"Tech Mahindra Limited Q4FY19 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Tech Mahindra Q4 FY19 Earnings Conference Call. As a reminder, all participant lines will be in 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 phone. Please note that this conference is being recorded. I now hand the conference over to Mr. C.P. Gurnani – M.D. and CEO of Tech Mahindra. Thank you and over to you, sir.

C.P. Gurnani: Good evening, good morning and welcome to FY'19 and Q4'19 Results. FY'19 was clearly a continuation of improvement in EBITDA margins, very happy with the increase in the TCV of the deal wins and more importantly, our increased footprint with the higher digital revenue. We see this stability to continue to aid the company in the journey towards USD 5 billion and beyond!

In FY'19 revenue, we had a growth of 12.9% YoY in rupee terms and we also saw EBITDA increase YoY in rupee terms approximately 35%. In dollar terms, we clocked 4970 million and we had a 5.8% YoY growth on constant currency business. Enterprise business was almost 10% YoY while the Communications business was 0.8% YoY in constant currency terms.

I am also very happy to report to you all that manufacturing as a vertical crossed a billion dollars in annual revenues and it has also shown a steady about 10% growth annually.

So, finally Communications has always been the billionaire but now we have Manufacturing also as the next billionaire. Growth in Digital revenue was very-very significant and now 31% of FY'19 revenue is Digital, with a growth of almost delta 41%. Your company is very-very proud that we were ranked 15th on the Forbes Digital 100 List and was the highest ranked non-US company in the list of FY'19.

Our EBITDA for the year was at 906 million, profit after tax for the year was at 615 million, cash and cash equivalent was at almost 1.4 billion.

Overall, the board was very-very pleased and we did discuss our capital allocation policy with you last quarter when we came and met you. We talked about that your capital allocation policy is #1 keeps sufficient cash but do not keep excess cash on your balance sheet. We have also discussed with you on capital allocation that we will earmark sufficient reserves for M&A and we did a buyback and the board has also been happy to maintain the dividend level at Rs.14 a share. So, overall, despite of a buyback of 280 million and a dividend of Rs.14 a share, we will have a healthy cash balance through the year.

Again, FY'19 happy with the Digital revenue, happy with the focus on select verticals, happy with the margin enhancement program, happy with the overall performance, particularly excited that the Manufacturing vertical has shown a steady recovery and now you will see that in this quarter they have grown 4.5%. The TCV has almost grown 33% over the previous year. TCV in Q4 was 408 million, active customers that we all have a chance to serve has grown by 25 and currently, our active customers are at 938, four $50 million plus customers added in FY'19 over FY'18 and two of them have come in Q4. So, I can only say is that your company is showing stability and a continuous improvement. You may be a bit disappointed with the Enterprise degrowth because we had a degrowth of 2.2% but in general Q4 also proved a point that Digital revenue is growing. My Digital revenue for this quarter was at 34.1%, up 4% QoQ. Also, when I analyze the revenue mix, we are getting a good mix on Cyber Security, Engineering Services and Device Ecosystem in IoT and Blockchain and we are getting little more traction in 5G also.

So, overall it's a vindication of TechM NxT as a strategy, which Jagdish Mitra had explained to all of us in the past. The recent order that Sujit Baksi signed up in Indian Navy, the order was really a proof of TechM NxT. We are now giving a whole new SI solution on RFID to the Indian Navy. With Telangana government, we are doing a new Blockchain operating system. We are doing an incubation center in Telangana. So, overall as we look forward, I think our growth outlook remains unchanged since we last met. The good news is the composition of growth may actually be more evenly balanced and I do realize that L. Ravi has a job cut on improving operational excellence, Manish, Jagdish and Ritesh will collaborate with all of us to focus on growth and Harsh, our CPO, is committed to skill development and to provide us the best supply chain in the world.

So, I am now going to request Manoj, our CFO, to take us through the financials of FY'18-19 and particularly Q4 '19. Thanks and over to you, Manoj.

Manoj Bhat: Thank you, C.P. If I look at firstly on profitability, the margins reported were about 18.4%. Now that does include an element of a charge which we do not expect to repeat. So, on a normalized basis, EBITDA margins are around 18.7% to 18.8% give or take and the decline in margins is largely attributable to currency headwind during the quarter.

