ExlService Holdings, Inc.
Form 10-Q
April 30, 2019

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

FORM 10-Q

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019

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 **82-0572194**

(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
280 PARK AVENUE, 38TH FLOOR, NEW YORK, NEW YORK	**10017**
(Address of principal executive offices)	**(Zip code)**

(212) 277-7100
(Registrant’s telephone number, including area code)

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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
Emerging growth company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of April 26, 2019, there were 34,341,972 shares of the registrant’s common stock outstanding, par value $0.001 per share.

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PART 1. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
EXLSERVICE HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	As of March 31, 2019 (Unaudited)	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	$86,688	$95,881
Short-term investments	216,056	184,489
Restricted cash	5,364	5,608
Accounts receivable, net	176,889	164,752
Prepaid expenses	13,145	11,326
Advance income tax, net	11,334	9,639
Other current assets	26,582	28,240
Total current assets	**536,058**	**499,935**
Property and equipment, net	73,447	73,510
Operating lease right-of-use assets	89,835	—
Restricted cash	2,575	2,642
Deferred tax assets, net	4,570	6,602
Intangible assets, net	90,008	95,495
Goodwill	350,239	349,984
Other assets	33,164	31,015
Investment in equity affiliate	2,686	2,753
Total assets	**$1,182,582**	**$1,061,936**
Liabilities and equity		
Current liabilities:		
Accounts payable	$4,560	$5,653
Current portion of long-term borrowings	20,876	21,423
Deferred revenue	11,132	7,722
Accrued employee costs	31,954	54,893
Accrued expenses and other current liabilities	65,827	64,169
Current portion of operating lease liabilities	22,306	—
Income taxes payable	595	1,012
Current portion of finance lease obligations	283	223
Total current liabilities	**157,533**	**155,095**
Long term borrowings	299,765	263,241
Finance lease obligations, less current portion	492	315
Deferred tax liabilities, net	10,103	8,445
Operating lease liabilities, less current portion	77,060	—
Other non-current liabilities	6,794	16,521
Total liabilities	**551,747**	**443,617**
Commitments and contingencies (Refer Note 26)		
Preferred stock, $0.001 par value; 15,000,000 shares authorized, none issued	—	—
ExlService Holdings, Inc. Stockholders' equity:		

Common stock, $0.001 par value; 100,000,000 shares authorized, 38,256,036 shares issued and 34,365,437 shares outstanding as of March 31, 2019 and 37,850,544 shares issued and 34,222,476 shares outstanding as of December 31, 2018	38	38
Additional paid-in capital	371,144	364,179
Retained earnings	498,939	484,244
Accumulated other comprehensive loss	(77,212)	(83,467)
Total including shares held in treasury	**792,909**	**764,994**
Less: 3,890,599 shares as of March 31, 2019 and 3,628,068 shares as of December 31, 2018, held in treasury, at cost	(162,333)	(146,925)
Stockholders' equity	**630,576**	**618,069**
Non-controlling interest	259	250
Total equity	**630,835**	**618,319**
Total liabilities and equity	**$1,182,582**	**$1,061,936**

See accompanying notes to unaudited consolidated financial statements.

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EXLSERVICE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In thousands, except share and per share amounts)

	Three months ended March 31,	
	2019	2018
Revenues, net	$239,573	$206,973
Cost of revenues(1)	157,240	138,101
Gross profit(1)	**82,333**	**68,872**
Operating expenses:		
General and administrative expenses	32,531	29,266
Selling and marketing expenses	18,047	13,952
Depreciation and amortization	13,667	10,504
Impairment charges	1,227	—
Total operating expenses	65,472	53,722
Income from operations	**16,861**	**15,150**
Foreign exchange gain, net	1,260	615
Interest expense	(3,582)	(538)
Other income, net	4,423	3,534
Income before income tax expense/(benefit) and earnings from equity affiliates	**18,962**	**18,761**
Income tax expense/(benefit)	4,200	(4,453)
Income before earnings from equity affiliates	**14,762**	**23,214**
Loss from equity-method investment	67	56
Net income attributable to ExlService Holdings, Inc. stockholders	**$14,695**	**$23,158**
Earnings per share attributable to ExlService Holdings, Inc. stockholders:		
Basic	$0.43	$0.67
Diluted	$0.42	$0.66
Weighted-average number of shares used in computing earnings per share attributable to ExlService Holdings, Inc. stockholders:		
Basic	34,374,815	34,446,265
Diluted	34,833,435	35,302,926

(1) Exclusive of depreciation and amortization.

See accompanying notes to unaudited consolidated financial statements.

