In fact, we expect that they will be the best-performing region for the year for us.

On verticals, we are seeing a little more weakness in the BFS sector than we anticipated at the beginning of the year. At this point, we do not expect that will change our overall performance because there are other verticals that will compensate or are already compensating for what you are seeing there. But we are clearly seeing a little bit of a wait-and-watch approach in BFS. We saw it was acute in the first part of the quarter. It is become a little better towards the end of the quarter, but the January and much of February there was a lot of ‘wait and watch’ in a lot of clients. We did a budget, but we are going to see how the quarter pans out before opening our money streaks. So we do expect that kind of a view to continue a little bit of wait-and-watch in BFS. And it is slightly weaker now than we anticipated at the beginning of the year.

Horizontal; IMS continues to do well. There is no news there from our perspective. However, I did say you are going to see accelerated growth in BPS. Our BPS growth was high 20s, even 30s going back a year, and it slowed down. But I said BPS growth will come back, so you are already seeing that. It is up to 22% Y-on-Y growth. And we actually think it will continue to maybe even accelerate from this point to go up.

With that, I am going to close with an update on guidance, and then Vikash will walk you through some additional aspects on numbers.

All of you will do the numbers that on this point, to meet the midpoint of our guidance of 12% to 14%, we need a 4% CAGR on revenue. And to maintain our EBITDA at last year level, we need about 7.5%. We actually feel quite good about both even though there is already forex impact on both at this point. As long as it does not get worse, we feel pretty good that we will do this CAGR asks that we see here, we will start getting ahead of this, at least on one of these metrics, even next quarter, both metrics certainly by Q3.

While, this is on EBITDA we said our EBITDA will be in line with revenue growth. EBITDA growth will be in line with revenue growth. We actually expect our EPS growth to be a little faster than EBITDA.

Two factors, you would see the forex numbers from Vikash. So we had a massive forex loss in Q4. We had another loss in Q1. And going forward, unless we have translation losses on the current level, we expect to see some profits. So actually, EPS growth will be faster than the underlying EBITDA growth. Additionally, we had guided earlier to an ETR of 20.5%.
We are now guiding to an ETR of 20%. This is entirely on account of improved revenues in offshore, a higher percent of revenues in offshore is what is driving the lower ETR.

But I am going to stop and turn it over to Vikash.

Vikash Kumar Jain: Thank you, Keech, and good evening, everyone. A brief recap on the numbers. Q1 revenue, $180 million, sequential growth of 2.2% and 2% in constant currency, year-on-year growth for the quarter at 10.9% and 13% in constant currency.

If we look at the chart on the left, you will see that we have delivered a double-digit year-on-year growth every quarter. In rupee terms, revenue for the quarter was Rs.12,640 million, a sequential growth of 0.9% and year-on-year growth of 20.5%. Sequential growth in rupee terms was lower, that is primarily because of INR strengthening during the quarter vis-à-vis USD.

Moving to the next slide, which is hedge. We continue with our hedging policy, wherein we take forward covers up to 24 months. And if you look at the chart you would see that our rates have actually moved up over the last 4 quarters. So as you can see, our forward cover rates are improving quarter-after-quarter, which is good news. As of March end, we had a total forward cover of $221 million, $197 million of that in U.S. dollar at an average rate of 72.93; EUR 6.5 million at a cover of 89.08; and GBP 13 million at a cover of 99.1. What I would like to highlight here is that despite the fact that we saw INR appreciating against USD and other currencies, hedge rates have actually improved on a quarter-on-quarter basis. So that is a pretty good work done by the team here.

Moving to the next one, which is an update on the forex gain or loss. The chart here actually reflects the forex gain or loss. What is presented is P&L impact for the last 5 quarters actuals and 2 forward-looking quarters. The actuals have an impact of 2 items, gain or losses from hedges and translation of monetary assets that we hold in foreign currency as of period exchange rate.

From a forward-looking perspective, what we take into consideration is assuming exchange rates are flat on a go-forward basis, how would hedging policy help us from a P&L perspective. And what you can see here is, in Q4, we had a loss in the books of $3.6 million, Q1 results were also impacted negatively by close to $1.2 million. But, if the exchange rates continue to be constant from now on, which are the Q1 closing rates, we expect to book roughly gains of about $920K in Q2 and $1.06 million in Q3. So that is what Keech was alluding to when he referred that we expect our EPS growth to be better than the
EBITDA growth. One of the items attributing to that is going to be the forex, where we are expecting that while there is a significant appreciation, the FX line actually on the P&L is going to be a credit.

