Tata Consultancy Services Limited

Q2 FY14 Earnings Conference Call.
October 15, 2013, 19:00 hrs IST (9:30 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, 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 '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kedar Shirali. Thank you, and over to you, Mr. Shirali.

Kedar Shirali Thank you, Inba. Good evening and welcome everyone. Thank you for joining us today to discuss TCS' Financial Results for the second quarter of FY 2014 ending September 30th 2013. 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.

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

Chandra and Rajesh will give overview of the company's performance followed by the 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' that we emailed out earlier this evening and which is also available on our website. With that I would like to turn the call over to Chandra.

N. Chandrasekaran Thank you, Kedar. I am happy to talk to all of you and report that we have had another strong financial performance in Q2.

The highlights of the quarter are as follows:

The volumes have grown strongly at 7.3%, of which Alti accounts for about 1.2%, so the organic growth is 6.1% sequentially.

Sequential revenue growth in rupee terms is 16.6%, in dollar terms 5.4% and in constant currency terms, a little under 6.1%.

Growth has come from across all markets, industries and service lines. In fact, the growth from each of the segments – whether it is from a geography perspective, from industry perspective or services perspective – has been decent and credible and close to the company average.

In terms of operating margin, it has been another great quarter with a sequential expansion of 314 basis points. The operating margin at 30.2% is our best yet. Besides all the currency benefit that flowed through to the operating margin level, we have had an operational improvement of about 40 basis points which was used to overcome the margin headwinds that came with the Alti integration.

In terms of net margin, we delivered 22.4%, an improvement of 130 basis points QoQ, overcoming three major headwinds – one is the higher tax rate, second is lesser treasury income because of the huge payout of the dividend at the beginning of the quarter; and higher hedging loss.

In terms of the customer metrics, again, it has been very nice; we have added 30 clients in the $1 million+ bucket, very significant coming through organic TCS growth, and 3 clients moved up to the $100 million+ category at the top end.

In terms of markets – Europe, UK and Asia Pacific led the growth. Amongst industries, Life Sciences, BFSI, Energy & Utilities and Media & Entertainment led the growth; in terms of service lines – Enterprise Solutions, Assurance, Infrastructure, Asset Leveraged Solutions led the growth.

We announced a good number of deal wins; very healthy. Employee addition was very healthy and utilization has gone up 70 bps excluding trainees and 250 bps including trainees. As you know, we have been operating at ~72% utilization including trainees and that has gone up to 75% this quarter. So overall, it has been an excellent execution on all fronts.

And from the market point of view, we got a contribution from the discretionary spend also. The demand environment is strong and we see good momentum and discretionary spend is expected to continue to pick up.

Specifically with regard to Q3, it is a quarter where we will have the effect of furloughs and that will be a growth dampener. Those are the comments I wanted to make to start with and will hand it over to Rajesh.

Rajesh Gopinathan Thank you, Chandra. Let me quickly go over the headline numbers once again.

Our second quarter revenue of Rs 209.772 billion represents a growth of 16.6% QoQ and 34.3% YoY. Revenue in dollar terms is $3.337 billion, which is a sequential growth of 5.4% and a YoY growth of 17%. In constant currency our revenue growth is 6% QoQ.

Organic revenue growth i.e. excluding the full quarter revenue from Alti was 15.2% in rupee terms and 4.2% in USD terms on a sequential quarter basis.

The breakup of our sequential INR growth of 16.6% is: volume growth of 7.3%, constant currency realization impact of -94 bps, currency benefit of +10.6% and offshore leverage of -38 bps.

We had an operating margin of 30.17% which is up 314 basis points over the previous quarter and reflects a 3.1% benefit from rupee depreciation.

Net income margin expanded by 130 basis points to 22.4% despite a higher effective tax rate of 24.8% and a forex loss of Rs 3.77 billion.

Our accounts receivable was at 80 DSO, which is two days less compared to the quarter ago period.

Invested funds as of September 30th was Rs 151 billion. And lastly the board has recommended interim dividend of Rs. 4 per share.

With that we can open the line for questions.

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

Joseph Foresi My first question is why has growth come back the way it has and how sustainable do you think it is? And is the goal still to grow faster than the industry?

N. Chandrasekaran We are on track as per the growth we have been delivering; in fact last quarter also we delivered a 6% volume growth. So I think we have been continuing to execute and deliver to the trend that we have been following.

