"Mphasis Limited
Q1 FY2020 Earnings Conference Call"

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Moderator: Good day, ladies and gentlemen, and welcome to the Q1 FY2020 Earnings Conference Call of Mphasis Limited. 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, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Varun Divadkar from CDR India. Thank you, and over to you!

Varun Divadkar: Thanks, Margareth. Good morning, everyone, and thank you for joining us on Mphasis' Q1 FY2020 Results Conference Call. We have with us today Mr. Nitin Rakesh, the CEO; and Mr. V. Suryanarayanan, the CFO.

Before we begin, I would like to state that some of the statements 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 Q1 FY2020 results announcement release that has been sent to you earlier.

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

Nitin Rakesh: Thank you, Varun. Good morning, everybody. Thanks for joining our call today. Trust you had the opportunity to go through our Q1 2020 results and other operational performance information in the MD&A.

Earlier in the previous quarter, while discussing the FY2019 results, we had outlined the changes in the marketplace that are impacting the business models of various companies including our clients and how we are aligning ourselves to these changing market dynamics to help our clients manage this transition. We outlined our growth themes that are anchored around the twin concepts of Consistency and Transformation led by both Direct Core and the DXC businesses.

We are happy to start this financial year FY20 on the same strong footing. Our service offerings pivoted around NextGen Services, focusing on cloud and cognitive by integrating our deep domain expertise with cutting-edge technology has been a strong enabler of our growth. We talked about the depth of capability and the intense focus we have been putting on strengthening the New-Gen Services centered on the modern GTM aligned towards agility, scalability and differentiation through the creation of capability tribes. Areas such as DevOps, NextGen app dev, legacy modernization, enterprise automation, NextGen data, cybersecurity and SecOps as well as a renovation of traditional AMS and IMS offerings during services transformation are actually starting to show results. The impact of these capabilities is starting to get visible in bolstering our differentiation with services like DevOps and NextGen app dev both becoming the linchpin of new deal wins. Combined with the intense focus on application of cloud platforms, containerization and the need for an agile digital modernization approach, this approach is giving us the ability to win longer-term strategic deals with our clients. Growth has also been very encouraging across the spectrum of our client segments within Direct Core as well as in the DXC/HP channel. To share a few sample examples of deals. We have been able to take on long-term application management businesses, apply service transformation levers to generate significant run savings and bundle legacy modernization to redefine the applications estate for large enterprises. Akin to what we call zero-cost transformation approach, this has become a market-leading model with significant replicability and scalability across clients as well as providing a good combination of new dev work along with enabling a longer-term revenue growth profile.

In another very successful pivot, our focus on design and engineering-led approach, where our digital architects work closely with clients for the right problem definition as well as the interventions required to address the same, create a significant shift left driven differentiation, positioning us very well in applying our T-shaped transformation approach. This has been extremely helpful in opening new clients as well as in expanding our wallet share within existing clients. Our win rates in client acquisition especially in New-Gen Services has never been higher both from a quality of logos or the profitability profile of the businesses being acquired. Combined with Talent Next and our delivery transformation program, we are also driving a transformation for our employees across the spectrum of sales, engagement, solutioning as well as keeping our delivery teams abreast with the new processes and embedding native approaches to embrace cloud and cognitive across a spectrum of all operations.

We have further enhanced our offerings on the cloud platforms and recently announced achieving the AWS Security Competency status. It differentiates Mphasis Stelligent as an AWS Partner Network member that provides specialized consulting services designed to help enterprises adopt, develop and deploy complex security projects on AWS. To receive this designation, APN partners must possess deep AWS expertise and deliver solutions seamlessly on AWS. And we are one of the few handful companies worldwide to achieve this status. We have also gone live in the AWS Machine Learning Marketplace with some of our NEXT Labs offerings including deep learning algorithms. We will share more details on these case studies and these developments in our upcoming Investor Day in August.

In Q1 2020, we won deals with TCV of $151 million in Direct International that sets the growth momentum for FY20. 80% of these deal wins were in New-Gen focus areas. The strong deal wins momentum that we are witnessing consistently is reflected in our revenue growth. Consolidated gross revenues grew 2% Q-on-Q and 11.5% Y-o-Y in constant currency in Q1 with 0.7% Q-on-Q and 13.1% Y-o-Y on a reported basis. Revenue growth was impacted by non-strategic ATM business. Excluding this segment, the core business grew 2.3% Q-o-Q in constant currency terms for Q1.

Direct Core, which constitutes 84% of Direct International business, grew 2.7% Q-o-Q and 17.2% Y-o-Y in constant currency terms on the back of a record growth year in FY19. Growth is broad-based across Strategic Accounts, Blackstone portfolio and new client segments. The investments in sales and marketing have been handsomely paying off. And I would like to highlight the significant growth achieved in the Blackstone portfolio which grew 55% year-over-year and in the new client segment which grew 104% year-over-year in constant currency terms.

New-Gen Services now contribute almost 51% of Direct Core revenues in Q1-20, representing a year-over-year growth of 35% on a reported basis. We continue to witness strong growth in Direct Core with great momentum in client wins as reflected in our elevated new logo closures as well as in new client revenues, as I just talked about.