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EXLSERVICE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(In thousands)

	Three months ended March 31, 2019	2018
Net income	$ 14,695	$ 23,158
Other comprehensive income/(loss):		
Unrealized gain/(loss) on effective cash flow hedges, net of taxes $1,189 and ($800), respectively	4,748	(4,214)
Foreign currency translation gain/(loss)	2,680	(7,811)
Reclassification adjustments		
Gain on cash flow hedges, net of taxes $354 and ($776), respectively[1]	(1,025)	(1,895)
Retirement benefits, net of taxes $109 and $1, respectively[2]	(148)	(40)
Total other comprehensive income/(loss)	**$ 6,255**	**$ (13,960)**
Total comprehensive income	**$ 20,950**	**$ 9,198**

(1) *These are reclassified to net income and are included either in cost of revenues or operating expenses, as applicable in the unaudited consolidated statements of income. Refer Note 17 to the unaudited consolidated financial statements.*

(2) *These are reclassified to net income and are included in other income, net in the unaudited consolidated statements of income. Refer Note 20 to the unaudited consolidated financial statements.*

See accompanying notes to unaudited consolidated financial statements.

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EXLSERVICE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)
(In thousands, except share and per share amounts)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Treasury Stock		Non - Controlling Interest	Total Equity
	Shares	Amount				Shares	Amount		
Balance as of January 1, 2019	**37,850,544**	**$ 38**	**$ 364,179**	**$ 484,244**	**$ (83,467)**	**(3,628,068)**	**$ (146,925)**	**$ 250**	**$ 618,319**
Stock issued against stock-based compensation plans	405,492	—	22	—	—	—	—	—	22
Stock-based compensation	—	—	6,956	—	—	—	—	—	6,956
Acquisition of treasury stock	—	—	—	—	—	(262,531)	(15,408)	—	(15,408)
Allocation of equity component related to issuance costs on convertible senior notes	—	—	(13)	—	—	—	—	—	(13)
Non-controlling interest	—	—	—	—	—	—	—	9	9
Other comprehensive income	—	—	—	—	6,255	—	—	—	6,255
Net income	—	—	—	14,695	—	—	—	—	14,695
Balance as of March 31, 2019	**38,256,036**	**$ 38**	**$ 371,144**	**$ 498,939**	**$ (77,212)**	**(3,890,599)**	**$ (162,333)**	**$ 259**	**$ 630,835**

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock		Non - Controlling Interest	Total Equity
	Shares	Amount				Shares	Amount		
Balance as of December 31, 2017	**36,790,751**	**$ 37**	**$ 322,246**	**$ 427,064**	**$ (45,710)**	**(2,902,018)**	**$ (103,816)**	**$ 224**	**$ 600,045**
Impact of adoption of ASU 2016-09	—	—	—	454	—	—	—	—	454
Balance as of January 1, 2018	**36,790,751**	**$ 37**	**$ 322,246**	**$ 427,518**	**$ (45,710)**	**(2,902,018)**	**$ (103,816)**	**$ 224**	**$ 600,499**
Stock issued against stock-based compensation plans	778,222	1	430	—	—	—	—	—	431
Stock-based compensation	—	—	5,074	—	—	—	—	—	5,074
Acquisition of treasury stock	—	—	—	—	—	(223,993)	(13,504)	—	(13,504)
Non-controlling interest	—	—	—	—	—	—	—	7	7
Other comprehensive loss	—	—	—	—	(13,960)	—	—	—	(13,960)
Net income	—	—	—	23,158	—	—	—	—	23,158
Balance as of March 31, 2018	**37,568,973**	**$ 38**	**$ 327,750**	**$ 450,676**	**$ (59,670)**	**(3,126,011)**	**$ (117,320)**	**$ 231**	**$ 601,705**

See accompanying notes to unaudited consolidated financial statements.

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EXLSERVICE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Three months ended March 31, 2019	2018
Cash flows from operating activities:		
Net income	$14,695	$23,158
Adjustments to reconcile net income to net cash provided/(used for) by operating activities:		
Depreciation and amortization	13,724	10,655
Stock-based compensation expense	6,956	5,074
Unrealized gain on short term investments	(3,185)	(2,842)
Unrealized foreign exchange loss/(gain), net	127	(3,319)
Deferred income tax expense	1,049	3,433
Allowance for doubtful accounts receivable	298	(612)
Loss from equity-method investment	67	56
Amortization of non-cash interest expense related to convertible senior notes	600	—
Impairment charges	1,227	—
Others, net	417	28
Change in operating assets and liabilities:		
Accounts receivable	(12,016)	(590)
Prepaid expenses and other current assets	591	(2,164)
Advance income tax, net	(2,099)	(13,906)
Other assets	388	(1,789)
Accounts payable	(1,159)	(1,726)
Deferred revenue	3,262	877
Accrued employee costs	(22,436)	(27,655)
Accrued expenses and other liabilities	5,837	3,317
Net cash provided by/(used for) operating activities	8,343	(8,005)
Cash flows from investing activities:		
Purchase of property and equipment	(10,878)	(12,680)
Business acquisition (net of cash acquired)	—	(380)
Purchase of investments	(47,683)	(20,310)
Proceeds from redemption of investments	21,361	30,358
Net cash used for investing activities	(37,200)	(3,012)
Cash flows from financing activities:		
Principal payments on finance lease obligations	(137)	(42)
Proceeds from borrowings	46,000	12,000
Repayments of borrowings	(10,572)	(5,036)
Payment of debt issuance costs	(97)	—
Acquisition of treasury stock	(15,408)	(13,504)
Proceeds from exercise of stock options	22	431
Net cash provided by/(used for) financing activities	19,808	(6,151)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(455)	(644)
Net decrease in cash, cash equivalents and restricted cash	(9,504)	(17,812)

