



## Hexaware Technologies Limited

### Q4 2012 Earnings Conference Call

**February 11, 2013**

Call hosted by



Hexaware Management:      Atul Nishar – Chairman  
                                         P R Chandrasekar – Vice Chairman & CEO  
                                         R. V. Ramanan – President, Global Delivery  
                                         Rajesh Kanani – acting CFO  
                                         Sreenivas V – Chief strategy officer

For any additional information: please contact  
Sreenivas V  
Chief Strategy Officer  
E-mail: [sreenivasv@hexaware.com](mailto:sreenivasv@hexaware.com)  
Phone: +91 99401 90091

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**Moderator**

Ladies and Gentlemen, Good Day and welcome to the Hexaware Technologies 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 at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing \* and then 0 on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Latika Gidwani. Thank you and over to you ma'am.

**Latika Gidwani**

Good afternoon to all of you and welcome to the Hexaware Q4 2012 conference call. From Hexaware we have with us, Mr. Atul Nishar – Chairman; Mr. P. R. Chandrasekar – Vice-Chairman and CEO; Mr. R. V. Ramanan – Executive Director and Head, Global Delivery; Mr. Rajesh Kanani – Acting CFO and Mr. Sreenivas – The Chief Strategy Officer. The safe harbor is available on the Hexaware website and I shall take it as read. With this I handover to Mr. Atul Nishar.

**Atul Nishar**

Good afternoon to all of you and I very much appreciate your time and interest in Hexaware. We have ended the calendar year 2012, our accounting year with a revenue growth of 18% in dollar terms clearing putting Hexaware among the top performers in the industry in terms of revenue ending with \$364 million revenue. In terms of EBIT margin we improved by 280 basis points over the previous year and even on quantum in terms of absolute value we achieved \$70 million of EBIT and \$76 million of EBITDA clearly again in terms of margin putting Hexaware at the top end of all the mid-sized companies in the industry.

In terms of profit after tax we achieved Rs. 327 Crores of profit which is up 23% year-on-year, but not just profit we have chosen to put money, significant part of this in the hands of the shareholders. So of the Rs.10.9 per share of diluted EPS we have put Rs. 5.40 in the hands of our shareholders in terms of dividend

which amounted to Rs. 186 Crores as the pay out during the year, which was distributed every single quarter through the year. However, in spite of that as on 31<sup>st</sup> December our cash position has improved to Rs. 447 Crores that is up by Rs. 43.7 Crores a quarter earlier.

In terms of the dividend policy for 2013 the board has decided to continue to maintain the same policy of declaring the liberal dividend distribution and we have decided to give approximately 50% of the PAT (Profit after Tax) back into the hands of shareholders. So there is consistency in the policy for 3<sup>rd</sup> consecutive year.

With these words I would hand over to our Vice Chairman and CEO – P.R. Chandrasekar.

**P.R. Chandrasekar** Thank you Atul, thank you all for joining us on this conference call. I know all of you are busy and I really appreciate your continued interest.

Well this quarter has been very interesting probably a lot more interesting than we would have liked or you would have liked based on the preannouncement that we made some time in December. Once again I wanted to reiterate to the group listening in that our intent was to give you news of a certain development at Hexaware as soon as it emerged and we gave you the best possible indication as we could at that point in time. Now that the quarter is over and now that we know our numbers and have published the same, given the circumstances I am glad to report that we have been able to manage this development at this specific client well and have been able to deliver you both revenues and margins in line with what we had indicated at the time that we knew about this development. Specifically, in terms of revenues a quarter we have come in at \$ 92.4 million. We had guided you to (\$ 92 mn). In terms of margin we had given an indication that our margins would be depressed somewhere in the range of 500 – 700 basis points. I

am glad to inform you that the actual numbers are a little better than that.

I thought I would also take a few minutes given that this was the last major item that we discussed as a group and I am sure it is on the top of everybody's mind to get that out of the way so that we can move on to both further aspects about the quarter as well as the up-coming quarters.

