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TATA CONSULTANCY SERVICES

Tata Consultancy Services Limited

Q3 FY13 Earnings Conference Call.
January 14th, 2013, 19:00 hrs IST (08:30 hrs US ET)

Moderator Ladies and gentlemen, good day, and welcome to the TCS Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Kedar Shirali of TCS. Thank you. And over to you sir.

Kedar Shirali Thank you, Marina. Good evening and welcome everyone. Thank you for joining us today to discuss TCS' financial results for the third quarter of fiscal year 2013 that ended December 31, 2012. This call is being webcast through our website and an archive including the transcript will be available on the site for the duration of this quarter. The financial statements, results presentation and press releases are also available on our website and have been emailed out to those on our mailing list.

Our leadership team is present on this call to discuss our results. We have with us today, Mr. N. Chandrasekaran -- Chief Executive Officer and Managing Director; Mr. S. Mahalingam – Chief Financial Officer and Executive Director; Mr. Phiroz A. Vandrevala – Director; Mr. Ajoy Mukherjee – Head of Global Human Resources.

Chandra and Maha will give a brief overview of the company's performance and that will be followed by a Q&A session. As you are aware, we do not provide specific revenue or earnings guidance. Anything said on this call which reflects our outlook for the future or which could be construed as a forward-looking statement must be reviewed in conjunction with the risks that the company faces. We have outlined these risks in the second slide of the analyst presentation available on our website.

With that, I would like to turn the call over to Chandra.

N. Chandrasekaran: Thank you, Kedar and thank you all for joining the call. I would like to start by saying that we have delivered a very good quarter; another strong performance across all parameters.

I just want to give a little background. Typically Q3 is a soft quarter due to two things: one is the fewer working days and the other is the furloughs which have come to be the norm for Manufacturing and Hi-tech companies. So our focus was to deliver revenue growth and also, focus on operating margins and productivity improvements, primarily because of the anticipated low volume in such a quarter.

During the quarter, we also cautioned that we have had furloughs with more companies, beyond the Hi-Tech and Manufacturing industries, especially in the Financial Services vertical. So volumes are really soft. In that context, we have delivered an excellent quarter: revenue growth of 2.9% in rupee terms; 3.3% in dollar terms. We have seen an operating margin improvement of 51 basis points which positions us nicely for our targeted operating margin for the year. At the Net Profit level, we have shown a 1.1% increase, despite a forex swing of Rs 1.60 Bn negative.

The nature of growth has been pretty holistic. We have seen good growth across markets. The US, UK, Latin America, India, Asia Pacific – all of these markets have grown.

Financial Services has done particularly well. Despite the furloughs, it has demonstrated very good volume growth, in fact, higher than the company average. Also Financial Services revenue growth has been very good. We have also seen growth in the Manufacturing sector, Retail and Consumer Products sector, Energy and Utilities, etc.

From a services perspective, we have seen very good traction for Consulting and Enterprise Solutions, apart from Infrastructure Services and our own Asset Leveraged Solutions.

So, overall, it has been a very well-balanced performance from a growth perspective, from a margin perspective and also from a distribution perspective, it has been very broadbased.

Customer metrics have been particularly good. We have added clients across all the revenue bands. The number of clients in the $100 million plus band has gone up by 2, in the $50 million plus has gone up by 2 and in the $20 million plus has gone up by 6. And there are a lot of additions in the $1 million+, $5 million+, $10 million+ customer segments as well.

The deal wins have been very good. Our order book has been solid this quarter. We do not publish that number, but it has been pretty solid. We have signed at least seven large deals.

In terms of the pipeline, it is pretty robust. We have not received any cautionary statement from any of our clients nor have we picked up anything [negative] from the market in any of the industries or markets in which we operate.

Employee additions have been solid – over 17,200 at a gross level, and 9,500 at the net level. The overall count is at 263,000 plus associates. We have already come close to adding 50,000 associates which was the annual target this year and we should be adding at least another 10,000 in the next quarter.

While our push for non-linear revenues continues, and we are seeing traction and are winning our share of wins in the non-linear space to establish our reach for our products and platforms, the traditional model continues to be solid and we are continuing to invest in growing the business.

The pipeline is healthy and we remain positive about Q4 as well as about FY14. Those are the comments that I would like to make. With that, I would like to pass on to Maha for his comments.

