

eClerx Services Limited Q2FY24 Earnings Conference Call

November 10, 2023

eCLERX MANAGEMENT:

**KAPIL JAIN – MANAGING DIRECTOR AND GROUP CEO
PD MUNDHRA – CO-FOUNDER AND EXECUTIVE DIRECTOR
ANJAN MALIK – CO-FOUNDER AND NON-EXECUTIVE DIRECTOR
SRINIVASAN NADADHUR – CHIEF FINANCIAL OFFICER**

CONFERENCE CALL PARTICIPANTS:

**ARVIND CHETTY – DYMON ASIA CAPITAL
AYUSH BANSAL – EMKAY GLOBAL
HITESH ARORA - UNIFI CAPITAL
MIHIR MANOHAR - CARNELIAN ASSET MANAGEMENT
NIKHIL CHOUDHARY - EDELWEISS SECURITIES
NITISH REGE - CHRYCAPITAL
SANDEEP SHAH - EQUIRUS SECURITIES
SHRADHA AGRAWAL - ASIAN MARKETS SECURITIES**

Asha Gupta:

Good evening, participants, and welcome to the Q2 FY24 earnings call of eClerx Services Limited. Please note that this webinar will be recorded.

To take us through the results and to answer your questions, we have with us the top management of eClerx represented by Kapil Jain - Managing Director and Group CEO; PD Mundhra - Co-Founder and Executive Director; Anjan Malik - Co-Founder and Executive Director; and Srinivasan Nadadhur - Chief Financial Officer. We will start the call with brief opening remarks by Srini, and then we will open the floor for Q&A session.

I would like to remind you that anything that is said on this call that gives any outlook for the future, or which can be construed as a forward-looking statement must be viewed in conjunction with the risks and uncertainties that we face. These risks and uncertainties are included, but not limited to what we have mentioned in the prospectus filed with the SEBI and subsequent annual reports, which you can find it on our website.

With that said, I will now hand over the call to Srini. Over to you, Srini.

Srinivasan Nadadhur:

Thanks, Asha. Ladies and gentlemen, good evening. Welcome to eClerx earnings call for Q2 FY24.

We've reported robust top line and bottom-line performance in Q2 with revenues of \$87.6 million, up 4.4% quarter-on-quarter, both in USD as well as in constant currency terms. Total INR revenue for the quarter was INR 7,359 million, up 6.4% quarter-on-quarter. Revenue performance was complemented by an equally strong performance on the margin front. EBITDA for Q2 was INR 2,189 million, up 25% sequentially, and the EBITDA percentage was 29.7%, up 445 bps QoQ. Net profit for the quarter was INR 1,360 million, up 28% sequentially and at 18.5% margin. Our financial markets and customer operations businesses were the key contributors for the strong top line performance in this quarter with onshore wins in the former, and offshore wins in the latter driving much of the growth. Delivery costs in this quarter were largely flat, resulting in the margin boost. There are small increases in utilization and onshore revenue in this quarter. Exit headcount is up by 600 people from the previous quarter's exit. Attrition is marginally up from the previous quarter but well below the usual percentages that we see.

Outlook for Q3 is positive. We expect to show sequential growth. However, macroeconomic uncertainties still prevail. Our clients' budget for CY'24 are being firmed up and so our view of Q4 will solidify over the next few weeks. In the previous earnings call, we had mentioned that full year EBITDA margin may be below the lower end of the 28% to 32% range. Given the strong margin performance in Q2, we are revising this view, and we now expect full year EBITDA percentage to be within the stated range.

With this, we come to the end of our opening remarks. We can now move on to the Q&A. Asha, over to you.

Asha Gupta:

Thank you, Srini. We have first question from Nikhil Choudhary from Edelweiss.

Nikhil Choudhary:

Congratulations on a very strong set of numbers. So, first question is regarding the growth. Like you mentioned, growth rebounded much more stronger than our expectation. Can you highlight what led to such strong outperformance? Any particular segment, subsegment where you saw better-than-expected growth? And then I have a follow-up on margins, Srini. Again, what you even highlighted that Q2 margins were stronger than expected. So even there, what led to surprise and what was our initial expectation?

Srinivasan Nadadhur:

I'll cover the margin question and then I will redirect to Kapil for the growth. So, on the margin, the delivery costs are flat because there's been a change in the mix in the people offshore. So, the growth in delivery headcount has been largely at the bottom of the pyramid. The second reason is that you can see that the headcount in tech has reduced, and that's a result of planned streamlining of bench, which has happened over the last 2 quarters, in Q1 and Q2. And both these factors have contributed to the flat delivery costs. I'll hand over to Kapil for commentary on growth.

