

“Tech Mahindra Limited Q1FY20 Earnings Conference Call”

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MANAGEMENT: **MR. CP GURNANI** – MD & CEO, TECH MAHINDRA LIMITED
 MR. L. RAVICHANDRAN – CHIEF OPERATING OFFICER
 MR. MANOJ BHAT – CHIEF FINANCIAL OFFICER
 MR. HARSHVENDRA SOIN – CHIEF PEOPLE OFFICER
 MR. MANISH VYAS – PRESIDENT (COMMUNICATIONS BUSINESS, MEDIA
 & ENTERTAINMENT BUSINESS), AND CEO, NETWORK SERVICES
 MR. JAGDISH MITRA – PRESIDENT (ENTERPRISE BUSINESS)
 MR. RITESH IDNANI – PRESIDENT (BUSINESS PROCESS SERVICES)

Moderator: Ladies and gentlemen, good day, and welcome to the Tech Mahindra Q1 FY '20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. C. P. Gurnani – M.D. and CEO for Tech Mahindra. Thank you, and over to you, sir.

C. P. Gurnani: Good Evening. Good Morning. Welcome to Tech Mahindra Q1 Results. Q1 is marked with strong deal win momentum, much better than what we had witnessed last year. Overall, the pipeline is robust and much bigger. We always classify the business that we do as Run, Change and Grow. The change which is really the digital business, continues to grow and is showing very-very good results. Overall, we are confident of delivering higher growth for the company.

Few highlights for the quarter: Our revenue for the quarter was at 1247 million dollars, a de-growth of 1.6% QoQ. Our Communications business recorded de-growth of 3.2% QoQ. The softness is largely due to the seasonality in our Mobility business. Excluding the seasonality, Communications business is flat in constant currency basis. They have had a strong growth over the last three quarters and the deal pipeline looks very robust. So, I would only take this softness as a predictable softness in Q1. Enterprise business recorded a marginal decline this quarter. We had anticipated some sluggishness in our Auto and BFSI customers, which has played out, while Healthcare has rebound sharply. Hi-Tech continues to show good growth momentum. EBITDA for the quarter was at \$ 190 million. Profit after tax for the quarter is about 11.1% of the revenue. I know Manoj will help all of us understand more about where the EBITDA is and what is the impact QoQ. I am very happy to report that Digital revenue continues to grow strongly and it is now 36% of the Q1 revenue, which is a 3.9% QoQ growth. Digital will continue to be a major foundation stone of growth and we are getting a fairly good pipeline regarding digital transformation and our participation with our customers.

Today, your company also announced acquisition of digital company called Mad Pow based in US. It is a 70 people strong, a nice boutique with the capability in customer experience, human center design and understanding of behavioral science which will give Tech Mahindra significant edge in digital transformation projects that we are executing and we will also benefit with the Mad Pow's own footprint. I will let Vivek Agarwal take us through the Mad Pow acquisition when I invite him for further conversations.

A great quarter in terms of deal wins which is 475 million dollars in Q1, also deal wins in enterprise are highest in the recent past and we had large deals across verticals in BFSI, Healthcare, Manufacturing; Pipeline is at all-time high this quarter across Communications and Enterprise business. Some of the large deals are now in final stages of negotiation. They are meaningful and they will help us meet higher growth trajectory in the next three quarters. We have also seen good traction in 5G pipeline. We have also seen network services being cross-sold into enterprise customers; one of the the large deals in the 475 million is actually a financial services customer, but we have sold network transformation. So, clearly, Communications sector network is

becoming fast horizontal and it will even become bigger horizontal as the world starts adopting 5G. I was internally joking with our CPO, Harsh Soin that my best employees are actually humanoid called K2. I mean, this is our latest induction as we try and internally adopt to the digital transformation. Our humanoid K2 is taking over routine HR transaction, helping us create a better employee experience. K2 is a good example of artificial intelligence technology, machine learning and in a lot of ways helping us improve our customer scores as well our internal employee scores. Our HR has also implemented AI-based facial recognition system and your company continues to adopt the TechMNxt charter. We are collaborating with ecosystem of next-generation partners, new age industry solutions, working with various partners across the world. We also announced our collaboration with Mitsui to target SAP S/4 HANA transformation in the Japanese market.

