TATA CONSULTANCY SERVICES

Tata Consultancy Services Limited

Q1 FY18 Earnings Conference Call.
July 13, 2017,19:00 hrs IST (9:30 hrs US ET)

Moderator: Ladies and Gentlemen, Good Day, and welcome to the TCS Q1 FY18 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for 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. Kedar Shirali. Thank you and over to you, sir.

Kedar Shirali: Thank you, Zaid. Good evening and welcome everyone. Thank you for joining us today to discuss TCS's Financial Results for the First Quarter of Fiscal Year 2018 ending June 30th, 2017. 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, Quarterly Fact Sheet and Press Releases are also available on our website.

Our leadership team is present on this call to discuss our results. We have with us today Mr. Rajesh Gopinathan – Chief Executive Officer and Managing Director.

Rajesh Gopinathan: Hi. Good evening, all.

Kedar Shirali: Mr. N.G. Subramaniam – Chief Operating Officer.

N.G. Subramaniam: Good evening to all of you.

Kedar Shirali: Mr. V. Ramakrishnan – Chief Financial Officer.

V Ramakrishnan: Hello Everyone.

Kedar Shirali: Mr. Ajoy Mukherjee – EVP and Head of Global Human Resources.

Ajoy Mukherjee: Hi, Everyone.

Kedar Shirali: Rajesh and Ramki will give a brief overview of the company's performance, followed by a Q&A session. As you are aware, we do not provide specific revenue or earnings guidance, and 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 Quarterly Fact Sheet available on our website and e-mailed out to those who have subscribed to our mailing list.

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

Rajesh Gopinathan: Thank you, Kedar. Once again, good evening to all of you. It has been a very exciting and busy quarter for me personally, with lots of travel. NGS and I met with over hundred customers across all our major market and I am happy to tell you that they have been uniformly supportive and appreciative of the seamless leadership transition that we have had, and the stability of our management team and our relationships continue as before.

Coming to the quarter, we have started off fiscal year 2018 on a very promising note, with robust volume growth of 3.5% QoQ that translated into a constant currency revenue growth of 2% QoQ and 6.3% YoY.

A sharp appreciation of the Rupee against the US Dollar resulted in revenue tailwind in our USD reported numbers, and a bigger headwind in our INR numbers. In USD terms, we added incremental revenue of $139 million which is a QoQ growth of 3.1% and a year-on-year growth of 5.2%. In rupee terms revenue growth was flattish at (-0.2%) QoQ and 1% year-on-year.

Moving on to margins, wage increases and currency impact resulted in an operating margin of 23.4% and a net margin of 20.1%. Ramki will cover that in more detail.

Before I go on to the segment details, let me talk about an important organizational change that we made last quarter. Our service practices were reorganized and there were two main imperatives that drove this change:

- Customers are increasingly moving away from buying discrete services and looking to us to execute and to end Digital transformation, requiring a seamless orchestration of multiple our service teams. Think of it as our full services strategy in its second phase.
- Secondly, the individual components of the Digital service stack, such as, Analytics, Cloud, IoT and Automation have gained critical mass and with the right leadership focus will gain significant scale in the coming years.

To address these two imperatives, we have created new horizontal organization called the Business and Technology Services group, or BTS, headed by Krishnan Ramanujam, who until recently headed our Consulting and Enterprise Solutions business, whose revenue grew nearly three-fold under his watch, to $3 billion.

Within BTS, we have three groups:

- The Digital Transformation Services group which consists of a host of newly launched service practices, addressing different elements in the Digital service stack.
- The second group is called the Cognitive Business Operations which comprises of our erstwhile IT services and the business process group.
- Finally, the Consulting and Systems Integration group which will serves as an orchestration arm, bringing together various service teams to deliver transformational outcomes.

Each of these newly created units is headed by seasoned leaders such as PR Krishnan, Dina [Kholkar] and Regu [Ayyaswamy], each with a track record of building up multi-billion dollar businesses from scratch. That underlines our confidence in the future growth potential of these businesses and our commitment to invest significant management bandwidth to drive the growth and to participate in the evolving market structure.

So, I am confident that in the coming months and years we will see some good outcomes from these groups and we will be reporting on it incrementally as we go forward.

Simultaneously, service practices that are mature and at scale within our larger Industry Solution groups such as Banking or Retail BPS, EIS and EntSol in Manufacturing etc have been carved out and merged into the Industry Solution Unit Structure, enabling them to offer a more integrated solution stack to their customers. All these changes, while enhancing our focus and delivery capabilities significantly, do not affect our customer-facing organization.

