

ExlService Holdings, Inc.
Form 10-Q
November 14, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____**

COMMISSION FILE NUMBER 001-33089

EXLSERVICE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
Incorporation or organization)

82-0572194
(I.R.S. Employer
Identification No.)

350 PARK AVENUE NEW YORK, NEW YORK
(Address of principal executive offices)

10022
(Zip code)

(212) 277-7100

(Registrant's telephone number, including area code)

NOT APPLICABLE

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of October 31, 2007, there were 28,680,534 shares of the registrant's common stock outstanding (excluding 163,690 shares held in treasury), par value \$0.001.

Table of Contents

TABLE OF CONTENTS

| | PAGE |
|---|-------------|
| PART I. FINANCIAL INFORMATION | |
| ITEM | |
| 1. FINANCIAL STATEMENTS | |
| <u>Consolidated Balance Sheets (Unaudited) as of September 30, 2007 and December 31, 2006</u> | 1 |
| <u>Consolidated Statements of Income (Unaudited) for the Three Months Ended and Nine months Ended September 30, 2007 and 2006</u> | 2 |
| <u>Consolidated Statements of Cash Flows (Unaudited) for the nine months Ended September 30, 2007 and 2006</u> | 3 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 4 |
| 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 24 |
| 4. <u>Controls and Procedures</u> | 24 |
| <u>PART II. OTHER INFORMATION</u> | 25 |
| 1. <u>Legal Proceedings</u> | 25 |
| 1A. <u>Risk Factors</u> | 25 |
| 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 26 |
| 3. <u>Defaults Upon Senior Securities</u> | 26 |
| 4. <u>Submission of Matters to a Vote of Security Holders</u> | 26 |
| 5. <u>Other Information</u> | 27 |
| 6. <u>Exhibits</u> | 27 |
| <u>Signatures</u> | 28 |

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****EXLSERVICE HOLDINGS, INC.****CONSOLIDATED BALANCE SHEETS**

| | September 30, 2007 (Unaudited) | December 31, 2006 (Audited) |
|--|---|--|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 91,015,943 | \$ 85,366,103 |
| Restricted cash | 495,439 | 1,093,277 |
| Accounts receivable, net of allowance for doubtful accounts of \$27,542 at September 30, 2007 and \$100,828 at December 31, 2006 | 39,138,896 | 26,801,058 |
| Accounts receivable from related parties | 466,692 | 254,803 |
| Employee receivables | 1,076,522 | 638,589 |
| Prepaid expenses | 881,938 | 1,673,721 |
| Deferred tax assets | 3,833,839 | 3,570,990 |
| Other current assets | 8,213,152 | 3,321,992 |
| Total current assets | 145,122,421 | 122,720,533 |
| Fixed assets, net | 23,749,478 | 21,545,324 |
| Intangibles, net | 565,000 | 1,970,000 |
| Goodwill | 16,785,487 | 16,651,462 |
| Restricted cash | 289,499 | 302,160 |
| Deferred tax assets | 2,661,870 | 818,219 |
| Other assets | 6,968,475 | 1,601,244 |
| Total assets | \$ 196,142,230 | \$ 165,608,942 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,613,595 | \$ 3,161,942 |
| Deferred revenue | 4,288,146 | 6,376,725 |
| Accrued employee cost | 11,922,162 | 10,251,197 |
| Other accrued expenses and current liabilities | 13,115,860 | 14,336,829 |
| Income taxes payable | 1,062,720 | 2,705,326 |
| Current portion of capital lease obligation | 140,570 | 165,995 |
| Deferred tax liabilities | 159,000 | 700,901 |
| Total current liabilities | 32,302,053 | 37,698,915 |
| Capital lease obligations, less current portion | 298,988 | 227,651 |
| Deferred tax liabilities | 73,101 | 146,200 |
| Other non current liabilities | 448,517 | 339,715 |
| Total liabilities | 33,122,659 | 38,412,481 |

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| | | |
|--|-----------------------|-----------------------|
| Stockholders' equity: | | |
| Common stock, \$0.001 par value; 100,000,000 shares authorized, 28,825,204 shares issued and outstanding as at September 30, 2007 and 28,262,289 shares issued and outstanding as at December 31, 2006 | 28,825 | 28,263 |
| Additional paid-in capital | 109,005,649 | 98,429,374 |
| Retained earnings | 45,932,761 | 28,664,647 |
| Accumulated other comprehensive income/(loss) | 8,368,269 | 109,693 |
| | 163,335,504 | 127,231,977 |
| Less: 163,690 shares as at September 30, 2007 and 149,138 shares at December 31, 2006, held in treasury, at cost | (315,933) | (35,516) |
| Total stockholders' equity | 163,019,571 | 127,196,461 |
| Total liabilities and stockholders' equity | \$ 196,142,230 | \$ 165,608,942 |

See accompanying notes

Table of Contents**EXLSERVICE HOLDINGS, INC.****CONSOLIDATED STATEMENTS OF INCOME****(UNAUDITED)**

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|---------------|------------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues | \$ 46,090,300 | \$ 35,081,504 | \$ 128,240,552 | \$ 81,189,101 |
| Revenues (from related parties) | 538,750 | 583,541 | 1,262,785 | 1,264,186 |
| Total revenues | \$ 46,629,050 | \$ 35,665,045 | \$ 129,503,337 | \$ 82,453,287 |
| Cost of revenues (exclusive of depreciation and amortization) | 29,852,667 | 21,490,479 | 83,133,280 | 51,378,118 |
| Gross profit | 16,776,383 | 14,174,566 | 46,370,057 | 31,075,169 |
| Operating expenses: | | | | |
| General and administrative expenses | 6,990,766 | 5,802,239 | 19,831,654 | 13,110,619 |
| Selling and marketing expenses | 2,556,621 | 1,635,644 | 6,547,878 | 3,083,744 |
| Depreciation and amortization | 2,560,476 | 2,614,929 | 7,765,413 | 6,254,903 |
| Total operating expenses | 12,107,863 | 10,052,812 | 34,144,945 | 22,449,266 |
| Income from operations | 4,668,520 | 4,121,754 | 12,225,112 | 8,625,903 |
| Other income/(expense): | | | | |
| Foreign exchange gain/(loss) | 2,267,805 | 11,681 | 5,132,816 | (688,213) |
| Interest and other income | 1,028,192 | 310,945 | 3,054,776 | 912,327 |
| Interest expense | (12,837) | (275,310) | (39,917) | (479,077) |
| Income before income taxes | 7,951,680 | 4,169,070 | 20,372,787 | 8,370,940 |
| Income tax provision/(benefit) | 1,712,240 | (152,084) | 3,104,673 | 351,344 |
| Net income | 6,239,440 | 4,321,154 | 17,268,114 | 8,019,596 |
| Dividends and accretion on preferred stock | | (180,794) | | (523,173) |
| Net income to common stockholders | \$ 6,239,440 | \$ 4,140,360 | \$ 17,268,114 | \$ 7,496,423 |
| Basic earnings per share to common stockholders | \$ 0.22 | \$ 0.19 | \$ 0.61 | \$ 0.35 |
| Diluted earnings per share to common stockholders | \$ 0.21 | \$ 0.19 | \$ 0.59 | \$ 0.34 |
| Weighted-average number of shares used in computing earnings per share: | | | | |
| Basic | 28,644,120 | 21,603,812 | 28,387,242 | 21,583,084 |
| Diluted | 29,115,603 | 21,997,319 | 29,096,915 | 21,912,253 |

See accompanying notes

Table of Contents**EXLSERVICE HOLDINGS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOW****(UNAUDITED)**

| | Nine months ended September 30, | |
|---|--|--------------------|
| | 2007 | 2006 |
| Cash flows from operating activities | | |
| Net income | \$ 17,268,114 | \$ 8,019,596 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 7,765,413 | 6,254,903 |
| Amortization of deferred financing costs | | 45,000 |
| Amortization of deferred stock compensation and other non-cash compensation | 3,362,002 | 1,280,113 |
| Interest on senior long term debt | | 219,374 |
| Non employee stock options | 379,626 | 290,012 |
| Foreign exchange (gain)/loss (unrealized) | (1,053,580) | 1,331,004 |
| Deferred income taxes | (744,840) | (1,587,169) |
| Excess tax benefit from stock-based compensation | (631,861) | |
| Change in operating assets and liabilities (net of effect of acquisitions): | | |
| Restricted cash | 687,849 | (242,736) |
| Accounts receivable | (12,518,714) | (5,649,585) |
| Prepaid expenses and other current assets | 3,058,235 | 17,188 |
| Accounts payable | (921,440) | 276,056 |
| Deferred revenue | (2,266,560) | (1,744,669) |
| Accrued expenses and other liabilities | 4,151,018 | 5,263,488 |
| Income taxes payable | (1,658,937) | (342,846) |
| Other assets | (5,495,922) | (2,616,075) |
| Net cash provided by operating activities | 11,380,403 | 10,813,654 |
| Cash flows from investing activities | | |
| Purchase of fixed assets | (7,082,326) | (3,771,822) |
| Business acquisition (net of cash) | | (952,846) |
| Net cash used in investing activities | (7,082,326) | (4,724,668) |
| Cash flows from financing activities | | |
| Principal payments on capital lease obligations | (223,173) | (403,118) |
| Repayment of bank borrowings | | (3,150,000) |
| Repayment of long term debt | | (1,100,000) |
| Outflow from treasury stock transactions | (280,417) | (21,057) |
| Proceeds from exercise of stock options | 1,086,967 | 135,779 |
| Excess tax benefit from stock-based compensation | 631,861 | |
| Net cash provided by/(used for) financing activities | 1,215,238 | (4,538,396) |
| Effect of exchange rate changes on cash and cash equivalents | 136,525 | (162,348) |
| Net increase/(decrease) in cash and cash equivalents | 5,649,840 | 1,388,242 |
| Cash and cash equivalents at the beginning of the year | 85,366,103 | 24,240,632 |

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| | | |
|--|---------------|---------------|
| Cash and cash equivalents at the end of the period | \$ 91,015,943 | \$ 25,628,874 |
| Supplemental disclosure of cash flow information | | |
| Cash paid for interest | \$ 30,168 | \$ 127,554 |
| Cash paid for taxes | \$ 6,605,404 | \$ 2,288,491 |
| Supplemental disclosure of non-cash information | | |
| Assets acquired under capital lease | \$ 232,765 | \$ 158,357 |
| Fair value of the shares issued for non cash consideration | \$ 5,449,042 | \$ 9,134,669 |

See accompanying notes

Table of Contents

EXLSERVICE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2007

(UNAUDITED)

1. Organization and Basis of Presentation

Organization

ExlService Holdings, Inc. (ExlService Holdings) is organized as a corporation under the laws of the state of Delaware. ExlService Holdings, together with its subsidiaries ExlService.com, Inc. (Exl Inc.), exlService.com (India) Private Limited (Exl India), Noida Customer Operations Private Limited (NCOP), Exl Support Services Pvt. Ltd. (ESSPL), ExlService (U.K.) Limited (Exl UK) and Inductis Inc. and its wholly owned subsidiaries (Inductis), including Inductis India Private Limited (Inductis India) (collectively, the Company) is a recognized provider of offshore solutions, including business process outsourcing (BPO), research and analytics and advisory services. The Company s clients are located principally in the United States and the United Kingdom.

The Company completed its initial public offering in October 2006 and the common stock of the Company is listed on the NASDAQ Global Select Market under the symbol EXLS.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include certain information and note disclosures required by generally accepted accounting principles for annual financial reporting and should be read in conjunction with the consolidated financial statements and notes thereto included in the audited consolidated financial statements of ExlService Holdings for the year ended December 31, 2006 and Management s Discussion and Analysis of Financial Condition and Results of Operations included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

The unaudited interim consolidated financial statements reflect all adjustments (of a normal and recurring nature) which management considers necessary for a fair presentation of such statements for these periods. The consolidated statements of income for the interim periods presented are not necessarily indicative of the results for the full year.

The consolidated balance sheet at December 31, 2006 was extracted from the audited consolidated balance sheet of ExlService Holdings included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The unaudited consolidated financial statements include the accounts of ExlService Holdings and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the consolidated statements of income during the reporting period. Estimates are based upon management s best assessment of the current business environment. Actual results could differ from those estimates. The significant estimates and assumptions that affect the financial statements include, but are not limited to, allowance for doubtful accounts, future obligations under employee benefit plans, income tax valuation allowances and tax reserves, depreciation and amortization periods, and recoverability of long-term assets including goodwill and intangibles.

Foreign Currency

The functional currency of each entity in the Company is its respective local country currency, which is also the currency of the primary economic environment in which it operates unless otherwise specified. Monetary assets and liabilities in foreign currencies are re-measured into functional currency at the rates of exchange prevailing at the balance sheet dates. Transactions in foreign currencies are re-measured into functional currency at the rates of exchange prevailing on the date of the transaction. All transaction foreign exchange gains and losses are recorded in the accompanying consolidated statements of income.

The assets and liabilities of the subsidiaries for which the functional currency is other than the U.S. dollar are translated into U.S. dollars, the reporting currency, at the rate of exchange prevailing on the balance sheet dates. Revenues and expenses are translated into U.S. dollars at the exchange rates prevailing on the last business day of each month. Resulting translation adjustments are included in accumulated other comprehensive income/(loss).

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Pursuant to our investment policy, our surplus funds are kept as cash or cash equivalents and are invested in highly-rated commercial paper and money market accounts to reduce our exposure to market risk with regard to these funds.

Table of Contents***Fixed Assets***

Fixed assets are stated at cost. Equipment held under capital leases is stated at the lower of present value of minimum lease payments at the inception of the leases or its fair value. Advances paid towards acquisition of fixed assets and the cost of fixed assets not yet placed in service before the end of the period, are classified as construction in progress.

Fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable through an assessment of the estimated future undiscounted cash flows related to such assets. In the event that assets are found to be carried at amounts that are in excess of estimated undiscounted future cash flows, the carrying value of the related asset or group of assets is reduced to a level commensurate with fair value based on a discounted cash flow analysis.

Depreciation is computed using the straight-line method over the estimated useful lives of assets. Depreciation and amortization on equipment held under capital leases and leasehold improvements are computed using the straight-line method over the shorter of the assets' estimated lives or the lease term.

Accounts Receivable

Accounts receivable are recorded net of allowances for doubtful accounts. Allowances for doubtful accounts are established through the evaluation of accounts receivables aging and prior collection experience to estimate the ultimate collectability of these receivables.

Revenue Recognition

Revenues from BPO services include revenue from a range of services, including insurance services, banking and financial services, finance and accounting services and collection services. Revenues from advisory services include revenues from various services such as Sarbanes-Oxley compliance, internal audit outsourcing and financial reporting. Revenues from research and analytics services include revenues from services that are intended to facilitate more effective data-based strategic and operating decisions by our clients using research, statistical and quantitative analytical techniques.

The Company recognizes revenue as services are rendered, provided that persuasive evidence of an arrangement exists, there are no remaining obligations with respect to the services rendered and collection is considered probable. The Company invoices clients in accordance with agreed upon rates and billing arrangements, which consist of cost-plus, time-and-material, fixed price, contingent fee and unit-priced arrangements. The Company recognizes revenue from the last billing date to the balance sheet date as unbilled revenues and recognizes billings in excess of revenues earned or advances received from clients as deferred revenue.

In accordance with EITF 01-14, *Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred*, the Company has accounted for reimbursements received for out-of-pocket expenses incurred as revenues in the consolidated statements of income. The Company typically incurs telecommunication and travel-related costs that are billed to and reimbursed by clients.

