"Mphasis Limited Q2 FY-18 Earnings Conference Call"

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Moderator: Good day, ladies and gentlemen and welcome to the Q2 FY'18 Earnings Conference Call of Mphasis Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Varun Divadkar from CDR India. Thank you and over to you, sir.

Varun Divadkar: Thanks. Good Morning everyone and thank you for joining us on Mphasis' Q2 FY'18 Results Conference Call. We have with us today, Mr. Nitin Rakesh – the CEO and Mr. Suryanarayanan – the CFO.

Before we begin, I would like to state that some of the statements in today's discussion may be forward-looking in nature and may involve certain risks and uncertainties. A detail statement in this regard is available on the Q2 FY '18 results announcement release that has been sent to you earlier. I now invite Mr. Nitin Rakesh to begin the proceedings of the call.

Nitin Rakesh: Thank you, Varun. Good morning everyone and thanks for joining our earnings call.

I trust you all had the opportunity to go through our MD&A, which provides the details of our Operational and Financial Performance for the Quarter-ended 30th September 2017.

At the beginning of the year, we set out a board agenda of consistent, comparative, profitable and responsible growth. This is reflective in our recent performance. We are pleased to report another good quarter with strong TCV wins and broad-based growth across all our business segments. All the key operating metrics: deal wins, revenue growth and margin improvement are showing good traction. We accelerated the growth in our Direct Core portfolio, including addition of Blackstone opportunities and continue to find growth in HP and DXC business. Our Direct International business continues to track well with TCV closures at $123 million this quarter, of which 72% are in New Gen Services. This is higher by 47% on a YoY basis. This takes our H1 tally to $306 million as compared to $179 million in H1 of FY'17, higher by 71% YoY. Over 81% of the deal wins in H1'18 are in the focus areas of Digital, Next Gen and GRC Services.

Moving on to the Q2 FY'18 Financial Performance: Consolidated revenue grew 4.5% QoQ on a reported basis and 3.7% adjusted for currency movements. On YoY basis, revenue grew 5.7% on a reported basis and 8.9% adjusted for currency movements. The growth was broad-based across our core businesses. Direct Core, which contributed 78% of Direct International revenue in Q2 FY'18, grew 5.2% QoQ on a reported basis and 4.3% on a constant currency basis. Direct Core revenue grew 7.2% YoY and 10.6% net of rupee appreciation. The deal wins in this business are a reflection of the strong pipeline that we have talked about. Growth in Direct Core is broad-based and spread across new clients, strategic accounts as well as Blackstone portfolio. We are confident of sustaining our above industry growth in Direct Core through the remainder of the year as well.

Moving on to Digital Risk: We are pleased with the progress in this unit. Revenue grew 8.6% QoQ on a reported basis and 8.3% adjusted for currency movements in Q2 FY'18 on the back of deal wins over the recent quarters. While we still see YoY decline, we continue to stay focused on building our pipeline, converting it and expect to see stable revenues in the $28-30 million per quarter band, as stated earlier. We are also pleased with the trajectory of margin improvement and it will continue to be our focus over the next few quarters.

HP/DXC channel revenues saw another quarter of robust growth of 6.6% QoQ on reported terms and 5.7% on a constant currency basis. HP/DXC revenue grew 14.3% YoY on reported terms and 17.7% YoY, net of rupee appreciation. We have restructured the business to add many vectors of growth and are at the front end of a number of deals where we are jointly going to market. We are confident of continuing to work towards consistent growth in HP/DXC business and after several years of decline, we will see growth back in the segment in FY'18.

Overall, while normal seasonal quarterly factors will be at play, we are optimistic about continuing to focus on sustaining our growth over the remainder of the year.

Moving on to Margins: Operating margins have improved 60 basis points QoQ to 14.4%, driven by operational efficiencies. We are confident of staying well within the band of 14-16% EBIT for FY'18 including any impacts from our planned salary increments that are effective Q3'18 as well as impacts from any seasonal factors. We are focused on maintaining our growth and continuous improvement in margin trajectory as we start delivering and building scale on some of these large projects and bringing in efficiencies. Total cash on our balance sheet stood at Rs.21,085 million, i.e., $322 million. Adjusting for dividend payout, unsecured loan and non-cash adjustments, net cash generated from operations during the quarter was robust Rs.2,255 million.

