“Hexaware Technologies Limited Earnings Q1FY 09 Conference Call”

April 28, 2009

HOSTS: **Management – Hexaware Technologies Limited**

Moderator: Ladies and gentlemen, good morning, good afternoon and good evening. This is Rochelle, the Chorus Call conference operator. Welcome to Hexaware Technologies Limited Earnings Conference Call. As a reminder for the duration of this presentation, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touch-tone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Latika Gidwani from Hexaware Technologies Limited. Thank you and over to you, Ms. Gidwani.

Latika Gidwani: Thanks, Rochelle. Good evening to all of you. I would like to start by apologizing for the delay in starting this call. From Hexaware, we have with us Mr. Atul K. Nishar, Executive Chairman; Mr. P.R. Chandrasekar, Vice-Chairman and CEO; Mr. Prateek Agarwal, CFO; Mr. Ramanan, Head, Global Delivery; and Mr. Deependra Chumble, Chief People Officer. Before we start, let me just go through the disclaimer. Certain statements on this conference call concerning our future growth prospects are forward-looking statements which involve a number of risks and uncertainties that could cause actual results to differ materially from those in such forward-looking statements. The risks and uncertainties relating to these statements include but are not limited to risks and uncertainties regarding fluctuations in earnings, our ability to manage growth, intense competition in IT services including those factors which may affect our cost advantage, wage increases, our ability to attract and retain highly skilled professionals, time and cost overruns on fixed price, fixed time frame contracts, client concentration, restrictions on immigration, our ability to manage our international operations, reduced demand for technology in our key focus areas, disruptions in telecommunication networks, our ability to successfully complete and integrate potential acquisitions, liability for damages on our service contracts, the success of the companies in which Hexaware has made strategic investments, withdrawal of governmental fiscal incentives, political instability, legal restrictions on raising capital or acquiring companies outside India, and unauthorized use of our intellectual property and general economic conditions affecting our industry. I would now like to hand over to Mr. Atul Nishar.

Atul Nishar: Good evening. I am sorry there is a slight disturbance coming from outside the building but I will speak a little louder. Good evening, ladies and gentlemen and welcome to our First Quarter Results discussion. Currently, we are going through difficult times in view of the global environment and the prevailing macro economic conditions, I believe under the circumstances this has been a decent quarter and we have met our quarter one guidance by reporting revenue of $52.6 million. While our operating margin has fallen, our gross margin and PAT margins have improved marginally. I do recognize the fact that the year ahead is going to be tough and we do not yet see any sign of macro economic conditions improving and we could see anywhere from two to three quarters of difficult time continuing. However, my confidence is based on strong client relationships that Hexaware has, a very competent executive management team, talent pool and the competencies that we have invested in from time to time. We continue to make substantial investments in developing our domain expertise as also further building on the competencies that we have. We also are investing a lot on developing IPs to have IP-led service strategy. And as our testimony, we have built several tools and are actively offering these to clients as an integral part of our services and a major differentiator from competition. I would now request our CEO and Vice-Chairman, Sekar to walk you through the quarterly results.

P.R. Chandrasekar: Thank you very much, Atul. Good evening, ladies and gentlemen. Thank you for joining the call for first quarter earnings announcement. As Atul mentioned, the environment continues to remain challenging in all sectors, in all the verticals in which we operate as well as in all of the geographies. And although there are some emerging signs, it is difficult to say as to when the situation will truly improve. Given the circumstances and despite this, when I look at our quarter one 2009 results, there are a number of activities and positives to highlight. For starters, we met our revenue guidance and delivered revenues of $52.6 million. If you look at our gross margins, despite the pressures out there our gross margins actually improved by 70 basis points. And despite the fall in revenue as compared to our quarter four, we have been able to actually improve our profit after tax margins. This improvement in profitability is primarily on the back of a number of cost optimization initiatives as well as improved off shoring that we have been able to achieve in quarter one. Coming to some of the business updates, it is also notable that we have added nine new clients in this quarter across the world. These clients' acquisitions originate from all the three geographies and cover most of our service offerings, again offering testimony to the strength of the breadth of what we have to offer to our customers in the financial services, travel and transportation, as well as manufacturing and healthcare verticals. We expect these clients to ramp up and deliver growth in the forthcoming quarters. Looking at the demand side, while it may be too soon to read too much into this, it is also noteworthy to add that our new RFP responses and other activity indicators in March has improved compared to December, January and February, and we are hopeful this could spell some kind of an end to at least the worst of what we have seen in the last couple of quarters. That said, deal closures are still continuing to take long and the recessionary climate has clearly forced the clients to adopt a circumspect approach and this has resulted in a more tactical budget allocation on a monthly to quarterly level and therefore actual closures of deals remain somewhat uncertain. Given this global scenario, we as a company have continued with a two-pronged approach, one, which is strategic which is laying the foundation for sustainable and profitable growth and continuing to invest in our verticals as well as enhancing our horizontal offerings. In fact, we have actually increased our sales and marketing talent as well as have added key vertical salespeople who can further add a greater dimension to how we approach our customers and position our services. The second is we continue to have to necessarily be far more focused from a tactical standpoint in order to maintain our profits, utilization and other operating metrics. And we will continue to adopt this two-pronged approach at least in the near one or two quarters till the economy and the other circumstances stabilize. Having said that given all of these investments, the changes we have made in our organization, we feel we are positioned well to take advantage of the situation once it improves. I shall now hand it over to Prateek, our CFO, to discuss the financial highlights in quarter one 2009.