S. Mahalingam: Thank you, Chandra. I will reemphasize some of the figures. Our third quarter revenue of Rs. 160.7 billion represents a growth of 2.9% QoQ and 21.7% YoY. Revenue in dollar terms is $2.948 billion which is a sequential growth of 3.3% and YoY growth of 14%. In constant currency the revenue is $2.926 billion, a sequential growth of 2.65%.

Let me now give you the breakup of our sequential INR growth of 2.9%. Volume growth was (+ 1.25%); constant currency realization was (+1.3%); currency impact was (+24) basis points; onsite effort shift was (+9) basis points.

Our focus on cost management this quarter kept most expenses at around the same level in absolute terms or lower as in the last quarter. As a consequence, our EBIT margin expanded 51 basis points to 27.3%. I will give you the breakup of that margin expansion. Currency impact was (+3) basis points, productivity improvement was (+82 basis points), SG&A expenses contributed (-50) basis points, offshore shift of revenue was (+16) basis points and that has resulted in (+51) basis points.

Other Income as a percentage of revenue was 1.33% compared to 1.99% in the previous quarter, the difference being on account of forex losses from marking-to-market the option premia. Effective tax rate was 21.8% compared to 21% in the previous quarter.

The lower Other Income and higher provision for taxes negated the operating margin expansion and led to a net income margin of 22.1%, down 38 basis points QoQ.

Our accounts receivable stood at 79 DSO in dollar terms, down two days from the previous quarter. Invested funds as of 31st of December was Rs. 131.7 billion.

To conclude, by focusing on cost management and disciplined execution we not only overcame the margin headwind from a seasonally weak quarter but even expanded the operating margin beyond 27% for the quarter. With that we can open the lines for questions.

Moderator Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from Joseph Foresi from Janney Montgomery Scott. Please go ahead.

Joseph Foresi My first question is, you talked about the pipeline as robust and no major issues. Can you give us some idea then of what you are thinking about 2013? I know you do not give any guidance on that but does it seem like it could be faster or smaller than 2012, which is from a position heading into the year? And then can you help us reconcile that with the December quarter results, is that just simply seasonality?

N. Chandrasekaran We have said in the last call and we continue to maintain that the momentum that we see as we leave December 2012 is better than in December 2011. So we expect 2013-14 to be a better year for us than 2012-13. We are starting on a much better momentum and sentiment from the market point of view, from the customer's point of view.

More importantly, there is clarity around what customers want to do. It is not only about what the budget is, it is also about where do they want to spend the money that they want to spend and do they have clarity around the initiatives. Are they are making decisions? Do things ramp up? So, on all those parameters I think we are in a much, much better position this year than last year. There is lot more clarity in the minds of the customers about what they want to do, whether it is driving efficiency or adopting digital technologies or front office transformation and what have you.

Let me put it differently. The quarter has been from a growth point of view, from the volumes point of view, from the way how different industries segments behaved, there have been no major surprises apart from the one which you highlighted, which has been extra furloughs that we had to face, and which we communicated to you.

Joseph Foresi And then just maybe you can talk about a little bit about the market conditions from a competitive standpoint heading into 2013. Have you seen any shifts in competition, anything on the pricing side? And what are you focused on? What is going to be the major key for 2013 from a competitive standpoint?

N. Chandrasekaran From our point of view, we have said that it is a different environment we are operating in. Customer-centricity is key as much as it might look like a cliché. We continue to ask ourselves how we can be more relevant every single day, with every single market, industry and customer we work with. Our focus and our team's focus has been to stay relevant and partner and co-create. The whole discretionary spend is in the area of digital, apart from risk and compliance and regulations, etc.

There is a significant spent towards digital, whether we call it analytics, big data or front-office transformation, customer experience. It is called by different names, but the point is that there is a discretionary spend that is happening and that we need to invest, we need to partner and we need to exhibit leadership and that is an area where we are focusing.

And on the efficiency side, we are focusing on service management. Customers are demanding service management, not simple transformation of infrastructure or transformation of application management. Service management is becoming very critical where we are able to take an end-to-end perspective from the customers view in their existing footprints. So that is an area where we are focused on, apart from all the other usual opportunities, whether it is in Assurance, Infrastructure or anywhere else. These are showing up in our pipelines and we are investing.