Revenues for the following periods include reimbursements of out-of-pocket expenses:

| | |
|---------------------------------------|--------------|
| Three Months Ended September 30, 2007 | \$ 1,913,722 |
| Three Months Ended September 30, 2006 | \$ 1,427,367 |
| Nine months Ended September 30, 2007 | \$ 5,916,527 |
| Nine months Ended September 30, 2006 | \$ 3,379,371 |

During the three months ended September 30, 2007, two customers accounted for 26.5% and 25.7%, respectively, of the Company's total revenues. During the three months ended September 30, 2006, three customers accounted for 29.4%, 16.3% and 11.5% respectively, of the Company's total revenues.

During the nine months ended September 30, 2007, two customers accounted for 27.7% and 24.9%, respectively, of the Company's total revenues. During the nine months ended September 30, 2006, two customers accounted for 37.5% and 13.8% respectively, of the Company's total revenues.

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As of September 30, 2007, two customers accounted for 30.7% and 25.5%, respectively, of the Company's total accounts receivable. As of December 31, 2006, three customers accounted for 25.4%, 21.4% and 12.0% respectively, of the Company's total accounts receivable.

Business Combinations, Goodwill and Intangible Assets

Statement of Financial Accounting Standards No. 141, *Business Combinations* (SFAS No. 141), requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 specifies that intangible assets acquired in a business combination must be recognized and reported separately from goodwill. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, all assets and liabilities of the acquired businesses including goodwill are assigned to reporting units.

Goodwill represents the cost of the acquired businesses in excess of the fair value of identifiable tangible and intangible net assets purchased. Goodwill is not amortized but is tested for impairment at least on an annual basis, relying on a number of factors including operating results, business plans and future cash flows. Recoverability of goodwill is evaluated using a two-step process. The first step involves a comparison of the fair value of a reporting unit with its carrying value. If the carrying amount of the reporting unit exceeds its fair value, the second step of the process involves a comparison of the fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Goodwill of a reporting unit will be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount.

Based on the results of its first step impairment tests performed on October 1, 2006, the Company's goodwill was not impaired. The Company makes every reasonable effort to ensure that it accurately estimates the fair value of the reporting units. However, future changes in the assumptions used to make these estimates could result in the recording of an impairment loss. In the event we record an impairment loss in the future, such amount will not be deductible for tax purposes. As of September 30, 2007, our goodwill balance was \$16,785,487. The goodwill balance at September 30, 2007 has changed from the balance at December 31, 2006 due to purchase price adjustments recorded during the nine months ended September 30, 2007.

Table of Contents

Intangible assets are carried at cost less accumulated amortization. The intangible assets are amortized over their estimated useful lives in proportion to the economic benefits consumed in each period. The estimated useful lives of the intangible assets are as follows:

| | |
|------------------------|-----------|
| Customer relationships | 2 years |
| Trademarks | 1.5 years |
| Non-compete agreements | 1 year |

Segment Information

The Company is generally organized around its BPO, advisory and research and analytics service lines. The chief operating decision maker generally reviews financial information at the consolidated statements of income level but does not review any information except for revenues and cost of revenues of the individual service lines. Therefore, the Company does not allocate or evaluate depreciation, amortization, interest expense or income, capital expenditures, and income taxes into its various service lines. Consequently, it is not practical to show assets, capital expenditures, depreciation or amortization by operating segment.

Revenues and cost of revenues for the three months ended September 30, 2007 and 2006 for BPO, advisory and research and analytics services are as follows:

| | Three months ended September 30, 2007 | | | | Three months ended September 30, 2006 | | | |
|--|---------------------------------------|--------------|------------------------|---------------|---------------------------------------|--------------|------------------------|---------------|
| | BPO | Advisory | Research and Analytics | Total | BPO | Advisory | Research and Analytics | Total |
| Revenues | \$ 38,024,309 | \$ 2,794,847 | \$ 5,271,144 | \$ 46,090,300 | \$ 25,946,420 | \$ 2,295,794 | \$ 6,839,290 | \$ 35,081,504 |
| Revenues from related parties | | 538,750 | | 538,750 | 186,525 | 392,116 | 4,900 | 583,541 |
| Total revenues | 38,024,309 | 3,333,597 | 5,271,144 | 46,629,050 | 26,132,945 | 2,687,910 | 6,844,190 | 35,665,045 |
| Cost of revenue (exclusive of depreciation and amortization) | 24,396,665 | 1,863,921 | 3,592,081 | 29,852,667 | 15,623,428 | 1,535,228 | 4,331,823 | 21,490,479 |
| Gross profit | 13,627,644 | 1,469,676 | 1,679,063 | 16,776,383 | 10,509,517 | 1,152,682 | 2,512,367 | 14,174,566 |
| Selling, general and administrative expenses | | | | 9,547,387 | | | | 7,437,883 |
| Depreciation and amortization | | | | 2,560,476 | | | | 2,614,929 |
| Foreign exchange gain | | | | 2,267,805 | | | | 11,681 |
| Interest and other income | | | | 1,028,192 | | | | 310,945 |
| Interest expense | | | | (12,837) | | | | (275,310) |
| Income tax (benefit) provision | | | | 1,712,240 | | | | (152,084) |
| Net income | | | | 6,239,440 | | | | 4,321,154 |
| Dividends and accretion on preferred stock | | | | | | | | (180,794) |
| Net income to common stockholders | | | | \$ 6,239,440 | | | | \$ 4,140,360 |

Advisory gross profit for the three months ended September 30, 2007 reflects the impact of a change in bonus allocation methodology among service lines as compared to the three months ended June 30, 2007.

Table of Contents

| | Nine months ended September 30, 2007 | | | | Nine months ended September 30, 2006 | | | |
|--|--------------------------------------|--------------|------------------------|----------------|--------------------------------------|--------------|------------------------|---------------|
| | BPO | Advisory | Research and Analytics | Total | BPO | Advisory | Research and Analytics | Total |
| Revenues | \$ 105,710,335 | \$ 8,779,311 | \$ 13,750,906 | \$ 128,240,552 | \$ 68,017,315 | \$ 5,398,552 | \$ 7,773,234 | \$ 81,189,101 |
| Revenues from related parties | 382,920 | 836,516 | 43,349 | 1,262,785 | 342,860 | 916,426 | 4,900 | 1,264,186 |
| Total revenues | 106,093,255 | 9,615,827 | 13,794,255 | 129,503,337 | 68,360,175 | 6,314,978 | 7,778,134 | 82,453,287 |
| Cost of revenue (exclusive of depreciation and amortization) | 65,937,533 | 6,202,213 | 10,993,534 | 83,133,280 | 42,617,703 | 3,882,082 | 4,878,333 | 51,378,118 |
| Gross profit | 40,155,722 | 3,413,614 | 2,800,721 | 46,370,057 | 25,742,472 | 2,432,896 | 2,899,801 | 31,075,169 |
| Selling, general and administrative expenses | | | | 26,379,532 | | | | 16,194,363 |
| Depreciation and amortization | | | | 7,765,413 | | | | 6,254,903 |
| Foreign exchange gain/(loss) | | | | 5,132,816 | | | | (688,213) |
| Interest and other income | | | | 3,054,776 | | | | 912,327 |
| Interest expense | | | | (39,917) | | | | (479,077) |
| Income tax (benefit)/provision | | | | 3,104,673 | | | | 351,344 |
| Net income | | | | 17,268,114 | | | | 8,019,596 |
| Dividends and accretion on preferred stock | | | | | | | | (523,173) |
| Net income to common stockholders | | | | \$ 17,268,114 | | | | \$ 7,496,423 |

Stock-Based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (FAS No. 123(R)), which is a revision of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (FAS 123). FAS 123(R) supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* . Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The Company adopted the provisions of FAS No. 123(R) using the modified prospective transition method, which requires that the estimated fair value of stock-based awards granted under stock incentive plans is recognized as compensation expense for all share based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and that remain unvested on the date of adoption. See Note 13 for a detailed discussion of our stock-based compensation and our adoption of FAS No. 123(R).

Earnings Per Share

Basic earnings per share are computed by dividing net income (loss) to common stockholders by the weighted average number of common shares outstanding during each period. In determining the income to common stockholders, net income has been reduced by dividends and accretion on preferred stock. Diluted earnings per share are computed using the weighted average number of common shares plus the potentially dilutive effect of common stock equivalents plus the future stock compensation expense on stock options issued and outstanding at the reporting date. Stock options that are anti-dilutive are excluded from the computation of weighted average shares outstanding. For the three months ended September 30, 2007 and 2006, the weighted average number of shares used in calculating diluted earnings per share includes stock options for 471,483 and 393,507 shares (after giving effect to the stock split and conversion that occurred in connection with our October 2006 initial public offering), respectively. For the nine months ended September 30, 2007 and 2006, the weighted average number of shares used in calculating diluted earnings per share includes stock options for 709,673 and 329,169 shares (after giving effect to the stock split and conversion that occurred in connection with our October 2006 initial public offering), respectively. The calculation of earnings per share for the three months ended September 30, 2007 and 2006 excludes stock options for 558,600 shares and 592,900 shares (after giving effect to the stock split and conversion that occurred in connection with our October 2006 initial public offering) and for the nine months ended September 30, 2007 and 2006 excludes stock options for 360,000 shares and 592,900 shares (after giving effect to the stock split and conversion that occurred in connection with our October 2006 initial public offering), respectively, because the exercise price of such stock options is more than the average

price of stock and hence to include them in the calculation would be anti-dilutive.

Accumulated Other Comprehensive Income

SFAS No. 130, *Reporting Comprehensive Income* (SFAS No. 130), establishes rules for the reporting of comprehensive income and its components. Comprehensive income is defined as all changes in equity from non-owner sources. For the Company, comprehensive income/(loss) consists of net earnings and changes in the cumulative foreign currency translation adjustments and minimum pension liability adjustments. In addition, the Company, enters into foreign currency exchange contracts, which are designated as cash flow hedges in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133). Changes in the fair values of contracts that are deemed effective are recorded as a component of accumulated other comprehensive income until the settlement of that contract.

Financial Instruments and Concentration of Credit Risk

Financial Instruments: For certain financial instruments including cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and other current liabilities, recorded amounts approximate fair value due to the relatively short maturity periods.

Concentration of Credit Risk: Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents, accounts receivable and time deposits. By their nature, all such financial instruments involve risks including the credit risks of non-performance by counterparties. Pursuant to our investment policy, our surplus funds are kept as cash or cash equivalents and are invested in highly-rated commercial paper and money market accounts to reduce our exposure to market risk with regard to these funds. Trade accounts receivables are incurred pursuant to the contractual terms with customers. See *Revenue Recognition* elsewhere in this footnote. Credit losses on accounts receivable have not been material because of a large concentration of revenues with a small number of large, established companies. The Company evaluates the creditworthiness of its clients in conjunction with its revenue recognition processes as well as through its ongoing collectability assessment processes for accounts receivable.

Derivatives and Hedge Accounting: In the Company's normal course of business, the Company actively looks to mitigate the exposure of foreign currency market risk by entering into various hedging instruments, authorized under Company policies, with counterparties that are highly rated financial institutions. The Company's primary exchange rate exposure is with the U.K. pound sterling and the Indian rupee. The Company uses derivative instruments for the purpose of mitigating the underlying exposure from foreign currency fluctuation risks associated with forecasted transactions denominated in certain foreign currencies and to minimize earnings and cash flow volatility associated with changes in foreign currency exchange rates, and not for speculative trading purposes.

Table of Contents

The Company also hedges anticipated transactions that are subject to foreign exchange exposure with foreign exchange contracts that are designated effective and qualify as cash flow hedges under SFAS No. 133. Changes in the fair value of these cash flow hedges which are deemed effective, are recorded in accumulated other comprehensive income/(loss) until the contract is settled and at that time are recognized in the consolidated statements of income.

The Company had outstanding forward exchange contracts totaling \$43,250,000 and GBP20,500,000 as at September 30, 2007 and totaling \$33,000,000 and GBP21,700,000 as at December 31, 2006.

The Company evaluates hedge effectiveness at the time a contract is entered into as well as on an ongoing basis. If during this time, a contract is deemed ineffective, the change in the fair value is recorded in other income in the consolidated statements of income. For the three months ended September 30, 2007 and 2006, net gain/(loss) from ineffective cash flow hedges included in the consolidated statements of income totaled \$43,543 and \$(286,268), respectively. For the nine months ended September 30, 2007 and 2006, net gain/(loss) from ineffective cash flow hedges included in the consolidated statements of income totaled \$995,472 and \$(1,293,268), respectively. Such gain/(loss) is included in foreign exchange gain (loss) in the consolidated statements of income. For hedge relationships discontinued because the forecasted transaction is not expected to occur by the end of the originally specified period, any related derivative amounts recorded in equity are reclassified to earnings. For the three months ended September 30, 2007 and September 30, 2006, there were no amounts that were reclassified from other comprehensive income into earnings as a result of forecasted transactions that failed to occur.

We estimate that approximately \$5,700,000 of net derivative gains included in other comprehensive income could be reclassified into earnings within the next 12 months based on exchange rates prevailing as of September 30, 2007. At September 30, 2007, the maximum outstanding term of derivative instruments that hedge forecasted transactions was 15 months.

Recent Accounting Pronouncements

On January 1, 2007, the Company adopted FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. An Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interest and penalties recognized in accordance with the guidance provided in FIN 48, if any, are being classified as interest expense and general and administrative expense, respectively. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicated it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount, which is more than 50% likely of being realized upon ultimate settlement. The adoption of FIN 48 did not have any impact on the Company's consolidated financial statements.

All U.S. federal tax filings of ExlService Holdings and its U.S. subsidiaries for tax years since 2003 are subject to examination by the U.S. federal tax authorities, and the 2004 tax year for ExlService Holdings is being examined by the U.S. Internal Revenue Service. In addition, the 2005 tax year for Inductis is being examined by the U.S. Internal Revenue Service. All U.S. state tax filings of ExlService Holdings for tax years from 2003 to 2005 are being examined by the New York State tax authorities. All tax filings of the Company's subsidiaries in India are subject to examination by the Indian tax authorities for tax years since 2001-02, and the 2003-04, 2004-05 and 2005-06 tax years are being examined by the Indian tax authorities for EXL India. In addition, the tax filing for Exl Inc. for tax year 2003-04 is under examination by the Indian tax authorities. All tax filings of the Company's subsidiaries in the U.K. are subject to examination by U.K. tax authorities for tax years since 2004. Management believes that the outcome of these examinations will not have a material impact on the Company's consolidated financial statements.

3. Intangible Assets.

Information regarding the Company's other intangible assets is as follows:

| | September 30, 2007 | | |
|------------|-----------------------------|-----------------------------|------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Trademarks | \$ 330,000 | \$ (275,000) | \$ 55,000 |

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| | | | |
|------------------------|--------------|----------------|------------|
| Customer relationships | 1,360,000 | (850,000) | 510,000 |
| Non-compete agreements | 1,460,000 | (1,460,000) | |
| | \$ 3,150,000 | \$ (2,585,000) | \$ 565,000 |

Amortization expense for the three months ended September 30, 2007 and 2006, was \$225,000 and \$590,000, respectively. Amortization expense for the nine months ended September 30, 2007 and 2006 was \$1,405,000 and \$590,000, respectively. The estimated amortization for the intangible assets on a straight-line basis for the year ending September 30, 2008 is \$565,000.

4. Restriction on Cash Balances

Current restricted cash represents amounts on deposit with banks against letters of credit and bank guarantees issued by the Company for equipment imports amounting to \$495,439 that will mature on various dates within the next year.