Cash, cash equivalents and restricted cash at beginning of period	104,131	94,277
Cash, cash equivalents and restricted cash at end of period	$94,627	$76,465

See accompanying notes to unaudited consolidated financial statements.

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EXLSERVICE HOLDINGS, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2019
(In thousands, except share and per share amounts)

1. 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 and affiliates (collectively, the “Company”), operates in the Business Process Management (“BPM”) industry providing operations management services and analytics services that help businesses enhance revenue growth and improve profitability. Using its proprietary platforms, methodologies and tools, the Company looks deeper to help companies improve global operations, enhance data-driven insights, increase customer satisfaction, and manage risk and compliance. The Company’s clients are located principally in the United States of America (“U.S.”) and the United Kingdom (“U.K”).

2. Summary of Significant Accounting Policies

(a) Basis of Preparation and Principles of Consolidation

The unaudited consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles (“US GAAP”) for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by US GAAP for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

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

The accompanying unaudited consolidated financial statements include the financial statements of ExlService Holdings and all of its subsidiaries. The standalone financial statements of subsidiaries are fully consolidated on a line-by-line basis. Intra-group balances and transactions, and income and expenses arising from intra-group transactions, are eliminated while preparing those financial statements.

Accounting policies of the respective individual subsidiary and associate are aligned, wherever necessary, so as to ensure consistency with the accounting policies that are adopted by the Company under US GAAP.

The Company’s investments in equity affiliates are initially recorded at cost and any excess cost over proportionate share of the fair value of the net assets of the investee at the acquisition date is recognized as goodwill. The proportionate share of net income or loss of the investee is recognized in the unaudited consolidated statements of income.

Non-controlling interest is the equity in a subsidiary not attributable, directly or indirectly, to the parent and it represents the minority partner’s interest in the operations of ExlService Colombia S.A.S. Non-controlling interest consists of the amount of such interest at the date of obtaining control over the subsidiary, and the non-controlling interest's share of changes in equity since that date. The non-controlling interest in the operations for all periods presented were insignificant and is included under general and administrative expenses in the unaudited consolidated statements of income.

(b) Use of Estimates

The preparation of the unaudited consolidated financial statements in conformity with US GAAP 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 unaudited consolidated financial statements and the unaudited consolidated statements of income during the reporting period. Although these estimates are based on management’s best assessment of the current business environment, actual results may be different from those estimates. The significant estimates and assumptions that affect the financial statements include, but are not limited to, allowance for doubtful receivables, expected recoverability from customers with contingent fee arrangements, recoverability of dues from statutory authorities, assets and obligations related to employee benefit plans, deferred tax valuation allowances, income-tax uncertainties and other contingencies, valuation of derivative financial instruments, assumptions used to calculate stock-based compensation expense, assumptions used to determine incremental borrowing rate to calculate lease liabilities and right-of-use ("ROU") assets, lease term to calculate lease cost, depreciation and amortization periods, purchase price allocation, recoverability of long-lived assets including goodwill and intangibles, and estimated costs to complete fixed price contracts.

(c) Employee Benefits

Contributions to defined contribution plans are charged to the unaudited consolidated statements of income in the period in which services are rendered by the covered employees. Current service costs for defined benefit plans are accrued in the period to which they relate. The liability in respect of defined benefit plans is calculated annually by the Company using the projected unit credit method. Prior service cost, if any, resulting from an amendment to a plan is recognized and amortized over the remaining period of service of the covered employees.

The Company recognizes its liabilities for compensated absences depending on whether the obligation is attributable to employee services already rendered, relates to rights that vest or accumulate and payment is probable and estimable.

The Company includes the service cost component of the net periodic benefit cost in the same line item or items as other compensation costs arising from services rendered by the respective employees during the period. The interest cost, expected return on plan assets and amortization of actuarial gains/loss are classified in “Other income, net”. Refer Note 20 to the unaudited consolidated financial statements for details.