Joseph Foresi Last quick question from me, how do you think about your margin profile going forward? I mean what is the thought between the balance of revenue growth and margins and given the fact that commoditization is happening, probably at a relatively decent clip, what is a good margin profile? I'm obviously not looking for guidance but can you explain the balance there and what are you thinking on the margins over the long-term? Thanks.

S. Mahalingam We have always been saying that aspirationally we want to be somewhere around the 27%. That is based on a certain cost structure that we had evolved.

But one important thing that I want to mention is that while we talk about margins, it is not at the cost of either expanding geographically, because we *are* expanding geographically, or in terms of doing a lot of internal work to develop capabilities in the areas of demand that Chandra articulated just now. So we believe that what this would require is continuous improvement in productivity. That is definitely an important one.

And that improvement in productivity has to pay for the newer forays that we are making, whether it is in terms of service lines, we have talked about different service lines and so on or in terms of the non-linear initiatives that we are on the way to grow and so on and also in geographical expansion. So we believe we can maintain this balance.

We are a very large organization now with very mature businesses in many of the mature geographies and mature industries and so on and I think this is certainly the way that we are looking at [margins] without constraining the growth parameters.

Moderator Thank you. The next question is from Moshe Katri from Cowen & Co. Please go ahead.

Moshe Katri Continental Europe had a sequential decline during the quarter, maybe you can talk a bit about that and may talk about the outlook for Continental Europe? And then Financial Services continues to outperform, maybe we can talk a bit about some of the drivers and is that kind of a sustainable trend down the road? Thanks.

N. Chandrasekaran This quarter, if you really look at our growth, we had two soft points. One is Continental Europe, the other one is Telecom. Both are linked as well to a large extent, because we have had some project finishing and some phases finishing last quarter and we had an uptick in a couple of Telco clients. While they have not really fallen in terms of scope of work or in terms of volumes, that extra pop we got last quarter is not repeating. Enough growth was not there with the size and scale that we have in the rest of the markets in Europe and that is why you have seen a softer performance in Telco and Continental Europe this quarter.

Nothing fundamentally wrong. Our deal pipeline is good and we are still maintaining, as I said, Europe will have a better year next year. In fact, I would not be surprised if Europe grows faster than many other markets in which we operate. We are positive about Europe.

From a BFSI perspective, I think there is enough to be done. I think the customers in BFSI are going through a lot of changes. Yes, but having said that, technology is going to play a very important role in the Financial Services sector. So that is what we are seeing.

It is not about whether the Financial Services sector is restructuring itself or rebasing their cost structure. Yes, different financial institutions, banks in particular, are going through different types of situations but in all those situations, at least in our client base, technology has a very important role. We are seeing that in our discussions. We are seeing that in our pipeline. As I said, in spite of unexpected furloughs in Financial Services, we delivered good growth in Financial Services this quarter.

Moshe Katri And then just final question: 31 new client additions during the quarter. Is there a way to break it down by regions or maybe by some of the large verticals for the quarter?

N. Chandrasekaran I don’t have it offhand and we do not give this information. I do not want to start [reporting] a new metric. But having said that, I will tell you, if you see the seven large deals we reported, those have come two from Banking, one each from Telecom, Transportation / Logistics, Government, Retail and Healthcare.

Moshe Katri By region, is there anything substantial?

N. Chandrasekaran US still dominated. Four deals came from the US and one each from Asia Pacific, Latin America and Europe. If you look at our pipeline, as I said, the order book has been good this quarter and the pipeline fairly well distributed across industries and markets.

Moderator Thank you. The next question is from Sandeep Muthangi from IIFL. Please go ahead.

Sandeep Muthangi Chandra, I had a question on the BFSI. You highlighted that BFSI had challenges in the quarter. Despite that, growth was quite good. Can you give us more insight into what happened, what kind of projects during the quarter or any specific things that were looking really good?

N. Chandrasekaran As I said, there has not been an overall pullback in BFSI, except budgetary issues for the year and furloughs were declared at a couple of clients and that did affect the volume growth. Again, those furloughs also ended around the 20th of December. So they had to go through a budgetary cycle and they declared. Apart from that, there have been no surprises in BFSI. It has been good for us. No special project, one-off projects or anything that has come. It again falls into the same categories that I have been articulating.

