"Mphasis Limited Q1 FY19 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Mphasis Limited Q1 FY19 Earnings Conference Call. As a reminder, all participant 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 call is being recorded. I now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir.

Shiv Muttoo: Thanks. Good morning, everyone. Thank you for joining us on Mphasis' Q1 FY19 Earnings Conference Call. We have with us today Mr. Nitin Rakesh – CEO and Mr. V. Suryanarayanan – CFO of Mphasis.

Before we begin, I would like to state that some of the statements in today's discussion maybe forward-looking in nature and may involve certain risks and uncertainties. A detailed statement in this regard is available on the Q1 FY19 Results Announcement Release that has been sent to you earlier.

I now invite Mr. Nitin Rakesh to begin the proceedings of the call.

Nitin Rakesh: Thank you, Shiv. Good morning, everyone. And thanks for joining the call. I hope you have all had the opportunity to go through our Q1 2019 results and other operational performance information in our MD&A.

We entered FY19 with a strong pipeline and consecutive quarters of growth which was broad based across various key businesses within Mphasis. We have seen that momentum continuing in FY19 and have started the financial year 2019 on a strong footing, and our Q1 results reflect our strategic focus on consistent revenue growth anchored around four 4Gs of growth, i.e. Consistent, Competitive, Profitable and Responsible growth.

We are witnessing continued focus from enterprise clients to adopt New-Gen technologies to achieve operational efficiencies and to integrate into digital channels to get more customer insights, and thereby improving their customer experience. This trend has continued to create opportunity for service providers like us with right set of capabilities to serve this market demand.

Our $X2C^2$ and Front2Back transformation approach is helping our clients adopt new digital technologies and is helping us win in the market place. The share of New-Gen services in our revenue for Q1 2019 was 44.4% of our Direct Core business, which was a growth of 54% year-over-year.

Our continued investments and capability building around the New-Gen services are gaining visibility in the market place. We also hosted our maiden Analyst and Advisor Day in Boston earlier this month where we showcased our innovative solutions in cloud, intelligent automation, digital customer experience, data and more. This was well attended by leading influencers globally. We are now getting regular coverage in analyst reports as a leading New-Gen services provider. In addition, we are also partnering with disruptive start-ups to take cutting edge technology and solution to our clients through our Sparkle program. These investments and partnership framework building are ongoing as we continue to grow our business.

We continue to see strong traction in our deal wins with $153 million of TCV in the Direct International business against $116 million in the previous quarter. 78% of the deal wins are in the focus area of New-Gen services. Our pipeline continues to grow, and we are seeing increase in the average size of the deals we participate in and win.

The DXC/HP channel continues to maintain growth momentum. Our sales and strategic client engagements over the past couple of years have helped us build a solid partnership with DXC/HP and we continue to work towards being a valuable partner to them through this year as well.

Europe, which is another key vector of our growth strategy continues to witness growth. In Q1 2019 revenue from Europe had significant QoQ and YoY growth at 12% and 44% respectively on a reported basis. We continue to increase our focus on sales investments here and expect this to be a key growth driver through the remainder of year as well.

Digital risk continues to be stable and is above our stated revenue band and we are building sustainable and profitable pipeline in this business.

Moving on to financial results of Q1 2019.

Consolidated gross revenue grew 7.0% QoQ and 22.5% YoY on a reported basis. The growth was 2.9% QoQ and 16.2% YoY in Constant Currency terms. Excluding the one-time revenue from India Government business in Q4 FY18, gross revenue grew 3.6% QoQ in Constant Currency. The growth was broad based across Direct and DXC businesses.

Direct International grew 7.6% QoQ and 21.3% YoY on a reported basis and 3.2% QoQ and 14.8% YoY in Constant Currency. Direct Core which contributed 78% of Direct International revenue in Q1 grew 8.5% QoQ and 21.3% YoY on a reported basis, and 4.2% QoQ and 14.8% YoY in Constant Currency terms, driven by growth across key strategic accounts, Blackstone companies and new accounts.

DXC/HP business grew 8.3% sequentially and 29.9% YoY on a reported basis and 4.5% QoQ and 23.3% in Constant Currency terms. We continue to invest in the partnership and focused on bringing New-Gen services to the core.

Moving on to the margins, the operating margins improved 280 bps year-over-year to 16.6%. While the operating margin declined 20 bps QoQ, excluding the benefit of one-time revenue in Q4 2018 margins improved 40 bps. During the quarter, rupee depreciated significantly against the dollar. While we have a consistent hedging policy to mitigate the currency movement impact on margins, the forward rates in Q1 2019 declined compared to Q4 2018, impacting our margins by 60 bps, both QoQ and YoY.

Improvement in our key operating levers viz. fixed price revenue (which is now at 27% in Q1, one of the highest that we have ever had), pyramid optimization, automation and utilization helped us absorb this and improve our operating margins.

Our cash generation continues to be strong and total cash on the balance sheet as of 30th June stood at Rs. 27,372 crores which translates to almost $400 million.

In continuation of our philosophy of enhancing shareholder returns, the Board of Directors have approved a share buyback program at a maximum price of Rs. 1,350 per share, subject to approval of shareholders for an amount up to Rs.988 crores. Our strong cash balance, continued cash generation from operations and focus on improving efficiency give us adequate cushion to pursue our M&A strategy and other growth investments to build competencies such as Talent-Next.

