“Tech Mahindra Limited Q2FY19 Earnings Conference Call”

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Moderator: Good day, ladies and gentlemen, and a very warm welcome to the Q2 FY19 Earnings Conference Call of Tech Mahindra 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 call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I am now glad to hand the conference over to Mr. C.P. Gurnani – Managing Director and Chief Executive Officer for Tech Mahindra. Thank you and over to you, sir.

C.P. Gurnani: Thank you. Good evening, good day to all of you. Welcome to Tech Mahindra Q2 earnings call. I am delighted to inform you that your company has reached an important milestone in its journey to become a digital company of the future. Tech Mahindra has been highest ranked non-US company and the highest ranked amongst IT services and consulting companies amidst all our peers; it stood 15th in the overall rankings in the Forbes Global Digital 100 List. It is a proud moment for us to see Tech Mahindra emerge as a digital thought leader taking the world into the connected future and living up to its promise of connected solutions and connected services and I do believe the recognition is also reflected in the company's digital revenue share which you would recall was 28% in Q1, has gone up to 31% in Q2, roughly a growth of 10% QoQ.

Regarding the Q2 revenue, we clocked $1218.2 million and in rupee terms we are up 13.5% YoY and 4.3% QoQ. But clearly in terms of revenue growth, I would consider that performance as tepid and that is this basically because of little volatility in our Healthcare business, nothing seasonal, it is more of projects coming to a close in three or four large hospitals. And then the growth of the commentary you would realize that company had always committed that we will work on our operating margins, the company has committed that we would work on shifting the revenue towards digital and the company has committed on the Communications division growth and the company has committed on overall good performance. If I take away the HCI business, the company has grown well both in Communications sector as well as in the Enterprise sector. In constant currency, Enterprise growth has been 3.5%, Communications business saw a strong growth; 5% QoQ in constant currency, and frankly I am so happy because it is almost a good growth after a span of 15-quarters.

The other thing is that it is a record for us is that we signed $550 million worth of deals this quarter, which is a record for us. This makes me feel very happy.

Last but not the least, operating margins we are all on a weighing scale and this is clearly an increase of 240 basis points and even if I take out a few fluctuations which are the currency and the visa cost, I think the company's operations have done very-very well.

In general, your company continues to have new customers, your company continues to invest in technology, your company continues to invest in some of the big bets like 5G, Blockchain and Cyber Security. We continue to invest in innovation, we continue to invest in platforms, I think exciting times await us. I would let Manoj Bhat who is our CFO and L. Ravi who is our Chief Operating Officer to share a little more details with you but I can only say is that yes, we could have done better but overall it has been a great quarter. Thank you. Manoj, do you want to take over?

Manoj Bhat: Yes, thank you, C.P. So, I think C.P. has articulated the broad brush of the quarter. Going a bit into detail, if I look at constant currency revenue growth, it was about 0.4% and within this clearly there was a negative in excess of 40 million coming from our Healthcare business and without that I think we grew about 4.2% in CC terms. I think in terms of the margin, it improved about 240 basis points. Just a quick high-level breakup: Absence of visa cost which was about 60bps and currency impact was about 80 bps, about 140 bps was operational efficiencies at business mix and then we had wage hikes for a portion of our workforce, negative of about 40 bps. So, I think that is a journey from 16.4 to 18.8.

I think the other thing during the quarter was that other income was about $25 million compared to $16 million in Q1, almost all of it was because of the translation gain because the rupee has moved quite a lot during the quarter. From profit after tax it was about $149.4 million vs $131 million and in INR terms it was Rs.1064 crores.

Coming to cash flow metrics, CFO or cash flow from operations was about 141 million which is 94% of PAT and compared to last quarter that is 109, so there has been a substantial increase in CFO. Free cash flow was also up to 120 million which is about 80% of PAT versus about 81 million in Q1. Overall, cash and cash equivalents were down on account of dividend pay out of about 220-odd million, I think that has come down a bit. Hedge book was about 1.6 billion versus 1.45 billion in Q1. So, it has gone up and that is in line with our policy.

I think overall if I step back it has been a satisfactory quarter on the margin front, I think a lot of our metrics around deal wins, around digital growth are quite robust and we look forward to continuing this journey.

With this, I will throw the floor open for questions and move forward with the call. Thank you.

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

Sandeep Agarwal: I have two questions: C.P., one what is the change in environment you are seeing versus what you have seen earlier – are we consistently seeing upbeat in the mood from the client perspective, are they open to giving more deals and the size of deals are increasing and if yes, where we are seeing big positive surprises coming in? Secondly, can we confidently say that we are past the telecom pain which we have witnessed over last so many quarters? And then a follow up for Manoj, can we take this quarter's margin as a base margin now ex of wage hike going forward because I think we lost lot of margin last several quarters and last four, five quarters we have started regaining our margin, so still do you see ex of currency there is some more positive surprises coming or you think that you will pause here and try to grow more fast?