Non-current restricted cash represents guarantees against custom and excise bonding issued through banks amounting to \$289,499 that will mature after September 30, 2008.

Table of Contents**5. Comprehensive Income:**

The following table sets forth the components of comprehensive income for the three and nine months ended September 30, 2007 and September 30, 2006:

| | Three months ended | | Nine months ended | |
|--|---------------------|---------------------|----------------------|---------------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Net income available to common stockholders | \$ 6,239,440 | \$ 4,140,360 | \$ 17,268,114 | \$ 7,496,423 |
| Other comprehensive income: | | | | |
| Gain on effective cash flow hedges (net of realized gain reclassified to statements of income) | 561,919 | 420,503 | 6,294,538 | 256,685 |
| Foreign currency translation adjustment | 585,782 | 40,542 | 1,964,038 | (156,360) |
| Total other comprehensive income | 1,147,701 | 461,045 | 8,258,576 | 100,325 |
| Total comprehensive income | \$ 7,387,141 | \$ 4,601,405 | \$ 25,526,690 | \$ 7,596,748 |

6. Fixed Assets:

Fixed assets consist of the following:

| | Estimated Useful Life (Years) | September 30, 2007 | December 31, 2006 |
|---|-------------------------------|--------------------|-------------------|
| Network equipment, cabling and computers | 3-5 | \$ 26,864,184 | \$ 20,068,764 |
| Buildings | 30 | 1,994,160 | 1,814,245 |
| Land | | 1,306,125 | 1,192,666 |
| Leasehold improvements | 3-5 | 12,698,186 | 8,401,713 |
| Office furniture and equipment | 3-7 | 5,307,437 | 3,652,614 |
| Motor vehicles | 3 | 1,123,691 | 927,716 |
| Construction in progress | | 964,552 | 3,532,677 |
| | | 50,258,335 | 39,590,395 |
| Less: Accumulated depreciation and amortization | | (26,508,857) | (18,045,071) |
| | | \$ 23,749,478 | \$ 21,545,324 |

Depreciation and amortization expense for the three months ended September 30, 2007 and 2006 was \$2,335,476 and \$2,024,929, respectively. Depreciation and amortization expense for the nine months ended September 30, 2007 and 2006 was \$6,360,413 and \$5,664,903, respectively.

Construction in progress represents advances paid towards the acquisition of fixed assets and the cost of fixed assets not yet placed in service. The cost and accumulated amortization of assets under capital leases at September 30, 2007 were \$725,318 and \$272,371, respectively, and at December 31, 2006 were \$825,177 and \$456,082, respectively.

7. Senior Long-Term Debt

On December 13, 2002, certain new investors and members of management acquired senior promissory notes issued by the Company totaling \$4,674,000. The senior promissory notes were to mature on December 13, 2007. The Company issued additional senior promissory notes to employees of the Company during August 2003 in the amount of \$272,403. Interest on the principal amount was payable on maturity and accrued at a rate equal to the greater of (i) 2.02% semiannually or (ii) London Interbank Offered Rate.

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Deferred financing costs, totaling \$300,000, were included in other assets and were amortized to interest expense through the maturity date of the senior long-term debt. The Company repaid all outstanding promissory notes of \$5,821,190 with a portion of the proceeds from its October 2006 initial public offering. The un-amortized issuance cost was charged to interest expense upon the repayment of the senior long-term debt. For the three months ended September 30, 2007 and 2006, amortization of deferred financing costs amounted to \$0 and \$15,000, respectively. For the nine months ended September 30, 2007 and 2006, amortization of deferred financing costs amounted to \$0 and \$45,000, respectively.

8. Redeemable Preferred Stock

On December 13, 2002, the Company issued 45,304 shares of redeemable Series A preferred stock to certain new investors and certain members of management. The Company repurchased all of the outstanding preferred stock by repaying \$6,688,413 in October and November 2006 with a portion of the proceeds from its October 2006 initial public offering. The Company is currently authorized to issue up to 15 million shares of preferred stock.

Table of Contents

For the three months ended September 30, 2007 and 2006, the Company recorded \$0 and \$165,794, respectively, as dividends and accretion on preferred stock in the consolidated statements of income. For the nine months ended September 30, 2007 and 2006, the Company recorded \$0 and \$478,173, respectively, as dividends and accretion on preferred stock in the consolidated statements of income.

The preferred stock was recorded net of issuance costs of \$300,000, which were accreted over a period of five years. For the three months ended September 30, 2007 and 2006, amortization of issuance costs of \$0 and \$15,000, respectively, was included as dividends and accretion on preferred stock in the consolidated statements of income. For the nine months ended September 30, 2007 and 2006, amortization of issuance costs of \$0 and \$45,000, respectively, was included as dividends and accretion on preferred stock in the consolidated statements of income. The unamortized issuance cost was charged to expense on the repurchase of preferred stock.

9. Capital Structure**Common Stock**

Prior to the October 2006 initial public offering, the Company had Series A common stock and Series B common stock issued and outstanding. Holders of Series A common stock had one vote for each share held with respect to all matters voted on by the stockholders of the Company. Holders of Series B common stock did not have any voting rights.

In connection with the October 2006 initial public offering all outstanding shares of Series B common stock of the Company converted automatically into shares of Series A common stock (the *Conversion*). In addition, immediately prior to the consummation of the offering, the Company increased its total authorized number of shares of capital stock and effected a two-for-one stock split (the *Stock Split*). As a result of the October 2006 initial public offering, the Company only has one class of common stock outstanding.

10. Employee Benefit Plans

The Company's *Gratuity Plan* provides a lump sum payment to vested employees on retirement or on termination of employment in an amount based on the respective employee's salary and years of employment with the Company. Liabilities with regard to the *Gratuity Plan* are determined by actuarial valuation. Current service costs for the *Gratuity Plan* are accrued in the year to which they relate.

Net gratuity cost includes the following components:

| | Three months ended September 30, | | Nine months ended September 30, | |
|-------------------|-------------------------------------|-----------|------------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | \$ 76,475 | \$ 69,261 | \$ 275,365 | \$ 197,412 |
| Interest cost | 16,488 | 8,206 | 51,506 | 23,458 |
| Actuarial loss | | 4,183 | 5,232 | 4,183 |
| Net gratuity cost | \$ 92,963 | \$ 81,650 | \$ 332,103 | \$ 225,053 |

The Company contributes to the *Government Provident Fund* (a defined contribution plan) on behalf of its employees in India. The assets held by the *Government Provident Fund* are not reported on the Company's balance sheet. The contributions made to the *Government Provident Fund* for each period are as follows:

| | |
|---------------------------------------|--------------|
| Three months ended September 30, 2007 | \$ 512,029 |
| Three months ended September 30, 2006 | \$ 343,906 |
| Nine months ended September 30, 2007 | \$ 1,428,140 |
| Nine months ended September 30, 2006 | \$ 941,856 |

11. Leases

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The Company leases motor vehicles from finance companies for certain of its employees. Such leases are recorded as capital leases with interest rates ranging from 9.0% to 12.5%. Future minimum lease payments under these capital leases at September 30, 2007 are as follows:

| Year ending September 30, | |
|--|-------------------|
| 2008 | \$ 175,833 |
| 2009 | 168,294 |
| 2010 | 144,235 |
| Total minimum lease payments | 488,362 |
| Less: amount representing interest | 48,804 |
| Present value of minimum lease payments | 439,558 |
| Less: current portion | 140,570 |
| Long term capital lease obligation | \$ 298,988 |

The Company conducts its operations using facilities, office furniture and certain equipment leased under non-cancelable operating lease agreements that expire in November 2009. Future minimum lease payments under non-cancelable agreements expiring after more than twelve months are as follows:

| Year ending September 30, | |
|-------------------------------------|---------------------|
| 2008 | \$ 1,281,384 |
| 2009 | 731,397 |
| 2010 | 89,234 |
| Total minimum lease payments | \$ 2,102,015 |

Rent expense under operating leases was \$995,442 and \$881,271 for the three months ended September 30, 2007 and 2006, respectively. Rent expense under operating leases was \$2,675,178 and \$2,232,208 for the nine months ended September 30, 2007 and 2006, respectively.

Table of Contents**12. Income Taxes**

The Company recorded income tax expense of \$1,712,240 for the three months ended September 30, 2007 and \$3,104,673 for the nine months ended September 30, 2007. This amount includes current taxes of \$1,714,843 and a deferred tax benefit of \$2,603 for the three months ended September 30, 2007. For the nine months ended September 30, 2007 this amount includes current taxes of \$3,849,513 offset by a deferred tax benefit of \$744,840.

The effective rate of taxes has increased to a provision of 21.5% for the three months ended September 30, 2007, as compared to a benefit of 3.6% for the three months ended September 30, 2006. The effective rate of taxes has increased to a provision of 15.2% for the nine months ended September 30, 2007, as compared to 4.2% for the nine months ended September 30, 2006. This is due to the changes in the geographic distribution of our income and the impact of foreign exchange fluctuation. Certain of our Indian subsidiaries benefit from a tax holiday until March 2009.

Deferred tax assets and liabilities are recognized for future tax consequences attributable to temporary differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry forwards. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We recognize the effect on deferred tax assets and liabilities of a change in tax rates in income in the period that includes the enactment date. We determine if a valuation allowance is required or not on the basis of an assessment of whether it is more likely than not that a deferred tax asset will be realized.

The fiscal year under the Indian Income Tax Act ends on March 31 of each year. A portion of the Company's Indian operations qualifies for exemption from taxable income because its profits are attributable to work performed in Export Processing Zones. This exemption is available for a period of ten consecutive years beginning from the year in which the entity commenced commercial operations. Accordingly, Exl India, Inductis India and NCOP benefit from this deduction. This exemption shall terminate if the Company ceases to operate in Export Processing Zones or by March 2009 when the tax exemption period expires. ESSPL is not eligible for this deduction. The export revenue of Exl India, Inductis India and NCOP qualifies for a deduction from taxable income because its profits are attributable to work performed in Export Processing Zones, and a substantial portion of the temporary differences would not have any tax consequences as they will reverse within the tax holiday period. Pursuant to changes in the Indian Income tax Act from April 1, 2007, the Company has calculated its tax liability after considering the Minimum Alternate Tax (MAT). The MAT liability can be carried forward and set off against future tax liabilities. In accordance with SFAS 109 Accounting for Income Taxes a deferred tax asset of \$1,253,679 has been recognized as of September 30, 2007 with respect to this liability.

The deferred tax asset represents the tax effect of temporary differences related to the Company's domestic operations and to the Company's foreign operations that will reverse after the tax holiday period has expired.

The deferred tax benefit is primarily attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and arose due to differences in: (i) depreciation rates of fixed assets, (ii) provisions for gratuity and vacation pay which are allowable on a cash basis under the Indian Income Tax Act with respect to the Company's foreign operations, (iii) deferred compensation, (iv) MAT credit entitlement and (v) deferred revenue with respect to the domestic operations of the Company. At September 30, 2007, the Company performed an analysis of the deferred tax asset valuation allowance for its Indian subsidiary. Based on this analysis, the Company has concluded that a valuation allowance offsetting certain deferred tax assets should continue to be recorded at September 30, 2007 based on the conclusion that it is more likely than not that there will not be sufficient future taxable income to realize the deferred tax assets. The valuation allowance at September 30, 2007 is approximately \$4.3 million.

13. Stock Based Compensation

In 2003, the Company instituted the ExlService Holdings, Inc. 2003 Stock Option Plan (the 2003 Plan). The 2003 Plan covers all the employees of the Company and its subsidiaries. The Compensation Committee of the Board (the Committee) administers the 2003 Plan and grants stock options to eligible employees of the Company and its subsidiaries.

The Committee determines which employees are eligible to receive the options, the number of options to be granted, the exercise price, the vesting period and the exercise period. The vesting period is determined for the options issued on the date of the grant and is non-transferable during the life of the option. The options expire ten years from the date of grant and generally vest incrementally over a period of four years from the date of grant with 25% of the options vesting each year.

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Pursuant to the 2003 Plan, the Company reserved 1,600,000 shares of common stock after giving effect to the Stock Split and Conversion, for the granting of options. If an employee is terminated they must exercise any vested options within 90 days after termination or the vested options are forfeited. On September 29, 2006, the Company decided to cease making new grants under the 2003 Plan. Grants previously made under the 2003 Plan may continue to be exercised in accordance with the terms of the 2003 Plan. As of September 29, 2006, the pool of shares available for grant under the 2003 Plan was added to the pool of available shares under the 2006 Plan (as defined below).

In 2006, the Company instituted the ExlService Holdings, Inc. 2006 Omnibus Award Plan (the 2006 Plan). The 2006 Plan covers all the employees of the Company and its subsidiaries. Under the 2006 Plan, the Committee may grant awards of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units, stock bonus awards, performance compensation awards (including cash bonus awards) or any combination of the foregoing.

The Committee determines which employees are eligible to receive the options, the number of options to be granted, the exercise price, the vesting period and the exercise period. The vesting period is determined for the options issued on the date of the grant and is non-transferable during the life of the option. The options expire ten years from the date of grant and generally vest incrementally over a period of four years from the date of grant with 10% vesting in year one, 20% vesting in year two, 30% vesting in year three and 40% vesting in year four. Pursuant to the 2006 Plan, the Company reserved 3,399,384 shares of common stock (in addition to the available pool of 2003 plan) for the granting of options. If an employee is terminated they must exercise any vested options within 90 days after termination or the vested options are forfeited.

The compensation cost that has been charged against income for our stock based compensation plan is as follows:

| | Three months ended | | Nine months ended | |
|-------------------------------------|---------------------------|-------------------|--------------------------|---------------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Cost of Revenue | \$ 313,160 | \$ 220,446 | \$ 814,549 | \$ 248,213 |
| General and Administrative expenses | 628,421 | 642,172 | 1,789,451 | 1,015,156 |
| Selling and Marketing expenses | 217,567 | 16,744 | 474,144 | 16,744 |
| Total | \$ 1,159,148 | \$ 879,362 | \$ 3,078,144 | \$ 1,280,113 |

Table of Contents

The unrecognized compensation cost for unvested options as of September 30, 2007, is \$7,385,681, which is expected to be expensed over a weighted average period of 3.01 years. The fair value of the stock was estimated on the date of grant using third party valuations during the period when the Company was a non-public entity. The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions.

| | Three months ended | | Nine months ended | |
|-------------------------|--------------------|-------|--------------------|-------|
| | September 30, 2007 | 2006 | September 30, 2007 | 2006 |
| Dividend yield | 0% | 0% | 0% | 0% |
| Expected life (years) | 6.25 | 6.25 | 6.25 | 5.28 |
| Risk free interest rate | 4.26% | 5.00% | 4.85% | 4.93% |
| Volatility | 50% | 50% | 50% | 50% |

The Company estimates the expected term of options granted by taking the average of the vesting term and the contractual term of the option, as illustrated in Staff Accounting Bulletin No. 107 (SAB 107). In the absence of a history of volatility of our stock trading we have used the volatility of stocks of comparative companies with estimated life of options similar to ours. The risk-free interest rate that we use in the option valuation model is based on U.S. treasury zero-coupon bonds with a remaining term similar to the expected term of the options. We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option valuation model. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

Stock option activity under the Company's stock plans is shown below:

| | Number of Shares | Weighted | |
|--|------------------------|---------------------------|-------|
| | | Average Exercise Price | |
| Outstanding at December 31, 2006 | 1,642,190 | \$ | 10.46 |
| Granted | 357,000 | \$ | 21.44 |
| Exercised | (246,628) | \$ | 4.41 |
| Forfeited | (202,993) | \$ | 12.17 |
| Outstanding at September 30, 2007 | 1,549,569 | \$ | 13.67 |
| Vested and exercisable at September 30, 2007 | 281,069 | \$ | 9.92 |
| Available for grant at September 30, 2007 | 2,197,282 | | |

The weighted-average fair value of options granted during the three months ended September 30, 2007 and 2006 was \$9.89 and \$8.79, respectively, and weighted average fair value of options granted during the nine months ended September 30, 2007 and 2006 was \$11.7 and \$8.81, respectively. The weighted-average remaining contractual life of options outstanding and exercisable at September 30, 2007 and 2006 was 7.59 years and 7.69 years, respectively. The weighted average fair value of vested and exercisable options at September 30, 2007 was \$3.96.

