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G - Q3 2013 Genpact Ltd Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q3 2013 Genpact Limited earnings conference call. My name is Philip and I will be your operator for today. At this time, all participants are in a listen-only mode, and we will conduct a question-and-answer session today towards the end of this conference. We will expect the call to conclude in an hour. As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the call over to Bharani Bobba, Head of Investor Relations of Genpact. Please proceed, sir.

Bharani Bobba - *Genpact Limited - VP of IR*

Thank you, Philip. Welcome to Genpact's earnings call to discuss our results for the third quarter ended September 30, 2013. We hope you've had a chance to review our earnings release, which you will also find in the IR section of our website, Genpact.com.

With me in New York today are Tiger Tyagarajan, our President and Chief Executive Officer; and Mohit Bhatia, our Chief Financial Officer. Our agenda for today is as follows. Tiger will begin with an overview of our results in the context of our long-term strategy, with perspective on the current environment; followed by Mohit, who will discuss our financial performance in greater detail; and then Tiger will have some closing comments. Finally, Tiger and Mohit will be available to take your questions. We expect the call to last about an hour.

Please note that we have again included slides, which we hope makes our presentation easier to follow. You can find the slides on the webcast version of our call, and you'll be able to download them after the call has concluded.

Some of the matters that we will discuss in today's call are forward-looking. These forward-looking statements involve a number of risks and uncertainties, and other factors that could cause actual results to differ materially from those in such forward-looking statements. Such risks and uncertainties include, but are not limited to, general economic conditions and those factors set forth in our press release, and discussed under the Risk Factors section of our Annual Report on Form 10-K and other SEC filings. Genpact assumes no obligation to update the information presented on this conference call.

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In our call today, we will also refer to certain non-GAAP financial measures, which we believe provide additional information for investors, and better reflect the way management views the operating performance of the business. You can find a reconciliation of those measures to GAAP, as well as related information in our earnings release in the IR section of our website, genpact.com. Please also refer to the Investor Fact Sheet on the front page of the IR section of our website for further details.

With that, let me hand the call over to Tiger.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you, Bharani. Good afternoon, everyone, and thank you for joining us on our earnings call today. In the third quarter, Genpact revenues, adjusted operating income, adjusted operating income margin, and cash flows from operations, all increased year-over-year. Our revenue results for the quarter were less than our expectations for this point in the year, and we are reducing our full-year 2013 revenue guidance to a range of $2.12 to $2.13 billion. At the same time, our operating income margins are better than our expectations, and we are increasing our guidance for adjusted operating income margins to a range of 16.5% to 16.8%.

The top three drivers contributing to the change in our revenue guidance, most of which we have discussed previously, are as follows -

The first of the increase in the value and proportion of large deals in the pipeline. This trend, started towards the end of 2012, continues to accelerate through 2013, and now includes deals in a broad cross-section of vertical markets. These larger, complex, transformational engagements often include multiple components and service offerings, and require many levels of decision-making and approvals on the client side, which materially extends decision cycle times. Although conversion to revenues takes significantly longer than typical deals, transformational engagements are where we want to be, and where the depth of our operational capabilities and benchmarks add the most value to our clients. This has created a short-term impact on our revenues; but, in the long-term, it's positive for our business.

The second driver is the continued reduction in our mortgage originations business, related to softness in refinancing volumes in the US. Historically, most of our mortgage business has been origination processing in support of refinancing. Since midyear, we have seen a significant decline in refinancing volumes, in line with market trends in the US. We are investing in our technology platform to further differentiate our service offerings in new mortgage originations, and we expect to roll out that enhanced capability to clients in 2014.

In addition, we now expect the full-year impact of foreign exchange on revenue to be approximately $13 to $14 million, which is significantly more than anticipated. Although most of our revenues are in dollars, we receive some revenues in other currencies. The depreciation of these currencies against the US dollar, especially the yen and the rupee, is having an adverse impact on revenues.

The highlights of our third-quarter are as follows. Revenues of $535 million increased 9% year-over-year, led by Global Client revenues, which grew 13% in the quarter. Revenue growth was broad-based across industry verticals, led by Insurance, High-tech, Consumer Packaged Goods, and Life Sciences. Growth across our service offerings was led by Banking and Financial Services core operations, Re-engineering, and Finance and Accounting.

GE revenues declined by 3% year-over-year in the third quarter. We now expect total revenues from GE to be flat to slightly down for the year. Our relationship with GE, which is highly penetrated, continues to be strong, as measured by high Net Promoter Scores, and the value we deliver to GE businesses.

Our performance on all other key financial metrics is strong. In the third quarter, Adjusted Operating Income increased 19% year-over-year; Adjusted Operating Income margin was 17.8%; and Cash Flows from Operations increased 62%. Improved Adjusted Operating Income and AOI margin reflected cost and productivity improvement initiatives, as well as lower upfront spends related to delayed decisions in large deals. Our sales and marketing spending increased to approximately 4.7% of revenue in the third quarter, up from 4.3% in the second quarter, as we continue to invest. It is taking us longer than anticipated to hire the right client-facing leaders with the deep domain expertise and the industry verticals and geographies that we serve, and who will integrate well into our Company.

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We continued to expand relationships with existing clients in the third quarter, across a range of our industry verticals. Clients representing $5 to $15 million in annual revenue increased to 52 from 42 in the prior-year third-quarter. Clients in the $15 to 25 million category increased to 13 from 11. And clients more than $25 million in annual revenue increased to 12 from 11. This is evidence of our ability to grow relationships as we partner with clients to undertake transformational journeys, and drive better performance and outcomes for them over many years of engagement.

