EXL Service Holdings, Inc.

presentation delivered at the Ultimate Services Investor Conference on Thursday, November 17, 2022 at 2:15 PM

Puneet Jain: Good afternoon, everyone. My name is Puneet Jain. I'm a payment processing and computer science services analyst at J.P. Morgan. Glad to have here with us Maurizio Nicolelli, EXL Services EVP and CFO, welcome.
We also have Steve and John from the investor relations team here in the room. Welcome all of you. The format of this presentation is going to be fireside chat. I'll start with a few questions, and then I'll open the floor for questions from audience.

Maurizio, you hosted your investors' day yesterday, where you shared your long-term vision as well as financial targets. For the benefit of investors who may not be as close to the story, can you recap a few takeaways from investors' day, like where your focus is as a company, and recap the financial targets?

Maurizio Nicolelli: Sure. Thank you for having me today, Puneet. Welcome everyone. Yesterday, we had investor day in our office here on Park Avenue. The purpose of investor day was really to communicate our data-led approach in our business. We made the pivot to being a data-led company within analytics and digital operations solutions a few years ago, back in 2020.

It's been very successful. That pivot has been very successful for us. When you look back and you look at the growth rate on both parts of our business, and we highlighted that yesterday, it has been a meaningful change. If you look at digital operations, we were growing at a CAGR growth rate between 2016 and 2019 around 6 percent, between 2020 and 2022, it's at 12 percent.

Data analytics was at a CAGR of right around 15 percent during that same time period, 2016 to 2019, and now it's growing at a 28 percent annual CAGR rate. The pivot in our business being data-led is it has really pushed both areas of our business. Yesterday, when we went through the insights within that business, we also updated our financial targets, at least our medium-term targets going forward.

When we look at revenue, and we talked a little bit about revenue for the company yesterday, this year in 2022, we're growing 22 percent organically for the whole business, and that is with analytics growing over 30 percent, and digital operations growing right around 16 percent for the year.

When we look at our medium-term targets, we look at it allocates over a two-year plus period. We have very good visibility into one year, but not two years. Our medium-term target for revenue going forward is between 11 and 13 percent overall for the company. Now, when we had our investor day back in November of 2020, we were forecasting 10 percent plus for our medium-term targets.

What we have done is increased that. Now, when we go into the next two years, we still see a lot of uncertainty in the marketplace. The environment has significantly changed over the last 12 months, where there's also the risk of a potentially recession in the next two years. That hampers our medium-term outlook.

When we look at margins, when we talked about margins back in November of 2020, we spoke of 16 to 17 percent adjusted operating margins for the business. Our midpoint of our guidance for this year puts us at 18.3 percent. We've leveraged the company very well over the last two years. We've increased our margins by 240 basis points since 2020.

Going forward, we still think we can continue to drive margin, but it's incremental margin. Our guidance for the medium term is 18 percent plus, which essentially puts us in the 18 percent bracket. We're going to end the year in the low 18 percent range, but keep in mind, you still have headwinds in margins.

When you think about headwinds in margins, you have to think about wage inflation, which we are seeing within our business. Where we see wage inflation within our business, we see it in analytics, we see in technology, we see it in digital, in cloud. That is a piece of our core structure that is higher than what it has been.

We also have a certain amount of return to office expenses coming up. That also tempers our margin guidance for the next two years. Then EPS growth, we continue to see EPS grow in double digits going forward for our medium-term targets.

Just in summary, when you look at the medium-term targets that we had in November 2020 and where we are today, there's been an obvious increase in each one of those targets, and that's really reflective of the momentum in our business today.

Puneet: It was very clear, this data pivot that you talked about. It was very evident at the analyst day. Obviously, your analytics business is a huge beneficiary of that. Bring to life for us your analytics practice. Give us example of type of work you do for your clients. What does competitive landscape look like in analytics?

Maurizio: Our analytics business with its growth rate of 28 percent organic CAGR over the last two years, went from being 38 percent of our business to 46 percent of our business. It is really becoming almost half our business now. We have over 8,000 data scientist that support that business, and it's become a big meaningful piece of our business now.

One great example of our analytics business is one of the winds that we talked about back in the fall of 2021, where we brought in one of the big three automakers here in the US, they became a new client of ours. What do we do for them? We help them collect the data straight from all the sensors that sit in the cars that you drive that they own. We help them collect that data.

We help them manage that data, house it, some of it is unstructured, some of it is structured data. We help them manage that data, put it into either their cloud or our cloud. Then we help them also run the models and get the insights out of that data for them to use that data. We are running essentially an end-to-end process for that client, and that's significant.