Overall, a soft quarter from numbers but the deal win momentum gives us the confidence that demand environment is stable for us. We do believe that it will give us a decent start in Q2. We are optimistic about our growth potential in Communications business, we have analyzed the deal wins, we have analyzed the overall deal pipeline and Communications business has a slight edge in deal pipeline when we compare it with Enterprise business. Healthcare is showing a good track record and overall I can only say is that there have been some headwinds whether it is owing to currency, transition cost from the large deals or the wage hikes that we have given but we will try and recover some of the higher costs through our focus on automation, new age delivery, yield management and synergies across the year. BPS continues to grow. Ritesh has provided great deal momentum. We continue to add employees in the BPS. We continue to expand our global footprint in BPS.

And I would now like to invite Manoj Bhat, our CFO to share the Financials of Q1.

Manoj Bhat:

Thank you, C.P. I think C.P. covered at a broad level. First, if I look at the growth on a constant currency basis, I think the point to note is that if I exclude Comviva, Communications is flat and Enterprises about flat. So, in that sense the currency impact has been about 0.6% or so. In terms of the EBITDA margins, I think probably we should look at EBIT because we have also adopted IND AS 116 during the quarter and there is an interchange of some of the expenses between depreciation and rental lease expense. So, at the EBIT level, if I look at it, the lower margins largely is because of the portfolio companies. It has been an impact of more than 100 basis points in portfolio companies. The salary hike is about 100 basis points impact. If I look at the lower revenue, I think what we have continued to invest in manpower and that is across both IT and BPO. I think the utilization has dipped a bit. That is impact of about 60-odd basis points. H1B visa is lower, so it is about 40, 45 basis points impact. Currency is about 40 basis points. And deal transition and some of the expenses we are incurring will be about 20-30 basis points. So, to me I think this is a broad view of the margins and if I go through each one of these, I think some of the seasonality in our Mobility business will be covered and recouped back through the year. Salary hikes which is about 100 basis points we will recover it over the quarters ahead in terms of initiatives around new age delivery, automation, productivity. Utilization will correct itself as revenue growth comes back in which we expect to start from Q2. Visa cost is one-time and currency is an unknown but obviously we follow a hedging policy which just ensures some protection at the PAT level.

I think the other side of the story is the cash flow; the cash flow from operations for the quarter was about \$ 116 million which is about 61% of EBITDA which is a drop because one of the things which has happened during the quarter is if I look at our DSO it has gone up overall by about eight-days but most if it is unbilled revenue and that unbilled revenue will translate back into billed and then will be collected. So, I think we are seeing that impact in this quarter but it will correct over a period of time which is even the same thing had happened last year. So, going below that, cash and cash equivalents was about 1.2 billion as of 30th June. The dividend of about ~\$ 230 million will be paid out in Q2. So, that is something which will go away from this number. We spent about close to 270 million on our buyback which was concluded on 15th April 2019.

I would like to do is reiterate two or three things. While there are multiple headwinds on margins, we will be on a recovery journey as we go forward. What is very positive is we have had probably in terms of our funnel and in terms of late stage deals, we have had one of our strongest periods ever and that is something which bodes well for us in terms of the future and we remain confident that with some of the revenue growth coming back, I think we should be able to look at some of the view on Communications growth being much higher than last year and Enterprise growth what we had told you last time that it will be in and around the mid-single-digit growth.

So, with that I will throw the floor open for questions. We have Vivek Agarwal with us and if anybody has specific questions about Mad*Pow, we will cover that which is acquisition we did today.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: Subcontracting cost has gone up by about 176 million more or less, about 8-9 million QoQ. Is this largely due to an increase in HCI because that is project-based or this is largely due to the large deal that you are ramping up?

Manoj Bhat: It is predominantly because of HCI because clearly there is some short-term contracting work which we take onboard because many of these are quick ramp-up deals. I will also qualify that if I look at HCI some of them are short-term employees and some of them are short-term sub-con. So, it is probably going to be in both those buckets. The other thing is of course if I look at certain of our revenue streams especially in the TME vertical, we have had increase in subcon cost there which is because of the nature of work and we will need specific skill sets for about two or three months. So, we are seeing some of that. So, those are the two big reasons for the increase this quarter.

