Genpact LTD
Form 10-Q
August 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period ended June 30, 2016

Or

o 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: 001-33626

GENPACT LIMITED

(Exact name of registrant as specified in its charter)

Bermuda	98-0533350
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Canon's Court

22 Victoria Street

Hamilton HM12

Bermuda

(441) 295-2244

(Address, including zip code, and telephone number, including area code, of registrant’s principal executive office)

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 x No o

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 x No o

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

The number of the registrant’s common shares, par value $0.01 per share, outstanding as of July 29, 2016 was 207,294,663.

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GENPACT LIMITED AND ITS SUBSIDIARIES

Consolidated Balance Sheets

(Unaudited)

(In thousands, except per share data and share count)

	Notes	As of December 31, 2015		As of June 30, 2016	
Assets					
Current assets					
Cash and cash equivalents	4	$	450,907	$	407,260
Accounts receivable, net	5		590,137		598,228
Prepaid expenses and other current assets	8		154,025		196,841
Total current assets		$	1,195,069	$	1,202,329
Property, plant and equipment, net	9		175,396		185,643
Deferred tax assets	23		99,395		80,114
Investment in equity affiliates	24		6,677		6,230
Intangible assets, net	10		98,601		84,421
Goodwill	10		1,038,346		1,055,968
Other assets			180,005		219,810
Total assets		$	2,793,489	$	2,834,515
Liabilities and equity					
Current liabilities					
Short-term borrowings	11	$	21,500	$	60,000
Current portion of long-term debt	12		39,134		39,158
Accounts payable			10,086		12,373
Income taxes payable	23		24,122		43,911
Accrued expenses and other current liabilities	13		499,638		417,304
		$	594,480	$	572,746

Total current liabilities							
Long-term debt, less current portion	12		737,332			717,745	
Deferred tax liabilities	23		2,093			2,840	
Other liabilities	14		155,228			186,342	
Total liabilities		$	1,489,133		$	1,479,673	
Redeemable non-controlling interest			—			2,778	
Shareholders' equity							
Preferred shares, $0.01 par value, 250,000,000 authorized, none issued			—			—	
Common shares, $0.01 par value, 500,000,000 authorized, 211,472,312 and 208,953,289 issued and outstanding as of December 31, 2015 and June 30, 2016, respectively			2,111			2,086	
Additional paid-in capital			1,342,022			1,373,679	
Retained earnings			411,508			448,867	
Accumulated other comprehensive income (loss)			(451,285	)		(472,568	)
Total equity		$	1,304,356		$	1,352,064	
Commitments and contingencies	25						
Total liabilities, redeemable non-controlling interest and equity		$	2,793,489		$	2,834,515	

See accompanying notes to the Consolidated Financial Statements.

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GENPACT LIMITED AND ITS SUBSIDIARIES

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share data and share count)

	Notes	Three months ended June 30, 2015	Three months ended June 30, 2016	Six months ended June 30, 2015	Six months ended June 30, 2016
Net revenues		$609,532	$630,523	$1,196,685	$1,240,226
Cost of revenue	19, 24	366,304	383,755	723,780	756,603
Gross profit		$243,228	$246,768	$472,905	$483,623
Operating expenses:					
Selling, general and administrative expenses	20, 24	149,230	165,197	297,978	325,346
Amortization of acquired intangible assets	10	7,315	6,493	14,656	12,638
Other operating (income) expense, net	21	(2,670)	(4,862)	(3,132)	(9,923)
Income from operations		$89,353	$79,940	$163,403	$155,562
Foreign exchange gains (losses), net		7,433	4,808	(112)	3,810
Interest income (expense), net	22	(17,352)	(3,433)	(26,377)	(6,271)
Other income (expense), net		811	503	1,269	1,381
Income before equity-method investment activity, net and income tax expense		$80,245	$81,818	$138,183	$154,482
Gain (loss) on equity-method investment activity, net		(2,340)	(2,074)	(4,563)	(4,219)
Income before income tax expense		$77,905	$79,744	$133,620	$150,263
Income tax expense	23	15,204	15,395	26,266	27,638
Net income		$62,701	$64,349	$107,354	$122,625
Net loss (income) attributable to redeemable non-controlling interest		—	882	—	1,171
Net income attributable to Genpact Limited shareholders		$62,701	$65,231	$107,354	$123,796
Net income available to Genpact Limited common shareholders	18	$62,701	$65,231	$107,354	$123,796
Earnings per common share attributable to Genpact	18				