Sandeep Muthangi And also, in terms of the positioning for the next year you have been highlighting that 2013 you expect to be a better year than 2012. Anything else that you can highlight in terms of industries, which industries do you expect to do better and which might do worse off as compared to 2012 or is it primarily driven by Europe being much better than 2012 on what your expectations are based on?

N. Chandrasekaran We expect BFSI to do well. We expect Retail and Consumer Goods to do well. Telecom basically has been soft and we still feel that it is pretty volatile and while we are growing in some quarters still we do not feel that we have stability in terms of where we can see consistent growth. So Telecom is a concern from industry point of view.

From market point of view I think we are expecting to grow in all markets. I think US is going to be good, Latin America is good. Our Latin America market is pretty stable and it not only delivering growth, it also delivering good margins. We hope that the scale that we have attained in India is large enough that we can reduce the volatility. One of the things that we used to suffer from is volatility in India business. We have been working pretty hard on it in terms of having the right mix, picking the right deals and so on. It is not only about growth, it is about ensuring that you are not having the yo-yo and that has been the case in some markets and we have worked a lot on avoiding that and I think that should pay off. So it is going to be a balanced, well-distributed growth across markets and industries.

Moderator Thank you. The next question is from Ankur Rudra from Ambit Capital. Please go ahead.

Ankur Rudra I was just wondering, given the strong performance in Consulting, Enterprise Solutions from you and one of your peers recently after strong license growth numbers from SAP and Oracle, does it indicate maybe a better environment for discretionary spending?

N. Chandrasekaran I have been saying for the last few months that the discretionary spend is picking up. Clarity with clients in terms of what they want is very visible and we are not seeing delays. So I think it is a question of which clients want to spend where. It will not be uniform. Efficiency is the name of the game for everyone. Digital is the name of the game for most people. But from an Enterprise Solutions point of view, it will be selective in some customer-accounts where they are going to spend but they are making decisions and things are moving.

So overall it is another reason why 2013 will be a better year than 2012. In 2012 discretionary spend for vast majority of the year was just not there or people were watching. I do not know how much money will be allocated, I cannot be very certain about it, but it will be spent. No delays in decision-making, no waiting and watching.

Ankur Rudra In terms of the nature of work you are getting should I understand that it is equally spread between the traditional ERP implementations and new technology areas?

N. Chandrasekaran A lot on digital definitely. When you say ERP implementation, it may not be simple ECC 6.0 or a simple Oracle implementation. There are a lot of implementations related to whether it is the supply chain, whether it is the CRM on a salesforce.com. So there are varied kinds of deals that are happening in different products. It is not restricted to one or two products but multiple products. Big data analytics is picking up momentum and definitely there are opportunities in the mobile space which are short-cycle projects, but good volumes.

Ankur Rudra Just on the cost now, we saw a rise in sales cost this quarter which was slightly unexpected. Are you hiring sales team aggressively in a light of improving demand conditions and if you can just add some color where are you doing that?

N. Chandrasekaran We have certain margin goals which we are meeting and we are continuing to – see, we are not investing for the sake of investment but we are definitely continuing to…see, it is a continuous journey. We will always try and invest. We are investing in platforms significantly. We are investing in sales definitely. And sometimes related to a new offering, sometimes related to a new industry, but nothing I can mention that is going to stand out or anything like that.

Ankur Rudra Just finally on 4Q, I know you would not give guidance but any particular volume headwinds we should be aware of like lower working days?

S. Mahalingam There are no headwinds at this moment in time as far as Q4 is concerned. We have been maintaining that. As far as next year is concerned, it is going to be a good year.

N. Chandrasekaran But I think Q4 in terms of the working days onsite is more or less flat, onsite is one day down I think and offshore is almost flat or one day higher, something like that. Should not be an aberration.

Moderator Thank you. The next question is from Mitali Ghosh from Bank of America. Please go ahead.

Mitali Ghosh Mr. Chandra, I just wanted to reconcile the commentary on the better business momentum which is also reflected in your upping the hiring target and how we should interpret, reconciling the business momentum with the deal wins that you typically announce and I understand you do not necessarily announce all large deal wins. So how should we interpret the fact that the deal wins that you do announce have been somewhat lower in 2012 as compared to 2011 with the better business momentum? So is it reflected perhaps more in increasing discretionary spend and therefore perhaps smaller project size?