You might have noticed that this quarter we have not provided a revenue breakup by service practices. That is because the process of carving out revenues from the service practices into the vertical and vice versa is still underway. Accurately tagging and reviewing tens of thousands of ongoing projects and engagements globally is not a trivial task. Once the process is complete and the newly created units fully stabilize, we will start reporting our revenue breakup by service practices.

For now, suffice it to say that all new service lines are seeing good market traction. The newly formed Cognitive Business Operations grew over 5% in Q1 and all service lines have a robust pipeline to support secular growth.

There is another change that we have made in how we report our revenue breakup by industry verticals. The change in vertical reporting is primarily driven by the fact that most of our business comes from major markets like Americas, UK, Europe and Australia and revenue growth there tends to be fairly steady and stable. But there are also smaller parts of our portfolio which tend to be more volatile on account of their project centric nature. And when those volatile components are force-fitted into our verticalized reporting framework, the resulting numbers often distort market perception about what is really happening in the affected vertical segment.

To reduce such distortion and provide you a clearer picture of our performance in the various industry verticals in our major markets, we have extracted out the volatile elements -- such as some of our emerging markets and products business -- into a separate line called the Regional Market and Others in the Growth by Domain slide of our quarterly factsheet. These elements together constitute about 17% of our consolidated revenues.

Let me also clarify that the segmentation is purely to assist in a more accurate discussion of our growth numbers. The business segment definition in our financial statements remains unchanged. And for those of you who want a verticalized breakup of 100% of our revenue stack, you can find it along with their respective profit contribution in the Segment Information section of the Statement of Accounts.

Let me now get to our segmental performance:

As in the past, all growth figures I mention are in constant currency and they represent QoQ sequential growth.

The Banking, Financial Services and Insurance industry, which was flattish last quarter, has bounced back with a decent 2.3% growth, giving literally a promising start to the year.

While this is definitely better sequential growth compared to the last quarter, we would like to see more large deals in to the BFSI pipeline before we can take a more secular view on the nature of demand in BFS.

There are a couple of large wins in Insurance this quarter and are on the verge of concluding some more in the next two quarters. They should result in stronger performance in the second half of the year if these deals materialize.

The Retail and CPG sector whose growth decelerated very sharply last year, also had a reasonably good start to the year with 2% growth, driven mostly by Digital demand. The segment still requires close watching because some of our large Retail clients are still going through a restructuring which could result in volatility.

We have been saying for a while that deceleration in growth is cyclical, dragged down by weakness in BFSI and Retail and that is especially evident in our Q1 numbers. If you exclude BFSI and Retail & CPG, all other verticals grew more than 3.5% in our major markets.

Energy Resources and Utilities grew at 7.6%, Travel Transportation and Hospitality grew at 7%. And the Life Sciences and healthcare business grew at 4.7%. Other verticals like Communications, Media, Manufacturing, and Hi-Tech have also performed quite well.

In addition to good revenue performance, we have had strong deal wins across the board. So, the momentum, we hope, should sustain going forward. Of the 11 key wins in Q1, we had *two* each in Manufacturing, Hi-Tech and ERU and *one* in Life Sciences, and another *four* in the BFSI sector.

Coming to Digital, revenues from Digital engagements made up 18.9% of our overall revenues this quarter, a growth of 26% year-on-year.

We are seeing quite high client interest in Internet of Things with more than 20 engagements in the areas of Connected Home, Mobility, Energy Management and Remote Monitoring. Our early investment in IP building in these areas is now giving us significant traction. Case in point, a European global engineering company chose us in Q1 to develop an IoT platform for predictive maintenance and remote monitoring of machinery across geographies.

Even more encouragingly, these deals are now scaling up into fairly large-sized opportunities and multi-year engagements.

TCS was selected as a strategic partner by North American Manufacturing firm to build an industry 4.0 IoT-driven Big Data analytics platform to deliver insights and predictive analytics for their end customers.

Similarly, our Digital Interactive group also had a good quarter with multi-million dollar wins in Energy and Insurance verticals.

Our Cyber Security business has been experiencing double-digit QoQ growth on a very small base, driven by compliance requirements such as GDPR, Privileged Access Management and Cyber Defence.