Limited common shareholders				
Basic	$0.29	$0.31	$0.49	$0.59
Diluted	$0.28	$0.31	$0.48	$0.58
Weighted average number of common shares used in computing earnings per common share attributable to Genpact Limited common shareholders				
Basic	218,525,149	210,178,050	219,208,922	210,479,108
Diluted	220,962,306	213,803,134	221,654,703	213,848,050

See accompanying notes to the Consolidated Financial Statements.

GENPACT LIMITED AND ITS SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

(In thousands, except per share data and share count)

	Three months ended June 30,				Six months ended June 30,			
	2015		2016		2015		2016	
	Genpact Limited Shareholders	Redeemable Non-controlling interest	Genpact Limited Shareholders	Redeemable Non-controlling interest	Genpact Limited Shareholders	Redeemable Non-controlling interest	Genpact Limited Shareholders	Redeemable Non-controlling interest
Net Income (loss)	$62,701	$ —	$65,231	$ (882)	$107,354	$ —	$123,796	$ (1,171)
Other comprehensive income:								
Currency translation adjustments	(9,491)	—	(25,055)	39	(20,670)	—	(19,838)	39
Net income (loss) on cash flow hedging derivatives, net of taxes (Note 7)	(10,173)	—	(3,555)	—	11,660	—	(1,585)	—
Retirement benefits, net of taxes	(174)	—	(13)	—	112	—	140	—
Other comprehensive income (loss)	$(19,838)	$ -	$(28,623)	$ 39	$(8,898)	$ —	$(21,283)	$ 39
Comprehensive income (loss)	$42,863	$ -	$36,608	$ (843)	$98,456	$ —	$102,513	$ (1,132)

See accompanying notes to the Consolidated Financial Statements.

GENPACT LIMITED AND ITS SUBSIDIARIES

Consolidated Statements of Equity

(Unaudited)

(In thousands, except share count)

	Common shares				Accumulated Other	
			Additional Paid-	Retained	Comprehensive	Total
	No. of Shares	Amount	in Capital	Earnings	Income (Loss)	Equity
Balance as of January 1, 2015	218,684,205	$ 2,184	$ 1,296,730	$ 398,706	$ (412,484)	$ 1,285,136
Issuance of common shares on exercise of options (Note 16)	728,948	7	6,193	—	—	6,200
Issuance of common shares under the employee stock purchase plan (Note 16)	65,055	1	1,308	—	—	1,309
Net settlement on vesting of restricted share units (Note 16)	136,922	1	(1,007)	—	—	(1,006)
Net settlement on vesting of performance units (Note 16)	846,114	8	(8)	—	—	—
Stock repurchased and retired (Note17)	(3,628,449)	(36)	—	(81,363)	—	(81,399)
Expenses related to stock purchase (Note 17)	—	—	—	(73)	—	(73)
Stock-based compensation expense (Note 16)	—	—	11,314	—	—	11,314
Comprehensive income:						
Net income	—	—	—	107,354	—	107,354
Other comprehensive income	—	—	—	—	(8,898)	(8,898)
Balance as of June 30, 2015	216,832,795	$ 2,165	$ 1,314,530	$ 424,624	$ (421,382)	$ 1,319,937

See accompanying notes to the Consolidated Financial Statements.