To Conclude: In the midst of the technology shifts, we believe Mphasis is beginning to find a sweet spot in the visible space with unique combination of Cloud and Cognitive-based solutions in our chosen domains that help clients integrate front-end consumer-facing technologies with core back-end IT systems and infrastructure. We are focused on driving wallet share gains in our strategic accounts. We created a strong set of marquee clients and are building solutions in areas where we believe our clients need help. Our second engine of growth is in the Blackstone portfolio and we have a systematic approach in place to tap the opportunity. The third engine is taking a programmatic approach to strengthen our position within HP/DXC. We are confident that these would drive the overall growth of the company in the coming quarters as well.

On that note, I thank you once again for your sustained interest in Mphasis. I now request the operator to open the line for questions.

Moderator: Thank you very much. We will now begin with the Question-and-Answer Session. The first question is from the line of Ankit Pandey from Quant Capital. Please go ahead.

Ankit Pandey: My question is around what gives us confidence in DXC/HP? You did mention that you can see growth through the rest of FY'18. Could you just flesh it out a little bit more for us to understand?

Nitin Rakesh: Thanks for the question. If you go back to our last two calls, we talked about FY'17 as the year of stabilization for the HP/DXC relationship and we saw stable revenues for the last three quarters of FY'17 in the low-50s range. Starting first quarter, we basically called for FY'18 to be an year of growth for that relationship, primarily based on three core vectors. Firstly, it is not one monolithic relationship anymore, we have four distinct corporate entities that we now deal with: DXC; which was formed in April this year by merger of HP Enterprise Services and CSC, HP Enterprises; which is their main group; HP.Inc.; which is the consumer business that used to be within HP and the Micro Focus that was newly formed in September of this year. So there are four distinct sales and GTM motions. We are a strategic partner in all four entities. All four entities have large IT spends. Our wallet share is fairly miniscule in almost all three barring DXC, where we do have a large relationship. Finally, back in May we also announced Cloud GTM Partnership where Mphasis plays a key role in helping with application transformation and cloud migration across the client base of DXC. So, having said that, we clearly saw some robust growth in Q1 and Q2. We do expect that we will continue to see growth, even though I do not think we will see growth at the same rates that we saw in Q1 and Q2. But on a YoY basis, given our trajectory and run rates, we are fairly confident that we will be seeing growth this year. So that is kind of the breakdown of what is going on in that channel.

Ankit Pandey: If you could also talk a little bit about Digital Risk, what went on this quarter and its prospects; especially around profitability?

Nitin Rakesh: On Digital Risk, clearly the business is currently quite sensitive to the infrastructure environment in the US given that we are in the mortgage origination business. We saw the impact of that play out over the last two quarters; especially on a YoY basis; because as interest rates rise, the refinance volumes which is one big part of our operations business gets impacted because the volumes go down. What we have done over the last three to four months is to continue to find adjacencies in the mortgage space which are less correlated to the interest rate cycle., In addition we are gaining wallet share where we already have relationships and building new relationships as well. So the net result of all that has been; at least on a sequential basis; we have seen very robust growth in that business which also has helped ease some of the margin pressure there. On a go-forward basis , we will continue to bring in this business shift mix and make sure that we have a much more balanced portfolio of services over the next four to six quarters. While it will always be exposed to the interest rate cycle, intention is to reduce that correlation as far as possible and parallely focus on bringing in more and more efficiencies in terms of the way we operate that business, the way we have offshore leverage in that business and the way we can apply service transformation to that as well. So that is kind of what is going on at Digital Risk.

Ankit Pandey: Could you just also highlight whether we have reached a sort of high single digit target in the margins?

Nitin Rakesh: Yes, we have.

Moderator: Thank you. The next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: Firstly Nitin, it will be helpful if you could help us understand what is the addressable market opportunity within the DXC channel and how should one think about from long term point of view; let’s say two-to-three-year point of view rather than the next quarter?

