"Hexaware Technologies Limited Earnings Call"

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MANAGEMENT: **MR. R. SRIKRISHNA – CEO AND EXECUTIVE DIRECTOR, HEXAWARE TECHNOLOGIES LIMITED**
MR. ASHOK HARRIS, PRESIDENT OF GLOBAL DELIVERY, HEXAWARE TECHNOLOGIES LIMITED
MR. VIKASH JAIN – CHIEF FINANCIAL OFFICER, HEXAWARE TECHNOLOGIES LIMITED
MS. LATIKA GIDWANI – HEXAWARE TECHNOLOGIES LIMITED

Moderator: Good day, ladies and gentlemen and a very warm welcome to the Hexaware Technologies Limited Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. I am now glad to hand the conference over to Ms. Latika Gidwani from Hexaware Technologies Limited. Thank you and over to you, ma'am.

Latika Gidwani: Good evening, everyone. Welcome to the Hexaware Conference Call. From Hexaware, we have with us Mr. R. Srikrishna -- CEO and Executive Director; Mr. Ashok Harris -- President, Global Delivery; Mr. Vikash Jain -- CFO.

We shall run you through our presentation which is already available on the Hexaware website. The Safe Harbor statement is there on the Hexaware website, so we shall take that as read.

With this I hand over to you, Keech.

R. Srikrishna: Good Evening, everyone. Thank you for joining the call today. We have provided the guidance for Q4 in effect which is the wide range was between 171 and 179. Someone asked in the last quarter why is there such a wide range, what is it going to depend on, and I said it is predominantly on a single factor "Furlough." So here we are slightly above the midpoint of that. We had furloughs and you will see how much in a minute.

So we closed with revenues of $176 million. Actually, on September currency basis that revenue is closer to $177 million, so it is about 3.4% constant currency growth which actually is quite good for Q4 given the soft quarter on a number of fronts, we feel very good about where we were on revenue in Q4. We also closed the year with $677.7 million in revenue which represents 11.6% growth on a full year basis over last year. It is slightly worse than the 12% which we had guided to midpoint, but it is better than what we had said we will do last quarter.

From EPS perspective we ended the year at growth of 17% over last year. We had actually a sharp currency translation loss in the quarter which was not budgeted, we had budgeted for a hedge loss which did not materialize, but we had not budgeted for a translation loss which was $3.8 million in the quarter. So, as a consequence of that, the EPS was at 19-odd, still 70% growth but actually at a September currency level it is over 20% EPS growth which is what we had told you in the last quarter in the revised guidance.

We had a really solid quarter in terms of wins, one of our best quarters ever. Our total NN wins for the year are at $210 million which means for the quarter it is at $115 million. We also closed our first ever NN$100 million deal. So if you recall earlier in the year we said we did two material EN deals; one of them was about $100 million, so it actually marks the first year for us where we have done both $100 million EN deal and $100 million NN deal. I will talk more about the revenue translation of this when we talk about FY 19 guidance, but suffice to say at this point where it gives us a lot of confidence going into '19.

We continue to add headcount. So, it is again a demonstration of confidence in our growth. We have added for the year 2,500 people; in Q4 we added 155 and of that 2,500 about 660 were freshers, which we think again gives us an important kind of margin tailwind going into FY19. We have not done aggressive fresher hiring during the calendar year '17 and that did not help structural cost in '18, but in calendar year '18 we have been hiring freshers which we think will be an important tailwind for us from margin perspective in the calendar year '19.

We continued our dividend of 2.5. At the beginning we said we will do Rs.8 total, 8.5, so slightly over we will do.

If you look at Q4 from a margin perspective little more deeply, we finished with an EBITDA of 15.9 which is obviously a drop from the 17.5 in Q3, but I do want to call out that a sharp drop between Q4 and Q3 is quite normal and it happens every year, in fact, last year also a drop from Q4 to Q3 was right around 1.5%. We have a margin walk where we will do some more of this, but essentially 60 bps came from increments and 60 bps came from furloughs from a margin perspective. So those two accounted for a vast majority of the margin drops in the quarter, obviously, the furloughs will come back immediately and the salary increments will come back through the year. Because vast majority of our salary increments happen in Q4, so as a quick recollection our offshore salary increments are in three cycles -- August, September and October -- so there was a small impact in Q3 for those that have cycles in August and September and the other third of offshore is beginning October which is Q4. The entire onshore salary increments happen in Q4. So this is the quarter where the vast bulk of our salary increment in fact happens.

Below the line, from an EBITDA to PAT, our ETR actually improved slightly, we will talk a little more on that later when Vikash comes. Some of it is the regulatory changes but some of it is active management, let me give you one example where we picked up actually a new facility that costs substantially lot of money on rent but helps us improve ETR. So it is actually EBITDA-dilutive but accretive at a PAT level for us as an organization. You are seeing some of that impact in the numbers here. That is at EBIT level. In the past of course the numbers are impacted significantly by the FOREX issue that we spoke about earlier.

On revenue, the increase came predominantly out of the growth of 5 million revenue, there was little more than 10.5 million that came as a result of increased volume, which is very robust. We lost a little over 2.5 due to calendar and furlough… most of it is furlough and some calendar loss as well from Q3 and we lost 2.3 due to mix of our offshore revenues at this point are growing faster than onshore revenues which is good for us from a margin perspective long-term.

On gross margin and EBITDA walk, I already told you that our biggest drops came as a result of furlough 60 bps and salary increments 60 bps. There were small reductions due to the fact that lot of the volume increase were early stage deals where there is a cost of transition is at a lower margin than usual. So that is the other portion of the drop, again which will come back as we mature in execution of some of these deals. We had a slight increase in SG&A of 26 bps, that is on account of some new facilities that we have taken in anticipation of growth.