Kapil Jain:

Thanks, Srini. Nikhil, like Srini mentioned in his opening remarks, the growth came predominantly from financial markets and our customer service operations, and where we are doing on the financial markets on the compliance and regulatory side and the customer operations was areas that we service our clients.

Nikhil Choudhary:

Very helpful. Just one more question regarding the strong headcount addition. So, what you mentioned that you would be able to comment better on the client demand after seeing their budget allocation, but given the strong hiring, I just want to understand, is it based on the already wins you have or based on your pipeline?

Srinivasan Nadadhur:

Yes. So just to clarify my comments, I think we said that we'll show sequential growth in Q3. So Q3, we are fairly confident about. And I mentioned that we will have greater clarity on Q4, maybe a few weeks down the line.

Asha Gupta:

Thank you Nikhil. We have next question from the line of Mihir Manohar, he is from Carnelian.

Mihir Manohar:

Congratulations on good set of numbers, I mean, quite good set of numbers in this environment. Sir, you mentioned on the financial market side, the capital markets compliance driving the growth. So, if you can throw some more light as to what are the changes which have happened on the compliance side, which is driving your growth. And given the fact that there are structural changes, I mean, should we consider a similar kind of growth continuing at the company level for 3Q, 4Q? That will be helpful. Because how important this change is to understand that will be useful.

My second question was, after Mr. Kapil Jain joining in, is there any structural changes or any sales team augmentation or any delivery structure improvisation that has happened? Just wanted to understand around that, that would be really helpful.

And my third question was just on the proof of concepts. I know 32 proof of concepts you were working out of which 2 went commercial last quarter. I mean, is there any more update over there, any more commercialization happening? And just to understand quantum also, what is the quantum of commercialization that is happening, that will also be helpful. So those are the questions.

Kapil Jain:

I think the structural changes at this stage, we are not planning to make any structural changes. We will be investing in sales for growth. And I am planning to present my plan to the Board and some aspects of it, we will share with you in Q4, as we had indicated earlier. So that's on the structural changes.

On the client life cycle and KYC, we are seeing the demand on the compliance area. I think your question was Q3, Q4. Like Srini said, we are cautiously optimistic that we would be able to show a sequential growth in Q3, Q4, given the current volatility in the market and geopolitical risks, I think we should be in a position to tell you during our next call.

In terms of Gen AI, I think the number of active discussions has increased. We are in 55 active discussions. And most of the areas are in content operations, care ops and insights on demand. And we are building domain-specific IP on top of foundation models. We are also creating a customer advisory board where we are bringing some of our client executives from the technology side. And we are investing in training as well as enabling our people ready on Gen AI. So, these are some of the things that we are doing on the same.

Mihir Manohar:

Sure, sir, sure. That's helpful. And just lastly on the digital marketing side in Europe, I mean, how is the situation now over there? Because previously, I mean, the digital marketing piece in Europe was facing challenges. So, how is the luxury brand performing over there every day?

Kapil Jain:

I think on luxury brand, as you would see, like some of our key clients did not post very robust results. And I think there was a lot of pent-up demand post pandemic, which saw extraordinary growth in that segment. I think the normal is coming back. There is always a lag between when our clients' growth is declining versus where we see some caution. So, I think we are cautious on the luxury segment side in terms of what we are seeing with our clients the new normal, which is getting set up.

Asha Gupta:

Thank you Mihir. Next question is from the line of Sandeep Shah from Equirus. Sandeep please go ahead.

Sandeep Shah:

Just I think in the initial remarks, you said the client CY '24 IT budgets have been finalized but we may take some couple of weeks to get a view on the fourth quarter of this financial year. So, any early indication how the clients' IT budgets are shaping up?

Srinivasan Nadadhur:

Sandeep, I mentioned that budgets are being finalized. So, we don't have very well-formed view as of yet. But I think in the next few weeks, we should be able to give some kind of opinion.

Sandeep Shah:

Okay. And a question to Kapil, sir. Sir, I think eClerx, despite a strong operational capabilities and the delivery capabilities as well as rich client base, the issue in the past being roll-off impacting the growth opportunities. So, is there any strategy to reduce the impact of the roll-off by way of increasing the deal pipeline or in terms of augmenting the sales and marketing team, which helps us to create a stronger pipeline, stronger deal wins, which may actually compensate and keep the growth rate consistent or in line with the industry for a longer period of time, maybe over 3 to 5 years?