I had said that we will grow above the industry, above the NASSCOM estimate, and also that our growth this year will be better than last year. That is the statement I want to stick to.

Joseph Foresi I wonder if you could just drill a little bit down on, have you seen a shift at all on the ERP or SAP implementations that you have been doing towards newer technologies. And if so, how would you compare the growth rate of those two. I am just wondering if there has been any kind of major market shift on the Consulting side.

N. Chandrasekaran I will give you some broad statements, but I will not be able to quantify. The SAP, Oracle business is growing for us. But in addition, we are also seeing technologies like Salesforce, Workday, those kinds of technologies gaining traction with customers. Also, a lot of solutions are on digital which use a variety of products not necessarily the standard platforms, so it is a mixed bag.

Joseph Foresi And then the final question from me. If you look at your margin profile, how should we think about those margin levels going forward, especially since there has been a lot of commoditization taking place and how sustainable are the margin levels ex-currency?

N. Chandrasekaran We have basically said that we are comfortable operating around the 27% range. That is the indication we have given, I think we would like to stick to that. I am assuming that your question is more medium term, right?

Joseph Foresi I see it is both; it is medium and long, I am just wondering, we have also….

N. Chandrasekaran I do not know what is long, but we believe that in this industry it is important to execute at decent margins. That is what gives us the investment power and we need to be able to invest because the changes that are happening are pretty rapid and it will only get more rapid. Also the number of new business models, new nonlinear initiatives that we have to try, we need the ability to operate at good margins, so we are committed to operating at good margins and deliver growth. That is what we are committed to.

We have said that we were comfortable around 27% EBIT. If you remember, even when rupee was Rs 48 to a Dollar, we had operated close to 29%. So I think in general, our stand is that we would like to operate around 27%.

Moderator Our next question is from Anantha Narayan from Credit Suisse. Please go ahead.

Anantha Narayan A couple of more questions on the margin front; the first is addressed to Rajesh. Have you changed your exchange rate assumptions while bidding for fixed price projects or are you still retaining what you had say 3 months back? Secondly, just on the margins, assuming the Rupee remains at say Rs 60 for the next foreseeable future, is that comfort range still 27% or would you revisit that?

Rajesh Gopinathan We have actually discussed it in early September. The currency volatility that we are seeing currently is just a couple of months old, and we would like to wait to see where the currency settles before making a significant change to our strategy. Our target operating range of 26 to 28% as of now continues. If there is a change of strategy, we will communicate that at an appropriate period. As of now, there have been no internal changes to assumptions on the model side. We are in a wait-and-watch mode as far as the currency goes.

Moderator Our next question is from Diviya Nagarajan of UBS. Please go ahead.

Diviya Nagarajan Couple of questions: Chandra, you spoke about furloughs that could impact the December quarter, could you kind of give us a sense on what is the normal seasonality that you see versus any abnormal furloughs that you could see because of the government shut down in the US?

N. Chandrasekaran No, I am not factoring in anything because of the government shut down. Basically in the Q3 quarter, we face furloughs especially in the manufacturing companies, in Hi-Tech companies, sometimes Telco's. Last year we even faced in some services companies.

So in some companies where there is a furlough, we already know and some we will get to know during the course of the quarter, so that could impact. But I am not factoring in anything because of the government shut down or anything. It is just a seasonal thing and Q3 tends to be a dampener due to furloughs.

Diviya Nagarajan Ajoy, a question on the hiring front: this fiscal so far we have seen very lateral-heavy hiring and entry-level hiring seems to have come off. Utilization ex-trainees is just a couple of percentage points away from your all-time highs. So any thoughts on how this will progress for the rest of the year or will it continue to be heavily skewed towards the lateral hiring?

Ajoy Mukherjee As far as hiring for this year is concerned, we had said it will be about 45,000 to 50,000 and we are pretty much on track. If you are looking at from lateral to trainee kind of percentages, it will be difficult to get a sense of the numbers because the hiring is geography-specific, it is service line-specific, hiring in BPO Vs IT turn out to be different. But as far as IT services and India hiring is concerned, we are pretty much on track for what we had mentioned earlier about the trainee to lateral kind of ratio and we are continuing with those targets.

N. Chandrasekaran We will maintain the higher trainee additions, and we will also factor it in when we plan for next year, we are already taking about it, and so we will ensure that the trainee component is maintained.

