"Mphasis Limited Q2 FY23 Earnings Conference Call"

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MANAGEMENT: MR. NITIN RAKESH – CEO
MR. MANISH DUGAR – CFO

Moderator: Good morning ladies and gentlemen and thanks for joining the Mphasis Q2 FY 2023 earnings conference call. I am Aman, your moderator for the day. We have with us today Mr. Nitin Rakesh – CEO of Mphasis and Mr. Manish Dugar – CFO.

As a reminder, there is a webcast link in the call invite mail that the Mphasis management team would be referring to today. The same presentation is also available on the Mphasis website www.mphasis.com, in the investor section under the financial and filings as well as on both the NSE and BSE websites. Request you to please have the presentation handy.

As a reminder, all the 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 the operator by pressing "*" then "0" on your touch-tone phone. Please note that this conference is being recorded.

Before we begin, I would like to state that some of the statements made in today's discussion may be forward-looking in nature and may involve certain risks and uncertainties. A detailed statement in this regard is available on the Q2 result release that has been sent out to all of you earlier.

I now hand over the floor to Mr. Nitin to begin the proceedings of the call. Thank you and over to you, Nitin.

Nitin Rakesh: Thanks everyone for joining us today. Apologies for a late start. We were waiting for confirmation on the upload of the deck to the exchanges. This is a unique and dynamic environment, represents both challenges and opportunities for all of us. Regardless of the circumstances, we continue to move forward from a position of strength. We have a foundation of strong industry solutions, marquee client base, and earnings and cash flow. All of this will help us continue to execute our growth strategy and insulate us from market challenges.

Let me start by sharing some insights that we witnessed from our vantage point. As per a recent tech spending survey by Bain, two-third of surveyed enterprises expect to increase IT spends in 2023. Tech spends appear to be more resilient relative to the volatile macro conditions compared to their behavior in the past. Furthermore, changing deal constructs and managing flexibility in fixed costs favor tech spends. Top client priorities continue to be leveraging the cloud for digital transformation and leveraging data and analytics for decision making and customer intimacy. Nearly two-third of the surveyed enterprises expect vendor consolidation to be a priority area, which we believe this is likely to play out with greater vigor in 2023 as enterprises contend with difficult macro conditions.

Our Q2 FY23 revenue represents a 16.8% YoY growth in constant currency terms. Direct revenue grew 2% quarter over quarter and 19.2% year over year in constant currency. In the second quarter FY23, we experienced a furlough impact from our key client together with slightly greater than expected ramp-down in our mortgage BPO LOB. This impacted our sequential growth in the second quarter FY23. Our Direct business accounted for 94% of revenue in this quarter. DXC's contribution to our revenue is 4.6%. Given the low and declining contribution of DXC to our overall revenue, Direct business strong growth reflects our overall growth.

Regarding geographic growth, our anchor geography Americas has fared better with an overall growth of 20.4% in constant currency terms. Excluding DXC, the US growth is marginally higher at 21.4% in constant currency terms.

From a services perspective, our Application service line has been a driver of our growth with 34% growth in Direct Apps this quarter, thanks to the secular themes of digitization and transformation. We believe that continued strong growth in apps is a testament to our continued investments in the right service areas using our unique Tribes & Squads-led competency development model as well as our ability to leverage the repeatability that comes with this highly efficient model.

All our verticals saw a double-digit year over year constant currency growth in this quarter. Our anchor vertical, Banking and Financial Services, which saw an impact from a decline in the mortgage LOB, nonetheless grew 15.3% in constant currency terms. Direct BFS grew 15.7% in constant currency terms on a YoY basis. We continue to enjoy market share gains with our key BFS customers.

Direct TMT grew 33% year over year in constant currency terms. This is a focus vertical for us. Direct Logistics and Transportation business grew 16.5% in constant currency terms.

Our smaller verticals such as Healthcare clubbed in the Others segment continue to grow faster registering 34% year-over-year growth within Direct. This robust growth of smaller verticals reflects the success of our New Client Acquisition strategy. I will speak more about it in a few moments.

Contribution from Fixed Price as a percentage of revenue has risen by 410 basis points on a year-over-year basis. FY23 builds on our client mining improvement in FY22. As we said before, we continue to consolidate our standings with our key clients resulting in continuing market share gains. This is borne out by our client metrics. The middle chart of the slide shows that our Top 5 and Top 10 clients have grown consistently registering 28% and 29% growth respectively in second quarter FY23 in constant currency terms on the last 12-month basis. Our Top 3 clients contributed $150 million plus each in the last 12 months with our top client's LTM revenue contribution exceeding $200 million. The average LTM contribution of our Top 5 clients exceeds $150 million. All of our Top 6 clients are greater than $75 million which we continue to believe is quite unique for a company in our category. Our Top 6 to 10 clients grew 30% constant currency on the last 12-month basis. Notably, our 11 to 20 clients grew 35% LTM constant currency indicating the increasingly broad-based nature of our overall growth. Our New

Client revenue continues to grow rapidly, growing at 53% constant currency terms on a year-over-year basis in the second quarter '23 over second quarter '22.