C.P. Gurnani: So, let us address the two questions on environment and the telecom spend. I think on the environment, it continues to be a mixed bag, US economy you all know that the positive velocity, China or Japan or Europe, there are changes happening in their economic structure, Middle East continues to have pleasant side as well as few difficulties. So, overall I would say economic climate since our business is 48% US and 52% rest of the world, I would say that to us there is a greater sovereigns and flexibility to compensate for some of the swings.

Right now, yes, there is a demand for the digital, yes, some of our tool sets, so I will give you example, in my BPS business we have added about 5,000 employees, BPS business is because your customer experience management is taking a higher priority despite of much higher level of automation, much higher level of productivity but just that customer intimacy is becoming so much more important. So, that is one part that I would like to say. Telecoms in general know that they need to equip themselves to become better players in the market. The fact is that the growth is coming in data communications and to be able to leverage the growth in data communications the CAPEX spending has increased. #2 is some of the systems of the past need to be modernized. So, the basic philosophy that we followed across our customer base which is run the operations better, change or grow the business together, I think it worked out well, there is no new wave that has come in, we are all working towards the new wave which is the 5G but at this stage, I think it is more of operational efficiency improvement of our customer and being able to work better and being able to sign large deals. Manish, if you are on the call, do you want to add anything on the telecom side?

Manish Vyas: No-no, C.P., I think you have articulated it quite well, I think it is indeed like you said telecom industry is continuing to go through the process of transforming itself and there are multiple players out there. We have always maintained that we have put the strategy together to keep a multi-dimensional, very diversified portfolio that helps the service providers to improve their operations, be ready for the future and then eventually take advantage of the opportunities that come forward. So, all the action that we have including some of the deal wins are all very-very aligned to the strategic bets that we have taken. So, we will see how it goes from here on.

Manoj Bhat: On the margin, I think your question is 18.8 new base line and do we see margins improve from here ex of currency. So, to me clearly I think this is a journey and we have talked about this in the past and we had set certain goals for six quarters till March 2019 and we are progressing very well on the journey, I think margins will go up albeit, the pace of margin improvement has been quite fast but we will see gradual margin improvements is what I would build in as a base case from here over the next two quarters. I do not think we have commented going into FY20 and beyond. But at least in the next two quarters, our goal would be to do gradual margin improvement from here.

Moderator: Thank you. We will take the next question from the line of Viju George from JP Morgan. Please go ahead.

Viju George: I had a question on HCI. It is pretty sharp drop out there. I am just curious as to what kind of a business it can be if revenues drop more than 50% in a quarter’s time? Secondly, therefore do you see new wins out there which can also bring about a kind of wish up back revival?

Manoj Bhat: Viju, this is Manoj. I think it is a good question and let me explain the business a bit and what was playing out and this is not something new we had pointed this out that there is implementation revenue in there which could potentially drop off and we have said that in Q4 as well as Q1. Even very aware of the cycle of implementation and then new orders coming in and new implementations in this business. So, if I look at the entire provider space that what HCI does, they do implementation, training and go-live support right. And the moment it goes live, I think the revenue drops off very-very sharply. From that perspective, there was a big wave where I think there were six or seven hospitals and providers who were going through this phase and HCI was in a position where it was won all of those deals and that is where the ramp-ups were very-very steep over the last four quarters. It so happened and coincidentally all the implementations ended probably in a span of one or two months at the end of Q1 and going into Q2. Of course the new order book is building up and this is going to be a little bit of year-on-year picture of HCI. I think on year-on-year basis the business will show growth. I think their target would be to go in excess of 10% and that is something which I think they feel pretty confident in terms of the management team. So, that is the way to look at it. A little bit of this business is going to be like this. To your second question, "Is it more in the nature of staffing?" I think ultimately if I look at the model of resourcing, there is always going to be a core group of employees who offer the services within HCI but obviously with the steep increases and decreases we do also depend on a lot of temporary employees because that is the nature of the business. To that extent, yes, there is going to be external thing up and down but if I look at the core group of people who offer these services, who think through these programs and to offer this kind of support, I think that continues to remain as HCI is the core offering. I do not know whether I answered the question.

Viju George: Sure. But Manoj, just taking this forward, the revenues are more than halved, so while you did point out that you would see some impact in this quarter, I reckon that the actual decline must have been sharper than what you expected or estimated. That said do you think that there is a potential for this business to get back to the revenue base that it saw and what is it take to get there and how you are tracking against that?