Looking ahead, the macro environment continues to be mixed, but our pipeline has increased to historically high levels, with a significantly bigger value and proportion of larger transformative deals. Clients continue to focus on improving their business models to adapt to a continuously changing environment, now with increasing interest in longer-term, more transformative engagements, as well as continued demand for immediate cost-reduction opportunities.

The fact that we are engaged broadly in these larger deals is a reflection of the investment we have been making in client-facing leaders over the last few years. So while the longer cycle times have clearly pushed out some revenue, the opportunity these deals present is very exciting for us and for the long-term secular growth in our market.

Our market is large and underpenetrated, and we are addressing this expansive opportunity through our growth strategy. Today, the key elements of this strategy are as follows-

First, as industry thought leaders, we define and design the roadmap and then guide global enterprises to best-in-class through our proprietary Smart Enterprise Processes framework that delivers measurable business impact and insights. Our clients seek innovative solutions that help them transform the way they run their businesses to drive real business impact. One of our key differentiators as a partner is our ability to understand the end-to-end process, and deliver better outcomes and effectiveness, not just in the specific services we manage for the client, but across the client's entire delivery footprint. This strategic view of the process and roadmap, along with measurable outcomes, resonates with clients in today's environment.

The second key element of our growth strategy is to invest in expanding our capabilities in specifically targeted industry verticals and build deep domain expertise in them. Clients want partners who are experts in their industry and a wide range of processes at a granular level. Our strategy is to focus our investments and resources on specific targeted industry verticals that offer long-term growth potential where our capabilities and services are truly differentiating. Our investments include building capabilities internally and through acquisitions that fill gaps, and extend our end-to-end services; developing innovative solutions that combine-and truly integrate-process, technology, and data analytics; and recruiting professionals with deep industry knowledge.

As an example, we have hired a number of very senior client-facing leaders over the last two quarters- all with tremendous pedigrees, similar to the investments we made in client-facing teams in Europe in the past few years, which have paid off well.

The third element of our growth strategy is to allocate capital and resources in support of our strategies, and drive sustainable, profitable growth and shareholder value. We are committed to investing in the right people and capabilities to fully serve the needs of clients in our targeted vertical markets, and we believe the time is right to think more boldly about the next phase of our growth. This requires consistent discipline in cash and capital allocation, balanced with, and measured by, strong returns on cash flows.

The fourth key element of our growth strategy is basic for us -- to execute seamlessly for clients across service lines and geographic markets. This is in our DNA and a hallmark of our differentiated reputation for delivery, operational excellence, and controllership and compliance, whether it is managing core operations, delivering on technology projects, or building analytical insights from data. The entire organization is unified in support of driving client outcomes and best practices, while providing seamless delivery from any of our global delivery centers. Our relentless focus on operational excellence is a critical foundation for transformation.

Looking forward, as we think about the medium and long-term, we have begun a series of important initiatives that we expect to take Genpact to the next level. Specifically, we are actively driving change to our growth strategy, to expand and capture a bigger set of market opportunities. To give you an early sense of this in advance of our next Investor Day, we would point to two significant underpinnings.

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First, we're enhancing our level of focus, targeting specific industrial verticals, service lines and geographies, where our capabilities are truly differentiated, and our ability to generate business impact is the greatest. As part of this, we will be even more focused on how we are allocating our capital and resources. We are excited about the opportunity these changes create for our business, and expect this to result in an even more compelling value proposition for our clients and a much larger share of the market.

Second, we are increasingly working with clients who are seeking transformational change, something that more companies are demanding. We are convinced that we will be able to add differentiated value. As part of this, we have already begun to de-emphasize growth in some emerging markets, where clients are not yet ready to engage in transformation.

These strategic shifts are already underway, but they will take some time to fully implement. We are confident that they will result in increased opportunities for our Company. Given the importance of this, we will be speaking in more detail about this developing evolution in our strategy at our next Investor Day in February.

With that, I'll turn the call over to Mohit.

Mohit Bhatia - *Genpact Limited - CFO*

Thank you, Tiger, and good afternoon, everyone. Today, I will review our third-quarter performance, followed by a summary of key highlights on the balance sheet and statements of cash flow.

On a year-to-date basis, our revenues were $1.574 billion, up 13% compared to the first nine months of 2012. Our adjusted operating income for the first nine months of 2013 was $267 million, up 16.5% compared to the same period last year, representing a margin of 17%, up 60 basis points.

I will now move to the third-quarter results.

We closed the third quarter of 2013 with revenues of $534.9 million, an increase of 8.9% year-over-year. Revenues from Global Clients increased 13% year-over-year. Within Global Clients, Business Process Management revenues increased 10%, within which Smart Decision Services grew 14%. Our Global Client IT Services revenues increased 20%. GE revenues declined 3%, with growth in IT Services more than offset by a decline in Business Process Management.

Our overall Business Process Management revenues increased 7%. Our overall IT services revenues increased 16%, driven by growth in both Global Clients and GE, including the contribution from our February 2013 acquisition of Jawood.

Adjusted income from operations totaled $95 million, an increase of $15.3 million from the prior year. This represents a margin of 17.8%, up from 16.2% in the third quarter of 2012. Our margins for the quarter were higher than last year and expectations, due to continued efficiencies, slower ramps in front-end and domain-expert hiring, and delays in large deals that typically require upfront spends.

Our gross profit for the quarter totaled $206 million, representing a gross margin of 38.4% compared to 39.5% last year. This margin decline was less than expected, due to improved operating efficiencies that partly offset the impact of wage inflation.

SG&A expenses totaled $117 million, representing 21.9% of revenue, an improvement of 220 basis points from 24.1%, or $119 million, in the third quarter of last year. The improvement was driven by continued better utilization of resources and technology.