Overall, we are pleased with the consistent growth trajectory from FY18 continuing in FY19 with strong QoQ and YoY growth in Q1. We are focused on expanding Mphasis' wallet share across all key client segments and businesses through offering additional services across the digital technology footprint, including Front2Back as well as Service Transformation. We have a systematic approach towards growing the Blackstone portfolio and are strengthening our partnership with DXC/HP to position us as a value-added partner in helping them win in the market place. We also continue to focus on expanding our European footprint across our chosen market segments.

On that note, I thank you once again for your interest. And I will request the operator to open the line for questions.

Moderator: Thank you very much, sir. Ladies & gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Apoorva Prasad from HDFC Securities. Please go ahead.

Apoorva Prasad: My first question is on the HP/DXC channel. We have been talking about strong growth there, what has really been driving this? You had guided to at or above industry type of growth, I am really trying to understand how has that changed from a quarter back and how do you see it really now?

Nitin Rakesh: Short answer is, actually nothing has changed. We continue to focus on the vectors we defined earlier. We have been a long-term partner. We understand those clients and their customer segments, we understand their own internal businesses in case of the various HP entities. And our approach is really two pronged, continue to bring value to them in their existing business and continue to bring new capabilities that helps them win in the market place. And that is the reason why the partnership, combined with long-term track record is how we are executing. So, this is really a continuation of same execution road map that we laid out last year. There is really nothing more to add to that.

Apoorva Prasad: And is it broad based across service lines, verticals or is there a skew anywhere within it?

Nitin Rakesh: No, it is fairly broad based. It is something we started focusing on four or five quarters ago. And as I said, this is a continuation of that across multiple parts of the entire value chain; across all the entities in HP.

Apoorva Prasad: And your thoughts on Digital Risk? You mentioned it is above 30 million. Can you also help me with the revenue number for the quarter and your outlook there?

Nitin Rakesh: So, we stated a band of 28 million to 30 million, we are actually over 31 million in this quarter. You have to keep in mind two things: our stated objective of FY18 was to stabilize the top-line because entering FY18 the top-line trajectory was fairly challenged because of the headwinds that we saw in the mortgage origination business. Those headwinds, while we have seen a few cycles of interest rate hikes, have not fully disappeared. So, what we have done to counter the volume drop coming out of the origination business is to build adjacent lines of business as well as to find ways to take some of our existing services to those clients. And that is the reason we have actually seen some good growth in the digital risk business; at least on a YoY basis. At this point in time we continue to focus on keeping that stable, at or above this revenue guidance range. We have obviously transformed the margin profile of that business dramatically in FY18 and that has continued in FY19 as well.

So, on a YoY basis we have seen 13% growth in that business. From base effect perspective we will probably see some of that growth still play out on a YoY basis. But given the fact that the underlying dynamics of the business is still not fully out of the headwinds in environment, we will be cautiously optimistic in how we build that from a growth perspective. But we are overall very pleased with the way we have transformed that business over the last four quarters.

Apoorva Prasad: And any win which you would want to call out from the Blackstone portfolio in the first quarter TCV?

Nitin Rakesh: No, I mentioned this last time, we are not going to break out TCV any more than we already do. If we do, it will be on a case by case basis, probably on a year-end basis. But for now, No.

Moderator: Thank you. Our next question is from the line of Madhu Babu from Prabhudas Liladher.

Madhu Babu: Sir, the information technology and communication vertical has been showing strong YoY growth. Any sub-segments where we are seeing strong growth there and on the vertical side as well?

Nitin Rakesh: Yes, a little bit of that is the reflection of the growth we are seeing in HP and DXC channel, given that we do work for internal IT there as well. And some of it is also when we run a shared service type operation which cuts across multiple end clients, we kind of classify that as a horizontal under the HP. So, again, good growth overall across high tech and ITCE. But clearly it includes mainly the DXC/HP growth.

Madhu Babu: Sir, we have been talking about Front2Back transformation strategy, even in the last Analyst Meet. So, have we already executed in the non-BFSI verticals and any reference clients do we have for this execution ?

Nitin Rakesh: Yes, we do. Actually, we have reference clients across the value chain: we have in banking, we have in wealth management, we have in mortgages, in insurance, as well as outside in our emerging vertical as well as in segments that sit within the non-BFSI.

Madhu Babu: And the last question, the onsite revenue has been increasing steadily over the last few quarters, any reason for that?

Nitin Rakesh: I think it is broadly linked to the higher percentage of New-Gen services. Because, if you see, almost 80% of our new deals are coming from that area that requires whatever upfront interaction from a design, thinking or workshop's perspective. Some of the large deals require that investment upfront. But if you look our headcount is fairly stable: both onsite and offshore. So, some of that is also a reflection of our healthier billing rates onsite. So, revenue percentage may go up, that can also be linked to billing rates. Headcount is actually fairly stable across onsite and offshore.

Moderator: Thank you. Our next question is from the line of Dipesh Mehta from SBICAP Securities. Please go ahead.

Dipesh Mehta: Sir, just two questions from my side. Top client is doing very well for us for quite some time, so can you help us understand what is driving this? And across the top 20 clients also we are seeing decent traction. So, if you can help us understand what is driving growth for us? Second question is about emerging industries. This time after few quarters of softness, we have seen some uptick in that industry. So, if you can help us understand any change in strategy and how one should look at it going forward? Thank you.

