Tata Consultancy Services Limited

Q1 FY19 Earnings Conference Call
July 10, 2018,19:00 hrs IST (9:30 hrs US ET)

Moderator: Ladies and gentlemen, good day and welcome to the TCS Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kedar Shirali. Thank you and over to you, sir.

Kedar Shirali: Thank you, Karuna. Good evening and welcome, everyone. Thank you for joining us today to discuss TCS' Financial Results for the First Quarter of Fiscal Year 2019 ending June 30th, 2018.

This call is being webcast through our website, and an archive, including the transcript will be available on the site for the duration of this quarter. The Financial Statements, Quarterly Fact Sheet and Press Releases are also available on our website.

Our leadership team is present on this call to discuss our results. We have with us today Mr. Rajesh Gopinathan -- Chief Executive Officer and Managing Director; Mr. N.G. Subramaniam - Chief Operating Officer; Mr. V. Ramakrishnan -- Chief Financial Officer; and Mr. Ajoy Mukherjee -- EVP and Head of Global Human Resources. Additionally, given how much banking and financial services has been in the news recently, we have asked Mr. K. Krithivasan -- President and Head of our BFSI Business to join us this evening as well.

Rajesh and Ramki will give a brief overview of the Company's performance followed by Q&A session.

As you are aware, we do not provide specific revenue and earnings guidance, and anything said on this call which reflects our outlook for the future or which could be construed as a forward-looking statement must be reviewed in conjunction with the risks that the company faces. We have outlined these risks in the second slide of the quarterly fact sheet available on our website and e-mailed out to those who have subscribed to our mailing list.

With that, I would like to turn the call over to Rajesh.

Rajesh Gopinathan: Thank you, Kedar and once again good evening to all of you. We have begun the new fiscal on a very strong note with our growth engine firing on all cylinders. Strong sequential acceleration gave us Q1 revenue growth of 15.8% YoY in rupee terms, 10% in dollar and 9.3% in constant currency terms.

On the margin front, as you know, we have a fairly steep margin headwind in the first quarter of every fiscal from the annual salary increases and promotions. This year was no different. Despite that, our operating margin for the quarter declined sequentially by just 0.4% to 25%, compared to the 23.4% margin we had for the same period of last year. Our net margin for the quarter came in at 21.4%.

Let me spend some time on the demand drivers and what is driving the strong growth:

In earlier calls, I had spoken of our Business 4.0 thought leadership framework, and how that is resonating well with our customers. From a technology perspective, successful enterprises are investing in agility, intelligence, automation and the cloud. Each of these technology pillars is a big business opportunity for us, and I can talk at length on each.

However, one of the risks of simplification and reductive representation is that we lose a lot of nuance and color, and run the risk of misunderstanding the nature of the demand. We saw this happen at the start of the digital wave when people reduced it to an acronym of four or five new technologies, and effectively masked the far more profound and transformative nature of the phenomenon.

So today, I just want to focus on one element – Automation. When we talk about automation, there are multiple dimensions to it. The most obvious one is the use of automation tools, either in the form of robotics process automation or cognitive software, to execute work that was until now being done by human workers.

This in itself is a fairly large opportunity where we enjoy a strong differentiated positioning on account of our historical embrace of such automation. The launch of ignio™, our cognitive automation software three years ago is just the latest initiative in a long tradition of research and innovation in this area, which has delivered industry-leading tool sets, which in turn gave TCS an unmatched track record for delivery excellence.

While that kind of automation results in superior outcomes as well, the primary driver for decision-making is still the quest for greater efficiency.

There is another kind of automation where customers are turning to us to build systems that carry out incredible amount of computations on large data set and deliver actionable insights at speeds that a human being should never be able to match. A good example for that is in the retail industry, where pricing of a certain item of merchandise was until now, a relatively straightforward matter of applying a certain mark up to the cost of that item. Today, in algorithmic retailing, as represented by our Optumera™ suite, we now use more than 500 factors like social media trends, demographics, competitor pricing, category specific variables, including the interplay of these factors on each other to determine the optimal pricing for that item at that point of time, which enables dynamic pricing changes, multiple times during the day.

The third form of automation is the use of blockchain, which is attracting a lot of interest among our customers. Although, a lot of initiatives are still in the POC or pilot phase, some of our customers are now moving to the next phase. We had spoken in the past about BNP Paribas Securities which has implemented our Quartz blockchain solution to streamline the sharing of corporate events across their various cross-border affiliates. We now have other use cases, such as a stock exchange in North America which is using blockchain for OTC settlement of high value, low volume assets; Banks in MEA forming a network for cross-border settlement, and now in India, we are in advanced discussions with an auto major for a blockchain solution to automate their bill discounting process.