Moving to the next one; our cash generation for the quarter remains strong, and total cash on the balance as of March 31, 2019 is $125.9 million. This is after paying out close to $13 million of dividend, including taxes during the quarter. Quarter-on-quarter, we added $6.4 million of cash to the balance sheet, and the cash flow from operations is one of the highest in the industry.

DSO, pretty good news there. DSO, including unbilled, is at 74 days, an improvement of 7 days versus last quarter. So that is pretty good.

On dividend, you already heard us say that we are going to be paying Rs.2.5 per share, which is a payout of 125% per share and in line with what we guided at the beginning of the year.

The chart on the right-hand side actually reflects how the effective tax rate for the company has moved over the last 3 years. And you would see that our ETR on a year-on-year basis has been constantly coming down. And even from a current year perspective, while entering the year, we have guided that ETR is going to be 20.5%, but now we feel pretty confident that is going to be in the range of 20% on a go-forward basis. We expect close to $3.5 million on capex during the quarter.

So that is pretty much what we had in terms of Q1 results. We will now open up for Q&A.

Moderator: Thank you very much. The first question is from the line of Sandeep Shah from CGS-CIMB. Please go ahead.

Sandeep Shah: Thanks for the opportunity. Just, Keech, I wanted to understand, at the gross margin levels, so if I look at in this quarter, the gross margins have been down by 180 BPS while on a Y-o-Y basis, if I look at the same is down by close to around more than 300 basis points. And if I look at over the last several quarters, it is down materially. So the one way to look at it, gross margin actually defines the strength of the business. So what is causing this? And do you believe that the last time you said that the billing rate can be a tailwind going forward? So you believe there could be a reversal in the gross margin going forward?
R. Srikrishna: So actually, we think there will be a reversal on gross margin from next quarter, not going forward long-term. And this is without accounting for pricing tailwinds, which we still think is absolutely an opportunity. What I said last time is that there will be some customers who will pay for some services. We continue to remain quite optimistic on that front. But you will see gross margins improve, I would say, materially from Q2 onwards.

Sandeep Shah: Okay, And what other levers are you counting? As you have said, billing rate may not come immediately from 2Q.

R. Srikrishna: That one is the utilization. I think there will be some improvement there. So you will see clear improvement in here from Q2 onwards.

Sandeep Shah: Just a related question, so is it that the gross margin decline is also because of some renewal pressure which is coming for some of the deals which you might have signed earlier, which are coming now for renewal, and there will be some productivity gains being passed on?

R. Srikrishna: I mean, on a long-term basis, kind of part of what has driven our gross margins down is really a mixed issue. So our pricing and our gross margins for each of our onshore and offshore businesses have largely remained intact. What has happened is that the percentage of business from onshore has gone up. I am saying now, you said many quarters. You are right. So those are many quarters, Sandeep. We have turned that corner. I mean, we feel reasonably good that we are now at a point where it certainly would not become any worse and, overtime, it will improve. So it is not the mix that caused the gross margins for the past couple of quarters, it is the other issue on some accounts going through transition, higher-than-anticipated costs to transition, stabilize. So that is what is causing it right now. But that will improve quite a bit starting Q2 and starting immediately. But the long-term one is really whether it plays the mix issue, which we think we have made the U-turn there. But it will be a slow change. It is not an overnight offshore business will go up dramatically, but we think we will keep chipping away at that a little bit every quarter.

Sandeep Shah: Okay. Fair enough. Then just on the NN booking, it looks good that there is a Y-on-Y growth in this quarter. So is it higher than your anticipation? And how do you link this in terms of a demand outlook? Do you believe that momentum may continue starting 2Q? Or you believe that BFS caution, which you have said, may have some amount of caution in terms of the order booking going forward as well?

R. Srikrishna: Yes. So in aggregate, between our EN and NN, we are very sure our order book will be robust. I think last quarter or even from the quarter before, I have been saying that EN is
becoming increasingly more important for us. We have acquired a number of good accounts over the last few years. And in general, EN is relatively important. It has increased quite a bit, but generally will continue. So in aggregate, between EN and NN, notwithstanding what I said on BFS, we think our booking will be higher this year, materially higher this year than it was last year. In NN, it is still early in the year, but we do not see a weakness in pipeline. BFS, what happens is that I think kind of the pattern on spend changes, there is still opportunities for challengers on BFS, right? On automation-led outsourcing deal, they tend to be very long gestation, 1, 0 type deals, but those types of deals and opportunities exist in the BFS space for us.

**Sandeep Shah:** Thanks. If I have more will come in the follow-up.

**Moderator:** Thank you. The next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

**Gaurav Rateria:** Keech, I wanted to understand a little bit more on the BFS budgets, how the behavior of clients is manifesting. Is it leading to longer decision cycle and, hence, a longer time to close the deals? Or is it that the deals are closed, but the ramp-ups are taking more time?

