Eclerx Services Limited
Q1 FY21 Earnings Conference Call

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Diwakar Pingle:

Good evening, friends. Welcome to the Q1 FY2021 earnings call of eClerx Services Limited. Please note that this webinar is being recorded. The transcript for the webinar will be made available in a week's time from the call. Joining you today to give an update about the quarter and to answer your questions, we have with us, PD Mundhra, Co-Founder & Executive Director; Anjan Malik, Co-Founder & Director; and Rohitash Gupta, Chief Financial Officer. I now hand over the conference to Rohitash Gupta, Chief Financial Officer of eClerx Services. He will make his opening remarks and then we'll move to the Q&A. As far as the Q&A is concerned, I will let you know the rules as we start that particular session. Over to you, Rohitash.

Rohitash Gupta

Thank you, Diwakar. Good evening and thank you for joining eClerx Q1 call for the quarter ending 30th June 2020. We are excited to join you today through video conference for the first time and hope this trial attempt will work out for you.

Q1 was by far the most challenging quarter for our BPM industry with dual challenges on Supply and demand side. However, excellent cost management and tremendous dedication shown by our global workforce and support from currency and hedges helped us navigate the quarter with negligible impact on the margins. We used the good part of quarter to provide computing assets to our employees including many who were out of town, and we also used the opportunity to convert all the rental assets into bought out assets. This move will provide some support in upcoming quarters to the extent of spread between rental cost and depreciation, provide cost efficiency during future asset refresh cycles and help in maintaining high productivity during future BCPs. Lastly, revenue from travel clients in our digital vertical is unlikely to revive until global travel activity increases further.

Demand side challenges saw some easing out in Europe, and we saw a resurgence of new business related conversations across all verticals in July. Although the pipeline conversion timelines may remain challenged for some more time, we feel that the increase in pipeline from Q4 levels across all three verticals is a good first indicator. We saw a clear trend in Q1 where new ramp-up’s went down both on YoY and QoQ basis, and at the same time roll offs also came down by a similar quantum, thus keeping the net revenue momentum positive for Q2. I want to provide some color on a sample of new revenue streams that we have worked during the quarter –

1) We are currently training a batch of large new offshore chat program for an existing cable client
2) We started on a new campaign management program for an existing digital client in urban mobility space
3) We started delivery on a new product data management project from an existing MRO client
4) We won an analytics program from a large food ordering company thus adding our second logo in this industry
5) We won a new customer interaction analytics project from an existing strategic Hi-Tech client
6) We secured a Nordic regional bank as new logo for KYC work
7) We revived relationship with a Fortune500 American financial corporation through a new consulting project for a large scale middle office re-platforming
8) We doubled our relationship size from a Fortune 100 tech client that we won two years back providing them with rapid robotic process automation solutions

Looking back at the quarter, onshore business including CLX were most impacted and are likely to revive earlier than the BPO business during FY21. The revenue decline in Q1 was fairly broad based affecting most segments, services, and clients across delivery models except for technology services revenue which remained steady. We are probably one of the first companies in our industry to have paid out usual performance bonuses to employees for FY20 during the quarter and announced annual wage hikes for all employees except top management and these hikes will be effective from 1st July and 1st October respectively. The entry level management hires from campuses have either joined or will join as soon as domestic travel restrictions ease out further. We have also started return to office in all locations in a cautious manner and some G&A and travel costs are likely to increase over next few quarters. Our cash balances are likely to be at a near term low point due to the share buyback, dividend payout and increased capex and it will reduce the other income in upcoming quarters. These factors put together are likely to limit any upside to margins even if revenue were to increase in future quarters.

Our Q1 revenue at US$44.8mn dropped sequentially by about 6% in line with BPM industry. EBITDA and EBIT increased marginally from the last quarter and increased by about 30% on YoY basis. Our Net operating cash flow converted at over 100% of PAT in Q1 similar to trend observed in past few quarters. We were able to improve DSO this quarter through active collaboration with clients on releasing Q4 outstanding's, but we remain cautious about DSO in Q2. Our global headcount remained flattish although attrition dropped to an all-time low of 16% this quarter, which helped us in managing cost and productivity during a distributed working environment. We also feel that the incredible effort done by our HR team through flexible policy changes and online engagement initiatives during this pandemic may help to moderate the attrition in medium term.