As you can see, an individual element such as automation has multiple dimensions from a technology perspective. Even the buyers for these different dimensions tend to be fairly diverse within the client organization.

While automation of IT operations may be of interest only to the CIO, Robotic Process Automation of a certain process may be of interest to somebody from ops. The customer for our dynamic pricing software is often a Chief Merchandizing Officer. Our Cyber Security and Data Privacy offerings are being consumed by Chief Risk Officers. Blockchain solutions are sold to CXO-level executives who head a line of business. Looking past these point solutions at the larger, integrated engagements which use multiple services and solutions, the executive sponsors for these larger core transformation programs is often the COO or the CEO.

Our deep domain expertise, contextual knowledge and strong solutioning capabilities built up over the last many years positions us well to sit across the table with each of these diverse buyers and articulate very compelling value propositions.

Our success at winning those large core transformation opportunities which leverage our full spectrum capabilities is showing up in our numbers every quarter. Revenue from digital engagements crossed an important milestone, making up **25%** of our revenue. Our growth in digital further accelerated in Q1 to **44.8%** YoY.

Needless to mention it is also resulting in robust contract signings quarter after quarter, giving us good visibility into the medium-term. Starting this quarter, we will start sharing this visibility with you. The total value of contracts signed in Q1 is **$4.9 billion**. This translates into book-to-bill ratio just under 1 which is in line with our historical conversion rates.

Coming to how the various segments performed during the quarter, a quick reminder: all the growth numbers that I will mention from this point on are YoY and in constant currency terms.

You might recall from our last call that I had expressed some optimism on BFSI demand in North America. We are happy to inform you that the optimism has been vindicated and our BFSI vertical grew very nicely this quarter, recording strong sequential growth and YoY value of 4.1%. The growth has been very well-rounded, cutting across all sub-verticals and across geographies.

Let me also clarify that this does not include any of the revenues from our recent Insurance platform deals which we report separately under our Regional markets and Others category.

What has changed is that within the North America BFS segment, some of our more progressive banking customers, who are looking to leverage technology for growth and transformation, have begun engaging very strongly with us because of our early investments in Cloud, AI, Automation and location independent agile, as well as our Business 4.0 thought leadership framework which differentiates us from other providers, as well as their own captives.

Overall, we had strong deal win in this quarter in BFSI, giving us confidence in our ability to sustain this growth in the medium-term. I am happy to report that of the overall TCV that we signed up in Q1, BFSI alone accounts for **$1.6 billion**.

Our second largest vertical, Retail and CPG, got a little larger within our portfolio because we have integrated the Travel and Hospitality unit into this cluster. Our Retail cluster continues to perform well, growing at **12.7%** in Q1. Here too, we saw our customers accelerate their digital investments, convinced of the value of their technology leverage strategy, and getting traction against their online-only competitors.

As with BFSI, our Retail business is also punching its full weight in terms of deal signings, recording TCV of $759 million for the quarter, giving us confidence that the momentum will sustain.

Other verticals continue to grow well, with Energy and Utilities leading the pack with 30.9% growth. Life Sciences and Healthcare which grew 12.1%, and CMI which grew 9.5%, also added to the growth.

Geography wise, growth during the quarter was led by UK which grew 18.7%, Continental Europe which grew 18.6% and Asia Pacific which grew 10.8%. Growth in North America continues to accelerate, currently clocking at 7% YoY for the quarter, supported by BFSI and Retail recovery. North America accounted for more than fair share of the total volume of contracts we signed in Q1 with the TCV of $2.7 billion out of the $4.9 billion.

Our client metrics continue to reflect the strong participation we have in their incremental spends, particularly in the new technology areas. During the quarter, we added **2** more clients in $100+ million revenue band bringing the total to **40**, **5** more clients in the $10+ million band, **13** more clients in the $5+ million band and **15** more clients in the $1+ million band. This gives us greater confidence in the broad-basing of our client portfolio and the foundation for future growth.

Coming to Products and Platforms, TCS BaNCS, our flagship product suite in the financial services domain had a very good quarter with **8** new wins and **4** go-lives in Q1. TCS' Advanced Drug Development platform, which is transforming the clinical trial process for our Life Sciences customers by harnessing cognitive technologies to reduce human intervention enjoyed **2** new wins.

Ignio™ – our cognitive automation software and a core component of our Machine First Delivery Model (MFDM™), celebrated its third birthday with **7** new clients this quarter. During the course of this quarter, we will be sharing a lot more with you, as we celebrate this big milestone for us.

On the people side, we have crossed a big threshold this quarter, crossing the 400,000 mark in Q1. The workforce continues to become more and more diverse. The proportion of women rose further to 35.6% in Q1 and we now have 143 nationalities represented in our work force.