For those of you that can see Slide #8 to the business chart that is hard to talk through without seeing, it shows improved depth of customer relationships, there are three, four things I want to call out here. Our number of million-dollar customers is now close to 100, some 99 million-dollar customers. If you look at the middle of the pyramid, it is what actually gives us the maximum confidence in future is the 5 to 10 bucket, it has gone up from 7 to 18. We think each of these 18 customers represent the solid base to move up. The one immediately above 6 to 4, 6 went down 4 in the 10 to 20 million bucket, one of them went up and one of them came down to the 7 to 18, but again the fact that we think these 7 going up to 18 just represents solid base for us for continued growth given that these are very high quality clients.

In addition to that, what you will see on the couple of charts on the right, you are seeing the slide is that our client concentration of the top is inching down and that has been happening now for some time, it continues to inch down that the top-20 clients are growing slightly slower than our rest of the clients, which we think is very positive for us in the longer term in terms of reducing our concentration risk.

I spoke about the fact that we had simply the best quarter ever in terms of NN wins including the single deal of $100 million, which is our first ever. This is really for transformation of finance, accounting, tax, software platform-based services company. We have also Cloud Native platform development for the European shipping company which would provide information on all ports in the world, variety of information for ships that would like to dock in those, this is the complex Cloud Native project and we have complex DevOps implementation for a large North American commodities exchange company. Those are some examples in this quarter.

Our attrition continues to tick up a little bit. We are not happy with where it is, and we have very active management efforts to bring this down. We spoke a little bit about this last quarter that we are in a situation where supply of talent is constrained. Still then others in the market have also spoken about. I told you our strategy is to preserve market share. We expect that customers will eventually pay for some of the increased cost associated with the talent supply side issues. We continue to believe that it is not going to happen overnight, but we think some customers at least will pay for some skills for sure.

Our growth from our geographic perspective if you look at our annual growth, YoY growth, it is pretty solid across all of our geographies. In this quarter, Europe was the softest but in truth actually they are both from a YoY perspective for this quarter and we are going to show you in a minute the full year numbers. Europe is actually our best performing geography and we actually expect that will continue in 2019 as well.

From what is the perspective for this quarter, again, GTT has been our worst performing, but all other verticals you see three verticals have done very well; BFS has done reasonably well. From a service line perspective, IMS has continued to do well on the back of automation-led transformation of clients and digital assurance has grown as well as BPO during the quarter.

Because it is a full year I am going to take a few additional minutes of commentary to give you a full year view of the same numbers we have given you Q4 view till this point. I am going to move to slide #14 where you see the full year view of geo cart, vertical cart and service line cart. So you see here that Europe and APAC both growing very robustly; North America is growing at 7.2, but we actually expect North America to do much better in '19 and Europe is in mid-20s and APAC is in low-30s, we expect actually Europe to continue or even improve the performance in '19 and North America to substantially improve the performance.

From a vertical perspective, we have couple of things to call out here. Our Travel and Transportation business continues to be spotty, the one where we have the client which insourced, then we have a client where we have the big cloud migration project coming to an end. Net of those we are still growing, but I think you would start seeing QoQ growth in a quarter or two.

The second thing to call out which is the second slowest growth here is our PS vertical; it is at 5.3%, but that 5.3% is actually solid given that this is net of the second client issue we had in '17. So the overhang of that in '18 net of that they grew at 5.3% which is solid. The vertical that did not have client issues are really growing very well; M&C at 26%, HNI is close to 23% and BFS is growing at a solid close to 10%. We actually expect BFS to improve performance in '19, we expect M&C and HNI to sustain performance and PS and GTT improve performance.

On the horizontal slide, you see apart from IMS which has been doing well for a while, you are seeing solid performance from ADM. ADM has been growing on the back of cloud and digital are the two themes in our strategy that is driving ADM growth. So ADM has consistently been the third fastest growing line for our service line and that continues even this quarter. Automation is driving, BPO and IMS which are once again the top two growing service lines for this year, but Analytics has actually done very well as well and you have seen after sometime that, that business line is back to a solid growth and we expect to continue to see that through '19.

With that we are going to come to guidance for '19. We expect organic revenue growth of 12% to 14%. Q1 this year like in '18 and like in the years prior to '18, Q1 has a soft calendar plus there are usually uncertainties in Q1. So we do not expect huge amount of growth in Q1. We do expect growth to be sure, we expect growth in Q1 but it will be lower than the yearly average and Q2 and Q3 will be substantially higher than yearly average. We expect our EBITDA to grow in line with the revenue growth, which means certainly that EBITDA will go up substantially from our Q4 levels. I already showed you the walk there is a salary increase which comes back through the year and there is a furlough which will come back immediately.

Finally on dividend, we expect to continue essentially the same levels of payout in absolute terms, but the big caveat this time we are putting is that this is subject to M&A activity, would be speaking for sometime about M&A activity to be clear what if and when there is an acquisition that will add to the 12% to 14% organic growth, because that has been a question that will come sometime before is your acquisition strategy going to be a substitute for organic growth? It is not. If and when it happens it will materially add to this growth number. So depending on our M&A pipeline and the need for capital, we may choose to adjust the dividend policy, but at this point of time, we expect to continue to do what we have been doing.

With that I am going to turn over to Vikash.

Vikash Jain: Thank you, Keech. Just a recap on the numbers; so Q4 we closed at $176.1 million of revenue, that translates to a sequential growth of 3% in reported currency and 3.4% in constant currency; the year-on-year growth for the quarter was 12.8% and 14.2% in constant currency.

For the year, the revenue for the full year was $677.7 million, we clocked a growth of 11.6% year-on-year. If you look at the chart on the left hand side you would see that we have had a double-digit year-on-year growth every quarter. In rupee terms revenue for the quarter was Rs.12,524 million, which translates to 3.5% sequential and 24.6% year-on-year growth, ended the year with a strong revenue of 46,478 million in rupee terms, that translates to 17.9% of year-on-year growth.