Moderator Our next question is from Keith Bachman of Bank of Montreal. Please go ahead.

Keith Bachman I want to also ask a question on margins, but I wanted to ask about a different way. As you think about over the next 4 quarters, if you exclude currency because we can make our own assumptions there, what are the puts and takes that you think about either positive or negative as it relates to your margin, including areas such as utilization, do you think that is up or down? Mix, how do these other forces or any other that you want to address as you think about the margins over the next 4 quarters, even directionally up or down. And then I have a follow up, please.

Rajesh Gopinathan Our margin profile is a net outcome of the operating model that we have and the strategy that we have put in place over the last few years, so it is a factor of mix of service lines, mix of geographies, broad-based delivery organization, focus on execution and better client mining. In the context of that, we believe that we are fairly confident of operating in a narrow range that we have specified with the currency volatility being outside of this. So over a 3 to 4 quarter period I do not see any change to this model and we should be fairly confident of executing within that range.

Keith Bachman Then as a corollary, I guess, if currency goes against you, can you maintain within this range given some of the opportunities such as utilization that you might have to offset it?

Rajesh Gopinathan Again, as I said, within that range of currency we have said that we will maintain the 26 to 28%. If currency swings widely, at that time we will have to see what changes would have to be made and we will address the question at that point.

N. Chandrasekaran The other thing that I want to highlight is when we invest in strategic initiatives we also take into account the number of initiatives we want to pursue at any point in time. And there also we take a call based on the comfort we have because we commit to these initiatives whether it is going into a new market or a new bet that we are making, etc., how much fund we allocate, etc., all those things we take into account, what are the comfort level is at the margin and the currency.

Keith Bachman Let me transition to a specific opportunity for you guys in Business Process Services. The growth was a little bit under your corporate average, how are you seeing the competitive dynamics in this particular area you look out over the next four quarters, is it getting more competitive and/or would you envision that Business Process Services would grow faster or the same or slower than the corporate weighted average?

N. Chandrasekaran If you look at our Business Process Services business over the last 2 years or 3 years, we have grown faster than anyone else. It has been one of the good service lines which has built scale. Post the Citi acquisition, we have been able to expand into a number of customers in the Financial Services and in many Transaction Processing areas.

Our Business Processing Services is vertical-based and also platform based. So we see lot more opportunities, not only for Transaction Processing but also for platform-based offerings. It depends on which timeframe you are talking about. Platforms take time to mature. Even the Diligenta platform which we created took 5 years for us to mature it. Now it is very industrial strength and we are trying to scale it across markets. So similarly, those kind of initiatives we will take and they will take time to mature, but in terms of Transaction Processing and domain BPOs, value-added BPO, I think we do not see an issue.

Moderator Thank you. Our next question is from Sandeep Agarwal of Edelweiss. Please go ahead.

Sandeep Agarwal I have two questions; one question from Chandra and then I will follow up with Rajesh with another question. Can you throw some light on the BFSI recovery because you know it is one of the largest verticals and we know that at least TCS is doing good in that vertical but what is your sense now, is there any significant change which should be called out, are you seeing an increasing traction there? And another question on the SMAC space, I know the deal sizes probably are slightly smaller in that space compared to the transformation ones, but how frequent are those deals, is decision making faster or not in that area?

N. Chandrasekaran On the BFSI side I think we have delivered a good quarter; our growth has been 6.1% on constant currency terms and 17% on rupee terms. We see a lot of traction in BFSI across markets, both in the developed markets and in the emerging markets, it is one of our strong verticals.

The type of engagements or optimization-related, risk and regulatory compliance-related and also digital-related. So we see traction across the board. Also there are opportunities to create platforms in the BFSI space which we are pursuing.

In terms of the Digital space, a lot of opportunities… especially discretionary spend is going in this direction. In our press release we have given a large number of engagements, just to give you a color on the type of engagements we are seeing it is Cloud-based, some are Big Data-based, some are Mobility in terms of tablet-based, Omni-channel, multichannel… There is a huge number of engagements.

Customers are looking to look at these technologies in a holistic manner to be able to see how they can reinvent themselves in terms of business models and business processes. So it is a good opportunity. Yes, deal sizes are small, but then we kind of win and execute and bill and collect the money in 1 or 2 quarters.

Sandeep Agarwal One follow up question from Rajesh. When you say that you are building in 26 to 28% kind of margin that is a comfortable level where you see the company to execute excluding currency, does that number anyways take a cautious stance on utilization levels from here or do you take a stable state utilization level?