In Q1, self-motivated learners logged in **11 million** learning hours and as of June 30th we have trained over **262,000** employees in digital technologies and more than **240,000** employees on Agile. By building this capabilities organically, we are able to better integrate them in the solutions we build for our customers, and also leverage the specific contextual knowledge that individual possess in designing and deploying solutions that are better tailored for each customer. Our focus on organic talent development and giving opportunities to our people is driving industry-leading retention, with attrition reducing by a further **0.1%** QoQ to **10.9%**.

Finally, coming to the brand, the trust we enjoy with all our stakeholders – our employees and prospective employees, our customers, our investors and local communities that we work with across the world – goes towards building up the TCS brand. This is amplified by our various initiatives such as the sponsorships for high profile events like the New York Marathon, our #digitalempowers campaign and our partnership with the World Economic Forum.

Earlier this year our brand value was assessed at over $10 billion, and TCS was ranked the fastest growing brand in IT Services. I am happy to inform you that we have now been named among the top 60 brands in the United States by brand value, on an overall basis and not just limited to the IT services sector; a befitting recognition in the 50th anniversary of our founding.

To sum up, we have had a very strong start to the new fiscal with good growth acceleration in BFSI as well as North America. Our growth this quarter has been very holistic, driven by our strong participation in our customers' digital spending across industry verticals and geographies. Our accelerating digital business is an indicator of the strong traction we are experiencing on account of our early investments, our differentiated capabilities and our Business 4.0 thought leadership framework.

We expect this to sustain in the medium-term as more customers take up core transformation initiatives and scale up their digital investments. In the medium-term, our visibility significantly enhanced by the strong deal wins that we have had, which we are very happy to share with you.

With that, I will turn this over to Ramki.

V. Ramakrishnan: Thank you, Rajesh. Let me go through the headline numbers:

In the first quarter of FY'2019, our revenues grew **4.1%** QoQ and **9.3%** YoY on a constant currency basis. The very sharp cross-currency movements during the quarter resulted in a top line benefit of **+2.7%** in INR terms but a significant **-2.5%** impact in USD terms.

Reported revenue in INR was **₹342.7 billion** which is QoQ growth of **6.8%** and YoY growth of **15.8%**. In USD terms, revenue was **$5.05 billion** which is a milestone, and also which is QoQ growth of **1.6%** and YoY growth of **10%**.

Moving on to the Operating Margin, we had the usual seasonal impact from the wage increases that went into effect from April 1st. This time around, the margin impact was **-1.8%**. However, disciplined execution helped us generate efficiencies to the tune of **0.7%**. The sharp depreciation of rupee against the USD gave us further margin benefit of **0.7%**, resulting in an operating margin of **25%**, a QoQ decline of **0.4%**, but a significant improvement from the 23.4% margin we had for the same period in last year.

Higher other income mitigated some of the operating margin decline, so the net income margin was **21.4%**, mere **0.1%** lower than the prior quarter. Effective tax rate for the quarter was **24.8%**. Our accounts receivable DSO was at **75** in dollar terms, it was **up one day** QoQ.

The net cash flow from operations was **₹76.1 billion** which is **22.2%** of revenue and **103.7%** of net income. Free cash flow was **₹71.8 billion**. Invested funds as at 30th June stood at **₹474.5 million**. The board has recommended an interim dividend of **₹4** per share.

With that we can open the line for questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: Starting with revenue growth, have you seen an overall improvement in enterprise technology spending or have your participation rates gone up which indicates overall better growth rate across multiple verticals?

Rajesh Gopinathan: Ankur, I think it's a difficult one to answer actually, but let me put it this way: in a lot of the deals that we are talking of, we are uniquely positioned. These are not the regular RFP-driven deals. It is a leverage of the full portfolio of capabilities that we have built. In addition, there is an uptick in enterprise spend, and there is a greater propensity to spend that we are seeing across many of the geographies. So, it is a combination of both.

Ankur Rudra: If you could just maybe elaborate on the recovery in BFSI that you have called out, would you say all parts of BFSI – maybe US large banks, mid-market banks, European banks, capital markets, insurance, are they all firing or do you still have relative pockets of weakness which can improve over the course of the year, so maybe you can highlight what you have seen in the last two quarters and what gives you confidence for the rest of the year?

Rajesh Gopinathan: Let me start by saying that BFSI in the European market has continued to be strong through last year also. So the recovery really is coming out of the North American geographical market and UK. To give more color, I'll ask Krithi to speak about it.

K. Krithivasan: Thanks, Rajesh. One, the higher growth is across all segments and all geographies. Like Rajesh said, we always been having strong growth in Europe and UK and this quarter, we have seen a good recovery coming from North America.