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GENPACT LIMITED AND ITS SUBSIDIARIES

Consolidated Statements of Equity and Redeemable Noncontrolling Interest

(Unaudited)

(In thousands, except share count)

	Common shares No. of Shares	Common shares Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity	Redeemable non-controlling interest
Balance as of January 1, 2016	$211,472,312	$2,111	$ 1,342,022	$411,508	$ (451,285)	$1,304,356	$ —
Issuance of common shares on exercise of options (Note 16)	631,422	6	10,051	—	-	10,057	—
Issuance of common shares under the employee stock purchase plan (Note 16)	60,636	1	1,489	—	—	1,490	—
Net settlement on vesting of restricted share units (Note 16)	102,954	1	(98)	—	-	(97)	—
Stock repurchased and retired (Note17)	(3,314,035)	(33)	—	(86,371)	-	(86,404)	—
Excess tax benefit on stock-based compensation	—	—	6,699	—	—	6,699	—
Expenses related to stock purchase (Note 17)	—	—	—	(66)	—	(66)	—
	—	—	13,516	—	—	13,516	—

Stock-based compensation expense (Note 16)							
Acquisition of redeemable non controlling interest	—	—	—	—	—	—	3,910
Comprehensive income:							
Net income	—	—	—	123,796	—	123,796	(1,171)
Other comprehensive income	—	—	—	—	(21,283)	(21,283)	39
Balance as of June 30, 2016	208,953,289	$ 2,086	$ 1,373,679	$ 448,867	$ (472,568)	$ 1,352,064	$ 2,778

See accompanying notes to the Consolidated Financial Statements.

GENPACT LIMITED AND ITS SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Six months ended June 30,	
	2015	2016
Operating activities		
Net income attributable to Genpact Limited shareholders	$107,354	$123,796
Net income (loss) attributable to redeemable non-controlling interest	-	(1,171)
Net income	$107,354	$122,625
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	26,811	26,997
Amortization of debt issuance costs (including loss on extinguishment of debt)	12,759	767
Amortization of acquired intangible assets	14,656	12,638
Intangible assets write-down	-	5,814
Reserve for doubtful receivables	1,266	4,467
Unrealized loss on revaluation of foreign currency asset/liability	3,397	2,055
Equity-method investment activity, net	4,563	4,219
Excess tax benefit on stock-based compensation	-	(6,699)
Stock-based compensation expense	11,314	13,516
Deferred income taxes	(8,242)	17,870
Others, net	(87)	54
Change in operating assets and liabilities:		
Increase in accounts receivable	(34,451)	(15,137)
Increase in prepaid expenses, other current assets and other assets	(32,423)	(62,414)
Increase in accounts payable	1,165	2,881
Decrease in accrued expenses, other current liabilities and other liabilities	(27,678)	(76,806)
Increase in income taxes payable	34,176	26,341
Net cash provided by operating activities	$114,580	$79,188
Investing activities		
Purchase of property, plant and equipment	(30,172)	(46,595)
Proceeds from sale of property, plant and equipment	784	236
Investment in equity affiliates	(9,924)	(5,283)
Payment for business acquisitions, net of cash acquired	(17,718)	(11,633)
Net cash used for investing activities	$(57,030)	$(63,275)
Financing activities		
Repayment of capital lease obligations	(1,091)	(903)
Payment of debt issuance and refinancing costs	(6,584)	—
Proceeds from long term debt	800,000	—
Repayment of long-term debt	(664,875)	(20,000)

Proceeds from Short-term borrowings	1,451,500	60,000
Repayment of Short-term borrowings	(1,565,000)	(21,500)
Proceeds from issuance of common shares under stock-based compensation plans	7,509	11,547
Payment for net settlement of stock-based awards	(6,532)	(97)
Payment of earn-out/deferred consideration	(126)	(1,132)
Payment for stock purchased and retired	(81,399)	(86,404)
Payment for expenses related to stock purchase	(73)	(66)
Excess tax benefit on stock-based compensation	-	6,699
Net cash used for financing activities	$(66,671)	$(51,856)
Effect of exchange rate changes	(10,912)	(7,704)
Net decrease in cash and cash equivalents	(9,121)	(35,943)
Cash and cash equivalents at the beginning of the period	461,788	450,907
Cash and cash equivalents at the end of the period	$441,755	$407,260
Supplementary information		
Cash paid during the period for interest	14,671	9,125
Cash paid during the period for income taxes	24,706	30,269
Property, plant and equipment acquired under capital lease obligations	876	959

See accompanying notes to the Consolidated Financial Statements.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

1. Organization

The Company is a provider of digitally-powered business process management and services. The architect of the Lean Digital^{SM} enterprise, the Company uses its patented Smart Enterprise Processes (SEP^{SM}) framework to reimagine its clients' operating models end-to-end, including their middle and back offices. This creates Intelligent Operations^{SM} that the Company helps to design, transform, and run. Today, the Company generates impact for a few hundred strategic clients, including approximately one fifth of the Fortune Global 500, and has grown to over 75,000 people in 25 countries.