Nitin Rakesh: We are fairly pleased with the performance we are seeing across our strategic account segment which is where our top clients sit. And to be very honest, that is the litmus test of our service offerings and our capabilities, if we cannot sell them into our existing client base then it is going to be hard for us to sell them into new clients. So, it is very much by design. What is resonating very well is all the things we talked about in terms of service transformation, digital deals, analytic capabilities, our IP assets like Deep Insights, ability to do cloud native, AppDev, the Sparkle program, the partnerships we have built on the new technology industries, including things like Pivotal. So, it is primarily driven by the increased focus on investment in New-Gen areas and that is why you see growth in New-Gen for us is also very strong. And obviously, given that large clients have a decent percentage of their wallet share and we are gaining that wallet share is now sliding into growth in the top client segment. Something that we are again, as I said, very-very pleased about, because those become reference clients for every new service line and every new capability that we are building. Good news also, it is fairly broad based, it is not just one client in the top ten, it is actually quite broad-based, and we have seen multiple clients in our top ten that have actually given us healthy growth through both sequential as well as YoY basis.

On the emerging segment, again this goes back to our chosen strategy of identifying some certain horizontals through verticals. Within Direct Core, we have been looking at multiple areas that we can then call for as engines of future growth. I talked about that in the Analyst Day strategy presentation as well. While parts of banking and insurance are important, we have started to see traction coming out of areas like travel and logistics, some traction coming out of healthcare and the like industries which are all clubbed within the emerging segment right now. So, again, pleased by the fact that we are bringing some diversification, but there is opportunity across the board in our entire Direct Core book of business.

Dipesh Mehta: Some of the verticals in emerging would be relatively sub-scale, so if you can help us understand investment likely to be made and the trajectory of growth? Because multiple industries seem to be relatively lower percentage of revenue.

Nitin Rakesh: Yes, about 25% of our revenue is emerging. I would say there are two main segments there, travel and logistics which is quite at scale now and the other one I called out healthcare which is a near neighbor of insurance that we already do under BFSI. I would say these two constitute majority of what is in emerging, so anything else is really not something that we are going to focus on. So, that is why our investment horizon in these two markets are very clearly identified from the emerging segment.

Dipesh Mehta: And geographically would it be similar to company average or is there some skewness there?

Nitin Rakesh: It is probably, I would say, similar. There are some clients in emerging that we service globally, but they are probably more US centric right now given that that is our home market, and that has been the market we operate and provide services. So, I would not say it is any different from what you would see at a company level.

Dipesh Mehta: And last question, considering Q1 we have strong margin performance, can you help us understand the FY19 margin we should expect?

Nitin Rakesh: We gave out EBIT range of 15% to 17%. We are very pleased that we are in the 16.5% range right now which is obviously closer to the upper end. Some of it has obviously been a little bit more muted due to the hedge delta between Q4 and Q1. But despite that, we have created significant operating efficiency and this gives us a lot of headroom as we need to continue to invest in pretty much every part of the business, both capability as well as go-to-market. And, this sets us up nicely to absorb impact of the wage hike that starts in Q3. So, we are maintaining the margin guidance band of 15% to 17%. Of course, there is a strong bias towards continuing to perform towards the upper end of that band for the remainder of the year.

Moderator: Thank you. Our next question is from the line of Abhiram Eleswarapu from BNP Paribas. Please go ahead.

Abhiram Eleswarapu: My question is on the buyback, just curious to know why the Board decided to accept a buyback at these valuations? To me, it appears that it may be EPS dilutive and whether the Board, and of course the Management, considered all other options and ruled them out before the buyback? For example, let's say an acquisition or maybe just cash on the balance sheet in case an opportunity comes up later. Thank you.

Nitin Rakesh: So if we look at the quantum of buyback, it is about $145 million compared to our total cash position of $400 million, and by the time we affect it we will probably generate another $60 million – $70 million of cash. We are very adequately funded from a free-cash perspective, it is about one-third of our cash position by the time we actually effect the buyback at the end of Q3. If I consider existing strategic options from a capital allocation perspective, there are three core buckets that we are considering. Firstly look at strategic M&A and tuck-in M&A and both of these are on the table, both of these we are actively scouting in the market. And as we feel we have adequate cash available, because we are also fairly underleveraged, so there is an opportunity for us to correct our overall balance sheet and play on the balance sheet if we need to. At this point in time, I think we have enough cash and we do not foresee that happening in the near-term. But if an opportunity so arises, we do believe we have enough flexibility on the structuring of deals and our cash generation continues to be very-very strong. Second, of course, from a capital allocation perspective, we have looked at consistent dividend track record, so that is why roughly 50% of the net earnings has been the track record that we have maintained this year as well. And thirdly, if we still feel after one and two we have excess cash and there is an opportunity to optimize our ROE without necessarily impacting our strategic roadmap, then we will look at, on a case by case basis, returning the excess cash of shareholders, which the Board decided yesterday. From an EPS perspective, this will broadly be neutral, because obviously that consideration was looked at before we made the decision and chose the price.

Moderator: Thank you. Our next question is from the line of Abhishek Bhandari from Macquarie. Please go ahead.