If you look at the segment by size, again, there is no variance based on the size of the bank. Almost all banks and financial institutions have grown. We also experienced similar consistent patterns across insurance and banking – we do not see a big difference between the segments. As we said, Europe and UK continue to grow strongly, and US is recovering.

Ankur Rudra: Just on that, how much of our growth in BFSI has come from lesser of a headwind perhaps from work going to captives versus incremental absolutely new work that you are participating in?

K. Krithivasan: Last quarter also, we mentioned that banks are spending towards their internal workforce and workplace reimagination and that is tapering off. What we see now is that banks are trying to launch new programs. Our investment in Business 4.0 is paying off, and we are very well positioned to attract such investments because banks value us for the capabilities we bring in through Business 4.0, which is a big differentiator for them over their own captives as well as other service providers.

So, I would not say that our growth is coming because of one single program, but we think that internal workforce reimagination and workforce planning has stabilized, and so the banks have started spending on newer transformation programs and we are benefiting through them.

Ankur Rudra: Just one quick question on margins. I know there are a lot of large deals in maybe previous quarter and coming quarters as well. Is there a component of the large deals which may have some transformational business which have margins which can offset potential headwind from onsite staff onboarding?

V. Ramakrishnan: I think we have said it in the past couple of quarters as well. We do not structurally believe that the large deals that we have signed are very different from any of the other programs which we have. These programs have started off well, and the implementations are as per plan and the overall margin numbers reported is the proof of what is happening.

Rajesh Gopinathan: The large deals by nature will have a slightly more distributed margin profile, but nothing to call out on it right now.

Moderator: Thank you. We will take the next question from the line of Anantha Narayan from Credit Suisse. Please go ahead.

Anantha Narayan: So Rajesh, you provided the order booking numbers, so thank you for that. I think that's a useful metric to keep track of. But one number by itself doesn't really mean much to us.

A couple of questions here; one is you mentioned the book-to-bill ratio has been broadly similar historically as well. Can you just give us a bit of color on typically what tends to be the peak and the trough of these ratios over the past three years? Secondly, how much of this is typically renewals versus new business. Finally, just going forward, just for us to understand this metric better, should we expect any significant seasonality across the four quarters?

Rajesh Gopinathan: Anantha, first of all, it has taken us some time to get to share this. Let me put it this way. We ourselves are getting to grips with this number, and one of the reasons why we are sharing it is coming from greater confidence in that metric. So the caveat here that in the course of the next few quarters, expect some volatility in it and combine this with the commentary that we are giving and the color that we are giving in our commentary, around the metric itself. I have always in the past been skeptical about sharing it because these numbers tend to be lumpy and volatile.

You asked about the multi-year trend - we are not going to share the historical trends with you, but over time, this will build up and we will be able to look at it over time. What we are sharing with you is across some of the big segments, like North America, BFSI, Retail, but it has been lumpy in the past which is one of the reasons why we had not been sharing it. But in our ongoing convergence with global reporting trends, we are sunsetting some metrics and introducing some new metrics. So, work with us as we go through this.

Anantha Narayan: On the seasonality part, is that also unpredictable or there is some clear seasonality in that number?

Rajesh Gopinathan: Actually, seasonality is not very dramatic. Q3 number which is the calendar year-end is always a bit on the weaker side, but otherwise, especially in our recent past, the large deal closure has sometimes belied the seasonality. So if you look at the deals that we have announced, it is in the most unexpected quarters that the largest of the deals were closed.

So, there is a typical seasonality to deal flow, but the TCV number, the contract signings sometimes actually do not reflect that. We have not announced Q4 contract signings value, but Q4 was our all-time high, whereas from a traditional seasonality perspective, Q4 is not a very strong quarter.

Moderator: Thank you. We will take the next question from the line of Diviya Nagarajan from UBS. Please go ahead.

Diviya Nagarajan: Just a follow up to an earlier question on whether you are taking market share, is it something that you are seeing in the markets specific to BFS, is the recovery that you are seeing more a function of as we pointed out the insourcing trend really dying down and the reengineering work really picking up, or is there also an element of share gain that you are seeing here, could you run us through that, that is one thing? Secondly, I think you spoke about your aspirational margin still being at 26-28%. Ex-currency, we are still well below that range. How do you think about margins going forward and under what conditions do you think we will get back to 26-28% in constant currency terms?

Rajesh Gopinathan: Diviya, let me address the margin one and then I will leave it to Krithi to address the BFSI part of it. I think we have spoken about it in the past in our earnings calls and other places. The idea of thinking of our margin ex-currency is artificial, and it is a wrong construct because the reason we have constant pressure now on our margin is because of differential inflation between where our talent pool and delivery location is, and the inflation that you see on the pricing side. So this differential inflation will always be reflected in the currency movement. Currency movements tend to be lumpy by nature, but the differential reflection in the currency movement is a core component of our business model and our economic model.