Manoj Bhat: So, the nature of this business is it is very difficult to predict because also towards the end of the cycle it is a bit need based, so, it is very difficult to estimate what the exact drop can be. So, to that extent, maybe your impression might be right that it maybe a few million dollars more than what we thought but the broader point is I think more orders will come in and I think we will see revenue growth coming back going forward. All we can do is this is the business, if it moves up sharply, we will come back and tell you that this is another implementation cycle starting and the other strategy we are using is winning synergy deals which then kind of balance out the revenue streams on QoQ basis so that the perspective in terms of how to model it QoQ I think it becomes a little bit easier, that is the effort we are doing to balance this kind of implementation cycle curves out.

Viju George: Obviously, this has been a very strong driver of the growth in Enterprise side of the piece over the last four, five quarters. Looking forward, if we take this out, given that it is inherently unpredictable, so while the worst maybe over, you do not know what nature of the upside will be, do you think the rest of the portfolio can grow sufficiently stronger than in the past to get the same kind of growth going forward on Enterprise side?

Manoj Bhat: Viju, I think the way this is phased out, right, it is across two years. So, even if I do ex this growth, right, whether last year or going into this year projections, I think the impact is not so severe, #1, right. #2, I think from a perspective of overall Enterprise, I would like Manoj to add to that question, because it is a question of broader Enterprise and Manoj, maybe you can talk us through how do you see broader Enterprise growth?

Manoj Chugh: Thank you very much, Manoj. So, Viju, in terms of the overall Enterprise business, despite the challenge that we have had this quarter on account of the HCI business, still if you look in constant currency terms, the overall Enterprise business has grown by 9.2% and we have been maintaining that our business will grow 8-10%, so clearly we are on track in terms of whatever we have been articulating. Again, I think our diversified portfolio plays to that advantage and you would see that if I keep the HCI business aside, in constant currency terms, even this quarter the Enterprise business has grown by 3.5%. Clearly, some verticals will do better than others in each quarter and we have been saying this and we have been maintained this that it is not that you are going to see every vertical grow substantially every quarter, there will be some verticals which will do better than others. So, for example in this quarter, the Retail vertical has done well for us. So, I think we will continue to see consistent constant growth in the Enterprise business, it may come in from different verticals at different points in time and clearly, the number speak louder than words. So, we continue to maintain our stance around the overall broad-based growth 8% to 10% in terms of constant currency across our portfolio.

Moderator: Thank you. The next question is from the line of Divya Nagarajan from UBS. Please go ahead.

Divya Nagarajan: Just following up on the Enterprise statistics question, what do you see as the overall growth for Healthcare given that the HCI acquisition is currently looking at some amount of replenishment there, so for the next couple of quarters what are we looking at in terms of growth? Secondly, I am sorry if I missed earlier, you seem to have had very strong contracts in this quarter. So, did it run through the mix across Telecom and Enterprise segments in terms of the contracts?

Manoj Chugh: Divya, I think maybe Healthcare perspective is better appreciated on a full year basis right, so I believe there will be quarter-on- quarter growth right, going into next quarters, but overall I think if I look at, whether it is HCI or our other Healthcare business, so I would say, our target would be like double-digit growth and that is what we are going to try and achieve. Moving on to your other question, out of the 550 million of deal wins, roughly 300 million is Communications and 250 million is Enterprise. If I look at the deal win composition, if I look at the Enterprise side, the whole customer experience management, the whole integration of some of our platforms to deliver solutions in the customer experience area, that has been a big component of deal wins. There have been many interesting wins on some of the transformation programs and infrastructure and so on and so forth. On the Communications side I think clearly first of all, it is geographically dispersed, and I think it is pretty much all the way from ANZ to US, so it is across multiple areas. So, to me the way I look it is these are typically four to five year kind of deals and some of them might be shorter cycles where there is just a transformation, but that is the way I would credit. Does that answer your question, Divya?

Divya Nagarajan: Sure. Just a follow-up, on HCI, there is a slowdown or lack of interpretation pick up, how long do you expect this to last and when will we see replenishment of those contracts? The last follow-up is on margins. We have kind of reached around the target margins that you are talking about for the year. How should we think about where margins are likely to head from here on, what is the target now?

Manoj Bhat: On HCI, I do not have a number for you in terms of what could be the growth and so on and so forth, my sense is it will gradually build up going into Q3 and Q4. I think today I have no full visibility to full replenishment, but partial replenishment will happen as the deal wins translate into revenue. So, that is on the HCI question. On the margin question, clearly, our internal targets were always higher, and we were goaled to a higher number. What has happened is of course that there are two things playing out right, so as the digital revenue acceleration is happening and as we substitute somewhere low yield revenues with the higher yield revenue streams, I think there is an inherent margin lever which is coming and then of course there is automation, AI, and all the other initiatives which we spoke about. I do not think I have a new target or new aspiration which we have disclosed, but as I said there will be gradual margin improvement over the next two quarters is what we believe.