Specifically, as I am sure many of you have already gleaned from the press release that we issued as you can see the impact of the revenue decline was contained with one specific client as we had elaborated it was also a lot more isolated within that client itself. As is also very obvious that client remains a very important client of Hexaware. The relationship with their organization is very much intact. Their particular project situation that we had mentioned but cannot really talk too much in detail about is under control. We have set a lot of things right. However, from an operating metrics standpoint for that particular project and therefore given its size impacting the rest of Hexaware as well in terms of utilization, etc., there will be and continue to be a bit of a drag of this going into Q1 2013 but we expect the client to normalize to a steady state from a revenue stand point in Q2 2013 and for the operational metrics stand point for the company sometime at the end of Q2 2013. I also want to mention that this particular client in addition to remaining important has given strong indications based on which we believe that we will grow with this particular customer in Q1 2013 itself and continue on our growth path with this customer going forward into the rest of the year and we have every reason to believe that 2013 will overall be a growth year vis-à-vis 2012 as far as this customer is concerned as will Hexaware.

Now having got that out of the way which did depress our numbers materially as you can see and therefore both on the revenue and margin side we do enter 2013 admittedly with a little bit of less momentum than we would like. Having said that I do want to

reiterate what Atul mentioned that it is important for all of us to recognize that 2012 notwithstanding or despite this quarter was frankly a good solid year for Hexaware on all fronts: revenues, gross margins, EBIT margins, people addition, introduction of verticals, new customer additions, the average size of our top customers, and operating metrics across the board. So here is a company that fundamentally in every single aspect of its operations whether it be execution and business development, whether it be in terms of the management team, whether it be in terms of its thought leadership and its technical talent in the geography, whether it be in the vertically areas that we have chosen to focus, whether it be in each of the horizontal to practices which we have chosen to build capabilities on. Each and every single one of them has grown and each and every single one of them we have strengthened during the year. We have added sales people, we have added practitioners, we have added domain people and all our focus verticals and horizontals without exception have grown in 2012. We remain confident that we will continue to do so because structurally in every fundamental aspect Hexaware remains a strong, healthy, and profitable yet growth-oriented organization.

Based on all of these facts as well as data that we have with us on both the pipeline as well as the orders, we were comfortable enough to come out and say that we will grow by double digits. Now I know there will be a lot of you who will wonder what that means. But everything that we know today suggests to us that we are comfortable about the double digit growth what more it will be we will be willing to and be able to tell you more precisely somewhere when we make our Q1 2013 earnings announcement and as we progress further in the year, when we will have a lot more clarity both with this customer and various other opportunities that we are currently chasing. We can also tell you with a degree of confidence as we have that in Q1 2013 our margins will improve some-where between 1.5% – 2% points on a

constant currency basis and we also believe that they will continue to improve materially going into Q2 2013 as well.

I did also want to point out to all of you that if you look at our customer distribution the top ten clients of Hexaware have increased marginally in Q4 to 51 plus percentage points which actually also indicates to you despite the issue that we have had with one of our top clients impacting more than 3% points of that particular customers revenue this quarter. The top 10 clients given this strength and the fact that we have a lot of diversity in those clients have delivered and made up these numbers if anything, they have exceeded sequentially.

So I just wanted to let the team and the people listening to us know that the fundamentals strength of us in account mining, in our ability to deliver value to clients have in no means been dissipated if anything they have been strengthened.

We believe 2013 will be a strong year. We are committed to again being one of the leading companies delivering and performing in this industry. With that I will close my remarks and hand it over to Mr. Rajesh Kanani, who will now give you and walk you through greater details on our financials. Thank you.

**Rajesh Kanani**

Thank you Sekar, I will take up revenue and EBIT walk. To start with revenue is down by 50 basis points in the last quarter. The primary reason is low volume which has reduced our revenue by 110 basis points but FOREX has impacted positively giving 28 basis points upwards and bill dates had also increased revenue by 36 basis points.