Our investments in Digital, our scale, capabilities and high quality of engagement have resulted in a good recognition from customers and industry analysts. We were ranked as leaders in 12 of the 14 Digital related assessments that we participated in this quarter, including one for overall Digital transformation capability.

In addition, we were ranked leaders in three assessments and Intelligence Automation, two each in Analytics, IoT and Assurance and one in Cloud ERP implementation and Cyber Security.

From a geography perspective, growth was led by a strong 5.9% QoQ growth in Continental Europe and 2.8% growth in the Latin Americas. US and UK had a relatively soft start for the year.

In terms of key deals signed this quarter, North America accounted for 7 of the 11 wins. We had 2 wins in Europe and 1 each in APAC and UK.

From a client metrics perspective, we track this very closely because customer-centricity is at a core tenet of our strategy and an organization is essentially tuned to account centric-organization.

Much of our investment goes into building new capabilities that allow us to continuously expand our participation in the customers spend and increase our wallet share. This results in a set of metrics where you see customers continuously moving up the revenue bands.

The progression trends can sometimes be distorted by currency -- what we report is based on trailing four quarters' *USD* revenues. Similarly, corporate divestitures can result in larger clients slipping down the revenue buckets even as the divested entity might show up as a new client in the lower buckets.

That said, during the quarter we have added one incremental client in the (+100) million revenue band and even more encouragingly 12 clients in the (+10) million revenue band and five in the (+5) million band. So, overall I am quite happy with the way our client portfolio is filling out and the base of the pyramid is nicely expanding as we participate more and more in the evolving landscape.

All our products and platforms continue to fare well in this market. TCS BaNCS marked its 10^{th} anniversary by launching two exciting new Digital offerings, Quartz – a set of distributed ledger-based solutions, I am sure NGS will talk about it in more detail. And even more interestingly we launched an App Development Kit or an ADK that empowers a bank's business teams to very quickly design and build apps on their own, using modern principles of responsive web design, without requiring any mobile development skills.

In addition, in US we are happy to announce that Zions Bank, our very first customer in the United States for TCS BaNCS core banking software, went live this quarter.

Ignio™ continues to grow well with seven wins in Q1, bringing the total number of clients to 32. We celebrated its second birthday by launching Ignio™ for SAP, a new solution that removes complexity from SAP basis management and resolves common errors affecting business processes, and audits all transactions for potential fraud across 150 compliance functions.

During the quarter, MasterCraft, our Digital platform to automate and manage IT processes, had five wins. We also had one win for Optumera – our Digital retail merchandizing suite; and TAP – our Accounts Payment Platform.

Coming now to the people metrics, we added 11,200 employees on a gross basis, which included 3,254 employees outside India and closed the quarter with a headcount of 385,809 employees.

Attrition in IT Services went up slightly to 11.6% on a sequential basis, but this is typical due to the seasonality with this being the time of the year when many youngsters leave for higher studies. Compared to last year, it is still lower, with Q1 last year having 12.5% attrition. As a reason our new addition was pulled down.

Additionally, we had fewer freshers onboarded in Q1 2018 compared to the same period last year. This is more of a timing issue, a much larger number of freshers is scheduled to be onboarded in Q2 and subsequent quarters.

In conclusion, we had a promising start to the fiscal year with robust growth across most of our industry verticals and improved performance in BFSI and Retail.

We had a strong deal signing this quarter with more to come in the next couple of months. Hopefully, that should result in improved momentum in the rest of the year.

Demand for our services, particularly in Digital is very strong and driving price stability. Our service practice reorganization is settling down well and should emerge as a game changer in the coming years.

Over to you, Ramki.

V Ramakrishnan: Thank you, Rajesh. Let me walk through the headline numbers:

In the first quarter of FY2018 our revenues grew 2% QoQ on a constant currency basis, driven by a robust volume growth of 3.5%.

The very sharp cross currency movement resulted in a top-line impact of (-2.2%) in INR terms and a 1.1% benefit in USD terms. Reported revenue in INR was ₹295.84 billion, which is a flattish sequential growth and YoY growth of 1%. In USD terms, revenue was $4.591 billion which is a QoQ growth of 3.1% and YoY growth of 5.2%. Constant currency realization movement during the quarter was (-1.5%).

Moving on to the operating margin, we had two main headwinds in Q1 – one was the usual seasonal impact from the wage increases that went into effect from April 1st. This time around the impact was (-1.5%). In addition, the sharp appreciation of the rupee against the USD and to a lesser extent against other currencies resulted in a margin impact of (-0.8%). Together, this resulted in an operating margin of 23.4%, a QoQ decline of 2.3%.