**R. Srikrishna:** I think it is a bit of both. And even a third, which I will say was what we saw in the early part of the quarter is to kind of delay even kind of re-upping projects because many types of work, the projects, I mean, the budgets need to be reallocated at the beginning of the year. They were delaying it. Even a 1-week push or a 2-week push has a substantial impact for the quarter. So we saw that actually in many pockets. That is improved I have said through the course of the quarter. But there is still some of that. And definitely, there is, we think, higher gestation periods for decision-making. We are not seeing what was already decided. We are not seeing a slowdown in execution there, but what, we are definitely seeing a little bit slower and higher gestation period in new business decisions.

**Gaurav Rateria:** Second, just an observation that during the quarter, the growth was largely driven by the new clients, while revenues from existing clients have remained largely flattish. Is there any phenomenon going on with respect to renewals or the pressure on the kind of existing renewals being more than earlier? Any such phenomenon?

**R. Srikrishna:** I do not know where, if there was something I said that led you to believe that the growth was driven by new clients, not at all, so all the booking we spoke about, there is virtually no revenue in the quarter. So it is all ahead of us, so all the growth in the quarter came from existing clients only.
Gaurav Rateria: Sure. I was looking at the repeat business. So maybe my understanding is a little different on that. And last question from me on the cost side. You guys have taken multiple initiatives to make sure that the attrition comes under control. You talked about onsite attrition now kind of flattening up. Any color on that, that, how much more of that is left for the coming quarters? Or do you think that has already peaked out and, from here on, margins have to only improve?

R. Srikrisna: I mean, they are slightly different topics, the attrition and the investment and skill creation they are linked, but they are different. So let me address each of them separately, right? So we think onsite attrition it has flattened out, but we do not think they are kind of out of the woods by any stretch. And that is not a function of us; it is really a function of the macros. Until the labor market tends to be super tight, attrition is always at risk of going up or returning to what it was a quarter or two ago. Then, in terms of investments and skill creation is the other one; I think kind of, we will have continued investment through this year. But there was a bit of a peak. I think we will reduce on the peak. But in absolute terms, we will continue to invest, but on a Q-on-Q basis it will reduce from where it is in the current quarter. It varies a bit in Q2 and thereafter.

Gaurav Rateria: Thank you.

Moderator: Thank you. The next question is from the line of Abhishek Bhandari from Macquarie. Please go ahead.

Abhishek Bhandari: Good evening Keech. Keech, I have 2 questions. One, if I look at the significant drop in SG&A expenses, this is I am talking more from 4Q to 1Q, can you just elaborate a little bit what have been the factors driving the drop there? Is this sustainable at this 15 to 16 percentage point level?

R. Srikirshna: Actually, every year in Q1, we have a bit of a drop as we kind of re-up and adjust for bonuses and stuff like that, which we accrue through the year. So it is not a sustainable thing, but it is there every year in Q1. And it is a good kind of margin difference for us every year in Q1 because there is the visa cost that comes. And we always have this people delaying revenues and renewals at the beginning of the year. All of that happens in Q1. And then there is a good kind of counter to that. So it is not sustainable, it will go up actually sharply, but so will our margins. So we actually expect like I said in the guidance update, we expect, even given my commentary on BFS weakness, we still expect to meet or exceed
our guidance on both revenue and margin fronts, notwithstanding both BFS and notwithstanding a little bit of currency impacts we already have.

Abhishek Bhandari: Sure. My second question is on certain TV interviews you have started giving out your amount for your spend on M&A, which is $250 million to $300 million. For the first time, you started giving out that numbers over there. So if you could elaborate what is your strategy out there because it seems to be a reasonably good amount of money given our balance sheet size? And it could add a good amount of growth, as you said, in certain periods up to 5% to 6%, so if you could give some color over there, will be helpful.

R. Srikrishna: The first thing I would say is that we anticipate M&A to act as a growth and not as a substitute to our organic growth. We feel very good about continuing solid, long-term organic growth. Last 5 years has been close to 13% CAGR. We would be disappointed if we do not do that or better organic alone in the coming 5 years. The $200 million to $300 million, let me lay out some characteristics of M&A. We will do it in at least 2 deals, maybe 3 deals. So that is 2 to 3 deals, which means we are not looking to kind of do a lot of smaller ones, we are looking to do reasonable-sized ones. For me, like minimum revenue size of an acquisition is $24 million. So that is one characteristic. The second one is we are looking at targets which have a reasonably high revenue per client. There are a lot of digital business models that have small revenues for clients. We have chosen to not look at those, which takes me to the third point. We think those business models, on paper they are high-gross margin, very high SG&A. In some paper, there is potential leverage at some point of time to improve EBITDA. We do not think that leverage is real because such businesses will continue to demand a very high SG&A to sustain growth. So we are not looking at those kinds of business. I am actually defining what we are obviously not doing. In general, we will look at businesses that are reasonably profitable. It need not be better or equal to us, but it should be similar to ours or that should be a very quick and a clear pathway to get to our level of profitability. And finally, of course, one of the areas so we have 3 themes, automate everything, cloudify everything, and transform customer experience. These are not independent themes. These, we think of it like a Venn diagram. So we are not looking to acquire in the automate space. We are looking to acquire; our first dollars will go in the customer experience transformation space. Our second dollars will go to the cloud space. What will be sweet is if we find companies that are in the intersection of more than one area. So if there is an intersection of, let us say, automate and customer experience transformation that will be great.