(d) Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments purchased with an original maturity of ninety days or less to be cash equivalents. Pursuant to the Company’s investment policy, surplus funds are invested in highly-rated debt mutual funds, money market accounts and time deposits to reduce its exposure to market risk with regard to these funds.

Restricted cash represents amounts on deposit with banks against bank guarantees issued through banks in favor of relevant statutory authorities for equipment imports, deposits for obtaining indirect tax registrations and for demands against pending income tax assessments (refer Note 26 to the unaudited consolidated financial statements for details). These deposits with banks have maturity dates after March 31, 2020. Restricted cash presented under current assets represents funds held on behalf of clients in dedicated bank accounts.

For purposes of the unaudited statements of cash flows, the Company includes in its cash and cash-equivalent balances those amounts that have been classified as restricted cash and restricted cash equivalents.

(e) Revenue Recognition

Revenue is recognized when services are provided to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for our services.

Revenue is measured based on consideration specified in a contract with a customer and excludes discounts and amounts collected on behalf of third parties. The Company recognizes revenue when it satisfies a performance obligation by providing services to a customer.

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer, are excluded from revenue.

Adoption of ASU 2014-09 Topic 606, “*Revenue from Contracts with Customers*” *(Topic 606)*

On January 1, 2018, the Company adopted Topic 606 using the modified retrospective method and applied its guidance to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606. The effect from the adoption of Topic 606 was not material to the Company's financial statements.

Nature of services

The Company derives its revenues from operations management and analytics services. The Company operates in the business process management (“BPM”) industry providing operations management and analytics services helping businesses enhance revenue growth and improve profitability. The Company provides BPM or “operations management” services, which typically involve transfer to the Company of business operations of a client, after which it administers and manages those operations for its client on an ongoing basis. The Company also provides industry-specific digital transformational services related to operations management services, and analytics services that focus on driving improved business outcomes for clients by generating data-driven insights across all parts of their business. The Company also provides care optimization and reimbursement optimization services, for its clients through its healthcare analytics solutions and services. The Company offers integrated solutions to help its clients with cost containment by leveraging technology platforms, customizable and configurable analytics and expertise in healthcare reimbursements to help clients enhance their claims payment accuracy.

Type of Contracts

i. a) Revenues under time-and-material, transaction and outcome-based contracts are recognized as the services are performed. When the terms of the client contract specify service level parameters that must be met (such as turnaround time or accuracy), the Company monitors such service level parameters to determine if any service credits or penalties have been incurred. Revenues are recognized net of any penalties or service credits that are due to a client.

b) In respect of arrangements involving subcontracting, in part or whole of the assigned work, the Company evaluates whether it is in control of the services before the same are transferred to the customer to assess whether it is Principal or Agent in the arrangement based on guidance on “Principal versus agent considerations” in Topic 606.

ii. Revenues for the Company’s fixed-price contracts are recognized using the proportional performance method when the pattern of performance under the contracts can be reasonably determined. The Company estimates the proportional performance of a contract by comparing the actual number of hours or days worked to the estimated total number of hours or days required to complete each engagement. The use of the proportional performance method requires significant judgment relative to estimating the number of hours or days required to complete the contracted scope of work, including assumptions and estimates relative to the length of time to complete the project and the nature and complexity of the work to be performed. The Company regularly monitors its estimates for completion of a project and record changes in the period in which a change in an estimate is determined. If a change in an estimate results in a projected loss on a project, such loss is recognized in the period in which it is first identified.

iii. Revenues from the Company's software and related services contracts, which are not significant, are primarily related to maintenance renewals or incremental license fees for additional users. Maintenance revenues are generally recognized on a straight-line basis over the annual contract term. Fees for incremental license without any associated services are recognized upon delivery of the related incremental license. To a lesser extent, software and related services contracts may contain software license, related services and maintenance elements as a multiple element arrangement. In such cases, revenue is allocated to maintenance based on the price charged when that element is sold separately.

iv. Revenues from reimbursement optimization services having contingent fee arrangements are recognized by the Company at the point in time when a performance obligation is satisfied, which is when it identifies an overpayment claim and the same is acknowledged by its customers. In such contracts, the Company’s consideration is contingent upon the actual collections made by its customers and subsequent potential retraction claims. Based on guidance on “variable consideration” in Topic 606, the Company uses its historical experience and projections to determine the expected recoveries from its customers and recognizes revenue based upon such expected recoveries. Any adjustment required due to change in estimates are recorded in the period in which such change is identified.

Arrangements with Multiple Performance Obligations

The Company’s contracts with customers do not generally bundle different services together except for software and related services contracts, which are not significant, involving implementation services and post contract maintenance services. In such software and related services contracts, revenue is allocated to each performance obligation based on the relative standalone selling price.