Nitin Rakesh: Let us give a little perspective on the business portfolio of DXC itself. Between CSC and HP Enterprise Services it is the third largest system integrator world-wide. But a fairly sizable percentage of revenue is derived from managing large infrastructure and doing virtualization and transformation on that infrastructure over the last few years. They also have a product portfolio across multiple domains from healthcare to insurance to airlines to banking. Our current revenue footprint there is predominantly the legacy HP ES/EDS portfolio that we service. With the partnership, we have added a new vector of growth there. The way to think about that is the partnership and the Cloud opportunity puts us at the front end of some new deals that we are trying to help them cross-sell to their existing client base because that is an area where together we are better than the competitors. On the core services, our focus is to apply service transformation and gain more and more efficiency both for them and for ourselves. So if we can continue to focus on that relationship to at least give us at market growth, that will really take away large part of the overhang that we have had for the last four or five years. From an aspirational perspective, that is what is going to help us achieve above market growth for overall company if we keep that at least at market growth.

Gaurav Rateria: Secondly, margins have declined YoY despite revenue growth improving in the first half. If you could break down into various components like Digital Risk or Direct Core or HP, where the margins have fallen and what has led to that decline?

Nitin Rakesh: Gaurav, it is difficult to break it down by unit. There is a fair amount of information available in the MD&A but let me give you some color that will help you understand what is going on. Firstly, when you had a declining business, you have the luxury to keep utilization at a fairly high level. If you see our historical trend of utilization it used to be in the mid-80s. We have to bring that down in Q1 to almost 76% primarily because we needed to ramp up for the growth that we were forecasting in Q1 and Q2. Secondly, the wins that we had in the first half, 80% of the wins are in new gen areas. Fourth quarter FY’17; 63% of the wins were in new gen areas. So you can see incrementally most of our new businesses starting to come in new gen areas because one, that is where we have strength and two, more importantly, that is where customers have needs and demands. That by definition, the mix shift requires a higher onsite proportion at least in the initial stages of those deals. To counter that, we have also started to apply service transformation and increase our portion in fixed price. So that is kind of the counterbalancing weight of that. Net result of all the puts and takes is that we forecast stable margins for FY’18 compared to FY’17. Obviously, quarter-by-quarter they may vary. I think that is the reason we feel confident that

despite all the headwinds we have the ability to improve our operating profile, find efficiencies, feed the growth, take the impact of our salary increments and still be within the stable margin band that we gave, which is 14-16% EBIT.

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

Ashish Chopra: Nitin, just wanted to understand a little bit more on the HP/DXC front basis your comments earlier on. So, would it be fair to assume that the bulk of the growth there going forward would be dependent on the growth that HP/DXC also has in the market or do you think that there is enough potential to grow over and above their revenue growth by breaking into some of the already existing revenue base?

Nitin Rakesh: Ashish, it will really a combination of both. They have $25 billion portfolio and we think we can play a role in helping them gain efficiency in that portfolio especially given that we have complimentary service capabilities. Secondly, it is still early days for the partnership. While we have had some early success, there is a good pipeline and if we can convert part of that, it will also help us over FY'19. In a very short run, we have obviously seen some very-very robust growth in the first half, we are at 17% YoY growth. I just want to manage expectations to say that it is not fair to assume that every quarter will be such a growth quarter from the HP/DXC side because there was a little bit of a catch up that we were playing in over the last two quarters because we had not seen growth over the last few years. But on overall basis as I guided, from our modeling perspective, the way we are thinking about it is if we can continue to wire that channel between HP and DXC and all the vectors I talked about to give us at least at market growth than at least it sets us up to grow faster in other units and find above market growth for the company overall. As that happens, we believe we can also continuously improve our operating margin profile over a medium to long-term.

Ashish Chopra: Lastly, if you could share a ballpark about how much of the HP/DXC channel revenue is from DXC versus maybe HP.Inc and Micro Focus and the HP Enterprise?

Nitin Rakesh: Roughly 80% of it is from DXC because that is where the legacy EDS/HP was and the remaining 20% is from other units of HP, which again is an opportunity for growth even though it might take a little longer to break into those because those are large enterprises in themselves.

Moderator: Thank you. The next question is from the line of Rahul Jain from Emkay Global. Please go ahead.