N. Chandrasekaran There are multiple things, Mitali. One is that just the deal wins alone does not translate. As you rightly said, we announce at least a certain number of deals, we do not announce all the deals then you can keep on announcing more things, but we do not announce revenues for example. So we are pretty selective in what we announce. Having said that, there are a number of parameters that we need to look at.

First of all, the customer migration. So sometimes the deal win gets an entry into the customer. After that, you are continuing to migrate that account very beautifully and that shows momentum for us and how much of volume that we are gaining in that account. It will not reflect in any deal wins. You do see it in the customer migration.

And also the size of the deals. Sometimes you do large deals and you may say everything is above 50 million or above 100 million. Sometimes it is 100 million, sometimes it is 500 million, sometimes even more than that.

So, it is pretty difficult to just come to a conclusion based on the number of deal wins. Deal wins is something that we share with you to tell you that decisions are getting made and what are the profiles of deals that are happening, in which markets they are happening, in which industries in which it is happening. That is the intent of sharing it with you.

The reason I say there is a good momentum is definitely customer migration is happening. Our order book is pretty good and even this quarter, the total cumulative order book that we had is excellent and that has come from both existing customers and new customers.

The pipeline of deals that we are chasing and the size of those deals is pretty solid. Customers have clarity about where they want to spend their money and they are executing as per plan. And discretionary spending situation is much, much better as we enter January 2013 as opposed to January 2012. I think these are the qualitative comments I can give.

Mitali Ghosh So basically on the fourth quarter then like you mentioned it is perhaps so fast started off well and broadly therefore one should expect like a steady quarter from a revenue kind of perspective?

N. Chandrasekaran I think so.

Mitali Ghosh And just one question on fourth quarter margins. Again, just one question that despite very huge hiring in the December quarter, utilization has been kind of flat. So is there a likelihood that utilization could drop in the next quarter because of perhaps hiring towards the end of the quarter and therefore are there any margin headwinds that we should watch out for?

N. Chandrasekaran I think from execution point of view there are so many things that have come together very well in Q3. In spite of such a low volume growth, compared to Q4, Q1, Q2, and this was lower volume growth. In spite of that our utilization excluding trainees went up by 10 basis points. So it has been a very well executed from HR point of view. Even if you look at the cash flows I think it has been a fantastic execution. I think as a percentage of revenue it is all-time high.

So from an execution point of view, whether it is productivity, whether it is financial management in terms of cash flows and other operating parameters or utilization in terms of HR, I think we have a very, very solid engine that is focusing on all these parameters.

Maha has said it multiple times what our exit rate of margin for the year that we are looking at, around 27% and we will stick to that. Since we knew that Q3 is a tough quarter or a weak quarter from a volume perspective, we did make our efforts on operating margin productivity and that has paid off. So, I think we are in a much better wicket with the kind of operating margin that we have produced in Q3 to deliver the margins for the year in Q4.

Moderator Thank you. The next question is from Diviya Nagarajan from UBS. Please go ahead.

Diviya Nagarajan Just trying to reconcile the improvement that we are seeing in discretionary spending, especially on the Consulting and Enterprise Solutions side. What we are seeing with some of your global peers who seem to be seeing a deceleration in the space, do you think this is a market share shift going on that we have been waiting for several years out, what do you think is happening here?

N. Chandrasekaran I am not extrapolating, intrapolating any of those. I think there is a very good traction around a number of areas in Consulting, a lot on digital space, whether it is in Analytics, whether it is in Supply Chain, whether it is in Mobility and also in terms of transformation of Enterprise Solutions, Consulting around domain services like if you take Retail or CPG, inventory optimization, those kind of deals were coming and regulatory compliance and risk related deals are coming. So there is a well-rounded growth in Consulting Services, both domain-intensive and also deals like the front office transformation. So there are lots of opportunities.

Also, you should see it as a thing that is happening as a result of the sustained investments that we have done. It is not an overnight thing. We have always said that. Three, four years ago I remember calls in which [they asked] when will your GCP pick up etc. The nature of the business is that it is not something that you can do overnight. It is not a question of just hiring 500 people. It is a question of hiring people, it is a question of building talent, it is the question of integration, etc. So I think we are steadily making progress, but we still have a long way to go.