Abhishek Bhandari: Got it. And any timeline around this 2, the area you spoke about?
R. Srikrishna: Yes. So I said last quarter, and I have made that public that we will spend that money in two to three years. So we have a very active program. We have had an active program for a while. So it is just that we are patient. We are not going to pull the trigger unless there is a very high level of conviction behind what we are doing. But we have a very active program, and the plan is to spend that money in the next two to three years.

Abhishek Bhandari: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Kawaljeet Saluja from Kotak Securities. Please go ahead.

Kawaljeet Saluja: Keech, my question is that what are the risks that you will run for the execution engine and customer satisfaction in light of your decision to perhaps increase utilization rates at a time when the attrition rate is also increasing?

R. Srikrishna: We are not going to push it up like crazy. I think our goal will be maybe to push it up 1 point, maybe 1.5. So we do not see an impact. I mean, we are growing as an organization, so we do not see an impact. I mean, if you try to take it to more than that, we will definitely have, produce inability to service clients. But with that 1% - 1.5%, and that 1% - 1.5%, in some ways, is already there. They are already operating at that. It is just that those people are being trained, right? So there is some of, not all of it, but some of those are already in training. So we do not think of, we do not think it will have any kind of impact.

Kawaljeet Saluja: So how does utilization increase the margin levers? The headroom is just 2%, but 1% is not even, at times cannot be even sustained as such. So how does utilization increase the margin lever in that case?

R. Srikrishna: It is not only margin lever. I said, right, for us, our gross margin improvement, the biggest thing that will drive the improvement from current quarter to next quarter and for rest of year is the fact that we have had a number of projects where higher costs of settling in and transition and getting them into the end state. And we are at the end of that. That will be the bigger driver. Utilization will certainly be one of them. Please bear in mind that some of this utilization actually is onshore. So the cost, takeout of the cost impact of that 1% of utilization point is higher than usual because some of the improvement will come in onshore.

Kawaljeet Saluja: Now second thing is that, Keech, have you done a deep dive into the potential reasons for increase in attrition to your potential exit interviews or which the HR team would have
done? Anything that has come up, which is Hexaware-specific or the entire increase is just tight labor market in general?

**R. Srikrishna:** We have done all kinds of analysis. I mean, we have hired specialist firms who do surveys where people will quit because exit interviews have limited validating than most people in the industry know it. So yes, we have done more than what we do usually to try and understand what is happening. We have not found anything that is unique to us. I mean, there are always some things, but nothing that is actually causing this issue. The only thing that gives a little bit of comfort is that everybody’s is going up. So we are not, if ours were going up and everybody else was going down or staying flat, then we will be even more worried. We do not think it is a factor unique to us.

**Kawaljeet Saluja:** Just a final question. Your tax rates have gone down quite substantially in the last maybe perhaps two or three years. What has been the genesis of that? Is it basically an indication of decline in onsite profitability with a combination of move of workflow to the SEZ centers? Or is there something more to it?

**R. Srikrishna:** So there are two or three things. I think kind of one is the U.S. tax break that helped last year, the Jobs and Tax Act. The second thing is an improved percentage of offshore business. The third, I will spend some time explaining last time how we have some active management strategies, but actually it has the impact of reducing our EBITDA, but improving our EPS by reducing ETR. So there were some active strategies to kind of make sure that we are delivering the right kind of work from the right kind of right tax zones. Even if we did not have the real estate infrastructure, we went and vet it out, spent more on EBITDA, but we knew it was going to be EPS-accretive ultimately.

**Kawaljeet Saluja:** Thanks a lot.

**Moderator:** Thank you. The next question is from the line of Viju George from JPMorgan. Please go ahead.

**Viju K. George:** Thank you for the question. Sorry, I got dropped off a short while back, but I was just struck by your comment saying that you are seeing some weakness in financial services. Which segment specifically are you seeing this weakness in? And is this something that you anticipated at the start of the year?