Ravi Menon: Quarter-on-quarter the 180 basis points headwinds in cross-currency, this seems to be significantly higher than say results reported but which are the major currencies that have caused this, like your exposure of pound or the euro, even Australian dollar which gives, that does not seem to be very different from what they have, another 25% which is the miscellaneous currencies, anything there that you like to call out?

Manoj Bhat: Quarter-on-quarter is not 180; it is about 60 basis points.

- Moderator:** Thank you. The next question is from the line of Mohit Khanna from Future Generali Life Insurance. Please go ahead.
- Mohit Khanna:** I had a question regarding the margin trajectory for the company. If we see the past 2019, while we continue to win deals, our margins kept on sliding and now we are at 11.5% on EBIT margin for this quarter which is 4 percentage points below QoQ and 2 percentage points nearly YoY. So, is it fair to say that Tech Mahindra would be a company with 11%, 12% or 13% EBIT margin company or probably 15% is achievable in coming quarters?
- Manoj Bhat:** If I look at our margin trajectory, clearly, part of this drop as I explained is a function of two or three things coming together in, in the same quarter, so which is your seasonality on the Comviva mobility business, it is also the salary hike and H1B. If I add all of those, it is a swing of about 240, 250 basis points and there is 50 basis points approximately of currency. So, that is 3%. If I look at the total decline of 380 basis points at EBIT level QoQ, that balance 80 bps is really because the utilization has dropped and we are investing a bit in transition cost. And historically what you would have seen even last year is we make up the margin on the salary hike which come during the year, we make up margins on the seasonality which the business operates at a certain level which is steady in the mid-teens. So, some of those will go away, which leaves effectively currency transition and potentially utilization kind of cost in there. Now, again, two of these will improve with revenue growth. Currency is something which we cannot control. So, that is the way to look at our margin and that is the way we are actually focused on trying to swing this around. Even if I look at last quarter, EBITDA was about 16.4 which then jumped higher and so on and so forth. I think specifically there was a currency tailwind last year and there is probably a currency headwind today and that is one of the differences also on margins.
- Mohit Khanna:** So, in the medium-term, 13% EBIT margin is what we can look at even though it is 11.5% today?
- Manoj Bhat:** We do not guide in terms of what would be a margin level. But, do we have the levers to hit 13% margin? In my mind that is clear but of course I have to balance it out with two or three things, right -- so there is currency, there is potentially if many of these deals get bunched together, there will be impact of transition cost as well as some investments we are making ahead of time in facilities, in people in certain skill sets, dependence on subcontractors. But to me do we have the levers to hit 13%? Absolutely.
- Mohit Khanna:** If you could comment on the latest acquisition, what is the company's revenue for the full year and margin that it made?
- Manoj Bhat:** I will ask Vivek Agarwal who heads Corporate Development and BFSI. He is also on the call to answer that.
- Vivek Agarwal:** The revenues for the current year are 17.5 million and the margin is in the mid-teens. The way we have looked at this acquisition is significant part of synergy opportunity across Healthcare, Financial Services and the Media industry where Mad*Pow brings in thought leadership in digital transformation using BFS, Analytics as a key lever.