It is wrong to think about margin ex-currency, where I am giving an 8% salary hike on the one hand and on the other hand, say that we will give it without the currency support. If the currency was not what it is, I would not give an 8% hike, but a 2% hike, which is where the developed market has benchmarked at. So we need to keep this in mind.

We have discussed this multiple times, but we always keep coming back to it. The fact is currency markets tend to be lumpy. So, you will find sudden corrections at times, but long-term trends actually reflect the differential inflation and it is a component that we are pretty much banking on, when we talk about our confidence in maintaining stable margins.

K. Krithivasan: There are two questions; one is on insourcing and where we are gaining growth from. On insourcing, we would like to point out that the headwind from that has always been exaggerated. Our view is that insourcing was isolated to a few banks and it was not a very common phenomenon, and that too we believe has stabilized.

On where we are getting growth from, it is again a combination of factors and depends on the geography. In geographies like Europe, you would find growth both from transformation as well as some new generation outsourcing happening in places where it has not happened before, and market share gain. But if you look at more mature geographies, you would find that it is happening primarily through transformation. Transformation plays a big role in our overall growth.

Diviya Nagarajan: Just a kind of clarification and extend that question on both banking and margins. I think on the banking sector, could you just kind of help us understand, is this something that you think is a broad-based phenomenon across the banking sector or do you think in a sense that we will see this reflected across multiple participants who service the banking sector or do you think this is specific to TCS, that is one. Rajesh, going back to the margin question, under what kind of growth rates and conditions, do we get back to 26-28% on the margin side?

K. Krithivasan: On the BFSI, Rajesh mentioned in the beginning as well. We have got a differentiated positioning today because of our Business 4.0 framework. We got a rich set of tools and framework to help our customers leverage the benefit coming out of these technologies. Because TCS is growing, whether everyone will grow is something not for me to say. We believe that our customers are seeing us as a differentiated player, and we get lot of benefit through their investments.

Rajesh Gopinathan: Margin side, Diviya, we have spoken again in the past that our business model is actually tuned for a double-digit or even mid-teens kind of growth rate. The other part of it is that we are not wedded to a margin range. We have always been investing and will always prioritize investments over it.

Currently, we are very enthused by the growth in digital and digital continues to suck in lot of investment. Our approach to investment has been to run it through the P&L, and not through the balance sheet. We put it in our talent development and our organic growth focus. So, we have been reporting steadily about our talent development program and that keeps pulling in a lot of investment side.

So the 26% to 28% is our target range. We are quite confident of going back to it in a more stable environment, as growth rate continues to pick up. What you saw this quarter is a validation of that. As we saw good growth coming in, into the quarter, we were able to offset more than half of our salary increases through efficiency gains that we are making through the scale element of it. So those dynamics will continue to play out, but it is very difficult for us to give an upfront call as to when the 26% range will be achieved.

Moderator: Thank you. We will take the next question from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: Just wanted to check on the SG&A leverage that we see in this quarter which is one of the best QoQ improvements that we have seen. So, is it mostly due to cross-currency or should we actually think of those as something that benefits from the large deals?

Rajesh Gopinathan: SG&A leverage is not coming from cross currency. If you look at our dip in the gross margin it is higher than the dip in the operating profit margin. So the efficiency gains are really coming from SG&A leverage. You will see currency impacting both sides of it, but despite the benefit, we are losing almost 90 basis points at the gross margin level due to the salary increases, whereas we were able to bring it down to less than 40 basis points at the operating margin level. So the remaining 50 bps came from the SG&A leverage.

Ravi Menon: Just a follow on there, so if the rupee were to stay where it is, do you think you will increase the sales and marketing investments?

Rajesh Gopinathan: Again, we have shared in the past that our investment in sales and marketing is not linked to where the rupee is. Some of our inorganic growth in the past, our investments in areas like France and Japan were calibrated based on where we found opportunity from a fast depreciating rupee. That kind of a tactical call we will take, but we are far away from that. The rupee depreciation that we have seen has to be seen in perspective of what has happened over the last two, three years. We had a strong rupee, which is where the margin pressure was coming from. So we are far away from correction on the other side. If it were to happen like the last time that it happened, we went down 29-30%, and we said we will invest some part of the gain in expanding in more challenging markets. Our investments in Europe during that period are showing rich gains for us right now, and similarly our investments in France and Japan which were calibrated at that time, are steadily adding to our growth currently.

Moderator: Thank you. We will take the next question from the line of Ashish Chopra from Motilal Oswal. Please go ahead.