I will take the EBIT walk now. EBIT has gone down by 480 basis points. The breakup is like this:

The gross margin has dropped by 350 basis points, SG&A is higher by 130 basis points and depreciation has hardly any impact.

I will also now give the reasons for lower gross margin:

- The main reason was the utilization drop because of which margin has gone down by 216 basis points.
- More onsite business has resulted in lower margin by 49 basis points.
- FOREX mainly INR appreciation has given 14 basis points lower margin
- And other cost factors and calendar days' variance have given us 90 basis point lower margin. The only plus point was bill rate which has given us a positive 22 basis points margin.
- If you look at SG&A, SG&A has dropped by 130 basis point. It is mainly due to investment in people or marketing activities and we have started new premises on rental in Coimbatore center.

Our CAPEX spent for the quarter was Rs. 19.2 Crores and YTD was Rs. 74 Crores. We are planning to spend Rs. 85 – Rs. 90 Crores in 2013. ETR was Rs. 17.9% this quarter versus 21.1% last quarter. We had a one-time set off of past losses and underlying ETR is going to remain around 22% - 23% in 2013.

DSO is 66 days versus 55 days last quarter and with unbilled it is 77 days. DSO has gone up mainly because the last few days the collection was lower and every year this happens, in 2011 also we had 62 DSO and our DSO has gone down to less than 60 days in January

From hedges standpoint, we are going to be positive in 2013 if rupee remains at 53.50.

**Moderator**

Ladies and gentlemen we will now begin the question and answer session. The first question is from Srivathsan Ramachandran from Spark Capital. Please go ahead.

**Srivathsan Ramachandran** Just wanted to get an update on 2 specific things: 1) There are a couple of large deals stated to ramp up starting this quarter. Just wanted an update on that? 2) Could you just elaborate on the large deals, pipeline, knowing that 4Q would not be a great quarter for closure? Just wanted to get an update as to where we are on the large deal pipeline?

**P.R. Chandrasekar** I guess one of them you are referring to is the large BOT deal we announced some time back, with one of our leading customer some time back and that is still in progress, we have generated a lot of activity and traction but we are waiting to see for 2013 to see active revenues emanating from this project. With regards to the other deal it is going on track and we have begun to see revenues generated from it and we think they would be a reasonable decent size customer for us in 2013.

**Srivathsan Ramachandran** The second one on large deal pipeline and closure?

**P.R. Chandrasekar** On regards to the large deal pipeline we have 2 – 3 deals in our pipeline in terms of how we define it. One of them is in a reasonably advanced stage and we hope to get more visibility into that in the coming few weeks.

**Moderator** Thank you. The next question is from Kunal Tayal from Bank of America. Please go ahead.

**Kunal Tayal** Sekar, I was hoping for some qualitative inputs on your revenue guidance. Firstly let us say getting to about 13% growth in this calendar year. How much of the business do you think would be reasonably in the bag versus how much is yet to be won? Secondly, just comparing with CY12 is your visibility on the CY13 revenue guidance may be similar or less or do you think you have been more conservative this time around?

**P.R. Chandrasekar** Look at the revenue guidance that we have given of double digits for 2013. First I am sure all of you are obviously intimately familiar

but arithmetic does pose a bit of a challenge for us given the fact that we enter with a little less momentum specifically Q4 and to a little extent even Q3. And you have also seen the kind of guidance that we have given for Q1 of 2013 which is based on what we best know and also accounting for the fact that this particular situation that hit us in Q4 continues to have been a bit of a drag on us in Q1. Having said that, we are therefore feeling that in order to hit the double digits you are talking of (+4%) QoQ growth going into Q2 onwards. The pipeline that we have, the interactions that we have had with our top 20 customers are the fairly detailed discussions we have with our top client as well as the pipeline we have leads us to believe that that is something that we will be able to deliver. In terms of confirmed business and pipeline I do not want make a specific comment but it is a similar to what we had experienced at a similar time in 2012.