In particular, we are pleased with the results of our New Client Acquisition engine. We have reinvigorated this program with dedicated leadership, as we had called out before. We carved out 5 well-considered select verticals to focus on for NCAs, as we now call them Enterprise 5, namely BFS, in which our positioning and track record is already solid and this vertical is large enough to continue to provide growth run rate in the long term, Insurance, Logistics, TMT and Healthcare. Each of these 5 NCA verticals has its respective client acquisition strategies led by dedicated sales, delivery, domain, and technical leadership. We have an elaborate operating model in place to transition clients to a strategic status with a client engagement structure and investments defined through the phases of the transition. As clients move through the transition phase and become strategic, we progressively bring the full force of our engagement model, dedicated client resources and GTM motions in engaging with such accounts.

Three of our 5 NCA verticals have become $100 million verticals on a run rate basis within 3 years of setting up the NCA architecture with fastest growth in smaller verticals such as Healthcare and Travel. NCA has almost doubled in revenue over a 2-year period on an LTM basis and now constitutes almost a quarter of our Direct revenue. This growth is reflected across our NCA verticals as shown here.

What's behind our strong TCV track record is our evolving Tribes and Squads model. This model, which has helped us scale our ability to service the growing pipeline and to close many more deals, continues to mature. The portfolio squads within each tribe continue to ensure that we constantly evolve our solutions, adopting the newer tools and methodologies. To cater to our customers' need for speed, the tribes have evolved a composable approach to our offerings. This enables us to combine offerings from multiple tribes effectively to address the typical requirements of our customers. We have also identified over 40 solution archetypes that are typically needed, thus allowing us to build frameworks and accelerators that facilitate faster deployment. These archetypes are then contextualized to the needs of a specific domain or even a specific customer by our deal squads. We have also updated the definition and content of our Tribes recently based on key trends and customer needs. In addition, we have constituted a Transformation Program Office with a team of seasoned large program management execs, who help in crafting large transformation deal constructs, post-deal governance models and to ensure lessons learned with each such program are templatized and carried forward in additional programs. Almost all of our pipeline is Tribe-driven and is up 18% quarter over quarter despite record conversion from pipeline to new sold TCV in the last 4 quarters.

We recorded TCV of $302 million of net new deals won in second quarter FY23. Our average TCV is trending up over time and is now about 300 million plus. 81% of the TCV is in new-gen areas. Our deal wins in this quarter include 2 large deals of cumulative $110 million in TCV. While we retain our market share with BFS clients, our large deals are increasingly coming from other smaller verticals as well outside of BFS and we continue to generate a high percentage of our TCVs through proactive deal pursuits where win rates are materially higher than in competitive RFP situations. As we report our TCV on a net new basis excluding renewals, we find a correlation between our Direct TCV and revenue growth to be reasonably high, exceeding 0.8.

Coming to our client metrics, our track record in migrating clients from one revenue bucket to the next continues to be healthy. In this quarter, we sequentially added to our count of $5 million and $20 million revenue categories while our larger $50+ million category relationships continue to deepen further as discussed. In this quarter, the LTM contribution of our top client crossed $200 million. As mentioned, we have won 2 large deals in this quarter taking the total number of large deals in the last 4 quarters to 12, double of what it was in the prior period.

Coming to our financial metrics, our margin philosophy affords us the flexibility to manage our profitability in a volatile environment. EBIT margins at 15.3% is fairly stable and within the stated band of 15.25% to 17%. In keeping with this margin model, we were able to absorb the rising personnel costs by tightly managing the SG&A and other levers as we intended to.

Operating profit grew 3.3% quarter over quarter and 24.5% year over year to Rs. 5,376 million in the second quarter of FY23. Our EPS for the quarter at Rs. 22.2 grew 4% quarter over quarter and 22% year over year. Our cash conversion measured as operating cash as a percentage of PAT stays at near 100%.

Vectors of our growth strategy align around the core themes of tech capability expansion, vertical focus, and geography expansion. Under technology capability expansion, we are investing in accelerating our hyperscaler strategy in refining our GTM approach and increasing our repeatability of deal-archetypes using the Tribes & Squads model which we have discussed earlier.

On vertical focus, we are focused on improving our end-to-end solutions in BFS and Insurance while investing in developing our technology points of view in other verticals under the NCA program as I just discussed before.

Our geo expansion strategy sees us making investments in the smaller geos such as Europe and Canada and expanding our core vertical strengths in BFSI to clients in the geography.

We have conceptualized and are well- positioned to execute against our playbook for growth in the current environment depending on how the macro pans out. The key ingredients of our playbook include propositions for consolidated cost takeout, accelerating the transition from Run to Change, and strategic and tuck-in M&A. The actions have also been customized with in-account action plans keeping in line with our account-centric GTM motions. Some of our key clients may embark on vendor consolidation exercises in the response to the macro economy. We are confident that we will be strong net grainers in such scenarios based on our positioning and track record with them and prior outcomes in such scenarios in the past.