Moving to the next one where we have an update on the hedges, we continue with the layered hedging policy wherein we take the forward cover up to 24-months in advance. We have a higher coverage for the first 12 months and we gradually keeps on reducing it for the future quarters. The chart you are seeing here provides compare of how the hedge trends have actually moved over the last four quarters. This is an information we have been publishing at every quarter and it is just a compare of what we have brought, so that you can see it at one place. What this indicate is that our forward rates are actually improving quarter-after-quarter which is the good news. As of December end, we have a total forward cover outstanding of $183 million, of this $162 million is the US dollar cover at an average rate of 71.83, €5.8 million at a rate of 88.22 and 11.3 million of GBP at a cover of 98.7.

Those of you who have the slide in front of you, I am on slide #19. This chart what you see here has an impact of two items on the FOREX gain or loss -- One is the gain or loss just from hedges and the second piece is the translation of monetary assets what we hold in foreign currency at the period end exchange rate. We have provided a seven-quarter view which is the five- quarter of actuals starting Q4 ‘17 and two forward-looking quarter basis the estimate what we have right now. You can see that Q4 ‘18 has been one off quarter where we have had material FOREX loss in the P&L and 100% of it was actually driven by the period in translation with rupee appreciating in December versus the September close. For the next two quarters we expect to have profits back again driven by forward hedges.

Moving to balance sheet and other update, our cash generation remains very strong and total cash on the balance sheet as of December end is 119.5 million, this is after paying 12.2 million of dividend including taxes during the quarter, quarter on quarter we ended up adding 19 million of cash to the balance sheet, this was one of the strongest cash generation quarter for us. DSO including unbilled at 81-days, marginally down from Q3, it looks like there is an uptick. Some scope for improvement, but we are comfortable with this level of DSO.

On dividend, as you heard, we would be paying Rs.2.5 per share for Q4 which would take the total to Rs.8.5 rupees for the full year of 425 percentage payout.

The bottom right on the chart, we have the Hexaware ETR trend for the last three years and that is one of the thing what Keech was alluding to some of the investments that we are making in the G&A actually gets benefit in form of reducing the ETR. So some of it is basically how we are accelerating the tax planning and that is how it gets reflected. ETR for the year was at 19.7 which was significantly lower than the past two years. ETR for Q4 was 19.9 and we had some one-time credit. So, for all practical purposes our base ETR on a go-forward basis is going to be sub-20.5. On the CAPEX front, we spent $2.5 million in Q4 and $8.8 million from full year perspective.

So that is what I had to share from FY18 results perspective. Looking forward to 2019. That is all from me. Keech, handing it back to you.

R. Srikrishna: So before we do questions, I wanted to actually provide one additional commentary on our guidance as it pertains to that single $100 million deal that I spoke about. It is a long cycle execution. It is in Europe. So there is some complex labor laws to be gone through and re-badging. So essentially that deal will give us revenue some in September and Q4. So our guidance obviously accounts for that. The point I am making is that actually there is going to be solid incremental growth just on this deal even from CY'19 into CY20 as well. So this deal is an important part of why growth is happening, but it is only one quarter of that deal's revenue which we expect to come.

With that we will stop for questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Abhishek Bhandari from Macquarie. Please go ahead.

Abhishek Bhandari: My first question is on your guidance. When you have said that your revenue guidance is 12% to 14%, at the same time, you mentioned that the EBITDA growth will be in line of revenue. Does it mean that the absolute EBITDA growth will mirror the revenue growth? If that is the case then probably you are alluding for some further margin pressure?

R. Srikrishna: Yes and no, we are not alluding to further margin pressure. We do expect that the absolute EBITDA growth will be in line with the revenue growth for the full year, so may be that will help clarify. The full year '18 versus full year '19, we expect to maintain or improve EBITDA percentage while growing revenue at 12% to 14%. Does that clarifies?

Abhishek Bhandari: Keech, that would mean that the EBITDA margin will go down because if the absolute EBITDA grows at let us say midpoint at 13%, the EBITDA margin on 15.8 from 18 has to come into that number. Am I missing something?

Vikash Jain: What we are trying to say is that if revenue growth is going to be 12%, the absolute EBITDA growth is going to be 12%. If revenue growth is going to be 13%, the absolute EBITDA growth for the full year is going to be 13%. In other words, what we are trying to say is FY'18 we closed EBITDA at 16.5% from a full year perspective we expect to maintain 16.5% for the next year.

Abhishek Bhandari: Keech my second question is when you mentioned that you are trying to take care of the utilization by hiring little bit more and that will probably be a tailwind into the margin going forward as well. Is your commentary around these availability of labor being a challenge to meet revenues changing because of this action taking place or do you think that still remains even with the hiring going on?

R. Srikrishna: Actually, there is a kind of two independent things. The fresher hiring that we alluded to was in India, but we have a program of fresher hiring going on in the US also, but that is a much smaller number. The 662 that I spoke about was all in India. The supply side challenge is predominantly in the US. We do have a fresher hiring program there too, that will help mitigated but the scale of that is nothing close to the fresher hiring program in India. The fresher hiring program in India we think will help us improve margins because it takes about 6 to 9 months to kind of make them productive essentially billable if you will from the time they come in. So, you got to pull the trigger well in advance. So we did not do it in '17, so it helps '17 short-term, but it hurt '18 but we have done it in '18, so it will help us in '19.

Abhishek Bhandari: My last question is around your growth. So, if you look at your growth profile on a full year basis, still seems to be lopsided towards a few verticals, and also some of the problem areas that where we are trying to address especially around Enterprise Application, (EA) and all, seem to be still a work-in progress. So do you think you are taking enough action or enough corrective measures to make it a little more well-rounded and especially on the areas where the growth has been quite volatile as far as quarterly or annual number whatever the way want to look at?

