



EMPOWER RESEARCH KNOWLEDGE SERVICES LIMITED

Rating Action

Long-term rating

[ICRA]AA- (Stable)/reaffirmed

Short-term rating

NA

Total Limits Rated

Rs.4800 crore

Sector

Information Technology

Sub-sector

Others

Rating Methodology

- » Corporate Rating Methodology
- » Framework for Liquidity Analysis
- » Impact of Parent or group support on an Issuer's Credit Rating

Company Profile

Genpact Limited is a BPO and IT/ITeS services provider with more than 800 clients globally. The company has an employee base of ~72,400 employees with a global network of delivery centers in 25 countries - India, Brazil, China, Guatemala, Columbia, Hungary, Japan, Mexico, Kenya, the Philippines, Poland, Czech Republic, Netherlands, Romania, South Africa, United Arab Emirates and USA. Genpact group started as a business unit within General Electric Company (GE), with the view to offer business process services to GE's businesses. In January 2005, Genpact group became an independent company and was listed on the New York Stock Exchange in August 2007.

Empower Research Knowledge Services Private Limited (ERKS), along with other operating companies including Genpact India, are delivery centers for the Genpact group. Genpact US is the customer facing contracting entity for contract/mandate origination, marketing and business development. Genpact US enters into subcontracting agreements with its delivery centres for execution of contracts.

Key Rating Considerations

Credit Strengths

- Strong parentage with Genpact Limited (rated Ba1/Positive by Moody's and BBB- by S&P) and strategic importance of Indian operations
- Diversified service offerings spread across industries and business verticals mitigates business risks and lend stability to cash flows.
- Margins though declining on account of lower billing rates for incremental business still remain healthy due to cost arbitrage of Indian operations.
- Healthy capital structure with low gearing and strong interest cover though issuance of debt has slightly altered the credit metrics.
- Interest deferment clause (till September 2016) and moratorium period allow sufficient buffer for servicing of debt.

Credit Challenges

- Event risk in the form of share buyback or relatively sizeable dividend payout. ICRA however assigns low probability to this risk as the present structure was implemented to avoid share buybacks and dividends for cash up-streaming.
- Change in ownership at parent level could alter the business strategy and relative importance of Indian operations.
- Vulnerability to wage inflation and competitive pressures along with the challenge of managing employee attrition.

Sensitivities

- ⚡ Slower-than-anticipated growth in the sales and significant erosion in operating profitability
- ⚡ Weakening of operational and strategic linkages with the parent

Website

www.icra.in

Rating Rationale

The proceeds of the said NCD program were used by Empower Research Knowledge Services Limited (ERKS) to part-finance the acquisition of 100% stake in Genpact India. As a result, the rating is based on a consolidated view on the credit risk profiles of ERKS and Genpact India (the key operating and cash flow generating entity in India), given the ultimate objective to merge the two entities to ensure serviceability of the NCD programme of ERKS (resultant entity after merger). However, in the wake of delays in obtaining the requisite approvals, ERKS and the investor, Genpact Luxembourg (another Genpact group company) have mutually agreed to revise the first due date for the interest payout by from 31 March 2016 to 30 September 2016. ICRA notes that both the entities have subsequently obtained required approvals to merge their operations under ERKS and the merger is likely to be completed in the short term. ERKS and Genpact India are together referred to as Genpact India Consolidated.

The rating continues to factors in the strengths Genpact India Consolidated derives from its parentage viz. Genpact Limited (referred to as Genpact Group) (rated Ba1(Positive) by Moody's Investor Services). The ratings are supported by the strong business position of Genpact Group characterized by a strong client base, its global execution capabilities and an experienced management team. Genpact Group has diversified service offerings across business verticals/service lines and long term customer relationships which lend stability to cash flows. In addition, the rating takes into consideration the strategic importance of Genpact India Consolidated for Genpact Group given that 69% of global revenues are being serviced from India and 75% of global headcount is based in India.

The rating draws comfort from the robust financial profile of Genpact India Consolidated as reflected in strong cash flows on account of steady business generation/allocation of assignments by Genpact Group, moderate gearing levels and robust interest coverage. The operating profitability of ERKS (including Genpact India), though declined in FY15, has remained healthy at 28.8%. This along with low depreciation and interest expenses, and availability of certain tax benefits has led to robust net margins at 22.2% on a consolidated basis. ICRA also factors in the long-term stable outlook for outsourcing services from India, considering its technical talent pool and cost advantage.