With continued and increasing investments in sales, marketing, brand building, and domain expertise, we expect our margins to be sequentially lower in the fourth quarter. Given higher-than-expected year-to-date margins of 17%, as previously noted, we now expect full-year 2013 Adjusted Income from Operations margin to be higher than our earlier guidance.

Net income was $70.3 million, or $0.30 per diluted share, in the third quarter of 2013, up from $25.2 million, or $0.11 per diluted share in the third quarter of 2012.

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The year-over-year increase of $0.19 in earnings per share was driven by the following --

- Contribution from higher operating income of $0.05;

- Foreign exchange re-measurement gains recorded below the income-from-operations line of $11 million this quarter, versus a loss of $13 million in the same quarter last year, contributing $0.08;

- The recapitalization-related costs incurred in the third quarter of last year of $0.04;

- and, a lower effective tax rate contributing $0.02.

Our adjusted EPS for the third quarter of 2013 was $0.33 per share, up from $0.18 per share in the third quarter of 2012.

Our tax expense for the third quarter was $21.9 million, compared to $15.2 million in the third quarter of 2012, representing an effective tax rate of 23.8%, down from 37.7% in 2012.

This improvement was primarily driven by the growth of our operations in low-tax and tax-exempt locations, primarily in India, and the impact of certain period items in the third quarter of 2012 relating to the 2012 recapitalization, including withholding taxes of $2.3 million and other expenses that were largely not tax-deductible.

We now expect our 2013 effective tax rate to be in the range of 24% to 26%, an improvement over the 25% to 27% range that we mentioned in the last quarter call. We expect continued growth in tax-exempt and low-tax jurisdictions.

I will now turn to our balance sheet. Our cash and liquid assets totaled approximately $499 million, compared to $536 million at the end of the second quarter of 2013. This was after repayment of $115 million of our short-term debt and utilizing $11 million for capital expenditures. With undrawn debt capacity of $246 million and existing cash as stated previously, we continue to have the necessary resources to pursue growth opportunities. Our net debt to EBITDA for the last four rolling quarters was approximately 0.4X.

Our days sales outstanding stood at 80 days, unchanged from the second quarter, and an improvement of four days from the third quarter last year.

Turning to operating cash flows, we generated $126 million of cash from operations in the third quarter of 2013, up 62% from $77 million in the same quarter last year. This improvement in cash flows was due to higher operating income and lower investment in working capital, driven by improved DSOs.

As discussed in our previous calls, our second-quarter 2012 cash flows included a receipt of an upfront client payment of approximately $45 million. On a year-to-date basis, and after normalizing for the timing of this payment, our cash flows have grown 42%.

We now expect our full-year cash flow from operations to decline less than 5% versus last year. This is an improvement over the 5% to 10% decline indicated in our previous call.

Capital expenditures as a percentage of revenue were approximately 1.9% in the first nine months of 2013. Capital expenditures are at lower levels due to better utilization of existing infrastructure and technology, apart from lower than planned growth.

We now expect capital expenditure as a percentage of revenue to be in the range of 2% to 2.3% for the full year, compared to 3% to 3.5% mentioned in the last quarter call.

With that, I hand it back to Tiger for his closing comments.

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Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you, Mohit.

In closing, Genpact helps clients navigate economic and secular change. Our clients continue to face uncertainty that is forcing them to demand better returns on investment, develop more competitive insights, and re-think their business models, while they drive growth.

In order to best serve them, we continue to focus on four things -

First, we are excited about what we believe is a very long runway for growth, and our position of strength in our core markets.

Second, we are strategically investing to provide clients in our targeted industry verticals with the differentiated and integrated capabilities, insights and services that will enable them to transform and run their business processes and operations better.

Third, we are actively driving change in our growth strategy, with increasing focus on those opportunities, especially larger transformational engagements and vertical markets, where the growth potential and our competitive advantages are clear.

And finally, our relentless focus on operational excellence drives measurable business outcomes and high client satisfaction levels, while it serves as an essential foundation for transformation.

In short, our goal is to provide world-class service to our clients, and to drive sustainable profitable growth and value for our shareholders.

I will now hand the call back to Bharani.

Bharani Bobba - *Genpact Limited - VP of IR*

Thanks, Tiger. We'd like to open it up for Q&A at this time. Operator, can you please give the instructions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Tien-Tsing Huang, JPMorgan.

Tien-Tsing Huang - *JPMorgan - Analyst*

Yes, a couple bigger picture questions, I suppose. Just thinking about what we've heard throughout the turning season, it feels like the larger diversified IT players are faring a little bit better than the pure play BPM players. Is this a real trend to watch, Tiger? Is it coincidental? Just would love your feedback on maybe what's happening there between the diversified guys and the pure plays.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, Tien-Tsing, the way I probably would answer that question is less about what others are doing and more about the way we see our performance in the quarter, as well as for the year, and the way we see the market in that context. Clearly, the large transformational engagements are ones where clients are talking about a very long-term journey. And we are actually getting invited more and more to them. And we feel very good about that.

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It does involve multiple service lines. It is often -- most often global. And unfortunately, because of the nature of those transactions, tends to take much longer in decision-making and goes much higher in decision-making. Do those types of transactions allow the larger diversified players that you're talking about to be actually the key competitive set that we see? The answer is yes.

So, we've always competed with them. We see them as often as we've seen -- there are many more of such transformational engagements, is probably the way I would characterize our current market.

Tien-Tsing Huang - *JPMorgan - Analyst*

Okay. No, that's helpful. I guess another way thinking about the same theme, just if discretionary spending is improving on the IT services side, are you seeing some of that maybe stealing opportunities for a pipeline conversion on the BPM front? Or is it simply what you said, just large deals obviously taking longer because of the more players involved in the scope? (multiple speakers)

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Tien-Tsing, historically, we haven't seen a direct correlation in the same time period between discretionary spends that often impact technology spends and the BPM business. We have seen some correlation to reengineering assignments, but probably another correlation to analytical kind of assignments that are discretionary. We often haven't seen a connection to BPM. We don't see it today. This is more about long-term change and less about discretionary spend in the case of our business.