R. Srikrishna: First is from a growth, right. We feel very confident that we will be back to delivering industry-leading growth. That is what we are doing before and we have this overhang coming from the client which kind of depressed our growth by 3%-odd in '18, that is behind us. So we feel very good that we will be back to delivering solid growth. 11.5% is not bad, but we think we will do way better than that. The second thing you called out the problem areas. So, we called out actually three problem areas to fix – M&C, PS and ES as horizontal. So ES if you see has degrown 1.3% or 1.5%, so it is still going down, but it is stabilized, there is some volatility quarter-on-quarter but at a full year it stabilized, it was growing down faster before, it slowed down. On the other hand, the other two areas actually gives fix spectacularly. M&C is actually the fastest growing vertical this year and PS at 5.3% growth is actually a kind of belies the factor there is spectacular growth if you normalize for the loss that happened. So actually, PS we feel very good about from growth perspective and M&C is already growing very well… actually the PS the fact that what I am talking about even the full year growth is only 5.3 if you look at two of the metrics, look at that Q1 growth and you look at their YoY growth as of this quarter both are solid numbers; 7%. So PS has been fixed well and truly, M&C is being fixed well and truly, ES, yes, that is still work-in progress, it has improved from where it was but it is not where we wanted to be. So certainly, there is focus and attention happening in the ES space. One of the important things we spoke briefly about it last quarter, we announced partnership with Microsoft, we pick seven or eight services that we will jointly take to market. Still very early days, but three of those are actually in the space. So as that matures we should see a positive tailwind on the ES business.

Moderator: Thank you. The next question is from the line of Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah: Keech, wanted to understand that in CY'18 it looks like three large deals of $100 million plus, two from existing and one from new. Is it a right way? If you are saying that for this quarter out of 116 new NN wins, one deal of 100 million, so the balance is $16 million and the 100 million is likely to ramp up in the fourth quarter or by September, then what will drive the second and the third quarter growth?

R. Srikrishna: So, lots of other deals, right. So I want to correct, you said three 100 million, actually there are two 100 million, another one which is pretty large, but not 100, so the other one though large was not 100. So the other one which is not quite 100 will actually give us revenues from Q1, it still will not go to 100% revenues in Q1, it will keep stepping up through the year, there are waves of transition that are being completed. So that is one driver for growth. The $100 million deal that we signed in the middle of last year from an existing client is already giving revenue and does not give full revenue, so that also there is a ramp up over a period of time and then there is a number of other deals, right. So the last NN $100 million deal will only give us in Q4, but any number of other deals we did including some of the smaller ones that we did this quarter, will give us the growth in Q2, Q3 plus, this is only that pertains to new deals, right. So I think there is a lot of solidity and confidence in growing existing clients. One of the not 100 million but a material EN deal that we spoke about last year, will give us revenue from Q1, keep stepping up through Q2, Q3 is for that deal that we signed, but we already have double, triple that pipeline in their account. It is a very large top 10 global bank. So the headroom for growth there is enormous. That is one example. So there is just lots of strength in our existing customers.

Sandeep Shah: In terms of entering CY'19, we have heard many of the large peers are saying that they are aggressive in terms of tapping the demand for which if they need to invest in terms of margins they will and they will optimize over a longer period of time. So do you see there is a lot of competition from large peers and is there any large client-specific issues for Hexaware in entering CY'2019?

R. Srikrishna: First is we definitely do not have large client-specific issue. That is why my previous answer to Mr. Abhishek I was saying there is just an enormous confidence in doing very well on the growth front, because that is truly behind us, right. So we had YoY issues going even a little bit into Q4 right, certainly all of Q3 we had those YoY issues. So finally you see YoY on constant currency our growth is over 14%. So we have no client specific issues. As to competition from the larger players, frankly I do not think that it is a new thing, most of our accounts we coexist with others in the industry. There is not a single account where there is not at least one, in most cases two of the larger players that we do coexist with. So competing with them and winning business against them is not new. What I said is that they are not going to let higher cost of talent come in the way of, they are not going to let that reduce their market shares, but exact same thing we said last quarter too that there is an increase in cost of talent, we are going to pay more and you are seeing that in terms of the fact that we have 60 bps loss in margin due to increments in the current quarter, we said we also pay higher for talent that we are hiring new, but eventually we think customers will pay for it, and we are going to keep market share…. So, we do not see a threat if that is the question, we do not see a threat at all, we think it is just normal competing with who we do on a daily basis.

Sandeep Shah: On the margin, need a clarity, so CY'18 was 15.8% EBITDA margin versus, you said it is 16.5% and Q4 levels was 15.3%, so for us to have a flattish or improvement in the margin from 15.3% to 15.8%, there has to be QoQ improvement. So do you expect that because on the margin front there has been a miss for us because of the cost issues but do you believe that CY'19 most of those pressures are behind and we can improve from 15.3 to achieve our guidance as a whole? Second, follow up, the sales growth guidance, is it in US dollar terms or is it in INR terms?

R. Srikrishna: The second one is easy right. Definitely not in INR terms, it is in US dollar terms. So, thank you for calling that out, everything we said is in US dollar terms. On the margins, will there be an improvement from Q4 level? Absolutely. So we absolutely expect to see quarter-on-quarter improvement from the current levels. Again, some of it there is a lag we said, there are price increases we expect with some lag, customers will eventually pay for it. So we may see some improvement in Q1, but remember there are other cyclical headwinds in Q1 like the visa cost. Certainly net of the visa cost, we will see an improvement in Q1, but through the year we will certainly see a step-up from the current margin levels and we will see us at least reverting to the current year average.

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

Madhu Babu: This $100 million deal, what is the service line of offering and who were the competitors in this deal and what helped us in winning this deal?

R. Srikrishna: The deal of this size you would imagine there is a lot of people around the world who are interested. Ultimately, I think what helped us win is three or four things. This has become typical in many sales processes. That is not about giving a proposal in writing, it is about showing a lot of things that you will deliver. So number of automation solutions, digitization solutions, we actually built, it has been a year and a half long sales process, in this course we have actually built and showed them number of automation solutions that will work in their environment. The other reason is actually we had solid relationship. We had at least one important decision maker who is our client in the previous organization, so he really loves what we did for them over the years in that client, so there was a lot of trust.

Madhu Babu: So we displaced incumbent who was doing this work and we are getting this deal?

R. Srikrishna: No, it is the first time outsource.

Madhu Babu: Second on the attrition actually has been inching up. Do we think we need to do further wage hikes next year because attrition across the sector has been picking up? Second on the onsite scarcity, could we talk about more, is it like the H1 renewal which is becoming the issue for the high number of requests or evidence coming up in US, what are the subtle factors for this on onsite scarcity?