- Mohit Khanna:** And we paid around \$70 million?
- Vivek Agarwal:** So, the structure is that we are buying 65% upfront and for that 65% we are paying about \$17 million, that is correct and the balance 35% will be acquired subsequently from the management team and the founders who have taken the business.
- Moderator:** Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.
- Sandeep Agarwal:** My question is to CP and Manoj basically is that why this growth has been so low even if you assume that Comviva has not grown, but at least except Comviva do you not think that Communications should have contributed at least some portion of growth and even Enterprise should have found some strong recovery because we have been seeing jump in deal wins for quite some time now?
- Manoj Bhat:** A fair question. Let me first pick the Communications vertical and clearly, we had three quarters of growth and potentially I think what we are seeing is a pause, as we had indicated last time also that we believe that our growth this year will be higher and if I really look at at the funnel and the conversion rates which we are seeing, we do believe that conversion has only increased after this quarter. And to your specific question on what happened this quarter, of course, when you have ramp ups in certain deals, I think there is little bit of a plateau sometime and sometimes there is also a timing issue. So, that is what you are experiencing and I think that will correct itself. On Enterprise, we were always talking about a softer quarter. I think if I look at the broader trends there is a slowdown which we are seeing specifically in the Auto vertical. I think we are also seeing some sort of a slowdown broadly in Europe. That is two buckets right there which if I look at the Enterprise side of things, that is one thing which is dragging. If you remember I think in the previous quarter we had indicated that Enterprise will be soft and it is almost like a period of one or two quarters and that is why we had said that from a full year growth perspective, we would look at a lower number than we were looking at in the past. Now again coming back to whether our outlook for the full year has changed, potentially with these deal wins and others which are in the funnel, we still have a very good shot at meeting our view and outlook which we expressed on the previous call, and that is just a function of what we are seeing out there in terms of deals where we are down selected to a position where we believe we have a fair shot at winning the deal. So, that is one way to look at it. The other side of the story is if I look at some of our customers specifically again in Auto I think we are seeing some softness from the EV market in China for example that is one of the reasons for this decline and those have been fully baked into the numbers. So, to me that negative drag will potentially start going away and that has played out over a couple of quarters. So, that is the other probably sequential view of things which will also start helping just reported growth numbers going forward. That is my quick view on how we look at this and that is why we are saying that we look at the full year, we are looking at growth acceleration coming through the quarters and potentially a very strong second half of the year.
- Sandeep Agarwal:** A very small follow up on that. Basically if I put all the three pieces together as you explained like Communications may be slightly better because of the deals and everything, may be little softer and then on the top of that, there are some losses on the margins which are little longer and the ramp up of deals and

everything. Basically, the math suggests that this year even if we may see some revenue growth, we may not see any earning growth. Is that a fair calculation? I am not asking for outlook, but is the direction of the thoughts right?

Manoj Bhat:

There is a currency impact so are you excluding currency/including currency, but leave that aside for a minute. So, from a full year perspective I cannot answer an EPS kind of question. I did articulate the levers and I think it is a function of two things in my mind right. When do we close this deal? And how do the transition cost bunch up? So, for example if I am looking at them closing early this quarter potentially some of the margin recovery should start happening in Q4. So, it is a bit of question about timing of conversion of these deals from funnel to actual. So, if it comes later, I think we cannot take away the transition margin impact that easily. I am sorry I am giving a roundabout answer because there are variables involved.

Moderator:

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

Pankaj Kapoor:

Manoj, in the last conference call you had mentioned that for the top line you are looking at about 8% to 10% kind of a revenue growth and your base case margin outlook was of basically flattish margin at the quarter close currency rate. So, today out of these two which one are you more confident of? I think what you had mentioned was the overall growth was 8% to 10% with Communications being higher than what we indicated earlier and Enterprise going lower than that.

C. P. Gurnani:

I did not say that, but let me answer the question differently. I think given the conversion I think the revenue visibility has increased dramatically and I think we are far more confident of meeting and beating whatever we thought was the previous kind of number. If I remember some of the statements, I had made we first said mid-single digit on Communication and then we said it has improved and now we are saying potentially it has improved further. And on Enterprise we were in that industry growth rate range and we had said that because we had missed a couple of quarters it has dragged lower. So, given this quarter which has happened and looking at the funnel I think we believe our confidence level is higher on achieving those kinds of numbers, #1. #2, on the margin side ex-currency, I think there are two things which have happened -- one is of course I do believe that as we go into this acceleration phase, we might see some margin drag because of transition, which we are already seeing some of it coming through. And that might change the numbers a bit towards the downside. And I think then it depends on, as I explained, which quarter and how the deals come through and which deal comes through and what is the understanding with the customer in terms of whether a TCO based saving structure and so on and so forth, which are the variables I was alluding to when I was addressing Sandeep's question.

Pankaj Kapoor:

And I don't know if Manish Vyas is on call, but I had a couple of question on the telecom side. So, CP alluded to a large deal, or rather deal pipeline getting built up on the 5G side. So, any color in terms of what kind of a scale of these deals are? And where are we in terms of decision-making process?