Rajesh Gopinathan Again, on the margin, we are not calling out individual lever by lever and giving linkage to that. So within certain ranges that we are operating on all our various operating parameters, we are comfortable maintaining that range and there are multiple levels to play around with.

Sandeep Agarwal So let me rephrase the question, is this utilization level on the higher side or is it in the comfortable zone?

Rajesh Gopinathan This utilization is in line with our operating model and to that extent we do not see it on either being on the higher or lower side, this is in our operating range.

N. Chandrasekaran The point we would like to convey is that it is a statement of intent and also commitment to operate at that margin level. There are a lot of levers. And I have said in the past, if we have to push up the utilization above 85% we can. When we are talking about 300,000 people it is not the same company when we were 100,000**.** So these parameters, these targets, etc., will keep changing. So we would not like to be rigid about anything. We have a business model, we have a need for operating at a certain margin level and achieve certain growth rate and then we have got levers which we will work through and it is very difficult to give you certain numbers on each parameter and lock ourselves in a spreadsheet.

Moderator Our next question is from Sandeep Shah of CIMB. Please go ahead.

Sandeep Shah Sorry to stress again on the margin, just one thing like FY13 the realized rupee/dollar for TCS was Rs 54.40 and at that point in time we delivered ex of one-off margin of closure to around 27.3, 27.4. Today rupee/dollar is closer to around 60, 61 and we are still maintaining guidance of 27% kind of a comfortable level. So what do we foresee in terms of a size of the investment to be made in future or still remain sizable to still keep the guidance at the same level despite rupee depreciation of 10 to 11%? Is it a fair way to look at what you are trying to say?

N. Chandrasekaran First of all I want to say is that it is not guidance. You kept repeating "guidance" multiple times - we are not giving any guidance. It is a comfort level and it is our intent to operate at that level is what we said.

That does not mean that any excess margin will be immediately invested. We will have to make the right decisions. For example, this time we captured the upside straightaway and reported 30.2%. So whatever we do, we will be sensible.

Our need to operate at that operating margin is what we are conveying. It is not that we cannot operate above that margin at some point in time or we will not go below that margin at some other point in time if some other factors occur. But our statement of intent is to operate at that level and that is the message we are giving.

Sandeep Shah What explains the 94 bps change in the realized pricing because of the mixed change despite we had ALTI which has been consolidated which according to me is more towards discretionary and looking at the growth also more balance or slightly tilted towards discretionary revenue, because even the effort mix has not materially changed on a quarter-on-quarter basis?

Rajesh Gopinathan If you look back our historical realization trends what we have said is that we report realization and not pricing. Realizations gets impacted by various factors including number of working days, mix, pricing, and geography mix, etc., and you will find that realizations stays in a certain band. It might go up a couple of quarters, down a couple of quarters, a quarter flat and that has been in the range.

So what you should look for is multi-quarter trends rather than quarter-on-quarter changes. Last time also, we had said that we will not call out individual quarter impact; we do not think that is material. We do not see a change in the pricing environment. If there is a directional change either up or down, we will call it out and let you guys know.

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

Nitin Padmanabhan Just wanted to understand what is TCS' perspective in terms of what you see in the overall demand environment? Do you get a feel in terms of the deals and the traction that is out there that FY 15 could be a better year for the industry? What are your thoughts broadly in terms of the demand overall?

N. Chandrasekaran It is too early to comment on FY15, so I think you should give us some more time to come back to you on FY15. In general, I have been positive both in the press announcements and also in the media interviews. We find the demand environment to be strong, robust pipelines both in terms of annuity business as well as in terms of discretionary spend. How it will translate in the next 8 to 10 quarters, we need to wait and see. So at this point in time I am positive.

Nitin Padmanabhan When you look at competition generally when it comes to pricing for deals, does it work out at the end of it that the vendor who basically uses the rupee benefit, who is able to get the lowest prices, is that the trend that you are seeing or that is not something that vendors are doing in terms of competitiveness?

N. Chandrasekaran I cannot really tell which vendor is going to use the currency benefit. I can only know some people when they drop the price, they drop the price, whether they drop the price for what reason, etc., I cannot say. But it is not nothing new, you always have a situation where somebody is undercutting. That is not very specific this quarter; it has always existed, and as you build your business it is something that you learn to live with. And it is more important for us to do what we think is right and what works for us. I would not sweat about it.