Abhishek Bhandari: I have two questions. First, more on the margins side. So, we lifted our margin band by 100 bps from the fourth quarter level. We have seen currency move up by 5% in terms of dollar getting appreciated against rupee. So, does it in any way change the band that you have in your minds?

Basically, what I am trying to understand, is the maths and currency different for you from the other company's perspective?

Nitin Rakesh: I will make a couple of very high-level comments and Surya is actually going to give you a breakup of the bridge between Q4 and Q1 and how it plays out so you get a pretty clear understanding. And all of this information is available in our MDNA. If you need any additional help in identifying where it is, more than happy to do it. But broadly, our consistent hedging policy is in play, we hedge four quarters on a rolling basis and partial hedge two quarters outside of that. So from that perspective, on a short-term basis we will not see the positive impact of currency depreciation or rupee depreciation in our P&L. That impact will start showing up as the forward hedges start getting renewed at better forward rates. So, some of the impact that you expected will actually happen in FY20 and beyond, not necessarily in FY19, which is why we have maintained our EBIT guidance between 15% and 17%. Despite the fact that we took a negative hit from lower hedge gains this quarter, we have actually increased our operating EBIT pretty significantly. So on an overall basis, EBIT focus should mostly be from operational performance, hedge will not really give you any lift in EBIT for FY19. And we will give you a little more color on that. Surya, if you can break out the performance.

V. Suryanarayanan: So, I just want to go back and explain this a little more in detail. As you know hedging is basically a de-risking tool to minimize our volatility and exposure, both revenue and margin. What we see in the hedge line in our revenue in relation to what you said with respect to other companies is a function naturally of the exchange rate movement. About 80% of our revenues is in US dollar and around 40% are hedged considering a large onsite component of our total revenues. The average hedge rate in Q4 was 68.8, we had a good forward rate in Q4 2018 whereas the corresponding spot rate was around 64.5. And in Q1 the forward rate was 67.5 and there was a significant rupee depreciation in Q1 2019 which resulted the exchange rate on an average of around 67.8. This resulted in a hedge loss for Q1 2019. The average rates for F19, which we have called out earlier also, is around 67.5 and assuming the spot rate remains around what was there at end of Q1, we will not have any significant impact on the revenue line with respect to the hedge amounts. However, as Nitin had elaborated, when we had spelled out the band of 15% to 17% for FY19, we have factored these aspects.

Abhishek Bhandari: Nitin my second question is more on the deal inflow numbers, so if I look at the current number 153 looks to be slightly lower than 183 what we had corresponding quarter last year. I understand there was some bunching of Blackstone deals and all. What I am trying to get to, what are the new avenues we are looking to elevate this number from 150 – 160 levels and do you think there is kind of a volatility in the deal wins what you report, or this is the run-rate which tends to remain?

Nitin Rakesh: So, you are right, quite nicely picked Q1 last year but not looked at the remaining quarters for the last year. So, in FY17 this number used to be below 100, probably in the 70 to 80 range. In FY18, of course, we had a pretty bumper Q1 and we actually called it bumper Q1 for that reason.

We upped that rate to between 120 and 150, we are very pleased that we started the year with 153. Our pipeline continues to be very strong. The vectors of growth or the engines of growth are no different from what we have been calling out and we are just executing on those. So, we look at strategic accounts, we just talked about the growth in our top ten accounts, we are starting to see good traction in both service transformation which is core systems and how do we apply transformation to core IT, whether it is applications or cloudification, as well as in digital new deals. So that is clearly working for us. Strategic account is probably I would say the continued focus on finding new deal wins. Second, we talked about Blackstone portfolio, we announced that number for FY18, about 160- odd million across the full year. As we make more progress and probably in the right time we will give some more color on that for FY19 as well. Just one quarter ago we gave you details on that. And thirdly, even equally importantly is continued traction in new clients, and that motion is twofold: firstly it is obviously our own sales motion, we have a very focus account list that we have targeted in our chosen segments in our chosen geographies. And secondly, we are augmenting that with our activity in the third-party deal advisor market, I talked about the analyst and advisor focus that we are bringing in. And we are also starting to see deal sizes and large deals trickle into our pipeline from all the efforts that we are doing, not just with advisors, analysts but also on our own sales efforts. So, I would say the deal pipeline has actually been very strong and we saw some conversion of that in Q1, but it continues to get bigger. And we are very enthused by the fact that a lot of our services are getting good traction in terms of opening up opportunities. Now the focus is really continuing to close these opportunities through the remainder of the year, and obviously adding new deals to the pipeline.

Moderator: Thank you. Our next question is from the line of Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah: Just one question on the HP side of the business. If I look at the client contribution where we disclose the 20 million revenue clients, 10 million revenue clients, 5 million revenue clients, 1 million clients, so DXC/HP channel has been fairly constant in terms of number of clients in each bucket as a whole while the growth has been really phenomenal and very impressive. So, is it the strategy here is to go deeper and mine the client or to actually grow across clients within the DXC/HP channel wherever the target market is?

Nitin Rakesh: It is all of the above, there is no one thing that we are doing. We are obviously expanding geographically, we are expanding service lines and we are expanding client segments. Of course, that is a little more diversified when it comes to vertical segmentation, it is not just BFSI centric because their business is more diversified given their size. So, it is a combination of everything you just talked about. And from that perspective, if you see we have added new clients that have started trickling into that segment. So, question really is, can we continue to help them gain wallet share? And the best place to start is where we already have a track record jointly.