Net income margin in the first quarter declined 2.2% QoQ to 20.1%.

Effective tax rate for the quarter was 24%. Our accounts receivable was at 72 DSO in dollar terms, down 1 day QoQ.

Net cash flow from operations was ₹61.7 billion, which is 20.9% of the revenue and 103.8% of net income.

Free cash flow was ₹55.8 billion. After returning ₹160 billion through the buyback process and another ₹60.7 billion as the last fiscal's final dividend during the quarter, our invested funds as of June 30th stood at ₹322.7 billion.

The Board has recommended an interim dividend of ₹7 per share.

With that, we can open the line for questions.

Moderator: Thank you, sir. Ladies and Gentlemen, we will now begin with the question and answer session. The next question is from the line of Diviya Nagrajan from UBS Securities. Please go ahead.

Diviya Nagrajan: Rajesh, two questions for you. Your Digital business has been roughly adding about 1% of revenue exposure per quarter, what can we expect in terms of future trends here, is this the kind of addition that we should look at, 4% revenue exposure addition per year or are there any plans to fast track this so that the legacy track starts to diminish as we go forward?

Rajesh Gopinathan: As we said, we have restructured our service practice organization and we will relook at how we categorize these revenues. But the intent of the whole service practice reorganization really is to give increased focus onto the sub-segments within the Digital stack.

We are committing a lot of management bandwidth into each individual segment as we see the opportunity for accelerating growth in that area. You will see in a few quarters our reporting metrics also being more granular along those lines and that gives us a better idea about how this growth is panning out.

Diviya Nagrajan: Got it. My second question is on the realizations, you spoke about volume growth of about 3.5% and there seems to be almost 1.5% gap between the constant currency revenue and the volume growth. Could you just run us through what led to this gap this quarter and it seems to have widened, are we looking at more pricing pressure even with Digital kind of picking up, how should we read this?

Rajesh Gopinathan: As we said, we report realization and not actual pricing. If you look at it over a period of time, typically it is not unusual to see some quarters with a wider swing. But for the full year, our realization last year compared to the year before that has been almost flat with a very small decline. And over the last four, five years, while this question has come every time there has been some volatility on a QoQ basis, we have always maintained that we see a fairly stable pricing regime, adjusted for the nuances for the newer service lines obviously coming at better price-points. So, that theme has played out over the last three, four years and I don't think that this quarter is significantly any different from that.

Diviya Nagrajan: Thanks. I obviously have questions on your margins, but I will come back later in the queue. Thank you very much and have a good year.

Moderator: Thank you. The next question is from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: First question is on the BFS and Retail side. Your year-over-year growth in both these verticals now appears to be somewhat softer than one of your largest peers which has a very high Digital proportion and one of your smaller peers. And I remember in the televised commentary I think NGS made some comments that TCS is probably not addressing some of the demand because of business structure issue making a three to five years case versus a seven years case. I am just wondering, is this more than that -- is there a go-to-market issue here and on overall basis what should give investors comfort that TCS is not losing share?

Rajesh Gopinathan: I do not know exactly which is the larger one and which is the smaller one you have referred to, but in the scheme of things, compared to a larger one, we have managed to take away 25% market share over the last five years. So, on a QoQ basis I wouldn't think it is a big thing. We continue to have leadership status in the BFSI segment and we are nicely broadbasing our BFSI customer base, going further down the stack, working with smaller sized institutions as well as emerging businesses in this industry which are driven more from a technology basis. So we are quite confident and positive about our participation. And some of the ones like NGS or rather we mentioned about, I think here also I have spoken in my opening comments -- our core banking platform has gone live in US. One of the deals that we talked about is platform-based, in the UK. We had good wins in the Australian market. So we are seeing very broad-based participation, both in existing customers as well as new customers. So, I am quite positive about our success in this section. NGS, do you want to add anything?

N.G. Subramaniam: That is fine. Thank you.

Ankur Rudra: Sure, that is helpful. And I think the other question I had is, you met with a lot of clients in the last six months since both of you have taken over. I am just wondering why is the visibility still relatively soft or relatively, let's say, unclear for over 50% of the business? Is this because the demand is not there, I am just trying to parse through your comments to understand whether this is a market wide problem or specific to you?