Pipelines continue to be robust with the approaches highlighted above being great positioning for our services. We will discuss the same in more detail in our upcoming Analyst meet as well, as well as talk about the plans to move forward on an accelerated growth path with plans to strengthen the GTM engine across multiple vectors.

Moving on to the DXC/HP channel, as mentioned in our previous quarter webcast, we continue to work diligently to apply consistent transformation through our partnership across all the vectors. Our strategic client engagement partnerships focusing on service transformation capability and the solution-led approach to GTM coupled with geographical diversification and industry vertical market focus is helping us maintain our growth consistency here as well. Q120 revenue grew 2.5% Q-o-Q and 16.5% Y-o-Y in constant currency. Our pipeline here continues to be robust as we increase our joint go-to-market efforts in partnership with DXC which should help us grow in line or slightly above market this financial year.

Digital Risk has seen stability with stable interest environment in the U.S. DR revenue grew about 1% Q-o-Q in constant currency terms as we ramped up capacity through the quarter to be able to service the demand generated from the turnaround in the mortgage volumes. We are confident of growing this business consistently in the coming quarters as we further convert the deals to revenue to move closer to the stated revenue band that we operated in previous year.

On the profitability front, we continue to operate in our stated EBIT band of 15% to 17%. The EBIT margins for Q1 20 was impacted by visa costs, mid-term salary increases and a one-time plan for strict provision for receivables as well as ramp-up costs for a few large projects in transition. As you can see from our utilization metrics, we took a few conscious operational decisions this past quarter, and we are now starting to shape the pyramid with more focus while ramping up to meet client demand in line with the deal closures as well as to match the landscape of these deals. As such, we saw a decline in utilization across the board especially including trainees in both apps and the BPS business. This also enables us to capture the revenue on sold deals as well as to service the pipeline that we are confident of converting. We used the operating leverage to fund these investments. And with the primary focus on revenue growth combined with cost optimization, we were able to continue to operate in the stated margin band. We will give you a little bit more color on the picture going forward in a short while.

Consolidated net revenue grew 1.9% sequentially and 13.3% Y-o-Y in Q1 FY20 to INR 20,626 million in reported terms. Direct Core revenue grew 1.3% Q-o-Q and 19.2% Y-o-Y on a reported basis and 2.7% Q-o-Q and 17.2% Y-o-Y in constant currency, as I mentioned before. DXC/HP business grew 0.9% sequentially and 17.5% Y-o-Y on a reported basis and 2.5% Q-o-Q and 16.5% Y-o-Y in constant currency.

Operating margins declined 30 BPS sequentially to 15.5%. We have certain puts and takes. The hedge gains added 50 basis points, and we had a marginal gain at an EBIT level from the Ind AS 116 change, but we invested almost 60 BPS back in through additional bench and pyramid actions for future billability and also had an additional 40 BPS impact from one-times like receivables and visa cost with the rest being balanced through operating levers. As stated earlier, with strong revenue growth and optimizations, we expect our operating margins for FY20 to be in the band of 15.5% to 17% with an improving trajectory through the remainder of the year.

Our operating cash generation remains strong and total cash including investments on the balance sheet as of 30th June stood at Rs.21,580 million, which translates to about $313 million. Adjusted for the net loan repayment, cash and cash equivalents increased by Rs.2,263 million or almost $37.7 million during the quarter.

We are pleased with the health of our pipeline. The capabilities that we are building across the service offerings with continued strong execution and differentiation in New-Gen Services. We are confident that these will be reflecting in our performance in the coming quarters which will help us to deliver our stated full year growth objective of above-market growth.

On that note, I thank you once again. I request the moderator to open the line for questions.

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

Nitin Padmanabhan: Good morning. Nitin, from a supply-side standpoint, it will be great if you could give us some color there. So you did have some midterm compensation hikes. If you could throw some color in terms of how you will see that going forward. Do you think there is room to do more of that? Or what is it exactly that you are seeing in the market?

Nitin Rakesh: Sure. I think market is fairly polarized. There are 3 different vectors that are playing in the talent equation: firstly, the type of talent; secondly, the location, not just onshore or offshore. There are micro markets within offshore that are fairly different from each other across cities and even within cities. And thirdly, the ability to ramp up and create based on visibility and integration of that with your service offerings. So we have actually continued to work on all of these 3 fronts. Clearly, there is tightness in the labor market especially for new-gen skills on-site, and that obviously leads to an impact on both costs as well as the speed of ramp-up which potentially can start impacting growth. So we are pleased that we actually have not yet seen that happen in any meaningful way on our growth trajectory. And of course, we have used all operational levers to mitigate any impact of that on our margin trajectory as well. So that is the balancing act that is working continuously.

On the wage hike, we took a decision when we launched Talent Next almost 6 quarters ago that we will link our employee progression across all fronts, whether it is monetary or career track, to their ability and their progression by acquiring new-gen skills. And that is why you would be constantly seeing some of these will trickle into quarters beyond just the end of Q2 or October cycle, which used to be our traditional cycle. So some of this impact will be diffused through the quarters. And we may still consider certain actions at the end of Q2 that will just be more like a top-up or a balancing act.