Divya Nagarajan And could you also give us some color on the kind of discretionary spending that you expect to see across your major verticals, what would essentially be the key areas that are driving that discretionary spend?

N. Chandrasekaran I thought I just listed it, Divya.

Divya Nagarajan Fine, if you could just give us some color across your key verticals, which is Banking and Financial Services and Manufacturing? Any specific triggers that you are seeing other than the general trends of cost optimization, efficiency that we have seen in the past?

N. Chandrasekaran Cost optimization, efficiency, service management is a theme across the board. Risk and regulatory compliance, definitely in Financial Services and Digital is across the board. Both in consumer business or industrial businesses there are lots of opportunities.

When I say Digital, it is all the new technologies, whether it is cloud, whether it is multi-channel, including social media and front office transformation, big data analytics, all of those technologies and the interplay of these technologies. All of these are opportunities that we are seeing, both in Consumer business and Industrials business.

Divya Nagarajan Maha, just wanted to check what are the levers that you think that you can pull to keep your margins at 27% for the rest of 2013?

S. Mahalingam: Now, we are essentially doing all that we have been saying. The first one I would you to notice as far as this quarter is concerned is that there has been a productivity improvement. Ultimately, for realizing higher revenue, the number of people that we have deployed has been somewhat less. So that is really the definition of productivity improvement that has come in and therefore going forward I think that will get exercised a lot more, you will continue to see this kind of productivity improvement.

The second one is that the cost management, I have always said that we have created capacity and therefore we should be able to run to same absolute number for higher growth and that is another one that we would do.

We are not factoring in at this moment in time any change in the onsite/offshore mix because we are running at a fairly efficient mix there. We are not factoring in to account any pricing improvement in terms of renegotiations and so on. And if those things happen, then obviously, there will be an additional lever. So there are enough kinds of capabilities with the company to be able to maintain the margins, if not improve it.

Moderator Thank you. The next question is from Ravi Menon from Equirus Securities. Please go ahead.

Ravi Menon Just wanted to do a housekeeping item. The number of trainees that have been made offers to over the year, out of that I think about 24,000 or so have joined. How many more are expected to join over the next quarter?

Ajoy Mukherjee The total number of trainees that we had offered was 43,000. Out of that in Q1 a few joined and in Q2, Q3 are the majority of the trainees have joined. In Q4 we are expecting somewhere around 10,000 to come in, 9,800-10,000 somewhere in that range.

As far as next year is concerned, the 24,000 number that you have is the number of offers that we have given to the trainees to join us next financial year. That is 24,000 and we said that we will be giving about 25,000 offers and I will be closing that by January. So we should be completing our campus hires.

Ravi Menon So then it looks like you are relying a lot more on lateral hires next year. Is there a particular reason for that or is that because of a skill change?

N. Chandrasekaran I think that is not the way to look at it. There are two or three factors playing out. First is that our base is pretty large now and we still have opportunities to improve our utilization. The percentage does not tell the story. Today, we are a 263,000 employee company and we will be 275,000 and 300,000 very soon. And so we got to look at higher levels of utilization. That is one thing.

Second thing is the kind of engagements we are doing both on fixed price engagements and the consulting / SI engagements require a higher level of productivity. That is another thing. So we are doing it in a little bit calibrated way. That is the whole point and our attrition has come down from peak levels of 13% to 9.8% in IT and 11.2% overall. We have in the last 24 quarters, the best retention metrics this quarter.

So, I think there are several plays that are going on. So, we need to do it in a very calibrated way. And also, there are some markets in which we will take a differential view in terms of how we want to recruit, depending upon the pipeline that we generate.

Moderator Thank you. The next question is from Priya Sunder from Avendus Securities. Please go ahead.

Priya Sunder I wanted to ask about the subcontracting cost. This has constantly been going up over the last many quarters. Wanted to understand what are the specific areas where you are actually hiring more of these consultants and going forward what would be the outlook or what would be the trend?

Ajoy Mukherjee The subcontracting cost is going up. That is there are a few reasons for that. One is primarily from the point of view of protectionism and things like that. Visa availability, so that is the one where in order to fulfill is one reason. And second one is in terms of the kind of projects that you have, you will go for subcontracting where this is for a role of a temporary nature where these things would not last for too long. Those are the ones where you will have subcontractors and for niche skills as well. So it is from that point of view that subcontractor the number and the cost as a result of that has been higher.