Tien-Tsing Huang - *JPMorgan - Analyst*

Okay, understood. Fingers crossed that you'll close some of the larger deals. Last one, just -- I guess just looking at the stats, the $5 million to $15 million accounts and the $15 million to $25 bucket, looks like that was down sequentially a little bit. Did you lose some clients? Or was it just less spend from existing kind of -- I don't understand what happened there.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Yes, so Tien-Tsing, the quarter-by-quarter change is often rolling four quarters, and it's a function of often if the client in that bucket, a couple of clients in that bucket, have either technology or analytical weight in them, then as you roll the quarters forward, you might have more spend in one quarter and less in another quarter. We haven't lost a client that created that change in those numbers from one quarter to another -- specifically, quarter two of this year to quarter three of this year.

Tien-Tsing Huang - *JPMorgan - Analyst*

Understood, thank you.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you.

Operator

Rahul Bhangare, William Blair.

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Rahul Bhangare - *William Blair & Company - Analyst*

Tiger, you've previously mentioned a handful of large deals that you guys have won over the last 12 months or so. I was just wondering, how are those deals ramping? And the weakness this quarter, is it more due to some of those larger deals that have already been won, ramping slower than expected? Or is it really just the closing of some of those large deals that you're trying to win?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Actually, it's the latter, Rahul, are -- the deals that we have won are ramping as per plan. It's the decision-making on a very large set of large deals that we have in our pipeline that cuts across industry verticals, be it capital markets, consumer products, life sciences, banking -- and that decision-making taking longer that then gets converted to contract, that then allows us to ramp up. It's that cycle time that is extending.

Just to give you one example -- and this is just to add some color, because obviously, it's something I talked about in the script -- if you take an example of a client who should have closed a very interesting complex transaction with us in our sweet spot, some time for us to start execution in November has pushed it out to January. It's a sole-source discussion. It's an industry-leading discussion. We are extremely excited about the conversation and what it means for us, but unfortunately, that got pushed out into next year. And those are the kind of things that actually are pretty typical of large complex transactions that often, in these cases, go even up to Board levels in those client organizations.

Rahul Bhangare - *William Blair & Company - Analyst*

Okay, that's helpful. And then I guess, over the last couple of years, you've made several investments in the front-end, and I think we were expecting some of those investments to kind of ramp down over the next several quarters. But I think your commentary suggests that those investments are still ongoing. Can you just talk about the ramp of some of the investments that you've made over the last couple of years, and I guess your expectations going forward?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So the one that I would pick out, Rahul, is the client-facing teams and the domain expert teams that face clients, and actually engage in some of these transformative conversations that I talked about. We started that journey about two years back, as you rightly pointed out. At the time when we started the journey, we were sub-4% of those types of expenses as a percentage of revenue. And as we ramped our revenue up, we've also ramped that up now to 4.7% as we speak, in quarter three.

We had laid out a plan that said that should go to the 6% mark. We therefore continue to walk down the path of that ramp. We expect, in fact, quarter-four to be close to the 5.5% mark, just as for the quarter. So we will continue to drive those investments. It is actually slower than what we would like it to be, but we are very careful about bringing the right people in with the right expertise who integrate well, and are able to talk through the complex solutions.

The last point I would make is, some of the addition to the pipeline that we've seen over the last 12 months in the large deal transformative category are driven by a number of these big leaders who are leading those conversations with the clients in our key industry verticals.

Rahul Bhangare - *William Blair & Company - Analyst*

Okay, thank you.

Operator

Bryan Keane, Deutsche Bank.

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Bryan Keane - *Deutsche Bank - Analyst*

Just trying to make sure I understand the lower revenue. I guess it sounds like a lot of the same things that you mentioned last quarter are kind of the case this quarter, and especially something like large deals. That wouldn't have affected this quarter's numbers. So I'm just trying to get a handle on the surprise. Usually BPO companies don't have that big of a surprise on a given quarter. So I'm just trying to make sure I understand what caused the sudden shock into the system that caused the shortfall in the revenue?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Yes. So, Bryan, I would say two things were clearly a surprise, and then I'll talk about large deals. Clearly, mortgage and the extent to which the refinancing volumes in the US mortgage market that we -- our mortgage business has been focused on, dropped, was more than what we had anticipated. We anticipated some, which was the reason why we -- it impacted our full-year view in -- at the end of quarter-two, but I think beyond that, it went -- it was unexpected.

And the second is, the impact of continued -- what I would call other currencies that translate back into revenue and dollars. Those two were unexpected and unplanned beyond what we had planned when we were talking at the end of quarter-two. The deal delays and large deal delays, while we are anticipated, we actually expected to close a couple of them that we had clear line of sight to, in order to generate revenue in quarter-three, but more importantly in quarter-four. Those have got pushed out. And that -- and the combination of those three, what I would say has caused a change, from our view of the year at the end of quarter-two to our view of the year now.

Bryan Keane - *Deutsche Bank - Analyst*

Okay. No, that helps. And how much revenue now comes from mortgage processing or mortgage-related businesses, just so we can get a sense of how much further weakness could we get surprised by?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, it's about 2% of our revenue. And I would say while a further deterioration is probably not to be expected, the reality, Bryan, is that as we go into next year, we have pretty stiff comparisons, at least for the first few quarters. Because all of the change in the mortgage refinance business started happening somewhere towards the latter part of the second quarter of this year.

Bryan Keane - *Deutsche Bank - Analyst*

And then on FX side, isn't some of that hedged? I'm just surprised at the magnitude -- I think it was $13 to $14 million. Now it's become a headwind.