**Kunal Tayal**

In terms of what will drive this (+4%) CQGR Do you think it will be your existing set of top 10 clients once again or could faster growth come from outside of the top 10?

**P.R. Chandrasekar**

I want to go beyond the top 10 and go to the top 20. I think the top 10 given some variances with one or two customers in that mix will continue to drive and deliver the kind of growth we are looking at for the year meaning we believe that they will remain and will continue to deliver over 50% of our revenues in 2013. Now you could have pluses and minuses for any specific customer which I won't be in a position to detail in this call.

Other than that we have also successfully delivered a fairly healthy number in terms of our new business 6% to be precise, we have done it in 2011, we have done it in 2012 and we have done it during 2010. So 3 years in a row 6% of our revenues have come from new customers and based on all the pursuits that we have in our hand the significant strengths we continue to have in people soft, enterprise solutions offering, the significant strength we have in our capital markets and asset management space we feel very

comfortable that new customers will continue to deliver anywhere from 5% – 6% of our revenues.

That then leave us with the next slot to beyond the top 20 which I must say admittedly we have had somewhat more mixed success in mining and extracting more juice out of. We are taking a lot of steps towards the end of 2012 we have already done that we will continue to do more in the beginning of 2011, here I am talking about the balance whatever 150-180 customers of whom we believe there are another 50-60 with some material opportunities for us to mind. We are saying that those customers will also do a little better in 2013 then we have in 2012 and based on at least some of the proposal activities that we are already engaged in we have reason to believe that is the case. And that essence is where our numbers confidence for the guidance we have comes from Kunal.

**Kunal Tayal**

I think as part of your comments you did indicate an uptake in profitability may be Q2 as well. So good to assume that by Q2 the impact from this one off project cancellation should be completely behind?

**P.R. Chandrasekar**

See I do not want you to assume anything like that because we would like to provide you a little more color when we go into April based on what we see now we have said that we will improve our profit margins in Q1, we have also said that we will materially improve those even further in Q2. I would like to leave it at that now Kunal.

**Moderator**

Thank you. The next question is from Manik Taneja from Emkay Global. Please go ahead.

**Manik Taneja**

If you could possibly talk about your sales marketing investments going forward given the fact that we want to leverage that through most of CY11- CY12, so what kind of a number we should we build in going forward and secondly if you could talk about your inorganic

growth strategy because you indicated some intentions to look at an acquisition about a couple of quarters back?

**P.R. Chandrasekar** Manik, if you look at our SG&A I am not going to break up SG&A and the G&A piece but if you kind of that look at number we have steadily been kind of bringing that overall numbers down and if you look at on average barring the quarter 3 where I think we want to about 17.7. We were in the 18.5 kind of a range. We want to be a little more efficient going into 2013 so I think we will be in the 18-18.5 range may be closer to 18 that is the plan. However from a sales and marketing stand point, I do not want to give you a number, we have not and do not intend to reduce that percentage which is really your field force your practitioners, your account managers, those who can drive revenue and opportunity in the future. The second question was about inorganic?

On the inorganic front like we stated I think a quarter or so ago we are shall I say interested in looking for opportunities. We have the team in place and now I think we have the bandwidth to be able to look at it. We also have some clarity on the direction in which you want to go. So I am going to kind of leave it at that Manik, it is something that we will explore but we will not do it purely for the sake of acquisition, it has to make sense and add value to us and provide us the ability to kind of improve our market and growth possibilities.

**Manik Taneja** One final question on the top clients where we had some issues with the large project, you have indicated that you see growth from that client even CY13, so is that building in any recovery in terms of business in this particular project or except this project alone you are confident about revenue growth at the company wide level and growth in this particular client?.

**P.R. Chandrasekar** Regardless of whichever way you want to look at it Manik, what I am trying to say is that the client over all will grow in 2013.