Nitin Padmanabhan And one last one if I may: are you seeing any crunch in terms of availability of mid level talent? Is that something that you would worry about may be going into the next 12-months or so from an industry perspective, is that a difficult resource going forward?

Ajoy Mukherjee From a hiring point of view we do not see any issue so far. As you know that we hired about 17,000 as far as this particular quarter was concerned. And our hiring is global, so we are finding the talent that we need and particularly if you see our overall retention side we have been having the industry-leading retention.

Even in this quarter the attrition rate was 10.9, previous quarter it was 10.5. And our internal engine to develop competencies based on the need as far as the business is going and which way the business is growing and all these factors play into it. So I think we are not concerned as far as this particular aspect is concerned.

Moderator Thank you. We will take our next question from Yogesh Aggarwal of HSBC Securities. Please go ahead.

Yogesh Aggarwal Firstly on the demand environment, Chandra, you mentioned that discretionary spending is picking up but if you have to compare today's spending environment with let us say 2007 or 2010 both in terms of discretionary and rebid, how far are we in terms of pace of spending, is it still weak or are we matching up to those two good years? And secondly, just a quick one from Rajesh: the unbilled revenues have gone up in the past 10 quarters from 15% to 21% of sales but the fixed price contracts has not changed much so just two words on that would be great.

N. Chandrasekaran I think on the first question it is very difficult for me to visualize 2007 and 2010. I think the only comment I would make is that we are seeing a momentum in terms of discretionary spend. Customers are investing especially in Digital space and lot of transformation initiatives are receiving attention. I think the momentum is very good, it has been picking up continuously as I have been articulating for first two quarters. That is all I can tell you, I cannot really say whether it is like 2007 or like 2010 because I do not know what it means.

Rajesh Gopinathan On the UBR, Yogesh, you need to look at UBR minus UER as a metric because that gives you a better picture and if you look at that last two quarters that has been increasing, previous two quarters it was decreasing. And the overall trend is more a reflection of the nature of contracts and the size of contracts rather than just T&M versus Turnkey. When product-based or asset leverage-based projects kick in, those tend to have a different billing profile. So it is not just a difference between T&M and Fixed Price.

Moderator Thank you. Our next question is from Pankaj Kapoor of Standard Chartered Securities. Please go ahead.

Pankaj Kapoor I will just come back again on the realization because we have seen this quarter-on-quarter decline for the third quarter now. So I was just wondering what is basically changing in the underlying side in terms of the mix which probably determines this number if you can just give some color on that, please?

Rajesh Gopinathan Again, realization we have seen two quarters, previously we have seen flat and we have seen uptick previously, so you need to see it in a slightly longer horizon. As I said, reported quarterly realization is a factor of multiple things, it is not just price. So we do not see a trend in the either direction that we want to call out right now, and the proof of that is that this has been moving up and down and that stays volatile, it's in the nature of that metric.

N. Chandrasekaran Overall, we are not seeing a decline in pricing; pricing is pretty stable. The realization is a combination of several factors and as we expand into new markets when we have more revenue coming from the emerging markets in a quarter will behave in a particular way, more revenue is coming from established markets will behave in a particular way for example. So not only service lines but also you have to look at market in which we operate and as pointed out earlier also the number of working days, so many factors are there, but I think it is not a cause of concern.

Pankaj Kapoor Chandra, can you also put some number to the 8 deal wins that we had announced, any combined contract value or anything?

N. Chandrasekaran We do not publish the order book, so I do not want to introduce something suddenly in a call. I would say that our order book is healthy and we continue to do better every quarter in terms of the overall order book.

Pankaj Kapoor And is it fair to assume then that each of these deals would be like say (+50) million, any threshold that you have when you a large deal.

N. Chandrasekaran It is just another way of asking, so Pankaj I think I do not want to put a number.

Pankaj Kapoor Finally Ajoy if you can put some number to the campus offers that you are planning to give for the next year?

Ajoy Mukherjee Campus offers is something that we have started, what we did last year was 25,000. As far as the next year is concerned we have not announced that yet and that is something that we will be announcing in a day or two.

Moderator Thank you. Our next question is from Ravi Menon of Centrum. Please go ahead.

Ravi Menon I was just wondering about the new sort of Digital spending that you are seeing. How long are these contracts typically and what is the average contract value?