What we're seeing now in our analytics practice, historically we would have more project related work that would be somewhere between 6 to 18 months type work. Now, we're getting into much larger engagements that are end-to-end. There in that situation, we're also becoming an augmentation of their own staff. Essentially, we're becoming an extension of their analytics group.

Knowing that now we're getting into these much larger engagements, who are we competing with? We're competing with many of the large firms now, and also small firms. It's a very wide variety of competitors within analytics. You'll have the big accounting firms that have their own analytics divisions.

You'll have a lot of the competitors that we compete with in operations management that do some analytics work. Also, you'll see competitors like Accenture and a few others that are some of the larger players. Then you'll also have a number of the niche analytics players in that marketplace that we will compete with for certain jobs.

It's a wide variety of competitors that we have within analytics, which is a little bit different than within our digital operations and solutions business, where it's much more siloed to a couple handful of competitors.

Puneet: If I think about the company EXL 5, 10 years ago, it used to be an operations management company that also used to provide analytics. Now, analytics is half of the revenue. This is, I wouldn't say very different, but different business than operations management type of.

People you hired, the services you provide, the engagement models are different from operations management. How do you excel in both services which are somewhat different from each other? How do you provide those services? How do you operate internally?

What had to change or if there was any need for change in your internal process, the way you operate as a company to provide both services and also generate synergies between the two units?

Maurizio: A few years back in 2019 going into 2020, we restructured ourselves to create an analytics specific group. We have four segments within our business. We have insurance, healthcare, and what we call emerging. Those three segments are really focused on our digital operations solutions business. Then we created a fourth segment, which is strictly analytics.

What we're able to do is really focus on analytics in that group. Keep in mind, within our culture, we call it the one EXL culture, culturally, we're all under one umbrella. There's a lot of synergies to a certain extent between the two. If you look at the top 50 clients that we have, 60 percent of those clients do both digital operations to solutions and analytics business with us.

We are cross-selling between the two, so that means the front-end folks that we have are working together in front of the client as one unified company. Now operationally, we'll be separate just because it's a different type of work and also different type of employees that we're hiring between the two.

Overall, it's still under one umbrella, one company culture, and the front end is going to incline as one solution, or at least as one front-end face.

Puneet: Let's talk about current macro environment, obviously, a lot of uncertainty. We talked about it yesterday and mentioned today as well that 11 to 13 percent guidance for next two years, big seen some level of macro uncertainty.

What are the trends you are seeing in your client accounts? Are you seeing any pause, any delays in new project awards? Talk to us, if there is like a macro recession next year, what does that mean for EXL, how defensive your services could prove to be?

Maurizio: We have been talking about a potential slowdown with investors over the last couple of conference calls. We have not really seen much of a change in our selling environment with our clients. We see the macro environment being uncertain. We read the headlines no different than everyone else here. Within our business, we have not seen any significant change.

When we released the third quarter earnings, we increased our guidance for the rest of the year going into the fourth quarter because of a very good third quarter we had, and our forecast for the fourth quarter being just as positive. Right now, the momentum in the business really has not changed based on the macro environment.

We get confidence from that by looking at our pipeline. Our pipeline has grown significantly over the last 18 months, and it's still very robust. When we look at our pipeline, we look at the success we're having in our wins, that tells us that not much has really changed going into December and the beginning of 2023. That's why at investor day, I put up two slides.

The first slide was the increase in our guidance of 22 percent for the year in terms of revenue growth, and then the medium-term guidance, because that risk is still sitting out there. Knowing that risk is still out there, we still believe that we can grow 11 to 13 percent revenue even if the uncertainty turns into a recession and we get affected by it.

What gives us the ability to continue to grow through an uncertain environment? In digital operations, we lead with data, and using that data, we digitize our clients' operations. We'll win a deal to take over an operation for, say, an insurance company. Say, it's 200 people in that operation, we will embed digital to make it more efficient.

Why does the client come to us in this circumstance? They come to us for a few reasons. One is they want to de-lever themselves from having to manage that operation in a environment like when COVID hit. They saw that our operation did not get disrupted, so they're looking for risk management to de-lever themselves.

Two, they struggle to digitize their own operations, and they look to us. We have the domain expertise, and we have the digital capabilities to be able to do that for them as part of our agreement to run the process for them.

Then lastly, its cost. Cost is going to be a big factor in an uncertain environment where they have cost pressures. We can help them manage through that environment going forward. As much as an uncertain environment could be a headwind to us, it could also provide a little bit of a tailwind to us in digital operations.

In analytics, a few things are happening there. One is, the world is so centered now around making decisions around data, running analytics on the data and making decisions off that data, that we are benefiting from that significantly within our business. That is becoming core too many of our clients.

When we get into these larger engagements, that's what they view as an extremely critical item for them to make decisions. In data analytics, we're getting into much larger engagements with our clients, and that is becoming more core to them.