To sum it up, I will leave you with a few points. (1) Direct growth at 19 plus percent in constant currency terms in the second quarter despite headwinds from mortgage LOB and earlier than expected furloughs. (2) Our KPIs are moving in the right direction namely our consistently improving track record in large deals, our TTM TCV at $1.29 billion speaks to our rising run rate from a TCV standpoint. Improving client mining metrics across revenue buckets continues to strengthen our diversifying growth. As I previously stated, our average Top 5 clients' last 12 months' contribution has crossed 150 million. Our Top 6 to 10 clients continue to grow well above our Direct revenue growth with 30% LTM growth, while 11 to 20 clients have also grown very strong. Our pipeline has grown 18% on a quarter-over-quarter basis. Our talent strategy is on course. Our utilization reflects our efforts to infuse our talent supply chain with more freshers and optimize for pyramid. Our overall utilization in this quarter was impacted by furloughs; however, Q2 '23 exit utilization was 4 percentage points higher suggesting an improving exit run rate on this parameter. (3) Investing for growth by using operating leverage and operating in a stated target operating margin band. We believe that our margin stance ensures margin stability in a volatile environment. Our EBIT margin of 15.3% lies in the stated band and our adjusted EBIT margin of 15.9% is stable sequentially and on a year-over-year basis. To be sure, we are operating in an environment of increasing macro uncertainty which potentially affects decision making of clients potentially requiring them to repurpose their spends causing supply chain uncertainty and all of which can alter the complexion of near-term growth, while making sure that we are well positioned to gain through the uncertainties.

Coming to our FY23 outlook, we continue to maintain our growth focus even in the uncertain macro environment. Our account-centric strategy to seed the accounts up the value chain is working. All of our core areas are growing across a diversified industry client base. We are seeing some seasonal weakness in select clients but a strong order book in the quarter and 18% increase in the pipeline would help us navigate this going forward. We also feel confident of mitigating any headwinds in the mortgage business and actually see this LOB to be a growth driver as the macro turns stable.

Given the consistency in outcomes from executing our strategy, we are confident of maintaining our EBIT margins in the stated band. Given our actions on operation efficiency, we also intend to continue to invest in growth accounts to consolidate our position with the key customers, and a stable margin outlook gives us that flexibility.

With that, I am going to open up the line for questions and answers.

Moderator: We will now begin the question & answer session. The first question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: The first is, Nitin, how do you see the demand environment sort of evolving? I am sure the deals that you have closed this quarter would be the ones which you have been chasing for a while now. Incrementally, are you seeing any slowness in decision making that worries you in terms of closures that could impact next year in some form? The second is, considering the furloughs that you have seen in this quarter, how do you see furloughs going forward in Q3? Do you expect it to be higher than the previous years? Finally, on the Logistics vertical if you could just give some color on how client spend is evolving, because there have been news reports of some logistics players in the US suggesting weakness. Just wanted your thoughts on all the three.

Nitin Rakesh: Let me take the first one which is the demand environment. I think uncertainty is obviously not good because it creates all sorts of chaos when it comes to budgets and in-account actions and so on. I think despite that, 300 million plus TCV in quarter is actually a fairly satisfying number. We are very happy with the fact that we were able to close 2 large deals both meaningful. And I think there is definitely additional opportunity that is being thrown up as well through the environment. That's the reason pipeline has actually gone up and all the actions that we talked about from a playbook perspective are also going to continue to lead us to a hard pipeline environment and I think our focus really is now on making sure that we continue to find ways to close. While there have been some, I would say, uncertainty driven decision making reactions, I think for the most part given that we are playing more on the transformation and change side, impacting fairly large programs such as data center exits or data migrations, data engineering, new platform build, I think those continue to get a fairly stable funding. Of course, there are other parts of portfolios that are paying a price for it because clients are relentlessly prioritizing which programs to keep going and which programs to de-prioritize. I think from that perspective, being on the right side of that portfolio has definitely helped us and will continue to help us in winning deals. I think as the macro pans out and we get a better idea of the 2023 budgets in Q4, we will probably have a better sense of real impact, but at least at this point given our TCV velocity, given our pipeline which definitely to me is the lead indicator for what happens next. I think we feel pretty good about where we sit from a deal origination standpoint. I think not only are we closing, but also we are originating which is kind of extremely important.

I think your second question was around furlough. I think it's really, if you ask me, a very client-specific issue that happened. This definitely is a seasonally weak quarter, not only because of the furlough issue but also because of the holiday season and the number of working days issue. I think that's an industry phenomenon that you are all aware of. At this point, I think it is hard to say whether the impact will be higher or lower. I think at this point visibility-wise, we are not seeing that level of uncertainty that it is going to drive it materially higher compared to prior years but at the same time, I think we have work to do over the next 8 to 10 weeks, but at the same time, Q2 was not supposed to be a furlough quarter what it was. I think there are puts and takes that will come through.

On the third point around the Logistics and Transportation, I think I will guide you back to the comment I made on my first answer, which is that if you are on the right side of the portfolio, if you are in programs that are strategic, if you are in programs that are getting funded, no matter what the in-account action is, we will find and we have found ways to continue to expand our wallet share. While there may be short-term fluctuations in client actions, I think pipeline action, deal closure, and ability to win wallet share is actually helping us drive through that uncertainty as we speak.

Moderator: The next question is from the line of Mukul Garg from Motilal Oswal Financial Services. Please go ahead.