Rajesh Gopinathan: Our commentary is that we do not see any broad trend to call, so it is not an industry-wide uptick nor an industry wide slowdown. If you take BFSI, even amongst large customers, we have a set of customers where we are growing very strongly, and we have set of customers that are constrained and challenged.

If you take Retail -- in fact I was sharing earlier that some of the most exciting work that we are doing in Digital is actually coming out of the Retail sector -- we see customers who are investing significantly because they see technology as the only way that they can react to the market environment around. Having said that, some of them are, in fact, fairly stressed and therefore it is very difficult to say how it will pan out in the short to medium term.

Our commentary is more a reflection of the market as we see it, I do not think our participation [is suffering]…in fact, I would say that in Retail we are market leaders -- in many geographies, we are far ahead of anybody else. In BFSI, we are one of the largest, if not the largest.

So we are quite well positioned and participating very well. It is more a reflection of some parts of the industry than anything related to TCS.

Ankur Rudra: And just last question if I may, you had quite good wins in North America this time, it appears to have come back in deal wins. And some of the largest deals in insurance you commented about, maybe signed this quarter. Would that mean that your traditional surge that in BFSI we see in the first half may be delayed this time and the shape of the quarterly trajectory might be a bit different this year versus usual years? Thanks.

Rajesh Gopinathan: Let me first give a couple of facts on the question and then we will answer it more generically. The insurance win that we spoke about this time is different from the one that we had spoken about last time. We have had a platform win -- not a small one, but by Diligenta standards, a relatively smaller one. The Diligenta pipeline for larger deals is still strong. We hope that it should materialize during this quarter. But that one we will have to wait and see how that comes about.

The North American pipeline is especially strong on the non-BFSI side. We have had a good growth in North America, in fact the pipeline there is very strong compared to the past few quarters, but it is in the non-BFSI sector. So the BFSI side is muted in terms of size of deals or total opportunities, which is why that commentary about lack of visibility on BFSI side.

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

Viju George: Just a couple of questions on BFS and on Digital. Is there a possibility that maybe with some of the large banks, maybe their spending is largely on track as per their budgets, but they may be doing this more with some of the other vendors, may be non-traditional vendors or may be increasing their captive or in-house presence?

Rajesh Gopinathan: In fact, if anything, we have seen BFSI spend with non-traditional vendors has slowed down and they are moving more towards larger, traditional partners as the first phase of investments in some of these newer technologies ends and we are looking at impact to the core in many of the new investments. In fact, NGS, talk about FinTech approach.

N.G. Subramaniam: I think, overall, the angst around fintech appears to have diminished and banks have come out with options of integrating more and more fintech-related services and automation products into the overall solution.

I think there is some caution in terms of Digital spend, specially on automation…newer and newer automation opportunities and new waves of automation products are emerging...and changing by the week. Some banks are taking advantage of this newer technology immediately, some of them are saying, 'is it a right product or should we put in a combination of this?'

So, it is all playing out. I think it should stabilize in terms of putting together a strategic bot-architecture in every bank, which will consistently drive automation across what we call TechOps, DevOps, as well as BusinessOps. I would probably say that, rather than saying, 'look, there is a lack of spend'.

Ankur Rudra: And do you sense a continuing shift towards captives because that is something we have picked up in some of the large banks. Do you think that process is still on which may be also taking some share from third party players?

Rajesh Gopinathan: It is more a case by case thing. Some banks are thinking whether they should shift more into it. There are others who are aggressively moving in the opposite direction. So I would not characterize it as a trend. We have seen people on both sides of the spectrum.

Ankur Rudra: And one last question on Digital restructuring. I think you mentioned in your prepared remarks that you want to give more visibility and focus to each of your sub-segments within Digital, could you just elaborate on that given the restructuring you have done. And is this focus more on delivery execution side or is it also in go-to-market?

Rajesh Gopinathan: It is both on the delivery, as well as on the go-to-market side. So, I would characterize the approach similar to what we did early on in the e-business side. As different technologies and different product groups are gaining scale we are creating more focused services around that.

And on the delivery organization side, we have integrated our operations across BPS and Infrastructure into our Cognitive Business Operations practice, which is both, a delivery as well as a go-to-market change. From a delivery perspective, the integration of our mature service lines into the [respective] Industry Solution Units is primarily a delivery-related integration. So overall, it is a market facing as well as delivery optimization.

Moderator: Thank you. The next question is from the line of Anantha Narayan from Credit Suisse. Please go ahead.