Post close of the quarter, we also announced and completed an open market Buyback worth INR 1,095 mn thereby extinguishing 5.7% of shares from June end levels. We still do not have full clarity on timeline for receipt of FY19 SEIS scrips and we have even lesser visibility on approval timing and liquidity of SEIS scrips for FY20 onwards. Accordingly, we have not accrued any new SEIS income from April'19 onwards. Lastly, we have opened our new Dutch subsidiary this quarter to support our existing clients.

To sum it up, we are pleased with good performance on margins in this challenging quarter and are excited to participate in new opportunities that will open up with resumption of global economic activity.

With this, I will open up the call for Q&A.

Diwakar Pingle:

Thanks Rohitash. We will begin the Q&A session now. The first question is from Aditya Kondawar. Please go ahead.

Aditya Kondawar:

Thanks for opportunity and good set of numbers. I just wanted to ask you some questions based on your comments on the employee benefit expenses side. I see that they have come down. So could you just give more flavor on the same?

Rohitash Gupta:

Yes, Aditya, thank you for the question. The employee benefit expenses came down through the quarter simply because our headcount was very volatile through the quarter. And although the numbers that we give in our formal presentation are as at quarter end, the average quarter headcount would have been a slightly different number. That's why you will not get a correct picture by tallying those numbers. Having said that, we have made certain policy changes, and there were some reversals from the past year in terms of bonus payouts to the employees who were actually on rolls during Q1 at the time of payout. And that's why there is some decrease on that top.

Diwakar Pingle:

Thank you. The next question comes from Madhu Babu.

Madhu Babu:

My question is on the deals we announced, could you talk about some of the deal sizes, which we announced in the opening remarks? And how is the digital vertical and campaign management, how are we seeing the improvement in momentum considering that Europe is almost coming out of the COVID lockdown? And second is on the cash balance, now even after the buyback, we will have a very good cash of around INR 700 crores. So in terms of the acquisition target, could you talk more about are we looking at any acquisition in the medium term?

PD Mundhra:

So, let me take the second question first, which is about acquisition targets. You're right, we will have a cash balance of about INR 700 crores post the buyback, and we continue to look at potential opportunities. We do feel that there will be more deal flow that we will have available to look at. So certainly, in the medium term, I think it's possible that we may find something attractive. On your first question about the digital business, and as Rohitash mentioned in his opening remarks, there were some segments of our digital business that were particularly adversely affected in Q1, especially the travel clients as well as some brick-and-mortar retail clients. And of course, also, there was a substantial effect to our CLX business because Northern Italy, where our facilities are located, was the epicenter of the pandemic in the country. But I think as we get into Q2 and Q3, we should start seeing some recovery. So certainly, even for CLX, June was almost back to normal levels in terms of production and work. And also in terms of our retail and travel clients, I think retail will recover sooner. Travel might take longer time just given the client environment. So we are seeing a recovery, I think, across all 3 businesses. Pace will be a little varied in terms of speed of recovery across the 3 businesses. But as we guided in our Q4 call from a revenue perspective, we feel Q1 should sort of be the trough and Q2, definitely, we expect revenue to be higher from there.

Rohitash Gupta:

And Madhu, just to cover your question on deal sizes, the examples were obviously a sample one. However, most of them would be upwards of $0.25 million. But keep in mind that while I talked only about the new business, there is always some old business that goes away. And the net is what we actually accrue and show up in the revenue.

Diwakar Pingle:

The next question comes from Krishnamurthy Santhanam.

Krishnamurthy Santhanam:

I just want to know about the revenue you guided for the upcoming quarter?

Rohitash Gupta:

So Krishna, thank you for your question. As I mentioned earlier, we hope that Q1 was a low point. And from here on, the revenue should go up. I won't like to specifically guide on the quantum, but I have given you a couple of indicators, both in terms of roll-offs and go-lives. I have also told you about and PD also commented upon the resumption of some activity in CLX, which was very badly affected in earlier months. And also I talked about the pipeline, which has now grown from the Q4 level, which was another low point at that time. So all these indicators suggest to us that revenue should go up from here. However, quantum is TBD because our pipeline visibility at any point of time is a couple of months at best. And in these uncertain times, we will be a little more cautious about conversion timeline of that pipeline to put a number.