Moderator: The next question is from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Sir, my first question is on the revenue growth, if I look at last quarter obviously we had a seasonal impact and this quarter again we had HCI impact which was probably higher than what was initially anticipated. But if I look at as a portfolio, the growth in the first half would be significantly lower than what some of the peers have reported. So, A), how do you look at this whole portfolio going forward improving in the second half or even from a longer-term perspective, by when you think that we should be getting our growth rate move closer to the industry?

Manoj Bhat: Pankaj, that is a good question that if I look at it from a headline number, right, but as we mentioned that overall and some of this is CC terms into 10% was our goal in Enterprise, I think we will hit that. On the Coms side, clearly after Q1 we were talking about growth over three quarters which is also happening, and the deal wins are reflecting the core health of the business. So, I do take your point on the first half, obviously, there is no piece of the business we can exclude in terms of the portfolio, but what we were trying to do is kind of point out that various pieces of the business are moving differently and that is the reality of the business. So, to me I think over the next two quarters, we do see growth coming in the overall business and that is something which historically also the second half for us has been usually better than the first half and I think that trend will continue, and as we look forward I think there are opportunities which will be there both on the Communications side and the Enterprise side and as and when the quarters go we will talk more about it. So, that is a quick view on how we are thinking about growth and there is no denying, your point is valid that net-net if I take the top line I think whether it is currency, whether it is some seasonality, growth has been lower than where it was may be some time back.

Pankaj Kapoor: In terms of the deal wins, of course, this was probably one of the best quarters you have had. Can you give a sense like whether this was all net new or was there any renewals also in this?

Manoj Bhat: So, if I include renewals, the number is bigger. So, what we do is if there is a renewal with an increased volume, we only report the net increase as the deal win.

Pankaj Kapoor: So, I can take this as probably net new excluding any renewal? Okay. Manoj, lastly on the margins, is there a kind of a level which you have in mind where beyond which you would like to invest the incremental efficiency gain or even the currency gain back into the business to probably target a higher growth rate, I mean, if I go back into the history we had been may be three, four or five years back in the range of around 20%, 21%, so is that the kind of level one should be looking at and beyond which you would like to probably invest the efficiency and the currency gain back on to the business to strive for a higher growth at a top line, do you have some of those targets in mind, if you could share that?

Manoj Bhat: Pankaj, so a couple of points I would like make, right: So, first is it is not that we are not investing. So, we have had a quarter excluding HCI of 4.3% in constant currency growth which is obviously at the top end of growth for I think whichever is large, you take right. So, clearly a lot of the business, things are working, so I do not want you to take away that we are not investing and hence the results are not coming, because there is a lot of investment going on, whether it is the tech bets, whether it is in terms of re-skilling, whether it is in terms of partnerships, so that is something which I think we are adding front-end sales people, we are looking to add specific capabilities onsite. All of that is happening within the numbers. In terms of the margin, at what point will we say that this is something which is an optimum margin, I do not think we have any such definition in mind today. So, I think we are going to work towards both revenue growth and margin improvement to the extent possible. But at this point, I do not think we feel that we are constrained by margin improvement, and that is not a reason for the perceived lack of headline growth, because if I dive deeper into the number there is growth coming in most of the pockets of the business.

Pankaj Kapoor: And if I can just ask one last question on the DSOs which have been going up every quarter. So, what is our thought process on that, which obviously is impacting our impacting our cash conversion as well? Thank you.

Manoj Bhat: First of all, it is not impacting our cash conversion. Obviously, we can do better. But if I look at the metrics, they are in and about where they were. Secondly, I think the DSO this time, I think about two-odd days have been added just because of the currency movement because we convert all the AR into rupees at the quarter end rate and the revenues are generally converted at the quarter average rate. So, there is a difference of about 2% odd, which makes a difference of about 2 - 2.5 days roughly. So, part of that is there. But your point is taken, I think this is an area where we are stepping up our efforts and hopefully we should see reductions going into Q3 and Q4.

Moderator: Thank you. Our next question is from the line of Jiten Doshi from Enam Asset Management. Please go ahead.

Jiten Doshi: Congratulations, CP, on a good set of numbers and the entire team. But my observation is, every time we have these negative surprises, it’s there only from these acquisitions. I think last time also our margins were in excess of 20% and then suddenly I think we need to get into the right acquisitions. As shareholders we are feeling somehow that this strategy is not working optimally. That is my first point. And second is, somehow or the other our margins are getting diluted due to acquisitions. So, unless it is extremely strategic, and if it is strategic it should be margin enhancing. What is your view on this really?