Priya Sunder What are your tax rate assumptions going forward?

S. Mahalingam The tax rates will remain more or less at the same levels what we are seeing at this time.

Moderator Thank you. The next question is from Sandeep Shah from CIMB. Please go ahead.

Sandeep Shah Just one thing, employee cost within the cost of revenue line has more or less remain flattish despite adding 10,000 net employees in each of the quarter of this quarter as well as last quarter. I do agree that the employee cost within the SG&A line has gone up. So some of the trainee cost or the bench cost might have been reflected in the SG&A line. However, the proportion of the lateral employee addition continues to remain at 50 to 55%. So what explains this?

S. Mahalingam The main thing is that you have explained that we put the trainee and the bench cost, everything in SG&A, we do not put it in COR. What it really reflects is the productivity improvement, efficiency in terms of utilization of people, and therefore that is the reason why you have seen the kind of percentages that you mentioned in COR. There is an increase in the SG&A employee cost. And that really means that we have enough capacity to meet with additional requirements as we go along.

Sandeep Shah Maha, what I meant to say is the lateral as a percentage to the gross addition has not been really low, it has been remained at 50, 55%, that is why I was asking this. Because according to me I think lateral employee cost might have been sitting within the cost of revenue line rather than the SG&A line.

Ajoy Mukherjee Lateral is not 50, 55% if you look at the India hire this quarter, it is almost 66% are trainees and remaining 34% are laterals. Even in the previous quarter percentage wise the number of trainees was higher.

Sandeep Shah Second, just in terms of the BFSI, Chandra, can you explain us the demand environment in the traditional outsourcing business?

N. Chandrasekaran BFSI sector definitely the institutions are looking to restructure or rebase and plan their cost structure. So definitely efficiency is the theme across the board apart from all the other initiatives. So there is a demand from efficiency perspective and we are seeing it in the banks and we are also seeing it in the insurance companies.

Sandeep Shah And just last thing in terms of the discretionary projects you are saying that things are a little bit improving. So is it fair to say that clients are now little less hesitant in terms of the future macro issues and they are more open in terms of releasing the spend starting the projects and ending the projects versus what it used to be two to three months back?

N. Chandrasekaran I do not think that things have changed from two to three months back. I would say that things have changed compared to last year. And basically the point is customers understand the macro is what it is and it is going to be a steady slow recovery that is happening in different parts of the world. So from their point of view, in order to achieve whatever objectives they have, technology is very key and they recognize that. And so what they want to spend on technology there is a very clear clarity and it is just getting executed very well across the board.

Sandeep Shah Chandra, one of your competitors said that the pipeline from the Continental Europe is really robust even on a traditional outsourcing. So do we also believe that besides organic growth, inorganic growth could be the right solution for driving growth in the Continental Europe?

N. Chandrasekaran I think you always have to do a combination. Continental Europe is good for us also. The base is small. While you can say Continental Europe, it is just not one market. Each market behaves differently. France is different from Germany. Germany is different from Benelux and Nordic. So, each of these markets are different. And so we need to take call for each of these markets separately, because we cannot see Continental Europe as just one market.

Moderator Thank you. The next question is from Viju George from JP Morgan. Please go ahead.

Viju George I just wanted to understand this furloughs aspect a bit. It seems that you are seeing furloughs now extend to other sectors as well beyond traditionally Telecom and Hi-Tech, etc. Why is this happening and is there any correlation between those clients who impose furloughs and their spending for the coming year?

N. Chandrasekaran We have not said anything new other than what we have said when we met for mid-quarter briefing. Basically, this year apart from the Hi-Tech industries and the Manufacturing, we also saw furloughs in the Financial Services with specific clients and this we communicated. It is one-off in December. That has no bearing on the spend for next year as we can see. These clients have started operating and the projects have started from December 20th even in most cases. So there is no correlation with their spend for next year. And I cannot tell you what will be the situation in December.

Moderator Thank you. The next question is from Nitin Padmanabhan from Espirito Santo. Please go ahead.

Nitin Padmanabhan I just wanted to understand, one is in terms of pricing, during this quarter was it entirely portfolio led and what part of the portfolio? And two, Maha you mentioned that you expect realizations to improve going forward. Just wanted to understand does that mean that you see higher discretionary spends more to Consulting SI and the asset leveraged solution and thereby you see higher pricing, how do we read that?