Ashish Chopra: Just for the betterment of our understanding, if you could share on an average what are the durations like for this kind of a TCV deal number, and also if you could give the trend over the past three years would it have actually meaningfully come down or would it have remained within a tight range?

Rajesh Gopinathan: From a trend perspective, TCV has been steadily increasing over the past few years but beyond that, again as I said, I do not want to comment about the historical trends on a mass number that we were reporting. We will have to build up the history of this metric over time, and learn from the trend as we go along.

Ashish Chopra: Just one follow up on the previous question maybe, Ramki, if you could explain better. I think as far as the leverage in the SG&A is concerned, if I look at it both on YoY basis and QoQ, it seems to be in the SG&A employee cost. So while that has come down as a percentage of revenue significantly, whereas the employee cost and the cost of goods has gone up, could there also be an element of reclassification somewhere there or if not then just some more clarity on that would be helpful?

V. Ramakrishnan: There is no reclassification. It is, as Rajesh mentioned, a combination of various things. It is also an increase in our productivity across the board, be it from our delivery systems as well as from the sales and other supporting enablers. So you are seeing it also reflected in the savings from the SG&A.

Rajesh Gopinathan: Employee expenses constitutes 70% of our SG&A. So the leverage will come primarily out of that.

Moderator: Thank you. We will take the next question from the line of Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah: Just the question is in terms of the deal pipeline. So I think FY'18 you had a solid year in terms of many large deals which are even the mega deals which were announced. So, entering FY'19 if one has to compare your pipeline versus what you had in FY'18, do you believe such nature of the deals are still there and your confidence is still there that this is now a trend rather than one-off year of FY'18 and this can continue going forward especially for TCS as you are saying you are winning more of transformation non-RFP-driven deals?

Rajesh Gopinathan: The transformational non-RFP deals are definitely something that we are quite confident of participating in, and the deal pipeline is fairly strong in that.

The platform deals, as we have always shared in the past, are much more lumpy and difficult to call as to whether a platform deal will happen this year or not. These are fairly long gestation deals, but the good news is that the pipeline is good, but decision making seems to be unpredictable. So, platform deals difficult to say. Transformation deals, absolutely we are quite confident this year also.

Sandeep Shah: My question was on BFSI and Retail. So last year we said that these two verticals were not growing in line with the company average, and it looks like that actually there is a strong recovery in both of them. So is it fair to say that FY'19 could be on organic basis for you to achieve a double digit growth may not be a very tough task. I am not asking for a specific guidance or a number but just in terms of directionally, are these assumptions correct whether these two verticals will make a lot of difference in terms of overall growth rate in FY'19?

Rajesh Gopinathan: Directionally, Sandeep, this quarter we have grown 9.3% in Constant Currency on a YoY basis. And as I said in both the BFSI and Retail verticals our medium-term visibility is quite high. Beyond that, I do not want to comment about where it is. But as a management team, we have always said that our immediate term focus is to get back to double digit growth, and we are seeing that visibility on that is steadily increasing.

Sandeep Shah: Just last two questions, Ramki, I think in the notes to the accounts transition to IAS-115 we have said there is no material impact but even in terms of QoQ growth delta, is it some amount of materiality has come through this transition?

V. Ramakrishnan: No, we do not believe it is having any impact right now and also going forward, it is a question of significant more disclosures, but otherwise overall core principles of IAS-115, we have been following, so we do not see any significant impact.

Sandeep Shah: Rajesh, last thing, around AGM time you said that if there are no major investments, the 100% of free cash flow as a payout ratio can continue going forward. So one can consider this in modeling?

Rajesh Gopinathan: Absolutely. We have said 80-100%. You should consider that as an ongoing one. We are committed to it.

Moderator: Thank you. We will take the next question from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Rajesh, just one clarification, this order book number that you mentioned, is this the new order wins or does it also include renewals?

Rajesh Gopinathan: It includes everything. All contracts signed both existing as well as renewals.

Pankaj Kapoor: The other point which you mentioned was about a multiple of non-RFP deals that we have been able to successfully win in the last few quarters. So just wanted to understand that a bit, how is the commercial construct and the sales cycle time on these non-RFP pursued deals different versus the traditional RFP deals, since you probably be proactively constructing them, how is the digital playing a role in that, that will be helpful?

Rajesh Gopinathan: From a time perspective, some of them are very large deals which takes time to mature and also there is a question of when do you start the clock - because many of these are socialized early on, but then start gaining traction and momentum later on in the cycle, so what is the start point is a bit of question. But many of them are very small ones, which have a fairly fast closure time. So I would not characterize deals from a timing perspective.