Rahul Jain: Just one question in terms of the deals that we are adding up. If we see the run rate, it has moved significantly up from what it used to be a year ago, and if we see the Direct International revenue this quarter was the first quarter where the run rate has moved significantly. So when do we see a true reflection of this uptick in the deal converting into the revenue, or is it that larger multi-year deals are driving that number up and the revenue number would not chase with the same trajectory?

Nitin Rakesh: There are three things that I want you to think about as we look at the deal wins -- Firstly, the Direct International bucket includes Digital Risk, so YoY decline in DR is impacting the translation from TCV to revenue. Secondly, as you rightly said, some of these are multi-year deals and the fact that we moved the needle in fixed price basically means that we are able to get slightly longer term deals which we are very pleased about because that gives us multiple other levers. Thirdly, this is something that it is actually hard to predict, but we just manage it on a fairly consistent and dynamic basis. While we are seeing wins, and 70%-80% of those wins are in new gen areas, there is obviously a deceleration in core IT or rather legacy traditional services. This is not unique to us and what kind of impact that has in diluting the overall growth is something that we have to manage very carefully. Despite all these factors, we saw some very robust growth this year; we are growing in Direct Core at 10% YoY, which is kind of the true reflection of the business. Our intention for the next two-to-six quarters is to sustain above market growth in Direct Core and apply all the levers I talked about earlier.

Rahul Jain: On the margin front, though we have 14%-16% guidance, given the kind of deals we are doing, the kind of traction we are seeing, the kind of clients we have and the kinds of efficiency we can derive now given that those slow growth years are behind us, what do you think could be your aspirational profitability number? We used to have (+20%) margin a few years back when this company used to grow at market or better than market kind of growth and that we would slowly come back to that in may be FY'19, so whatever is the timeframe you define? What is that aspirational profit margin given the profile of business we have?

Nitin Rakesh: Rahul, there are two aspects to think about as we look at the margin -- As I said there is a business mix transformation underway not only for us but also the industry and that is a reflection of where the client demand is moving. While we may have had a certain profile a few years ago, I think the industry has obviously moved in a very different direction, and bulk of the demand continues to be in new gen areas. Yes, the ability to price there is higher, but also the cost of service is higher as well given the onsite-offshore mix and the scale mix. So FY'18 was a year for growth with stable margins. As we get into FY'19, we will give you some more guidance. But the longer-term goal that we have set for ourselves is above market growth with continuous improvement in operating margin profile. We aspire to achieve that over the next three years.

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

Ashwin Mehta: I just wanted to get a perspective in terms of the Blackstone portfolio. You mentioned that you are starting to see traction there as well. So is that part of the deal flow that has been announced or that is additional to the deal flow that has been announced and what exactly are you seeing in that portfolio?

Nitin Rakesh: Ashwin, in the first quarter when we had the call back in May, we gave a kind of breakage number which had four deals that we signed in the current financial year. So you can assume that Q2 onwards that number is going to be included in our TCV wins that we declare for the Direct International business because that business is in our Direct Core business which is part of Direct

International. So, to answer your question straight, yes, that is contributing to the deal wins. Those deals had a contribution in our total TCV number going up significantly because 80% of our full year FY'17 TCV is already booked and closed in the first half of this year and on a go-forward basis we expect that to continue to contribute to the Direct Core growth.

Ashwin Mehta: In terms of pricing, we have seen a surge in terms of your onsite pricing in the Applications space, last two quarters kind of moved more than 6% to almost $83. So what exactly is driving the surge and how sustainable do you think this pricing is?

Nitin Rakesh: It is very much tied to what I said earlier. If 70%-80% of our wins are in new gen areas, the ability to price is much better in those segments, because those are supply constrained and high demand. But at the same time, the ability to service also requires a slightly higher cost profile given just higher onsite mix and the talent mix. So overall basis we are fairly happy that we are able to drive some of that efficiency, but there is a lot more work for us to do to translate that higher pricing to flow into our operating margin, and that is the reason why I said long-term basis our intention is to seek continuous improvement in operating margin.

Ashwin Mehta: Just the last one in terms of salary increments from next quarter, how much of an impact do you see of that on margins? Secondly, in terms of hedge gains, we have had decent enough hedge gains over the last two quarters, how are we placed on that going forward?