I think moving on to some of the cash flow metrics, we have had our highest free cash flow ever in our history at about 173 million which is about 109% of PAT. Overall for the year if I look at the free cash flow is about 87% of PAT. So, clearly, lot of improvement has happened in terms of some of the metrics around conversion to cash and that is something which we want to keep a continued focus on. DSO days are down to about 102-days.

Quickly moving on to some of the hedge book. Hedge book is about $1.6 billion and our accumulated gain because the rupee has appreciated on the balance sheet is about $50 million. So, net-net in addition to what CP said, while there are pockets of weakness on the Enterprise side there has been a strong growth in Communications, our operating metrics look very-very healthy even now and of course that is something which we want to keep a continued focus on.

So, without further ado, I will open the floor to questions. Thank you.

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

Sandeep Agarwal: C.P., I have a couple of questions: One, on the enterprise side although you gave some insight but I would like to know what is happening there, is it a quarterly phenomenon or do you say that there is some kind of issues we are seeing or is there anything to do with any client, some clarity on that? Secondly, on the Telecom side, if you can give some more clarity on how we should see the demand going forward although you mentioned that the growth will be more even, whether there is a real pick up or how stronger the pickup is and how much of the pickup is led by 5G or anything like that?

C.P. Gurnani: Sandeep, I am going to let Manish Vyas come in and respond to you on the Telecom side and between Jagdish and Ritesh, let them cover on the Enterprise side.

Manish Vyas: Thank you, C.P. Sandeep, thank you for the question. I think we have been saying it for a few quarters now that there will be repurposing of some of the capital dollars as the telecom service providers either start doing some trials which will be small expenses initially more importantly, as they start modernizing the system process and the technology overall. So, clearly, the strategy that we build around helping people continue to drive automation and cost down and at the same time start doing transformation. That is what is at play. It is nothing new, nothing dramatically different though this itself is something which is we believe long-term sustaining type of a strategy, coupled with the broad-based portfolio that we have been building painstakingly over several years now, not just dependent on IT network, BPO, the value added services and so on and so forth. So, that is what is going on and we believe that we had said from Q2 onwards that our focus is going to be on large deal, our focus is going to be on the larger relationships that we have across the world and we will continue to stay focused on executing our simple strategy. So, we are pretty positive about the feedback that we have received, the TCV deals that have happened in the last three quarters, at one level are a good testimonial to the success of the strategy and your teams are very busy, continuing to do a non-core from an execution standpoint as what we have done in the last three quarters in the subsequent quarters as well. So, lot of work to do but the brand is getting more and more established as a leader brand as far as telecom is concerned.

Jagdish Mitra: Sandeep, this is Jagdish. So, on your Enterprise question, I think couple of points: Firstly, I think the Q4'19 degrowth was really at the back of higher Q3'19 base revenue as you would recognize and were some deferral of project commencements by a quarter in our Healthcare business. So, you would recognize that we had in Q3 growth in excess of 4%, largely contributed by growth in Manufacturing and obviously the retail seasonality is playing on. So, that is one of the reasons why we had a normalized Q4. Having said that, I think it is reasonable confidence with the TCV wins that we have had and the fact that the pipeline development is quite robust which has been one of our focus areas and third, if you recollect in the year we had set ourselves a growth or rather pretty much higher goals in terms of setting our profitable deals choice. So, we did exit a few not-so-profitable deals. So, that is primarily reason for Q4 which I think is a one-time impact.

Ritesh Idnani: Sandeep, if I can respond on the BPS, we had a strong quarter. Sequentially the revenues grew 5.3% QoQ and on an annualized basis in reported currency terms we grew the business at about 25% YoY. So, this has been a good year in terms of momentum. More importantly, I think our focus in terms of trying to be the provider, occupying the spot of one office transformation essentially providing a frictionless conduit between front, mid and back office leveraging automation, analytics and AI is resonating well in the marketplace, and we are able to win deals on a broad-based fashion across not just the communications, media and entertainment segment, but also across some of the enterprise portfolios whether it is in the new age companies, whether it is in retail, banking, financial services and insurance or on the manufacturing side of the case in point. I think what is helping us out there is the fact that we are using technology effectively to provide and deliver superior business outcomes for a customer.

Sandeep Agarwal: Are we disclosing the momentum in the TCV separately on Telecom and Enterprise, #1? And #2, can I conclude that the next quarter onwards the Enterprise will pick up quite strongly and we will see the growth similar to the last few quarters in the Enterprise business?