Manoj Bhat: So, I think fair point. So, if we look at one our initiatives was that if we look at our entire set of portfolio companies, we identified it as an opportunity where we significantly need to improve our performance. And if I look at four quarters I think there have been significant improvements. But I would still say there is a huge opportunity there in terms of improving margins. So, our margins are continuously improving over every quarter. Our synergy revenues are starting to kick in in some or the later acquisitions. And we are far better aligned on operations. So, I think all of those are happening. I think to your broader question, currently most of these acquisitions are clearly more on-site centric. So, as a rule they are probably lower margin. And also, a lot of the synergy revenue which already exists, for example, let me give you the example of SOFGEN. While SOFGEN acts as a front-end entity, but I think the synergy revenues are delivered from the offshore entity. So, clearly, the margins and the revenues will flow through into the offshore entity. So, the numbers reported, per say, might not be a true reflection of the success or failure. On the broad acquisition philosophy, you know we made a change in that in term of how we think of these acquisitions. And I have started pursuing acquisitions which will potentially be margin accretive. And the second thing we did is, obviously, go in for small acquisitions. So, some of those changes we have already made. So, I think I personally view it as an opportunity set again for the next four quarters to work on this and improve it. And your points on that they are dragging margins is still true. So, I think we will have to work with them and work with the management teams there to improve margins and improve revenue growth.

Jiten Doshi: So, this question is for CP. CP, I think in last 18 months there is a particular momentum in the company and there is a ray of hope and optimism, and we have seen very good things happening in your company. Now, in the midst of this momentum we should not take large acquisitions which again drag us down. I have no doubt in my mind that this company can deliver a 20% EBIT margin, if you do not do it over the next 18 months I would be very-very surprised. Because I think that most of the top-notch companies are delivering that and I do not consider you as any company less than the top-notch companies. So, I think our focus should be on bringing back a 20% EBIT margin in the business. And our focus should be on keeping this momentum alive. I can see that there is clear direction, momentum, and everybody is quite upbeat. In the midst of that if we do a large acquisition which will be dilutive to our margins, earnings or which will not be integrating quickly, I think we will hamper this whole process and once again we will go back to 2016, 2017, where the whole company really suffered. So, this is my observation and I would request that you please consider this.

Manoj Bhat: Jiten, I think CP's line has got dropped, I will convey it to him.

Jiten Doshi: Yes, but I think this is for all you, please. Because there is a good momentum, there is a good traction, everything is upbeat. I think now if you go and do another billion dollar acquisition and drag the whole thing down, I think it will put the whole firm down again. There is no doubt in my mind, would you rule out a 20% EBIT margin probably as a company coming back to that level?

Manoj Bhat: Jiten, I do not think we give guidance. So, there is nothing we are ruling out right now. So, as I answered Pankaj also in the question before, there is a set of initiatives that we are going to let it run. And of course, the pace of results from those initiatives is obviously far more accelerated than we thought. But as I said, we are not stopping because of that, we are continuing on this journey. And I do not think we have a number in mind saying we will stop here or we will stop there. So, that is might short answer. I know you are looking for a more specific number.

Jiten Doshi: No, I have only one suggestion to your entire company, that please consolidat what you have taken on hand, please take the margin to 18%, 20% EBIT margin which is higher in terms of EBITDA, please stabilize whatever you have on hand, come back to where you were. When I am talking about 20% EBIT, you have done it in the past. So, I am saying, come back to where you are. And once you come back then take a relook at all of that. So, you cannot ride so many horses because last time that the company went absolutely off-track was during the time when they made these big acquisitions, which did not work well for the company. We do not want to go back in that stage for sure. Everything is upbeat, there is a momentum and we need to be cautious. And I think there are a lot of tail winds we are enjoying, why don't you ride all of them. And don't think of any acquisitions at this moment till you stabilize the base, that is all my observation and suggestion to you.

Manoj Bhat: Yes, sir, taken on board.

Moderator: Thank you. Our next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: I just wanted to dig a bit deeper into the communications vertical which performed quite well this quarter. Can you help us break this into impact which came from the deal wins which you have done in last couple of quarters, and the structural change which is happening in this sector? And if it is the later than basically what has changed in communications compared to the last couple of years, which are the areas where you guys are winning more, is it more in the distance space or is it more a rebound which is happening in the larger client base of yours?

Manoj Bhat: I will request Manish, if you can cover your perspective on that question.

Manish Vyas: So, Mukul, thank you so much. The good news is that almost all the wins that we have had, the larger ones as well as the small and medium ones that we have closed, all of them have a very large element of digital and transformation to that. The one that we have done in Asia is putting a new digital platform for both customer management as well as the downstream business management systems. And the underlying driver for putting that whole transformation program together is to get this service provider ready for helping them play into a more digital services going forward, which will start in their world with, once they get ready for 4.5G and 5G and beyond. So, in many ways it is not a network deal, that particular one, it is a digital transformation deal, but it has got 5G written all over it.