R. Srikrishna: Will we need further wage hikes? We do not think so. We spent some time analyzing what we need to do, did our wage hikes a little bit later than we would do, but in essence what we did in that period was bump up what we have done otherwise, give a higher salary increase than we have done otherwise. So we think we are good. I think what we are investing in is onsite skill creation programs. It is actually three-pronged effort, right. So there is wage hikes, there is a program to hire and train freshers from colleges in the US, and the third strategy is to do the same in Mexico, so we are hiring and training actually multiple skill levels including freshers in Mexico. Mexico actually has a different visa category that is not under the usual H1 regime, it is on TN visa, it is a frictionless visa, you can get it almost immediately if you meet certain basic criteria. So, it is a three-pronged strategy, we are investing in all of those, it is not just one strategy of wage increase. At this point we do not believe that there will be further wage hikes required but we cannot rule it out. The other point of your question is what is causing it – is it H1? I think it is part of it. In general, I think you know as well as all of us do that the employment rates are very tight and it is just high skill labor shortage period.

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

Gaurav Rateria: Keech, one question on the disconnect between the macro environment and the strong demand which you are seeing in the business. If you could help us reconcile and provide some color on client budgets, your initial conversations, that will be very helpful?

R. Srikrishna: First of all, I do not know what data you are seeing to conclude that there is a macro issue. There is not. Is it going to slow down a little bit? Maybe from macro perspective, but if there is a material slowdown, we have not certainly seen an evidence on that at a macro level. In our clients, we certainly have not seen evidence of that at this point translating into budget discussions. Two clients where we watch very closely because in many ways their budgets if at all are closely tied to macro with some lag are the two secondary mortgage insurance companies. Both of them indicated a moderate increase in budget for the year.

Gaurav Rateria: Just on the guidance front, you talked about very high confidence about your guidance in 2019. What visibility you have like 60% of that is already in the bag in terms of order intake and the remaining 30, 40% needs to be won in the next few quarters, how should one think about visibility and how do you compare that compared to the last year?

R. Srikrishna: Our visibility I would say are order book at the beginning of the year, it is not exact number, but has inched up from low to 60s to high 60s at this point. So beginning of the year, typically very high 60s percentage that if all of our sales people went home, we still do that much revenue and then lot of the rest is really kind of renewing deals, re-upping budgets for clients or new business from existing clients. Our dependence on new deals that we need to win for our revenue projection is close to zero.

Gaurav Rateria: Last question on the margin front, if you could help us reconcile the margin from 2018 to 2019 in terms of the key headwinds which you are building in with respect to cost increases, wage hike and various other levers, that will help you to offset that and still deliver flat to better margin?

R. Srikrishna: The biggest factor is the wage hike. So you saw the one quarter impact and that one quarter impact is going to continue through the year and yet we are clearly seeing that the margins will improve from Q4… of course, calendar itself will improve, furloughs will improve from Q4. And we spoke about one structural cost improvement on offshore which is the freshers. Lot of freshers are hired during the year have been trained, we need to get deployed. So, I think you would see some utilization pick up. Right now the salary cost has already come down, but cost of delivery which is the salary cost driven by utilization has still not come down, but that will come down once the people that have been trained start getting deployed. And then we have some G&A leverage on a continuous basis. So, our G&A cost increase is kind of Q4 is a one-off. You will see that happen after a long time. There was a little quirk of due to some issues we have some chunk of double rent for some facility which gone up. Actually it is not negotiated for that way. Clearly not one facility moving into another. And that is how we are paying the rents; however, the lease there from someone's before they help us furnish the players and according laws forces to account for rent even in the quarters we are getting it free. So there is actually a double counting of rent in this quarter will actually happen and next quarter too even though we are not paying double rent. So that is the reason you are seeing an increase in G&A this quarter, but that is a blip. You will see that double accounting go away after Q1 and you will see the regular G&A leverage coming back to play.

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

Kawaljeet Saluja: In this quarter, your attrition rate has spiked and it is quite unusual for the attrition rate to go up in December quarter. Have you received any deep dive as to what is the cause for the increase in attrition rate whether it is onsite-centric, whether it is offshore and how does that tie-in with your overall commentary of clear shortage of skill sets particularly in US?

R. Srikrishna: The spike in attrition in Q3, Q4 for us is not unusual because it is of a salary cycle. So our salary cycles are August-September-October and people get a new salary and then negotiate basis that with their new employers. So, the cycle is not atypical; however, the extent of increases atypical. Have we done analysis? 100%. Any number of cuts of data not just along the parameters you said, on another 20-odd dimensions we have cuts of data, even gets third-parties to do service, with people who quit more than a month ago, so that they speak more openly. So we have done and we continue to do enormous amount of effort to understand and address the issue better. It is completely tied in with my earlier commentary on labor shortage. Basically anybody wants a job in tech in the US, 30-days you can get a job. And if you are already employed, you can get it at substantially higher salary than what you have at. So, the two are very-very tied.

Kawaljeet Saluja: Keech, in a way have you basically built in some kind of pass-through of this potential cost increase in US through a higher rate in the US when you basically laid out your guidance? Second is that how easy it is to push through rate increases. Is it simple COLA adjustment or does one have to get creative to push through rate increases but ask clients to pay for high cost in US?

R. Srikrishna: So the first question, we have included only increases where we have confirmed agreements with clients, where we have known agreements with clients, for example, we have won the SaaS in Feb, we have included that, for others we have not. Though I said that last quarter and I will say that again that we do expect some clients for some skills will pay more. But we do not extend on the timing. So it is not on the plan. What is in our plan is clients who already confirm. Is it as trade in getting pre-agreed COLA? Never has been, never will be. Even the contracts that have COLA clause, enforcing it has never been straightforward in our business. Clients will always find a reason not to pay and the biggest reason they will find not to pay is FOREX. You got all the FOREX benefit, what about that? So, it is never straightforward.