**R. Srikrishna:** We did not, I mean, we were a little bit cautious. We always anticipate some spottiness in Q1 in BFS. So there is nothing in Q1 that necessarily surprised us. BFS was a little bit
weaker than planned, but other verticals made up for it. So there was some cautiousness, but we think it is worse now, right? So we saw more than usual chops and delays at the beginning of the quarter than we do usually. And like I said, while it has improved during the course of a quarter, we think some of it is here to stay for the rest of the year. In terms of sectors, so we are kind of in sell-side capital market, I am sorry, buy-side capital markets. We are in secondary mortgage. Those are two big and we are challengers in the banking side. Some would say it is kind of all three. It impacts us the least in the banking side because we truly are a challenger. We do not have a lot of incumbency. So it could kind of turn into a positive for us in some ways in banking, but those are long plays. But in both of the other subsegments, we have seen some weakness.

Viju K. George: Sure. And Keech, it appears to me that when I look at your guidance, obviously, you might need a very near-normal environment to deliver on your guidance, at least the midpoint of the guidance. So it appears to me that even if the environment for tax spending or delays in the clients, spending delays from the clients deter even slightly, then that could be an issue, given how finely you are placed right now. Is that a fair observation?

R. Srikrishna: Actually, it is not because a lot of it is based on orders in hand. So a lot of our medium term, near term growth, Q2, Q3 is based on stuff that is already happened, stuff that happened last year, stuff that happened last quarter. There is obviously always some book and bill during the quarter, but it is not huge. Additionally, if you recall, last quarter, when we gave the guidance, I called out that in our planning process, we do not account for revenues from new clients. It is not that we are not going after new clients or we would not get revenues from them, but that kind of tends to be a nice buffer to have, if you will, right? So if everything goes well, that means that will add maybe 1.5%, 2% of growth. But if it does not, then it is a nice buffer to have, right? So no, we are not, the guidance reiteration is not subject to a perfect environment. It is mainly based on orders in hand.

Viju K. George: Okay. But is not there a possibility that the orders in hand, the translation of that to revenues can get delayed from client spend?

R. Srikrishna: Yes, it could happen.

Viju K. George: Lastly, on the margin side, you have talked about the levers, etc., but longer term, do you think that we should be modeling margins at the current levels of 15%? Or do you think this could take margins up, because you are often an advocate of keeping margins constant than trying to drive investments back in the topline?
R. Srikrishna:
Yes. So you should model at the current level, but that is not 15%. So our, both our Q4 and Q1 are usually low. Our Q2 and Q3 are usually a little too high. It is actually Q3 tends to be a little too high. So the right way to model it is pick the year average.

Viju K. George:
Thank you and all the best.

Moderator:
Thank you. The next question is from the line of Ashish Chopra from Motilal Oswal. Please go ahead.

Ashish Chopra:
Thanks for the opportunity. Keech, firstly, I just wanted a clarification on the comment that you had made on the expectation of deal wins for the year. So are you referring to the fact that the confidence on much higher bookings is on existing new and net new combined? Or were you referring to only net new?

R. Srikrishna:
Actually, it was on combined. So on combined, the confidence is very high, that it will be better than last year, because our EN pipeline is just very strong. On NN plus, on NN standalone, I mean, I have said this every year, if there is a year where we do worse than the previous year, we will be disappointed, right? It is still early. We have had a good start to the year, so we will see where it takes us. But in general, we will be very disappointed if we did lower than last year just from an NN standalone.

Ashish Chopra:
Got it. Just lastly from my side, so you mentioned that your guidance obviously is based on the visibility, on orders that you already have. So given that visibility, how should we expect the verticals to grow individually or which are ones which should be shouldering the weight of the growth this fiscal, considering that it would be a little bit more cautious on BFS and the transportation has not seen improvement. Do you see improvement in either of those?

R. Srikrishna:
So transportation is always spotty. I have always said it is a spotty thing. I think in our case, what is going to happen is that H&I and manufacturing are going to kind of do what they were supposed to do. Our Professional Services vertical, I think, is going to pick up the slack for BFS, Healthcare and Insurance may also pickup some of the slack. You are already seeing actually that PS is on track. They are close to 30% Y-on-Y growth. Recall this is the vertical where we had that one client where we lost a portion of business. That client in and itself has become bigger than what they were. In addition, we created a vertical around it. We have added a number of accounts because we have deep expertise on that business. So we think actually this vertical will end up shouldering some additional loss.
Ashish Chopra: That is it from my side. Thanks and all the best.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBICAP Securities. Please go ahead.

Dipesh Mehta: Yes. Keech, only one question about vertical-wise. Now what explains very significant growth rate on Manufacturing and Consumer? Can you help us what subsegment is driving growth?