Nitin Rakesh: On the salary increments, they are effective current quarter, October 1. We believe that we can actually meet 14-16% EBIT guidance including any impact from salary increments. Our increments really are in the low to mid-single digits depending on what the location is. So we are assuming that we will able to counter those through our operational efficiencies. On the hedge gains, I will request Surya to give us some colour.

V. Suryanarayanan: Ashwin, we follow a very consistent hedging policy and that has helped us protect any volatility between rupee, dollar and the other currencies. In terms of the exact rates, those are disclosed in our MD&A. Going forward, considering the currency movement, the hedge gains could be lower than what we have seen in the first half, but it is not going to significantly affect our overall margins.

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

Vishal Desai: A couple of questions from my side; firstly, in terms of the Direct Core business which is close to around 55% of the revenue, just wanted to get a sense how much would these new gen services, whether it is GRC or any of those contribute in terms of the overall share of the business in that?

Nitin Rakesh: Thanks, Vishal. As of Q2 that number is 39%.

Vishal Desai: Just going on in terms of the margins, while you said that Q3 will see the impact, could you just outline the levers that you have in terms of mitigating that for the full year?

Nitin Rakesh: If you see the optimization in terms of the number of those metrics over the last two quarters, our utilization improved by 2 percentage points, we have pyramid optimization where we are doing delayering which is under way, and most importantly, the fixed price movement that we have achieved from 17%-21% over the course of last 12-months. So those are the levers which we will continue to exercise. While our historic utilization has been in the low-to-mid-80s, we are still in the high 70s right now primarily to feed the growth. So we do have a few levers that we can exercise as we go through the remainder of the quarter.

Vishal Desai: The last one being on Digital Risk. Could you outline some color in terms of what drove this quarter performance being so strong and why do you expect it to be in that range of $28 million to $30 million going forward and why is it not sustainable?

Nitin Rakesh: The $28 million to $30 million range is sustainable. From a growth point of view, given that we are in the process of bringing a much better business mix, it is a little bit of a treadmill effect that is under play because just to even sustain the revenue level, we have to actually go find growth because the origination business is clearly in decline in the US. So that is why we forecasted stable top line and that was the attempt. We got growth sequentially but on YoY basis we are still on a decline. So it is fair to assume that even if we are able to keep top line stable and sell incremental deals in new adjacencies or even in our existing bucket of business, with the higher offshore leverage we can actually see stable revenue with an improving EBIT profile.

Vishal Desai: Just one last clarification; is it fair to assume that EBIT margin profile would be in mid-single digits currently?

Nitin Rakesh: It was in mid-single digits previous quarter and the current quarter has actually moved up higher.

Moderator: Thank you. The next question is from the line of Madhu Babu from Prabhudas Lilladher. Please go ahead.

Madhu Babu: What is the Technical Help Desk revenues which have seen a strong surge and that was accompanied by a strong increase in the ITO headcount in onsite? So, is there any IMS projects which you are doing in onsite?

Nitin Rakesh: Madhu, as we talked about the multiple segments within our client base, there is obviously a combination of core IT as well as service transformation, that is driving this growth. The intention for us is to be able to apply things like virtual help desk, virtual agent, analytics and that also basically equitize back to the fixed price managed services revenue increase that we talked about. So, I would not really say that there is any shift into IMS, but clearly, Apps, IMS and BPS are three segments of our business and we continue to find revenue growth in all three segments. That is why you will even see robust growth on the Apps side of our business as well.

Madhu Babu: Also, that onsite headcount increase, is it related to DXC relationship?

Nitin Rakesh: Not just any one relationship. Overall structurally also, next-gen services are driving some of that growth.

Madhu Babu: Sir, HP usually used to have furloughs as a weak seasonality in 3Q, but last year we arrested that. So this year, how should we see 3Q for HP channel?

Nitin Rakesh: It is fair to assume there will be some impact. We are still making sure that we are able to minimize as best as we can, but this is a challenging quarter from that perspective. While we think we will be able to minimize, some of that impact will still play out and that is why I called for moderation in growth as we go through the next two quarters.

Madhu Babu: Sir, can we disclose the next two quarters how much hedges are expiring and what is the rate and what is the reason for the sharp surge in unbilled revenue this quarter?