Restricted Stock and Restricted Stock Units

An award of restricted stock is a grant of shares subject to conditions and restrictions set by the Committee. The grant or the vesting of an award of restricted stock may be conditioned upon service to us or our affiliates or upon the attainment of performance goals or other factors, as determined in the discretion of the Committee. The Committee may also, in its discretion, provide for the lapse of restrictions imposed upon an award of restricted stock. Holders of an award of restricted stock may have, with respect to the restricted stock granted, all of the rights of a stockholder, including the right to vote and to receive dividends.

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The Committee is authorized to award restricted stock units to participants. The Committee establishes the terms, conditions and restrictions applicable to each award of restricted stock units, including the time or times at which restricted stock units will be granted or vested and the number of units to be covered by each award. The terms and conditions of each restricted stock award will be reflected in a restricted stock unit agreement.

Restricted stock activity under the Company's stock plans is shown below:

| | Number of Restricted Stock Shares | Weighted Average Intrinsic Value | Number of Restricted Stock Units | Weighted Average Intrinsic Value |
|---------------------------------------|--|---|---|---|
| Unvested at December 31, 2006 | 267,270 | \$ 9.34 | 16,000 | \$ 9.86 |
| Granted | 366,600 | 21.48 | 8,000 | 18.67 |
| Vested | (59,016) | 8.83 | (16,000) | 9.86 |
| Forfeited | (25,660) | 12.36 | | |
| Unvested at September 30, 2007 | 549,194 | \$ 17.42 | 8,000 | \$ 18.67 |

As of September 30, 2007, unrecognized compensation cost of \$7,812,246 is expected to be expensed over a weighted average period of 3.2 years. The weighted-average fair value of restricted stock and restricted stock units under the 2006 Plan during three months ended September 30, 2007 and 2006, was \$18.33 and \$9.19, respectively. The weighted-average fair value of restricted stock and restricted stock units under the 2006 Plan during the nine months ended September 30, 2007 and 2006, was \$21.42 and \$9.22, respectively. The weighted-average remaining contractual life of restricted stock and restricted stock units outstanding and exercisable at September 30, 2007 and 2006, was 9.06 years and 9.58 years, respectively.

The number of options and restricted stock has been adjusted to reflect the Stock Split described in Note 9.

The Finance Act of India 2007 has imposed a Fringe Benefit Tax (FBT) on equity compensation effective April 1, 2007. The FBT is calculated on the difference between the fair market value as of the vesting date and the exercise price of the equity compensation awards granted to India based employees. For the three months ended September 30, 2007 and nine months ended September 30, 2007, the Company recorded FBT expense of \$0.08 million and \$0.28 million, respectively.

Table of Contents
Advisory Board Options

In 2005, the Company granted to a member of its advisory board options to purchase 10,000 shares (after giving effect to the Stock Split and Conversion) of common stock at an exercise price of \$11.88 per share under the 2003 Plan. Using the Black-Scholes valuation model, the fair value of these options at September 30, 2007 was determined to be \$145,567. In 2003, the Company also granted to members of its advisory board options to purchase 20,000 shares (after giving effect to the Stock Split and Conversion) of common stock at an exercise price of \$0.12 per share under the 2003 Plan. Using the Black-Scholes valuation model, the fair value of these options at September 30, 2007 was determined to be \$423,394. These options vest over a period of four years and expire ten years from the grant date. For the three months ended September 30, 2007 and 2006, the Company recorded compensation expense of \$92,230 and \$32,438, respectively. For the nine months ended September 30, 2007 and 2006, the Company recorded compensation expense of \$110,814 and \$21,200, respectively. The fair value and related compensation expense will be re-measured for the unvested portion of these options at the end of each reporting period until such options are fully vested.

Client Options

In connection with the execution of a five-year services agreement, the Company issued options to purchase 230,200 shares of common stock (after giving effect to the Stock Split and Conversion) at an exercise price of \$6.25 per share in July 2004 to one of our clients. The option is fully exercisable and expires ten years from the date of grant. The value of the options on the date of issuance, using the Black-Scholes valuation model was approximately \$1,792,000. Such amount is being amortized as a reduction in revenue over the five-year term of the services agreement. Amortization for the three months ended September 30, 2007 and 2006 was \$89,604 and \$89,604, respectively. Amortization for the nine months ended September 30, 2007 and 2006 was \$268,812 and \$268,812, respectively.

14. Related Party Transactions

The Company received services in India for employee training performed by a company controlled by one of the Company's significant stockholders. This company is one of the many companies rendering such services to Exl India. The Company recorded expenses related to these services of \$0 and \$27,269 for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and September 30, 2006, the Company recorded expenses of \$0 and \$53,194, respectively. At September 30, 2007 the Company had a balance payable of \$2,044 related to these services. The agreement with this company terminated on September 30, 2006.

The Company recorded expenses of \$585,314 and \$0 for the three months ended September 30, 2007 and 2006, respectively and expenses of \$585,314 and \$0 for the nine months ended September 30, 2007 and 2006, respectively, for transition services performed by a company controlled by one of the Company's significant stockholders. As of September 30, 2007 the Company had a balance payable of \$585,314 related to these services.

The Company provides advisory services related primarily to compliance with the Sarbanes-Oxley Act of 2002 to Williams Scotsman, Inc., a provider of mobile and modular building solutions in North America. Williams Scotsman, Inc. is controlled by entities related to one of the Company's significant stockholders. The Company recognized approximately \$304,270 and \$248,696 in the three months ended September 30, 2007 and 2006, respectively, and \$394,816 and \$494,106 in the nine months ended September 30, 2007 and 2006, respectively, in advisory fees revenue and expense reimbursements from Williams Scotsman, Inc. At September 30, 2007 and December 31, 2006, the Company had an account receivable of \$196,173 and \$59,633, respectively, related to these services.

The Company provides BPO services to MedSynergies, Inc., a provider of outsourced billing, claims administration and payment processing services to healthcare providers. MedSynergies, Inc. is controlled by entities related to one of the Company's former significant stockholders and ceased to be a related party to the Company during the three months ended June 30, 2007. The Company recognized revenue of approximately \$186,525 in the three months ended September 30, 2006 from MedSynergies, Inc. For the nine months ended September 30, 2007 and September 30, 2006, the Company recorded revenue of \$382,920 and \$342,860, respectively for the period MedSynergies, Inc. was a related party. At September 30, 2007 and December 31, 2006, the Company had an account receivable of \$102,879 and \$130,020, respectively, related to these services.

The Company provides advisory services to Duane Reade Holdings, Inc., a New York City drugstore chain. Duane Reade Holdings, Inc. is indirectly owned by one of the Company's significant stockholders. The Company recognized revenue of approximately \$234,480 and \$143,420 in the three months ended September 30, 2007 and 2006, respectively, and \$441,700 and \$422,320 in the nine months ended September 30, 2007 and 2006, respectively, for advisory fees and expense reimbursements from Duane Reade Holdings, Inc. At September 30, 2007 and December 31, 2006, the Company had an account receivable of \$159,140 and \$55,350, respectively, related to these services.

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The Company provides analytical services to FTVentures, one of the Company's former significant stockholders. During the three months ended June 30, 2007, FTVentures ceased to be a related party to the Company. The Company recognized revenue of approximately \$4,900 in the three months ended September 30, 2006 from FTVentures. For the nine months ended September 30, 2007 and September 30, 2006, the Company recorded revenue of \$43,349 and \$4,900, respectively for the period FTVentures was a related party. At September 30, 2007 and December 31, 2006, the Company had an account receivable of \$8,500 and \$9,800, respectively, related to these services.

The Company entered into employment and non-competition agreements with certain members of senior management in November 2002. The initial term of these agreements was three years and the Company had the option to extend the term for two additional one-year periods. The agreements had been extended through September 30, 2006. These agreements were amended and restated in their entirety effective September 30, 2006. The amended and restated employment agreements will expire in December 31, 2009 and will automatically extend for successive 12-month periods unless either party provides the other with 120 days' notice of its desire not to extend the agreement.

For the three months ended September 30, 2007 and 2006, the Company accrued management fees of \$0 and \$50,000, respectively, to certain of its significant stockholders. For each of the nine months ended September 30, 2007 and 2006, the Company accrued management fees of \$0 and \$150,000, respectively, to certain of its significant stockholders.

15. Geographical Information

| | Three months ended September 30, | | Nine months ended September 30, | |
|---------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues | | | | |
| United States | \$ 22,118,124 | \$ 19,149,844 | \$ 60,990,345 | \$ 39,910,017 |
| United Kingdom | 24,392,299 | 16,204,839 | 68,216,222 | 42,228,908 |
| Rest of World (excluding India) | 37,324 | 310,362 | 204,147 | 314,362 |
| India | 81,303 | | 92,623 | |
| | \$ 46,629,050 | \$ 35,665,045 | \$ 129,503,337 | \$ 82,453,287 |

Table of Contents

| | September 30, 2007 | December 31, 2006 |
|--------------------------|----------------------|----------------------|
| Fixed assets, net | | |
| United States | \$ 1,623,702 | \$ 2,022,808 |
| India | 22,102,072 | 19,518,994 |
| United Kingdom | 23,704 | 3,522 |
| | \$ 23,749,478 | \$ 21,545,324 |

16. Commitments and Contingencies*Fixed Asset Commitments*

At September 30, 2007, the Company had committed to spend approximately \$860,000 under agreements to purchase fixed assets. This amount is net of advances paid in respect of these purchases.

Other Commitments

Exl India, Inductis India and NCOP have been established as Export-Oriented Undertaking enterprises under the Export Import Policy (the policy) formulated by the Government of India. Pursuant to this policy, the Company has benefited from certain incentives on import of capital goods. Under this policy, Exl India, Inductis India and NCOP must achieve certain export ratios and realize revenues attributable to exports of approximately \$244.5 million, \$21.8 million and \$43.4 million, respectively, over a period of five years.

If Exl India, Inductis India and NCOP are unable to achieve their commitments over the specified period, Exl India, Inductis India and NCOP may be required to refund such incentives along with penalties and fines. Management, however, believes that Exl India, Inductis India and NCOP will achieve these export levels within the required timeframe.

Contingencies

U.S. and Indian transfer-pricing regulations require that any international transaction involving associated enterprises be at an arm's-length price. Transactions among the Company's subsidiaries and the Company may be considered such transactions. Accordingly, the Company determines the pricing among its associated enterprises on the basis of detailed functional and economic analysis involving benchmarking against transactions among entities that are not under common control. If the applicable income tax authorities review any of the Company's tax returns and determine that the transfer price applied was not appropriate, the Company may incur increased tax liability, including accrued interest and penalties. The Company is currently involved in disputes with the Indian tax authorities over the application of some of its transfer pricing policies. The Company has received three assessment orders from the Indian tax authorities with respect to their audit of certain of the Company's subsidiaries. The Indian tax authorities are examining income tax returns for other tax years.

The first assessment for the tax year 2003-04 requires that Exl India pay additional taxes in the amount of approximately \$2.4 million. The Company has paid approximately \$0.8 million to the Indian tax authorities as a deposit in respect of the first assessment while it is contesting the above order before the appellate authorities.

The second assessment order issued by the Indian tax authorities regarding transfer pricing is with respect to their audit of EXL India's 2004-05 tax year. The assessment order alleges that the transfer price applied to transactions between EXL India and EXL Inc. for the 2004-05 tax year was not appropriate and requires that EXL India pay additional taxes of \$4.1 million. We have paid approximately \$1.7 million to the Indian tax authorities as a deposit with respect to this assessment while we are contesting the above order before the appellate authorities.

The third assessment requires the payment by Exl Inc. of approximately \$3.7 million for the tax year 2003-04. Out of \$3.7 million, the Company has already paid \$1.8 million as a deposit in respect of the third assessment while it is contesting the above order before the appellate authorities.

Based on advice from its Indian tax advisors, the facts underlying its position and its experience with these types of assessments, the Company believes that the probability of loss is remote and accordingly has not accrued any amount with respect to these matters in its consolidated financial statements. The Company does not expect any impact from these assessments on its future income tax expense. The Company is subject to U.S. income taxes on the profits it recognizes in the United States. There is a possibility that the Company might receive similar orders for other years until the above disputes are resolved. Amounts paid as deposits in respect of the assessments described above, totaling \$4.3 million as of September 30, 2007, are included in Other assets in our September 30, 2007 consolidated balance sheet.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in connection with our unaudited consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Some of the statements in the following discussion are forward looking statements. See Forward Looking Statements.

Overview

We are a recognized provider of offshore solutions, including BPO, research and analytics and advisory services, primarily serving the needs of Global 1000 companies in the banking, financial services and insurance sector as well as other industry sectors such as utilities. We provide integrated front-, middle- and back-office process outsourcing services and manage large-scale processes for our U.S. and U.K.-based clients. The BPO services we provide involve the transfer to us of select business operations of a client, such as claims processing, finance and accounting and customer service, after which we administer and manage the operations for our client. Our research and analytics services are intended to facilitate more effective data-based strategic and operating decisions by our clients using statistical and quantitative analytical techniques. Our advisory services include risk assessment, documentation and internal controls testing, business process re-engineering and process quality monitoring. A significant portion of our business relates to processes that we believe are integral to our clients' operations, and the close nature of our relationships with our clients assists us in developing strong strategic long-term relationships with them.

We market our services directly through our sales and marketing team, which operates out of the U.S. and U.K., and our business development team, which operates out of India. We currently operate nine operations facilities in India and the U.S.

We completed the Inductis Acquisition on July 1, 2006. The Inductis Acquisition has expanded the types and sophistication of the research and analytics services we offer. The results of operations of Inductis are consolidated in our financial statements with effect from July 1, 2006. As a result, our results of operations for the nine months ended September 30, 2007 are not comparable to our results of operations for the nine months ended September 30, 2006.

In October 2006, we consummated an initial public offering of our shares of common stock. Our initial public offering resulted in net proceeds of \$69.8 million to us after deducting underwriting discounts and commissions and related expenses. Our common stock is traded on the NASDAQ Global Select Market under the symbol EXLS. In connection with the October 2006 initial public offering, we effected the Conversion and the Stock Split.

Revenues

We generate revenues principally from contracts to provide BPO, research and analytics and advisory services. For the three and nine months ended September 30, 2007, we had total revenues of \$46.6 million and \$129.5 million compared to total revenues of \$35.7 million and \$82.5 million for the corresponding periods in 2006, an increase of 30.7% and 57.1% respectively. Revenues for the nine months ended September 30, 2007 were higher by \$6.2 million as compared to the nine months ended September 30, 2006 due to the inclusion of Inductis from July 1, 2006, the date of acquisition. The key drivers of our revenue growth for the three months ended September 30, 2007 were as follows:

Growth of our client base.

Ongoing growth in existing client relationships.