S. Mahalingam Let me answer the second question. What I said was that the productivity improvement should continue because that has been the kind of thrust that we have. One of the questions that keep getting asked of us is that next year you are recruiting only lower number of people and therefore are you planning for lower increase and so on. So we are not saying that. All that we are saying at this moment in time that there are enough productivity levers within the organization to be able to crank up, especially given that our size is very large. He is also questioning as to why the utilization rates cannot go up. We are essentially dealing with large organization and it is also essential for us to keep looking at productivity improvements and so on. And that is where I was coming from, that there is still some more room that we will attempt.

Nitin Padmanabhan But would that mean this quarter I think we have seen fixed price projects go up by 50 basis points. So does that mean that it is going to be driven by higher fixed price or some other measures?

S. Mahalingam: No, it will not be purely fixed price.

N. Chandrasekaran We also have to operate based on what the customers want. It is not something that we decide, frankly.

Nitin Padmanabhan And this quarter was totally portfolio led in terms of the realization increase?

N. Chandrasekaran Yeah.

Moderator Thank you. The next question is from Vinay Rohit from ICICI Prudential Life Insurance. Please go ahead.

Vinay Rohit I remember during our interaction, it was mentioned that furloughs in some of the BFSI clients were expected. So was there a negative surprise in terms of more furloughs in BFSI or this was as expected?

S. Mahalingam What we had said in October was that we do not expect the furloughs to be any different as far as this year is concerned and we said that later on we found that, there is going to be a slight increase that is about all.

N. Chandrasekaran The basic point is that though the furloughs are expected this year with more clients and also in Financial Services that is the main point. So the volumes are soft this quarter.

Moderator Thank you. The next question is from Dhawal Mehta from Edelweiss. Please go ahead.

Sandeep This is Sandeep from Edelweiss. Only important question which is there is on the utilization side. If you see we are now at 81.7% and I remember the comfort zone of 82, 83%, but with the kind of trainees which have joined this year and the number of offers made next year, so do you think that we will be at around 83 or do you think that it will be more towards 80% in the first half of the year?

N. Chandrasekaran It is very difficult to answer today, but we are comfortable to operate at 83%, in fact, as I said we will want to explore that further. And if utilization has to be at 81% or 80 point something, that is okay, we can handle that as well.

Moderator Thank you. The next question is from James Friedman from Susquehanna. Please go ahead.

James Friedman I wanted to ask briefly, if you could share some comments about the competitive environment, how you might characterize it currently and relative to the past couple of quarters or years?

N. Chandrasekaran There is nothing specific that I can say. I think you always find different companies operating with different strategies and you will always expect in every offering that we have in every market that we offer it, we face two or three competitors. The competitors may vary but at the end of the day it is for us to offer our value proposition and win. I do not think that I would like to offer anything specific because it will all be very subjective.

James Friedman I understand that, but perhaps if you could comment as to how rational you see the competitive environment without naming anyone specifically.

N. Chandrasekaran You always have rational players and irrational players. So you see both and how and in what situation somebody becomes irrational is very much depends on situation someone is in. So I think we believe that we got to operate in a way that we can maintain the growth, at the same time maintain healthy margins. It is very important for us to be able to invest and build the business for the future and we have been pretty successful in doing that. There is no particular concern that I have, let me put it that way, we do find time-to-time somebody is being irrational but that is fine.

Moderator Thank you. Ladies and gentlemen, due to time constraints that was the last question. I now hand the conference over to the management for closing comments.

N. Chandrasekaran First of all, I want to once again thank you all for making the time and listening to us in this conference call. As I said we have been quite happy with the performance, we have pretty much executed very well, and we knew that it is going to be a soft quarter on volume but we are quite happy with where we ended in terms of volumes, productivity, in terms of operating margin, and also in terms of the client wins as well as the client metrics, pipeline, and order book. So I think we are exiting Q3 and entering Q4 and 2013-14 with a positive frame of mind. Thank you and looking forward to speaking with you in three months from now.

Moderator Thank you members of the management team. Ladies and gentlemen, on behalf of TCS that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

[Note: The transcript has been edited for improved readability]