Prior to December 30, 2004, the business of the Company was conducted through various entities and divisions of GE. On December 30, 2004, in a series of transactions referred to as the "2004 Reorganization," GE transferred such operations to the Company. In August 2007, the Company completed an initial public offering of its common shares. On October 25, 2012, Glory Investments A Limited, an affiliate of Bain Capital Investors, LLC ("Bain Capital"), became the Company's largest shareholder when, together with its affiliated assignees and two additional co-investors, it purchased 67,750,678 common shares of the Company from the Company's initial private equity investors.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

2. Summary of significant accounting policies

(a) Basis of preparation and principles of consolidation

The unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information and the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q. 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 included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

The unaudited interim consolidated financial statements reflect all adjustments that management considers necessary for a fair presentation of the results of operations for these periods. The results of operations for interim periods are not necessarily indicative of results for the full year.

The accompanying unaudited interim consolidated financial statements have been prepared on a consolidated basis and reflect the financial statements of Genpact Limited, a Bermuda company, and all of its subsidiaries that are more than 50% owned and controlled. When the Company does not have a controlling interest in an entity but exerts significant influence on the entity, the Company applies the equity method of accounting. All intercompany transactions and balances are eliminated in consolidation.

Non-controlling interest in subsidiaries that is redeemable outside of the Company’s control for cash or other assets is reflected in the mezzanine section between liabilities and equity in the consolidated balance sheets at the redeemable value, which approximates fair value. Redeemable non-controlling interest is adjusted to its fair value at each balance sheet date. Any resulting increases or decreases in the estimated redemption amount are affected by corresponding charges to additional paid-in capital. The share of non-controlling interest in subsidiary earnings is reflected in net loss (income) attributable to non-controlling interest in the consolidated statements of income.

(b) Use of estimates

The preparation of consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant items subject to such estimates and assumptions include the useful lives of property, plant and equipment, intangibles and goodwill, revenue recognition, reserves for doubtful receivables, valuation allowances for deferred tax assets, the valuation of derivative financial instruments, measurements of stock-based compensation, assets and obligations related to employee benefits, and income tax uncertainties and other contingencies. Management believes that the estimates used in the preparation of the consolidated financial statements are reasonable. Although these estimates are based upon management’s best knowledge of current events and actions, actual results could differ from these estimates. Any changes in estimates are adjusted prospectively in the Company’s consolidated financial statements.

(c) Business combinations, goodwill and other intangible assets

The Company accounts for its business combinations using the acquisition method of accounting in accordance with ASC 805, Business Combinations, by recognizing the identifiable tangible and intangible assets acquired and liabilities assumed, and any non-controlling interest in the acquired business, measured at their acquisition date fair values. Contingent consideration is included within the acquisition cost and is recognized at its fair value on the acquisition date. A liability resulting from contingent consideration is remeasured to fair value as of each reporting date until the contingency is resolved. Changes in fair value are recognized in earnings. All assets and liabilities of the acquired businesses, including goodwill, are assigned to reporting units. Acquisition-related costs are expensed as incurred under Selling, General and Administrative Expenses.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

2. Summary of significant accounting policies (Continued)

Goodwill represents the cost of 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 on December 31, based on a number of factors, including operating results, business plans and future cash flows. The Company performs an assessment of qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of events or circumstances, the Company performs a quantitative assessment of goodwill impairment if it determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, based on the quantitative impairment analysis, the carrying value of the goodwill of a reporting unit exceeds the fair value of such goodwill, an impairment loss is recognized in an amount equal to the excess. In addition, the Company performs a qualitative assessment of goodwill impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. See Note 10 for information and related disclosures.

Intangible assets acquired individually or with a group of other assets or in a business combination are carried at cost less accumulated amortization based on their estimated useful lives as follows:

Customer-related intangible assets	1-14 years
Marketing-related intangible assets	1-10 years
Other intangible assets	3-9 years

Intangible assets are amortized over their estimated useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise realized.