Sandeep Shah: Just a follow-up question, in terms of wage increase which will come in Q3. Do you believe this year would be slightly different in terms of the impact versus last year? And can you share some numbers in terms of attrition which is there for this year versus last year?

Nitin Rakesh: Again, it is a little early. We are still forming our own assessments on what the right strategy should be, it is still some time away for us to estimate it. As we get more clarity we will update you in our next call. On attrition, there is nothing specific to call out. Clearly the market there is bi-polar right now, there are some segments where the demand is very high, there are some segments where the supply is very high. So how to balance that dynamic and how do you make sure that we have enough pipeline of in-demand skills. And so, I referred the Talent Next program that we talked about over the last few quarters which is all about creating these New-Gen skills actually by using technology and applying the same Front2Back transformation to our own business from a supply chain perspective. So, I think that is the focus right now. Everything we do from increments, to wage, to input, campus intake is actually tied into the Talent Next program.

Sandeep Shah: And just a few book-keeping questions, Surya. Just wanted to understand when we arrive at the dollar number excluding the FOREX hedge, for the HP channel the growth in this quarter is 3%. While the press release mentions 4.5% constant currency growth, while most of the invoicing for the HP/DXC channel would be in US dollar terms, so why this 150-basis point worth of cross currency headwind which can come for the HP channel?

V. Suryanarayanan: So, when we talked about DXC/HP moving from rupee to dollar we also have business from Europe on the DXC/HP channel. So, the cross currency also played out in this quarter, as you know the Euro and Pound depreciated with respect to the US dollar. And that was the impact from 4.5% to 3%.

Sandeep Shah: So, that invoicing could be even considerable, maybe more than 10% - 15% between Euro and GBP?

V. Suryanarayanan: Yes.

Nitin Rakesh: You have seen Europe growth play out as well, some of that growth is happening in the Direct Core as well.

Sandeep Shah: And last question, Surya, on the tax rate this quarter is slightly lower, so what could be your guidance for FY19 as a whole?

V. Suryanarayanan: I think you can model around 26% to 27% because it is also a function of revenues from various entities globally. So, accordingly the ETR percentage can differ quarter-on-quarter. But around 27% would be safe from a modeling perspective.

Moderator: Thank you. Our next question is from the line of Priyanka Sarkar from Motilal Oswal Asset Management. Please go ahead.

Priyanka Sarkar: Sir, just wanted to ask about breakup of the revenue by service line. So, basically the services and technical help desk has been growing at a very fast rate, I mean, Q1 FY17 it was Rs.32 crores which has moved close to Rs. 150 crores now. So, I just wanted to understand what is leading to the high growth in this service line. And if you could also kindly elaborate on the type of work we do in this service line?

Nitin Rakesh: Most of the growth was actually in early part of FY18, I think we bundled in some very large service transformation type approach deals where we basically took a set of existing processes and applied what we call intelligent automation and predictive analytics to them. So that was really early part of FY18 and that is why you are still seeing that issue if you look at over two years. On a YoY basis, it is fairly stable. Again, this goes back to applying transformation to core IT as one big lever of growth in terms of service transformation, and that cuts across both apps and infra.

Priyanka Sarkar: So, what I understand is still at the high end of the work is what we are doing?

Nitin Rakesh: Yes. I mean anytime you start applying transformation and predictive analytics you are actually starting to talk about applying some form of pattern recognition, machine learning, AI, so it requires fairly high amount of details.

Moderator: Thank you. Our next question is from the line of Sumit Jain from Goldman Sachs. Please go ahead.

Sumit Jain: Firstly, around the sustainability of growth in the DXC/HP channel, I guess there have been several questions around that. So, if I look at growth it has been phenomenal and most likely in FY19 you will end up much higher than the industry average. And going forward the base for you on a YoY basis will keep getting challenging, you are already clocking almost $300 million of revenue on an annualized basis. So, wanted to understand how big is this opportunity overall in terms of HP channel, are we still scratching the surface and based on your strategy to grow there, can you sustain this growth for next several quarters?

Nitin Rakesh: The question you asked me around sustainability of growth in HP/DXC has been a fairly constant question across I would say last six quarters. Of course, as we get the base effect comes into play and as we get through even on a sequential basis the higher revenue base, we will have to continue to grow to sustain. To continue sustain the growth, we have to start converting the pipeline at a faster clip. The overall macro opportunity still exists because we are still, as I said, about 1% of their overall revenue line. Of course, there are parts of the business where we are able to add high value and there are parts of the business that needs to be transformed. So, again, we are very pleased with the run-rate we have achieved for the year in Q1. We obviously have some more work to do to sustain this level of growth. Our objective as we entered FY19 was at or about market growth, clearly looks like we should be well on track for that objective. At the same time, we are also very pleased by the additional focus and pipeline buildup that we have seen in our direct business, especially direct core. So, I mean, it is a happy place to be to have two large units competing for growth with each other. Of course, in some quarters you see one unit lead the other, given that we have seen some strong off the gate performance from HP/DXC. I would not be surprised if we see some acceleration come into play from the other units as well. So, I would say it is a fairly balanced growth environment across both of our big large growth units. And nothing more to really call out more than what we have talked about over the last few quarters in terms of the way we are executing.