Mukul Garg: Nitin, basically given the diminishing contribution of mortgage business to your overall revenues, it would be helpful if you can just give us some sense of how the ex-mortgage core business grew during this quarter. Even qualitatively that would at least give us some sense of how to look at the Direct business. And second, on your top client, the growth was quite good. But we have been continuously hearing from them about increasing concern from their business, literally almost every month. How do you see that, and is that something which can kind of act as a risk to our growth?

Nitin Rakesh: Mukul, I think for the first question, the answer is that in the core business, there are some data points in the print that you can see. The Americas Applications, both of those metrics are a good indicator of how the core business growth has been. I think 34% application YoY growth and applications are now the highest it has ever been at 67% to 68%. I think those are 2 metrics that will give you a sense that outside of the mortgage LOB, the business has actually been fairly robust, both in terms of other metrics that I point to is the Top 5 and Top 10. By the way, that kind of growth is after the impact of mortgage as well. The next 10, NCA, I think the core business continues to be in great shape. We are very confident that we will continue to actually gain share through the uncertainty.

The second aspect of the issue around mortgage itself is that it is a very key part of the US banking industry. We took a very forward-leaning stance in the last cyclical downturn that happened in '18 and '19 when the interest rate tightening cycle was on. We added new service lines besides origination and refinance. That diversification has really helped us to some extent, but the pace of change has been so rapid in the last 2 quarters that the diversification can only work to a point because you are sitting at record rates over 40 years right now. I think that definitely has had an unprecedented impact greater than imagined.

From that perspective, we also think there is an opportunity for us to further consolidate our position in that segment. There are some active conversations with very large customers existing and potential, which basically give us the ability to really become very strong and add additional service lines that we don't do today. I think from that perspective, we are still taking a view that we have to be present in a very key segment of the US banking industry and we will continue to find ways to find growth in that segment the moment macro turns stable.

To summarize, the overall core business is strong. Client segments, verticals, core geo, new client, the strategy which we detailed out in the last few minutes and of course not to forget the TCV and the pipeline commentary.

Around the top client discussion, I think rather than getting into a specific discussion around the top client and the weather forecast from their business guys, I think the best thing really is to stay focused on where the spend is going, where there is opportunity and how do we expand the target addressable market in-account, which is exactly what we have done in the last 6 months. We have added a few things. One, we have added new service lines. For example, the Blink acquisition gave us a whole new market segment within all our top accounts including the one you are referring to. We were able to actually go in and open new deals that we never did before. Second, we continue to actually gain from wallet share – very-very strong gainers in wallet share. Thirdly, our capability-led model, especially around cloud and data is actually opening up a whole new set of spends, that even if they repurpose other spends, this is not going to get cut. I think positioning the portfolio in the right areas of spend and having the right differentiated capability is what is driving that growth.

Moderator: The next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Compared to the TCV wins that we had, the growth reported in the Direct business for the last 2 quarters is relatively slow. So, should we expect while numbers suggest, there should be a pickup in the next 2-3 quarters? And the correlation also reflects that. Is that a fair assumption or you think despite TCVs in the pocket, we may still see slower growth over the next 6 to 9 months? Second related is on TMT decline, like, what happened in that particular segment quarter-on-quarter, how is the deal flow, and what kind of outlook do we have there? And last one is related to utilization and margin. Now we are at 68%. Headcount addition has also sort of declined as far as IT services are concerned. So, how should we read that improvement of 400 basis points and the impact on margins?

Manish Dugar: Taking your first question, as Nitin was mentioning, there is an impact of furlough and there is an impact of mortgage business, which is contributing to TCV not translating into revenues as much as it should have. Even though if you look at it, the correlation coefficient of TCV conversion to revenue has remained steady. From a going-forward basis, TCV and pipeline growth gives us confidence that our conversation with the customers and our ability to convert deals continues to be good including large deals, having won 2 large deals adding up to $110 million in the quarter. So far as TMT is concerned, the furlough impact would have impacted the TMT numbers, and I don't think it is any indication of a directional movement. It is a specific impact in the quarter, and Q3 being a seasonally weak quarter anyways, I think probably we should be able to tide over that, as we get to Q4.

Utilization, as you rightly said, the exit utilization has improved by 4 percentage points, given that the IT and apps headcount gradually grew over the quarter. On an average basis, it has not improved so significantly. And furlough would have impacted it any which way. So, on a reported basis, the average utilization looks almost flat.

To your question on gross margin, utilization improvement, offshore increase, and our ability to make sure that we continue getting price increases, partially got compensated by furlough and some of the investments we have made in the accounts that we are focused on, trying to gain share as well as to grow the wallet size.

So, on an overall basis, the gross margin this quarter continues to be in line with what the gross margin for the same quarter last year was. And keeping to our philosophy of investing for growth and having levers to manage profitability within that narrow range, we were able to use those levers and offset the downfall in the gross margin percentages with the adjustment that we did in the sales and marketing and G&A.

As we have maintained, we continue to be confident on maintaining the margin in that range of 15.3% to 17%. If we are able to get tailwinds as we go forward on margin, we would like to continue investing, especially given in this environment where the customers are looking at partners who can help and who can kind of accelerate their requirements of cost takeout and consolidation.