Kapil Jain:

Sandeep, absolutely, that's the plan. Like you said, to invest in sales and marketing. Some of the roll-offs happen because of the nature of work, which is more consultative led. Typically, these projects are short term. So that's part and parcel of our business and we are working towards to see how we can strengthen our pipeline so that we could give growth in line with the industry growth over a medium-to long-term horizon.

Sandeep Shah:

Okay. So, in pursuit of that objective, is it fair to say we may be open to slightly compromised margin in the near term but that may give us growth opportunity and sustainability of growth over a longer period of time.

Kapil Jain:

Sandeep, like I said, I would be presenting my plan to the Board in Q4 and some snippets of it, we will be in a position to share with you after we have presented the plan to the board, and we'll have to strike a balance between growth and margins to see in terms of value we are delivering to the shareholders.

Sandeep Shah:

Okay. And last question to Srini, sir, generally, Q3, Q4 margins are mostly in line or better versus the Q2 margin. So, whether same trend can be expected even in this year? And any status update in terms of SEZ policy on work from office as of now?

Srinivasan Nadadhur:

The SEZ works from home has been extended till 31st of December '24, so next year. And on Q3, Q4 margin, we think it will be broadly similar, maybe a little up, a little down, but hopefully broadly in line with what we've been able to do in Q2.

Sandeep Shah:

Congratulations on a strong execution in this quarter.

Srinivasan Nadadhur:

Thanks, Sandeep.

Asha Gupta:

Thank you Sandeep. Next question comes from the line of Hitesh Arora from Unifi. Hitesh please go ahead.

Hitesh Arora:

So could you delve a little deeper into the financial services and the customers ops growth? Is it something more structural here? Is it just sort of one-off there was more trading activity linked, if you could kindly delve a little more, and similarly on the customer upside?

Kapil Jain:

It's not linked to higher trading activity, Hitesh. It is with respect to compliance and KYC, which is a strong offering from us as well as on the customer operations side. It is our strong delivery where we are seeing the growth. It's not related to any event led growth.

Hitesh Arora:

So, I mean my point is, is this something that we can think that this growth trend sustains?

Kapil Jain:

Hitesh, like I said, we are cautiously optimistic. And Q3, we should be able to deliver a sequential growth. Given the overall volatility in the market, I think it's a little difficult to predict what the Q4 would be, and we would be in a position to tell you in our next earnings call or as soon as we have some visibility.

Hitesh Arora:

Sure. Any commentary on the other parts of the business, if you could give, how were things there?

Kapil Jain:

I think, like I said, on the luxury, I spoke about. Hi-tech, I think, has been a little tepid in the last 1.5 year to 2 years, and I think they continue to be cautious. See, the overall macroeconomic environment is volatile and hence, clients are also being cautious in terms of how they are planning the spend. And they are also not making like in terms of discretionary spend continues to be on high visibility and watch.

Asha Gupta:

Thank you Hitesh. Next question comes from the line of Ayush Bansal, he is from Emkay Global.

Ayush Bansal:

I just had a couple of questions. Like in emerging clients, it views 3% sequentially in Q2 and it declined around 1% in Q1. So how do we look at it going forward? What is the thought process there?

Srinivasan Nadadhur:

I think our view has been to try and grow this over a longer period of time. In the medium term, we would expect these numbers to go up. I think quarter-to-quarter, it is hard to draw inferences based on any single quarter movement. So, we are working towards growing all parts of the business, especially with the focus on small clients. But I think variations in quarters in the short term is likely to happen.

Ayush Bansal:

Okay. Got it. And do you expect any seasonality in Q3 in certain parts of your portfolio?

Srinivasan Nadadhur:

No.

Asha Gupta:

Thank you Ayush. We have next question from the line of Nitish Rege. Nitish, please go ahead.

Nitish Rege:

This is Nitish Rege from ChrysCapital. My questions are for Kapil sir. Sir, how do you see the Gen AI impacting us based on whatever is seeing in the initial days. This is my first question.

Kapil Jain:

Nitish, I think we are seeing small projects. I think clients are also grappling in terms of what use cases they would want to work on while there is a lot of hype as well as in terms of what has been built around, but the use cases on which it will be deployed. Like I mentioned, we are working in the area of content operations, care ops and insights on demand. There may be some impact, but we are not shying away because I think we want to be ahead, given our domain as well as progress on the tech side as well as on the op side. So, I hope it answers your question.