Growth of advisory services including Sarbanes-Oxley compliance, internal audit outsourcing, internal controls documentation and value-added services.

We anticipate that our revenues will grow as we expand our service offerings, both organically and through further acquisitions. Revenues from new clients are an indicator of successful marketing efforts and do not represent a trend in our results of operations. We provide our clients with a range of BPO services, including insurance services, banking and financial services, finance and accounting services and collection services. Our clients transfer the management and execution of their processes or business functions to us. As part of this transfer, we hire and train employees to work at our operations centers on the relevant BPO service, implement a process migration to these operations centers and then provide services either to that client or directly to that client's customers. Each client contract has different terms based on the scope, deliverables

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and complexity of the engagement. The BPO services we provide to our clients (particularly under our general framework agreements), and the revenues and income that we derive from those services, may decline or vary as the type and quantity of services we provide under those contracts change over time, including as a result of a shift in the mix of products and services we provide. Our revenues may also be adversely affected to the extent our existing clients reduce or eliminate their use of our service offerings. Our operating results may vary significantly from period to period as a result of various factors, including, for example, seasonal changes in our clients' operations or macroeconomic effects on our clients' businesses.

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For BPO services, we enter into long-term agreements with our clients with initial terms ranging from three to seven years. Although these agreements provide us with a relatively predictable revenue base for a substantial portion of our business, the long selling cycle for our BPO services and the budget and approval processes of prospective clients make it difficult to predict the timing of new client acquisitions. Revenues under new client contracts also vary depending on when we complete the selling cycle and the implementation phase.

Our research and analytics services are intended to facilitate more effective data-based strategic and operating decisions by our clients using research, statistical and quantitative analytical techniques. We materially expanded our research and analytics capabilities and enhanced the strategic dimension of our services with the Inductis Acquisition.

Our advisory services include risk assessment, documentation and internal controls testing and business process re-engineering and process quality monitoring.

Our research and analytics services and our advisory services are cyclical and can be significantly affected by variations in business cycles. In addition, our research and analytics services and our advisory services usually consist of specific projects with contract terms generally not exceeding one year and may not produce ongoing or recurring business for us once the project is completed. These contracts also usually contain provisions permitting termination of the contract after a short notice period. The short-term nature and specificity of these projects could lead to material fluctuations and uncertainties in the revenues generated from these businesses.

We serve clients mainly in the United States and the United Kingdom, with these two regions generating approximately 47.4% and 52.3%, respectively, of our total revenues in the three months ended September 30, 2007 and approximately 53.7% and 45.4%, respectively, of our total revenues in the three months ended September 30, 2006. For the nine months ended September 30, 2007 these two regions generated approximately 47.1% and 52.7%, respectively, of our total revenues and approximately 48.4% and 51.2%, respectively, of our total revenues in the nine months ended September 30, 2006.

Table of Contents

We derive a significant portion of our revenues from a limited number of large clients. In the three months ended September 30, 2007 and 2006, our total revenues from our two largest clients grew to \$24.4 million and \$16.2 million, respectively, accounting for 52.2% and 45.7% of our total revenues, respectively, during these periods. In the nine months ended September 30, 2007 and 2006, our total revenues from our two largest clients grew to \$68.1 million and \$42.2 million, respectively, accounting for 52.6% and 51.3% of our total revenues, respectively, during these periods.

We provide services to Norwich Union (an Aviva company), which represented \$12.4 million, or 26.5%, and \$35.8 million, or 27.7% of our total revenues in the three and the nine months ended September 30, 2007, respectively, and \$10.5 million, or 29.4%, and \$30.7 million, or 37.5% of our total revenues for the same periods in 2006, under two framework agreements and work orders generated by these agreements. The first framework agreement and all work orders under that agreement can be terminated without cause by our client at anytime after January 1, 2008 by giving three months notice. Norwich Union may terminate this agreement without cause or penalty with three months notice. The second framework agreement expires in July 2009 and can be terminated by Norwich Union without cause upon nine months prior notice and payment to us of a break-up fee during its initial term. After the initial term of the second framework agreement, Norwich Union may terminate this agreement without cause or penalty with nine months notice. We provide services to Centrica plc, which represented \$12.0 million, or 25.7%, and \$32.3 million, or 24.9%, of our total revenues for the three and nine months ended September 30, 2007, respectively, and \$5.8 million, or 16.3%, and \$11.5 million, or 13.8%, of our total revenues for the three and nine months ended September 30, 2006, respectively, under an agreement that has an initial term that expires in January 2009 and that can be terminated by Centrica plc for cause only during its initial term. Contracts with other BPO clients representing approximately 26.1% of our total BPO revenues for the three months ended September 30, 2007 and 27.8% of our total BPO revenues for the nine months ended September 30, 2007 will expire prior to September 30, 2008, while the remainder of our BPO contracts expire in more than one year or do not have specified initial terms and remain in effect until terminated or until there are no work orders or engagement schedules.

We derived revenues from eight and three new clients for our services, including advisory and research and analytics services, in the three months ended September 30, 2007 and 2006, respectively. By acquiring Inductis, we obtained 17 additional new clients in 2006. We derived revenues from 32 and 12 new clients for our services, including advisory and research and analytics services, in the nine months ended September 30, 2007 and 2006, respectively. Although we are increasing and diversifying our customer base, we expect in the near future that a significant portion of our revenues will continue to be contributed by a limited number of large clients.

We recognize revenues from services provided under our client contracts on a cost-plus, time-and-materials, fixed price, contingent fee or unit-price basis. Under cost-plus arrangements, we apply a mark-up (based on the service levels we achieve) to the contractually agreed direct and apportioned indirect costs we incur and invoice the client for the marked-up cost. Time-and-materials arrangements typically involve billings based on productive minutes or hours as we perform the related services. Unit-price arrangements involve billings based on productive units (such as the number of e-mail responses) as we deliver the services to the client. If we do not estimate the resources and time required for a unit-price project accurately or do not meet our contractual obligations within the required timeframe, we could incur a material adverse effect on our business, results of operations, financial condition and cash flows.

Revenues also include amounts representing reimbursable expenses that are billed to and reimbursed by our clients and typically include telecommunication and travel-related costs. The amount of reimbursable expenses that we incur, and any resulting revenues, can vary significantly from period to period depending on each client's situation and on the type of services provided. For the three months ended September 30, 2007 and September 30, 2006, 4.1% and 4.0%, respectively, of our revenues represent reimbursement of such expenses. For the nine months ended September 30, 2007 and September 30, 2006, 4.6% and 4.1%, respectively, of our revenues represent reimbursement of such expenses.

We also bear the risk of inflation and fluctuations in currency exchange rates with respect to our contracts, and our operating results could be negatively affected by adverse changes in wage inflation rates and foreign currency exchange rates. Although we take steps to hedge a substantial portion of our Indian rupee/U.S. dollar and U.K. pound sterling/U.S. dollar foreign currency exposures, our results of operations may be adversely affected if there is significant fluctuation among the Indian rupee, the U.K. pound sterling and the U.S. dollar or if our hedging strategy is unsuccessful.

Norwich Union has the option (Transfer Option) from January 2008 through February 2011 under one of its contracts with us to purchase the shares of our subsidiary that operates one of our facilities in Pune, India, by paying us an amount that will approximate the net asset value of that facility on the date of transfer. On September 10, 2007, the company entered into a letter agreement, effective as of September 6, 2007, with Norwich Union, amending the terms of exercise of the Transfer Option. Pursuant to the Letter Agreement, the earliest date of exercise of the Transfer Option has been extended from October 1, 2007 to January 1, 2008. As a result, if the Transfer Option is exercised, the earliest date by which the Company would be required to transfer the Pune, India, facility to Norwich Union, is April 2, 2008. The remaining terms of our agreements with Norwich Union remain unchanged. The exercise of this option would result in both a loss of revenues and the loss of all of our employees who are at that time working under that contract. Norwich Union has exercised its option to assume the operations of the facilities of

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one of its third party vendor-contractors and has publicly announced its intention to start exercising its option to assume the operations of the facilities of certain of its other third party vendor-contractors, including our facility in Pune. The affected facility generated 15.2% and 15.9% of our total revenues in the three and nine months ended September 30, 2007, respectively, as compared to 16.3% and 20.6%, respectively, for the corresponding prior year periods. We expect that any impact of decline in revenues that we would experience when Norwich Union exercises this option would be partially offset by a decrease in expenses associated with the operation of the affected Pune facility.

Table of Contents

Expenses

Cost of Revenues

Our cost of revenues primarily consists of:

employee costs, which include salary, retention and other compensation expenses; recruitment and training costs; non-cash amortization of stock compensation expense; and traveling and lodging costs; and

costs relating to our facilities and communications network, which include telecommunication and IT costs; facilities and customer management support; operational expenses for our outsourcing centers; and rent expenses.

The most significant component of our cost of revenues is employee compensation, recruitment, training and retention. Salary levels in India, employee turnover rates and our ability to efficiently manage and utilize our employees significantly affect our cost of revenues. Salary increases are generally awarded each year effective April 1. Accordingly employee costs are generally lower in the first quarter of each year compared to the rest of the year. We make every effort to manage employee and capacity utilization and continuously monitor service levels and staffing requirements. Although we generally have been able to reallocate our employees as client demand has fluctuated, a contract termination or significant reduction in work assigned to us by a major client could cause us to experience a higher-than-expected number of unassigned employees, which would increase our cost of revenues as a percentage of revenues until we are able to reduce or reallocate our headcount. A significant increase in the turnover rate among our employees in India, particularly among the highly skilled workforce needed to execute BPO services, would increase our recruiting and training costs and decrease our operating efficiency, productivity and profit margins. In addition, cost of revenues also includes a non-cash amortization of stock compensation expense relating to our issuance of stock options to employees directly involved in providing services to our clients.

We expect our cost of revenues to continue to increase as we continue to add professionals in India and the United States, to service additional business, in particular as our research and analytics and advisory services businesses grow, both organically and as a result of acquisitions, and as wages continue to increase in India. In particular, we expect training costs to continue to increase as we continue to add staff to service new clients.

Cost of revenues is also affected by our long selling cycle and implementation period for our BPO services, which require significant commitments of capital, resources and time by both our clients and us. Before committing to use our services, potential clients require us to expend substantial time and resources educating them as to the value of our services and assessing the feasibility of integrating our systems and processes with theirs. In addition, once a client in a new contract engages us, our cost of revenues may represent a higher percentage of revenues until the implementation phase for that contract, generally three to four months, is completed.

We also expect cost of revenues to increase when we add new operations facilities due to increases in telecommunication and rent expenses and other facilities operating costs. In particular, we recently opened a new operations facility in Noida, India, having a total capacity of 1,200 workstations, and are contractually committed to one of our clients to establish and maintain a viable BPO offshore operation outside of India by September 2008. As we increase the amount of physical infrastructure available to perform our operations, we expect that utilization will decrease and this will have a negative impact on our operating margin. The India Finance Act, 2007 has imposed additional taxes on leased real estate. As such, we may determine that it is in our interest to exercise our purchase options with respect to certain of our leased properties. In addition, in the future we may decide to purchase real estate instead of leasing it, which is likely to increase our initial cash outflow in connection with any expansion of our facilities.

SG&A Expenses

Our general and administrative expenses are comprised of expenses relating to salaries of senior management and other support personnel, legal and other professional fees, telecommunications, utilities and other miscellaneous administrative costs. Selling and marketing expenses primarily consist of salaries of sales and marketing personnel, client relationship management, travel and brand building. We expect that sales and marketing expenses will continue to increase as we invest heavily in our front-end sales and client relationship management functions to better serve our clients. We also expect our costs to increase as we continue to strengthen our back-end support and enabling functions and drive additional management development programs and training initiatives. SG&A expenses also include non-cash amortization of stock compensation expense related to our issuance of stock options and restricted stock to senior management, members of our board of directors and advisory board, other support personnel and consultants.

Depreciation and Amortization

Depreciation and amortization pertains to depreciation and amortization of our tangible assets, including network equipment, cabling, computers, office furniture and equipment, motor vehicles and leasehold improvements and intangible assets. Amortization of intangible assets acquired in the Inductis Acquisition is part of depreciation and amortization. As we add facilities, we expect that depreciation expense will increase, reflecting additional investments in equipment such as desktop computers, servers and other infrastructure.

Foreign Exchange

Exchange Rates

We report our financial results in U.S. dollars and a substantial portion of our total revenues is earned in U.K. pound sterling. Accordingly, our results of operations are adversely affected if the U.K. pound sterling depreciates against the U.S. dollar. Although substantially all of our revenues are denominated in U.S. dollars or U.K. pound sterling (47.4% and 52.3%, respectively, for the three months ended September 30, 2007 and 47.1% and 52.7%, respectively, for the nine months ended September 30, 2007, as compared to 53.7% and 45.4%, respectively, for the three months ended September 30, 2006 and 48.4% and 51.2%, respectively, for the nine months ended September 30, 2006), most of our expenses (66.6% in the three months ended September 30, 2007 and 66.0% in the nine months ended September 30, 2007) were incurred and paid in Indian rupees. The exchange rates among the Indian rupee, the U.K. pound sterling and the U.S. dollar have changed substantially in recent years and may fluctuate in the future. The results of our operations could be substantially impacted as the Indian rupee appreciates or depreciates against the U.S. dollar or the U.K. pound sterling.

Table of Contents

Currency Regulation

According to the prevailing foreign exchange regulations in India, an exporter of BPO services that is registered with a software technology park or an export processing zone in India, including each of our subsidiaries Exl India and Inductis India, is required to realize its export proceeds within a period of 12 months from the date of export. Similarly, in the event that such exporter has received any advance against exports in foreign exchange from its overseas customers, it will have to render the requisite services so that the advances received are earned within a period of 12 months. If Exl India or Inductis India did not meet these conditions, it would be required to obtain permission to export foreign currency from the Reserve Bank of India.

ExlService Holdings and Inductis receive payments under most of their respective client contracts and are invoiced by Exl India and Inductis India, as applicable, for services that Exl India and Inductis India, as applicable, provide to our clients under these contracts. Exl India and Inductis India hold the foreign currency they receive, primarily from ExlService Holdings and Inductis, in an export earners foreign currency account. All foreign exchange requirements, including import of capital goods, expenses incurred during foreign travel of employees and discharge of foreign exchange are met using the foreign currency in that account. As and when funds are required in India, such funds are transferred to an Indian rupee account.

Income Taxes

The India Finance Act, 2000 provides Exl India and Inductis India with a ten-year holiday from Indian corporate income taxes as an entity exporting IT services from designated software technology parks and export processing zones in India. The India Finance Act, 2000 phases out the tax holiday over a ten-year period from fiscal 2000 through fiscal 2009. Accordingly, facilities established in India on or before March 31, 2000 have a ten-year tax holiday, new facilities established on or before March 31, 2001 have a nine-year tax holiday and so forth until March 31, 2009. After March 31, 2009, the tax holiday will no longer be available to new facilities. Exl India provides BPO services from its wholly owned, export oriented units situated in Noida and Pune. The income derived from the services rendered from these facilities is not subject to taxes in India until March 31, 2009. Inductis India is located in Gurgaon and its services also qualify under the India Finance Act, 2000 for a tax holiday until March 31, 2009.

As a result of the tax holiday, our BPO service operations have been subject to relatively lower tax liabilities. For example, we recognized lower income tax expense with respect to the Company's foreign operations for the three months ended September 30, 2007 as a result of the tax holiday, compared to approximately \$1.0 million that we would have incurred if the tax holiday had not been available for that period (without accounting for double taxation treaty set-offs). When our tax holiday expires or terminates, our tax expense will materially increase. While we have incurred losses in the prior periods under applicable Indian tax laws, we have decided not to carry forward these losses.