N. Chandrasekaran It comes in all formats, some are small contracts running under a million dollar, some are multimillion dollar, and some are set up as a big initiative and lot of small projects are done within that initiative. So the contract values vary but generally the billing and invoicing timelines are a couple of quarters.

Ravi Menon And what do you think, that these are little more onsite heavy than average?

N. Chandrasekaran In some places, yes, but not everywhere really.

Moderator Thank you. Our next question is from Nitin Mohta of Macquarie. Please go ahead.

Nitin Mohta Chandra, I just wanted to get your thoughts, there is a lot of disruption in the market in terms of whether be SaaS or organization making changes to endorse to this technology in a big way. So from a deal size perspective does it make things tougher for the vendors? The other way to ask is that is there a need to pull the funnel faster as compared to how things worked say 3 or 5-years ago?

N. Chandrasekaran What is the reason you are asking whether there is a problem, organization change where in the customer organizations?

Nitin Mohta Your clients probably endorsing either say SaaS or making changes in the frontend with digital technologies, is it making it difficult in terms of the deal tenure?

N. Chandrasekaran Not really. Actually, the deal cycles and negotiation times are not longer, the only time they will be longer is whenever we are looking at a platform-based solution and those deal cycles are longer. But discretionary projects in terms of digital, etc., no. It’s normal.

Nitin Mohta If I can squeeze in a second one, Europe has been a great performer for FY-’12, FY-’13, continues to do well but in just in terms of the gap in growth rate between Europe and North America, any thoughts over there, how exactly you expect that to shape up?

N. Chandrasekaran I think Europe is still much smaller for us compared to North America, so we have gained critical mass not only Europe as a whole but individual markets, whether it is Nordics, Benelux, Switzerland, Germany or France, we are gaining critical mass. So when we get that critical mass and have a number of reference clients in each one of those markets then automatically our growth rate will pick up, so over the next 2 to 3-year period I expect Europe to grow faster.

Moderator Thank you. Our next question is from Ashwin Mehta of Nomura. Please go ahead.

Ashwin Mehta One question in terms of discretionary spending you mentioned that you are seeing this continue to pick up. So where exactly is the outlook incrementally better versus say a few quarters ago?

N. Chandrasekaran I think the Digital space is picking up lot more momentum now, that is investments in big data, investments in multi-channel, Omni-channel, and customer insights platforms all the front end stuff, I think the investments are picking up.

Ashwin Mehta And especially on the core ERP side any changes versus because that is been one segment which has been sluggish in the past?

N. Chandrasekaran In the core ERPs there are definitely opportunities for upgrades, consolidation, and new models like the Salesforce, Workday model and those kinds of engagements are definitely picking momentum in the traditional ERP space.

Ashwin Mehta Secondly, what are we looking at tax rates going to this year and the next?

Rajesh Gopinathan This quarter we have had a slight increase in our ETR; it has gone up to 24.76%. One of the major factors that is impacting it is we have declared a dividend of 250 million from our overseas subsidiaries and there is a tax impact of it both GAAP difference between IFRS and IGAAP as well as some incremental tax related to that. Net of that there are minor Q-on-Q variations; we think that this range of 24% to 24.5% would be the stable range for the near future.

Moderator Thank you. Our next question is from Mukul Garg of Societe Generale. Please go ahead.

Mukul Garg You are seeing quite a bit of discretionary spends on new digital technologies, Chandra, especially in Mobile, Big Data, Omni-channel, etc. Can you help us quantify the dollar revenue impact from this segment and any suggestions on how the growth rate is compared to your normal business would be quite helpful?

N. Chandrasekaran We do not have a separate segment for that, so obviously I cannot answer that question. We have been winning a number of engagements and the deal sizes range from a few hundred thousand dollars to a few million dollars – those are the typical deal sizes. I have listed a large number of engagements just to give you a color at this stage. It is attracting lot of investment.

Moderator Thank you. Our next question is from Pramod Gupta of HDFC Standard Life. Please go ahead.

Pramod Gupta I just had one small query regarding the cash flows. We have had a very good revenue growth in dollar terms upwards 16.5% in the first half, EBIT has growth about 23%, but somehow our cash flow growth is very low and in fact it is negative if we take CAPEX and acquisition. What is the view of the management on that and do we expect it to improve, if you can give some color on that?