The another deal that we have done is a very operations transformation deal. But a big shift that has happened is it is not a lift and shift type of a deal, it is a deal that is built on lot of autonomics, lot of digital platforms that we have put together to help predict the customer engagement, customer responses with service assurance, the new service delivery. And that is also in the enterprise space of a service provider so that they can be ready to start demanding more business from their enterprise customers as they deploy new network and new assets together. So, in many ways these deals that we have done, that also figure prominently in our pipeline as we speak, is all in the transformation in the digital and in the new telco of the future, network of the future type models. And when I say all, I mean, some of these transformation deals that we are currently fighting are in that category. I wouldn't attribute these deal wins to any one particular factor, whether it is a structural change or anything else, I think it is a journey that we are on which is powered by a strong need for the service providers to continue to reinvent themselves. And for us to continue to deliver on the investments that we have continued to make. In an earlier question Manoj was saying, which is absolutely correct, we have continue to invest, we have not taken our eyes off the ball from the future as we have continued to correct our current operating metrics, which also applies to the telecom business as well. So, I hope I could answer your question, Mukul.

Mukul Garg: So, Manish, do you think that you guys are more prepared now versus earlier to offer these services to your telco clients going forward as well, or do you think it is still a bit dynamic scenario where things will things will keep on moving up and down as far as spending is concerned? We clearly understand that pure 5G spending has still not started, but the whole shift spend towards digital is that pick sustainable over next maybe year or so.

Manish Vyas: Please don't get me wrong when I say this, Mukul, I do not believe and I have always maintained that we have always been better positioned in the industry to take advantage of the opportunities as they come, because we have been consistently staying invested and focused on our strategy, our portfolio, and the market. We definitely did go wrong in our execution in one or two of the acquisitions and couple of initiatives, but even those have allowed us to play very prominently now in the areas where the focus and the growth will be. So, I think we remain focused and I believe that your company continues to remain very well positioned to take advantage of the holistic opportunity that will come up as things evolve in the telecom and the media space.

Mukul Garg: My second question was for Manoj, if we look at the other enterprise business, excluding the HCI, there are a few verticals which have been relatively weaker over last couple of quarters. And that trend has been quite stark compared to what the rest of the industry is talking about, especially if I look at the BFSI space, after many quarters of good growth when the whole industry was delivering weak performance, last four quarters have been quite weak for you, whereas the commentary from others have been improving. So, can you help us understand how we should look at these areas like manufacturing and BFSI going forward?

Manoj Chugh: So, first of all on manufacturing, as I said, we have shown good growth over the last many quarters, I am sure you will agree with me. This quarter is benign on a quarter-on-quarter basis but if you look at the numbers on a year-on-year basis our business has drawn 11%. So, I think that is decent performance. Coming to financial services, you have rightly said that in the past when everyone was challenged our business did grow well. So, in fact, last year you would perhaps remember that our BFSI business grew by 18%. So, clearly, to some extent there is a base effect. My belief is that our pipeline on BFSI is strong and you should see growth coming in from this sector going forward in the future. So, I would say, what you have seen in the last couple of quarters is more a result of a much higher base as compared to what we have traditionally had. And our pipelines are building up well, so hopefully we should see the results.

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

Sumeet Jain: Firstly, wanted to just understand on the telecom vertical side, I remember Manoj, you gave a guidance of probably low single-digit what you can achieve for the full year, given we had a significant decline on the first quarter. So, are we still looking at that kind of a growth for the full year, given the kind of deal wins you already have? And also that implies a close to 5% to 6% CQGR ask for the remaining two quarters.

Manoj Bhat: So, every quarter we have cross currency impact, so I have to keep reworking the numbers. But suffice it to say that I think there is momentum in the business and I think what we said is that every quarter we will grow. Now, CQGR 4%, 5%, 3% is a different matter, you know historically second half is stronger for us in the coms vertical specifically. So, I think that is where we stand today. And I think the momentum is there, the deal wins are there. And you heard Manish, and Manish if you want to add anything to the commentary there?

Manish Vyas: Not anything on the numbers, Manoj, you have answered it. All I would just say and reiterate that we continue to remain very busy with the kind of opportunities that we have closed. There are similar patterns. And the good news is, at this point, I think Manoj had alluded to this earlier I believe, that the growth is pretty comprehensive in terms of even a regional mix. So, we are seeing pretty good traction across almost all the markets that we are operating in. And we continue to remain hopeful that we will maintain. Of course, that is subject to several other variables, some of them are not in our control. But we continue to strive hard for what we said that we want to continue to do.

Sumeet Jain: And secondly, I can see your SG&A expense levels were a bit elevated this quarter, so from the forecasting standpoint how should one look at it going forward?

Manoj Bhat: I think from an SG&A perspective you should expect it to moderate back over a period of time. So, there were certain expenses which we made which are in the nature of an investment over a shorter period of time. So, as those kind of go through the system and as we get revenue in return, some of those will moderate back to the older levels I would say.

Sumeet Jain: And lastly on the tax rate, again, it was a bit high, so any guidance for the full year?