Sumit Jain: Secondly, if I look at your blended rates this quarter I think there is some weakness out there, despite your onsite mix going up and more contribution of digital projects. So, can you comment anything to call out there in terms of blended pricing rates this quarter?

Nitin Rakesh: Some of that, Sumit, there is a little bit of an aberration that sometimes creeps in as you start moving projects to fixed price and you have to start applying the transformation. I think what we are seeing is only in the ITO segment which is causing this distortion. As we apply transformation I think you will see some of this even out. You might sign a multi-year deal and off the gates the deal will take some time to transform. So, it may take a couple of quarters for us to apply the transformation. The right metric to focus on is the non-linearity of growth between headcount and revenue as well as the impact it has on the operating margin and the fixed price percentage. At 27%, it is the highest fixed price percentage you have in the history of our business.

There was another question earlier about onsite revenue going up, actually our head count has only gone up by 25 on a sequentially basis. So, most of the revenue growth you are seeing really is baking in some of these efficiencies on fixed price as well as on pricing.

Sumit Jain: And lastly in terms of the margins and the digital business, can you comment where it stands for you as of now, is it similar to corporate average or slightly higher? And how is it about the industry right now, if you can comment anything.

Nitin Rakesh: You are talking about the New-Gen services and not Digital Risk, right?

Sumit Jain: Yes, largely, the New-Gen services how you call out.

Nitin Rakesh: Correct. So, it is fair to assume that our ability to price those services is pretty good. Obviously, those services have a higher direct cost profile as well. So, the overall margin profile is fairly consistent at this point in time. But as we start scaling them and as we start applying certain global delivery metrics to them, we might actually see that becoming a lever for us to also look at margin expansion in the medium-term to long-term.

Moderator: Thank you. Our next question is from the line of Rishi Jhunjhunwala from IIFL. Please go ahead.

Rishi Jhunjhunwala: Nitin, a couple of questions. Just wanted to get some sense around, your sales and marketing headcount. It has been going down consistently over the past five quarters, in fact, down 22% year-on-year. And during the same period, you had significant amount of deal wins as well as revenue growth. So, I can understand a some bit of it was coming through rationalization of probably, a bloated structure earlier, but what do you think is the way forward and where is the adequate level of sales and marketing headcount that you would want to have? Just trying to assess the kind of investments that you would still want to make?

Nitin Rakesh: So, there are two aspects that you need to focus on. I would say between FY17-2018 and today, as you rightly said, we did fairly significant rationalization to create right sizing and focus the team in the right areas. That was done, I would say, in early part of FY18. So, that is why you are still seeing that base effect plays out. We also effected slightly more integrated approach in the first quarter of this year. Back in May when we did the analyst meeting we announced the one Mphasis approach. We actually broke down our silos further between our various units within the direct business. So, in a way, we are actually integrating DR, Wyde and the likes into our overall Direct business and that also releases certain efficiencies because there was certain domain duplication as well as certain sales coverage duplications which have actually released some efficiency. If you look at our overall sales cost as a percentage of revenue, that has actually gone up this quarter because we are investing in overall sales and marketing effort, our rebranding effort took some investment. So, we found some room from within our rationalization to actually reinvest that back into our sales and marketing expense. So, at 6.2% versus 5.8% or so last quarter, on an expended revenue base you can actually see that the overall dollar investment is actually going up and going up pretty nicely. So, do we expect this number to stay steady? I think so and on a headcount basis you may expect this number to probably go up slightly as we continue to focus on building sales presence in areas and accounts that we talked about. As we convert those pipelines we will need more sales coverage as well. But on a percentage basis we should probably stay consistently in that 6% odd range.

Rishi Jhunjhunwala: And secondly on the buyback or the capital allocation. So we have always had a capital allocation policy which was largely through dividend, basically paying out 50% plus distribution tax. Just wanted to understand what is the thought process going forward and if buyback will primarily be in lieu of the dividend that we have been paying historically or it will be over and above the allocation that you have been giving in the past?

Nitin Rakesh: I think there is no change to the dividend thinking. Buyback is really I would say on a case by case basis or one time, if we expect based on our expected use of cash and our existing available amount of cash.

Rishi Jhunjhunwala: And lastly a little bit on insurance segment which has been weak for a few quarters. So, just wanted to understand, what is the nature of weakness, whether it is customer specific, pricing related issues or whether it was driven by some of the CAT events that happened in US last year, what is driving that weakness and what is the turnaround outlook for that?

Nitin Rakesh: Firstly, very pleased that on a sequential basis we are starting to see growth. This quarter we saw 3% reported growth in insurance in the book of business that we report. So, we already are seeing signs of turnaround. We have focused on stabilizing that through the last few quarters. In terms of what the issues were, it was a combination of everything you said, it was specific client issues, clients having their own challenges because of high claim ratios as well as the fact that there was actually a fair amount of disruption and pricing ability in the insurance market as it was taking a beating as well. Now, as the interest rate environment has changed we are starting to see some investment come back from the life and the retirement companies, because they are investing in consumer facing tech and broker workstations, because that has been a long, suppressed, under invested segment of their market. We are also starting to see some additional investment go through in areas like insurance broking. So, those were the two segments that we are starting to see some pickup, early signs. We are also converting some deals from our pipeline, so actually we have a pretty healthy pipeline that is highly convertible, and it is included in 153 million that we talked about.