Manoj Bhat: Sandeep, this is Manoj. So, two or three things, right. I think if you look at our Enterprise segment performance, it has been volatile, right, it has been swinging quite a bit. So, on a full year basis, we do believe we will catch up in terms of some of the growth expectation. The second thing is I think from a perspective of overall growth for the company I think what Jagdish said also is that the funnel is building up, I think there is a good chance that we should be able to convert but that is something which is a function of some of the things which happened during the quarter that there were certain deferrals into potentially Q1 and Q2. So, to me that is the thing in play. As we said that overall, I do not think we are changing our view on growth, maybe the composition of growth might change a bit in favor of communications.

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

Ashish Chopra: Manoj, just a question on the Enterprise growth on the back of your comment. So, when you say that the composition of growth might move in favor of Communications, I would have expected that if there are deferrals within the Healthcare into 1Q and 2Q which impacted 4Q, then perhaps FY'20 should have seen the benefit of that growth which was one. The other question that I had really was that the other drag on Enterprise has been BFS for some time. So, what would be your outlook on that?

Manoj Bhat: I think two or three things. If I look at BFS – and we have said this before, if I look at the composition of the business we do not have too much run the business, we have a lot of change the business and clearly there are deals in the pipeline which are potentially large and that is something we need to close to put BFSI back on the growth's track. Overall, I think for the full year, we do expect that BFSI will grow. Now the rate of growth will depend on some of the deal conversions which we expect to happen in the quarter or two and that is something we are looking at. What was the other question?

Ashish Chopra: My question really was that if there was a spillover of deals in Healthcare into the first half of FY'20, then should FY'20 not have maybe a better growth and the impact in FY'19?

Manoj Bhat: I think there are two, three points which we are making and maybe I will summarize that so that we are all on the same page in terms of Q4 Enterprise, right. So, partially it is because Q3 was very strong in retail and that has come off because it is the seasonal kind of variation. The second is that some of the projects have ended and new projects which were supposed to be signed, that is getting moved to the subsequent quarters.

And third is you are talking about Healthcare and there is an impact of that also. So, the Healthcare will definitely come back. The other two is something which we are looking at in terms of gradual recovery growth rates in Enterprise. That is the way I would look at it.

Ashish Chopra: Secondly, maybe to Manish, so you mentioned that the focus was on larger customer in larger deals. But if we look at the top-5 and top-10 clients this fiscal, so the revenues overall have been down marginally in FY'19 over FY'18. So, are we saying that this should be much better basis the deals that we have within these customers?

Manish Vyas: Ashish, I am so happy you asked that question. When I said large customers, in fact, it is based on your feedback and lot of other discussions, we have been broad-basing our account strategy, we have identified about 52 companies that we consider large and by large does not mean only our existing real estate being large, it is basically their spend patterns being large and we have invested across these. Actually, it is a positive thing that your observation that growth has actually come from not the same conventional few good large companies but even the other larger companies that we have started focusing on and we would actually like this trend to continue. I am not saying we will degrow anybody, but we want to continue to grow in this paradoxical world where the revenues of service providers will still take some time to get an uptick and this has been the feature for a very long time in the telco industry. What we are trying to do is to continue to a) garner larger market share from others and b) to continue to be part of the transformational programs and some of the deals we have announced in the last two quarters including Q4 were part of that. I hope that answers your question.

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

Abhishek Shindadkar: First question is regarding the growth across the four quarters. So, how do you see the seasonality in FY'20 -- do you still believe that H2 would carry the momentum or otherwise?

Manoj Bhat: H2 has been seasonally strong for us, will continue to be and potentially more so this year because I think from our perspective as we look at our funnel and the maturity and potential trends in some of our larger customers, for example, some of the wins we are seeing now probably will start translating into revenues in second half of Q2. So, some of these numbers which we will see flowing through will come through then. So, Q1 will be muted because that Comviva business goes down, Q2 will be better, Q3 and Q4 will be qualitatively much-much better and also in terms of the growth rate. So, that is the way I see this year going from a growth perspective.

Abhishek Shindadkar: Second, the book-keeping question for you Manoj. You know the fourth quarter of '18 segmental results have seen quite a re-statement, in the fourth quarter margins as per the last year's filing and this year filing, the unallocated expenses have gone down. Could you help us understand what could be the reason for the same?