Anantha Narayan: My first question, Rajesh, was this new segmentation that you have reported, excluding the regional markets and others -- which by the way is quite insightful, so thanks for that. So, my question was on that regional markets and others piece. Now, is there something that he company can do to address the volatility in this piece or is this going to be a structural issue for the foreseeable future? The reason I ask it is, it is almost about one-fifth of the total revenue, this piece can actually swing growth quite significantly...

Rajesh Gopinathan: Anantha, our focus of course is to get to annuity based revenues in most of the markets that we operate in. If I take a market like Japan, while we currently do not have a significant presence, it is definitely a market in which as we grow in scale, it will become much more annuity based and much more predictable and long-term.

Markets like India are unlikely in the near future to swing to that. Middle East is a mixed one. We are trying, especially in some of the banking relationships, to move towards more and more on the annuity side. We have had some early success in some banks and some telecom companies, but the focus is to gain market share and to maintain it by participating in wherever the demand comes from and to stay focused on profitable revenue streams. So, the intent is to participate while moving systematically towards [more annuity business].

If you take something like Diligenta, and I have said this before also, while the revenue profile is very atypical to our normal business, in toto, it is a very attractive business to be in. When you think about that business over the full cycle of its revenue streams and combine it with our products and delivery capability, it is a very attractive business to be in. So, we do not want to shy away from participating in that just because it inserts QoQ volatility and I have to stand and explain why that volatility is there.

I think this gives us a framework for a much more transparent and involved discussion where we will continue to participate in markets that we think either have future potential or are good value creation, irrespective of what their revenue profile looks like.

Anantha Narayan: Thanks, Rajesh. And my final question was on the medium-term margins front. So, when you look at this 26% to 28%, if you want to sustain this 26% to 28% band, excluding currency movements, and given that there has to be constant investments made in the business, then you have your annual wage increases, etc, can you give some sort of indication on what sort of revenue growth will be required to sustain that margin band?

Rajesh Gopinathan: Anantha, we do not have a scientific answer to that. In the past we have always felt that somewhere close to the mid-teens would definitely be a comfortable one, but we are tweaking our model to make sure that it can be sustained at a lower revenue growth level.

To some extent, it will play out based on how fast and how extensive the Digital churn is. Also, on how fast Digital services coalesce into larger groups into which greater profitability can be driven. So, there are many moving pieces out there.

The way to put it is that among all market participants, we are best positioned to drive profitability in that. And we are continuing to participate and simultaneously looking for opportunities to impove profitability.

Moderator: Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: I have a couple of questions for Rajesh. Rajesh, we appreciate the extra effort you have taken to break down the revenues and giving us also the piece which has been impacting the revenue growth quarter-on-quarter either positively or negatively in terms of Regional Markets. But just wanted to understand two things, in one or two quarters what will be the timeline by when we will be able to get the breakup of the new verticals as you mentioned, I mean that detail is not there yet. And secondly, within those pieces will there be a piece which will be equally volatile in terms of the way we are seeing in the regional market? What I am trying to understand is, is there also a piece which is probably equally volatile like the regional market so that the prediction of revenue becomes much more difficult. Do you foresee that kind of scenario?

And also the second question is on the Digital side, on the Digital side we heard you on the televised interview that you said that Digital yields are increasing year-over-year in size. But do you see that deals reaching a level where you know these smaller vendors who have been introduced earlier to test from client perspective, they will be now moving out because the sizes are becoming that big, or you think that transition is still some time away?

Rajesh Gopinathan: Sandeep, first of all, I fully appreciate the challenge that you guys have because of our not sharing the service practice breakup numbers. We are committed to doing that as soon as we are confident about it and can have a commentary that is stable and can give you appropriate color and visibility.

At this stage I do not know when that will be, but we are committed to that path of sharing it once it stabilizes.

From my internal focus perspective, it is more important that the new leaders and the new services get to a stable base and they do the transition *properly* rather than work on an artificial timeline of having to clean it up for external reporting. So we are trying to balance the need for external transparency with organizational imperatives and we will come back to you as early as possible.

As for whether some lines in that be more or less volatile, in total that is 100%, and the vertical segments and regional markets is 100% -- that is just a different cut [of the same revenue]. The aggregate volatility of the service practices and the aggregate volatility of the vertical segments is the same. Some service lines might be volatile because especially they are new and growing, but it does not change the overall nature of the business. So, this is not another set of revenue streams that we are going to introduce which would change the overall mix. That is the point on that.