Diwakar Pingle:

The next question comes from Rahul Jain.

Rahul Jain:

Congrats on the better execution. My question is to PD or Rohitash is this that what are the post pandemic or kind of a thing that you see in most of your business? Of course, you're talking a little better reaction from a Q1 to Q2 basis. But if you would like to see what businesses have been reacting more severe in terms of impact on a sustainable basis? And what are the areas where we possibly see a gradual better traction, especially on let's say on the digital side or any other business? So if you could give that kind of a picture, what changes that you see right now?

PD Mundhra:

Rahul, in terms of industry verticals, as you can guess, I would say, the impact has been quite different across the different client industries. So for example, I would say, given the type of work we do for the banking clients, there hasn't been much adverse impact on demand there. Similarly, business coming from our tech and cable clients, their business has been very resilient through the pandemic. So there hasn't been any systematic effect on demand there either. I would say most adversely affected, as we mentioned earlier, are travel and retail and North Italy because of location earlier in the quarter. I think it's also fair to say that as we look ahead, what's a little bit uncertain is conversion times and generation of new pipeline because a lot of the deals that we converted in Q1 were items that had already been in the pipeline sort of before the pandemic hit. And so in that sense, they were further in the funnel, and they were closer to the finish line. I think it's still TBD when we talk about generating entirely new opportunities, especially with new logos in this environment, how feasible is that, and how quickly do those opportunities ultimately convert into revenue, that needs to be seen. But Anjan, I don't know if you want to add some more color on this?

Anjan Malik:

I have got nothing to add. That's cool.

PD Mundhra:

Rahul, does that answer your question?

Rahul Jain:

Yes, I do understand, I mean, it's too early to call out any trend. I know it's tough, but what I was more looking is not what could be the immediate thing. Because what we are hearing in some of the call is there are some trends where there is an advantage or a tailwind from a digital acceleration kind of a thought process. So is there a certain aspect of your business where you see an increase outsourcing or increase adoption kind of an advantage that you get directly, indirectly in some of your processes? Or you won't like to hazard that right now?

PD Mundhra:

I think it's very early to say that Rahul. At least there's no instance that come to mind, that I would say that because of this environment that we are in, it is creating a lot of tailwind for certain service segments. I think it's early to say.

Diwakar Pingle:

Next question is follow on question from Madhu Babu. Madhu you can go ahead please.

Madhu Babu:

Sir, the emerging accounts, that has been on a weak note this quarter, especially, the top 10 accounts have actually done well. So I think even on a Y-o-Y, the emerging accounts, the fall has been a bit substantial. So how is the mining there? And just on the top 10 accounts, which are the subsegments where the momentum is? Because there's only 1.5% to 2% drop in this quarter in the top 10 accounts?

Rohitash Gupta:

Madhu, actually, this quarter is a little difficult to make sense out of metrics because of the external environment both on the supply and demand side. As you will understand that emerging is a set where most of the clients from retail and travel and luxury goods come in. And they were more affected, some of them. Whereas on the top 10 clients, the challenge was more on the supply side, which only gradually got resolved through the quarter and for different processes, different clients at different times during the quarter. That's why it will be very difficult to put a very coherent answer to why emerging did better or worse than strategic at this time unless we look at client-specific situations of how we resolved and when we resolved the supply side problems, especially.

Madhu Babu:

Sir, second one on the broader view. I mean, last 3, 4 years, organic growth obviously has been hit because of the top clients and automation impact and all. But with this current cash balance and would we like to look into traditional BPO and all where the market size is huge? And now that the margins are around 22%, maybe give up some part of margin and chase the bigger market on the traditional BPO offerings? I mean, is that a possibility?