Manoj Bhat: What we have done is we have actually looked at our allocation methodology once again and then actually drilled down to the level of how much would be allocated to each segment. So, that is the change. But that does not change it directionally much I would presume, but was there a question behind it, was there issue…?

Abhishek Shindadkar: The point is the segmental margins have seen lot of change in terms of what you reported last year and this year. So, I just want to understand what could have changed in the unallocated expenditure maybe we can take it offline if you want, but your answer could be helpful.

Manoj Bhat: Just a flavor, now we have frozen this allocation methodology based on that this margin is the way we would calculate going forward. To me of course the normalized margin for the BPS business is in that 19% to 21% zone, has been historically and obviously there will be transition blips up or down as we go through this growth phase. That is the way I would look at it if that is helpful, but of course you can connect with me offline and we can discuss further.

Moderator: Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: If we look at the attrition rate, it continues to remain sort of elevated. I think we have compensation increases next quarter. So, just wanted to get your sense of how one should think about margins going into this year and whether the compensation increases will be higher than what we have seen in the previous year, any sort of color or sense you could give there please?

Manoj Bhat: Harsh, I will invite you, but before that I think two comments only and Harsh will talk about the measures we have taken. Actually, attrition has come down on a quarterly annualized basis and secondly is of course wage hikes have been announced effective April 1 and they are higher than last year. Harsh, if you want to expand on what are the measures, we have taken on all of these areas where the questions are from Nitin.

Harshvendra Soin: Thanks Manoj and thank you Nitin for asking that question. So, what we are seeing is that as Manoj mentioned if you take the Q4 annualized number our attrition actually came down in excess of 200 basis points or thereabout and our X-raters which are our top talent continues to be much lower. This has obviously been a result of some of the action we took to ring-fence our top talent and also the sort of thing necessity that we did, one, of course, was that we did a deep dive into specific segments and we addressed them over the last quarter also. We also introduced many career transformation programs which actually helped our associates to meet the career aspiration -- One of them is I can give you an example Talex which is our AI-based career development market and of course apart from that as normal we have also been ring-fencing critical talent in normal short-term incentives. So, we have seen a good indicator in Q4 and hopefully it will continue going forward, but we will have to watch.

Nitin Padmanabhan: Manoj earlier I think around the analyst meet you had basically highlighted that this year could be a 5% kind of growth for Telecom and 8%-odd per cent kind of growth for the Enterprise business. Now if we look at the exit revenue run rates annualized, it looks like the Telecom itself gives you 5%-odd whereas the Enterprise is a marginal decline. So, how was that thought process change versus what you had highlighted then?

Manoj Bhat: Nitin, that is where I said that if I look at my overall view on growth, it is probably not change, but composition might change because clearly when we spoke then I think we had only one quarter of Communications growth behind us and now we have had three solid quarters of growth and I do remember the questions around sustainability of Coms growth and of course from our perspective given the offerings, given the coverage, given the areas where the telos are spending in and our investments in the right areas I think we do believe that is something which will continue to grow in a meaningful way. So, that is where I had said at the beginning of may be about 15-minutes back that overall growth view might not change but what might change is the composition because of course, Coms will grow better than what we thought, Enterprise might be a tad bit lower than we thought, but that is where we stand today, and all of these are subject to change because I did say that we have a funnel out there on the Enterprise side which potentially we did announce one of the deals today in terms of the Naval RFID deal. There are a few others in the funnel. And that could change the outlook in terms of enterprise, again, upwards; as and when we land those deals. So, that's where we are today. But as I said, overall growth view has not changed.

Nitin Padmanabhan: Sure. Manoj, I think one thing you missed on the previous question was, how should one think about margins for this year versus what we have achieved in the previous year, in the context of, obviously, the higher compensation and everything. So, how should one think about overall margins?

Manoj Bhat: So, Nitin, let me baseline this as March 31 exchange rates and then talk, because the rupee keeps moving. So, when we look at the margins from that perspective, I think we still probably stand by that statement that from our perspective the goal would be to hold our increased margins, and we do believe there are enough levers out there. Now, obviously, Q1 margins will dip because of the seasonality in Comviva, the H1B fees and the wage hikes, all coming together in one quarter. And then we will recover as we go along with some efficiency improvements, if you look at utilization, for example, it's down to 82%. If I look at portfolio companies, we have started the journey. So, the leavers have not changed. I think we are just approaching it from a fresh perspective in terms of what else can we do? And overall, from a perspective of some of the untapped leavers, maybe during the later quarters we can look at offshore as a lever. So, to me, that's the way I would think of it, the baseline would be margins would be flat, the goal would be to increase margins, which is in-line with what we said even last quarter.