Manoj Bhat: So, I think our guidance remains about 24%, 25%. This time I think there was kind of a one-time tax of about 4 million. So, if I remove that I think we will be in that range and that is the range we are consistently going to be in on an average.

Moderator: Thank you. Our next question is from the line of Parag Gupta from Morgan Stanley. Please go ahead.

Parag Gupta: I had two questions, both on the communications vertical. So, the first question is, you had some really good momentum and deal wins in the telecom vertical in the second quarter. Could you give us some sense on the visibility or the pipeline and how that is building up? So, can we see the same momentum continue going forward as well? And the second question is, we have heard some of the larger peers talking about getting interested in the telecom vertical, especially given their eyes on 5G as it starts rolling out globally. So, the question is, are you seeing any increase in competitive intensity or do you think it is more or less similar to what it used to be in the past? Thank you.

Manish Vyas: So, Parag, I think the deal momentum is good. It is very consistent not only with the deals that we have announced, we have similar deals in the funnel right now. I just cannot predict when do we close those. But they are also very consistent with our credentials and our portfolio and the kind of business that we have been saying that we are investing in across the run, change and group portfolio, and across the bets that we have taken between network, software, managed services and customer experience transformation. So, all of that remains, we know where we are playing. More importantly, I am sure you like when I say this that we have also decided many areas that we will not play any more in so that we have a more predictable and a better chance of succeeding going forward from an execution standpoint. So, that was the first part of your question. What was your second one?

Parag Gupta: Are you seeing any increase in competitive intensity in the telecom vertical?

Manish Vyas: Well, I think I wouldn't say it is more or less, it is always high. There are more people who are always excited about anything that is high on the hype cycle. But there is a greater degree of maturity in the industry right now in terms of knowing the people who have deep and deep routed expertise. And also the ability to transform versus people who are building the capabilities up-fresh. One thing that we have always said, we have consistently maintained that in each of these areas in telecom, particularly in the network business, the entry barriers are very-very high, because the skill levels that are needed are pretty complicated and very diverse. So, I wouldn't say that we are overtly worried, but the fact is that the kind of business we are building in telecom we do not really have one dimensional competition, it is always very different type of people that we compete with. In some cases, we do not even compete with the other peer group that you all compare us with, we compete with a very different type of company. So, it is always exciting, it is always challenging, and these are the people who keep us honest to our capabilities and commitments. I wouldn't say it is anything different than it was in the past.

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

Sandeep Shah: Just a question, again, follow-up on the telecom side. Manish, just wanted to understand that suddenly there is a big momentum which is building up in terms of deal pipeline and you eluded that it is coming across various markets and it is not skewed to few accounts. So, what has led to this, is it also a factor of vendor consolidation which is helping you? Because we get to hear that the balance sheets of major telcos are actually under stress. So, what has led to this kind of decision making which is getting accelerated for the large deal awards as a whole? And when you say that they are getting ready for 4.5G to 5G, is it fair to say that now the timing of the 5G related demand is more visible for you to target? Or still you believe that we do not have a color on the same?

Manish Vyas: So, Sandeep, first question, the deals are both of consolidating and transforming the existing spend on the OPEX side, the deals are never, let me not say never but are seldom created for consolidating vendors. The deal wins that we have had, one of the largest we have had last quarter is built around transforming the existing operations by leveraging digital and automation. In the process we have ended up consolidating a whole host of vendors, mini vendors, and some of them are large companies, some of them are small companies. So, that is always part of the feature. So, it, in many ways, is not a new dollar, it is the same dollar but that is getting repurposed for helping the service provider become better at what they do. And then the other kind of deals that we have one, including the one I was alluding to earlier in Asia, which is a new CAPEX dollar that we are enjoying being part of, which is helping them put a completely new digital platform together so that they can do their transactions and their customer integrations on a new platform, which will enable them to provide products and services in a very digital, web-scale type fashion. Now, that is a new spend, that is a new budget that they have allocated in this space. So, we are seeing a pattern of both, you are absolutely right that the rate at which the data is growing in the industry which is very high, is not commensurate with the rate of revenue growth at this point in time. So, the service providers are continuously exploring possibilities and opportunities to remodel their business plans, which hopefully will happen with 5G and beyond. But at this point in time we are there because our relationship with the accounts continue to remain very-very deep.

On your second question, look, I still think two quarters ago if you recall CP had said that 5G is not going to be like 4G or 3G, it is going to be very non-uniform. We continue to see that pattern, and within markets different operators will take different approaches. And that story has still not been completed, it is still getting evolved. So, I do not believe that we really know all the answers to how the revenues will shape up in that business, we will still need a couple of quarters to get a better definitive idea on that.