V. Suryanarayanan: In terms of the outstanding hedge, it is all in the similar levels and as I mentioned earlier, those are disclosed in our MD&A including the rates. The unbilled is more because of the SOWs coming in from the clients at the last stage. By the time it gets invoiced, it is getting delayed. It will get evened out by end of Q3.

Nitin Rakesh: I think the overall DSO should stay stable.

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

Sandeep Shah: Earlier, two-three years back when the growth was a challenge within the HP channel, the incremental growth used to go to the captives and that is what we used to report in our annual report as well. Do you believe that risk can emerge going forward? How are we tackling that conflict of interest where HP/DXC or HP/CSC both have a captive in India versus Mphasis being one of the preferred partners in India?

Nitin Rakesh: It is a valid question. That risk exists not just for HP/DXC, but for every large client relationship, because they are not the only ones with captives, with almost all large banks, insurance companies also have their captives in India. So we have to find our sweet spots within those relationships and win business based on our capability which is complementary or in areas where they need help. And a good example of that with DXC is the application transformation and cloud partnership that we announced. So that is the way we think about it and that is the way we continue to find roads.

Sandeep Shah: Nitin, you believe the incremental growth in HP/DXC could be more towards the incremental revenue growth garnered by the joint marketing or it could be also through the transformation of the existing portfolio, where could the delta move -- it could be more through new business or it could be more through transformation of existing business of HP/DXC?

Nitin Rakesh: We have a belief that it is never "or" it is always "and". So we will continue to make sure that we are able to have as much in the pipeline from every funnel as possible. So my belief is that both of these should contribute to growth. Obviously, the impact one will have over the other in a particular quarter may vary.

Sandeep Shah: Just on the BFSI, what are the recent interaction with the top clients in the BFSI indicates because some of your large peers are saying that still clients are not in a decisive mode in terms of IT spend even in the second half of the financial year? What is your view and what are you witnessing?

Nitin Rakesh: It is hard to make a comment on what others are seeing and I can give you a little bit color of where we are. Firstly, what you are seeing in BFSI is a direct reflection of which part of the IT Services value chain you are playing in. If you are playing within back office, traditional IT, ADM, IMS businesses, it is very hard to find growth. There is obviously a lot of pressure on CIOs to reduce spend and find efficiencies. But if you are playing in new gen areas, consumer-facing deck, application of analytics and cloud technologies, applying cognitive capability to do personalization, integrating things like voice, virtual assistance etc there is a lot of demand and that is the reason why we are starting to obviously see robust growth in deal wins mostly coming out of those areas. The other aspect is that the ability to find the right deal with the right price is much higher in these areas as well. So it is really a question of where you play in the value chain and hence you will get conflicting answers from across the industry depending on where a particular player is playing.

Moderator: The next question is from the line of Deepesh Mehta from SBI Capital. Please go ahead.

Deepesh Mehta: Nitin, just wanted to get a sense, the way quarter panned out, whether it was broadly in line with way you anticipated at the beginning of the quarter. And now whether we are more incrementally positive about growth and margin than where we were at the beginning of year? Question #2 is about Digital Risk. This time we have seen decent uptick in Digital Risk business. But if I look headcount wise, it is showing some kind of muteness. I think you alluded to some kind of mix shift which we are trying, appreciate if you can help us understand how to reconcile these two things?

Nitin Rakesh: The first question was, "Is the growth as per our expectations?" As I said, we broadly set out two objectives for ourselves -- The Direct Core business should continue to grow faster than market. So while we expected some of this growth, we are very pleased by the deal wins we have had especially in the three segments -- Existing Clients, Blackstone Portfolio as well as New Clients. Obviously, all three are at different level of maturity and we think we have a lot more work to do in the latter two because there is a larger scale opportunity available. Also, on the margin side, going into the year we knew some of the headwinds, but at the same time we had to take certain actions to maintain and find more efficiency. So again, I am pleased by the actions that had to be taken which required some heavy lifting to be done. Our expectation still is that we have to continue to keep Direct Core stay ahead of market growth because that is the best way we can

continue to gain wallet share with our existing clients as well as find new clients. On Digital Risk, one part of our strategy was to find expansion in EBIT profile which required us to take certain actions to optimize and centralize certain functions and activities which is why you will probably see some headcount movements. There is also the ability to actually apply service transformation which means you start looking for opportunities to apply automation and that helps in taking out cost and reducing the head count. So as we transform the mix of that business to be less sensitive to the macro interest rate environment, we will continue to see what is the best way to run that operation with offshoring being just one of those levers.