Anjan Malik:

I know there were a lot of questions being asked around industry direction based on rapid digitization. So I would like to address both that question and this question about larger BPO opportunity. I think whilst we are not seeing direct impact from this "digitization", I think the people that are getting affected the most are our clients. And we are sort of second or third order derivative impact of that change. So for example, we may find that certain customers of ours win market share as a result of this change and others lose. And I think you will see that play out over the next year or two depending on which client wins and which client doesn't. So I think that's where you'll see the digitization impact will play out. On the larger BPO front, we actually are seeing a fair amount of interest in clients looking to offshore more work because cost obviously has become a big item for them. Secondly, we're seeing India actually be of more interest to our clients than it has been in the past because people feel that, in general, India performed well as an outsourcing destination during the COVID period. And the last part of it, on the M&A front, we continue to be very open-minded about the opportunities to buy. I don't think we're setting a target on what kind of business we're buying, but I do think we care about the stickiness of the clients that we're able to inherit in the portfolios that we buy. So I'd say it's a 3-fold answer. One is that I think the digitization is going to affect our clients, which affects us. Secondly, we will look at more work coming to India. So in that context, obviously, any opportunities for us to buy assets that have any kind of BPO portfolios we would look at subject to most importantly, that we are extremely confident that they'll keep clients.

Diwakar Pingle:

The next question comes from the line of Saurabh Penkar.

Saurabh Penkar:

Thanks for great execution of buyback guys. What is your thoughts about maintaining the capital structure? In the past call, you had mentioned about maintaining a certain cash percentage as a percentage of the revenue. And it seems to be almost at the 50% of the revenue. Is that the level you are anticipating going forward? Or what is the right level according to you for the business? And are there any further restriction from the SEBI about conducting a further buyback? I think the last one was conducted at like 9.9% of the existing capital and reserves. So just wanted to get clarity on that side.

PD Mundhra:

So, maybe I can answer that. And again, I think answering the second question first may be helpful. so SEBI rules require a 12-month interval between successive buybacks. So given that we just finished one, last month, it's another 12 months before we can pursue another buyback. So that's not an immediate option for us. In terms of capital structure, I think in these times, it's useful to have some cash in hand. Because if you link back to the earlier comments around M&A opportunities, having that cash is helpful in allowing us to pursue deals. So I think we have done the buyback for this year. We will continue to look at M&A opportunities. And then depending on where we are next year, we can take a call on how much to distribute to shareholders and how much to retain in the company.

Diwakar Pingle:

The next question comes from the line of Ketul Shah.

Ketul Shah:

Yes, I was happy to see the report. And I have a couple of questions. One question is, what are our hiring targets for the next 1 year or so? I mean which segment at high level, software or software developer or which type of people you're are planning to hire in next 1 year? And next question is in line of, what are our work from home, means, let's say, after the COVID goes, are we going to…I mean, there are a few companies which have given highlights like they are planning to have their 50% of the office working from home. So what are our recommendation? Or what as a company we are planning to do in that case?

Rohitash Gupta:

So, Ketul, probably I can take both the questions. So on the hiring targets, actually, we don't have any, simply because it depends on the business and also depends on the attrition level. So whatever attrition happens for the live project has to be refilled as soon as possible, and that becomes our immediate hiring target for that month or that quarter. As far as campus hiring goes, we do only once in a year for about 100 to 200 guys, which enter typically our first level entry management positions. But as you can imagine, 100 out of 8,000, 8,500 employee base is not a significant chunk of hiring through campuses. Then your second question was about the work-from-home longevity, and I think we have addressed it in Q4 as well. The commentary that you may be hearing from larger companies is predicated on their 80% business coming from IT or software development or maintenance kind of work, whereas what we do squarely falls in live process execution in business process management segment. And specifically within that, the cable and telecom clients and the financial and banking clients that we have, which is roughly about 60% of our company, they will prefer, if things are normal, for their work to be executed in offices. So I don't think we have an option if things were to become normal, to keep working from home in any large numbers. The only flexibility we may have is for our some portion of our shared services or the support services, which don't work on client processes and maybe a very small segment of digital. So I don't think that we can aspire to be a majority work-from-home company in long term, given the current visibility that we have on client preferences.

Diwakar Pingle:

The next question comes from the line of Bhavin Vakil.