Even when you look at the project work that we do in analytics, we put up a slide yesterday that said today, 81 percent of our revenue is annuity-type based, meaning it's more than one year. 54 percent of our revenue is digital operations solutions, that average contract is four to five years. What you're seeing is an annuity base in our business that is fairly long.

The project-type business that we have that's just slightly less than 20 percent is the entryway with clients to enter into much longer engagements. As much as that is project work that's less than one year, it's actually our entryway if we do a good job, to get into much longer agreements with clients. That's how we really view that project work.

Puneet: You mentioned clients try to de-lever themselves like during the COVID times, and that happened in 2008/2009 when a lot of clients looked to sell their in-house operations. Many vendors did employee re-badging deals and all that.

Maybe talk about the insourcing versus outsourcing in this new macro environment which we're in? Also, if you are seeing any trends of vendor consolidation, which happened back in 2008/2009 as well.

Maurizio: In terms of insourcing/outsourcing, in terms of clients selling their operations, we will take a look at that, but that's not a big area for us to really build our business around. What we want to do is really win the operation and really run it for the client. That's where we've been very successful at going forward.

Puneet: Is there increased demand for outsourcing because of all this macro headwinds that client's facing that instead of doing it themselves, maybe not sell it to the vendor, but outsource it to someone else?

Maurizio: In the areas that we have domain expertise, particularly insurance, healthcare, and a few other segments, we're seeing that increased demand. What we're also seeing is larger deals coming our way. We've been talking about that over the last three to four quarters because that's what's really driving the pipeline.

We're seeing slightly more in total number of deals, but the deals are becoming much larger, particularly in the area where we have domain expertise. I think clients are looking to do more in terms of outsourcing. These larger deals are opportunities for us to really extend our growth of the overall company.

That's what's driving digital operation solutions right now. In the third quarter, we grew 17 percent in digital operations solutions over the prior year. That's significant. It's never been that high at EXL, and that's at the top of the industry right now.

What we're seeing is there are much bigger deals because clients are willing to outsource more. For us, it means we're becoming more strategic to the client. The discussions are going farther up the chain into the CXO level.

Puneet: Given lot of your clients could be going through their annual budgeting processes right now trying to decide next year's spending priorities and taking those decisions.

Given the long sales cycles in operations management, how much of next year's revenue will stem from projects that will start next year, which might be somewhat dependent on macro area, say, if there is a severe recession versus the work that's already been decided, being awarded, or is close to being awarded now?

Maurizio: When you look at our revenue for 2023, when we close out 2022, we will have close to 90 percent visibility into next year. It gets back to what I talked about in terms of annuity. 81 percent of our revenue right now is annuity-based, more than one year. That gives you clear visibility for that 81 percent going into 2023.

Every year, we really start the year with some very good clear visibility going into the following year, and then we have the stub of revenue that we need to go win in the current year to hit our targets for revenue for the rest of the year.

Puneet: Let's switch gears a little bit, talk about margins. You guided for 18 percent plus margin over the next two years. You mentioned wage inflation as one of the headwinds. Are you seeing any ease in supply pressure which would push wages much higher than normal levels?

Maurizio: I think we've seen a good amount of wage inflation over the past 12 months in those areas that I talked about. We'll probably continue to see that going into 2023. Does that continue? I am not sure we really know that just yet. We are planning for it to continue. We're not going to assume that it's going to come down, but we're still seeing that.

For us, analytics is so core to our growth that we're going to ensure that we fund the right level of compensation for our employees within analytics. We're also mitigating that through price. We have set up a standardized rate card within analytics, and we have been driving price off that rate card as we've increased price of few times now off that rate card to mitigate that wage inflation.

As much as there's wage inflation, we're also looking to mitigate that through price. We have not seen much in terms of losses because we have increased price. It tells me that our services are very much valued, and inclines to a certain extent in that area, expect a certain level of price increase.

Puneet: Is it fair to say that analytics gross margins, because you're getting price increase offset wage inflation, can stay at current levels in be in line with operations management over the next two years?

Maurizio: When you look at gross margins, our gross margins between analytics and digital operations, which can be very comparable. When you go down the line below gross margin, what you're going to find is you're going to have far less overhead for analytics. Why is that? 46 percent of our revenue is driven by 8,000 employees, 54 percent of our revenue is driven by 35,000 employees.

You're optimizing and you have a higher margin in analytics, which in the very long run, what that should do is create leverage for margins going forward, meaning you should be able to increase margins over time if a bigger portion of your revenue is in analytics.

Puneet: Talk to us about your delivery model. Before COVID, it was almost 100 percent work from offices. Last year or last couple of years, it's been 80/90 percent from home. Where are you right now in terms of where people are based at? What do you see that model evolve to over long-term?