Nitin Padmanabhan: Sure. But how large are these interventions? Is it meaningful impact from an overall margin standpoint and from a quarter perspectives?

Nitin Rakesh: I called out the impact of visa and these interventions in the range of 40 to 50 BPS as of course Visa is for one-time. But that we are talking about potentially large talent pool that should not have to wait for the next cycle if they have displayed the ability to raise up-skill themselves, and that obviously means that we have the ability to then deploy them and generate revenue. And the fact that we obviously have some pricing leverage in new-gen skills affords us the ability to apply that straight through to the employee as well. So these are meaningful interventions, but they are linked very closely to the way we are managing the business.

Nitin Padmanabhan: Thanks. I will come for followup.

Moderator: Thank you. The next question is from the line of Aniket Pandey from Prabhudas Lilladher. He seems to have lost his line, so we will move to the next question which is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: Thanks for the opportunity. Nitin, basically, you have been making some investments in the European geography in recent times. Could you help us understand what you are seeing on the ground there? And secondly, is pricing in Europe better than uneasy markets of the U.S.?

Nitin Rakesh: We saw Europe accelerate for us for about 2 years, maybe 6 to 7 quarters and went from being 9% of our revenue in a growing revenue line to about 11% of our revenue. And now it is kind of stabilized at about 11%, I would say, for the last couple of quarters. And the reason is the rest of the company continues to grow very robustly as well. But we are still seeing definitely growth in Europe on a consistent basis.

The market is definitely a little bit more challenging today especially in the U.K. with all the macro uncertainty around Brexit. And of course, there are certain segments of the market in Europe especially in banking, investment banking, markets and trading, especially the banks that have a global footprint that are challenged. And there, I do not think it is just going to go away anytime soon because they are pivoting from the global banking model with roots in their home markets. Luckily for us, the impact of that has been less muted, and hence, we feel that with continued investments and additional leadership changes and enhancements that we have made in the market over the last 6 months, we still think there is room for us to grow Europe faster than the rest of the company.

From a pricing standpoint, there is not that much of a difference because the markets and the buyers are fairly mature from a price competitiveness perspective. But of course, from an adoption standpoint, U.S. still continues to lead adoption of new tech versus other parts of Europe. There are other micro markets. There are parts of banking, for example, in France that are fairly sophisticated, and there is a very active start-up ecosystem in France that is doing innovation. But from an adoption standpoint, U.S. is the leading.

Manik Taneja: Sure. If I can ask one more question, you have been doing very well with your top customer. If you could give us some sense of how do you see things playing out over the medium term?

Nitin Rakesh: Firstly, It is an important sign that our largest clients continue to buy from us. And I think we have been very clear that while we are very excited about the opportunity to sell new clients or new deals, it should not happen at the cost of gains in large strategic accounts. So that what you see, and that is what we think is driving some of the growth that you are seeing in the large account as well as a category or what we call a strategic account growth.

But again, supplementing that with 2 new engines of growth, and I am still talking about primarily in the direct channel, we are very pleased with the progress we are now starting to see in the new client acquisition business. All that really means is we have created a fairly hyper-growth segment of clients that, for 3 quarters in a row, have now grown and are starting to be meaningful when it comes to contribution to growth. For a segment of clients to grow 100% on a Y-o-Y basis, it basically gives us a lot of confidence that our ability to generate interest, to show differentiation and bringing in these large and I am talking about some fairly large Tier 1 names across the segment we operate in, whether it is banking, financial services, insurance, even health care, we started to see that impact. So that is clearly a very, very good sign for us for the long-term growth of the business.

And then we supplement that with the Blackstone channel that gives you an additional tail-winded growth environment.

Manik Taneja: Thank you and all the best for the future.

Moderator: Thank you. The next question is from the line of Abhishek S. from Equirus Securities. Please go ahead.

Abhishek S: Thanks for the opportunity. Nitin, it would be helpful if you can reconcile the growth rates on a year-on-year basis across key verticals and if you can put them in the buckets of top customers. And the reason I am asking is the year-on-year growth rate in BFSI is now down to almost high single digit. And our top customer continues to grow sharply. And likewise, the top 6 to 10 and others are decelerating from a top customer perspective and still insurance and emerging industries is growing very high on a Y-o-Y basis. So if you can reconcile the growth rates that would be helpful?

Nitin Rakesh: Sure. So firstly, it is your presumption on the top customer being in a certain industry vertical. I am not going to confirm or deny what that industry vertical for that customer is because we do not have a policy of naming clients. I will reconcile the industry growth rates for you. What is happening in BCM is that the Y-o-Y decline in Digital Risk is skewing the growth rate for the overall business. And if you actually look at the Direct Core business, which is obviously 80-plus percent of our direct business, the Y-o-Y growth in banking has been over 11.5%. And a sequential growth has been around 3.0%. So that should tell you that for us, both on a Y-o-Y and a sequential basis, we continue to see good growth in the core IT services businesses in banking and capital markets.