Bhavin Vakil:

Yes, I think it is a very good number, which management has come out. My question is basically in terms of M&A, which management talked about, what kind of nature of business or deal size are you looking at going forward?

PD Mundhra:

So maybe I can start and Anjan, you can round off. So, nature of business, I think, as Anjan alluded, they are quite flexible. I think what is very important to us is the client demographics of the business. So who are the clients? What is the nature of the relationship? Is it long term work? How sticky are those relationships? Because ultimately, I think our DNA as a company is built around serving large corporate clients and ideally for work streams that tend to have long tenures. So I think that is one very important consideration for us, when we evaluate potential M&A targets. Then, of course, we have other filters around fit with management, financial metrics and so on and so forth. But in terms of filter criteria, I would say, #1 is client demographics and nature and durability of relationships. What was your other question Bhavin?

Bhavin Vakil:

My other question was considering you have INR 700 crores cash in the company, what kind of size are we typically looking at, any flavor on that?

PD Mundhra:

Yes. So I think, again, while we have some flexibility, I can share what our past experience has been. So obviously if you look at assets that are very small, let's say, sub-$10 million. They don't really move the needle for us and all the process of conducting diligence and closing that deal probably is not worth it in terms of what we end up buying. At the same time, we haven't seen too many assets that I would say are north of $50 million in revenue. So if you ask me what is most likely, I will say it's that range between $10 million and $50 million in revenue, that's where the bulk of the deal flow that we've seen has been. Anjan, I don't know if you want to add something more on the M&A front, both in terms of nature of targets or size?

Anjan Malik:

No, I think you got it, PD.

Diwakar Pingle:

The next question is from Devang Bhatt.

Devang Bhatt:

I just wanted to know what was the revenue impact in the CLX business? What was the normal run rate? And how much will come back in the subsequent quarters? Second, if you could help us with vertical wise contribution, like you said, banking and cable is 60%. Last quarter, you said 10% is from retail and travel. What else is there? And you also mentioned in your opening remarks that you are shifting some facilities from lease to own. So what would be the cost saving from that? What would be the amount from that?

Rohitash Gupta:

Thank you, Devang. I can take the third one, and then I will ask PD to take the first 2 about CLX and the vertical contributions. So my opening comment was about computing assets, which are essentially computers and related stuff which make people work from home. So we have replaced our rental laptops, which we took early on when the lockdown started. And now we have returned them and converted it to a purchased model, wherein we own the laptops that our employees use at their home. So it is not about the leased facilities, but about the computers.

PD Mundhra

Thanks, Rohitash. So on the other 2 questions, on CLX, we saw a reduction in revenue of about 20% to 25% in Q1 from what the normal run rate would have been. Having said that, I think June was reasonably close to what normal levels would be. In Q2, we should see some relatively normal performance on CLX. The other question was about industry breakup. So yes, as Rohitash said, 60% is banking financial services and cable and telecom. The remaining 40% is digital. And within that bucket, I would say, the big industry clusters are around technology, around luxury clients, around retail, and also around travel. So those 3 or 4 would be the large industry clusters within the digital business.

Diwakar Pingle:

We will take the next question from Sandip Agarwal.

Sandip Agarwal:

Thanks for taking my question. Very good execution, I would say, in such difficult situation. I have 2 questions, PD. One, strategically, what is your sales? How do you see this pandemic turning out for our kind of business? Is it going to be a big game changer in medium to long term? And trust me, I am not asking you for any quantitative data or any guidance. I'm just trying to understand, see my view is that this pandemic has been immensely probably favorable to technology industry and the health care. Is that the way you also see our business getting impacted strategically over medium to long term? Number one. Number two, as you said, $10 million to $50 million is our target range for acquisition. I would believe that probably right now is the time to stabilize our current operation a little more. I know you have done a great job in doing that for last few quarters. Will it not be very good to do that for another year or so, so that things are stabilized, and we start generating a lot more cash than we are generating right now? And I know that opportunities don't come until, let's say, it is a very screaming opportunity, which you want to plunge and take in. But broadly, will it not make more sense to not go for that kind of acquisition right now because do we really need to burn so much of cash immediately because these companies that you see will come at a huge cost because the valuations are not at bottom or something like that because there is a euphoria about small companies and others to acquire. So that was one question?