R. Srikrishna: I heard the question. I can repeat it for everyone. I think the question was, is there something driving the very sharp growth in M&C? So you look at the Y-on-Y, the quarter-on-quarter is a, there is a big project. So that will taper off. So it is not sustainable, that is the kind of quarter-on-quarter growth. One, actually, it has been growing quite well. I mean, it has been in 20s growth for a while. So we think it will continue to do well, maybe not in 20s, but we think, in general, it will grow about company average. This quarter, the spike is a big project that got executed on milestone billing. So this quarter growth is not sustainable.

Dipesh Mehta: Second question is what subsegment if you can provide some color on what work we do? And what is giving incremental confidence about sustainability of 20% plus growth?

R. Srikrishna: In the Manufacturing and Consumer vertical, yes. Well, I do not know if it should be 20% plus, but there is confidence it will be higher than company average. In the past, it was, last year, it was 20% growth, okay? So the subsegments we operate on, so we do process manufacturing. We are in education, we are in retail and we are in telecom. Those are the 4 subsegments that we operate in, in this vertical. There are like one-off other accounts, but the majority of revenues come from these 4 subverticals.

Dipesh Mehta: And all of them are doing very well for us in terms of in line growth of subsegment or how it is?

R. Srikrishna: No. Actually, I am going to say I do not have the numbers, so I am going to give you our broad commentary. Education is the last bastion left in the world for PeopleSoft. Many universities around the world still use PeopleSoft. There are even Greenfield implementations that happen now on PeopleSoft because there is actually no other campus solution. Workday does not have a campus solution. And actually, we are actually pretty strong in that segment. We have a really good set of paws. We have done any number of large complex universities. So that is kind of the driver in Education. So it is not like grow
rapidly, but we think we will maintain a reasonable growth owing to this. That is not the only thing we do, but this is the reason why we are strong in that segment. Retail is driven by, so we are not incumbent in retail. So that is the good news, right? We do not have these large infra or BPO or ASM contracts in retail, so where our current engagements are all in the customer experience transformation side. And so that portion is growing, right? And there is no negative coming for us because of incumbency. On the telecom is actually kind of a narrow vertical for us. We have a handful of clients, but they are material for us, and we are doing well in those clients. So it is not a segment-wide phenomenon I can call out. But the clients we are in, we are doing well. And they are growing as customers. They are acquiring one of them being acquisitions. So it is helping us grow as well.

Dipesh Mehta: Understand. Thank you.

Moderator: Thank you. The next question is from the line of Madhu Babu from Centrum Broking. Please go ahead.

Madhu Babu: Sir, the headcount of 16500 employees, how many are in BPO? And what is the net addition in the BPO the last 12 months, because you added almost 1900 employees.

R. Srikrishna: Ashok will address the second. Okay. So Ashok, go ahead.

Ashok Harris: Yes. Overall headcount from IT is about 7000 and about 5500 from BPO.

R. Srikrishna: And the addition, additions?

Ashok Harris: So YTD, addition in BPO is 194.

Madhu Babu: Yes. So 5500 is the BPO headcount as of today?

R. Srikrishna: Yes.

Madhu Babu: And just two more questions. You have mentioned some platforms in our website, that CarrotCube for healthcare, I mean, it is been there for quite some time. So how is the traction on these kind of platforms? And second is on the customer experience transformation. You have mentioned a few case studies, but which are the verticals where we are seeing good growth in the customer experience deals?
R. Srikrishna: So on CarrotCube, it has not been there for a long time actually. We only launched it I am going to say, in Q3 last year. So it is a very new initiative. It is a bit of a moonshot initiative for us. We do not have current quarter or current year plans hanging on the success of CarrotCube. CarrotCube is a population health management platform. The problem we are trying to solve is very large. And hence, the opportunity is very large. And the opportunity window is like a decade or longer. It is not going to change. The problem we are trying to solve is, how do you keep patients out of hospital, so bending the cost curve in healthcare, not trying to reduce cost of delivery, but just reducing or eliminating the need for delivery by keeping patients out of the hospital. So that is the problem that that platform is trying to solve. Portions of it are built on Salesforce. We actually have one live client on it. So we only launched in Q3. We won one client in Q4. And I think that client has just about or shortly been go-live. And we have a building pipeline. So it is a slow process. They will get one or two clients, and then they are going to work really well or build some, those customers will go on and speak to other clients. And this is being sold to hospital systems. And U.S. hospitals are notoriously clannish and slow in decision-making. So it is going to take a while, but we were really pleased to get our first client in our first quarter of the launch. I am sorry you did have the second question. I forgot what it was.