Moderator: Thank you. The next question is from the line of Sashi Bushan from Axis Capital. Please go ahead.

Sashi Bushan: We have been basing our growth a lot in FY20 on communication side. Now, do you think the recent restrictions on Huawei and ZTE both in terms of market access and supply chain, could impact 5G rollout worldwide? And how does it impact Tech Mahindra?

Manoj Bhat: Manish, I will let you answer the 5G rollout question. But from a Tech Mahindra perspective, and obviously these are early days, but from our evaluation it has no impact on us. And something which we don't foresee it will be an impact on us, unless something changes again. But that is a short answer for the Tech Mahindra. But in terms of the global 5G impact, Manish, do you have a view?

Manish Vyas: Yes, absolutely. No, I think it's almost the same answer as Manoj gave, it's in two parts. There will be some impact because we don't know how exactly will this manifest itself in certain parts of the world where some of these companies are much bigger player than otherwise. As far as the next 12 months are concerned, anyway, a lot a lot of the 5G activity was going to be, if I may, headquartered out of U.S. And some of the other countries were going to follow in some time. That has always been the projections and the planning. And these companies have not had a big play in the U.S. anyways, for historical reasons. Number one. Number two, as far as our business is concerned, the way we are playing from a software lead type of a transformation. We don't believe there will be from this year's planning standpoint, we don't see much of an impact. But again, I think it's a good question, it's an important question that we also, like you everybody is just about learning on what exactly could happen as things unfold. For all you know, it could even present itself as a good opportunity for us to collaborate with some of these Telcos in helping them mitigate the risks that come out of this kind of a situation. So, all in all, I guess, if there is one positive thing out of this it is, I maintain our access rights that we have inside all the major operators. So, we do have a ringside view of what is going on, and hence our ability maybe to respond to the challenges that people throw at us. Could be better than most other people. I mean, that is all I could say at this point. But early days at best.

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

Srinivas Rao: First, just wanted to get, again, if you could reiterate what is the thought on the overall growth for the company? I know you have mentioned the potential change in the mix, but what is the range on the growth you are looking at? That's number one. The second, again just taking that forward on the Huawei issue. I just wanted to get a sense as to, given that you touch so many Telco's, what is your sense of the potential outcome say in U.S. of course it looks blocked, but in other parts of the world where the equipment is still being used, and then at least Telco's don't seem to have fallen in line with the ban. So, does that have a potential impact for you?

C.P. Gurnani: So, let's take a breather for a minute. And I am fully aware these calls are recorded and I need to be sensitive that what I say. Huawei, yes, we do business with them, but they are not our top-20 or top-30 customers. Number two, that if I go back and look at the ZTE situation, I mean, I think it did hurt ZTE. But eventually in the U.S., as you have seen. Everything, whether it was the BP Oil Spill or whether it was any other kind of event, Deutsche Bank, you name it, I mean, there has been the reasons where the U.S. authorities have gone after the companies, but they have always, always, and 100% track record there they have always settled. I am not saying that Huawei is at fault or not at fault, because I am not an authority on that. So, by that definition, this particular situation will hurt Huawei, but I do believe that they will settle. The third part is that in networks, Huawei was never present in U.S., which is a substantial part of their business. They used to sell devices and they were very big in U.S. But what will hurt is on devices saying there will not be any upgrade of Android, or they will not allow you to further upload xyz. But knowing China, they will always have a substitute ready anyway. Now, but it will definitely help the devices market because I would not, even if I was an Android user, I would buy a Xiaomi, I mean Xiaomi also eventually will get hurt, but I would not buy a Huawei handset if the standard features like a Google Maps is not available. So, the net, net is, Huawei will get hurt. As of date our work should not get impacted, because we participate with them in a few network rollouts. And all of them are in Middle East and Europe and they are not in any sensitive territory at the moment.

Srinivas Rao: On the revenue and growth?