Sandeep Shah: Just follow-up, Manish, as you said that the funnel is also similar to what you have seen in the order book, is it fair to say that the YoY growth in the order book in telecom is actually likely to improve and continue to inch up going forward? And for you to have a growth momentum continue may not be just in the near-term but may also over a medium to longer-term, because these are transformational changes which are coming in. Is it a fair way of looking at it in terms of communication, growth visibility for Tech Mahindra?

Manish Vyas: All I can say, Sandeep, it is a fair way to set that expectation off us. And I can assure you that we are going to strive for that.

Sandeep Shah: Just last thing, Manoj, last time we said that we will achieve flat to low single-digit kind of a growth in the telecom as a whole. So, even at a current run rate that may require close to a 4% compounded QonQ growth rate. So, we are still at the lower end flat growth kind of an estimate is still visible for you?

Manoj Bhat: No, I just answered that question, so we are seeing growth, now whether it is 3%, 4%, 5% is a different matter. And I think the range of possibilities includes flat to low single-digit growth even now. So, I think we will have to see. As Manish also mentioned in his answer, there are some external factors in terms of how these deals convert into revenue and how does the funnel convert in revenue or deals. We will have to see how it goes, because I think if I look at the funnel, if I look at everything else that is going very well today.

Sandeep Shah: And just last, Manoj, on the margins on the gross level, at 34% gross margin it is at a multi-quarter high. So, do you believe that these kind of gross margins are sustainable ex of currency going forward looking at some of the supply side issues which are coming? And we also have a bit of a client concentration where a bit of a deal renewal leads to a dampener in terms of a gross margin. So, how well prepared we are in terms of maintaining or defending such kind of gross margin level? Because that will help you in terms of margin consistency going forward.

Manoj Bhat: So, I would like to restrict my answer to EBITDA. And as I mentioned before, we do see gradual increase in EBITDA. Obviously, there are risk to this as with everything else, and we will monitor the situation. But if I look at the combination of our investment and return on investments as well as our overall efficiency in terms of SG&A as well as the gross margins, and as our digital business is increasing I think there are pulls and pressures. But I think our broader view is that EBITDA margins will gradually improve at least over the next two quarters and then we will see as time goes along.

Moderator: Thank you. We will take the last question from the line of Rishi Jhunjhunwala from IIFL. Please go ahead.

Rishi Jhunjhunwala: Just a quick question, again, on HFCI. So, basically, what was the impact on the margins from this $40 million revenue decline that we saw? And also, is it the bottom in terms of the revenue level that we could possibly see on an annualized basis? And would there be a sequential pickup as a result?

Manoj Bhat: I think this is the bottom, is what we believe. Second, in terms of margin impact, see most of these were flexi staffing or flexi employees. And obviously the system there works that it is proactively managing those. So, the margin impact has not been very severe. And also, it has been cushioned by the replacement of that revenue with higher margin revenue, which is also including offshore revenue. So, that is the way to look at margins without going into the specifics of HCI quarter-on-quarter margin movement.

Rishi Jhunjhunwala: The reason I ask that is because if we really look at your difference between consol and standalone in terms of margins, EBITDA margins have been going down for the past two quarters whereas on consol level it has been expanding. So, just wondering if profitability of your subsidiaries is worsening in the past two quarters?

Manoj Bhat: This quarter if you look at subsidiary versus consol difference, I think that is because of certain dividends paid out during the quarter, I thought, because there is a large number in the subsidiary column.

Rishi Jhunjhunwala: That comes under EBITDA?

Manoj Bhat: Yes. Where you referring this from, sorry, maybe I am looking at the wrong number?

Rishi Jhunjhunwala: It is just the difference between your consol and standalone numbers, so subsidiary financials give EBITDA margin decline.

Manoj Bhat: Standalone and the impact of dividend income.

Rishi Jhunjhunwala: On EBITDA margin side?

Manoj Bhat: How are you calculating that? Actually, why don't we connect offline, because I think let's talk through it. See, broadly, the way I look at it is that I think if I take a longer term picture I think both margins have improved both standalone as well as subsidiary margins. I think quarter-on-quarter there might be fluctuations here or there.

Rishi Jhunjhunwala: So, let me just rephrase, do you have headroom on improving your subsidiaries profitability as well in a meaningful way? Because it has been quite weaker in the past two years.

Manoj Bhat: That is what I was answering in response to a previous question, that I do believe there is still an opportunity which will play out in terms of overall subsidiary margins going up.

Moderator: Thank you. That was the last question. I now hand the conference over to Mr. Manoj Bhat for closing comments.

Manoj Bhat: Thank you, everyone, for joining our call. I know that there are some people in the queue who could not ask questions. So, if you could email it across to us, we will try and get them answered. Thank you so much for joining.

Moderator: Thank you. Ladies & gentlemen, on behalf of Tech Mahindra Limited, that concludes the conference call for today. Thank you for joining us. And you may now disconnect your lines.

Note: The above transcript has been edited for better readability

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