Moderator: Thank you. Our next question is from the line of Ashwin Mehta from Nomura. Please go ahead.

Ashwin Mehta: I had two questions, one on the Blackstone channel. So, while you are reserving comment on any quantitative color, but anything qualitative that you can give us in terms of how the progression is happening, any positive, negative surprises there in that channel?

Nitin Rakesh: No news is good news, so it is actually I would say fairly consistent performance, we have a systematic approach, we are still executing on that approach. We have a great set of sponsors in Blackstone and we are really leveraging the entire network to continue to find opportunities and convert them. So, there is nothing out of the ordinary to talk about. The reason I am reserving quantitative comments is because we do not want to make any metric for every yardstick because given that it is a fairly niche segment of our overall Direct market there is always going to be some lumpiness. So, in periodic times, probably on an annual basis we will definitely give you that outlook.

Ashwin Mehta: And just one question on headcount. If you look at your headcount over the last year, onsite has been largely where the headcount addition has happened. But sequentially there seems to be a shift towards offshore addition. So, are you seeing more opportunities in terms of moving work offshore on your Next-Gen services and how should that play out in terms of margins going forward, would that be a tail wind going forward?

Nitin Rakesh: What you are seeing is as our percentage of fixed price goes up we are obviously applying the lever of right shoring. So, that is actually starting to show up in the offshore headcount line. Secondly, as I mentioned on a sequential basis, even though the addition of net headcount onsite has actually been fairly small, we are definitely starting to see some of those transformation deals having the ability to leverage offshore play out as well. And thirdly, we are transforming our pyramid, and that also means that we will actually be focusing on certain actions that will show up in offshore hiring numbers in advance of demand showing up. So, I think all the three factors will go into that number you talked about.

Moderator: Thank you. Our next question is from the line of Rahul Jain from Emkay Global. Please go ahead.

Rahul Jain: Given that we had a meteoric rise with HP/DXC in past, so technically when Mphasis during a period along with GFC when no peers did well, now again with HP/DXC strategic partnership and Blackstone advantage can we see this two-factor kind of deal against compared to other peers and thus should support significant growth outperformance in general over market growth rates?

Nitin Rakesh: I think slightly different environment from the time you are comparing it to, because today the ownership structure is different, we are an independently owned, independently operated business. So, we actually see every customer as a customer and a client and we basically focus on creating value. So just because of that contract or because of our affinity or past ownership I do not think we have any additional advantage. So, it is really about using the leverage that we have had because of our relationship and understanding of the end customers and using that to actually create value. So, that is probably the only way I can answer the question.

Rahul Jain: And maybe to put in a different way, we have seen a much higher revenue contribution from the HP in past. So, just to match those things in terms of what can be a possible opportunity may be kind of a moon shot on what can be opportunity in this case?

Nitin Rakesh: I do not necessarily understand where you are heading to, but if you are talking about looking at the captive opportunity, that is probably not something that we should break into our outlook. Every company will have multiple delivery options available to them and Mphasis continues to be a very strong delivery option and partnership option available to those entities. In terms of growth vectors, while FY18 was a year where we had some sharp turnaround, low base translating into high growth, what I am very pleased about is that in Q1, we have had an equally strong growth from the Direct business at a much bigger base. So, it is really about creating a balanced growth environment, because that is the only way we can be consistent, we do not want to overly dependent on just one segment for growth.

Rahul Jain: And from a profitability perspective with accelerated growth rate and higher fixed project, improved revenue mix, what is the aspirational operating margin level for the business over next few years?

Nitin Rakesh: We have not really broken that out into a number. Our overall strategic roadmap is continuing to grow above market and continue to have an improving operating margin profile. And I think that is what we are executing on over the last few quarters.

Rahul Jain: So, rather than on a number of like 18% - 20% it is more like improving every year kind of a thing?

Nitin Rakesh: Yes, continues improvement is the mindset.

Rahul Jain: And then given the way we are in terms of pricing, offering, anything, any dynamic that impacts this number, do you see there is a very significant upside to the current level of profitability?

Nitin Rakesh: I think the proof of the pudding is in the number you are seeing at 16.6%. We are already edging towards the upper end, given that we took a 60-bps hit from just hedge movement in the last one quarter. I think our operating efficiency improvement has almost been 100 bps over the last one quarter. So, that should give you some confidence that our service offering, our business portfolio, our business model mix, all of them are really helping this. And I also talked about other factors like pyramid, right-shoring and fixed price. So, everything is going into continuing to create this operational efficiency. Of course, we want to do it consistently because we are investing back in the business as well, and that is the role that Surya and I have to play in terms of deciding how much of the investment to plough back and how much to take back into our EBIT line.

Rahul Jain: So, that is very well but the thing we are trying to understand is that if you see where we are today and just think about profitability just two years back would have been a very difficult thing to imagine, so that is a commendable achievement. But what we used to do in 20% kind of a margin we are still very away from that number. So, given the kind of profile we had at that point of time and the kind of work we are doing now, you think this is where we are actually directionally moving towards?