To give you a little bit more color, there are segments of banking and capital markets, as we call it BFS in the industry, that are growing faster, and there are segments that are shrinking faster. Any consumer-facing segment, whether it is consumer bank, wealth management, consumer lending, payments, is actually seeing a fairly robust environment for investment led primarily by the fact that these require digital interventions that are fairly strong. However, segments especially in the core services especially legacy, infra legacy applications, they are actually not seeing growth, in fact, are being shrunk by client activity. So that is the dynamic that is going on in BFS.

There are certain segments in BFS like global trading and markets, asset management, where there is pressure on their core business either because of interest rate or because of pressure on their fees or because of general headwinds in the trading business worldwide. And again for us, that is not a meaningful part of our client segment, and hence, that gives us the ability to weather that slowdown, which a number of our peers have actually called out as well. So that is a little bit of color on the banking and financial services or the banking and capital markets side. Obviously, financial services is a little bit less immune to cyclical and interest rate headwinds than core banking is.

On insurance, Y-o-Y we had a specific issue with a client a couple of years ago that got washed through the system in FY18. And beginning 2019, you saw a good sequential growth, and that is showing up in the annual growth rate of insurance as well.

Emerging has been a good business and it is almost 28% of our direct business. It is a collection of multiple micro verticals. There is healthcare in there. There is high tech in there. Logistics and travel also there. We have not broken it out because these are still fairly small, but almost all of them are in a hyper-growth mode right now given one, the base effect; and two, the fact that we are now starting to create accounts that are upscale in these micro verticals. So that is what you will continue to see emerging industries grow faster at least as things stand today. So hopefully, that gives you a little bit of color on what is going on across the verticals in the business.

Abhishek S: That is helpful. Thank you for taking my question.

Moderator: Thank you. The next question is from the line of Aniket Pandey from Prabhudas Lilladher. Please go ahead.

Aniket Pandey: Good morning Sir. Thanks for the opportunity. I had a couple of questions actually. So, first is on your insurance segment. So, can you please explain us, what has been the drag and also on your outlook on your banking segment?

Nitin Rakesh: I just talked about banking. For us, two-thirds of the business comes from banking and financial services. So we actually continue to see that very favorably because a lot of our clients, both large and emerging, especially the new logos, are actually giving us the belief that we have good, strong differentiation in the service offerings, hence, our ability to drive wallet share will actually be fairly good.

On insurance, there is a sequential onetime impact from our product business in Wyde that is causing the distortion on a Q-o-Q basis. There was a project that ramped, that was delivered, and we have not obviously backfilled it. But other than that, the core insurance business continues to be fairly strong as we can see from a Y-o-Y basis as well.

Aniket Pandey: Sir, secondly, on the Direct Core, I mean any specific trends with respect to banking sector and any change in client behavior you are seeing on spending environment over there?

Nitin Rakesh: No. Again, I just talked about it in the previous question as well. There are parts of banking, there are in investment mode because of the pressure from consumers. Consumer banking, payments, lending, wealth management, all driving growth for us as well as for spend growth in banking. But then there are the other segments that are not driving growth. Asset management because of pressure on fees; and investment banking and trading because of the global macro headwinds is a drag. But again, keep in mind, across the board, the real investments are really coming through from either transformation or the ability to bring agility and customer experience and essentially taking money out of the way things were done 2-4 years ago, which was the legacy we are doing applications and infra management.

There is one other dynamic in banking that some of our peers have talked about which is the threat of in-sourcing, so let me address that also briefly. We are operating in a model where almost all large banks have a fairly hybrid approach to sourcing. And what we are now starting to see is what we call a best-in-breed approach. If there is a service line or a set of capabilities that are very strategic to the bank, they would like to find ways to invest in that themselves. If there are service lines that are much commoditized, they would like to sometimes not pay the premium or the service provider to run those commoditized services.

But as long as we have the ability to help them make the right decisions in deploying what I called out in my script the architecture and design-led thinking, then there is no dearth of shifting left and helping them really define the right set of problems and finding solutions. And hence, our win rates continue to be very, very healthy when it comes to wallet share gains in existing accounts. As well as the rate at which we are winning new logos has also accelerated because of the same capability. And so, so far, while there are always going to be multiple sourcing channels, this dynamic of finding the right solution set, helping them to find the right problem through design workshops and then applying those interventions in an agile manner really helping us.

Aniket Pandey: Sir, one last question actually. So we are seeing since last 8, 10 quarters, your top 5, top 10 client concentrations has been consistently going up. So basically, my question is really on how can we execute, so will it be margin accretive going forward?

Nitin Rakesh: Well, in the same last 8 quarters, our margin has actually also gone up consistently. If you look at FY18, FY19, both those years, we delivered in an increasing EBIT margin. I do not think the margin is an issue when it comes to large client growth. But that it was a very conscious strategy to find immediate growth in FY18 and 19 through existing relationships while seeding ourselves for growth through Blackstone and new client. And hence, I spent time in giving you statistics around the growth in NC, which is actually over 100% right now, which gives us the ability to then start creating new engines of growth. And hopefully, as some of these clients mature and scale with us, we will start seeing them break into the top 5or top 10.

Now keep in mind the top 5, top 10 that you see are not the same names that we publish. We publish them by size every quarter so some of them may not be in totally in like-to-like comparisons. But as long as we continue to point broad-based growth across line segments, across geographies and across units within Mphasis, we will be in good shape.