In business combinations where the fair value of identifiable tangible and intangible net assets purchased exceeds the cost of the acquired business, the Company recognizes the resulting gain under “Other operating (income) expense, net” in the Consolidated Statements of Income.

(d) Financial instruments and concentration of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk are reflected principally in cash and cash equivalents, derivative financial instruments and accounts receivable. The Company places its cash and cash equivalents and derivative financial instruments with corporations and banks with high investment grade ratings, limits the amount of credit exposure with any one corporation or bank and conducts ongoing evaluations of the creditworthiness of the corporations and banks with which it does business. To reduce its credit risk on accounts receivable, the Company conducts ongoing credit evaluations of its clients. GE accounted for 18% and 16% of receivables as of December 31, 2015 and June 30, 2016, respectively. GE accounted for 19% and 17% of revenues for the six months and three months ended June 30, 2015 and June 30, 2016, respectively.

(e) Recently adopted accounting pronouncements

The following recently released accounting standards have been adopted by the Company. Adoption of these standards did not have a material impact on the Company's consolidated results of operations, cash flows, financial position or disclosures:

Effective January 1, 2016, the Company has adopted FASB ASU 2015-01 (Topic 225): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items ("ASU 2015-01"). Such items are defined as transactions or events that are both unusual in nature and infrequent in occurrence, and, currently, are required to be presented separately in the income statement, net of income tax, after income from continuing operations. The changes eliminate the concept of an extraordinary item and, therefore, the presentation of such items will no longer be required. Notwithstanding this change, the Company will still be required to present and disclose a transaction or event that is both unusual in nature and infrequent in occurrence in the notes to the financial statements.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

2. Summary of significant accounting policies (Continued)

Effective January 1, 2016, the Company has adopted FASB ASU 2015-05 (Topic 350), Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"), which provides explicit guidance to evaluate the accounting for fees paid by a customer in a cloud computing arrangement. The new guidance clarifies that if a cloud computing arrangement includes a software license, the customer should account for the license consistent with its accounting for other software licenses. If the arrangement does not include a software license, the customer should account for the arrangement as a service contract.

Effective January 1, 2016, the Company has adopted FASB ASU 2015-16 (Topic 805), Business Combinations ("ASU 2015-16"), which eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. The guidance requires that the acquirer shall recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined.

Effective January 1, 2016, the Company has adopted FASB ASU 2015-02. In February 2015, the FASB issued ASU No. 2015-02, Amendment to the Consolidation Analysis, which specifies changes to the analysis that an entity must perform to determine whether it should consolidate certain types of legal entities. These changes (i) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, (ii) eliminate the presumption that a general partner should consolidate a limited partnership, (iii) affect the consolidation analysis of reporting entities that are involved with variable interest entities, particularly those that have fee arrangements and related party relationships, and (iv) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

3. Business acquisitions

A. Acquisitions

(a) Endeavour Software Technologies Private Limited

On April 13, 2016, the Company acquired 100% of the outstanding equity interest in Endeavour Software Technologies Private Limited ("Endeavour"), a private limited company incorporated under the laws of India. The preliminary estimated total purchase consideration for Endeavour is $14,443, subject to adjustment for closing date working capital and net debt. This amount includes the estimated fair value of the contingent earn-out consideration and cash consideration of $10,028, net of cash acquired of $2,345, and a preliminary adjustment for working capital and net debt. Of this amount, $639 has been withheld for payment of taxes and $95 is payable to one of the sellers. The purchase agreement also provides for contingent earn-out consideration ranging from $0 to $3,500, payable based on future performance relative to the thresholds specified in the earn-out calculation. This acquisition enhances Genpact's digital capabilities by adding critical end-to-end mobility services.

In connection with the transaction, the Company recorded $800 in customer-related intangibles, $900 in marketing-related intangibles and $950 in other intangible assets, which have a weighted average amortization period of three years. Goodwill arising from the acquisition amounted to $8,870, which has been allocated to the Company's India reporting unit and is not deductible for tax purposes.