Rajesh Gopinathan Actually, our view is much more positive than that. In terms of cash from operations, we generated about Rs 3900-odd crores from operations and invested about Rs 700 crores in capex, giving us a free cash flow of about Rs 3200 Cr.

The cash from operations to revenue is about 18.7% and our target range is about 17% to 19% which I think is a stable range given our current capex investment horizon and the growth profile that we see and this is a range that is fairly good.

Last quarter we had a one-off fluctuation which we had called out separately and explained what the changes were but otherwise if you go back couple of quarters back it has been fairly in this tight operating range.

Pramod Gupta This 17 to 19% is the range that we can basically expect the cash flow?

Rajesh Gopinathan Absolutely.

Moderator Thank you. Our next question is from Dipesh Mehta of SBICAP Securities. Please go ahead.

Dipesh Mehta One update on furloughs – in last few days whether we have seen any unusual weakness in any of the vertical than what we usually see from seasonal perspective?

N. Chandrasekaran No, it is just a yearly pattern that I was highlighting; I am not giving any specific data point.

Moderator Thank you. Our next question is from Yash Mehta of Equirus Securities. Please go ahead.

Yash Mehta Just wanted to know that if the currency stays at the current level then just as we had forex loss of Rs 377-odd crores, what kind of a forex impact are we looking at?

N. Chandrasekaran You mean for next quarter?

Yash Mehta Yeah.

Rajesh Gopinathan So we have carried an OCI impact of Rs 139 crores, which is the net impact that we could expect at our closing rates. This is spread over Q3 and Q4.

Moderator Thank you. Our next question is from Ankit Pande of Quant Capital. Please go ahead.

Ankit Pande I just had a question with respect to the various service lines especially where the growth visibility that we have that will pan out over the next 3 or 4 quarters. So amidst Infra or Managed Services and ADM and Enterprise how do we see that shaping up which is likely to gain more share?

N. Chandrasekaran If you look at our track record and also the pipelines and the deals we have won definitely (IS) Infrastructure Services we will do very well, Assurance, we also expect to do very well in Enterprise Solutions and Digital. So I think IS, Assurance, Digital, and Enterprise Solutions definitely.

Ankit Pande And just a little bit more information on the Immigration Bill side and how are we are tackling that issue. So have we changed anything in the way we have set up to service onshore and nearshore service centers, are we hiring more?

N. Chandrasekaran Since we had a conversation last I think the situation has been quite soft on that front and we have to watch what happens because all of you are aware of the current version of the bill and then the old version of the bill. So we are waiting and watching what the final version of the bill is going to be. We have multiple scenarios and we are working on all those scenarios depending upon where we will finally end up.

Ankit Pande So at this point in time we have changed nothing as far as subcontractors or anything of that sort?

N. Chandrasekaran The things that we are doing to prepare ourselves for all different scenarios.

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

Sandeep Shah Rajesh, wanted to know is there any change in terms of the type of the cover which we take in the hedging? Are we moving more from an options to a forward kind of a scenario, if you highlight some color on that?

Rajesh Gopinathan Structurally no. We use forward cover primarily in our receivables positions and options primarily on our revenue hedge positions; no change in that. We cover one to two quarters forward and again as a strategy no change in that. Currently we are covered for Q3 and light on Q4.

Sandeep Shah And Chandra just a comment, in terms of a large outsourcing deal flows are you witnessing that, starting from Q3 of this calendar year the deal flows is better versus what it used to be in the first half of the calendar year?

N. Chandrasekaran As I have said it is incrementally getting better. We said last quarter also we are comfortable. We continue to maintain that. The environment is quite good.

Moderator Thank you. Ladies and gentlemen that was our last question. I now hand the conference back to the management for closing comments.

N. Chandrasekaran Thank you all for listening and very nice to talk to you once again. To summarize, I would like to say that we have had a good strong set of numbers broad-based across markets, across industries, and across service lines. Our operating metrics, whether it is in terms of volume or in terms of operating margins or net margins, everything is on track and quite strong this quarter.

Deal wins have been good. Utilization is good. We have already improved the trainee utilization which has been one of the important achievements this quarter. Our cash generation this quarter is significantly better than last quarter. Last quarter we had a one-off effect which we had explained and this quarter we are back on track. In terms of the pipeline, it is quite strong, and we remain positive as we leave this conference call. Thank you.

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

Note: This transcript has been edited for readability and does not purport to be a verbatim record of what was said during the call.