Nitin Rakesh: Just one more point to that. I think from a pipeline perspective, TMT is actually fairly strong even today. I think this was a very specific client weakness that caused that disruption.

Mohit Jain: On the headcount, sir, there was this headcount reduction quarter on quarter in tech services offshore.

Nitin Rakesh: Yes, again, I think there is a slightly mixed impact of furlough plus in-account actions, but at the same time, the deal wins that we talked about will actually start ramping up offshore as well. So, from an overall standpoint, I think the story of offshore-led growth will continue to happen. As you know, when we have large lumpy deals that ramp up, we ramp up the on-site portions first. That's kind of a little bit of what you saw towards the end of this quarter in the IT business.

Manish Dugar: Just to add Mohit, the billable headcount has actually grown by 700 people. What has reduced is the overall headcount.

Mohit Jain: Sir, I am looking at offshore billable technology services. This is on page number 11.

Manish Dugar: I think the way to think about it is the overall headcount because we would like to make sure that beyond a point, we also look at profitability and utilization. I think we are sitting on pretty comfortable levels of utilization. If we don't have a challenge in meeting our demand, we would not like to continue increasing that bench. So, I don't think overall headcount should be seen, especially given the lower levels of utilization we are at.

Mohit Jain: So, therefore, coming back to the previous point, there should be margin tailwind because you have given a band and most of the times, we are at the lower end of the band.

Nitin Rakesh: Yes, there should be margin tailwind as long as we make sure that the decision-making process is really around do we need to invest with a customer in a deal in a particular capability. I think as the utilization improves, as some of the headwinds from supply recede, offshore tailwinds, we definitely see a bias on the upward side with the margin. But again, we will make a decision depending on what the business needs because I think at this point in time having a forward-leaning stance in helping finding growth with customers is going to take priority.

Moderator: We have the next question from the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: In terms of the client in which we witnessed the furlough in this quarter, that client back in terms of normal operations or there could be some further impact in this quarter as well?

Nitin Rakesh: As I mentioned, it is too early to talk about client-specific impacts in Q3, but again, keep in mind, this is a client that has a pattern of year-end closures and I think that impact might continue in this quarter as well, but we will obviously try to mitigate as much as we can in terms of what we think is doable.

Sandeep Shah: Nitin, can you throw some light in terms of how the mortgage business one should look like on a going-forward basis? Has it now bottomed out, or there could be further headwinds as a whole, entering into the second half?

Nitin Rakesh: Unfortunately, I think it is very hard for me to give you a forecast because all said and done, as I mentioned, it is a key part of our portfolio and it is a key part of the US banking industry. There are parts of that business that actually have grown in the last 3 quarters, because that was the whole countercyclical investment we made towards other lines such as home equity, diligence, and servicing. There are still parts of that business in which we haven't yet invested. As I mentioned, right now, our stance is to consolidate our position, because we are one of the leading providers. We have obviously also integrated tech with it. So, there are customers where we might actually end up taking a big role in rolling out a whole new service line for them, build the platform, then run the operation, use offshore as a leverage to lower the cost, and so on. I think there is a lot happening in that vertical. It is very hard for me to give you a specific answer on when it will bottom or what the outlook will be. I think we just have to deal with that uncertainty for a little while longer until we see some stability. But I am 100% convinced that there is a lot of growth to be had in that business over the medium to long term.

Sandeep Shah: And just last bookkeeping question. What is the difference between adjusted EBITDA margin of 15.9% versus reported 15.3%?

Nitin Rakesh: EBIT, not EBITDA.

Manish Dugar: The primary adjustment that we are sharing with you is, if you remember when we did the Blink acquisition, we had talked about the fact that there are charges that will continue for a period and then stop, and these are mostly intangible amortization. So, the adjustment is only for that, and as the quarters progress, it continues to decline both in absolute terms and in percentage terms.

Moderator: The next question is from the line of Dipesh Mehta from Emkay Global. Please go ahead.

Dipesh Mehta: A couple of questions. First, I just want to understand the correlation decline now from deal win to revenue conversion. Earlier correlation used to be 93% to 94%, now it came down to 85-odd percentage when growth rate also moderates while deal intake remained more or less about $300 million. So, can you help us understand how it plays out? Second thing is about the deal pipeline QoQ growth. If I look for the last 2 quarters, growth remained healthy, but deal intake is not showing that kind of sustained trend. So, if you can provide some sense whether we are seeing an elongated sales cycle, or if you can provide some color on it, what is playing out there? Third thing is about the revenue growth. For the last couple of quarters, we are growing lower than some of your peers, which eventually will translate into obviously YoY growth. Currently, we are doing well on YoY, because of a healthy trajectory in FY22. How do you expect the trajectory on YoY to evolve over the next few quarters? Do you think QoQ-wise, we will see acceleration playing out in H2 or it is more in FY24?

Manish Dugar: Dipesh, I will take the first question and probably Nitin will take the subsequent one. While you are right that the correlation coefficient is looking like 0.9% going to 0.8%. The primary reason for that is the impact that we saw because of, on one side mortgage business slowing down, on the other hand furlough, both of which impact the run rate revenue which, as you know, are cyclical and hopefully will correct as the interest rate corrects. But for that, the correlation coefficient of TCV conversion to revenue continues to be in that 0.9% range.