Genpact India Consolidated remains a key revenue and cash flow driver for the Genpact Group and the healthy revenue growth leads to sizeable cash flow generation at Genpact India Consolidated level. This steady internal cash generation has translated into robust debt protection metrics. The Genpact Group has reported steady growth in revenue generation along with operating profitability in the 18%-21% range, aided by healthy margins in India. Despite a sizeable equity share buyback in Q2CY14 and an acquisition, the capital structure of Genpact Group remains conservative with limited debt repayment commitments in the medium term. Moreover, the group has a steady cash flow generation track record, which gives it a comfortable liquidity position.

The rating of ERKS however is constrained by the vulnerability of profitability of Genpact India Consolidated to wage inflation and competitive pressures from both within India and other low cost countries. In addition, Genpact India Consolidated faces challenges with respect to employee attrition rates and recovery of dues from clients. Moreover, the operations of Genpact India Consolidated remain susceptible to any legislation, especially in the US/EU region, which may restrict outsourcing to low cost countries. The profitability of the Genpact India Consolidated is exposed to adverse foreign exchange movement given that majority of the company's revenues are generated in US\$ and a significant part of expenses are in Indian Rupee. However, this risk is hedged to a large extent by buying forward covers at the global level. ICRA also takes note of the possibility of sizeable dividend payout, share buyback or acquisition given the comfortable liquidity position and history of such events at the Genpact Group level. Given the strong linkage, this may adversely impact the liquidity of Genpact India Consolidated.

Update on Business and Competitive Position

Strong parentage with and strategic importance to Genpact Group

Genpact India Consolidated is a step down subsidiary of Genpact Group (rated Ba1 (Positive) by Moody's Investor Services). Genpact Group is a Business Process Outsourcing (BPO) and Information Technology enabled-services (ITeS) provider with annual revenues of USD 2.46 billion and over 800 clients globally. Global execution capabilities, experienced management team and a strong client base mark the group's strong business position. The Genpact Group has diversified service offerings across business verticals/service lines and long term customer relationships.

It has reported steady growth in revenue generation along with operating profitability of 18% in last four years aided by healthy margins in India. Despite periodic equity share buyback undertaken by the company, the capital structure of Genpact Group remains conservative with net gearing of 0.61x as on December 2015 and limited debt repayment commitments in the medium term.

Indian operations are of strategic importance for Genpact Group given that over two thirds of global revenues are being serviced from India and three-fourth of global headcount is based in India. While Genpact Group is the customer facing entity for contract/mandate origination, marketing and business development, the Genpact India Consolidated acts as the execution arm for the parent entity. Genpact Group subcontracts the assignment to various delivery centers across geographies including Genpact India Consolidated depending upon assignment requirements and capabilities of respective delivery centers. Genpact India Consolidated remains a key revenue and cash flow driver for the Genpact Group.

High competitive intensity along with weak economic prospects could moderate the growth for the company; regulations against outsourcing remains a key business risk

The Genpact Group remains vulnerable to slowdown in the demand from end-user segments on account of weak economic prospects. While this is already evident in the revenue growth in the last four years over CY2012-CY2015 which has moderated to single digits, the increased degree of competition has also moderated the average billing rates for incremental business and renegotiation of earlier contracts at the time of renewal. Genpact India Consolidated is vulnerable to wage inflation which could alter its competitive positioning vis-à-vis other delivery centers within the Genpact Group.

ICRA notes that the operations of Genpact India Consolidated also remain susceptible to any legislation, especially in the US/EU region, which may restrict outsourcing to low cost countries. Any legislation restricting outsourcing or immigration in its key markets such as the US immigration bill may have an adverse impact on the current business model of the company.

Business restructuring of Indian operations likely to be concluded shortly with requisite approvals already in place

A reorganization exercise was initiated at the India level to consolidate the Indian operations under ERKS, by merging the operations of major cash flow generating entity namely Genpact India and its subsidiaries with ERKS. To fund this reorganisation, Genpact Group entities in Singapore and Luxembourg infused equity and subscribed to NCD of ERKS. As NCD was used to part-finance the acquisition of Genpact India (the key cash generating entity of the Genpact Group in India) by ERKS, and the two entities are proposed to be merged, the NCD shall be serviced from the cash flows of the consolidated entity. While the transaction shall be cash neutral for the group, the timely conclusion of the merger of Genpact India and ERKS remains critical for the servicing of the said NCD. ICRA notes that both the entities, ERKS and Genpact India have obtained the required approvals to merge their operations under ERKS and the merger is likely to be completed in the short term. ERKS and the investor, Genpact Luxembourg (another Genpact group company) have mutually agreed to revise the first due date for the interest pay out from 31 March 2016 to 30 September 2016 due to some delays in obtaining the requisite approvals.