Aniket Pandey: Thank you. That is all from my side.

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

Ashwin Mehta: Thanks for the opportunity. Nitin, I just want to get a sense in terms of the traction that you are seeing in the Blackstone channel. This was 5% of your Direct Core business last year. Where do we see this business from a 3-year perspective? And how many clients are we currently targeting? How should the scale-up be? Should it be more back ended, more front ended?

Nitin Rakesh: We gave out some statistics. We talked about the fact that in FY19, 3% out of the 16.5% growth that Direct Core saw came from Blackstone channel. At a broad level, they are about 6-odd percent of our revenue within Direct Core. And it is entirely possible for us to take it to healthy double digits. And it has been fairly consistent. Of course, there are cycles.

There is a pipeline. We continue to monitor the pipeline and, as we are converting, make sure that we are filling it with new logos or with the digital work from the same clients as well. So, we are still fairly under-penetrated in the channel. There are over 100 companies. And we are barely at about 9 or 10 of them, as we gave the statistics out last time. And of course, we have added some more in the last quarter as well. But for us, it is a secular opportunity.

Also, keep in mind that this is not a static pool. There are companies that get added. As they buy new businesses, they have raised 2 new funds recently that will also give us some strong entry points as they deploy these funds over the next couple of years. So it is a fairly well-oiled machine right now. We have invested significantly in understanding that channel, understanding the way they operate, what drives the deal partners and the portfolio companies and what are the touch points we can create in understanding how we can run with that.

So for me, we are very encouraged. In the last 6, 7 quarters, we have created a growth engine that is growing at 50-plus percent. But I still think there is a long road ahead because it is still a fairly small percentage of our revenue.

Ashwin Mehta: Okay. So, my next one is in terms of the midterm wage hikes that you have given do you see a more moderate wage hike in 3Q now?

Nitin Rakesh: That is probably the way it is going to turn out because the whole idea was to link the wage hike more to people up-skilling themselves because that gives us the operating leverage to then redeploy them. Now how much of that will be top up versus how much of that will have to be put in lump sum is something we have not decided yet because we are still evaluating. The market is pretty dynamic. We have a pretty strong pipeline, and we have sold some nicely. So it is really a question of how all of these things balance out. But the idea was to actually dampen that impact instead of having it all in one quarter, rather make sure that we link it and create an incentive for employees also to act.

Ashwin Mehta: Okay. And just the last one, in terms of hedging, what is the rate that you can protect in FY2020?

V. Suryanarayanan: Good morning. This is Surya here. As we had earlier indicated, we would see positive impact of hedging in the current financial year. So, we are looking at about 50 BPS in margins going through incrementally in the current year because of the hedging.

Ashwin Mehta: Okay. And if I can squeeze just one last one in terms of the 4% sequential addition on headcount this quarter, what would be the skew towards fresher here?

Nitin Rakesh: Yes. We are not breaking the data out completely. But consciously, we are driving and that is why if you can actually reconcile that with the utilization including and excluding trainees, you will see that our intake of fresh grads is actually up meaningfully in the last 12 months. Almost, I would say, close to 50% increase in the number of fresh grads we are on-boarding. So idea really is to make that a conscious part of our pyramid optimization model.

Ashwin Mehta: Thank you. All the best.

Moderator: Thank you. The next question is from the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain: Congratulation on strong execution. Nitin, you shared about the enhancement of the GTM and Geo reach within the DXC channel. If you could share the benefit of those, so what could be those things? And how more good start would help you from a better-best prospect on the business growth this year?

Nitin Rakesh: So is this focused more on the DXC business only, or are you talking of the overall company from a geographical perspective?

Rahul Jain: DXC specifically.

Nitin Rakesh: Yes. So if you look at the webcast document that we put out last quarter, we talked about the fact that in FY2017, almost 90% of our business used to be Americas. And we have actually now brought it down to about two-thirds in Americas and the rest is split between U.K., Europe and ANZ. So that is the diversification that has given us additional drivers of growth. And that is something that we continue to expand on. Of course, then it required us to invest in these markets with both sales and solutioning as well as delivery coverage, but that is the investment that is actually paying off really well to us. So if you look at Page 7 and 8 of the webcast document, it breaks out the impact from the regions as well as the type of services we are selling over the last 8 quarters.

Rahul Jain: Given the good start, do we see a better prospect than what we were expecting on HP? Or this is just in line with our expectation?

Nitin Rakesh: Well, the question is your expectations or our expectations? Because we have actually never really lowered our expectations on this business. But it seems like the analyst community, based on certain news flow from the client side, lowered their expectations. So I am actually very happy to see that we have continued to grow this consistently. And we have been very consistent in saying that we want to grow this at least at or above the market. So I am glad your expectations are likely to change, and some of the clouds will go away. But that is always been our position.

Rahul Jain: Yes. That is it from my side. And it is always good to beat the expectation, so it actually helps.

Nitin Rakesh: I am glad as well, Rahul. Thank you.

Moderator: Thank you. The next question is from the line of Madhu Babu from Centrum Broking. Please go ahead.

Madhu Babu: Sir, the ITO building rate on-site, there was a steep moderation. And headcount in ITO has been strong so any view on that?