C.P. Gurnani:

I mean, I will try and get Manish on the call. But the way things are is that 5G licensing hasn't been very fast, as you know China has taken a lead, South Korea just launched the 5G, in a month they got about 1 million

subscribers. 5G use cases for enterprise are being developed. And our labs wins with Rakuten in Japan and in Bangalore are working very, very well. We are in advance conversations with two or three customers, which want to deploy 5G as their differentiator in business, which means enterprise customers wanting to look at 5G use cases. So, I would think is that the full-blown year for 5G is actually going to be in FY21 and FY20 would remain as a warm up year. Though in US 5G has now been launched in almost 12 plus cities, but it is very clear that B2B would be the biggest beneficiary.

On the large deal front, as I said, our pipelines are stronger. Our current weightage of pipeline is slightly favoring communication business. Enterprise business is, when you look at the weighted qualified pipeline, then communication business pipeline... I'll give you different examples, BPL in New Zealand onwards to network practices, to modernization of the legacy tech, to launching new services with the help of 5G. So, the good news is that pipeline covers majority of our service offerings. If Manish has joined, Manish, I don't know how much you heard, but if you want to chime in.

Manish Vyas:

No, I did CP. I think in addition to what CP just said, all I would say is that when we look at 5G, and we have been consistent about it that there are three type of businesses and transactions that will happen. One, which is around deploying, integrating 5G and related technologies. Second is, enabling in readiness for 5G, which is a lot of other digital change type offerings, and opportunities across BSS and the landscape, there is a huge opportunity in that space and that's underway. And the third is there will also be a lot of displacement which is, as companies start getting ready for 5G, there will be opportunities that we are in good discussions on starting to help people create the capital for them to generate the bandwidth for the 5G deployments. So, your company is right now busy with discussions across all three spectrum, which is what we call as the run, change and grow in one format. So, I don't think I want to add anything more to that, but we are extremely busy in a couple of good conversations as we speak.

Pankaj Kapoor:

So, Manoj, just one last question on the capital allocation, you have been saying that anything excess of a particular level of cash you would like to return to the shareholders. So, can you clarify what is the level of cash balance that you will be comfortable with?

Manoj Bhat:

So, in my mind we have not thought of a number per se. So, if I look at the level of cash flow we generated last time, I think we paid out almost all of it because we hardly did any M&A deals. And to me, that's probably a model to think about that as and when we don't use a cash for M&A and other investments, we would be inclined to return it in whatever form to the shareholders. And we have said that multiple times in terms of excess cash. And that's something which we intend to continue.

Pankaj Kapoor:

So, I can safely assume 90% to 100% of free cash flow each year is something what you can return to the shareholders?

Manoj Bhat:

It's not a stated policy, but it's a statement of intent, right? So, that doesn't mean we want to keep excess cash if we are not using it.

Moderator:

Thank you. The next question is from the line of Surendra Goyal from Citigroup. Please go ahead.

Surendra Goyal: Just had a couple of questions. I'm just trying to understand things a little better here. So, large deal wins in FY19 were up 28% year-over-year. And in the last three quarters, you have been doing 400 million, 500 million of deal wins a quarter, while growth YoY in this quarter is around 2% or so, and YoY obviously takes out the seasonality. So, how should we reconcile deal flow with growth? Is it really leading indicators or is there going to be a limited correlation of growth with deal flow going forward?

Manish Vyas: Thanks for that question. So, if you really look at it, and I did explain it in bits and pieces across multiple answers. So, two or three things are happening, I think one is clearly, I think if I look at the communications side, while there are new deals which have ramped up, the traditional business, of course, it's not growing, which we have said before, right? And that's a trend which is kind of universal. The second thing is, if I looked at manufacturing, and specifically auto, I think that's one more vertical, which has not done well if you take that period. I think the third thing is that if I look at the constant currency, the 2% becomes probably a higher number, more like 4%, 4.5%. The fourth way to look at it is that I think the combination of all these things is probably giving that view that the business is dealing from the deal wins. As we stand today, there is some decline, and we have spoken about it also in multiple discussions in the past that one of our large enterprise customers was going through a change period which has impacted revenues, it's a large conglomerate. So, multiple reasons there about when you look at that metric.

Now, as we look forward, I think there is stability in some of our customers, revenue streams, I would say and I answered this before when I was answering one of the questions, that there is some stability which we see on the auto vertical side and that's something which we are... because it's been declining for a couple of quarters now. And so that's the way I see it. And that's why from now on, I think, when we see the deal wins, it should translate into revenue growth in a much more meaningful fashion.