Commercials also, it depends. Transformative deals, we have been quite open to taking on market-making, investment-centric deals, whereas with some of the newer services like digital interactive, etc., there the commercials are very-very attractive. They are much simpler, direct services deals.

Pankaj Kapoor: The second question is on the hiring given the visibility that you have and you also spoke of very healthy pipeline. Is there any change of view in terms of your hiring plan? Although I understand you do not disclose the utilization number and probably that may not be relevant also, but do you think that you have enough capacity to fulfill the requirements going forward?

Ajoy Mukherjee: From a requirement point of view for fulfilling our requirements, yes, we do have capacity to fulfill the requirements and there are different ways, one is through the employee headcount and then also the kind of optimization that is driving our efficiency and productivity.

From a hiring side, yes, we have been hiring and going forward our hiring will be higher than what we have been doing. The gross numbers we have not been giving out, but that is visible from our net addition that you see in Q1 itself is about 5,800. That is much higher than what it was at the same time last year. So, this is all going towards the kind of demand outlook that we have.

Pankaj Kapoor: Ajoy, is it possible to get a sense how much of that 5,800 employees we added were organic and how much came through some of these deals that we took over?

Ajoy Mukherjee: We have not given that break up. There were some questions even during the press conference, and what we have said is that it includes both. As far as this quarter is concerned, that number from an insourcing point of view is slightly higher than what our average number because of some of the large platform deals where we insourced people and integrated them into TCS. But overall, it has been both – organic hiring of fresh entry level talent as well as lateral hiring, and insourcing, all three put together is about 5,800 net hiring in this quarter.

Pankaj Kapoor: Ramki, I think you mentioned in the press conference that some of the operational efficiency that typically kicks in from the second quarter onwards you are able to realize from first quarter itself. So does it mean that is there some change in the way because of the growth and all we have been able to realize something incremental or you think that it is just something getting preponed to the quarter? So overall for the full year the margin lever from the efficiency gain will be comparable to what we will typically get in the earlier years as well?

V. Ramakrishnan: I think there is a slight understanding issue with what I said. What I said was in the previous quarter, not just last year, but also in the past years, the first quarter is when we have wage increases and over the next few quarters, we recover most of the decline in margins or all of it through various margin levers. This year, in the first quarter itself, we have been able to get almost 70 basis points through the operational efficiency.

It does not mean that it is something which would have otherwise come in the later quarter and which has come here. We continuously look at opportunities where we can drive these efficiencies and continue to drive on a disciplined manner. So, we do believe that trend will continue.

Moderator: Thank you. The next question is from the line of Sandip Agarwal from Edelweiss. Please go ahead.

Sandip Agarwal: One question, Rajesh, on the digital side, we continue to see a very robust growth. I just wanted kind of flavor, is it more with the same client increasing its budget on the digital side or it is more widespread like it is a mix of new client coming in and the older one scaling up on the digital side?

The second question which I have is that on the BFSI front particularly, it is a strong revival as it looks like and you have already mentioned that in medium term you have good visibility. But will it be fair to assign some credibility to the recovery in the US economy, the interest rate hikes and also some bit of more openness towards outsourcing on the European and UK geography, how much will you like to credit this revival to?

Finally, on the margin front, what I am trying to understand here is that you have given margin guidance range on a constant currency basis, so at least the currency movement which has happened can we adjust that in our model?

Rajesh Gopinathan: If we take the margin one, the margin range is not on a constant currency basis, it is on an absolute reported basis. What we have said is that extreme movements on currency will give you visibility to it. But as I explained to Diviya's question, the currency is a core part of this margin defense strategy and therefore it is not on a constant currency basis.

Let me take the digital one and then I will hand it to Krithi for the BFSI question. Digital definitely has a role in terms of new client acquisition, but by and large a lot of the digital revenues that we see is coming from our existing customers and our participation in their digital investments rather than this revenue coming from a new set of customers. But there is some element of new customer acquisition primarily led by digital, but bulk of it is coming from our existing customer base.

K Krithivasan: On the BFSI growth in North America, our position is that, the clients are seeing the opportunity to leverage this technology which gain more growth and transformation leveraging this technology. So, many of the investments coming from that desire and we have been able to participate in a much bigger way and gaining traction. But there could be increase in spend, or there could be element of optimism based on the macro-economic conditions in US which cannot be ruled out, but our position is that overall there is a greater desire to achieve growth and transformation which is driving this growth.

Moderator: Thank you. The next question is from the line of Srinivas Rao from Deutsche Bank. Please go ahead.

Srinivas Rao: I have two questions; one on the digital side. Your commentary indicates double digit growth on cloud. Could you throw some light as to what is the broad share of the cloud migration part within your digital revenue pie, that will be my first question?