Madhu Babu: Yes. Just from the customer experience, that was the third thing within our strategy, enhance your customer experience. So within our vertical, the focus verticals which are the verticals where there has been a good amount of customer experience transformation kind of deals?

R. Srikrishna: Interestingly, in our portfolio, BFS is where it is kind of lesser than the other verticals. Actually, all of the verticals, there is good amount of work. In our subsegments in BFS, there is a lot of B2B businesses like asset managers, there are secondary mortgage companies that is less of CXT kind of work. There is in the banking sector, but like I said we have a challenger there, but in all other sectors, actually, it is pretty good, in manufacturing, it is there in retail, healthcare, insurance. Actually, the insurance companies, we have a huge focus for them. In Professional Services companies are investing big time in CXT. For example, one of the deals we won this quarter, much of we have called it out. One of the deals we won this quarter is for our Professional Services firm where we are actually kind of using an IoT AI to generate customer letters on an automated basis. So it is very much in that CXT space in a peer's business, so all verticals except for BFS for us.

Madhu Babu: Sir, just one last question. Would we start classifying digital? Because I think we had only services rendered which is not giving that proportion as of now.
R. Srikrishna: Right. I said I think last quarter that we are thinking through how to demonstrate progress to you on our three strategies. So all of our three strategies are digital. We are thinking through how best to demonstrate progress. We will let you know through the course of this year how we will do that. We do not know what form it will take, but we will definitely add some reporting to give you confidence that we are making progress here.

Madhu Babu: Thanks.

Moderator: Thank you. The next question is from the line of Prashant Kothari from Pictet. Please go ahead.

Prashant Kothari: Keech, two questions. First, on the attritions front, can you please explain what have you done to kind of control the onshore attrition? And what are the interventions needed to control the offshore attrition now? And second question is about the Baring’s deal to buy NIIT Tech. Are there implications for us? Is there any possibility of merger of the two companies going forward?

R. Srikrishna: Second one is easy. The sale on Baring that is a no. That really is a no. So it is not, there are no ifs, buts, nothing. It is a clean no, okay? We had our board meeting today, so I was talking last minute with Baring. We said if you know how key companies operate, that is just not how we do business. We are certainly from separate funds. We are from fund 5 or 4 or whatever we invested 5 years ago. NIIT is from their latest biggest fund. It is just almost impossible for them to do this even, right? It is technically impossible for them. There are different set of investors behind these funds, certainly, it really is a no. I personally do not think there is long-term value in such a deal personally, okay? But that is not even in question. It is not on the table. On your first question the attrition. So what did we do? I mean, we do not know what worked, but there is a number of things we did, right? We just kind of increased our HR-to-employee ratio in certain pockets. We have big presence in three, four, locations, Virginia, Atlanta, and Chicago. So we actually increased our HR presence. Massive focus on inclusion diversity, programs to kind of celebrate diversity, improve inclusiveness. That was actually the biggest kind of area. We did a program called Catapult. It is a manager intervention program to help our managers become better managers. And a lot of cross-training work, right? So it is all of these. And there were some others, too, but these were the big programs we did.

Prashant Kothari: And on the offshore attrition, if you can, for this, what are the interventions you need there to bring that under control now?
R. Srikrishna: I mean we are doing a number of programs that we have been doing, right? So it is, we relaunched or completely redone reskilling program. It is called Evolve. It is not a short-term impact for attrition, but we think, long-term, just provide many pathways for our employees to improve skills and will benefit us. We have launched the program to improve employee experience literally from the time they interview with us to their day 0 experience, on-boarding experience, what happens when their first step into any of our campuses, which is just relooking at that entire value chain and thinking about how can we improve employee experience. We already have some, and the focus is to bring technology. For example, we have a program that is currently live, where if you have kind of forgotten to bring your badge, earlier, you have to kind of go into a security booth and do some 20 things to get a temp badge. Today, you can just walk in front of a kiosk. It will recognize your face. It will send you an OTP on your cellphone. And if you put that OTP at that kiosk, it will print a temp badge for you. And this whole experience takes 30 seconds. Now, unfortunately, we cannot make it as the production system because of SEZ laws. So that is an example of how we are using technology to improve employee experience. So that is it. And both of these things that I said are kind of long-term, what we think will bend the curve because there are other short-term things. We do those, salary increment in Q3 and some in Q4. We are watching the impact of that. We think it is okay. While like I said earlier, we are not going up alone. It seems to be going up consistent with what is happening elsewhere. So we do not like what is happening, but we are not alarmed by it.

Prashant Kothari: Thank you.

Moderator: Thank you. The next question is from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: Keech, just one question on Europe. So you mentioned that geography is expected to recover and, in fact, lead growth further. So any drivers there that you can outline outside the large NN win?