Deepesh Mehta: Just about first question remaining part, whether we are incrementally more optimistic about growth trajectory than where we were, let's say beginning of year based on the deals which we have in the pipeline or broadly this is how we expected the year to pan out?

Nitin Rakesh: We clearly had a blowout Q1 with TCV wins, we had a very good Q2 as well with TCV wins. If we keep the TCV win trajectory higher than what it was last year, clearly, our confidence will keep going higher. But given that we are heading into seasonally slower quarters, it is fair to assume that we are cautiously optimistic about the trajectory.

Moderator: Thank you. The next question is from the line of Ankit Pandey from Quant Capital. Please go ahead.

Ankit Pandey: I have a follow-up especially on the part that our realizations and our fixed price metrics are moving along in one direction. But on the other hand, maybe, there is a bit of trade-off and I would like you to clarify that. The operating cash flow as a percentage of revenue has come down significantly from last year, at least this quarter was 13.1% and last year was 18% or so. So is there a structural trade-off that you see or is it some kind of seasonality or some kind of a one-off?

V. Suryanarayanan: In this quarter, we had a dividend payout, so considering the cash balance at the end of Q1 and Q2, there is a marginal decrease after taking into account the cash inflow from the operations. In fact, the cash inflow from operations has been better in Q2. However, offline I will talk to you and understand what your data point really is.

Ankit Pandey: I am looking at the proper accounting as per accounting format in the other PDF that you sent, but that is H1 upon H1 the write-up. So maybe we will clarify that offline. But is there any sort of impact that you have seen on cash flow basis; especially Nitin that you can clarify; any structural shift that we are experiencing in terms of cash flow impact? I am referring to your release on consolidated financial statements, the group deck PDF, and in there, I am taking the H1 operating cash flow only and comparing that year upon year. There has been marked decrease from 18% of sales to 13% of sales, again, I am taking it to revenue. So is there an impact? Is there a structural thing or is there not too much to read into it?

Nitin Rakesh: I do not think there is much to read into it beyond that. It is probably an issue of unbilled revenues and receivables which we talked about. As long as we keep our DSOs in the mid-60s range, I do not think there is anything else to read into it.

Ankit Pandey: If you can talk a little bit about, especially we are sort of elevating the quality of work that we are doing or moving into a different area in some cases. How do we keep up with our workforce, the training part of it and are we engaging in outsourcing a little bit more than others, because I do not have a handle on the outsource cost, so may be, you can help with that?

Nitin Rakesh: There is an initiative we launched about a quarter ago called "Talent Next" and the idea is to provide a platform to reskill and upskill our workforce along the vectors of what we call "Invest Areas of New Tech." Obviously, as we do it, we also have our current business to feed. So, the intention really is to provide a learning platform and move our existing workforce along the vectors of new areas of investments and technologies that we are making. There is also an element of creating certain tools in IP where we have to make sure that our workforce also attunes to using some of those frameworks and tools. That is another effort which is under play. Thirdly, we are aligning our GTM engine as well as with our delivery engine along the vectors of this cloud and cognitive play that we started investing in over the two quarters. So there is a fair bit of work being done. Fairly, significant effort as well as some investment is being made into these areas. A lot of the operating efficiency that we are generating, we are also ploughing some of that back into investing in our people.

Ankit Pandey: Is there any impact from outsourced cost, is there a break up that Surya can help me with maybe?

V. Suryanarayanan: As part of normal operations, there would be a certain percentage of outsourcing and that continues. There is nothing abnormal in this quarter.

Nitin Rakesh: It has not picked up; rather it is fairly stable. Maybe it is probably in the other direction.

Ankit Pandey: My last question would be again on profitability. If I look at the segment wise break up, ITC&E segment profitability was (+30%) last year and this year it is below 20%. So could you just clarify that?

V. Suryanarayanan: In terms of the type of deals we got and as Nitin mentioned earlier as well, these deals to start with, are onsite centric, and that had certain impact on the margin. But over a period, as it shifts to offshore, margins will improve.