Nitish Rege:

Okay, sir. And just one other one. Now that we have like more than INR 900 crores of cash, what is the capital allocation plan? We've also hired a head of M&A recently. So, is there any M&A activity or anything you are assessing right now and which kind of space will we be looking at?

Kapil Jain:

We would be looking for synergistic opportunities in areas where we have capability as well as the valuation has to be the right one.

PD Mundhra:

I think Kapil has made exactly the right point. I think capital allocation policy continues to be that if there is an attractive acquisition opportunity, the funds are available for that. In the absence of that, we will continue to maintain distributions as we have done in the past. I think one thing we do expect to change is the more proactive approach in terms of trying to source good deal flow and good assets that might fit in with the overall corporate strategy of the firm, which is why we have also made investments, as you noted, internally in these sources so that we can have a more proactive approach of going out scanning the market and trying to earn out opportunities more predictably than just be reliant on incoming teasers.

Asha Gupta:

Thank you Nitish. We have next question from the line of Shradha Agrawal from AMSEC.

Shradha Agrawal:

So sorry I'm repeating some questions because I logged in late. Sir, I just wanted to get your sense on the deal pipeline, how are the sales cycle and deal conversion cycle looking like now? Because earlier you had indicated about some slowdown in deal conversion.

Kapil Jain:

So Shradha overall pipeline continues to be in the same way, so there's no significant change in the overall pipeline. I think like I said, given the overall visibility we have, Q3, we are cautiously optimistic. Q4, we would give a view closer to the date. And like as we move forward. And in terms of conversion cycles, they stay the same in terms of what we had indicated. There has been no remarkable change from what we have said earlier.

Shradha Agrawal:

And secondly, in terms of margin progression, so are we expecting better margins in the second half versus what we've seen in 2Q? Or how are we looking at the margins going into 3Q and 4Q?

Srinivasan Nadadhur:

I would think broadly in the same range, a little up, a little down. I don't think we are saying that we continue to go on [increasing]. We'll have to see how that will go on.

Shradha Agrawal:

Right. And sir, structurally, how should we now look at our margins going into FY'25? Would it be required to make more investment into sales? Or how should we look at the new margin profile of the company and Mr. Kapil Jain now?

Srinivasan Nadadhur:

I think that a lot depends on the plan that Kapil presents to the Board. But as he has said, I think the intention is to boost growth, and therefore, there will be some investments in the onshore sales and team, and maybe that will lead to some trade-offs in margin. How much I'm unable to quantify now but there will be some downward impact to margins.

Asha Gupta:

Thank you Shradha. We have follow-up question from Sandeep Shah from Equirus.

Sandeep Shah:

Any color in terms of a demand shaping up in the cable and wireless segment?

Kapil Jain:

Sandeep, like I said, in the Cable & Wireless segment, the demand continues to be in the area in which we are servicing our clients. And our delivery continues to be robust, which is why we are seeing the increase, which we saw in the Q2 in the customer operation.

Sandeep Shah:

Okay. So, in that scenario, is it fair to assume that demand is good in almost BFSI and customer operation or cable or wireless kind of a segment, which, if I'm not wrong, close to 60%, 65% of the revenue and 1/3 of the segment may slightly be cautious in terms of the demand.

Kapil Jain:

At this stage, what you've said is right. However, like I said, the clients are also looking at quarter-on-quarter, given the interest rate volatility, geopolitical risk and many other factors, which are playing. So yes, currently, financial markets and customer operation, we can expect what you have indicated.

Sandeep Shah:

Okay. And sir, just a follow-up. In terms of fourth quarter outlook, is it fair to say is there any customer-

specific issue or in terms of any roll-offs, which we anticipate where it does not give us a confidence about visibility as of now or it's more to do with the macro uncertainty, and that's where we are slightly being not able to give outlook for the fourth quarter?

Srinivasan Nadadhur:

Sandeep, it is the latter.

Sandeep Shah:

Okay. And last question on Gen AI. In the first phase of option, do you believe there would be additional spend even with a vendor like eClerx where clients help would be required from the vendors in terms of creating a large language model doing data engineering, data testing. And in the second phase of adoption, there could be some more revenue cannibalization led impact. Is it the right way of looking at it, how to see this adoption journey from the client side on the Gen AI?

Kapil Jain:

Yes, Sandeep. I think that's the right way to look at it. However, in the Phase I that you described, we will see some demand and spend. These projects are typically small in size but that's the flow it will follow. And we are hiring in 3 different streams, ML researchers, business analysts and as well as the implementation team.