Nitin Rakesh: You can ask me the same question five times over, my answer is going to be the same. So, the point is very simple, right now for this year we have a 15% to 17% EBIT range. We have a stated goal of continuing to improve our margin profile. Right now, I really cannot comment on the margin we were in 2009-2010 when 75% of the revenue came from one client. Obviously, you do not have a sales expense when that happens, so your EBIT will be very-very different. I do not think our gross margin profile would have changed dramatically even since those days. So, I think you have to keep everything in mind, the business profile portfolio mix is very different where today 75% of the revenue is actually direct which obviously requires significant investment in SG&A. So, just keep all of that in mind when you think of a number. My goal is pretty straight forward, we were 14% to 16% last year, we are 15% to 17% this year, we started Q1 very nicely with upper end of the band, we want to be able to sustain this trajectory. So far we are not changing the range, we are still keeping at 15% to 17%. As things span out through the year, as we look at various levers that we have to apply we will update you. But so far, this is where we are.

Moderator: Thank you. Our next question is from the line of Ashish Chopra from Motilal Oswal Securities. Please go ahead.

Ashish Chopra: Nitin, I just had one question on the fixed price and time and material in the context of New-Gen services. So, the onsite centric New-Gen, is it also now more skewed towards fixed price given your focus especially in areas like service transformation, etc, or would that be split between T&M or more skewed towards T&M right now?

Nitin Rakesh: I think you already answered your own question, if it was service transformation deal then there is possibility it may be a fixed price or a managed services deal, because we may take over an existing operation and apply transformation to it over a period of time. If it is a net new development or a digital development project, it will likely be on a project basis. It may not be T&M and it may be capacity, it may be development, it maybe story points, but it will definitely not be a fixed priced development project. So, it really depends on the type of project in New-Gen. So, there is a healthy slice of incremental managed services coming out of service transformation in New-Gen as well.

Ashish Chopra: And would it be fair to assume, and in partly you alluded to this earlier in the call, the fixed price contracts would have a greater propensity to be more offshore centric or be able to leverage the global delivery network as compared to a pure New-Gen kind of a T&M deal?

Nitin Rakesh: Yes. But I think it will be very deal specific, because in some cases you may start onshore and you may start in a non-managed service or a managed capacity or a T&M basis, but that will evolve as you get into pure execution. So, it does have a propensity to morph. Of course, when we engage with clients and we do the design workshops that becomes part of consideration. And that is why you have to also stay competitive, even though we do not play the price game but every client obviously at some level becomes sensitive to the cost of ownership.

Ashish Chopra: So, perhaps that also explains the way you have been improving your growth trajectory and signing a lot of deals, and that has lead to maybe the increase in onsite as well. But do you see that kind of getting capped sometime soon. So, now once the mix of new business and existing business kind of settles after this growth ramp up, probably that is the new number?

Nitin Rakesh: As I mentioned earlier in the call, for me when I manage the business I look at where are we adding people and what incremental delta revenue are we generating from those people. If I only added 25 people onsite but I still generated another additional 1% revenue from onsite, I do not worry about it too much because that means that either we have bundled something into a service transformation deal that required us to be onsite that quarter or we got into a digital project that gives us very healthy margin and healthy rate. So, the real metric really is from a headcount split perspective 70% - 75% of our focus will still be global delivery primarily offshore India centric. And as long as we continue to maintain that model we will stay competitive and we will also have the opportunity to win deals, apply transformation and have a healthy margin line.

Moderator: Thank you. Our next question is from the line of Ravindra Kedia from MH Capital. Please go ahead.

Ravindra Kedia: Your promoter holding has reduced significantly, last quarter it was around 60.38% and currently stands at 52.37%. So, my first question is, what is the rational for this reduction? And in the buyback, it is also mentioned that the promoters have an intent to participate in the buyback. So, post the buyback will the promoter holding stay unchanged or it could reduce?

Nitin Rakesh: So, firstly, there was an action that was announced in May after the Q4 number where there was a secondary offer for sale that was executed for about 8% of the holding. That was a onetime event. And the promoters were very open and articulate in saying that this was a onetime event and they do not plan to offer any more shares for sale. So, that is the answer to the first question. Happy to send you the press releases from the May time frame, they are available on our website as well. On the buyback and the impact that it will have on the promoter holding, it really is a question of how the rest of the 48% odd investors participate. If everyone participates on a pro-rated basis I do not think the change will be dramatic. Of course, the retail investors get priority and preference, so depending on how that dynamic plays out, we will only know once we actually close the buyback tender offer and we will update you right after that.

Moderator: Thank you. Our next question is from the line of Ruchi Borde from Bank of Baroda Capital Markets. Please go ahead.

Ruchi Borde: Recently DXC carved out their US public sector business and integrated with two entities to form a bigger entity for public services. Just wanted to know does Mphasis have a potential play there? To get a sense, does that increase our opportunity size?

Nitin Rakesh: I would not want to comment specifically on the breakup of that, but I would say so far there has been no impact to us. Because as I said our primarily relationship with DXC stays unchanged. So, we are not necessarily big in the government sector, you know all the restrictions that apply after they actually split that business. So, at this point in time there is nothing to call out.

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

Nitin Rakesh: Again, I just want to thank you all for your time, your effort and your coverage. We continue to look forward to working with you. And we will talk to you again at the end of our next quarter call. So, thank you all for joining.

Moderator: Thank you very much, sir. Ladies & gentlemen, on behalf of Mphasis, that concludes this conference call. Thank you for joining us. And you may now disconnect your lines.