Acquisition-related costs of $338 have been included in selling, general and administrative expenses as incurred. In connection with the transaction, the Company also acquired certain assets with a value of $5,691 and assumed certain liabilities amounting to $1,853. The results of operations of the acquired business and the fair value of the acquired assets and assumed liabilities are included in the Company's consolidated financial statements with effect from the date of the acquisition.

(b) Strategic Sourcing Excellence LLC

On January 8, 2016, the Company acquired 51% of the outstanding equity interest in Strategic Sourcing Excellence LLC ("SSE"), a Delaware limited liability company. The preliminary estimated purchase consideration for SSE is $14,490, subject to adjustment for closing date working capital, transaction expenses and indebtedness. This amount includes the fair value of earn-out consideration, initial cash consideration of $2,550, and a preliminary adjustment for working capital, transaction expenses and indebtedness. The equity purchase agreement also provides for contingent earn-out consideration of up to $20,000, payable based on future performance relative to the thresholds specified in the earn-out calculation. Up to $9,800 of the total potential earn-out consideration, representing the selling equityholders' 49% interest in SSE, is payable only if either the put or call option, each as described below, is exercised.

The equity purchase agreement grants the Company a call option to purchase the remaining 49% equity interest in SSE, which option the Company has the right to exercise between January 1, 2018 and January 31, 2018. If the Company does not exercise its call option during such period, the selling equityholders have the right to exercise a put option between March 1, 2018 and April 30, 2018 to require the Company to purchase their 49% interest in SSE at a price ranging from $2,450 to $2,950. The equity purchase agreement also provides for contingent earn-out consideration ranging from $0 to $9,800, included as part of overall contingent earn-out consideration and payable only if either the call or put option is exercised. This acquisition strengthens the Company’s sourcing and procurement consulting domain expertise.

Acquisition-related costs of $164 have been included in selling, general and administrative expenses as incurred. Through this transaction, the Company acquired assets with a value of $327 and assumed liabilities amounting to $617. The preliminary estimated purchase consideration for the Company’s interests in SSE is $14,490, including the fair value of earn-out consideration and a preliminary adjustment for working capital, transaction expenses and indebtedness. The results of operations of the acquired business, the fair value of the acquired assets and assumed liabilities, and redeemable non-controlling interest are included in the Company’s Consolidated Financial Statements with effect from the date of the acquisition.

In connection with the transaction, the Company recorded $300 in customer-related intangible assets with an amortization period of five years. Goodwill arising from the acquisition amounted to $14,479, which has been allocated to the Company’s India reporting unit and is deductible for tax purposes.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

B. Asset held for sale

The Company is in the process of selling its cloud-hosted technology platform for the Indian rural banking sector (the "Business"), which was acquired in 2012. As of June 30, 2016, net assets relating to the Business amounted to $2,014.

During the three and six months ended June 30, 2016, net revenues attributable to the Business were $4,234 and $9,162, and net income was $802 and $182, respectively. The operations and net assets of the Business are not significant to the Company's operations. The Company expects to complete the divestiture of the Business within the next 12 months.

4. Cash and cash equivalents

Cash and cash equivalents as of December 31, 2015 and June 30, 2016 comprise:

	As of December 31, 2015	As of June 30, 2016
Cash and other bank balances	$ 450,907	$ 407,260
Total	$ 450,907	$ 407,260

5. Accounts receivable, net of reserve for doubtful receivables

The following table provides details of the Company's reserve for doubtful receivables:

	Year ended December 31, 2015	Six months ended June 30, 2016
Opening Balance as of January 1	$ 15,192	$ 11,530
Additions charged to cost and expense	2,449	4,467
Deductions/Effect of exchange rate fluctuations	(6,111)	(566)

Closing Balance	$ 11,530	$ 15,431

Accounts receivable were $601,667 and $613,659, and the reserves for doubtful receivables were $11,530 and $15,431, resulting in net accounts receivable balances of $590,137 and $598,228 as of December 31, 2015 and June 30, 2016, respectively. In addition, accounts receivable due after one year of $8,348 and $6,387 as of December 31, 2015 and June 30, 2016, respectively, are included under other assets in the Consolidated Balance Sheets.