Mohit Bhatia - *Genpact Limited - CFO*

Yes, Bryan, this is Mohit. We typically hedge to protect our margins, and we hedged to full in the mid to long-term, which is why the impact of volatility of various currencies has not had any material impact on our adjusted operating income margin.

Having said that, on the revenue side, we have a bunch of revenue that is billed in non-US dollar currencies. And the volatility in those currencies does impact our revenue because we're a US dollar-reporting company, and we have to convert those billings in Japanese yen and Indian rupees back into dollars. And that volatility does impact our top line.

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Finally, on the FX front, while I said that volatility has not had an impact on our adjusted operating income margins, it did impact us positively on the re-measurement gains that we made below the income from operations line, where we made a $11 million gain this year compared with a $13 million loss last year, which will show up in positive EPS.

Bryan Keane - *Deutsche Bank - Analyst*

Okay. And then just last question for me. It looks like total headcount growth is still up a little over 2% year-over-year. I guess that's lower than historical standards, and even revenue per employee declined sequentially. So just how do we think about those metrics going forward? Should we see a pickup in both of those?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, I would say that, first of all, we don't really target headcount growth, Bryan. We really like the fact that our revenues grow, and has been growing much faster than headcount. It's a reflection of three or four things.

One, as we continue to do more transformative engagements, that happens. As we continue to do more reengineering and analytical type services, and higher value-added finance and accounting or procurement, or back office and financial services, or capital markets, that happens. As we continue to have delivery that has an onshore/nearshore component -- and typically, that happens again in more complex regulated kind of services -- along with a global offshore delivery in a Manila or a Guatemala or an India, that happens -- all of which we like, because it makes the end-to-end services that we provide much more valuable for our clients. So we like the fact that having revenue grows faster than headcount, and we would like it to continue into the future.

Bryan Keane - *Deutsche Bank - Analyst*

Okay, and then just sequentially, the revenue per employee being down?

Mohit Bhatia - *Genpact Limited - CFO*

Sequentially, there is no material change on revenue per headcount, if that was your question.

Bryan Keane - *Deutsche Bank - Analyst*

Or I'm thinking of revenue per employee. I think (multiple speakers) --

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Tiger Tyagarajan - *Genpact Limited - President and CEO*

(multiple speakers) We'll get back on that, Bryan. And then, again, I'd just like to point out that quarter-by-quarter, we don't actually measure the business on revenue per headcount each quarter, because there are ramps going on that are transition ramps that happen, that are technology projects that wind down and start again. So, I wouldn't watch that number quarter by quarter. We look at it on a year-by-year basis. Most of our metrics really start making meaningful sense only on a year-by-year basis.

Bryan Keane - *Deutsche Bank - Analyst*

Okay. No, that makes sense. Thanks so much.

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Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you.

Operator

Edward Caso, Wells Fargo Securities.

Edward Caso - *Wells Fargo Securities - Analyst*

I was curious if the delay in these large contracts are sort of a function of your efforts to get into sort of a more complex market, so sort of a Genpact phenomena? Or if it's more of a sort of a market phenomena pause in Europe, say immigration concerns in the US? Because often a lot of these large deals imply the transfer of people from the US or Europe overseas. I mean, could you sort of talk about sort of your refocusing versus sort of the market, as far as the delays are concerned? Thanks.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Ed, thank you. That's a great question actually. I would start by saying that there is clearly a more transformative -- I want to run my business differently as I think about the future in a number of industries that we've been seeing for some time and continues to gather momentum -- in the US, for sure, but also in Europe. And this applies to Continental Europe as well.

The second -- those tend to be global. It includes people who are already part of client-shared services. It includes people who are fragmented across multiple countries. It includes multiple divisions. It includes multiple service lines. And often it includes process technology and analytics coming together, in many cases, as solutions.

So, there is a clear market trend and demand that says in the new normal -- to use an often-used term -- we'd like to undertake this journey. The good thing about that -- and this relates to Genpact -- is we are getting invited more and more into those conversations. And I think that's a reflection of the maturity of our journey, things like Smart Enterprise Process that we worked on for so many years, as well as the client-facing people with the right caliber, and the right experience and domain expertise, who are now able to have those conversations at the right level.

We think we need to continue to drive those investments, to add more such people, as we continue to drive even more focus in the chosen verticals, where such transformation in the chosen geographies where those transformations are happening. So, I would say it's a reflection of both -- the market as well as our being prepared and participating in those opportunities. The last reaction I would have is, we don't see this as having any connection to any of the immigration conversations, whether it's in Continental Europe or in the US.

Edward Caso - *Wells Fargo Securities - Analyst*

Okay. Some of the outsourcing advisors sort of emphasize that the clients are now getting pretty sophisticated, the Global 1000. And that because of that sophistication, they can sort of -- it's not just sort of a do it the old way or go offshore. But they're also working more shared services, call them captives, into the equation. Are you seeing any sort of diminished BPM opportunity because of the clients sort of deciding to sort of do what you do but do it inside the firewall?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

No, Ed. Actually, first of all, your statement there is accurate. Clients are looking at a more expansive set of opportunities as they think about shared services. In fact, often these days the term used is not shared services, it is global business services. Because they're thinking about captives. They're thinking about working with partners such as us. They're thinking about hybrids, which is a combination of the two. They're thinking about a range

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of services that cuts into the kinds of things that they would never hand over to a third-party, and yet, they want help in centralizing -- creating shared services for those types of things, and bringing in our type of thinking and DNA.