Maurizio: We've been working on our future operating model for at least 12 months now with clients, in that we want to make sure clients are comfortable with our future operating model. We don't want to develop that without the insights from clients and what they're comfortable with. Some clients want us in the office because of data security concerns.

Some clients have their employees working from home, so they don't mind us working from home as long as we have the right controls in place. We think about it as a third, a third, a third. Our hybrid model will tell you that about a third of our employees are going to work in the office, a third are going to be hybrid, coming in two to three days a week.

The last third is going to be working from home. Currently, we have 68 percent of our employees globally either working from home or working in a hybrid environment. Overall, we're almost there to that future operating model.

Puneet: What does that mean for your margin profiles? You talked about return to offices as one of the headwinds. Not just margins, what does that mean for your hiring and your retention of employees?

Maurizio: Our attrition rate at the end of the third quarter was 34 percent, and it actually came down from 38 percent at the end of June. Why did it come down? It actually spiked higher in June than where we have historically been. We've historically been in the low 30 percent range. It spiked higher because of the issues that us and many of our competitors were having in the Philippines.

Now we have been able to get that situation under control. The government has become much more open to having people working from home or in a hybrid environment in the economic incentive zones. That has become much better. It has alleviated a lot of the attrition that has happened prior to the third quarter. We've come down to right around 34 percent.

Going forward in this new future operating model, we'll probably hover somewhere in the low 30 percent range for attrition. There is a certain amount of high attrition in our digital operations solutions business because we run operations, not just during the day, but also at night. That nightly shift creates a lot of attrition for us also.

Overall, we'll get back down to the low 30 percent range. We are fairly comfortable that is a good working percentage for us going forward. It still is below a lot of our competitors in the space.

Puneet: Are there any questions from the room?

Audience Member: Historically speaking, [inaudible] of your business has had some [inaudible] this time around? I guess the answer is analytics. First of all, am I understanding that correctly? Secondly, what is the lag in the business? These are pretty big projects, they take a long time to negotiate and implement. If you did see a slowdown, would it just take a while because of the lag effect in the business model? Thanks.

Maurizio: What we've seen since COVID is decisions being made faster than what they were historically, which was really interesting. We never thought that that would be the case. You're right, it used to take a long time to get to a decision with a client particularly for a digital operations deal. In COVID, that extenuated, and that time became much shorter.

It's a few things. One is client wanted to make decisions quicker. It was also easier connect with people because everyone was home, it was easier to get someone on a call. That's going to help us going forward. This time around, we have not seen any change. It's the pipeline again, that really drives our mindset on what's happening within our client base.

If that significantly change and we see potential deals that are in our pipeline that all of a sudden get discarded or no are longer in there because the client pulls it, that would tell us that something's happening within the market. That's not the case.

In analytics, we're seeing longer type engagements now as we're getting to much bigger engagements, whereby we're not just running analytics or developing models for our clients, we're actually helping them manage their data in a significant way. That's much more time consuming and a much bigger deal there.

Those two will help us really mitigate through a potential uncertain or potential recessionary environment. That's why we get comfortable with 11 to13 percent, which is far lower, by the way, in where we are today. We still have that momentum where we are today, we're just cautious when we give that medium-term guidance, if that explains it.

Puneet: Any other questions?

Audience Member: Just on the analytics piece, you guys are doing a great job, you're growing faster than your comps and everything. If analytics is the secret sauce these days, why is~~n't~~ nobody else doing it? What's running your competitors?

It's not like you guys have patents, intellectual property. You have people, and you lose a third of your people every year. Why isn't anybody else just hiring these analytics people and doing the same thing?

Maurizio: Well, attrition in analytics is lower than a third. In analytics and digital, it's significantly lower than a third, so that's critical. If you have higher-value services, you can't lose a third of your employees, that would be a problem. We have the capabilities, we've developed the capabilities over time.

We started analytics in 2006 when we bought a company called Inductis in India. We got into analytics probably much earlier than a lot of the competitors you're thinking of. We've built up those capabilities, but on top of that, we have built up the pipes into the graduate schools in India to really fund the supply needs for our growth. That I think is a big deal.

If you look at the 2,000 people that we hired in the third quarter, 500 were in analytics, right out of the graduate schools in India, and they're getting trained right now to supply the business that we win in Q4 and Q1. We're front-running our hiring. We have developed a very good pipe into the colleges to be able to get that supply.

I don't know if all of our competitors have done that, nor did they get into analytics as early as we have to develop that capabilities. Could they do that over time? Yeah, absolutely. We're starting to build also that reputation of being one of the biggest analytics houses globally now.

Puneet: Thanks a lot.

Maurizio: Thank you Puneet. Thank you, everyone.

[applause]

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