Nitin Rakesh: I think there is also an element of transition cost in there.

Ankit Pandey: So you do expect this all the way back to 30%?

V. Suryanarayanan: So Ankit we should look at overall company level margins instead of specific sub-segments where there are puts and takes which happens in those parameters.

Ankit Pandey: So, do you mean to say there is an element of shared costs and expenses in outsourcing there?

Nitin Rakesh: No, not really. The way to think about is that we are buying service transformation. You start with the certain profile of the business and then you transform that profile. That is over the life of the deal you will effectively be in a similar margin range that you are used to operating in.

Moderator: Thank you. The next question is from the line of Devanshu Bansal from Nirmal Bang. Please go ahead.

Devanshu Bansal: Sir, can you comment on the nature of engagements in the Blackstone portfolio and in the new clients which we have won? Whether, these are multi-year engagements or project type deal? Also sir, can you please tell us the average period of deals which we have won?

Nitin Rakesh: It is fair to assume that the wins we are having whether it is in Blackstone or new clients or even in existing clients are fairly typical. These are in some cases, depending on the nature of the business, two-three year' deals and in some cases if it is Dev or Digital project, it may be shorter term in nature with the expectation that our engagement will continue to roll over to the next phase. So, it is not different because it is a different customer channel. However, given that a lot of the new digital projects are done in agile mode, they are what we call "Digital Programs" which will effectively have a phase-1 funding and phase-2 funding once you deliver the minimum viable product. So from that perspective, I think the shift mix will determine how you sign a deal and what the duration of the deal is, but on an overall basis, there is nothing significantly different to call out.

Moderator: Thank you. The next question is from the line of Neerav Dalal from Maybank. Please go ahead.

Neerav Dalal: Trade payable have moved up quite a bit this half. So anything to read into this?

V. Suryanarayanan: It is more of a timing issue and there is nothing specific to call out for the movement.

Moderator: The next question is from the line of Rahul Jain from Emkay Global. Please go ahead.

Rahul Jain: If you could share what is the revenue from the new gen services in H1 or in this quarter?

Nitin Rakesh: Within Direct Core, there is about 39% of revenues.

Rahul Jain: Secondly, we have several relationships of our top direct international clients being some of the largest BFSI players in the world. How do we see the next leg of growth within this? Something you already alluded in terms of what offering you are suggesting to these clients and because the spends may happen in those buckets. But if we are doing $100 revenue where we see how we can take it to let us say double of that, triple of that over a period -- would it be more service offering, would it be more wallet share, how it would work out for us?

Nitin Rakesh: I will again go back to what I said, it is a combination, it is always an 'and' so we always aim to get higher wallet share and also continue to win business in new areas of spend. But given the recent trajectory and our strengths, we definitely believe that new gen services is the way to continue to grow in these lines.

Rahul Jain: Are they seeing any benefits in terms of incremental spend on overall basis or these are just three bucket shifts that is helping us?

Nitin Rakesh: That is a question of specific clients having specific budget trajectories. But on an overall basis, I think the budgets are actually fairly stable, because if anything technology is becoming an integral part of almost every business. Bt the bucket shift is far more acute than budget shift.

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

Sandeep Shah: Is it possible to share revenue contribution from Blackstone portfolio as of now? I do agree it may be immaterial but just for a book-keeping question.

Nitin Rakesh: Sandeep, it is never a book-keeping question, it is always a metric. We have decided not to share it separately at this stage. If that changes in the future, we will let you know.

Sandeep Shah: You earlier said that out of 71-72 clients, you identified 20-clients. So, can you give us a progress how we are going and has that list gone beyond 20?

Nitin Rakesh: That list does not typically change on a quarterly basis as we do our FY'19 budgets and plans, we will think about what changes we need to make to that list. But as of now, it is a fairly stable list, and as I said that strategic account list is definitely contributing to growth.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Nitin Rakesh for closing comments.

Nitin Rakesh: Thank you, all. It is a pleasure to have answered all these questions. Thanks for your interest and all the work you do towards our coverage and we look forward to speaking to you in the next quarter.

Moderator: On behalf of Mphasis Limited, that concludes this conference. Thank you joining us and you may now disconnect your line.