Nitin Rakesh: On the second point around deal cycles, I think the fact that we did close $300 million plus in TCV despite a segment of our business actually not seeing any large TCVs on the mortgage side should tell you that in the core side of our business, there is ability to convert and close deals and move forward with customers. I think there is some degree of uncertainty for sure in client execs, especially as they are busy finalizing their FY23 budgets, which is why we had to kind of lean in on some of the survey results to see what stance we should take, what services we should strengthen, and all of that went into the decision behind creating the playbook that I shared with you earlier today.

On the third question of the sequential versus YoY growth, I think you are absolutely right. We obviously have paid the price for the cyclicality playing out. I think the focus really is on making sure that through the remainder of the year, we are able to continue to take a forward-leaning growth stance and convert as much of this TCV into revenue and as much of the pipeline into TCV. If pipeline and TCV continue to operate, I think the sequential growth and the YoY growth will both come to where we need them to be.

Manish Dugar: Just to add to that Dipesh, on your last point, interest rate hardening has been at such a fast pace that the countercyclicality has not played on as much as we would have expected, causing a surprise on the impact of mortgage business because of the interest rate. And add to it, the surprise that we got of furlough in quarter 2, which was again typically not a trend; it would normally be in the quarter 3.

Moderator: Our next question is from the line of Divyesh as a text question on the webcast. What is the reason for decline in non-billable workforce?

Manish Dugar: The utilization was probably at a level where there was an opportunity to improve. And as we had more people deployed to billable projects, we did not necessarily need to recruit people to fulfill that requirement. We could use the people who were in the bench to do the fulfillment, and that led to a reduction in non-billable people.

Nitin Rakesh: By design.

Manish Dugar: Yes.

Moderator: The next question is from the line of Ashwin Mehta from Ambit Capital. Please go ahead.

Ashwin Mehta: One question, in terms of our on-site headcount seems to have gone up by almost 9% while on-site revenues are down. What explains that? Is it the transition for the new deals that you signed in? And has that had an impact in terms of your margins as well?

Manish Dugar: As you know, most of the mortgage revenues are on-site and a large part of the furlough impact was also on-site. So, you are right that while the headcount increase has happened on-site, it is not showing up in terms of revenues because of these 2 large primary factors.

Ashwin Mehta: No Manish. I was talking about the tech services headcount. Tech services headcount is up 9% for you sequentially. The BPO headcount is actually down on-site. What explains the substantial increase in on-site headcount? Our utilization seems to have dropped on-site and our on-site revenues also seem to have dropped.

Manish Dugar: The headcount increase, Ashwin, is a period and point-in-time data while the utilization is an average through the quarter. So, you are right that headcount, as we look at, as on the 30th of September looks like an increase, but the billability came in only towards the last month of the quarter, which is why we actually shared the fact that our utilization is actually 4% better when we look at it at the end of the quarter versus when you look at it through the quarter. So, while furlough would have impacted the on-site revenues in tech services, but the headcount increase did not translate to billable headcount during the quarter because addition happened mostly during the quarter.

Nitin Rakesh: But that is in the run rate for Q3.

Manish Dugar: Yes, it should come in as a revenue in the Q3 run rate.

Ashwin Mehta: Just one more question in terms of insurance, that's been a segment that's been kind of sluggish for us for a while. So, what's the outlook in terms of insurance and any signs of pickup there?

Nitin Rakesh: I think, Ashwin, a good question. If you look at the NCA chart that I shared, I think ideally what we want to do is to create a few anchor clients in each of the segments of insurance – life, C&C, and brokerage. I think they are at a point where we have made a lot of investment in the last 2 to 3 years in strengthening and broadening that client base in insurance. There's still work to be done, and I think again it's a prioritization of investment dollars, sales dollars, account coverage both in the US and in Europe, especially UK. I think we do see that there is runway for us to continue to grow that business line. At this point, I think at least the NCA side of the house has grown well and we do see a potential to add new large marquee names. But it's a motion that is driven primarily by the addition of new logos, because we do need to expand our client base. We have done some of that in the last 2 years. We have added some marquee logos in those 3 segments, but there is more work to be done there.

Moderator: The next question is from the line of Vibhor Singhal from Phillip Capital. Please go ahead.

Vibhor Singhal: A couple of questions from my side. I am sorry if I missed that. Somewhere in between, I got dropped off. Can you just provide us a broad range as to how much of percentage of our revenue today would be the mortgage centered business and how much of that would be interest rate sensitive? I know you mentioned it's hard to give an outlook, but as a percentage of our revenue, how big could it be?

Nitin Rakesh: We started clubbing it in the Direct business 2 years ago and I don't think we want to break it out separately at this point. All I will tell you is the interest rate-sensitive piece of the business is kind of low single-digit percentage of revenue, but that's kind of where we will stop with the disclosure.