Kawaljeet Saluja: In that case, what gives you the confidence that is able to push the rate increases through?

R. Srikrishna: The ones that we have in the plan are already we have negotiated and they have agreed contractually and it is signed, done. What gives me confidence is that other clients will pay. I think COLA tends to be like an across the board thing, that the rate card will reset by x-percentage on July 1st, that kind of thing I do not think will happen…could still happen in pockets but not across the board. I think what customers understand is that if they want to get DevOps skills, if they want to get full stack developer skill, if they want to get Cloud Native development skills, they are going to have to pay more and it is not a question of margins, it is not a question of cost, it is simply boils to question of can I get the bid. For them the issue is delay in execution becomes a bigger issue than the cost of execution.

Kawaljeet Saluja: Is the increase in the attrition for the quarter largely because of increase in attrition in US or is just a broad-based increase in attrition?

R. Srikrishna: There is some increase offshore too, but it is sharper in the US.

Moderator: Thank you. The next question is from the line of Hiten Jain from Invesco. Please go ahead.

Hiten Jain: I have two questions; firstly, on the margins, so on an earlier question, when you spoke about the headwinds and tailwinds on margins next year, I was wondering you did not mention any cost related to transition of large deal and especially given that the deal in Europe where you said you need to rebadge employees which will come through in Q3 and Q4, so could you help me understand that?

R. Srikrishna: I think it is a good call. There will be some incremental costs associated with transition. Then we do have some of that on an ongoing basis, every year there are deals where we go through that, there will be some incremental, but we still kind of almost think of that is BAU. I think there will be some quarters where it is worth calling out, like this quarter we did have some if you actually see the EBITDA walk chart, we have called out 20 bps due to volume which means the volume increase came with the lower margin than usual and that was on account of deal margins. Likewise, when we have the $100 million deal coming to revenue in Q4, actually the Q4 margins will be quite low for that deal. We know that already because the first six months is all rebadge revenue and then we get to transform, move some of the work offshore, move some of the work nearshore, automate, all of that will start later. So we will call it out in specific quarters, but still I think for the full year we do not see as a material headwind incrementally to what we already have this year.

Hiten Jain: One thing if you could help me understand, you spoke about in your initial remarks because you have rented a property and that is where you got some tax advantage, so on EBITDA level it was dilutive but on EPS level it was accretive because if I look at your numbers, QoQ the tax rate has gone up from 20% to 21%? And secondly, you also have some properties under construction in Chennai where just what tax advantage you have kept that property. So on one hand you are renting a property and on the other hand you have some property under construction which you have just kept it just to take tax advantage?

R. Srikrishna: The second one, let me address first, the rental properties in Mumbai. It is in different locations. We have a large customer base that is already serviced in Mumbai and we will have to continue to service them and expand them. So, this rental facility I am talking about is in Mumbai and it is not QoQ. Actually, what I said actually it has been active strategy through the year. So it is not Q4 thing. There were two different comments I made about rental -- The tax one has been in play through the year. So through the year there has been some EBITDA dilution on account of that but it has improved ETR and at PAT level it has been accretive. The second comment I said is Q4 specific that we have a double rent and we will also have double rent in Q1, that is an accounting quirk, that will actually go away.

Hiten Jain: But for Q4, you said 24 bps on your presentation. You are saying rental for new facilities. That is QoQ impact, right. Why the tax rate QoQ has not gone down or it is just a matter of time that will play?

R. Srikrishna: No, let me explain again. There are two different issues at play -- One issue at play is we spent money on rent in new facilities. We actually have some own facilities in Mumbai too. What we spent on rent which impacts our EBITDA but improves our ETR. That is not QoQ thing. That has been happening throughout the year. We just called it out when we spoke about the full year performance, it is not QoQ. In addition to that, that rental facility actually we were in a temp facility, we were moving to permanent facility as we talk and expanding. So in that we were supposed to pay rent for the new facility, two rents were not supposed to overlap, the rent for the current new facility was not supposed to overlap and they do not from how we written the contract. But, there is an accounting quirk that allows that needs us to account for those costs even though we have not occupied it and even though we are not paying for. So that is the 24 bps that we have called out and that is QoQ impact.

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

Deepesh Mehta: A couple of questions; first is about last quarter we indicated about delay in transition in I think for a deal which is related with regulatory approval. If you can give us some update how that is playing out? Second question is about to some extent you try to provide some detail on $100 million. But if you can help us understand what is the nature of work, whether it is into new areas or if it is in existing areas, some more detail would be very helpful?

R. Srikrishna: The two deals that I said delayed ramp up have gone live. So, that is behind at this point. One went live earlier in Q4, one went live later in Q4, but they are both live. I think one important color I missed adding which is actually a very important color is the deal is in Nordic. We have been speaking for some time about Nordic as an important new geography for us. This actually represents our second new customer in Nordic this year but this is a big one. If you kind of follow how Nordic works, a lot is based on trust. Your success tends to build on success. You do well with one client, you are going to get other clients. Even this client we won, because one individual came from one other Nordic client which was our first Nordic client. So, I think that is one important mention I will add. It is not a new vertical or a new service line. It is a new geography in some ways. From a service line perspective, I think it is going to take to next level potentially a lot of what we have been talking about and doing in automation and digitization, I think we are going to do a lot of it at scale in this account, so that is very good. It is in the PS vertical, it is not a new vertical but a recently formed vertical.

Deepesh Mehta: Last question is about two large clients of ours where we face supply side. How is the situation – whether now it is under control and we are seeing growth opportunities or it will take some time before growth?

R. Srikrishna: Last question here is what I said. I think we are kind of sticking to that, that it is not going to get solved overnight, it will get partially solved in Q4 which I think it did, even better solved in Q1. So, it is going to take us let us say another one or two quarters for it to be fully solved. To be sure when I say fully solved, I do not think the supply situation in US is going to improve anytime soon. I think solving it has to include sources of labor that are creating new cadre of labor in the US which is hiring freshers, investing and training them which we are doing and it has to involve sources of labor from outside US which is not H1B which also we are doing in the form of labor from Mexico. So that is how we think it will get solved. We do not think the tightness in labor market will change.