Surendra Goyal: Sure. Thanks Manoj for clarifying. And just on the margin side, one more question. So, I think you mentioned the numbers 13% in an earlier answer. So, is that a realistic estimate, given that you started a lot lower? And I think you mentioned in response to another question that there could be some impact of ramp-ups on margins in the near-term. So, when you put it all together and assuming that currency remains at current level, is that a realistic number to work with for this year?

Manoj Bhat: So, I don't have a margin guidance right now. What I was answering was, I think the question was, is 13% possible? And I said yes, 13% is definitely possible. And of course, we will try to maximize margins to the extent possible.

Moderator: Thank you. Next question is from the line of Viju George from JP Morgan. Please go ahead.

Viju George: Thank you. I think my questions have been answered. Thanks.

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

Sandeep Shah: Just on the communication side, when we say the pipeline edges higher versus the enterprise side, this is broad base across our large clients in each of the geographies of US, Europe, how has it been? Because one

of your large client in the North America has been awarding large deals to some of your global peers. So, just wanted to understand, is it that we are not competing for that kind of a deal or is it some amount of wallet share competition which is happening in that account? And this is a broader question in terms of how you say that what makes you believe that the pipeline is stronger in communication side?

C. P. Gurnani: Sandeep, I really don't want to comment on a particular client view, and what's happening there. Suffice it to say that, obviously, we are winning deals across the globe, and the funnel does cover some of that. So, if I look at some of the deals in the pipe, I think there is a couple of deals in Europe, there is one deal in Asia-Pac and then a couple of deals in the US. And that's something which we will have to see how we convert. So, that's why I think we feel very, very positive about the momentum and the growth. And that's we are saying this that we do see that we are in a position to win. Some of these deals at least, if not better than that. So, I think it's a very short answer and I definitely don't want to comment on any specific client or anything which is work in progress in terms of deals.

Sandeep Shah: Okay. But there is no worry in terms of any kind of a wallet share loss in any of our clients, especially in communications side?

Manoj Bhat: So, I think that is subsumed in probably what we said, right? I think we are reaffirming and feel more confident about revenue growth in the comps vertical.

Sandeep Shah: Okay, that is helpful. Just a follow-up to that, Manoj. I think you said that, the high single-digit could be a possibility in the communication, which you implied. And if earlier you were saying that you were looking at enterprise growth lower than the industry, but the confidence is now better than what you estimated earlier. So, for overall consolidated revenue growth of 5%, the ask rate is almost like 3% QoQ for the next three quarters, taken together the Communication and Enterprise. And this would be actually looking at your comments, you are targeting higher than 5% growth. So, am I directionally correct in assuming that looking at the pipeline, and the deal wins more than with single-digit consolidated revenue growth could be a better target to watch out for? I'm not asking for guidance, but is it directionally correct based on what the comments you are saying?

Manoj Bhat: If we convert the deals in the time frame we are seeing, as we have already indicated that it's going to be a very strong second half of the year.

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

Sumeet Jain: Firstly, Manoj, wanted to understand in the communication vertical, I mean, we had a very strong deal win last year, on a YoY basis it was up quite significant. And you mentioned, excluding the reverse seasonality the growth was largely flat in constant currency terms. So, I mean, does that mean that the traditional business in telecom is still declining for us out there?

Manoj Bhat: I did mention traditional business is flat, as think of it as a step up ramp kind of model, right? So, you have to constantly win deals to ramp-up, otherwise you are flattish. That's what seems to have happened this quarter.