R. Srikrishna: Yes. The larger NN win if you recall, was only going to have revenues from Q4. So outside that, I mean, we have had kind of more than our fair share of NN wins, last year from even outside the deal was from Europe. In fact, even this quarter, they have had an outsized portion of NN deals. So if you look at our kind of revenue mix in Europe, one of, a lot of our insurance business actually comes from Europe. And I have spoken in the past about how Guidewire, the core transformation on insurance is an important kind of growth driver for us. Last quarter, we became a formal partner for Guidewire, which is actually quite a big
deal because it is a highly restrictive ecosystem. We have been investing to become a partner for like 2 - 2.5 years, a good part of my tenure here. There are companies, we even evaluated at some point, where it acquired to get into that ecosystem. We did, we thought we will invest organically. So, and that trend is true, and it is global. But in our customer portfolio, we actually have a bigger concentration in Europe. So our insurance business in Europe is really, really doing well.

Apurva Prasad: Thanks, all the best.

Moderator: Thank you. The next question is from the line of Ruchi Burde from Bank of Baroda Capital Markets. Please go ahead.

Ruchi Burde: My question is regarding the large deals, which in some way supported our outlook for FY2019 that the growth will be back-ended. So I wanted to ask how the transition for those deals is progressing still in terms of talent planning, timelines and regulatory sign-offs, if any?

R. Srikrishna: So of kind of the, let me see, three material deals, 1 NN, 2 EN from last year, the 1 EN one, we are in the tail end of transition, okay? So there is still growth directly on account of that from Q1 to Q2 and even some from Q2 to Q3, but a chunk of it is behind us. The other large EN deal, same case, material portion of the transition is done. There is still growth ahead of us on a quarter-on-quarter basis for the next couple of quarters. The third one is, of course, as I said, Q4. So it is still a little early at this stage. The focus there is not on transition, but it is all on the legal stuff and employee stuff, workers' comps and discussions, so these early stage for that.

Ruchi Burde: Understood. Thank you.

Moderator: Thank you. Ladies and gentlemen, we will take the last question. That is from the line of Sandeep Shah from CGS-CIMB. Please go ahead.

Sandeep Shah: Thanks for the followup. Keech, though you answered this question, but just to follow up regarding the Baring acquiring NIIT Tech. So NIIT Tech has given us an understanding that the contractual agreement says that for the first two years? There would not be any merger? So you believe that even after two years that would not be a possibility going forward?

R. Srikrishna: Well, we cannot rule out what could or could not happen two years from now, but what I totally kind of the structural issues around it, right? Of course, there is a contractual one,
which we do not know about. It is a contract between Baring and NIIT. But they made it public. So yes, apparently, they cannot merge for two years. But even so, we are from different funds. The fund from which they invested in us, I think expires in 2021 or 2022. The fund, in which they investment in NIIT, started just now. So it is like, I think that one of them described it to me. Even trying to do this is like going to the dentist 10 times in a day. Even if they want to do it, it is very hard structurally. Additionally, I personally do not think that there is value. If I could spend $1 billion in acquisitions, I would buy them the CXT in the cloud space.

Sandeep Shah: Thanks for this. And just on the ESOP cost and the bookkeeping so the quarterly run rate has fallen from almost like $90 million to $95 million to almost $42 million. So that has been a tailwind of 40 BPS in this quarter. Can we expect this run rate to continue in the next three quarters? And what has driven this in terms of a lower expense on ESOP?

R. Srikrishna: Yes, we can expect that to continue. What has driven it is that we built a program, which kind of, that program has run its course. So that is the best way to describe it. So there is a big program, and there is a big cost associated with that taken for five years, good part for five years, but that program has run its course. There may be additional programs in the future. But certainly, for the remainder of this year, you can assume that the current run rate will continue, even a little bit beyond that, for sure. I do not want you to interpret this as we still have a material portion of all of our important leaders covered under material stock programs, but just many quirks in the accounting processes that we essentially accounted for the costs of that program. Or the program has not ended. We finish accounting for the majority of the costs of the program over there.

Sandeep Shah: Got it. Thanks and all the best.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. R. Srikrishna for closing comments. Thank you, and over to you, Sir!

R. Srikrishna: Well, thank you all for being here. Thank you all for your patience. We went over 15 minutes, but I did want to address all the questions that came. And look forward to talking to you next quarter. We may end up meeting next quarter. We are likely to end up doing an Analyst Day that we do every alternate year. So that is likely to be next quarter. So please watch out for details from us on that. Have a good evening.
Moderator: Thank you very much. Ladies and gentlemen, on behalf of Hexaware Technologies Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.