**Moderator** Thank you. The next question is from Ashwin Mehta from Nomura.

**Ashwin Mehta** Just wanted to get sense in terms of from a segmental perspective where you see the growth this year which are the areas where you see strength, what are you seeing in terms of decision making at clients and secondly from PeopleSoft 9.2 perspective when do you see that kicking in, would that be a 2013 end phenomena or the upgrades will possibly a 2014 phenomenon.

**P.R. Chandrasekar** I am going to let Ramanan answer the question on 9.2 But first let me address the larger question you asked about where we see growth coming. Here I am going to focus primarily on Hexaware and not really comment on the market environment or the economy and things like that in nature. If I look at Hexaware specifically and where our growth would come from, from an account perspective our top 10 accounts will continue to drive growth at Hexaware. As I already said, new customers will continue to give us anywhere around 5-6% of our revenues. The focus is going to be to go and get more out of beyond the top 20 as well. From a vertical standpoint we have done well even in 2012 in BFS, we did well in 2011, the pipeline is healthy. We have some new offerings which have generated a lot of interest both with the existing and new customers and we continue to believe that BFS will deliver above Hexaware above average growth rate in 2013.

We believe Healthcare and insurance given the customers that we have, given several new customers that we have acquired, the specific deals that in which we are participating in this area will also grow faster. That leaves us with travel and transportation, that sector is overall the market place is being challenged, because of the situation that many airlines find themselves in, however given our own customer profile we continue to believe that they will remain fairly steady and in addition to that we have also invested significantly over the last 2-3 quarters in logistics which will generate some new business for us in 2013.

In addition the growth is also likely to come from 2 other areas which has started evolving and emerging for us that growth here is 1) APAC where we will be growing steadily, the baseline is still very project based, it is still somewhat opportunistic, but over the last few quarters we have built both the team as well as the set of customers that leads us to believe that we grew by 30% in 2012 and will continue to at a fairly healthy rate probably faster than the industry & company in 2013. That is as far as APAC is considered. Finally they have also made headway with some multiple opportunities as well as expanded our base presence in Mexico. We also now have a small presence in Brazil. I think Latin America if you want to, although I know Mexico would not quiet fall in that category, but if you see the non-North American markets will also generate us somewhere between 5-10 million dollars going into 2013-14. That is really what it is. Clearly on the technologies before Ramanan gets into specific people soft, if you have been looking at us our business intelligence and data warehousing practice has really been powering our growth. They have gone from somewhere from 8% of our revenue to 12% in the last quarter. We have lot of things in the pipeline. We have added both good capability and making investments. Ramanan may be able to elaborate little bit on that in addition to the people soft. That's also a sound area for growth. With that I will let Ramanan answer the specific question on people soft and may be add a little more color on some of the other technologies.

**R. V. Ramanan**

Regarding people soft 9.2 the question was specific to 9.2, as you know any kind of version change gives us lot of upgrade revenue and upgrade is our good portion of our ERP revenue. We expect that this year 9.2 upgrades will start which means that we will win orders, we will get new logos, will book orders. But significant portion of the revenue will start flowing in from 2014. Or towards the end of this year third, fourth quarter we will start winning the orders. But revenues will take uptake only from 2014. Having said that even on the ERP side in addition to people soft we have also

invested quite a bit, we are expanding our presence, especially with cloud and SAS based ERP structures. We have partnered with SAS based implementation partners. In order to expand and make sure that we are in line with the current technology trends in the industry as Sekar mentioned in one of the investment strategy especially in the BI area we have invested quite a bit. We have expanded our capabilities around big data which is the in thing in the market today and where we are seeing quiet bit of traction and we are significantly expanded our capabilities in this areas.

**Moderator** Thank you. The next question is from Deepesh Mehta from SBI Caps Securities. Please go ahead.

**Deepesh Mehta** Just need your comment about 2-3 things: 1) We have seen some kind of weakness in Europe even if I exclude top clients performance it appears to be relatively weaker. 2) Your comment about BPO business and just 3) more about deal win in last 2-3 years we have sizeable deals. So the decline what we have seen in business, is there any kind of decline that we have seen in any of those deals? And last question is about your hiring plan?