- Sumeet Jain:** Got it. And I mean, on the margins I wanted to understand, I mean, the portfolio companies was one of the key levers for you in the last one and a half, two years, and this quarter we had 100 bps kind of a negative impact on margins. So, can you let us understand what the nature of this margin impact is and can be recovered going forward?
- Manoj Bhat:** Actually, the portfolio company impact is probably higher than 100 bps, but out of that 100 bps is the seasonal component, right? So, that's something which I did mention in the beginning that will equate itself out on a full year basis. What has happened is, some of our portfolio companies have been impacted by the slowdowns I was indicating in terms of both revenue and margins. And that is something which we have to work on, because that is now driven by a market event and a demand event. And that's something we have to work out on. And incrementally if I see from last quarter to this quarter, that is one element which is new, which is something we have to work on.
- Sumeet Jain:** Got it. And lastly on the manufacturing vertical outlook, I mean this is the steepest decline we have seen for you for the last several quarters, and you highlighted the EV market in China is one of the reasons for that. So, can you help us understand what's the percentage exposure for us in manufacturing towards the China EV?
- Manoj Bhat:** So, right now it's got down to zero, almost zero because we are out of those engagements.
- Sumeet Jain:** Okay. So, going forward we will not see further decline in manufacturing vertical at least?
- Manoj Bhat:** Yes, at least the China EV was the question. But I do believe that from an overall vertical perspective also I think the drag we see it being minimized as we go forward.
- Moderator:** Thank you. Next question is from the line of Divya Nagrajan from UBS. Please go ahead.
- Divya Nagrajan:** Two questions here. Could you kind of give us a sense of the 36%, 37% exposure you have to digital? And how margins look there versus the rest of the business? That's question number one. And two, I think you have talked about certain subsidiary impact on margins, could you just highlight which of the subsidiaries has seen the most impact of margins, other than comps of course?
- Manoj Bhat:** So, the second question, first. So, I don't want to get into individual subsidiaries, because I think... but just to give some color, there are two which has changed this quarter, out of which one we believe will be fixed pretty quickly and the other one is a probably more a structural issue, which we have to work on. And I think on the first question, sorry, Divya, what was your first question?
- Divya Nagrajan:** How do your digital margins compare to the rest of the company?
- Manoj Bhat:** So, we have never disclosed it, but the way I think about digital is, of course, in terms of realizations and per head as well as cost per head, it's higher, but also we are investing a lot. So, probably an EBITDA level, including investments, probably it is with this quarter marginally higher than the rest of our business.

- Divya Nagrajan:** Sir, I was also trying to reconcile the impact that it has on your overall margins, because we have seen a fairly strong ramp-up in digital in the last few quarters. And if margins are slightly on the positive side, why is that not able to offset some of the negatives that you are seeing elsewhere? The other way around, at what concentration of revenue does the offset really kick in for you?
- Manoj Bhat:** So, I think this quarter specifically, if that is the questions, I think a lot of our Comviva revenue, right, we would classify as digital, because there is a lot of business we do in mobile payments, enabling mobile payments, enabling video and such applications for our customers, as well as there are a couple of analytics platforms and so on and so forth. So, clearly if I look at this quarter standalone digital, of course, the margin would have dipped even this quarter, because that impact would be all pervasive and it will impact the overall margins. But generally speaking, I think, as I said that now we would see digital as slightly higher than core business margins on a four-quarter average basis.
- Divya Nagrajan:** One last question, if I may. From a contract flow perspective, clearly as you have explained, the new contracts are not able to fully offset in terms of the declines that you are seeing in the traditional portfolio. So, what kind of deal flow should we then be targeting for that offset to really start working for you?
- Manoj Bhat:** So, I think what I said is if I look at the last three, four quarters, I think that was true, because there were certain other factors at play. As we see some of the pressures around, specifically as I hinted at auto, and some of our customers cycles I think we do expect stability, that's why we expect that some of that will start coming into the growth numbers in a much more meaningful manner.
- Moderator:** Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.
- Nitin Padmanabhan:** A couple of clarifications, actually. One is, what would be the IndAS impact this quarter on EBITDA?
- Manoj Bhat:** About 60 bps, give or take. That's why when I was answering, I was answering mostly EBIT, because that's probably a better way to look at it. Because there is a little bit of difference between EBIT last quarter and this quarter.
- Nitin Padmanabhan:** Right. Second is, if we look at the commentary on margins, well, you did mention that 13% is something that's doable, you also had a couple of caveats in terms of possibly transition costs on deals, actually the investments on simply deals ahead of time and so on so forth. So, it appears there are moving parts to that 13% as well. Is that a fair understanding overall?
- Manoj Bhat:** So, Nitin, I think there are moving parts either way, right? So, under certain scenarios it could be below 13%, under certain scenarios it could be above 13%. So, as I said, I was answering a specific question from someone saying do you think 13% is achievable? And I said it is achievable. But then I said that but it depends on the timing and how the deal flow is going to be, considering some of the deals we are looking at are fairly large in size. Right? And I did say of the call, I am giving a roundabout answer, but that's the situation at the moment. And as we have better visibility into what is a margin which we can come back and say, that's probably going to happen in a quarter or so, we will know where we stand with a lot of the deal pursuits. And

that might be a much better time to think about margins in a more structured manner, which you are looking for.