And all of that put together makes it a very complex conversation, complex transaction, long-term roadmap and a long-term journey, but with a real value that gets created as you undertake that journey. What it means is a much more expansive set of opportunities. What it means is, larger deals, obviously, more complex. But will also have meant for us, which is kind of what I alluded to as I started talking about our rethink and beginning to start driving some initiatives, is reallocation of resources, focusing on some industry verticals where we think some of these changes are happening, some of the service lines where we think it's happening, and some of the geographies where it's happening. So, you hit the nail on the head in that question.

Edward Caso - *Wells Fargo Securities - Analyst*

Great. Final question. Obviously, you've got a fair amount of cash here. Can you update us on your acquisition sort of where you're focused, what your intent is and whether we might see anything in the near-term?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, Ed, clearly, we continue to focus on adding capabilities to our focused industry verticals, focused service lines and focused geographies. If we think that those capabilities are best brought into the Company through an acquisition, and if the target provides the right kind of opportunity to do that, we've always said that well-run, operationally-great client satisfaction, financially accretive, culturally possible to integrate, are the kind of acquisitions that we like. We have a number of them that we continue to look at.

I think the one difference that I would point out, if I were to look at this now, versus a couple of years back, is that it's much more focused, it's much more targeted in the industry verticals that we want to focus on, and the service lines that we want to focus on, and the geographies that we want to focus on. Our cash does provide us that ammunition to look at those opportunities. You know, clearly, obviously, we'll talk about them when we see us close one of them, but we continue to look at those.

Edward Caso - *Wells Fargo Securities - Analyst*

Great. Thank you.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you, Ed.

Operator

Ashwin Shirvaikar, Citibank.

Ashwin Shirvaikar - *Citibank - Analyst*

I guess my first question is, today, obviously, you're facing an issue because your decisions are being delayed. But these are complex deals. And when you win a few of these -- hopefully, in the next three or six months -- will the ramps be equally complex? Are you prepared in terms of your -- in terms of the people that you have, to deal with those more complex ramps? Do you need to make any investments? Could you talk a little bit about the operational aspect of what happens when these wins actually come through? When is the revenue impact? Is it going to be equally delayed?

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Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, Ashwin, actually great question and I would answer that in two different answers, because you're actually asking two different questions. One is, clearly, these complex deals as they get decided will also require complex execution, both in terms of geographic spread, in terms of capabilities, in terms of bringing a number of our service lines together, et cetera.

We are extremely well-prepared for execution. We consider ourselves to be really good at execution. Our history has demonstrated that. So we feel very confident about execution. We have actually executed on a number of these similar ones in our history. So, we feel very confident on our execution capabilities, as these get to that execution mode. So that's one part of the answer.

We continue to obviously invest in those execution capabilities, whether it is building the delivery teams, the domain experts, the solution experts, and so on. As I think about timing, that's where these complex deals, while decision-making is one part of timing, ramp also had an element of timing attached to it, because complex deals take longer to ramp; take longer from the client's perspective to bring it all together, so I would say we are well-prepared, we continue to invest. Our delivery teams provide a strong foundational base to continue to build leaders who can execute on these. If I look at the capital markets space, the acquisition that we did with Headstrong two-and-a-half years back, provides strong capabilities in the capital markets domain, as an example, in some of these areas in the capital markets space. It's more the ramp time around these complex transactions beyond decision that one has to think about and take into account as we go into next year.

Ashwin Shirvaikar - *Citibank - Analyst*

Okay. And to what extent is this year's better-than-expected margin and cash flow performance directly related to this year's worse-than-expected signings and revenues and ramps? So, in other words, will it -- will the margin and cash flow performance reverse next year?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, I'll talk about margin first, and then I'm going to ask Mohit to comment on cash flow. So, in terms of margins, clearly, there is an impact on margin positively when ramps don't happen and when ramps get delayed. I mean, large deal decisions do get delayed. So to that extent, as those get done, any time they get done, they will be money spent for ramps, which is great. More importantly, I think margins also got impacted, which is temporary, positively at the moment, because we have taken time to ramp up on our investments. And we will continue to do those ramps.

As I said, our visibility into Q4, for example, on the client-facing teams and the spends on client-facing teams, is 5.5% odd of revenue, which is up from 4.7%. That's a significant continued ramp. So, I would say some of it is explained through the large deal spends that happen upfront, which will happen as we continue to win those deals. Some of them is just delay in our investments that we will continue to do. And therefore, those will go back. And some of it we will continue to drive, which is efficiency and productivity -- which, again, is part of our DNA.

So I would say coming back to the kind of margins that we have talked about is what we would absolutely expect. Anything more than that would not be expected.

Ashwin Shirvaikar - *Citibank - Analyst*

Okay. And a couple of wrap-up questions. One is (multiple speakers) --

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Ashwin -- sorry, Ashwin, on cash flow, I just want make Mohit complete the answer and then back to you.

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Ashwin Shirvaikar - *Citibank - Analyst*

Sure.

Mohit Bhatia - *Genpact Limited - CFO*

Sure. So we are obviously very happy with the performance of our cash flows. And the key reasons that I had mentioned earlier were higher operating income, better performance on DSO, and managing our working capital. We've also got some benefit from lower cash taxes and some of the foreign exchange gains that I spoke about earlier. You know, on a go-forward basis, while I continue to feel good about cash flows, obviously, to a certain extent, it's going to depend on cash taxes, on some of how foreign exchange realized gains, et cetera, happen. But from my perspective, cash flows will continue to be healthy as the revenues ramp up in Genpact.

Ashwin Shirvaikar - *Citibank - Analyst*

Okay, understood. The -- you said you're exiting certain markets, emerging markets. So, which are those? And what's the revenue impact and timing on that? And then the second question, I may have miswritten in my notes here, but I'm looking at it saying you have some difficulty hiring certain kinds of people. Can you comment on those things?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, I'll comment on the second one first, because it's not about difficulty in hiring, Ashwin; it is that we are very clear about the standards and the caliber and the culture of the people who come into the Company at these levels to do what they have to do with clients, at very senior levels in clients. These are long-term investments. The people who come in, we expect to be with the Company for the long haul, and will make a huge difference to the Company.