On Digital businesses, anecdotally we have seen clients come back to us from smaller vendors as deal sizes have increased. More importantly, the driver is not so much increase in deal size, it is the fact that as they have to touch the core and as they have to get more into enterprise wide systems, a lot of the engineering capability that we bring to bear and the contextual knowledge that we have of the customer environment become a significant part of the value proposition and the differentiator. It is a space where we are much more competitive than in the early stage experimental and pilot based projects. But how is that churn going, that is difficult to call. I would say that it is unidirectional, but I cannot put a number as to how far ahead we are on that.

Sandeep Agarwal: Thanks, Rajesh, for that clarification. But let me try to little bit rephrase the question again. What I am trying to understand here is if you see some of the central European, east European, South American companies, although extremely small in size but they have been posting very good growth above 20% and so for the last several quarters. Although they are extremely small in size, so probably they do not have a legacy baggage or something. I am trying to understand that whether that kind of piece is existing in our structure as well, but right now because of lack of reporting it is not showing up?

Rajesh Gopinathan: I do not know which are the very small ones that you are talking about, but if you take some of the medium-sized, mid-tier eastern European players, our win rates against them are higher today than they were even a couple of years back. In recent times I do not recall anything that we have lost to them. But that is anecdotal, and I do not know about other smaller ones.

Overall, in almost every single market that we participate in, our market share is going up. There is consolidation happening and we are coming out positive on the consolidating side.

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

Sandeep Shah: Just on the BFSI growth in a constant currency, which is 2.3%, is it possible to give us a growth separately for BFS and insurance?

Rajesh Gopinathan: We do not break that out.

Sandeep Shah: Just Rajesh, on the BFS, you also said that the large deals are not up to the mark and you need more large deals to see a sequential pickup in the demand. So is it more to do with the decision making delay, especially in North America looking at lot of noise on the regulatory changes on the outsourcing or do you believe that there is a pause in terms of structural shift of the spend which used to happen earlier versus now? Or is it more to do with intense competition in the market?

Rajesh Gopinathan: I did not say that how do you characterize it that the large deals are not sufficient I did not say that. What I said is that it is not a broadbased trend. There are customers where we have large deals and significant growth and investment. And there are customers who are more constrained and challenged.

In fact, we are pursuing multi-hundred million dollar kind of deals [in BFSI]. And if you look at wins in this quarter, of the 11 that I announced, four are in BFSI: two in BFS and two in insurance. So it is not that there are no large deals. The comment was more that it is not homogenous for us to make a broad-based comment about the sector. It is a more diverse kind of a demand environment that we see.

Sandeep Shah: And is it for the North America, I think the deal wins overall is also better, so it is fair to say that QoQ, the decision making is improving in North America or you are still a wait and watch before you call it as a trend?

Rajesh Gopinathan: Again as I shared with you, we are seeing good pipeline and good closure in North America, but coming outside of the BFSI sector. So, to make a comment about is it increasing or decreasing, it is very difficult to say, I mean industry itself is doing well and that shows up in our growth figures also. So, if you look at Travel or Utilities, those are doing better than 7%, Life Sciences is doing higher than 4%. So, that is showing up in that side, but beyond that I do not think we can give a generalized characterization of whether it is faster or slower.

Sandeep Shah: Just on the M&A, now looking at the service reorganization and most of the M&A focus of the peers, even the larger peers is more on the service side, more on the innovation side. So, with the new service reorganization whether the TCS' openness on the M&A will increase or we will continue to remain in terms of focusing on more adding value. I agree that is the key but is it the frequency of M&A may go up with the new service reorganization?

Rajesh Gopinathan: First of all, it is important to remember that TCS probably has the most successful M&A track record in this industry and we have never shied away from investments. When we find the right asset at the right price point, we move in. A great example is the investment that we did in the Citibank back-office at the peak of volatility of the financial crisis, when M&A was not the flavor of the month.

We believe that a disciplined approach to M&A is the path to value creation and it is a complimentary process to organic growth. We are always on the lookout for the right opportunity, at the right price points.

With the new structure also we will continue to remain open to opportunities, whether it is from the services perspective or verticals perspectives or from the geographical perspective – where, in fact, we have been very active. I am quite positive about the success that we have had in each of these dimensions.