Manoj Bhat: So, Srini, I thought we clarified a couple of times on revenue growth. So, I am not sure what were you seeking?

Srinivas Rao: Well, you mentioned that the communications will probably grow faster than what you had initially indicated in the Analyst Day.

Manoj Bhat: What I said is that our growth outlook has not changed, it's just the composition potentially which has changed. So, if I look at some of the numbers, I think we were talking about 8% to 10%, which is about industry growth or there about on enterprise and about mid-single-digits on comms. So, what I am saying is that from our perspective, that overall growth number might be constant, I think the composition might favor more on the communications side. I don't know whether that's clear, Srini, or…?

Srinivas Rao: Yes, this is this is helpful. I will come back for more questions. Thanks.

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

Sandeep Shah: I think if I look at the order book split for the whole year, it looks like the enterprise order book on a YoY basis for the new businesses is flat, while entering with this fact in FY20, does this bother in terms of expectation of an even growth in communication as well as in the enterprise? Or do you believe the order book built up due to be strong and achieving this even out growth will not be a big challenge?

Manoj Bhat: I think without getting into too much of the stats, I think Sandeep, the way to look at it is, if I look at the deal wins potentially, right, in the enterprise there has been a spacing out of the large deal wins, right? So, that is one of the reasons we are seeing some kind of volatility in the growth. And as I said, there is a funnel there and we feel pretty good about converting. Now, clearly, only after we convert can we talk about it. But that is something which you need to wait and watch in terms of Q1 and Q2. As I said that it will be a recovery which will be gradual in Q1 and Q2.

Sandeep Shah: Okay. And just follow-up, in terms of our chosen sub-segment within the enterprise, do you believe is there still a capability mismatch where we may have to focus on M&A? Because some of the last few M&As has helped us in terms of ramping up the sub-segment specialty or in terms of the growth, so do believe the M&A may be revived incrementally in FY20, especially in the enterprise?

Manoj Bhat: Sandeep, the way to look at it is, we were always looking, right. So, it's not that we have shut down M&A, but we have not found the right targets. So, as and when we find the right targets, and the focus will be largely on the enterprise side, because of course, there is a wide area of opportunity. And the second element which is probably common across communication and enterprises is the digital side which we are also actively looking. So, to me the fact that there was less M&A in FY19 is a function of we were not able to find the right target rather than change in direction or a change in strategy.

Sandeep Shah: Okay. And just in terms of when I look into the growth within IT service versus BPO, I think versus the growth in the digital it looks like most of the digital growth is driven through BPO and that too through markets outside U.S. and Europe. So, am I wrong in terms of interpreting this that most of the digital growth is coming through BPO? Because the IT services growth across four quarters has been really anemic, out of which only 3Q we had shown a positive growth Q-on-Q while rest of the three quarters there is a decline in IT service in dollar terms.

Manoj Bhat: No, I would like to look at it slightly differently, right. So, within the IT portfolio traditional is something which is being replaced by digital, that's one way to look at it. So, that is the reason you see that. So, what is happening is when digital grew 41%, probably traditional declined. And I am guessing probably give or take 8% to 10%, I don't have the exact number with me. And that's the right way to look at it. And to me, and I do expect that trend to continue, because what is happening is that as people go through their journey of digital transformation, more and more bigger buckets get carved out and maybe, for example, if the architecture is being changed to microservices, to me doing work on a microservices architecture for changing the client's portfolio is something which we would classify as digital. Right. So, that's the way I would interpret it.

Sandeep Shah: Okay. And Manoj, just last thing in terms of the lease accounting change, how this impacts your EBITDA and EBIT margins and the PAT margins?

Manoj Bhat: Initial preliminary view is less than $2 million impact on EBITDA.

Sandeep Shah: Okay. Because we largely operate through own premises that’s why?

Manoj Bhat: Absolutely right.

Sandeep Shah: Okay. And just Manish Vyas, if you can give us a color in terms of looking at the announcement which have been made by some of the Telcos in the Europe as well as in the U.S. about the 5G rollouts in some parts of the countries, towns within those countries. Do you believe 5G will become more catalyst in terms of growth acceleration in communication in FY2020 or it may be still a FY21 kind of a reality?