Asha Gupta:

Thanks Sandeep. We have next question from the line of Arvind Chetty. Arvind, please go ahead.

Arvind Chetty:

This is Arvind from Dymon Asia Capital. My question is more on the headcount addition. For the last few quarters, we've seen headcount sort of growing in line with our revenue or vice versa. Is that a fair assumption that for the next few quarters, given the uncertainty that's how it should pan out or headcount and revenue growth should be correlated for next few quarters?

Srinivasan Nadadhur:

Largely, that has been the case because technology is a smaller part of our business, a large part of it is operations and the BPaaS portion of it where we are pricing on fixed price is about 25% of the business. So, the majority is FTE based. So, it will grow largely in line with revenue.

Arvind Chetty:

Great to know that. So, to that extent, given the headcount that we have had this quarter, so Q3 could be very similar to what Q2 growth was or maybe only slightly lower. And then Q4, we will see if we have to add headcount, is that right way to look at the business?

Srinivasan Nadadhur:

It's a fair assumption, I think.

Arvind Chetty:

So, we'll be making investments in sales going forward. Do we anticipate growth to accelerate next year onwards? And because we will be augmenting our sales, and I guess that should be the thought process, right?

Kapil Jain:

Arvind, like Srini mentioned, yes, we would be investing in sales. And given the current environment, I think we continue to hire, and we will be bringing more salespeople. In terms of the growth, as you know, there would be some lag between the time we would make the investments in sales and when the growth will happen and also as a function of the overall market. But we would be well poised given our delivery capabilities, strong set of clients and investments that we would have made in sales to capture the demand as when the market conditions are more certain as well as on the back of investments that we would have made.

Arvind Chetty:

Got it. And would we expect FY '25 to be better than what FY '24 is going on?

Kapil Jain:

I wish, Arvind, I could have given you that answer. I think it depends on many factors, which are beyond our control and it's a very forward-looking statement in terms of what the outlook would be in FY '25. We don't have our 2020 vision on Q4 of FY'24. So, FY '25 is a little distant away.

Asha Gupta:

Thanks Arvind. We have next question from the line of Nitish Rege.

Nitish Rege:

So based on current client meetings, what is the low-hanging fruit in terms of mining, considering we've such a strong client roster?

Kapil Jain:

So Nitish, I think basis whatever I've spoken to the clients and have met some of our large clients, I think they continue to give a thumbs up on our strong delivery, our agility, speed of response and the domain and technology that we bring to the table. So, it's not like there are some low-hanging fruits or something but I think we are working and in discussion with a lot of our clients to see where the opportunities are and where we could potentially create the pipeline and hence, the growth as well.

Nitish Rege:

Okay. And just again on Gen AI, do you see anything to worry about in terms of the extent of revenue deflation we can see from this?

Kapil Jain:

No, not at this stage.

Asha Gupta:

Thank you Nitish. We have a next follow-up question from line of Sandeep Shah.

Sandeep Shah:

Yes, just a bookkeeping. If I look at the average hedge rate for the last 3 quarters, has been 83 to 84 and this time, it's upward of 84, but when I look at the realized rate for the quarter versus the spot average rate, it's still lagging the realized rate versus the spot average. So, when do you expect this to reverse looking at the current outstanding hedge position and this may be a tailwind on the margin, is it fair to say, going forward?

Srinivasan Nadadhur:

So, if you look at the hedge updates, I think you will see that somewhere around Q4 if the current exchange rate stays that's when you would expect that to the go reverse.

Sandeep Shah:

Okay. So, by Q4 if spot rate remains, it could be a tailwind on the margin.

Srinivasan Nadadhur:

Yes.

Sandeep Shah:

Okay. And just a last question to Kapil, sir. In terms of strategy and investment in sales and marketing, is it fair to say we may even think to diversify beyond the current industry verticals as well as service offerings? Or we believe the opportunity untapped is still bigger in the existing verticals and services, so our focus would be to invest in those domains rather than diversifying beyond the current domain?

Kapil Jain:

Sandeep, in short term, the focus would be to take the existing set of capabilities. And in medium to long term, we will evaluate and look at in terms of new capabilities that we will have to build to stay relevant for our clients.

Asha Gupta:

Thank you Sandeep. I think as there are no further questions, I would ask management for closing comments.

Srinivasan Nadadhur:

Thank you, everyone, for joining the call. We'll see you again with the Q3 results. Happy Diwali to everyone.

Asha Gupta:

Thank you, everyone. This end eClerx's call. Happy Diwali, to everyone.