We recognize deferred tax assets and liabilities for temporary differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry forwards. We determine if a valuation allowance is required or not on the basis of an assessment of whether it is more likely than not that a deferred tax asset will be realized.

The India Finance Act, 2007 includes the imposition of MAT obligations beginning in April 2007. Pursuant to such change we have calculated our tax liability including MAT. The MAT liability can be carried forward and set off against future tax liabilities. In accordance with SFAS 109 Accounting for Income Taxes a deferred tax asset of \$1,253,679 has been recognized as of September 30, 2007.

U.S. and Indian transfer-pricing regulations require that any international transaction involving associated enterprises be at an arm's-length price. Transactions among our subsidiaries and ExlService Holdings Inc. may be considered such transactions. Accordingly, we determine the pricing among our associated enterprises on the basis of detailed functional and economic analysis involving benchmarking against transactions among entities that are not under common control. If the applicable income tax authorities review any of our tax returns and determine that the transfer price applied was not appropriate, we may incur increased tax liabilities, including accrued interest and penalties. We are currently involved in disputes with Indian tax authorities over the application of some of our transfer pricing policies. We have received three assessment orders from the Indian tax authorities with respect to their audit of certain of our subsidiaries. The Indian tax authorities are examining income tax returns for other tax years.

The first assessment order issued by the Indian tax authorities regarding transfer pricing relates to the audit of EXL India's 2003-04 tax year. The assessment order alleges that the transfer price we applied to transactions between EXL India and EXL Inc. for the 2003-04 tax year was not appropriate and disallows certain expenses claimed as tax deductible by EXL India. This assessment demands that EXL India pay additional taxes in the amount of \$2.4 million. We have paid approximately \$0.8 million to the Indian tax authorities as a deposit in respect of this assessment and may have to deposit additional amounts in the future while we are contesting the above order before the appellate authorities.

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The second assessment order issued by the Indian tax authorities regarding transfer pricing relates to their audit of EXL India's 2004-05 tax year. The assessment order alleges that the transfer price we applied to transactions between EXL India and EXL Inc. for the 2004-05 tax year was not appropriate and demands that EXL India pay additional taxes in the amount of \$4.1 million. We have paid approximately \$1.7 million to the Indian tax authorities as a deposit in respect of this assessment and may have to deposit additional amounts in the future while we are contesting the above order before the appellate authorities.

The third assessment order issued by the Indian tax authorities, which was issued against EXL Inc., relates to EXL Inc.'s 2003-04 tax year. The assessment order alleges that EXL Inc. has a permanent establishment in India and demands that it pay additional taxes of \$3.7 million. Out of the \$3.7 million demanded, we have paid approximately \$1.8 million as a deposit in respect of this assessment and may have to deposit additional amounts in the future while we are contesting the above order before the appellate authorities. If EXL Inc. were found to have a permanent establishment in India, it would be required to pay Indian taxes on the income deemed attributed to such permanent establishment for the 2003-04 tax year as well as for subsequent years.

Based on advice from our Indian tax advisors, the facts underlying our position and our experience with these types of assessments, we believe that the probability of loss is remote and have accordingly not accrued any amount with respect to these matters in our unaudited consolidated financial statements. We do not expect any impact from these assessments on our future income tax expense. We are subject to U.S. income taxes on the profits we recognize in the United States. There is a possibility that we might receive similar orders for other years until the common dispute is resolved.

Table of Contents**Critical Accounting Policies**

We consider the policies discussed below to be critical to an understanding of our unaudited consolidated financial statements, as their application places the most significant demands on management's judgment regarding matters that are inherently uncertain. These policies include revenue recognition, estimating tax liabilities, stock-based compensation, derivative instruments and pension plan liabilities. These accounting policies and the associated risks are set out below. Future events may not occur exactly as forecasted, and estimates routinely require adjustment.

Revenue Recognition

We derive revenues from BPO, research and analytics and advisory services provided on a cost-plus, time-and-materials, fixed price, contingent fee or unit-priced basis. We recognize revenues as services are rendered, provided that persuasive evidence of an arrangement exists, there are no remaining obligations with respect to the services rendered and collection is considered probable. We invoice clients in accordance with agreed rates and billing arrangements. We recognize revenues from the last billing date to the balance sheet date as unbilled revenues, and we recognize billings in excess of revenues earned or advances received from clients as deferred revenue.

Under cost-plus arrangements, we apply a mark-up (based on the service levels we achieve) to the contractually agreed direct and apportioned indirect costs we incur and invoice the client for the marked-up cost. Time-and-materials arrangements typically involve billings based on productive time as we perform the related services. Unit-price arrangements involve billings based on productive units as we deliver the services to the client.

Income Taxes

As part of the process of preparing our consolidated financial statements, we estimate our income taxes in each of the jurisdictions in which we operate. Tax estimates include decisions regarding the timing and amount of deductions and the allocation of income among various tax jurisdictions. Based on our evaluation of our tax position, we believe we have adequately accrued for probable exposures as of September 30, 2007. To the extent we are able to prevail in matters for which accruals have been established or are required to pay amounts in excess of our reserves, our effective tax rate in a given financial statement period may be materially impacted.

We recognize deferred tax assets and liabilities for future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry forwards. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We recognize the effect on deferred tax assets and liabilities of a change in tax rates in income in the period that includes the enactment date. We determine if a valuation allowance is required or not on the basis of an assessment of whether it is more likely than not that a deferred tax asset will be realized. At September 30, 2007, we performed an analysis of the deferred tax asset valuation allowance on our Indian subsidiaries and concluded that a valuation allowance offsetting certain deferred tax assets be recorded, based on our conclusion that it is more likely than not that there will not be future taxable income to realize the deferred tax assets. We perform this assessment at the end of each period. See Note 12, *Income Taxes*, in the notes to our unaudited consolidated financial statements for the three months ended September 30, 2007.

Stock-based Compensation

Effective January 1, 2006, we adopted SFAS No. 123(R) using the modified prospective method of transition with regard to stock-based awards. Before the consummation of our October 2006 initial public offering, we used a third party valuation firm to perform valuations of the fair value of our securities in connection with certain stock-based equity grants.

See Note 2, *Summary of Significant Accounting Policies*, and Note 13, *Stock Based Compensation*, in the notes to our unaudited consolidated financial statements for the three months ended September 30, 2007, for significant factors considered in determining the fair value of our stock based equity grants.

Derivative Instruments

In the normal course of business, we actively look to mitigate the exposure of foreign currency market risk by entering into various hedging instruments, authorized under our policies, with counterparties that are highly rated financial institutions. Our primary exchange rate exposure is with the U.K. pound sterling and the Indian rupee. We use derivative instruments for the purpose of mitigating the underlying exposure from foreign currency fluctuation risks associated with forecasted transactions denominated in certain foreign currencies and to minimize earnings

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and cash flow volatility associated with the changes in foreign currency exchange rates, and not for speculative trading purposes. We also hedge anticipated transactions that are subject to foreign exchange exposure with foreign exchange contracts that are designated effective and qualify as cash flow hedges, under SFAS No. 133. Changes in the fair value of these cash flow hedges which are deemed effective, are recorded in accumulated other comprehensive income/(loss) until the contract is settled and at that time are recognized in the consolidated statements of operations. We evaluate hedge effectiveness at the time a contract is entered into as well as on an ongoing basis. If during this time, a contract is deemed ineffective, the change in the fair value is recorded in the consolidated statements of operations.

At September 30, 2007, forward exchange contracts of \$43.3 million and GBP20.5 million were outstanding. We have evaluated the effectiveness of all our forward exchange contracts. For the three months ended September 30, 2007 and 2006, net gains from ineffective cash flow hedges included in the consolidated statements of income totaled \$0.0 million and \$(0.3) million respectively. For the nine months ended September 30, 2007 and 2006, net gains from ineffective cash flow hedges included in the consolidated statements of income totaled \$1.0 million and \$(1.3) million respectively. For hedge contracts discontinued because the forecasted transaction is not expected to occur by the end of the originally specified period, any related derivative amounts recorded in accumulated comprehensive income are reclassified to earnings.

Table of Contents**Pension Plan Liability**

We provide our employees in India with benefits under a defined benefit plan, which we refer to as the Gratuity Plan. The Gratuity Plan provides a lump sum payment to vested employees on retirement or on termination of employment in an amount based on the respective employee's salary and years of employment with us. We determine our liability under the Gratuity Plan by actuarial valuation using the projected unit credit method. Under this method, we determine our liability based upon the discounted value of salary increases until the date of separation arising from retirement, death, resignation or other termination of services. Critical assumptions used in measuring the plan expense and projected liability under the projected unit credit method include the discount rate, expected return on assets and the expected increase in the compensation rates. We evaluate these critical assumptions at least annually. We periodically evaluate and update other assumptions used in the projected unit credit method involving demographic factors, such as retirement age and turnover rate, to reflect our experience. The future mortality rates used are consistent with those published by the Life Insurance Corporation of India.

The discount rate enables us to state expected future cash flows at a present value on the measurement date. The discount rate we use is equal to the yield on high quality fixed income investments in India at the measurement date. A lower discount rate increases the present value of benefit obligations and therefore increases gratuity expense. Since our Gratuity Plan is unfunded, we have not assumed any returns on assets.

Results of Operations

The following table summarizes our results of operations:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|---------------|------------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues (1) | \$ 46,090,300 | \$ 35,081,504 | \$ 128,240,552 | \$ 81,189,101 |
| Revenues (from related parties) (1) | 538,750 | 583,541 | 1,262,785 | 1,264,186 |
| Total revenues | \$ 46,629,050 | \$ 35,665,045 | \$ 129,503,337 | \$ 82,453,287 |
| Cost of revenues (exclusive of depreciation and amortization) (2) | 29,852,667 | 21,490,479 | 83,133,280 | 51,378,118 |
| Gross profit | 16,776,383 | 14,174,566 | 46,370,057 | 31,075,169 |
| Operating expenses: | | | | |
| General and administrative expenses (3) | 6,990,766 | 5,802,239 | 19,831,654 | 13,110,619 |
| Selling and marketing expenses (3) | 2,556,621 | 1,635,644 | 6,547,878 | 3,083,744 |
| Depreciation and amortization (4) | 2,560,476 | 2,614,929 | 7,765,413 | 6,254,903 |
| Total operating expenses | 12,107,863 | 10,052,812 | 34,144,945 | 22,449,266 |
| Income from operations | 4,668,520 | 4,121,754 | 12,225,112 | 8,625,903 |
| Other income/(expense): | | | | |
| Foreign exchange gain/(loss) | 2,267,805 | 11,681 | 5,132,816 | (688,213) |
| Interest and other income | 1,028,192 | 310,945 | 3,054,776 | 912,327 |
| Interest expense | (12,837) | (275,310) | (39,917) | (479,077) |
| Income before income taxes | 7,951,680 | 4,169,070 | 20,372,787 | 8,370,940 |
| Income tax provision/(benefit) | 1,712,240 | (152,084) | 3,104,673 | 351,344 |
| Net income | 6,239,440 | 4,321,154 | 17,268,114 | 8,019,596 |
| Dividends and accretion on preferred stock | | (180,794) | | (523,173) |
| Net income to common stockholders | \$ 6,239,440 | \$ 4,140,360 | \$ 17,268,114 | \$ 7,496,423 |
| Basic earnings per share to common stockholders | \$ 0.22 | \$ 0.19 | \$ 0.61 | \$ 0.35 |

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| | | | | |
|---|------------|------------|------------|------------|
| Diluted earnings per share to common stockholders | \$ 0.21 | \$ 0.19 | \$ 0.59 | \$ 0.34 |
| Weighted-average number of shares used in computing earnings per share: | | | | |
| Basic | 28,644,120 | 21,603,812 | 28,387,242 | 21,583,084 |
| Diluted | 29,115,603 | 21,997,319 | 29,096,915 | 21,912,253 |

- (1) In accordance with GAAP, we include the amount of telecommunications and travel-related costs that are billed to and reimbursed by our clients in our revenues.

- (2) Cost of revenues includes \$0.3 million and \$0.2 million for the three months ended September 30, 2007 and September 30, 2006, respectively, and \$0.8 million and \$0.2 million for the nine months ended September 30, 2007 and September 30, 2006, respectively, as amortization of stock compensation expense relating to the issuance of equity awards to employees directly involved in providing services to our clients as described in Note 13 to our unaudited consolidated financial statements. Cost of revenues excludes depreciation and amortization related to fixed assets.

- (3) SG&A expenses include \$0.8 million and \$0.7 million for the three months ended September 30, 2007 and September 30, 2006, respectively, and \$2.3 million and \$1.0 million for the nine months ended September 30, 2007 and September 30, 2006, respectively, as amortization of stock compensation expense relating to the issuance of equity awards to our non-operations staff as described in Note 13 to our unaudited consolidated financial statements.

- (4) Depreciation and amortization includes \$0.2 million and \$0.6 million for the three months ended September 30, 2007 and September 30, 2006, respectively, and \$1.4 million and \$0.6 million for the nine months ended September 30, 2007 and September 30, 2006, respectively, of amortization of intangibles as described in Note 3 to our unaudited consolidated financial statements.

Table of Contents**Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006**

Our results of operations for the three months ended September 30, 2007 were favorably impacted by an increase in BPO and advisory services revenue and changes in exchange rates of U.K. pound sterling with respect to U.S. dollars.

Revenues. Revenues increased 30.7% from \$35.7 million for the three months ended September 30, 2006 (including \$1.4 million of reimbursable expenses) to \$46.6 million for the three months ended September 30, 2007 (including \$1.9 million of reimbursable expenses). Revenues attributable to eight new clients (excluding revenue increase attributable to existing clients) were \$1.1 million during the three months ended September 30, 2007. Revenue increases from existing clients were attributable to faster than expected volume increases within existing processes and the addition of new processes. The increase in revenue was also attributable to the strength of the U.K. pound sterling with respect to the U.S. dollar during the period.

Cost of Revenues. Cost of revenues increased 38.9% from \$21.5 million for the three months ended September 30, 2006 to \$29.9 million for the three months ended September 30, 2007. Salaries and personnel expenses increased from \$14.6 million in the three months ended September 30, 2006 to \$21.8 million in the three months ended September 30, 2007 as a result of an increase in headcount and salary levels. Facilities operating costs increased from \$2.3 million for the three months ended September 30, 2006 to \$2.9 million for the three months ended September 30, 2007, primarily reflecting our increased workforce and increased operating capacity. Cost of revenues also increased due to the strengthening of the Indian rupee with respect to the U.S. dollar. As a percentage of revenues, cost of revenues increased from 60.3% for the three months ended September 30, 2006 to 64.0% for the three months ended September 30, 2007.

Gross Profit. Gross profit increased 18.4% from \$14.2 million for the three months ended September 30, 2006 to \$16.8 million for the three months ended September 30, 2007. The increase in gross profit is primarily the result of increased revenues. Gross profit as a percentage of revenues however decreased from 39.7% for the three months ended September 30, 2006 to 36.0% for the three months ended September 30, 2007.