A separate contract is generally drafted for each type of service sold, even if to the same customer. The typical length of a contract is 3 to 5 years for our operations management contracts.

Allocation of transaction price to performance obligations

The transaction price is allocated to performance obligations on a relative standalone selling price basis. Standalone selling prices are estimated by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. In assessing whether to allocate variable consideration to a specific part of the contract, the Company considers the nature of the variable payment and whether it relates specifically to its efforts to satisfy a specific part of the contract.

Variable Consideration

Variability in the transaction price arises primarily due to service level agreements, cost of living adjustments, and pre-payment and volume discounts.

The Company considers its experience with similar transactions and expectations regarding the contract in estimating the amount of variable consideration that should be recognized during a period.

The Company believes that the expected value method is most appropriate for determining the variable consideration since the company has large number of contracts with similar nature of transactions/services.

Unbilled Receivables

Unbilled receivables represents revenues recognized for services rendered between the last billing date and the balance sheet date. Unbilled receivables also include revenues recognized from reimbursement optimization services when the Company identifies an overpayment claim and the same is acknowledged by its customers, however not invoiced at the balance sheet date. Accordingly, amounts for services that the Company has performed and for which an invoice has not yet been issued to the customers are presented as a part of contract assets as accounts receivable.

Deferred Revenue

The Company has deferred revenue attributable to certain process transition activities, with respect to its customers where such activities do not represent separate performance obligations. Revenues related to such transition activities are contract liabilities classified under “Deferred Revenue” in the Company's unaudited consolidated balance sheets and subsequently recognized ratably over the period in which the related services are performed. Deferred revenue also includes the amount for which services have been rendered but other conditions of revenue recognition are not met, for example where the Company does not have persuasive evidence of an arrangement with customer. Costs related to such transition activities are contract fulfillment costs, and thereby classified under “Other Current Assets” and “Other Assets” in the unaudited consolidated balance sheets, and are recognized ratably over the estimated expected period of benefit, under Cost of Revenues in the unaudited consolidated statements of income.

Other incremental and direct costs incurred for acquiring contracts, such as sales commissions are contract acquisition costs and thereby classified under “Other Current Assets” and “Other Assets” in the unaudited consolidated balance sheets. Such costs are amortized over the expected period of benefit and recorded under Selling and marketing expenses in the unaudited consolidated statements of income.

Any upfront payments made to customers are contract assets and classified under “Other Current Assets and Other Assets” in the unaudited consolidated balance sheets. Such costs are amortized over the expected period of benefit and are recorded as an adjustment to transaction price and reduced from revenues.

Reimbursements of out-of-pocket expenses received from clients are included as part of revenues.

Payment terms

All Contracts entered into by the Company specify the payment terms and are defined for each contract separately. Usual payment terms range between 30-60 days. The Company does not have any extended payment terms clauses in existing contracts. At times, the Company enters into fixed price contracts and software licenses involving significant implementation wherein the milestones are defined such that the Company can recover the costs with a reasonable margin.

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Practical expedients and exemptions
The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of 1 year or less and (ii) contracts for which the Company recognizes revenue at the amount to which we have the right to invoice for services performed.
Accounts Receivable
We record accounts receivable net of allowances for doubtful accounts. Allowances for doubtful accounts are established through the evaluation of aging of accounts receivables, prior collection experience, current market conditions, clients' financial condition and the amount of accounts receivables in dispute to estimate the collectability of these accounts receivables.

(f) Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, current portion of operating lease liabilities and operating lease liabilities, less current portion in the Company's unaudited consolidated balance sheets. Finance leases are included in property and equipment, current portion of finance lease obligations and finance lease obligations, less current portion in the Company's unaudited consolidated balance sheets.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. For leases in which the rate implicit in the lease is not readily determinable, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Lease terms include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for operating lease arrangements is recognized on a straight-line basis over the lease term. The Company has lease agreements with lease and non-lease components, which are accounted for separately.

On January 1, 2019, the date of initial application, the Company adopted, *Leases* (Topic 842), using the modified retrospective method. The modified retrospective method provides a method of recording those leases which had not expired as of the date of adoption of January 1, 2019. The prior period unaudited consolidated financial statements have not been retrospectively adjusted and continues to be reported under Topic 840.

The Company elected the practical expedient permitted under the transition guidance under Topic 842, which amongst other matters, allowed the Company (i) not to apply the recognition requirements to short-term leases (leases with a lease term of 12 months or less), (ii) not to reassess whether any expired or existing contracts are or contain leases, (iii) not to reassess the lease classification for any expired or existing leases, and (iv) not to reassess initial direct costs for any existing leases.