So, while I'd love to have invested faster, I am very, very thrilled at the kind of people that we are bringing in, the caliber of those people, and the way they are able to integrate in. It's also important that those who come in integrate well. So, I don't think I would characterize that, and we don't characterize it ourselves, as difficulty in bringing people in. In fact, if anything, I would say that we've had a great response from the market, as we've gone out and met people to try and bring into the Company.

On the other question on emerging markets, first of all, we are not exiting emerging markets. And I just want to characterize exit was de-emphasizing. We have a range of clients in emerging markets. Emerging markets being typically, would be for us, India -- clients in India, and I'm talking about clients that are headquartered there, et cetera; clients in China, clients in the Middle East are three examples where we've built a set of great relationships.

We will continue, and do continue, to service those relationships actually at great value to them. They belong to the same verticals that we are engaging across the world. Our objective there is not to further invest in adding new relationships in those markets. When we think that a lot of the clients there are not yet ready for transformational engagements that drive the outcomes.

We also think that the market opportunity, with the changes that are happening in the larger developed economies and global corporations there is so much, that we think it's the right time for us to redirect some of those resources into those markets. And that's the change we have driven. The impact on -- it's about 2% to 3% of our revenues as the total base that we are talking about. And I would say, for this year, that redirection of resources is an impact of about $5 million of revenue that we did not add because of that redirection of resources. But we think that's the right strategy for us.

Ashwin Shirvaikar - *Citibank - Analyst*

And so next year, that becomes 5 time 4 for the four quarters or --? I mean, what's the impact next year?

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Tiger Tyagarajan - *Genpact Limited - President and CEO*

I don't think, Ashwin, I would characterize it that way, because I don't think this is a one-quarter event. We started moving in that direction as we went through the year. And all we are saying is we've not added more. So, as long as that continues, then we don't add more, it would be broadly a similar impact for that segment of the business.

Ashwin Shirvaikar - *Citibank - Analyst*

Understood. Thank you, guys, for the insights.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thanks, Ashwin.

Operator

Joseph Foresi, Janney Capital Markets.

Joseph Foresi - *Janney Capital Markets - Analyst*

Could you quantify the large deals as a percentage of revenue -- or pipeline? And how that's increased? And given your pipeline now, when do you expect to see the acceleration in revenue growth?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, Joe, the large deal and our characterization of large deals has doubled in our pipeline, as we've gone through the year, starting the end of last year. And we talked about that characterization even on the last earnings call. So, it is a significantly higher proportion of our pipeline. And, in terms of absolute numbers, it's -- on value -- it's doubled. In terms of when do we expect that to convert to revenue, it is going to be a long ramp.

I would say, clearly, over three to four quarters is when some of these ramps will start, once decisions are taken. And as I said, I just gave you the example of the deal we are working on with a great relationship we have, which is not even competitive. And yet the decision cycle time is much longer than either of us had expected. So, clearly, this is a long cycle, and one would think about this as a three to four-quarter kind of cycle.

Joseph Foresi - *Janney Capital Markets - Analyst*

Okay. And then last question from me, on the top line, the reduction in your guidance, how much of that is a revision for FX, and how much of it is a revision for mortgage? In other words, what was in the guidance for FX? And what was in the guidance for mortgage? And what is in it now?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, if we think about the whole year, and think about the overall change across the whole year, I would say about 20% would be mortgage; 20% would be FX; 20% would be the large deal kind of pushouts. And then, of course, we have, if you think about the whole year, if you remember, we also had a couple of the analytics clients that we talked about in quarter-one who took their business in-house. So if you put all of that together. And then, of course, we talked about last quarter, GE Capital's balance sheet and the work that we do for GE Capital and GE not growing as much

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as we had expected at the beginning of the year. So, I would characterize that in that fashion as we went from the beginning of the year to the end of the year.

Joseph Foresi - *Janney Capital Markets - Analyst*

Thank you.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you.

Operator

Paul Thomas, Goldman Sachs.

Paul Thomas - *Goldman Sachs - Analyst*

Thanks for taking my question. I guess how do we get comfortable with year closings at this point? We've heard deals taking longer to close for a while now, but it still seems to be happening in a worse-than-expected fashion. When you guys are putting together your guidance, what criteria are you using to decide if a deal is going to close in the quarter? And has that changed at all over the last couple of quarters?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Paul, great question. And as we reflect back on the end of quarter-two and the dialogue we had in our earnings call at the end of quarter-two, we should have taken an even more conservative view probably of that deal closing in hindsight. So, it is tough to exactly hone down and nail down exactly when some of these large deals will definitively close. The good news is that every one of them is progressing. Every one of them is progressing in terms of dialogues at very senior levels with a lot of investment of time from our clients. So that tells us that they will get to an answer, and the only problem is exactly when. So, as we think about going into the future, we will have, and we will take into account, the fact that some of that deal-closing time will move, more because these are large complex deals.

Paul Thomas - *Goldman Sachs - Analyst*

Okay, thanks. I mean, one more on GE. How do we think about revenue from GE beyond the end of this year, guess the next three or four quarters? Are you seeing any movement in GE Capital or industrial that would make you think that there's going to be some kind of pickup in the next several quarters? Or should we be thinking kind of flat to down for, I guess, into at least the first half of next year?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, Paul, clearly, we're talking about flat to slightly down for this year. I think we'll talk about 2014 when we close the year and we think about guidance for next year. But broadly, if you think about GE Capital as a business, they have talked about continued shrinkage in GE Capital's balance sheet. And that does mean, given our penetration, that some of the work that we do would tend to reduce. But obviously, at the same time, we have other work that we add from the other GE businesses.