Nitin Padmanabhan: The other thing was, if I look at the growth overall for the enterprise side of this business, it appears that it requires a fairly strong run rate over the next three quarters to be even close to mid-single-digit. And if we expect the pickup to happen in H2, it appears to be quite meaningful in terms of the pickup that's required. So, how do we basically see Q2, are there worries around underlying pressure in the business for the near-term for Q2 or do you think they will be fairly even?

Manoj Bhat: I do expect, I mean, Nitin, if I look at the business into three markets, right, so large deal wins, and I do believe we will have a strong quarter even in Q2 in terms of the wins. Second is in conversion into revenues, we will see partial conversion starting to happen in Q2 of the previous wins, and then building up momentum from this, right. And that's where I am indicating a stronger H2 or a very strong H2. And that's something which we are building into our base case. And that's something which we believe will happen, just considering on where we are on some of these deals. So, is there any other perspective you wanted, Nitin?

Nitin Padmanabhan: So, from what you are saying, I think overall it looks like we will end the year with a very strong exist and much greater and a much better sort of clarity on margins and a build for the next year, that's a fair takeaway, right?

Manoj Bhat: That is a fair take away that the exit will be strong. That's what we anticipate as we see today. And, of course, by that time, given that the margin situation in terms of how the transition cost evolution happens and how the recovery has happened of whatever we have seen as headwinds in Q1, I think we will be in a much better position to see that. But I am also saying that end of Q2 is a much better position, again, to look at margins, and given that there are these multiple things in the pipeline.

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

Ashwin Mehta: Manoj, I had a question on the BFSI and the retail piece which has been sluggish for you. So, what is the outlook there? When do we start to see a recovery there? And secondly, this quarter saw the other segment drive your growth. Now, that being the HCI business which is typically project based, how sustainable does the growth look in terms of looking at how the pipeline is shaping up for you?

Manoj Bhat: Yes, so I think there are two questions you are asking, right?

Ashwin Mehta: Yes.

Manoj Bhat: So, one is BFSI, why is it sluggish, when do we see a recovery? Second is HCI, do you think it is short-term growth and I would kind of answer it in two ways. So, one is, of course, what HCI does and the synergy kind of pipeline. So, I think Vivek can answer probably both the questions, he's also looking at the portfolio companies as well as the BFSI practice. So, Vivek, why don't you pick that up?

Vivek Agarwal:

So, I think on the second question first on HCI and Healthcare. So, the focus on the business in HCI is to get to long-term multi-year contracts in the healthcare ecosystem, especially the providers. And some of the projects which are shorter term implementation projects will continue to be part of the portfolio. So, what you are seeing is building long-term scalability in the business, and not only doing the short-term implementation projects. And I don't know if that answers your second question. And on the BFSI, in terms of continued sluggishness, our pipeline and deal wins give us the confidence that there is a reasonably healthy growth in the future. And as you know that over the last few quarters the business has scaled up significantly, so this is just a cycle around implementation of projects, etc. So, there we don't see a fundamental issue with the threat of the pipeline.

Ashwin Mehta:

And if I can squeeze one more, this is on telecom where you mentioned that there is an opportunity in terms of displacement to create capital to build bandwidth for 5G investments for the Telcos. So, given that we also have a large legacy piece, do you see any risks in terms of that on our portfolio?

Manoj Bhat:

Manish, you want to pick that up?

Manish Vyas:

Absolutely. I think it's always a mixed bag, but this story played for us in the past as well in 4G. We believe that our existing access rights, our existing incumbency actually works to our advantage more. There are always two ends of the spectrum. But the way we are looking at the outlook based on what Manoj and CP have already highlighted, we feel that we stand to gain if we play our cards well, and which is what we are busy with right now.

Moderator:

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

Manoj Bhat:

Thank you, everyone, for joining this call. I know there will be a lot more questions, so please do feel free to reach out to Kaustubh or me via email and we will try to answer if there are any unanswered questions. So, thank you so much for attending.

Moderator:

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

Note: The above transcript has been edited for better readability

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