The adoption resulted in the recognition of ROU assets of $80,328, net of deferred rent of $8,626 and lease liabilities of $88,954 for operating leases as of January 1, 2019. The Company's accounting for finance leases remained substantially unchanged. The adoption had no impact on opening balance of retained earnings.

Refer Note 21 to the unaudited consolidated financial statements for details.

(g) Recent Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-13, *Financial Instruments - Credit Losses*, which requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is to be deducted from the amortized cost of the financial asset(s) so as to present the net carrying value at the amount expected to be collected on the financial asset. The new guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The amendment should be applied through a modified retrospective approach. Early adoption as of the fiscal years beginning after December 15, 2018 is permitted. The Company is currently evaluating the impact that the adoption of this guidance will have on its consolidated financial statements.

In June 2018, FASB issued ASU No. 2018-07, *Compensation-Stock Compensation* (Topic 718): Improvements to Non-employee Share-Based Payment Accounting. This ASU involves several aspects of the accounting for non-employee share-based payment transactions resulting from expanding the scope of Topic 718, Compensation-Stock Compensation, to include share-based payment transactions for acquiring goods and services from non-employees. The amendments in this ASU affect all entities that enter into share-based payment transactions for acquiring goods and services from non-employees. This ASU is effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity's adoption date of Topic 606. The adoption of this ASU is not expected to have any material effect on the Company's consolidated financial statements.

In August 2018, FASB issued ASU No. 2018-13, *Fair Value Measurement* (Topic 820): Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this ASU modify the disclosure requirements on fair value measurements in Topic 820, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. The amendments in ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. An entity is permitted to early adopt either the entire standard or only the provisions that eliminate or modify requirements. The adoption of this ASU is not expected to have any material effect on the Company's consolidated financial statements.

In August 2018, FASB issued ASU No. 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans-General* (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans. The amendments in this Update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. The amendments in ASU are effective for fiscal years beginning after December 15, 2020. An entity is permitted to early adopt this Update. The adoption of this ASU is not expected to have any material effect on the Company's consolidated financial statements.

In August 2018, FASB issued ASU No. 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software* (Subtopic 350-40): This ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). Accordingly, the ASU requires an entity (customer) in a hosting arrangement that is a service contract to follow the guidance in FASB Accounting Standard Codification Subtopic 350-40 on internal-use software to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The ASU 2018-15 also provides guidance on amortization and impairment of any costs capitalized, along with new presentation and disclosure requirements. The new guidance is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted and both prospective and retrospective transition methods are allowed. The Company is currently evaluating the impact that the adoption of this guidance will have on its consolidated financial statements.

(h) Recently Adopted Accounting Pronouncements

In February 2016, FASB issued ASU No. 2016-02, *Leases* (Topic 842), which requires the identification of arrangements that should be accounted for as leases. Lease arrangements exceeding a twelve months term should be recognized as assets with corresponding liabilities on the balance sheet of the lessee. This ASU requires recognition of an ROU asset and lease obligation for those leases classified as operating leases under Topic 840, while the income statement will reflect lease expense for operating leases. The balance sheet amounts recorded for existing operating leases at the date of adoption of this ASU must be calculated using the applicable incremental borrowing rate. The Company adopted Topic 842 as of January 1, 2019 using the modified retrospective method provided by ASU 2018-11. The adoption had a material impact on the Company's unaudited consolidated balance sheets, but did not have a material impact on the Company's unaudited consolidated income statements and unaudited consolidated statements of cash flows. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases, while the Company's accounting for finance leases remained substantially unchanged. Refer Note 21 to the unaudited consolidated financial statements for details.

In July 2018, FASB issued ASU No. 2018-11, *Leases* (Topic 842), which provide entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity’s reporting for the comparative periods presented in the financial statements in which

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it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). The Company adopted Topic 842 as of January 1, 2019 using this ASU. Refer Note 21 to the unaudited consolidated financial statements for details.

3. Segment and Geographical Information

The Company operates in the BPM industry and is a provider of operations management and analytics services. The Company has eight operating segments, which are strategic business units that align its products and services with how it manages its business, approaches its key markets and interacts with its clients. Six of those operating segments provide BPM or “operations management” services, five of which are industry-focused operating segments (Insurance, Healthcare, Travel, Transportation and Logistics, Banking and Financial Services, and Utilities) and one of which is a “capability” operating segment (Finance and Accounting) that provides services to clients in our industry-focused segments as well as clients across other industries. In each of these six operating segments, the Company provides operations management services, which typically involve transfer to the Company of the business operations of a client, after which it administers and manages those operations for its client on an ongoing basis. The remaining two operating segments are Consulting, which provides industry-specific transformational services related to operations management services, and Analytics, which provides services that focus on driving improved business outcomes for clients by generating data-driven insights across all parts of their business.