Nitin Rakesh: It is transition related. We are transitioning some deals that will require us to on-board that right now is not showing up in our billability. It will get corrected.

Madhu Babu: Okay. And second, on the New-Gen Services, I think recently one of a mid-cap peer is starting to build a subsegment of digital, which are like UX and how much is Cloud. And within our 80% New-Gen, can we get breakup of which is the subsegment where we are seeing good growth?

Nitin Rakesh: Yes. We can definitely give some more color, and we probably will do that as we present on the Analyst Day. So please book your slot. The thing you have to keep in mind is that a lot of these services are so tightly interlinked that it will be difficult for us to say that this is only U.S and this is only data and this is only applications. So, we will present you a certain flavor. It will probably be along the 8 tribes that I talked about, from DevOps to NextGen app dev to legacy modernization because those are the 8 capability areas we are actually investing and building through. But we will give you a little bit of color on that when we meet next time.

Madhu Babu: And sir, on the buyback. The buyback tax has been introduced post this budget. So, we had done a buyback earlier. So how we should see the capital allocation? I think we have a fairly good cash of around Rs.1700 Crores. So, would we continue to stick with the mix of buyback and dividend? Or how should we see it?

Nitin Rakesh: So, I will just give you an outline, and then Surya will add some more color to it. We have never really put a policy on a stated goal of dividend versus buyback. But what we have done is we followed the practice of giving at least 50% of earnings as net dividend which means, obviously, we have been paying out almost 60% on a gross basis. And we have just announced that last quarter. The shareholders have voted on it yesterday. So hopefully, we will soon get to know the resolution on that.

Buyback has always been on a need basis or a case-to-case basis which the Board has considered given the cash position and the use of cash. At this point in time, till December we have no outlook. And that is kind of the way we are looking at it. Of course, that tax change will become a consideration when the Board considered the use of cash and capital allocation as significant.

Madhu Babu: Sir, the last one from my side, in terms of hiring of any senior resources, we have not mentioned much over the last few quarters in the press release. So, when we ramp up all these New-Gen Services, so what kind of hiring has been done in the mid and senior level? Can you share any number on that?

Nitin Rakesh: Yes. We have been giving out press releases. We can present some more color. That should be in our press section on the website if you missed them. We have added people, both from a tech competency perspective especially in the LT2 level, which means one level below the leadership team, as well as in the lower levels, we have got a fairly robust program on re-skilling going on. We have added people in delivery and solutioning and more importantly, even in our leadership team. In fact, in the last quarter, we added 1 new leader in my team. That was also announced. We added the payments practice leader, who came from Amex. So on a need basis, we constantly keep adding people. It is not done in bulk. Obviously, it is done on a bootstrap basis where we have the room and the need.

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

Sumeet Jain Congrats, Nitin, for good execution. So firstly, you have seen a very strong ramp-up in your client add particularly in the direct channel in the last 3 to 4 quarters. But if I look at the deal win momentum in the direct channel, that has been fairly stable at around $150 million, so can you just comment when do you see that picking up going forward maybe both from the Blackstone portfolio perspective and ex of Blackstone?

Nitin Rakesh: Sumeet, that is a great question because that, goes to the buying pattern and the buying behavior in the enterprise market that is now starting to show up in multiple smaller but more frequent deals versus every 3-year or every 5-years large megadeals. So in fact, there was a session hosted recently by an industry analyst firm called “The Death of the $1 Billion Deal”. And the whole session was focused primarily on the fact that the buying behavior has moved more towards best in breed versus one large megadeal bundled into everything. So that is why when we enter a new account, it is typically using some of the

Trojan horse services like DevOps or app dev. And then app dev, kind of multiple flavors from digital to data to really building a completely new application that they may be trying to launch a new market or a new geography or a new segment. So those become really our entry points. Good news is these are logos that were traditionally considered as very mature buyers and, hence, very competitive logos, very difficult to enter because they were locked up by incumbents.

What we have seen and realized over the last 3, 4 quarters is that, actually, there are no mature markets. If you have the right level of differentiation, you should be able to drive the ability to open any logo you align yourself to. And that, to me, is the sign for long-term growth sustainability. Of course, some of that already is reflecting the TCV wins. And in the same number of 150, 160 that you are seeing today, that number used to be 2 years ago was 60 - 80, then we brought it to 100-plus. So of course, we will continue to focus on how we can keep ramping that up further especially as we start getting to some scale in some of these accounts. Not all of them will scale also because each account has its own dynamic. Remember, we entered an account through an AWS partnership agreement. We have entered that account for specific engagement. Then it is up to us to ramp up our engagement with models. And that is why actually the trends in the call, in my comments earlier, that we are now planning the next phase of our GTM expansion.

Sumeet Jain: Got it. And also, can you just give us a sense of how much is the proportion of new deal wins and the recurring revenue or deal win proportion?

Nitin Rakesh: Yes, no doubt or you mean the nature of revenue? Because we do not include renewals in our TCV wins. So, these are all net new wins. There is no renewal in these numbers.