Selling General & Administrative (SG&A) Expenses. SG&A expenses increased 28.4% from \$7.4 million for the three months ended September 30, 2006 to \$9.5 million for the three months ended September 30, 2007. General and administrative expenses increased 20.5% from \$5.8 million for the three months ended September 30, 2006 to \$7.0 million for the three months ended September 30, 2007 and selling and marketing expenses increased 56.3% from \$1.6 million for the three months ended September 30, 2006 to \$2.6 million for the three months ended September 30, 2007. These increases were primarily due to the addition of corporate and sales and marketing staff in the United States, appreciation of the Indian rupee against the U.S. dollar, as well as an increase in audit and other professional fees incurred. SG&A expenses include \$0.8 million and \$0.7 million for the three months ended September 30, 2007 and the three months ended September 30, 2006, respectively, on account of amortization of stock compensation expense relating to our issuance of stock options to our non-operations staff. We expect our SG&A expenses to increase as we add significant additional sales and marketing staff in the United States and the United Kingdom. As a percentage of revenues, SG&A expenses decreased from 20.9% for the three months ended September 30, 2006 to 20.5% for the three months ended September 30, 2007.

Depreciation and Amortization. Depreciation and amortization remained at \$2.6 million for the three months ended September 30, 2006 and for the three months ended September 30, 2007. There was an increase in depreciation due to changes in exchange rates on the depreciation related to foreign subsidiaries and expansion of our infrastructure. However this was offset by a decrease in amortization of intangibles acquired from Inductis. As we add facilities, we also expect that our depreciation expense will increase, reflecting the additional investment in equipment and facilities necessary to meet service requirements.

Income From Operations. Income from operations increased 13.3% from \$4.1 million for the three months ended September 30, 2006 to \$4.7 million for the three months ended September 30, 2007. The increase in income from operations is primarily attributable to an increase in revenues. As a percentage of revenues, income from operations decreased from 11.6% for the three months ended September 30, 2006 to 10.0% for the three months ended September 30, 2007.

Other Income/(Expense). Other income/(expense) is comprised of foreign exchange gains and losses, interest income and expense and interest expense on redeemable preferred stock. Other income increased from an expense of \$0.0 million for the three months ended September 30, 2006 to income of \$3.3 million for the three months ended September 30, 2007. The increase is due to an increase in interest income on the net proceeds from our October 2006 initial public offering, foreign exchange gains on forward contracts and a reduction in interest expense due to the repayment of our preferred stock in October and November 2006.

Provision for Income Taxes. Provision for income taxes increased from a benefit of \$0.2 million for the three months ended September 30, 2006 to a charge of \$1.7 million for the three months ended September 30, 2007 and the corresponding effective tax rate has decreased from a

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benefit of 3.6% for the three month ended September 30, 2006 to a rate of 21.5% for the three months ended September 30, 2007. This is due to the changes in the geographic distribution of our income and the impact of foreign exchange fluctuation. See Note 12, *Income Taxes*, to our unaudited consolidated financial statements for the three months ended September 30, 2007.

Dividends and Accretion on Preferred Stock. Dividends and accretion on preferred stock were \$0 for the three months ended September 30, 2007 compared to \$0.2 million for the three months ended September 30, 2006, reflecting the repayment of our preferred stock in October and November 2006.

Net Income to Common Stockholders. Net income to common stockholders increased 50.7% from \$4.1 million for the three months ended September 30, 2006 to \$6.2 million for the three months ended September 30, 2007. Net income margin increased period-to-period due to the increased revenue and impact due to changes in exchange rates after considering hedge gains. The significant increase in net income to common stockholders does not represent a trend in our results of operations and will vary as we build capacity for future ramp ups and as exchange rates fluctuate. As a percentage of revenues, net income increased from 11.6% for the three months ended September 30, 2006 to 13.4 % for the three months ended September 30, 2007.

Nine months Ended September 30, 2007 Compared to Nine months Ended September 30, 2006

As a result of the Inductis Acquisition, our results of operations for the nine months ended September 30, 2007 are not comparable to the nine months ended September 30, 2006. Our results of operations for the nine months ended September 30, 2007 are impacted by an increase in revenues attributable to the increase in BPO and advisory revenues, the Inductis Acquisition and changes in exchange rates of U.K. pound sterling with respect to U.S. dollars. As we increase the amount of physical infrastructure available to perform our operations, we expect that utilization will continue to decrease, which will have a negative impact on our operating margin. Also, exchange rates fluctuations will have a positive or a negative impact on our net income depending on the direction of fluctuation.

Revenues. Revenues increased 57.1% from \$82.5 million for the nine months ended September 30, 2006 (including \$3.4 million of reimbursable expenses) to \$129.5 million for the nine months ended September 30, 2007 (including \$5.9 million of reimbursable expenses). Revenues for the nine months ended September 30, 2007 are higher by \$6.2 million as compared to the nine months ended September 30, 2006 due to the inclusion of Inductis from July 1, 2006, the date of acquisition. Revenues attributable to 32 new clients obtained during the nine months ended September 30, 2007 was \$5.5 million. Revenue increases from existing clients were attributable to faster than expected volume increases within the existing processes and the addition of new processes. The increase in revenue was also attributable to the strengthening in the U.K. pound sterling with respect to the U.S. dollar during the period.

Cost of Revenues. Cost of revenues increased 61.8% from \$51.4 million for the nine months ended September 30, 2006 to \$83.1 million for the nine months ended September 30, 2007. Cost of revenues for the nine months ended September 30, 2007 are higher by \$6.8 million as compared to the nine months ended September 30, 2006 due to the inclusion of Inductis from July 1, 2006, the date of acquisition. Salaries and personnel expenses for the Company increased from \$34.4 million in the nine months ended September 30, 2006 to \$59.2 million in the nine months ended September 30, 2007 as a result of an increase in headcount and salary levels. Cost of revenues also increased due to an increase in reimbursable expenses, primarily as a result of significant additional costs associated with training activities on client premises. Facilities operating costs for the Company increased from \$6.0 million for the nine months ended September 30, 2006 to \$7.7 million for the nine months ended September 30, 2007, primarily reflecting our increased workforce and increased operating capacity. Cost of revenues includes \$0.8 million and \$0.2 million for the nine months ended September 30, 2007 and September 30, 2006, respectively, for amortization of stock compensation expense relating to our issuance of stock options to employees directly involved in providing services to our clients. As a percentage of revenues, cost of revenues increased marginally from 62.3% for the nine months ended September 30, 2006 to 64.2% for the nine months ended September 30, 2007.

Gross Profit. Gross profit increased 49.2% from \$31.1 million for the nine months ended September 30, 2006 to \$46.4 million for the nine months ended September 30, 2007. The increase in gross profit is primarily the result of increased revenue. The increase in gross profit does not represent a trend in our results of operations. As a result, gross profit as a percentage of revenues decreased marginally from 37.7% for the nine months ended September 30, 2006 to 35.8% for the nine months ended September 30, 2007.

SG&A Expenses. SG&A expenses increased 62.9% from \$16.2 million for the nine months ended September 30, 2006 to \$26.4 million for the nine months ended September 30, 2007. General and administrative expenses increased 51.3% from \$13.1 million for the nine months ended September 30, 2006 to \$19.8 million for the nine months ended September 30, 2007 and selling and marketing expenses increased 112.3% from \$3.1 million for the nine months ended September 30, 2006 to \$6.6 million for the nine months ended September 30, 2007. These increases were primarily due to the addition of corporate and sales and marketing staff

Table of Contents

in the United States, as well as an increase in audit and other professional fees incurred as a result of becoming a public company. SG&A for the nine months ended September 30, 2007 are higher by \$3.4 million as compared to the nine months ended September 30, 2006 due to the inclusion of Inductis from July 1, 2006, the date of acquisition. Salary and personnel expenses increased from \$9.4 million for the nine months ended September 30, 2006 to \$12.3 million for the nine months ended September 30, 2007. SG&A expenses include \$2.3 million and \$1.0 million for the nine months ended September 30, 2007 and the nine months ended September 30, 2006, respectively, on account of amortization of stock compensation expense relating to our issuance of stock options to our non-operations staff. We expect our SG&A expenses to increase as we add significant additional sales and marketing staff in the United States and the United Kingdom. As a percentage of revenues, SG&A expenses increased from 19.6% for the nine months ended September 30, 2006 to 20.4% for the nine months ended September 30, 2007.

Depreciation and Amortization. Depreciation and amortization increased 24.1% from \$6.3 million for the nine months ended September 30, 2006 to \$7.8 million for the nine months ended September 30, 2007. The increase was primarily due to the amortization of intangibles acquired from Inductis. We constructed a new operations facility in Noida, having a total capacity of 1,200 workstations. As we add facilities, we also expect that depreciation expense will increase, reflecting the additional investment in equipment and facilities necessary to meet service requirements.

Income From Operations. Income from operations increased 41.7% from \$8.6 million for the nine months ended September 30, 2006 to \$12.2 million for the nine months ended September 30, 2007. Operating margin increased due to a significant increase in revenue from BPO and advisory services partly caused by seasonal factors and a higher than expected demand. This was partly offset by a loss of \$3.1 million at Inductis due to lower demand caused primarily by lower discretionary spending among its largest customers. As a percentage of revenues, income from operations decreased marginally from 10.5% for the nine months ended September 30, 2006 to 9.4% for the nine months ended September 30, 2007.

Other Income/(Expense). Other income/(expense) is comprised of foreign exchange gains and losses, interest income and interest expense. Other income increased significantly from an expense of \$0.3 million for the nine months ended September 30, 2006 to an income of \$8.2 million for the nine months ended September 30, 2007 as a result of interest income on the net proceeds from our October 2006 initial public offering, increase in foreign exchange gains and reduction in interest expense due to the repayment of our preferred stock in October and November 2006.

Provision for Income Taxes. Provision for income taxes increased from a charge of \$0.4 million for the nine months ended September 30, 2006 to an expense of \$3.1 million for the nine months ended September 30, 2007 and the corresponding effective rate of taxes has increased from a provision of 4.2% for the nine months ended September 30, 2006 to a provision of 15.2% for the nine months ended September 30, 2007. This is due to changes in the geographic distribution of our income and the impact of foreign exchange fluctuation. See Note 12, Income Taxes, to our unaudited consolidated financial statements for the three months ended September 30, 2007.

Dividends and Accretion on Preferred Stock. Dividends and accretion on preferred stock were \$0 for the nine months ended September 30, 2007 compared to \$0.5 million for the nine months ended September 30, 2006, reflecting the repayment of our preferred stock in October and November 2006.

Net Income to Common Stockholders. Net income to common stockholders increased 130.4% from \$7.5 million for the nine months ended September 30, 2006 to \$17.3 million for the nine months ended September 30, 2007. Net income margin increased period-to-period due to the increased revenue, impact due to changes in exchange rates after considering hedge gains and better capacity utilization. The significant increase in net income to common stockholders does not represent a trend in our results of operations and will vary as we build capacity for future ramps ups and exchange rates fluctuate. As a percentage of revenues, net income increased from 9.1% for the nine months ended September 30, 2006 to 13.3% for the nine months ended September 30, 2007.

Liquidity and Capital Resources

At September 30, 2007, we had \$91.0 million in cash and cash equivalents on hand.

In October 2006, we consummated an initial public offering of our common stock. In the offering, we issued and sold 5,750,000 shares of our common stock at an initial offering price of \$13.50 per share, resulting in gross proceeds of \$77.6 million and net proceeds of approximately \$69.8 million after deducting underwriting discounts and commissions of approximately \$5.4 million and related offering expenses of approximately \$2.4 million. We used approximately \$6.7 million of the net proceeds from the initial public offering to repurchase all of our outstanding shares of preferred stock and approximately \$5.8 million to repay all outstanding senior promissory notes payable to certain stockholders.

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Cash flows from operating activities increased from \$10.8 million in the nine months ended September 30, 2006 to \$11.4 million in the nine months ended September 30, 2007. Generally, factors that affect our earnings for example, pricing, volume of services, costs and productivity affect our cash flows provided by operations in a similar manner. However, while management of working capital, including timing of collections and payments, affects operating results only indirectly, the impact on working capital and cash flows provided by operating activities can be significant. The increase in cash flows from operations is predominantly due to the increase in net income adjusted for non-cash items. This was offset by an increase in accounts receivable, deferred revenue, other assets and payment of income tax liabilities. Net income adjusted for non-cash items increased in the nine months ended September 30, 2007 by \$10.5 million compared to the nine months ended September 30, 2006 due to the continued growth in our business.

Cash used in investing activities increased to \$7.1 million in the nine months ended September 30, 2007 from \$4.7 million in the nine months ended September 30, 2006. The increase is a result of the purchase of fixed assets for the new facility in Noida, India which has a total capacity of approximately 1,200 seats and renovation of certain existing facilities.

Cash flows from financing activities increased from an outflow of \$4.5 million in the nine months ended September 30, 2006 to an inflow of \$1.2 million in the nine months ended September 30, 2007, primarily due to proceeds from exercises of stock options in the nine months ended September 30, 2007 and repayment of bank borrowings and long term debt in the nine months ended September 30, 2006.

We expect to use cash from operating activities to maintain and expand our business. As we have focused on expanding our cash flow from operating activities, we have made significant capital investments, primarily related to new facilities. Capital expenditures we make to meet client needs represent primarily leasehold improvements to build out facilities, telecommunications equipment, and computer hardware and software we purchase in connection with managing client operations. We incurred \$10.4 million of capital expenditures in 2006. We expect to incur approximately \$11.0 million to \$15.0 million of capital expenditures in 2007 primarily to meet the growth requirements of our clients, including expanding our facilities in India and in the Philippines, as well as to improve our internal technology. We have constructed a new operations facility in Noida, India, having a total capacity of 1,200 workstations at a total cost of approximately \$8.3 million, out of which approximately \$4.3 million was incurred in 2007.

In addition, we are contractually committed to one of our clients to establish and maintain a viable offshore BPO operation outside of India by September 2008, either on our own or through a relationship (such as a joint venture, partnership or alliance) with other parties where we maintain at least 26% of the controlling interest. This new facility must be capable of providing the services currently being performed for that client in India at a comparable cost to us and must be comparable in size to the existing facility from which the client services are being provided. We are presently in the process of establishing a new facility in the Philippines that we expect to become operational during the second quarter of 2008. We anticipate that we will utilize cash flow from operating activities to finance the capital expenditures related to this facility.

Table of Contents

We currently have no other individually large outstanding commitments for capital expenditures. The timing and volume of such capital expenditures in the future will be affected by new contracts we may enter into or the expansion of our existing contracts.

In addition, in connection with the tax assessment orders issued against EXL India and Exl Inc. we may be required to make additional deposits in the near future pursuant to these assessments or future related assessments.

Pursuant to the Inductis Acquisition, we paid a \$0.4 million bonus to former Inductis shareholders in January 2007.

Depending on Inductis profit adjusted earnout revenue for 2007 and 2006, no more than an aggregate of 778,764 shares of our common stock is to be issued to the former holders of Inductis common stock and restricted stock under the earn out provisions. We issued 257,273 shares of common stock as earn out consideration for performance related to the period ended December 31, 2006. We may also need to make certain additional contingent payments to former holders of Inductis securities in a mix of cash and additional shares of our common stock, the mix of which cannot be determined until the size of the contingent payments, if any, is determined, based on the satisfaction of certain agreed-upon financial performance goals for the historic Inductis business in 2007. The value of any such contingent payments would range from \$0.6 million to \$6.5 million. However, based on the current and expected performance of Inductis in 2007 it is unlikely that any such contingent payments will be made.

We intend to use the remaining net proceeds from our October 2006 initial public offering for working capital and general corporate purposes. We anticipate that we will continue to rely upon cash from operating activities and remaining proceeds from our October 2006 initial public offering to finance our capital expenditures and working capital needs. We believe that cash flow from operations and the remaining net proceeds from our October 2006 initial public offering will be sufficient to meet our ongoing capital expenditure, working capital and other cash needs over the next two years. If we have significant growth through acquisitions or require additional operating facilities to service customer contracts, we may need to obtain additional financing.