Vibhor Singhal: Also, Nitin, I just wanted to basically dig a little bit deeper into the margin trajectory. I think last year when the entire sector had tailwinds from lower travel cost and facility expenses and all, you had mentioned that we are utilizing that to reinvest into the business to secure growth. In FY22 also, I think we were probably at par in terms of growth with some of the similar-sized peers. This year, of course, as I think a couple of participants earlier mentioned, our QoQ growth has been steady. Of course, it has been impacted by a couple of headwinds and all. But net-net, I think we haven't achieved anything on the growth front, which is remarkably different from some of our other similar-sized peers and despite the fact that we let go of the margin expansion opportunity that we had in FY22. So, how do you see that playing out ahead? The margins are going to remain in the same margin band that we are operating right now at around 15.5% plus minus some range, and probably a similar kind of growth. I am not talking about the near-term, I know it's volatile times ahead. But on a longer-term perspective, do we have a target to maybe take margins north of 15%, to a sustainable growth kind of target, or do you think this is the comfort band that we are operating in right now?

Manish Dugar: A few things. First of all, unlike what you said, last year was actually an industry-leading growth for Mphasis, 34% organic and 36% inorganic in the Direct side of the business. We have stated that our philosophy will be to invest in growth while maintaining margins in a narrow band, and we have consistently followed and executed on it. There has been an increase and a decrease in margin in the peer group, but we have remained nearly flat. In many cases, actually, there has been a decline from pre-pandemic margin levels versus where the peer group is today while we have not seen that happen. Even now, there are significant opportunities for investment, and some of those investments are impacting the reported numbers and some of those are baked into our reported numbers. The ones which are impacting the reported numbers, we have called it out earlier, the charges for M&A and the stock compensation that we have given to our leadership team.

Having said all of that, I think we continue to have significant margins. We have talked about utilization; we have talked about price increase continuing to come in. We have talked about the continuing reduction in stock compensation and M&A charges, and we keep making sure that if there are opportunities to invest where the returns are more than what we would do with the cash generated in our balance sheet, we continue making that investment.

What you see today is a confluence of quite a few things coming together, leading to the softness in revenue. I don't think it should be seen as an indication of a directional change. Like Nitin mentioned, everything that relates to our strategy to growth, whether it is account-centric growth, whether it is Applications-centric growth, whether it is top 5, top 10, top 20, whether it is vertical expansion, whether it is making sure that competency-led and new gen proactive deal wins, I think we are seeing significant positivity in all of those metrics, as it relates to our core business. And we feel confident that our strategy of continuing to invest in growth while maintaining margins in a stable range is the right strategy to adopt.

Having said all of that, we have also said before that we believe there should be a northward bias to the margin. It is a question of when and not if, and the reason why it is a question of when is because there is an uncertainty in the macro both in terms of what we see happening from a geopolitical perspective as well as what we see happening from a supply perspective. As some of those things become clearer, we will have a better view of when that margin expansion will start becoming visible. But otherwise, the strategy continues to be investing for growth, while maintaining margin in this narrow range.

Vibhor Singhal: Really glad to hear that we maintain that northward bias in the margins. Difficult times and really volatile times ahead at this point of time, but thanks for explaining that in detail.

Moderator: Our next question is from the line of Sameer Dosani from ICICI Prudential AMC. Please go ahead.

Sameer Dosani: Just to understand this headcount addition in on-site, is it fair to assume that the going forward onshore revenue would increase and that could have a margin impact? And also just to understand the new deals, when would be the ramp-up starting for the newer deals that you have won? because these are fairly large deals and will take time? And whether initial period would be on-site role because that would then again also have a bearing on the margins?

Manish Dugar: Sameer, first of all, the headcount addition on the IT and apps business happened towards the end of the quarter, which is why it did not reflect in revenue in the quarter. And like Nitin mentioned, it should come-in in the run rate revenue in quarter 3. From a profitability perspective, as we had talked about in our previous calls, the margins are not measured based on offshore, on-site, etc. Typically, we try and make sure that the delivery assurance and the quality of delivery is primary and then we decide how much should be on-site and offshore. And given most of what we do are proactive and value delivery rather than cost takeout – and when I say cost takeout, it's not an input cost conversation – clients are more than happy to make sure that irrespective of the mix of on-site and offshore, we are able to get the margins that we desire. So, even if it is on-site centric revenue which comes in because of on-site addition, we don't think that has any impact on the margin, so to speak, as we go forward. And the revenue for that headcount addition should start showing up in quarter 3.

Nitin Rakesh: And also, there will be pull-through revenue offshore because these are deals that will effectively have a pretty healthy element of offshore as well. So, that offshore tailwind will help mitigate any margin impact that you're worried about, from an onshore expansion perspective.

Sameer Dosani: And also the new deals, these ramp-ups; when do we expect a ramp-up to start on these deals because we have got a fairly large deal wins.

Manish Dugar: Sameer, the deals are not any different in terms of tenure. These are typically the same 3 to 3.5, 4 years kind of life of deals. And if you consider a ramp-up period of 1.5 to 2 months, we should start seeing the run rate revenue starting to flow in in 2.5 to 3 months. So, depending on when the deal got closed…. like when we did the last earnings announcement, we had talked about the fact that we had already won a $60 million deal. So, technically, that revenue should have already started coming in as we speak in October, on a run-rate basis. And then some, what we won in August, would come in a little later and September may be a little bit more later.