PD Mundhra:

Sandip, I'll take the second question first and maybe Anjan can take the first one later. I think that's a tricky one. In terms of timing and whether or not you want to proceed with an M&A transaction. And ultimately, I think it comes down to a very subjective assessment of risk versus reward. And that you need to make on a case-by-case basis. And I think all I would say is we have been looking at deals in some way, shape or form for the last 7 or 8 years. So from our perspective, we think we have a set of filters as to what is attractive, what's not. And if you find something that's within those filters and at a price that's fair or decent value, it's only then that we would like to proceed. At the same time, I would say that while there is a risk to doing a transaction, there is also a risk to not doing a transaction. Because if you look, for example, at our cable and telecom business, had we not done that acquisition back in 2012, I would argue that some of resilience that the business has demonstrated over the last 2, 3, 4 years would have been very challenged. So it's a very fine line. And unfortunately, you only know what the right decision was in hindsight after 2 or 3 years have passed. But that decision has to be made when you're looking through the windshield and not in the rearview mirror. So ultimately, it comes down to a management call of do you feel that, that risk reward is worth it? And we feel that, on average, our industry has tailwinds. We provide good value to clients. So if we can find good assets, which have sticky revenue streams at what I would call sensible valuations, then we should look strongly at that. And I'll let Anjan talk about the first question in terms of the longer-term effect of the pandemic on our business.

Anjan Malik:

Yes. I think my answer to that will be the same as part one of my answer to the last question, which is I think lesser pandemic, but our response to pandemic will mean that certain industries win, certain lose. And within those industries, certain companies will win, and others will lose. So what happens to companies like us will really be a function of what companies we end up serving as clients. If you look at our history as a business, I think, ultimately, we are a function of what our clients have made on us. So the strategy of staying close to customers, providing very high-value services and making sure we keep investing in our own learning and skills and capabilities is ultimately the only thing we can do. I think to the point that PD is making, our ability to make very large bets or even our desire to make very large bets one way or the other on how we think this pandemic will play out and what things we ought to be investing in, I think is a risky strategy and probably not one which we'd be very successful at. I do think that this pandemic and the shift to more digital has helped companies like ours because it's proven that the cloud is our friend as opposed to our enemy, right? Because a lot of the services that we're able to continue to provide in a work-from-home environment or from an office environment has shown our clients that we can be very flexible in different operating environments. And I think that's broadly very bullish for our industry and for companies like us, subject, of course, to our clients still being around.

Diwakar Pingle:

The next question is from the line of Sanjay Panicker.

Sanjay Panicker:

I just want to step back to the answer that PD had made to the previous question on how revenues are defined. PD mentioned that 40% approximately coming from digital. The question I had was, I know it sounds a little basic, but how do you guys define digital? It's a little confusing to me.

PD Mundhra:

Actually, I think that's a great question, Sanjay, because digital, analytics, I mean these words are things that mean very difficult things for different companies. So for us, I would say digital basically consists of 3 or 4 main service buckets. The first one is around creative production. So the kind of work that CLX does, producing beautiful images and videos that clients can use on their website to sell products. So that's one big stream of services within digital. The second big bucket, I would say, is around digital operations, which is basically helping clients perform all the nuts and bolts, activities of running their e-commerce websites or their representatives. So everything from e-mail marketing campaigns, search engine optimization, managing data and their ERP systems, for product data, pricing data, all of that kind of work. And the third broad area would be around analytics. So both digital analytics in terms of analyzing traffic that's coming on the website as well as other more general marketing analytics. So those would be the 3 main service buckets within the digital business. All of them typically serve the marketing organizations within our client industries. I hope that's helpful.

Diwakar Pingle:

Rohitash as there are no further questions, I will pass it back to you for your closing comments.

Rohitash Gupta:

Thank you everyone for joining us in this video conference and look forward to talking to you in Q2.

Diwakar Pingle:

Thank you. That concludes today’s call and you can now disconnect your lines. Thank you so much for joining the eClerx Services Q1 FY21 earnings call.