Second question is you said your investments which you have focused lot more on internal talent development rather than at least for now not making any visible acquisitions. Do you think the acquisitions at this stage are more difficult to add value or any perspective on that would be helpful?

NG Subramaniam: On the cloud aspect now, there are multiple offerings that we have on cloud and each one of them we are winning opportunities and winning deals. We see fairly good traction in terms of enterprise systems being transformed into cloud. It is actually a combination of infrastructure, applications and then software as a service, platform as a service and all of those things happen and coupled with the Digital Core actually being moved into the cloud, we have the APIfication and all the other things also kick in. So overall it is very difficult to say how much of it is from what areas of cloud, but the growth that we have provided is truly a combination of infrastructure, applications as well as SaaS and PaaS as I explained earlier.

On the acquisitions, we keep looking for opportunities and as we explained in the previous quarter, I think we have one of the best track record of acquiring companies, integrating and leveraging better value out of the acquisition. But our key focus at this point in time is to clearly grow organically, we are extremely focused on upskilling, reskilling to our digital training initiative and capture the demand that we see out there for the digital skills.

Srinivas Rao: Is it fair to say the strategy which is in a bit of contrast from the rest of your industry peers which you would agree and that is the reason to ask, do you see bigger risk, or you do not see acquisitions of scale which can move the needle for you?

NG Subramaniam: We clearly note that there have been skepticism about our strategy of growing this particular business organically. We were very clear that contextual knowledge is very important, and people having that contextual knowledge to be trained on digital will be the best way forward to deliver greater business value to our clients. I think that, combined with the digital offerings and the Business 4.0 thought leadership framework, all have resulted in benefits to us in terms of growth and better participation in the transformation programs. We feel that we are vindicated by growing this as organic strategy.

But having said that we are open to keep looking at niche players, niche skill sets and niche competencies that are available, and if it makes sense, then we will go for it.

Moderator: Thank you. The next question is from Sudheer Guntupalli from Ambit Capital. Please go ahead.

Sudheer Guntupalli: Especially in Retail and Communications if we look at it, these two verticals have done quite well in this quarter. So, just want to understand what is driving growth in these two verticals and I think one of your global competitors have also reported growth acceleration especially in Communications vertical, so is there some vertical related tailwind over here or what exactly is happening?

Rajesh Gopinathan: Communications vertical continues to generate lot of fresh investment post its consolidation phase. As we saw in most of these markets, the CSP universe which was a significant segment of our customer base has gone through a series of consolidation exercises and now have switched into market making and investment mode, and we are participating in their investment cycle - both from an engineering perspective, where they are trying to essentially up their infrastructure to provide smart infrastructure play as well as on the digital market place and digital ecosystem driver kind of path where we are working a lot with them in enabling a much more holistic product suite to their customer set. So, the Communications vertical we are quite positive on, and we think that it should continue across most of the developed markets.

Retail, I shared with you that this is coming from brick-and-mortar retailers integrating digital technologies a lot more with their existing assets and providing much more holistic experience to their customers and going beyond just a lowest price offer or category selection offer that is the hallmark of online. This one is a more difficult one to say how it will go, because the industry is still significantly challenged. So, we will see both participation and some large transformational deals as well. There will also be the constant risk of bankruptcy or any such corporate actions derailing some part of the revenue streams in different parts of this industry.

Moderator: Thank you. Ladies and gentlemen, this was the last question for today. I now hand the conference over to the management for closing comments. Over to you sir.

Rajesh Gopinathan: Thank you. So to sum up the call:

- Q1 revenues grew by 4.1% sequentially and 9.3% year-on-year and it has been a very holistic growth across segments marked by strong recovery in BFSI and North America.
- Growth was led by Energy and Utilities which grew at 30.9%, Retail and CPG which grew 12.7%, Life Sciences, Healthcare growing at 12.1% and CMI which grew at 9.5%.
- The fundamental driver of our growth has been our strong participation in our customers' digital transformation journeys which we discussed at length today and their embrace of our Business 4.0 thought leadership framework.
- Our digital revenue touched the 25% mark in Q1 and grew 44.8% YoY. The digital traction is resulting in strong client metrics and robust contract signings which we are happy to share with you.
- The growth acceleration, disciplined execution and currency support, all gave us good margin support in Q1, positioning us well to reach our preferred range of 26-28%.
- Our investment in organic talent development is helping us better integrate new technologies with our contextual knowledge in the solutions we design for our customers. It is also resulting in industry-leading retention rate.

So once again thank you all for joining us in this call today and have a great evening.

Moderator: Thank you, members of the management. Ladies and gentlemen, on behalf of TCS that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

Note: This transcript has been edited for readability and does not purport to be a verbatim record of the proceedings.