Prateek Agarwal: Thank you, Sekar. Hello everybody. I will quickly walk you through the variance analysis on both the revenue and the margins. Starting with the revenue, the revenues in quarter one 2009 were impacted by about $200,000 on account of cross currency movements, primarily the depreciation of GBP and Euro and by another about $600,000 on account of increased offshoring. While offshoring reduced the revenue by $600,000, it actually had a positive impact on the margins as we will see going forward. The reduction on account of business volume accounted for the balance 8.4 million and the reported number as you know is 52.62 million. If we compare on a constant currency basis versus last quarter, the revenue would be 52.8 million. Going on to the margins front, our gross margins improved by 70 basis points. Clearly the driving factor there has been a 105 basis points improvement due to the offshoring impact. Also in the positive at an average level, the SG&A has improved by about 60 basis points. As Sekar mentioned earlier within the SG&A, we have made the investments in the sales and marketing part and drawn out the cost from the G&A part. In terms of forex, we had a net positive impact of about 15 basis points. This is the beneficial impact of USD-INR offset by the impact of cross currency; the net impact is 15 basis points. There are two negatives which hit us this quarter in terms of margins. There is a small 35 basis points impact due to the slight reduction in utilization from 73.8% to 72.2%. However, given the volume drop, maintaining even a 72.2% in this quarter, I think, is still an achievement. The other part which basically is the reason for the margins dropping from 15.7 to 12.3 is the volume drop because the depreciation and the SG&A expenses which are more or less flat in absolute values because of the lower volume in terms of percentages it looks like operating margins are going down. So if you look at SG&A expenses, the expenses actually dropped slightly despite INR depreciation on a quarter-on-quarter basis. However, on account of the drop in business volume, the SG&A ratio has increased. Similarly on depreciation. Going on to the metrics, our billing rates in Q1 have basically remained by and large the same, slight reduction, marginal reduction due to cross currency movement. We do see anecdotal instances of customers requesting for some concessions but we have not really seen any material impact on our billing rates at least in the last two to three quarters. What we have seen is only because of cross currency movement so far. Coming to some of the other financial metrics, we continue to maintain or slightly improve our DSO metrics. From a level of 63 days last quarter, we have actually improved to 62 now and our cash position is at a healthy 332 crores this quarter versus 285 crores last quarter, an increase of 47 crores. That said, I mean quarter two there are a bunch of payments starting with the variable and bonus payments this quarter as well as the dividends. And finally, coming to the Q2 revenue guidance, we have guided the same guidance as what we had given for Q1 which is $51 to $53 million. With that I leave the floor open to questions. Over to you, moderator. Thank you for your attention.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. At this time, if you would like to ask a question, please press "*" followed by "1" on your touch-tone telephone. If your question has been answered before your turn, you may withdraw your question from the queue by pressing "*" followed by "2." Participants are requested to use only handsets while asking a question. Our first question is from the line of Sarita Roy of SKS Securities. Please go ahead.

Sarita Roy: Yes, I want to just clarify on the hedges, etc. As I understand, we have hedged for the next year at a rate of about 40 point something, right?

Prateek Agarwal: That's right. We have hedged for about six quarters out.

Sarita Roy: Okay. Is that a typical practice we followed in the past in terms of hedging so far in the future?

Prateek Agarwal: Actually over the last few quarters, we have reduced the period for which we have hedged and every quarter it is reducing.

Sarita Roy: I am just surprised at the rate at which we have hedged because that was the rate which was prevalent almost more than a year ago and you are saying we have hedged six quarters hence, so that means we have entered into hedges of almost more than two years when we hedged basically, is my understanding correct?