Hedging of foreign-currency denominated receivables mitigate exchange risk; remains exposed to event-risks at Genpact Group level

Genpact India Consolidated remains exposed to adverse foreign exchange movement given that majority of the company's revenues are generated in foreign currency while a significant part of the expenses are denominated in Indian Rupee. However, this risk is hedged to a large extent through forward covers.

Given the comfortable liquidity position and history of corporate events at the Genpact Group level possibility of sizeable dividend payout, share buyback or acquisition cannot be ruled out. Due to the strong linkage of Genpact India Consolidated with the parent group, this may adversely impact the liquidity of Genpact India Consolidated. ICRA also takes note of a possibility of change in shareholding of Genpact Group, which is largely held by institutional investors with the largest being Bain Capital having 30.3% stake and these changes could alter the business strategy for the company, which could have an implication on Indian operations as well.

Business Outlook

ICRA expects Genpact India Consolidated's revenues to register moderate growth in the medium term in the wake of weak global economic outlook. Any adverse legislation against outsourcing of services in US, which shall undergo Presidential Election during the current year could have significant implications on the Indian business in the medium term.

Update on Financial Position

EXHIBIT 1: Trend in Key Financial Indicators

	FY2012-13	FY2013-14	FY2014-15	H1 FY2014-15	H1 FY2015-16
Revenue and Profitability Indicators					
Operating Income (OI)	4252.9	4528.1	4826.8	NA	NA
Growth in OI (%)	na	6.5%	6.6%	NA	NA
OPBDITA	1510.9	1497.5	1390.2	NA	NA
Profit After Tax (PAT)	1115.5	1046.8	1071.3	NA	NA
Net Cash Accruals (NCA)	1271.2	1189.4	1233.4	NA	NA
				NA	NA
OPBDITA/OI (%)	35.5%	33.1%	28.8%	NA	NA
PAT/OI (%)	26.2%	23.1%	22.2%	NA	NA
ROCE (%)	81.4%	56.3%	25.0%	NA	NA
Debt and Capital Structure					
Long-term debt	22.0	24.8	4624.6	NA	NA
Short-term debt	0.0	0.0	0.0	NA	NA
Total Debt	22.0	24.8	4624.6	NA	NA
Tangible Net Worth (TNW)	3497.9	1094.2	6795.6	NA	NA
				NA	NA
Total Debt/TNW (times)	0.0	0.0	0.7	NA	NA
Total Debt/OPBDITA (times)	0.0	0.0	3.3	NA	NA
Interest Coverage (times)	387.4	332.6	102.1	NA	NA
TOL/TNW (times)	0.3	1.1	0.9	NA	NA
NCA /TD (%)	5778%	4803%	27%	NA	NA
DSCR (excl STD/prepayments)	328.5	103.2	56.8	NA	NA
Working Capital Indicators					
Debtor Days	83	7	62	NA	NA
Creditor Days	50	59	66	NA	NA
Inventory Days	0	0	0	NA	NA
NWC/OI (%)	25.4%	2.0%	19.8%	NA	NA
Cash Flow Indicators					
Fund Flows from Operations	(233.7)	2,249.6	355.8	NA	NA
Retained Cash Flows	163.6	2,313.0	380.1	NA	NA
Free Cash Flows	(509.8)	2,175.7	206.6	NA	NA

Note: Amounts in Rs.crore; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; PBIT: Profit before Interest and Taxes; APAT: Adjusted Profit after Tax; DTL: Deferred Tax Liability; CWIP: Capital Work-In-Progress; NCA: Net Cash Accruals; TOL: Total Outside Liabilities; DSCR: Debt Service Coverage Ratio; NWC: Net Working Capital.

Source: Financial statements of Genpact India and ERKS; and ICRA estimates

Moderate revenue growth; operating profitability though declined remains healthy

Genpact India Consolidated's revenue growth moderated in last two years, FY2014 and FY2015 due to subdued economic environment and stress in corporate earnings. The revenue growth in FY2015 stood at 6.2% similar to 6% growth seen in FY2014.