Deepesh Mehta: Do you see race of competition gaining some wallets there in those accounts because of this delay in getting things done?

R. Srikrishna: One account not at all, another account very-very small pockets happened in Q3, not expanding in Q4 or further.

Moderator: Thank you. The next question is from the line of Ashwin Mehta from Nomura. Please go ahead.

Ashwin Mehta: Just two clarifications; One on the guidance, what is the INR rate assumption in terms of our guidance? Second, in terms of the two $100 million deal what would be the execution period, you indicated they were long cycle deal?

Vikash Jain: On the guidance what we have taken is Q4 closing, right, which is 69.78.

R. Srikrishna: On the deal executions, the first one was actually little north of $100 million, the existing client one, that we spoke about two quarters ago, that is over five years and that is already in revenue, so that already started in Q3. By the way in response to an earlier question, there was a lot of rebadging on that. So, there was a depressed margin and there is a depressed margin on that. Like I said, that happens every year. So that is why we do not necessarily see a huge material YoY change. The second one is we said long cycle is actually long cycle to start up. So we are going through all the works council stuff in the early part of the year. Once it starts which is September this year, then it is actually a 5.5-year period.

Ashwin Mehta: Just to understand in terms of these deals where you are taking over people and then transforming this deal over a period of time, typically what would be the level of shrinkage that happens in terms of the revenue run rate going forward?

R. Srikrishna: In this deal it is different but in a lot of deals there is not actually huge revenue shrinkage because we actually straight line it for the client or at least partially straight line it. So net-net actually it is really little bit of margin improvement on an ongoing basis for us because we are executing with the higher level of headcount but for a pre-fixed revenue, which is a straight line of the cost saving and then overtime as we execute the automation, we kind of uncover those margins. In this deal though there is little bit of straight lining but a lot of it is actually stepped down as it happens. So clearly during the rebadging phase, we are not kind of at the state revenues. From the beginning, in this case it is enormous because these guys are also all onshore. So it is an abnormal amount of shrinkage because they are all onshore and will move from the work near shore to our Bucharest and Warsaw center and the rest to India. So there is automation at play, but there is also labor arbitrage at play here.

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

Apurva Prasad: Just wanted your views on the pipeline overall. How are you seeing especially in the context of large deal such as this one?

R. Srikrishna: So NN deals above $100 million in the past, for those who have been on these calls regularly, I said that they are moon shots, we keep going after them, we will eventually win one and then we go, we did. I think what will happen is that deals of this size, this is not even public yet, and we cannot even make it public till we finish some of the work and stuff. So, once it becomes public and even more so after we execute it, well, I think we will get invited to a lot more of this deal size parties. That is not in our current pipeline but I am very sure it will happen.

Apurva Prasad: So, would this also be in the Finland geography?

R. Srikrishna: It is Nordic, yes, it is also in Finland, let us put it that way, they are in all the Nordic countries and in other countries.

Apurva Prasad: Also, Keech, how should I look at the onsite/offshore metrics, should offshore can that go up further from here?

R. Srikrishna: That is certainly our goal, I mean, if you look at kind of little bit of a margin attrition, the most important or almost a singular factor behind it is the mix change, right, that our onshore revenues have grown faster. In each of those businesses, onshore and offshore we have actually more or less preserve margins… actually in onshore even improved margins, but our mix has changed. But the good news is actually in the last couple of quarters we are seeing it reversed and I think you will on a long-term trend basis you will expect to see it reverse. There will be kind of spikes like when we do this rebadging, it will spike differently, but outside that on long-term trend basis, we think we can continue to improve offshore from this point.

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

Viju George: Keech, do you worry that very disproportionate part of your growth has been driven by just the IMS piece and that growth is probably not as where it is that you like it to be?

R. Srikrishna: I think let me put it differently, right; we see an opportunity to improve growth in other areas. ADM business is first of all a very large business, right, it is more than a third of our business and that is growing at about 10%, right, so that business is actually doing very well. Our DA business you would see actually coming back to robust growth in FY'19. Both the clients that we have issues with in '17 & '18 where we have a disproportionate portion of that revenue associated is digital assurance business. So actually, it does not worry me there at all, because that growth will come back…the underlying growth is pretty strong in that business, it is on account of the account-specific issues which is now behind us. So you see growth coming back there. BI has actually gone into double-digit growth. BPS actually slowed down this year, you are going to see it accelerate point a bit in 2019, not just the deal I spoke about because that is only Q4 revenues but even of the other two deals one of them is mainly BPO, not all, two-thirds BPO, one-third tech. Really remains as a challenge area for us is ES. I think that is getting a lot of focus from us as to how we fix that and what we can do in terms of portfolio to improve it. I gave you one example of Microsoft. Let me give you another example of what we have done there which is doing very well for us. Pega. We created for the first time partnership with Pega of about five months ago. We are already their fastest growing partner...so for 2018, we were their fastest growing partner. So there are good things happening in the business. What went wrong in '18 is that we thought we had kind of reached the bottom in the PeopleSoft business. That has not been the case. We thought we have reached a point where clients who have not moved out until this point would not move out, and that has not been the case. So the attrition has not just continued, it has accelerated. So we lost revenues in PeopleSoft faster than we thought, even faster than '17. But we have actually more than compensated for that. That is why you are seeing the growth rate is better than the previous year. We have done very well in Workday and we have added a new service line in Pega. But we think that remains important problem for us to solve our ES business.

Moderator: Thank you. The next question is from the line of Nirav Dalal from May Bank. Please go ahead.

Nirav Dalal: A couple of things; One is on the utilization. At the start of the call you said that utilization remains high, you are looking at getting it down and then as a margin lever you are also speaking of utilization improvement. So some clarification on that?