Sumeet Jain: Got it. And on the overall direct channel, I mean given that Digital Risk on a Y-o-Y basis is significantly down. But in the Direct International, Direct Core, we are growing pretty fast. So, given these 2 dynamics, do you see a double-digit growth, if any really, in the overall direct channel in FY20?

Nitin Rakesh: No, As long as sequential growth continues to happen in the year for DR, which has now happened for the first time in two or three quarters, I think we will be able to manage the Y-o-Y headwind because Direct Core has grown at about 17% Y-o-Y, two quarters in a row now, which is kind of it is edging at the highest rate of growth ever. And that is good news because that is the most competitive part of our business. So, the expectation and the plan is to manage the DR business to take care of the pipeline that we have converted. And as we have done significant ramp-up in our delivery capability in the last quarter to meet that pipeline, so as long as we see sequential growth in DR, we will be able to manage the Y-o-Y issue.

Sumeet Jain: Got it. That is helpful. And then maybe around the attrition levels that you can comment because we typically do not give those numbers, so where we are on that?

Nitin Rakesh: Again, as I mentioned, the labor market is tight especially in certain segments and certain levels. So that the vectors that I talked about in terms of location, skill set type and level of employee, all 3 actually mean that the attritional level continues to be very different across these 3 vectors. If you look at, the attrition is probably the highest in the lower end of the pyramid and fairly low at the top end of the pyramid for us, which in a way gives us a little bit of breathing room because that means that we have continuity in people who understand our business and are delivering the transformation both to our business and to our clients' business.

But from a historical perspective, yes, it is definitely elevated at the lower levels. But the reason why we focused strongly on taking some of the pyramid actions and the utilization discussion we had is really targeted towards making sure that we continue to see how we can manage the dynamic of both growth and cost.

Sumeet Jain: Just the last one, if I can squeeze up, I mean what is the impact of Ind AS adoption on margins, if you can quantify?

Nitin Rakesh: The EBIT level impact is marginally positive. But on a PAT level, actually, the impact is 0. And Surya, you can elaborate what the impact is.

V. Suryanarayanan: Sumeet, as you know, this Ind-AS 116 adoption is effective April and impacts the rental, which for us is predominantly on the leasehold properties. The change in the accounting standard has reduced the rent and substituted it with depreciation and interest. So, the overall impact to the financials is virtually nil because the reduction gets offset with the depreciation and the interest.

Sumeet Jain: Got it. But what is the positive impact on EBIT margin? Like if PAT is 0, what about on EBIT margin?

Nitin Rakesh: Sumeet, the impact on EBIT are also marginal because that got neutralized by, effectively, reclassification. So, we really do not think there is a massive impact on EBIT. Effectively, it is a wash through the line. EBITDA definitely has been impacted because there are certain other changes that have caused the EBITDA to go up but EBIT, not so much.

Sumeet Jain: Thanks for the clarity. That is all from my end. All the best.

Moderator: Thank you. The next question is from the line of Neerav Dalal from MayBank. Please go ahead.

Neerav Dalal: Thanks for the opportunity. Most of my questions have been answered. Just one on the ETR, if you are seeing an increase this quarter, what do you expect it will be in FY2020?

V. Suryanarayanan: We have given a range between 25 and 27. So that would be the ETR forecast for FY20.

Neerav Dalal: Thank you.

Moderator: Thank you. The next question is from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: Thanks for the opportunity. Nitin, you have mentioned that there are some segments or customers that you are seeing growth as high as 100% Y-o-Y, and these are fairly large logos. But if we look at the client deals, your $20 million-plus client count was flat Y-o-Y. The $10 million-plus client count is down by 1 to 17. The $5 million-plus client is also down from 37 to 33. Just USD $1 million client that is up slightly from 93 to 96. So are these fast-growing clients still fairly small?

Nitin Rakesh: The two dynamics there to think about, Ravi, one is that the client count, for historical reasons, includes clients that we have direct and from DXC. So, if there is a churn in the DXC channel that ended up distorting these numbers. We have many times discussed that we should actually change the classification. But then there is a pushback because people want to be able to compare apples-to-apples. So we might actually, at some point, create a backfill and change the way we classify these clients. So, we will see if there is a way for us to provide you some more color, so you can see, are we generating really small deals or are we generating decent sized deals. But for the most part, because the buying behavior is driven more by best in breed, I am not saying it does not happen, but it is unlikely that you will go in with the $50 million, $70 million, $80 million TCV deal. It might start as a $5 million, $7 million deal or even sometimes $1 million or $2 million deal. But the fact that we got entry into a Fortune 50 or a Fortune 100 bank, within a couple of quarters in itself is a fairly strong validation of the differentiation in the services that we have seen.

Ravi Menon: Okay. That is helpful. And secondly, your segment profit, IT, Communication & Entertainment, that is down 14.4% Y-o-Y although revenue is up 8.7%. So, what is the additional drag on profitability over the last 12 months given that Digital Risk has been a drag from years before that?

Nitin Rakesh: I do not think Digital Risk sits in the ITC; you talked about the segment reporting in the MD&A, right?

Ravi Menon: Yes. Sorry, so Digital Risk not having an impact, what is exactly the reason for the drag on ITC?