Prateek Agarwal: Yes, that understanding is correct. Back in 2007, I think we had hedged for more than two years and we have been drawing down on that. If you have been following this space, we actually had back in June, we had about $196 million which is now down to about $139.5.

Sarita Roy: So, essentially what we lost is loss of opportunity more than actual losses, is that correct? I mean, these are simple hedges or is there any thing, any derivative type of exposure which can actually multiply our losses more than the receivables?

Prateek Agarwal: These are very simple forward contracts. We are basically selling dollars forward.

Sarita Roy: Right. So a simple way to understand this had rupee remained at 40 to 41 that range, I mean the current performance is reflective of the performance had rupee not moved at all.

Prateek Agarwal: The current performance at a net margin level gives, I mean not for the whole quarter probably, but for some part of the quarter is now at 40 kind of levels. Not the entire quarter, however.

Sarita Roy: I guess I just wanted, when we look at the segment results, for example, we see a huge improvement in the results, before we account for exchange rate differences, let's say the segment result before tax for this quarter is 38.55 versus 20.51 for last year, same quarter which is a huge jump now. That's taking into account the current exchange rate, I suppose, right, the pathway?

Prateek Agarwal: Absolutely right.

Sarita Roy: And then you have other income which is income from your deposits which is sharply up this year. So one is that other income is almost double from last year, how do you explain that?

Prateek Agarwal: This has almost doubled over . . .

Sarita Roy: Which is almost double of last year, the net other income.

Prateek Agarwal: Okay

Sarita Roy: Which is almost 9 crores versus 4.5 crores last year.

Prateek Agarwal: Sure. Sorry for that misunderstanding. That other income is up basically because of the returns that we are getting on our cash surplus. At the beginning of the Q1 last year, cash surplus was not so high and the income that we made on that was also therefore lower. We have some, like I pointed out earlier, we have substantially improved our cash position over the last few quarters.

Sarita Roy: Okay. This is as a result of basically retained earnings or is it any… just pardon my ignorance since I don't have the historical financial with me, this cash position has improved as a result of fund raising or just cash generated from operations?

Prateek Agarwal: It is the effect of two major movements actually. Number one is because of, like you rightly pointed out, because of better profit and also we have consistently brought down our DSO. So as of last year same quarter, our DSO was in the region of 74 days which we have now brought it down to 62. So all that has contributed to the cash surplus.

P.R. Chadrasekar: In effect we have improved our operations. Nothing has fundamentally changed in terms of our capital position or our any other kind of funding position. So I don't know if you have been following the Hexaware results on a quarter-on-quarter basis, but clearly that will demonstrate to you that overall we have clearly improved our operating efficiencies and therefore results. The forex hedges are a legacy of certain moves that were made over two to two and a half years ago, which we are actively trying to minimize.

Sarita Roy: Right. So, I guess coming back to the forex hedges, since you know that is eating away almost half of our PBT this year, this is a likely scenario which is expected to continue for the next few quarters I guess.

Prateek Agarwal: I am not giving a guidance on this number particularly given the volatility that we have seen in the markets in the past few quarters and I may suggest we take this conversation offline. We have been having for sometime and I do want to give the chance to the others.

Moderator: Thank you. Our next question is from the line of Swapnil Gore of Span Capital Services. Please go ahead.

Swapnil Gore: Good evening, gentlemen. I have a question. You acquired Risk Technology, 15% stake in that company. How much did you pay for it?

Atul K. Nishar: It was very negligible, I guess. It is not a number worth disclosing.

Swapnil Gore: Okay. Out of 330 crores cash which is available with you, how much can you keep aside for acquisitions and how much is idle cash?

Atul K. Nishar: If you see our release, Swapnil, we have out of that 332 crores almost 258 crores is in the fixed deposit. So that could reasonably be looked as available for whatever use we want to put into.

Swapnil Gore: Okay and what is the realized hedging loss for this quarter?

Prateek Agarwal: We are not breaking that number down into the various components. The overall number as you can see is Rs. 198 million, almost 20 crores.

Swapnil Gore: Okay. And how many people are there on your virtual bench and how are they paid?

Deependra Chumble: Around 200 people are there currently on virtual bench and this number will keep changing every week.

P.R. Chandrasekar: No. I think it is worth mentioning that virtual bench number is significantly lower that the number that we had announced publicly sometime ago, number one. More importantly, we have actually recalled almost fifth of the people that we had put on the virtual bench. In terms of payments, there is a certain percentage of their current compensation that we are paying.

Deependra Chumble: We are paying 50% of their basic salary.