Manish Vyas: No, I think since you use the word catalyst, I will steal that. It is indeed a catalyst already. And just like you said, it will be build up, it has started slow, it will remain, this train will pick up some speed towards the end of this year. As more and more trials happen, more and more experiments happen around cities and more companies participate in this. For example, Middle East as a market could, for all you know, latch on to 5G faster than maybe Europe or some other parts. And there are early talks in those markets, but who knows. So, yes, it will be a catalyst and the some of the wins that we had in last quarter weren't, on a given day you need not classify them as 5G, but the long-term view of those deals, when these operators gave us those responsibilities were indeed 5G, because they wanted to be ready for 5G. So, the bouquet of 5G is going to be much wider and larger in terms of the type of things that one can do. But catalyst is a great word, honestly, I think that's exactly what it will turn out to.

Sandeep Shah: Okay. Sorry, just last question Manoj, just wanted to understand the share of profit and loss from the associate. This year that loss has been Rs. 66 crores, which is 1.5% of the PAT which is materially higher than the last year. So, what is it exactly? And how should one model that?

Manoj Bhat: So, this is predominantly because of our technical stake in Altiostar is about 20%. So, we are picking up share of loss for Altiostar. And that is what is causing this thing. Now, that is just an accounting thing because they are they are actually investing heavily into the product. And clearly there is success coming in that part. So, that entire difference is pretty much due to our stake in Altiostar.

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

Vibhor Singhal: Just one question from my side. Manoj, we have seen seven consecutive quarters of strong margin expansion for the company over the last couple of years. A large part of that I believe would have been driven by, basically, margin expansion in the subsidies' performance. So, just wanted to get your perspective on how does it look from here on? Do we have any more juice left that we can squeeze out of these subsidies, which will help us expand or maintain our margins in view of the headwinds that we have? Or it is going to be primarily a standalone game itself, in terms of whatever the margins move?

Manoj Bhat: Vibhor, on a lighter note, we don't want to squeeze any juice out of anything. But I think if the question is that, overall, as we think about both revenue and cost synergies and bringing about a certain degree of rigor into the process of the entire lead to cash process, I think that's a journey which will still continue. To me there is potential there, which I did mention I think even in this conversation that clearly that's one of the things we believe that we have done a good start, but there is something more to be done. And the second thing is, I think, at least in some of the subsidiaries we are seeing synergy revenue streams come through, which will hopefully, one, minimize volatility; two, create a more sustainable offshore base of revenues over a period of time; and give this kind of revenue stream of almost all of the subsidiary companies more permanent and a sustainable model of driving business performance. That is the goal and as part of that I think we will see some margin improvements also come through.

Vibhor Singhal: Sure, that is helpful. Just last one thing, I think I missed a number, I don't know if you mentioned before, what was cross-currency impact in this quarter?

Manoj Bhat: About 40 basis point - 45 basis points give or take.

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

Sumeet Jain: So, just wanted to explore the 5G opportunity in slightly more detail with Manish. I remember in the last earnings call, Manish, you called out that TechM is getting involved in the rollout of fixed wireless access in U.S. So, want to understand where are we in that stage? Secondly, Samsung, like launched their S10 version 5G enabled last week, so are you hearing any initial use cases from your customers, how that will pan out? And the last question on 5G is, let's say a 5G is more of a FY21 story for you, then what does that imply for your enterprise vertical, given that the industrial IoT would be a big booster out of the 5G? So, three questions in all.

Manish Vyas: Sure. Absolutely. So, I think the first one as far as the fixed wireless is concerned, I mean, that's an that we are engaging right now with one of those deals and the customers that we signed up with. The uptick on that is slow because of the stability of the technology that they the customer has chosen to deploy. I mean, that is probably running maybe at least a quarter, maybe four months behind schedule. But I don't think that is an extraordinary situation because that usually will happen in the turnkey program like this. And while we do that, there are tons of other activities that are going on in preparation for that from design to plan to other things. So, yes, that is an area that we should watch for in time to come, because as that operating model and that architecture settles down, there will be more people latching on to that bandwagon. Specific to Samsung, it is an important relationship that we have across the device and the network footprint. I can't give specifics right now, but we are clearly working with them as well in some of the interesting tie-ups that they have made, particularly in the U.S. Maybe we can talk about that in time to come in offline, but at this point we are clearly closely watching that and building a practice around their technology. 5G, industrial IoT will clearly be an opportunity in the enterprise, but that was always going to be following at some level a couple of cycles behind what will happen in the service provider, the network will have to be in place before any use cases start getting deployed. But what we are going to be busy with in the next several months is preparing, unlike the conventional IoT of past, what we are doing is to focus on, and Jagdish and I have put a task force together to identify specific things we will do and the things that we will not, including which verticals we are going to be focused on. And more importantly, with who's partnership or partnership with whom. But yes, the revenue side of this is going to be following a little later than the 5G rollouts happen, and that shouldn't be a surprise.