Accounts receivable from related parties were $1,980 and $1,192 as of December 31, 2015 and June 30, 2016, respectively. There are no reserves for doubtful receivables in respect of amounts due from related parties.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

6. Fair value measurements

The Company measures certain financial assets and liabilities, including derivative instruments, at fair value on a recurring basis. The fair value measurements of these derivative instruments were determined using the following inputs as of December 31, 2015 and June 30, 2016:

	As of June 30, 2016 Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Derivative instruments (Note a, c)	$34,832	$ -	$ 34,832	$ -
Total	$34,832	$ —	$ 34,832	$ —
Liabilities				
Earnout Consideration (Note b, d)	$18,438	$ -	$ -	$ 18,438
Derivative instruments (Note b, c)	$66,197	$ -	$ 66,197	$ -
Total	$84,635	$ —	$ 66,197	$ 18,438
Redeemable non-controlling interest (Note e)	$2,778	$ -	$ -	$ 2,778

	As of December 31, 2015 Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Derivative instruments (Note a, c)	$30,380	$ -	$ 30,380	$ -
Total	$30,380	$ —	$ 30,380	$ —
Liabilities				
Earnout Consideration (Note b, d)	$22,820	$ -	$ -	$ 22,820
Derivative instruments (Note b, c)	$59,620	$ -	$ 59,620	$ -
Total	$82,440	$ —	$ 59,620	$ 22,820

(a) Included in prepaid expenses and other current assets and other assets in the consolidated balance sheets.
(b) Included in accrued expenses and other current liabilities and other liabilities in the consolidated balance sheets.
(c) The Company values its derivative instruments based on market observable inputs, including both forward and spot prices for the relevant currencies and interest rate indices for relevant interest rates. The quotes are taken from an independent market database.
(d) The fair value of earn-out consideration, calculated as the present value of expected future payments to be made to the sellers of acquired businesses, was derived by estimating the future financial performance of the acquired businesses using the earn-out formula and performance targets specified in each purchase agreement and adjusting the result to reflect the Company’s estimate of the likelihood of achievement of such targets. Given the significance of the unobservable inputs, the valuations are classified in level 3 of the fair value hierarchy.
(e) The Company’s estimate of the fair value of redeemable non-controlling interest as of June 30, 2016 is based on unobservable inputs considering the assumptions that market participants would make in pricing the obligation. Given the significance of the unobservable inputs, the valuation was classified in level 3 of the fair value hierarchy. Refer to Note 3—Business Acquisitions.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

6. Fair value measurements (Continued)

The following table provides a roll-forward of the fair value of contingent consideration categorized as level 3 for the three and six months ended June 30, 2015 and 2016:

	Three months ended June 30,		Six months ended June 30,	
	2015	2016	2015	2016
Opening Balance	$ 33,415	$ 20,853	$ 33,990	$ 22,820
Earn-out consideration payable in connection with acquisitions	—	2,070	—	10,190
Payments made on earn-out consideration	—	(187)	(126)	(1,152)
Change in fair value and others	(730)	(4,298)	(1,179)	(13,420)
Ending balance	$ 32,685	$ 18,438	$ 32,685	$ 18,438

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

7. Derivative financial instruments

The Company is exposed to the risk of rate fluctuations on its foreign currency assets and liabilities and on foreign currency denominated forecasted cash flows. The Company has established risk management policies, including the use of derivative financial instruments to hedge foreign currency assets and liabilities, foreign currency denominated forecasted cash flows and interest rate risk. These derivative financial instruments are largely deliverable and non-deliverable forward foreign exchange contracts and interest rate swaps. The Company enters into these contracts with counterparties that are banks or other financial institutions, and the Company considers the risk of non-performance by such counterparties not to be material. The forward foreign exchange contracts and interest rate swaps mature between 0 and 54 months and the forecasted transactions are expected to occur during the same period.