Off-Balance Sheet Arrangements

As of September 30, 2007, we had no off-balance sheet arrangements or obligations.

Contractual Obligations

There have been no material changes to our contractual obligations during the period covered by this Quarterly Report on Form 10-Q from the statements set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 under Management's Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations.

Recent Accounting Pronouncements

On January 1, 2007, the Company adopted FIN 48, which clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interest and penalties recognized in accordance with the guidance provided in FIN 48, if any, are being classified as interest expense and general and administrative expense, respectively. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicated it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The implementation of FIN 48 did not have any impact on the Company's consolidated financial statements.

Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. You should not place undue reliance on those statements because they are subject to numerous uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Forward-looking statements include information concerning our possible or assumed future results of operations, including descriptions of our business strategy. These statements often include words such as may, will, should, believe, expect, anticipate, intend, plan, estimate or similar expressions. These statements are based on assumptions that we have made in light of our experience in the industry as well as our perceptions of historical trends, current conditions, expected future developments and other factors we believe are appropriate under the circumstances. As you read and consider this Quarterly Report on Form 10-Q, you should understand that these statements are not guarantees of performance or results. They involve known and unknown risks, uncertainties and assumptions. Although we believe that

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these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual financial results or results of operations and could cause actual results to differ materially from those in the forward-looking statements. These factors include but are not limited to:

our dependence on a limited number of clients in a limited number of industries;

fluctuations in our earnings;

our ability to attract and retain clients;

restrictions on immigration;

our ability to hire and retain enough sufficiently trained employees to support our operations;

our ability to grow our business or effectively manage growth and international operations;

increasing competition in our industry;

telecommunications or technology disruptions;

fluctuations in exchange rates between the U.K. pound sterling, the U.S. dollar and the Indian rupee;

negative public reaction in the United States or elsewhere to offshore outsourcing;

regulatory, legislative and judicial developments, including the withdrawal of governmental fiscal incentives;

technological innovation;

political or economic instability in India;

worldwide political, economic and business conditions;

our ability to successfully consummate or integrate strategic acquisitions, including the Inductis Acquisition; and

adverse outcome of our disputes with the Indian tax authorities.

Table of Contents

These and other factors are more fully discussed elsewhere in this Quarterly Report on Form 10-Q. These risks could cause actual results to differ materially from those implied by forward-looking statements in this document.

You should keep in mind that any forward-looking statement made by us in this Quarterly Report on Form 10-Q, or elsewhere, is current as of the date on which we make it. New risks and uncertainties come up from time to time, and it is impossible for us to predict these events or how they may affect us. We have no obligation to update any forward-looking statements in this Quarterly Report on Form 10-Q after the date of this Quarterly Report on Form 10-Q, except as required by federal securities laws.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

Market risk is the loss of future earnings, to fair values or to future cash flows that may result from a change in the price of a financial instrument. The value of a financial instrument may change as a result of changes in the interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributable to all market sensitive financial instruments including foreign currency receivables and payables.

Our exposure to market risk is a function of our expenses and revenue generating activities in foreign currencies. The objective of market risk management is to avoid excessive exposure of our earnings and equity to loss. Most of our exposure to market risk arises out of our foreign currency accounts receivable. Pursuant to our investment policy, our surplus funds are kept as cash or cash equivalents and are invested in highly-rated commercial paper and money market accounts to reduce our exposure to market risk with regard to these funds.

Risk Management Procedures

We manage market risk through our treasury operations. Our senior management and our board of directors approve our treasury operations objectives and policies. The activities of our treasury operations include management of cash resources, implementing hedging strategies for foreign currency exposures, borrowing strategies, if any, and ensuring compliance with market risk limits and policies.

Components of Market Risk

Exchange Rate Risk. The functional currency of ExlService Holdings, and our subsidiaries Exl Inc., Inductis LLC and Inductis Inc., is the U.S. dollar. The functional currency of Exl India, NCOP, Inductis India and ESSPL is the Indian rupee. The functional currency of Exl UK is the pound sterling. The functional currency of Inductis (Singapore) Pte Limited is the Singapore dollar. In each case, the functional currency is the currency of the primary economic environment in which that entity operates. Monetary assets and liabilities in foreign currencies are translated into functional currency at the rate of exchange prevailing on the related balance sheet dates. Transactions in foreign currencies are translated into functional currency at the rate of exchange prevailing on the date of the transaction. All transaction-related foreign exchange gains and losses are recorded in the accompanying consolidated statements of operations. The assets and liabilities of subsidiaries are translated into U.S. dollars at the rate of exchange prevailing on the related balance sheet date. Revenues and expenses are translated into U.S. dollars at the exchange rates prevailing on the last business day of each month. Resulting translation adjustments are included in the accumulated other comprehensive income/(loss) in our September 30, 2007 unaudited consolidated balance sheet.

Our exposure to market risk arises principally from exchange rate risk. Although substantially all of our revenues are denominated in U.S. dollars and U.K. pound sterling (47.4% and 52.3%, respectively, for the three months ended September 30, 2007 and 47.1% and 52.7%, respectively, for the nine months ended September 30, 2007), most of our expenses (66.6% in the three months ended September 30, 2007 and 66.0% in the nine months ended September 30, 2007) are incurred and paid in Indian rupees. The exchange rates among the Indian rupee, U.K. pound sterling and U.S. dollar have changed substantially in recent years and may fluctuate substantially in the future.

Our exchange rate risk primarily arises from our foreign currency revenues, expenses incurred by our foreign subsidiaries and receivables. Based upon our level of operations during the three months ended September 30, 2007 and excluding any hedging arrangements that we had in place during that period, a 5.0% appreciation/depreciation in the U.K. pound sterling against the U.S. dollar would have increased/decreased revenues in the three months ended September 30, 2007 by approximately \$1.2 million. Similarly, a 5.0% appreciation/depreciation in the Indian rupee against the U.S. dollar would have increased/decreased our expenses incurred and paid in Indian rupees in the three months ended September 30, 2007 by approximately \$1.4 million.

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We have sought to reduce the effect of Indian rupee and U.K. pound sterling exchange rate fluctuations on our operating results by purchasing forward foreign exchange contracts to cover a substantial portion of cost incurred in our India operations. Forward exchange contracts with a notional amount of \$43.3 million and GBP20.5 million were outstanding at September 30, 2007 and of \$33.0 million and GBP21.7 million were outstanding at December 31, 2006. The forward foreign exchange contracts typically mature within nine months, must be settled on the day of maturity and may be cancelled subject to the payment of any gains or losses in the difference between the contract exchange rate and the market exchange rate on the date of cancellation. We use these instruments as cash flow hedges and not for speculative purposes. We may not purchase contracts adequate to insulate ourselves from Indian rupee and U.K. pound sterling foreign exchange currency risks. In addition, any such contracts may not perform adequately as a hedging mechanism. We may, in the future, adopt more active hedging policies, and have done so in the past.

Interest Rate Sensitivity. We had cash and cash equivalents totaling \$91.0 million at September 30, 2007. These amounts were invested primarily in a short-term investment portfolio primarily comprised of investment grade commercial paper. The cash and cash equivalents are held for potential acquisitions of complementary businesses or assets, working capital requirements and general corporate purposes. We do not enter into investments for trading or speculative purposes. We believe that we have no material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. The interest income from these funds will be subject to fluctuations due to changes in interest rates. Declines in interest rates would reduce future investment income. A 1.0% decrease in short term rates would reduce our interest income for the three months ended September 30, 2007 by approximately \$0.2 million and by \$0.6 million for the nine months ended September 30, 2007.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports the Company files under the Securities Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), to allow timely decisions regarding required financial disclosure. In connection with the preparation of this Quarterly Report on Form 10-Q, the Company's management carried out an evaluation, under the supervision and with the participation of the CEO and CFO, of the effectiveness and operation of our disclosure controls and procedures as of September 30, 2007. Based upon that evaluation, the CEO and CFO have concluded that, as of September 30, 2007, our disclosure controls and procedures were not effective to provide reasonable assurance that the information required to be disclosed by us in reports filed under the

Table of Contents

Securities Exchange Act of 1934 were (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, to allow timely decisions regarding disclosure.

We have identified specific instances where our disclosure controls and procedures in the accounting and financial reporting areas were not effective. In these instances, the results of our evaluation indicate that our disclosure controls and procedures were adversely impacted by a number of events that occurred in the first three quarters of 2007, some of which were one-time events that are being addressed and are in the process of being remediated, including (i) insufficient staffing levels and capabilities in the accounting and financial reporting departments, (ii) insufficient automation of the accounting and financial reporting processes, (iii) the complexity and time sensitivity of our new financial reporting requirements, and (iv) the complexity of the continued integration of the financial reporting processes of Inductis with those of our historic service units.

We have undertaken the following action plan to address and remediate the issues identified in our disclosure controls and procedures: (i) the appointment of a new CFO on March 30, 2007, (ii) commitment to hiring additional experienced personnel in the accounting and financial reporting departments and recruiting for these positions as well as other open positions in these departments, (iii) continued review of all financial reporting processes, practices and policies for the purpose of implementing changes to strengthen the effectiveness of the financial reporting process, (iv) organizational changes to reflect a more effective span of control, (v) review of compensation structures in order to better attract and retain the necessary capabilities in the accounting and financial reporting departments and (vi) initiation of a program to reengineer and automate key financial processes and controls.

In connection with our ongoing review of financial reporting processes, practices and policies during the three months ended September 30, 2007, we have developed and implemented policies and processes to strengthen the documentation and control for the accounting, closing and financial reporting processes.

We expect that these measures will enable us to address and remediate the specific instances where our disclosure controls and procedures were not effective.

Changes in Internal Control over Financial Reporting

Except as otherwise described under "Evaluation of Disclosure Controls and Procedures", no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the three months ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We have disclosed under the heading "Business - Legal Proceedings" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 certain proceedings which may materially affect our business, financial condition or results of operations. You should carefully consider the disclosures set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and the other information set forth elsewhere in this Quarterly Report on Form 10-Q.

As previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, we are currently involved in disputes with the Indian tax authorities over the application of some of our transfer pricing policies. The Indian tax authorities have recently issued assessment orders against our subsidiaries EXL Inc. and EXL India. Two assessments issued with respect to EXL Inc. and EXL India allege that transfer pricing applied to transactions between such entities was not appropriate and demand the payment of additional taxes based on the disallowance of certain tax deductions taken by EXL India. An assessment issued with respect to EXL Inc. alleges that it has a permanent establishment in India and demands the payment of certain additional taxes based on such allegation. The Indian tax authorities are examining income tax returns for other tax years.

The first assessment order issued by the Indian tax authorities regarding transfer pricing relates to their audit of EXL India's 2003-04 tax year. Indian transfer pricing regulations require that any international transaction involving related corporations be at an arms-length price. The assessment order alleges that the transfer price we applied to transactions between EXL India and EXL Inc. in the 2003-04 tax year was not appropriate and disallows certain expenses claimed as tax deductible by EXL India. Transactions among our subsidiaries and us may be considered such transactions. This assessment demands that EXL India pay additional taxes in the amount of \$2.4 million. We have paid approximately \$0.8 million to the Indian tax authorities as a deposit in respect of this assessment and may have to deposit additional amounts in

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the future while we are contesting the above order before the appellate authorities.

The second assessment order issued by the Indian tax authorities regarding transfer pricing relates to their audit of EXL India's 2004-05 tax year. The assessment order alleges that the transfer price we applied to transactions between EXL India and EXL Inc. for the 2004-05 tax year was not appropriate and demands that EXL India pay additional taxes in the amount of \$4.1 million. We have already paid approximately \$1.7 million to the Indian tax authorities as a deposit in respect of this assessment.

The third assessment order issued by the Indian tax authorities, which was issued against EXL Inc., relates to EXL Inc.'s 2003-04 tax year. The assessment order alleges that EXL Inc. has a permanent establishment in India and demands that it pay additional taxes of \$3.7 million. Out of the \$3.7 million demanded, we have already paid \$1.8 million as a deposit in respect of this assessment and may have to deposit additional amounts in the future while we are contesting the above order before the appellate authorities. If EXL Inc. were found to have a permanent establishment in India, it would be required to pay Indian taxes on the income deemed attributed to such permanent establishment not only for the 2003-04 tax year but for subsequent years as well.

We are contesting all of these assessments and have filed appeals with the appropriate Indian tax authorities. Based on advice from our Indian tax advisors, the facts underlying our position and our experience with these types of assessments, we believe that the probability of loss is remote and have not accrued any amount with respect to these matters in our unaudited consolidated financial statements. Any amount paid by us as deposits will be refunded to us with interest if we succeed in our appeals. We cannot assure you that our appeals will be successful or that these appeals will be finally resolved in the near future. Amounts paid as deposits in respect of the assessments described above, totaling \$4.2 million as of September 30, 2007, are included in "Other Assets" in our September 30, 2007 unaudited consolidated balance sheet.

There is a possibility that we might receive similar orders for other years until these disputes are resolved. Future claims may be based on the transfer pricing or permanent establishment claims alleged by the Indian tax authorities, or may be based on alternative arguments. Any failure of our appeals or further assessments would reduce our profitability and cash flows.

ITEM 1A. RISK FACTORS

We have disclosed under the heading "Risk Factors" in our Annual report on Form 10-K for the fiscal year ended December 31, 2006 the risk factors which materially affect our business, financial condition or results of operations. You should carefully consider the "Risk Factors" set forth in the Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and the other information set forth elsewhere in this Quarterly Report on Form 10-Q. You should be aware that these risk factors and other information may not describe every risk facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Table of Contents

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Unregistered Sales of Equity Securities

None.

Use of Proceeds

We completed our initial public offering of our common stock under a Registration Statement on Form S-1 (File No. 333-121001), which became effective on October 19, 2006 and a Registration Statement on Form S-1 (File No. 333-138104), which became effective on October 20, 2006. The aggregate offering price of the common stock sold (including the exercise by the managing underwriters of their over-allotment option) resulted in net proceeds of approximately \$69.8 million to us. We used approximately \$6.7 million of the net proceeds from our initial public offering to repurchase all of our outstanding shares of Series A Preferred Stock and \$5.8 million to repay all our outstanding senior promissory notes payable to certain of our stockholders in 2006. The remainder of the net proceeds, approximately \$57.3 million, is being used for fixed asset acquisitions and general corporate purposes.

Purchases of Equity Securities by the Issuer

We purchased 14,552 shares of our common stock at a price of \$19.27 per share during the three months ended September 30, 2007 from employees in connection with withholding payments to tax authorities related to the vesting of restricted stock. Pursuant to our 2006 Plan, under which the shares of restricted stock were granted, the purchase price per share of \$19.27 per share was the average of the high and low price of our shares of common stock on the Nasdaq Global Select Market on the trading day prior to the vesting date of the shares of restricted stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Table of Contents

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits are being filed as part of this Quarterly Report on Form 10-Q:

- 10.1 Letter Agreement dated as of September 10, 2007 between Norwich Union and the Company.
- 31.1 Certification of the Chief Executive Officer of ExlService Holdings, pursuant to Rule 13a-14 of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer of ExlService Holdings, pursuant to Rule 13a-14 of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of the President and Chief Operating Officer of ExlService Holdings, pursuant to Rule 13a-14 of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of the President and Chief Operating Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

EXLSERVICE HOLDINGS, INC.

Date: November 14, 2007

By: /s/ Matthew Appel
Matthew Appel
Chief Financial Officer
(Duly Authorized Signatory, Principal Financial and
Accounting Officer)