Sumeet Jain: So, in a nutshell, would we see the deal win in telecom vertical continuing to be robust in FY20 similar to what we saw in FY19?

Manish Vyas: We are clearly working towards that.

Sumeet Jain: Okay, that's helpful. And one question for Manoj. I think you said your normalized EBIT margin is 30 bps, 40 bps higher than your reported margin. So, is there something one-off in your SG&A expense this quarter which should normalize?

Manoj Bhat: Yes, that is what I meant.

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

Rishi Jhunjhunwala: Sir, if we look at your headcount in software services or IT services, it is at a 17 quarter low. And over this period, we have seen your revenues go up by almost 50%. Of course, the large part could have been coming through utilization as well, but we have seen utilization peeking out for the past six or seven quarters. So, just wanted to understand how do we expect this to play out? First of all, what is the reason for this continuous decline and we are not seeing any incremental hiring? When do we see that starting and how would that play out into your outlook for margins?

Manoj Bhat: So, if you look at the same quarters, potentially you will see subcontracting expenses also go up in line, right. And within this, I think there are two categories, there are obviously what I would call headcount based subcontractors where we direct, and then there is the other one which if I look at an expansion of what we are trying to do with TechM next, as an ecosystem play, I think we are actually bringing in partnership and partner capabilities in both models, both in headcount models as well as in turnkey models. And that is the way we have kind of structured ourselves. So, part of the answer lies there. And if I look at sub-con expenses, its I think 13.3% of revenue this quarter.

The second thing is, of course, we believe that we took some time to develop the AQT framework in a very, very robust manner, gathering the best practices across multiple business units as well as external sources. But the momentum, which it's built up over a period of time, I think that has come only in the last few quarters in a way. And that is the momentum which we believe will still continue.

Thirdly, as you rightly said, revenues have gone up quite a bit from there. And so, from an overall perspective, I think the model stands that there is a certain degree of potential non-linearity which is coming into the business and that's something which is in a way positive, and clearly, I think we do have the ability to ramp-up as and when required. But we follow all models together, including depending on our partners as well as depending on our own people. So, it's a very long answer, but the reality is it is a complex subject which cannot be just answered just using one metric.

Rishi Jhunjhunwala: And secondly on capital allocation, so you are ranging it around 35% to 45% payout, including taxes on dividends. Just wanted to understand, you have recently done a buyback, do you consider that as allocation as part of FY20? And as a result it will see consequent a decline in dividends or this is something which is over and above that?

Manoj Bhat: So, I think our policies, we don't want to keep excess cash, right. So, I don't want to say this is against this year and that year. So, if you look at it, when we thought we have excess cash we did the buyback. And now we have done the dividend which is the same as last year. We want to keep this buyback almost as a policy decision and do it at periodic intervals. And that's something we intend to do consistently. And then the dividends and how much cash is required for investments, those are all other subjects and other topics. You must also understand that our cash flow increase has been quite a nice number, I think it is about 30% increase in free cash flow in dollar terms, which is a substantial increase. And we are hoping that we can continue to drive some operational efficiencies and discipline around some of the working capital management and the balance sheet management. And that will continue to drive higher cash flow. So, that's the way I look at it that we want to be consistent in the buyback program, dividend is also a function of the cash needs of the company. And the investments are predominantly I think, M&A, which as I mentioned could happen, could not happen, there are multiple. But broadly speaking, we don't want to keep excess cash. Hope that answers?

Moderator: Thank you. Ladies & gentlemen, due to time constraints that will be the last question. I now hand the conference over to Mr. Manoj Bhat for closing comments. Thank you and over to you, sir.

Manoj Bhat: Thank you all for joining the call. I am sure there are unanswered questions, so please do write to Jaidev and his team. And we will try to answer them offline as soon as possible. So, thank you once again for joining the call. Thank you.

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

Note: The above transcript has been edited for better readability

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