The Company presents information for the following reportable segments:

- Insurance
- Healthcare
- Travel, Transportation and Logistics (“TT&L”)
- Finance and Accounting (“F&A”)
- Analytics, and
- All Other (consisting of the Company's remaining operating segments, which are the Banking and Financial Services, Utilities and Consulting operating segments).

The chief operating decision maker (“CODM”) generally reviews financial information such as revenues, cost of revenues and gross profit, disaggregated by the operating segments to allocate an overall budget among the operating segments.

The Company does not allocate and therefore the CODM does not evaluate other operating expenses, interest expense or income taxes by segment. Many of the Company’s assets are shared by multiple operating segments. The Company manages these assets on a total Company basis, not by operating segment, and therefore asset information and capital expenditures by operating segment are not presented.

Revenues and cost of revenues for the three months ended March 31, 2019 and 2018, respectively, for each of the reportable segments, are as follows:

	Three months ended March 31, 2019						
	Insurance	**Healthcare**	**TT&L**	**F&A**	**All Other**	**Analytics**	**Total**
Revenues, net	$69,038	$ 20,569	$17,425	$25,724	$19,856	$ 86,961	$239,573
Cost of revenues[(1)]	46,692	16,995	9,800	14,274	12,577	56,902	157,240
Gross profit[(1)]	$22,346	$ 3,574	$7,625	$11,450	$7,279	$ 30,059	$82,333

Operating expenses	65,472
Foreign exchange gain, interest expense and other income, net	2,101
Income tax expense	4,200
Loss from equity-method investment	67
Net income	$14,695

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	Three months ended March 31, 2018						
	Insurance	**Healthcare**	**TT&L**	**F&A**	**All Other**	**Analytics**	**Total**
Revenues, net	$63,903	$ 22,797	$17,499	$23,972	$21,700	$ 57,102	$206,973
Cost of revenues[1]	42,427	17,242	10,443	14,729	15,185	38,075	138,101
Gross profit[1]	$21,476	$ 5,555	$7,056	$9,243	$6,515	$ 19,027	$68,872
Operating expenses							53,722
Foreign exchange gain, interest expense and other income, net							3,611
Income tax benefit							(4,453)
Loss from equity-method investment							56
Net income							$23,158

[1] Exclusive of depreciation and amortization.

Revenues, net by service type, were as follows:

	Three months ended March 31,	
	2019	2018
BPM and related services[1]	$152,612	$149,871
Analytics services	86,961	57,102
Revenues, net	$239,573	$206,973

[1] BPM and related services include revenues of the Company's five industry-focused operating segments, one capability operating segment and the consulting operating segment, which provides services related to operations management services. Refer reportable segment disclosure above.

The Company attributes the revenues to regions based upon the location of its customers.

	Three months ended March 31,	
	2019	2018
Revenues, net		
United States	$196,104	$171,198
Non-United States		
United Kingdom	29,101	28,016
Rest of World	14,368	7,759
Total Non-United States	43,469	35,775
Revenues, net	$239,573	$206,973

(In thousands, except share and per share amounts)

Property and equipment, net by geographic area, were as follows:

	As of March 31, 2019	December 31, 2018
Property and equipment, net		
India	$34,527	$36,152
United States	27,210	28,254
Philippines	7,703	5,985
Rest of World	4,007	3,119
Property and equipment, net	$73,447	$73,510

4. Revenues, net

Adoption of ASU 2014-09 Topic 606, "Revenue from Contracts with Customers"

On January 1, 2018, the Company adopted Topic 606 using the modified retrospective method and applied its guidance to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606.

The effect from the adoption of Topic 606 was not material to the Company financial statements.

Refer Note 3 to the unaudited consolidated financial statements for revenues disaggregated by reportable segments and geography.

Contract balances

The following table provides information about accounts receivable, contract assets and contract liabilities from contracts with customers:

	As of March 31, 2019	December 31, 2018
Accounts receivable, net	$176,889	$ 164,752
Contract assets	$5,241	$ 5,445
Contract liabilities:		
Deferred revenue (advance payments portion)	$8,906	$ 6,345
Consideration received from customer for transitions activities	$1,495	$ 1,669

Accounts receivable includes $75,832 and $63,952 as of March 31, 2019 and December 31, 2018, respectively, representing amounts not billed to customers. The Company has accrued the unbilled receivables for work performed in accordance with the terms of contracts with customers and considers no significant performance risk associated with its unbilled receivables.

Contract assets represents upfront payments made to customers.

Contract liabilities represents that portion of deferred revenue for which payments have been received in advance from customers including revenues attributable to certain process transition activities for which costs have been capitalized by the Company as contract fulfillment costs. The contract liabilities are included within deferred revenues in the unaudited consolidated balance sheet and are recognized as revenue as (or when) the performance obligation is fulfilled under the contract.