Moderator: Thank you, Mr. Gore. Our next question is from the line of Neerav Dalal of Capital Markets. Please go ahead.

Neerav Dalal: Sir, could you give me guidance on the operating margin going forward?

Prateek Agarwal: We do not give that guidance, Neerav.

Neerav Dalal: In a sense… okay, you have seen continuous reduction in employee count. Would we see that going forward?

P.R. Chandrasekar: Neerav, this is Sekar. Clearly the employee count for us and I guess for everybody else is a direct reflection on our revenue outlook. Our guidance for the quarter going forward which is quarter 2 is the same as it was in quarter 1 and if you go by that logic we are obviously expecting no material impact in our people head count.

Neerav Dalal: Okay and any outlook on the utilization?

Sekar: Our utilization I think if you notice is around 72.2% and we will like to be in that range somewhere in the 70%-75%.

Moderator: Thank you, Mr. Dalal. Our next question is from the line of Pratish Krishnan of DSP Merrill Lynch. Please go ahead.

Pratish Krishnan: Yes. Hi. Just wanted to clarify one thing. This is on your vertical split. I mean has there been any change in classification?

Prateek Agarwal: No, Pratish. There is no change in the classification.

Pratish Krishnan: Because the number seems to have shifted a lot in terms of the testing revenue is down from 300 point of basis points and the apps is up by around 400 basis points.

Prateek Agarwal: It is basically a reflection of what is happening out there in the market. So, if the testing work has come down, it is showing up here. And on the other hand, you know, if you see the previous quarter, we have been in the range of 13%-16%.

Pratish Krishnan: Fine. Now just to clarify the hedging also, what is the loss that is on your balance sheet today?

Prateek Agarwal: It is about 135 crores, Pratish, in the balance sheet results.

Pratish Krishnan: Okay. So if the rupee was to remain at this level, I mean one should expect this to hit your P&L over the next six to eight quarters. Would that be fair?

Prateek Agarwal: Actually, it would be lower because as you know that mark to market contains what is the forward premium amount as well. So if the spot was to remain where it was at 31st March, our losses would be lower than 135 over six quarters.

Pratish Krishnan: Over six quarters. Finally, in terms of the guidance for next quarter I mean like is it possible to give much more color in terms of what is the kind of pricing assumptions you have taken or the volume growth as you would have assumed?

Prateek Agarwal: We are basically guiding the same guidance and we are not really splitting it out between volume we do not expect any major changes either in volume or in the pricing assumptions.

Pratish Krishnan: Okay and finally in terms of the margin, I mean, initially you mentioned about this variable pay probably for Q2, that should impact your margins in the next quarter?

Prateek Agarwal: No, no. This is basically the payout of the 2008 variable pay. Obviously, we sort of can keep providing for it during every quarter. That was more from a cash perspective that I was talking.

Moderator: Thank you, Mr. Krishnan. Our next question is from the line of Akhil Dhavan of Locus Investment. Please go ahead.

Akhil Dhavan: Just a couple of quick things. One, could you give me your latest debt number? You gave the cash. What is the latest debt?

Prateek Agarwal: The debt number is about 20 crores, $4 million basically.

Akhil Dhavan: 20 crores. Okay. And is there any update on what capex will be for this year?

Prateek Agarwal: The capex number we announced is about $8 to 10 million for the year.

Akhil Dhavan: Okay. So that is why you are seeing the run rate for this year?

Prateek Agarwal: Yeah. That is right. For this quarter, it was about 13 crores and we expect to remain within that band of $8 to 10 million for the year.

Akhil Dhavan: Okay. And then the last thing which is tax rate for this year, sort of normalized, what would it be?

Prateek Agarwal: Our normal effective tax rate works out to something like 15% odd.

Moderator: Thank you, Mr. Dhawan. Our next question is from the line of Neerav Dalal of Capital Markets. Please go ahead.

Neerav Dalal: Sir, just to clear a point. The virtual bench is included in the head count, right?

Prateek Agarwal: That is right. Yes.

Moderator: Thank you. We have no further questions at this time. Mr. Atul Nishar, would you like to add a few closing comments?

Atul Nishar: Yes. I would like to thank of all of you for joining this late hour. Thanks a lot for your continued support to Hexaware.

Moderator: Thank you, Mr. Nishar. Thank you gentlemen of the Hexaware Technologies Limited Management. Ladies and gentlemen, on behalf of Hexaware Technologies Limited, that concludes this evening's conference call. Thank you for joining us in the Chorus Call conferencing facility and you may now disconnect your lines. Thank you.