R. Srikrishna: Sorry, I am not sure where you got that from. I did not say that our utilization is high and we need to bring it down. I did say that number of quarters ago during 2017 period that our utilization is a little high. The challenge is that this utilization is needed to service demand effectively. I do not say that today. From this point we clearly have an opportunity to improve it.

Nirav Dalal: In terms of the technical employee addition, this year has been very strong; we have added more than what our revenue growth has been. So, what is the outlook for next year on the employee addition front?

R. Srikrishna: The reason why we have added employees faster than revenue growth this year is on the back of transition work, right, and anticipation of solid revenue growth in '19. So, the employees right now who are doing transition work were not in our revenue or through a part of '18, were not in our revenue, were not even in our cost because we are yet to defer the cost to adjust with revenues beyond a certain size of transition. So, that was the reason why you saw headcount addition faster than revenue growth but it is clearly a sense for faster growth ahead. What do you expect in terms of headcount addition in '19? We expect it to be roughly in line with revenue growth, say maybe slightly lower because we have improved utilization.

Moderator: Thank you. The next question is from the line of Vandana Pareek from Jainem Share Consultants. Please go ahead.

Vandana Pareek: Sir, there is some news relating to your promoter bearing equity, planning to buy NIIT Tech and they are planning to merge it with Hexaware. So, any comment on that?

R. Srikrishna: I have no idea.

Vandana Pareek: As the major of your revenue come from BFS sector, so are you planning to come in another sector like that?

R. Srikrishna: If you see at this point our M&C, actually three are the verticals are growing faster than BFS and BFS is not doing badly which is a good situation, that is exactly the kind of situation we want to be in that eventually then some of the other verticals become bigger in relative size.

Moderator: Thank you. The next question is from the line of Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah: Just one thing, Keech, is it the time to now say what could be the digital services contribution based on the way you look at, at least for the Cloud kind of a work which we do?

R. Srikrishna: So, we are kind of debating at this point what kind of visibility do we bring to give you confidence that we are progressing in our strategy. I think that we will do. I do not know what form and shape which will take. Our three pillars of strategy are those three. Automate everything, cloud is everything, transform customer experience. All those three are digital. Most of the world would think of all of those three as digital. So, we will provide something to you that will allow you to see progress on those strategies by the end of the year is likely.

Sandeep Shah: Just a follow-up. I think it looks like the government shutdown in the US has not impacted your two mortgage accounts. So I think there is no correlation one should build into right?

R. Srikrishna: That is correct. The only linkage to the government is this that government is a shareholder. So the profits they may gets up to the US treasury. Otherwise, they operate like a private company.

Moderator: Thank you. The next question is from the line of Srinivas Rao from Deutsche Bank. Please go ahead.

Srinivas Rao: Just wanted to follow up on the comments which you gave on ES vertical. When you are transitioning from PeopleSoft to Cloud Native applications like Workday, I assume that there is a fall in the level of support in terms of time and material which you require. So, any feedback as to how that dynamics have worked out for you in terms of people required in order to support a set of clients versus what is now required once the Workday is implemented?

R. Srikrishna: If you want a rough number it is 3:1; so 3 revenues will go down to 1 from a support perspective and client moves from PeopleSoft over there. So what does it mean? It does mean we need higher volume and we need other services. So, we are not trying to replace PeopleSoft only with Workday. That arithmetic does not work. So we have to have other service lines. I gave you an example of Pega. Other services lines that have been there, but we are putting more focus on with Microsoft. What is certainly something that we are actually very bullish on. But it is not 1:1, we lose avenues like 3:1 when our client moves. So we need more volumes and we need new services.

Srinivas Rao: In that context, this is not just for your company but sector as a whole which has been fairly bullish on this transition to digital, how do you square that with what is arguably still fairly robust recruitment trends going on, if in future at least the requirement for support or absolute number of people will be less, how do you see the outlook, not just next year, I know you have given a fairly detail commentary on that, but just a bit far out on how the sector can play out?

R. Srikrishna: You got to do more volume, right, so in absolute terms you need the people. I also think the sectoral hiring kind of increase right now is a bit of cyclical thing. We are not there for, but for many people in the industry I think the utilization kind of maxed out a little bit. So we are not hiring not because of other factors or automation I think because we are pushing up utilization and now it has reached a point where we cannot do there anymore, we got higher. I think that cycle we are in. But if you kind of exclude those cycles, still these people for the same let us say for a given client let us say 20,000 employees PeopleSoft to work, you need lesser number of people for sure. But our business model what we are trying to do is get more of those 20,000 employee clients. That is the way we are managing to close to sustain the ES business. We still need many people.

Moderator: Thank you. The last question is from the line of Ashwin Mehta from Nomura. Please go ahead.

Ashwin Mehta: Keech, one question in terms of delivery from the staff in Mexico and TN visas. How does the margin compare versus when you deliver it through your H1B or local staff in the US?

R. Srikrishna: For Mexico we have two-pronged strategy; we have a delivery center in Mexico, we also use that delivery center as the source of talent for US exactly like India we deliver from India, we also have H1B visa staff going there. So I assume your question pertains to staff from Mexico coming into US, right. That is actually the best margin of all sources of labor, it is better than H1.

Ashwin Mehta: One more clarification; we historically used to have a big exposure to the buy side. How big would that be in terms of our BFSI exposure and any areas of concern there given that there has been a drop in AUM and one of the peers they indicate some issues in terms of demand here?

R. Srikrishna: It is still a significant portion. At this point now I am going to say second largest after the secondary mortgage, chunk of business in BFS, capital markets predominantly sell side, but we are little bit more diversified than pure sell side in that. Our sell side also includes we have three of the top five custodians as clients. So slightly different dynamics than a straight asset manager. So, we also have three large custodians. Not to say could not happen if there is continued pressure on the stock market. We have not kind of heard or seen kneejerk budget changes at this point of time, but if there is continued weakness, it could happen.

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. R. Srikrishna for closing comments.

R. Srikrishna: Thank you, all. We went overtime, but I was happy to given the questions. So thank you all for your patience and look forward to talking to you again next quarter.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Hexaware Technologies Limited that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.