The following table presents the aggregate notional principal amounts of outstanding derivative financial instruments together with the related balance sheet exposure:

	Notional principal amounts (note a)		Balance sheet exposure asset (liability) (note b)	
	As of December 31, 2015	As of June 30, 2016	As of December 31, 2015	As of June 30, 2016
Foreign exchange forward contracts denominated in:				
United States Dollars (sell) Indian Rupees (buy)	$1,139,400	$ 1,093,400	$(48,197)	$ (38,642)
United States Dollars (sell) Mexican Peso (buy)	8,520	4,620	(1,163)	(851)
United States Dollars (sell) Philippines Peso (buy)	58,500	37,050	(1,387)	(514)
Euro (sell) United States Dollars (buy)	146,719	142,546	9,109	5,936
Euro (sell) Romanian Leu (buy)	39,027	22,295	567	527
Japanese Yen (sell) Chinese Renminbi (buy)	62,740	85,348	(1,379)	(10,635)
Pound Sterling (sell) United States Dollars (buy)	118,438	132,489	7,496	15,147
Australian Dollars (sell) United States Dollars (buy)	106,544	89,661	5,714	1,793
Interest rate swaps (floating to fixed)	-	419,805	-	(4,126)
			(29,240)	(31,365)

(a) Notional amounts are key elements of derivative financial instrument agreements but do not represent the amount exchanged by counterparties and do not measure the Company's exposure to credit or market risks. However, the amounts exchanged are based on the notional amounts and other provisions of the underlying derivative financial instrument agreements.

(b)

Balance sheet exposure is denominated in U.S. dollars and denotes the mark-to-market impact of the derivative financial instruments on the reporting date.

FASB guidance on Derivatives and Hedging requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the Balance Sheet. In accordance with the FASB guidance on Derivatives and Hedging, the Company designates foreign exchange forward contracts and interest rate swaps as cash flow hedges. Foreign exchange forward contracts are entered into to cover the effects of future exchange rate variability on forecasted revenues and purchases of services, and interest rate swaps are entered into to cover interest rate fluctuation risk. In addition to this program, the Company uses derivative instruments that are not accounted for as hedges under the FASB guidance in order to hedge foreign exchange risks related to balance sheet items such as receivables and intercompany borrowings denominated in currencies other than the Company's underlying functional currency.

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

7. Derivative financial instruments (Continued)

The fair value of the Company's derivative instruments and their location in the Company's financial statements are summarized in the table below:

	Cash flow hedges		Non-designated	
	As of December 31,	As of June 30,	As of December 31,	As of June 30,
	2015	2016	2015	2016
Assets				
Prepaid expenses and other current assets	$ 17,400	$ 23,304	$ 884	$ 92
Other assets	$ 12,096	$ 11,436	$ -	$ -
Liabilities				
Accrued expenses and other current liabilities	$ 34,576	$ 28,931	$ 34	$ 666
Other liabilities	$ 25,010	$ 36,600	$ -	$ -

GENPACT LIMITED AND ITS SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

(In thousands, except per share data and share count)

7. Derivative financial instruments (Continued)

Cash flow hedges

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain (loss) on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is recognized in the consolidated statements of income. Gains (losses) on the derivatives, representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness, are recognized in earnings as incurred.

In connection with cash flow hedges, the gains (losses) recorded as a component of other comprehensive income (loss), or OCI, and the related tax effects are summarized below:

	Three months ended June 30, 2015			2016			Six months ended June 30, 2015			2016		
	Before-Tax amount	Tax (Expense) or Benefit	Net of tax Amount	Before-Tax amount	Tax (Expense) or Benefit	Net of tax Amount	Before-Tax amount	Tax (Expense) or Benefit	Net of tax Amount	Before-Tax amount	Tax (Expense) or Benefit	Net of tax Amour
ening ance	$(32,968)	$11,661	$(21,307)	$(27,267)	$8,977	$(18,290)	$(66,786)	$23,646	$(43,140)	$(30,090)	$9,830	$(20,2
gains sses) lassified o atement ncome npletion edged nsactions	(8,659)	3,062	(5,597)	(2,585)	587	(1,998)	(17,913)	6,313	(11,600)	(5,487)	1,289	(4,19
anges in value of	(24,331)	8,561	(15,770)	(6,108)	555	(5,553)	233	(173)	60	(6,187)	404	(5,78

ective tion of			
standing ivatives,			
n (loss) cash flow ging			
ivatives,	(15,672)	5,499	(10,173)