Sameer Dosani: Last question if I may. This is an industry phenomena, right? The pipeline is expanding on a Q-on-Q basis for all the companies, but the deal wins have remained more or less flat. Do you think this is an indicator that the competition is increasing in the industry? How should we look at that?

Nitin Rakesh: Comparability-wise, each company declares a different construct of TCV. So, you have to look at their own trend and apples-to-apples comparison of how their trajectory has been. We don't need to do renewals and I think for us we are focused on constantly making sure that we have enough deals in the pipeline for us to get a sustainable level of growth, especially as we described in the core business in the last few quarters. We have taken up that number quite consistently. It used to be sub-100 a few years ago, then it was 200 plus, 250 range, and now 300 plus quite consistently. I think our effort will be to make sure that we are consistently taking that number higher. This industry has always been hypercompetitive because unlike many other industries, there is a large-scale consolidation. I think we are used to the competitive intensity. That's the reason why we have to focus on finding our own specializations, differentiations, and positioning in each market that we operate in. I don't think I would read more than that into the TCV metrics.

Moderator: We will take the last question from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: If you could give some context on what's driven the drop in S&M expenses, and how we should think about that? And same thing on the gross profit line as well. If you could give some context on both, that would be helpful.

Manish Dugar: Furlough and the investments that we make in making sure that we are proactively working with the client for large proposals and consolidation initiatives, those are primarily gross margin and COGS-related costs and they impact the gross margin. From a gross margin to gross profit, I think that's primarily a numerator than a denominator change because of currency movement. And as you know, the currency moved significantly. While the gross margin moved by 1.7%, the gross profit moved by 3%, primarily because the translation led to a movement in the percentage higher than what the gross margin percentage movement happened.

And to your question on S&M and G&A, we have talked about the fact that there is an investment that we make which are short term and which are long term in nature and we have an ability to flex them up and down. We did take those cost measures which we could avoid spending on. Also, remember that same quarter last year, the percentages were almost similar to what it is now, 26.5% versus 27.1% and S&M and G&A were also in the 0.1% to 0.2% variance versus the same quarter last year. So, I don't think any of that action is a cut that we would have liked to avoid. It is just that we prioritized investing which had an impact on gross margin and deprioritized the investment which was going into S&M and G&A.

Moderator: Sir, we have one more question in the queue. That will be our last question for today. It's from the line of Abhinav Ganeshan from SBI Pension Funds.

Abhinav Ganeshan: I just had a couple of questions. First one is that, if you can just help me, how are we going to do things differently in Q3 and Q4 so that we can get a double-digit run rate of growth? And the second point is what would be a comfortable level of utilization that we are looking at going forward?

Nitin Rakesh: Abhinav, we are already at healthy double-digit levels of growth in the Direct business, it is close to 20% growth. Again, our business is fairly straightforward in terms of how we think about the health of the business and the future prospects. Lead indicator is pipeline, second indicator is TCV conversion and then everything follows from there. Pipeline to TCV, TCV to revenue, revenue to margin. Of course, there are lots of other moving parts in the process that we need to manage on a pretty dynamic basis. But that's really the way we think about the business. I think we have very transparently given you a fairly significant breakdown of the growth dynamic, especially driven by what we saw in Q2 and what we think is likely to happen in Q3. But given just the strength of the core business, the in-account model, client category growth, new client growth, application-centric growth, multiple verticals starting to come together, I think the core business continues to be in great shape. And if we just keep executing on that model of pipeline to TCV, TCV to revenue, I don't think we need to worry about the double-digit growth metric that you talked about.

Second, on the utilization front, again, when we had a little bit more visibility, we brought the utilization down, because we wanted to make sure that we had enough flex to find room to grow and to build a pyramid. We will be a little bit more nimble and probably make a little bit more dynamic decisions. So, we do expect the utilization to continue to trend up. I think it probably will get into the historical ranges that we were at. We probably have another 3 to 4 percentage points to go up over the next couple of quarters.

Abhinav Ganeshan: One last question if I may. Can you just throw some more color on this $200 million client that you have added? Which segment it is from if you could just enumerate?

Nitin Rakesh: We can't name the customer, but it is our long-standing relationship of over 20 years and it has constantly grown with us and it is a banking customer.

Moderator: Ladies and gentlemen, that would be our last question for today. I now hand the conference over to Mr. Nitin Rakesh for closing comments. Thank you, and over to you.

Nitin Rakesh: I think we are living through some interesting times. Overall, I am pleased with how we are navigating through this. We continue to focus intensely on executing our strategy, and while supporting our clients in this complex environment. We will continue to actively reinvest capital into our business to meet our customer needs and drive organic as well as inorganic growth. Thank you all for your continued interest in Mphasis and your sustained investment and time.

Wish you all a very Happy Diwali.

Moderator: Ladies and gentlemen, on behalf of Mphasis Limited, that concludes this conference. If you have any further questions, please reach out to Mphasis Investor Relations at investor.relations@mphasis.com. Thank you for joining us, and you may now disconnect your lines.