So, we've always talked about GE being flat and a little bit up or a little bit down, and that's been our history over quite a few years now. So -- but we'll get a better answer and a better fix on that as we get to the beginning of 2014.

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Paul Thomas - *Goldman Sachs - Analyst*

All right, thanks a lot.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you, Paul.

Operator

Keith Bachman, Bank of Montreal.

Keith Bachman - *Bank of Montreal - Analyst*

I want to ask a philosophical question first. You've talked about next year in one of the previous questions about margin reducing, but I'm wondering how you approach that? For instance, if I think about the factors next year for margins, presumably you'll have some large deals ramping, which will be a -- probably a material negative to margins. GE will be a lower percent of sales no matter what. And then this quarter, because it looked like you knew you were going to miss revenues if you cut OpEx. So presumably, you'll have some resumption of that OpEx.

So I'm wondering how margins aren't materially lower next year, as you think about those forces? Or are you trying to hold 16% or some number as your operating margin target, and you balance your investments around that? Was just hoping you could address that. And then I have a follow-up, please.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Keith, thank you. So I think two of your characterizations is right. So I would say, clearly, as we think about some of the large deals and the ramps on those, that would, as I said, have typical ramp investments and ramp expenses that would come in. We will continue to invest in our sales and marketing, and client-facing and domain expert teams, and transformational teams.

We haven't changed our operating expense and cut operating expenses in order to deal with our lower revenue. We continue to drive productivity. We continue to drive costs and leverage, and utilization of technology and assets and infrastructure. So, on the G&A side of the house, as well as on the gross margin side of the house, we will continue to drive that as we've always done in our history. In fact, as we think about 2014 and beyond, leverage will continue as we grow. So, it's not (multiple speakers) about heading towards that targeted operating margin number. It's more about what are the right investments to do in order to grab the market opportunities. And we'll probably get a better handle of that for 2014 as we enter 2014.

Keith Bachman - *Bank of Montreal - Analyst*

Right. So that was the root of my question. As you think about it, though, will you iterate around a number on operating margin? Or are you biased towards or try to favor revenue growth? Because I'm not sure you can do both.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

It is a classic question, Keith, and I think we will grapple with it as we finish the year and enter next year, and come to a good conclusion that we will be able to share both in the January and early February earnings call, as well as on our Investor Day that we are now planning very quickly after that. But it is that balance; that is the important balance to think through.

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Keith Bachman - *Bank of Montreal - Analyst*

Okay, well, my quick follow-up per a previous question, it sounds like you said you're revisiting some of the investments. And I understand you identified that not getting out of some emerging markets perhaps and investing less. But are there other areas that you're de-emphasizing as you think about your portfolio and try to ramp up in new areas? Is there other particular areas that you're going to de-emphasize besides the emerging geos?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So, again, Keith, great question that I think requires a longer conversation. It's going to be the focus of our conversation in the Investor Day. Some of that we are still finishing in terms of our thinking and evolution. But broadly, I would say the answer is yes. There will be some industry verticals that we would not do additional investments in, in favor of continuing to do even more investments in some industry verticals. And that applies to service lines. It clearly applies to geographies that we talked about.

So, the answer to your question is yes, there will be choices that we are making, which will get us to bigger opportunities in those chosen areas and a bigger playing field to play in those chosen areas. Because whichever area we choose, interestingly, all underpenetrated, all undergoing secular change, all opportunities that we can grab. We just think we need to make those choices to grab them even better. And we'll talk about that in more detail as we finish our exercise and we are ready for it in late January or early February.

Keith Bachman - *Bank of Montreal - Analyst*

Okay, many thanks, guys.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you.

Operator

David Koning, Baird.

David Koning - *Robert W. Baird & Company, Inc. - Analyst*

I guess I'll just ask one question. You talked a lot about growth already. So I'll just talk about Jawood. How much was the revenue contribution from that, just so we can back into organic growth?

Tiger Tyagarajan - *Genpact Limited - President and CEO*

So we should take a couple of percentage points, as we had said earlier from Jawood. The reality, David, as we said before, particularly in something like Jawood, when we get in a business that becomes part of our healthcare vertical, as it has done in the case of Jawood, it starts getting integrated from a combined technology and process, and in the case of healthcare, interestingly, analytics as well, and starts getting bundled often at the same client. We take those solutions to other clients.

So it becomes tougher and tougher as time passes by to parse that out separately. But clearly, we are in the range of the 2% mark so, the way to think about organic growth therefore would be to take that 2% broadly to get to that organic growth number.

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David Koning - *Robert W. Baird & Company, Inc. - Analyst*

Got you. Okay. And I guess the other one, you might have said this already. There was a lot of FX discussion, I know below the line stuff, et cetera. But just year-over-year on revenue, what was the impact on revenue again?

Mohit Bhatia - *Genpact Limited - CFO*

The impact of revenue for this quarter, for the third quarter, was about $3.3 million, which is about 70 basis points. And the impact we estimate for the full year in the range of $13 to $14 million, which again, is about 70 basis points of growth.

David Koning - *Robert W. Baird & Company, Inc. - Analyst*

All right, great. Thank you.

Tiger Tyagarajan - *Genpact Limited - President and CEO*

Thank you, Dave.

Operator

Ladies and gentlemen, this will conclude the question-and-answer portion of today's call. I will now turn the call back over to Bharani Bobba for closing remarks.

Bharani Bobba - *Genpact Limited - VP of IR*

With that, we're going to conclude the call for today. And as always, Tiger, Mohit, and I are available post the call to take further questions. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may all disconnect and have a wonderful day.

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