The operating profitability for Genpact India Consolidated witnessed a material decline from 33.1% in FY2014 to 28.8% in FY2015 primarily due to the increased marketing headcount in US, which is ultimately mapped to delivery centres with India accounting for over two-thirds of this cost. Further, the lower revenue growth in two consecutive years FY2014 and FY2015 led to underutilisation of resources as company does staffing keeping its budgets / targets in consideration and this impacted the profitability as well. The operating profitability, though under pressure, has remained healthy.

The net profitability also remains robust at over 20% with relatively low finance and depreciation charges. Further, the effective tax rate has remained relatively low on account of the tax benefits availed under the SEZ Act 2005¹. Genpact India's tax exemption will start expiring from FY2022 and will fully expire by FY2028 thereby shielding the cash flows for a visibly long period.

Moderate Working Capital Intensity primarily driven by its terms of trade with parent Genpact US

The working capital requirements of Genpact India Consolidated are driven by its agreement with Genpact Limited, which is the key business contracting entity. Genpact Limited bills its clients on a monthly basis and correspondingly Genpact India bills the parent company for its share of the work executed. However, the counterparty risks and any other adverse impact on profitability is borne by the delivery centre i.e, Genpact India as Genpact Limited charges fixed marketing costs and mark-up from the delivery centres,

Typically Genpact India takes about two months to recover the amount raised on Genpact US who needs to first recover the same from its client and then transmit back. Genpact India partially uses the contract workforce and avails a credit period of two months from them which helps support its working capital requirements.

Moderation in otherwise robust debt protection metrics on account debt issuance to fund business reorganisation

The capital structure of Genpact India, which remained robust with a negative net debt position till FY2014, has moderated on account of issuance of debt to fund reorganisation of the business operations. The net worth of the company witnessed a decline in FY2014 as the company bought back 10 lakh equity shares for a total consideration of Rs. 3425 crore, however the same was enhanced by infusion of fresh equity in FY2015 to enable the acquisition of Genpact India by ERKS from Genpact Group. In a way the transaction has resulted in front ending of Genpact India's cash flows to obtain financing, which would be serviced through its cash flows. As a result, consolidated metrics witnessed an increase in gearing to 0.68 times from 0.02 times and NCA / Debt reducing to moderate 27% in FY15.

Liquidity

Cash flows and liquidity weaken due to higher working capital requirements; significant cash balances offer liquidity support

The fund flow from operations (FFO) declined in FY2015 on account of a significant increase in working capital requirements. The debtor days in FY2014 reduced significantly as the Genpact Group settled the receivables early to boost the liquidity of Indian operations for its share buyback plan. However, the debtor holding period reverted back to about 60 days which increased the working capital requirements. The company undertakes regular capex at its delivery centres, which are funded through internal accruals. As a result, the company's free cash flow during the year remained positive. ICRA notes that while the business reorganisation exercise is

¹ Under this, the company's delivery centres in India located in SEZ's are allowed 100% tax exemption for first 5 years from the commencement of operations. Thereafter, 50% exemption is available for the next 5 years (year 6 to year 10) and 50% of the profits for an additional period of 5 years (year 11 to year 15), subject to the satisfaction of certain capital investment requirements.

unlikely to have significant impact on the ultimate liquidity position of the company, the free cash flows might suffer on account of interest payout as against share buyback programmes undertaken earlier.

Financial Outlook

EXHIBIT 2: Financial Outlook

Revenues	5%-6% growth year-on-year for the next three years
Profits	Margins are likely to remain healthy at about 28%-30% of Operating Profit Margin
Repayment obligations	To start from FY18 as per the terms of the agreement
Capital expenditure	Rs.100-120 crore over FY2015-16 to FY2017-18 Funding – Primarily through internal accruals
Debt	No additions expected besides current NCD issue
Capitalization and coverage	Healthy
Working capital intensity	~expected to be maintained at existing levels
Working capital utilization	None
Undrawn line of credit	None

Source: ICRA estimates

Detailed Breakup of Limits Rated by ICRA**EXHIBIT 3: Details of limits rated on long-term scale**

Bank Limits	Amounts (Rs.crore)	Rating
Fund-based facilities		
Non Convertible Debenture Programme	4800.00	ICRA AA- / Stable
Total	4800.00	

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