Revenue recognized during the three months ended March 31, 2019 and 2018 that was included in the contract liabilities balance at the beginning of the period was $2,777 and $3,710 respectively.

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Contract acquisition costs

The Company had contract acquisition costs of $513 as of March 31, 2019 and $713 as of December 31, 2018. Further, there was no additional capitalization made during the three months ended March 31, 2019. The Company amortized $200 and $73 during the three months ended March 31, 2019 and 2018, respectively. There was no impairment loss in relation to costs capitalized. The capitalized costs will be amortized on a straight-line basis over the life of contract.

Contract fulfillment costs

The Company had deferred contract fulfillment costs relating to transition activities amounting to $4,472 as of March 31, 2019 and $4,051 as of December 31, 2018. Further, we capitalized an additional $726 during the three months ended March 31, 2019. The Company amortized $305 and $111 during the three months ended March 31, 2019 and 2018, respectively. There was no impairment loss in relation to costs capitalized. The capitalized costs will be amortized on a straight-line basis over the life of contract.

Consideration received from customers, if any, relating to such transition activities are classified under Contract Liabilities and are recognized ratably over the period in which the related performance obligations are fulfilled.

5. Earnings Per Share

Basic earnings per share is computed by dividing net income to common stockholders by the weighted average number of common shares outstanding during each period. Diluted earnings per share is computed using the weighted average number of common shares plus the potentially dilutive effect of common stock equivalents (outstanding stock options, restricted stock and restricted stock units) issued and outstanding at the reporting date, using the treasury stock method. Stock options, restricted stock and restricted stock units that are anti-dilutive are excluded from the computation of weighted average shares outstanding.

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended March 31,	
	2019	2018
Numerator:		
Net income	$14,695	$ 23,158
Denominators:		
Basic weighted average common shares outstanding	34,374,815	34,446,265
Dilutive effect of share based awards	458,620	856,661
Diluted weighted average common shares outstanding	34,833,435	35,302,926
Earnings per share attributable to ExlService Holdings Inc. stockholders:		
Basic	$0.43	$ 0.67
Diluted	$0.42	$ 0.66
Weighted average potentially dilutive shares considered anti-dilutive and not included in computing diluted earnings per share	425,432	148,522

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6. Cash, Cash Equivalents and Restricted Cash

For the purpose of unaudited statements of cash flows, cash, cash equivalents and restricted cash comprise of the following:

	As of	
	March 31, 2019	March 31, 2018
Cash and cash equivalents	$86,688	$69,955
Restricted cash (current)	5,364	2,727
Restricted cash (non-current)	2,575	3,783
Cash, cash equivalents and restricted cash	$94,627	$76,465

7. Other Income, net

Other income, net consists of the following:

	Three months ended March 31,	
	2019	2018
Interest and dividend income	$796	$308
Gain on sale and mark-to-market of mutual funds	3,526	3,133
Others, net	101	93
Other income, net	$4,423	$3,534

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8. Property and Equipment, net

Property and equipment, net consists of the following:

	Estimated useful lives (Years)	As of March 31, 2019	December 31, 2018
Owned Assets:			
Network equipment and computers	3-5	$88,566	$85,921
Software	3-5	71,419	69,752
Leasehold improvements	3-8	40,312	39,533
Office furniture and equipment	3-8	20,783	20,097
Motor vehicles	2-5	719	635
Buildings	30	1,150	1,140
Land	—	753	746
Capital work in progress	—	12,596	11,026
		236,298	228,850
Less: Accumulated depreciation and amortization		(163,600)	(155,798)
		$72,698	$73,052
Right-of-use assets under finance leases:			
Leasehold improvements		$794	$778
Office furniture and equipment		344	53
Motor vehicles		707	628
		1,845	1,459
Less: Accumulated depreciation and amortization		(1,096)	(1,001)
		$749	$458
Property and equipment, net		$73,447	$73,510

Capital work in progress represents advances paid towards acquisition of property and equipment and cost incurred to develop software not yet ready to be placed in service.

During the three months ended March 31, 2019, there were no changes in estimated useful lives of property and equipment.

The depreciation and amortization expense, excluding amortization of acquisition-related intangibles, recognized in the unaudited consolidated statements of income was as follows:

	Three months ended March 31, 2019	2018
Depreciation and amortization expense	$8,139	$6,557

Effective January 1, 2017, the depreciation and amortization expenses set forth above includes the effect of foreign exchange gain/(loss) upon settlement of cash flow hedges, amounting to $57 and $151 for the three months ended March 31, 2019 and 2018, respectively. Refer Note 17 to the unaudited consolidated financial statements for further details.

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Internally developed software costs, included under Software, was as follows:

	As of	
	March 31, 2019	December 31, 2018
Cost	$9,457	$8,783