Nitin Rakesh: We talked about the fact that is linked to the earlier comment I made which was that we have actually seen a drop in realized rate, and that is because there is a bunch of work that we are converting. That has not actually generated revenue enough for us to be able to make up for the cost of those resources. So that is what is creating a drop in the in-quarter profitability for that particular segment. But the same thing has happened in emerging as well because of the impact from a couple of large deals that required us to ramp up in advance.

Ravi Menon: Great. And one last question, just about the comment of DXC/HP, you were saying that though DXC is in the midst of restructuring and doing a lot of layoff, you are continuing to see growth. I mean so how should we think about that? And why is that happening?

Nitin Rakesh: So Ravi, what I would recommend is you spend some time going through the deck we published last quarter because we actually gave out a full transformation roadmap and the relationship and what is driving growth for us.

I would just call out 2 things and I am happy to give you more color at the Analyst Day as well because that is going to be part of our discussion. Almost 100% of our business used to be outsourcing, which meant that we were an extension of their delivery till FY2017. If you look at Q4 FY2017, 100% of what we did was really effectively T&M- driven delivery extension of HP business. Starting FY2018, we started to really focus on transforming that by and we called out that in May of 2017, when we announced the partnership for being the application and cloud migration partner. And that for the first time, we started to go in there and apply more than just T&M levers and started to bundle those in 2-, 3-, 4-, 5-year deals even from the point of view of applying service transformation. So that is the one big transformation lever that we applied to a point that only 20% of our revenue is actually now outsourcing-driven. And 80% of the revenue has an element of either applications transformation or go-to-market partnership or service transformation. That is the big transformation we applied, which means that we have now started to go to market jointly and create opportunity for DXC that leads to further opportunities for us. And in a way, we have taken at least some of the risk off the table when it comes to what is the transformation journey of their business per se. In fact, we are helping them accelerate that. The second transformation was regional and geographic that I talked about earlier. Both of these are given out or broken out in great detail so if you want, we can definitely send you more information., But that is kind of the reason why we gave out that clarity on the last webcast.

Moderator: Thank you. The next question is from the line of Shyamal Dhruve from Phillip Capital. Please go ahead.

Shyamal Dhruve: Thanks for the opportunity. My question is on the service verticals. So, in the recent time, the growth is largely driven by the ADM segments while we have seen the decline on the IMS front. So, is it a planned strategy of increasing the focus on the higher capability vertical for us, which is ADM? Or whether IMS decline is largely due to the migration to cloud, which we are not compensated through the other deals?

Nitin Rakesh: It is a bit of both. So I think you answered the question yourself. Firstly, a lot of the new investments being made by enterprises are actually happening in what market calls digital, which by definition most of it is application development that is done in an agile or new age manner. So we call it a combination of Dev Ops and NextGen app dev. So if you break out the growth that we have seen, the parts of the growth we have seen are really in application development. On the IMS side, while we have seen some deals and we have also actually found growth, clearly, the headwind in the longer-term IMS business continues to be the deployment of cloud platforms. And that is the reason why while we will lead with service transformation, to bundle that into IMS deals, the real opportunity for growth continues to be in solution-led applications business.

Shyamal Dhruve: My second question is on the mid-term salary hike which you gave in this quarter. So I just wanted to get an idea like whether this trend of mid-term salary hike would continue going ahead as well like in FY2021, 2022 or it is just like this yearly phenomenon due to the supply-side issues?

Nitin Rakesh: Do not think of this as a midterm hike. We talked about the fact that we linked some of the wage actions to Talent Next and the ability of employees to up-skill and certify them because the idea at the moment that they are actually available. They have been re-skilled and are available for deployment in new-age projects. That creates our ability to actually then derive more operating leverage out of the same employee pool. So the idea was not just to give a midterm hike because of attrition issues. The idea was to link it, create some incentive, have a risk-reward aligned in favor of the employee and drive that transformation faster for us. That dynamic will actually only accelerate as we go through, and we are focused on how we can make sure that we, as far as possible, make this a dynamic realtime exercise versus a once in a year exercise.

Shyamal Dhruve: Thanks. All the best for coming quarters.

Moderator: Thank you. The next question is from the line of Hiten Jain from Invesco Asset Management. Please go ahead.

Hiten Jain: Sir, I am trying to understand this lease accounting because if I look at depreciation and amortization, it has gone up sequentially from Rs.20 Crores to Rs.55 Crores. But correspondingly, the rent should have gone down. I am assuming the rent would be captured in G&A, but even G&A sequentially is up. So, where do you capture rent? Do you capture rent in G&A or somewhere else?

V. Suryanarayanan: Rent comes in CoR as well as G&A. Depending upon the employees, the cost gets allocated proportionately between CoR and SG&A.

Hiten Jain: Okay. It is also part of cost of revenues?

Nitin Rakesh: Yes.

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

Nitin Rakesh: Thank you operator. Thank you, everybody, for your interest and your questions. And we continue to look forward to talking to you. And hopefully, we will see you at our Annual Analyst Meeting on August 9, 2019 in Mumbai. I think the invites have gone out, and we make sure that all of you have the details of that further. So, we look forward to seeing you guys there. Thank you so much.

Moderator: Thank you. On behalf of Mphasis Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.