**P.R. Chandrasekar** Deepesh those were quite a few questions that you asked into one so forgive me if I forget one or two you may have to remind me. The first one I think was about Europe. Yes, a lot of these dip in Europe is explainable by our top client: Is there certain softness? I do not want to say there is any softness because we have not been, in terms of size, our own numbers have not been affected that much in terms of numbers or we have not grown that much either. Having said that there are several customers as well as opportunities we are chasing in Europe even outside the top client which I believe will help us to grow, we are close to the company average in 2013. This is primarily still in continental Europe but we have also in the last one year expanded our coverage in certain sectors particularly ERP, BI and sign to win new engagements in the UK region as well. So all of this should help us get growth in Europe so I do not want to say is it easy? The answer is no but

actually our traction is as healthy as it has been in the last year or so.

**Deepesh Mehta** Is it possible to break-up between continental Europe and UK?

**P.R. Chandrasekar** All I want to say is continental Europe is bigger than UK for us. That really is the larger chunk of our business Deepesh. We are not as dependent on UK as many of our other competitors or peers, specifically for growth also.

With regards to BPO, I think to be candid has been sluggish for us as an organization. We have had problems because of the fact that several customers chose to move some processes in house. There was one customer that took or shall I say a strategic decision to move or cut an activity that they considered very core and critical also in house we have had more difficulties. We have won customers in our BPO subsidiary but the average sizes of those deals have been small. So we have had challenges in growing our BPO business. We do not think it is going to get much easier in 2013 the only good thing is there are a couple of deals, for them reasonable size one of them in an advanced stage if we are successful in winning that we believe that we will be able to at least normalize or even grow our BPO business a little more in 2013. But clearly at this point in time if you had to pick one area where we are struggling a little bit it is with BPO.

With regards to the deals that you talked about there is none that is structurally or in any way going down. I did mention the BOT operation which has not been as successful as we were hoping for and we would like, there is renewed vigor and focus at both the organization we are continuing to participate in deals and we are hoping to make at least some break-through in 2013. Hiring, I will let Ramanan answer that.

**R. V. Ramanan** You have had a question what is our hiring plan? Obviously hiring plan will be based on our demand for resources and one thing if you can see currently we would like to improve the utilization from

the current levels. So that would be the primary focus and then based on demand we will be hiring. As we say you know in the last year we have significantly tried to keep the fresher intake as about 40% - 50% of the net intake. That is also our focus area this year. We will continue to hire fresher's on a quarterly basis, we will not make a yearly projection but we will grow and laterals will be on demand basis but the initial focus is to improve utilization.

**Deepesh Mehta** Can you provide tax write-back that you have in this quarter?

**Rajesh Kanani** Just previous year losses we have got one of the losses to set off that is all. It is a one-time item.

**Deepesh Mehta** What was the amount?

**Rajesh Kanani** You can say underlying on Effective Tax Rate (ETR) was some 21% so that is the calculation

**Atul Nishar** Before I stop just one point I want to make to what Sekar said when he talked about in response to question on continental Europe verses UK I do want to add what he said that continental Europe is predominant but within that the pre dominant is all publicly known in Germany as a territory for Hexaware which has been the major territory for quite some time. A lot of our leading clients belong to Germany.

**Atul Nishar** I would like to thank all for you for having joined this call and really appreciate your interest and support and encouragement that you all have been giving to us and thank you very much for that. Good bye.

**Moderator** Thank you very much. On behalf of Hexaware Technologies that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.

For any additional information on Hexaware: please contact  
Sreenivas V  
Chief Strategy Officer  
E-mail: [sreenivasv@hexaware.com](mailto:sreenivasv@hexaware.com)  
Phone: +91 99401 90091