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

Sumeet Jain: Firstly, wanted to understand on the Digital project, are you really seeing bigger-sized projects in the Digital area, because as per NASSCOM, most of the deals in Digital are still pretty small. So, can you throw some color on that?

Rajesh Gopinathan: Compared to what they were earlier, some pretty large deals are also materializing. One of the deals that we are pursuing with an engineering major in UK is actually primarily an IoT and analytics driven deal, which is in the range of $50 million plus. So, large deals are coming. And definitely all Digital deals are probably larger than what they were earlier. But it is also a market which does have lot of small deals.

Sumeet Jain: And also, can you comment generally, is the pricing far better in the Digital project than the legacy ones, and also what is the ultimate margins we have right now and how do you believe it going forward?

Rajesh Gopinathan: Digital price points are definitely better than legacy price points and this is in the nature of this business. Any new technology commands a price premium and any scaled technology comes at a decreasing price point. That, in fact, is the key driver which enables technology adoption to keep on increasing at a client level and this is not just for services, [it applies to] any technology. The reason why technology is so successful overall is because it has a reducing per unit price point.

So, I would say that in the larger scheme of things we are riding that curve with a new set of technologies today. And ten years from now, there will be some other new set of technologies and we will have to ride that also. What is important is can we acquire these skill sets, can we reskill our workforce, can we participate in those opportunities; and to put it in a concise way, can we stay relevant to our customers?

And I think that client profile that we have shared, and the metrics that we share, is the final validation that our relevance to our customers continues to increase. Our ability to mine these customers is the best check of our health.

Sumeet Jain: Right. So, can you also comment on the profitability margins, because it seems that initially you have to invest a lot in the proof of concept and go-to-market team, so can you comment on the margin profitability as well apart from pricing what you said?

Rajesh Gopinathan: Again, our business margin is directly linked to scale. For any given service that increases in scale, the margin profile improves. While it is smaller, all the elements that you spoke about are true, greater investment as a percentage of revenue and much more SG&A expenses. But as it scales up, it becomes much more profitable. The pyramid improves, the leverage improves in all forms, lesser touch point and greater delivery certainty; everything adds to the margin benefit.

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

Rahul Jain: So, we saw this 1.5% impact because of the realization, if we see the CC and volume spread of 3.5% and 2% growth, so if you can divide this decline in realization in terms of either the mix or discount or shift how this would have panned out?

Rajesh Gopinathan: Rahul, on a quarterly basis I do not want to get into it. I had commented earlier that if you look at our full year to full year realization and these numbers here, for the last four years it has been -0.2%, -0.1%, 0.0% and 0.8% positive. So, I do not think that in a given quarter it is appropriate to try and break it up. We would not be able to share that.

Rahul Jain: But even in cases, so this is the net which we have gained but if we have to call for the trend even on the legacy side, as you said in the previous case that as the technology matures the pricing keeps on reducing. So, what is that number for us on corresponding portfolio to that would be what size?

Rajesh Gopinathan: Cannot share.

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

Ashish Chopra: Rajesh, just had one question on the margins. So, the cumulative impact from the currency in the last couple of quarters would be around 120 basis points, so excluding which you would be at 24.5% - 24.6%. So, which seems to be the farthest you have been probably from your aspire dreams of 26% to 28%. So, just wanted to know what would we attribute this to? And secondly, would you believe that Digital at 20% of revenues which at the scale at which it can still command a very healthy margin or really there is a long way to go there?

Rajesh Gopinathan: There is nothing specific. One of those I attribute it to… somebody had asked earlier about what is the growth rate that is required to sustain it. Part of it is a reflection of the growth profile that has panned out over the last few quarters, part of it is the whole area of Digital where we are investing in and trying to churn in.

While we are clubbing multiple things together and reporting Digital as one, which is in-line with the industry practice, the actual services -- if you think about it -- are very, very diverse businesses underneath that. Whether you think about cloud or automation or Digital interactive or IoT, these are all fairly granular services. And it is more a mathematical [exercise] to put it as 20% and classify it as one segment. So scale depends on a given service line scaling up, and as those scale up, I am sure they will lend themselves to much better profitability.

Ashish Chopra: Understood. So, would it be fair to assume that the scale in Digital would be one of the biggest drivers of bringing your margins back to the band that you think you can operate at?

Rajesh Gopinathan: All of it, scale in Digital and overall growth rates, and of course the volatility in the operating environment and productivity.

Moderator: Thank you. The next question is from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: I have heard from industry sources that US environment for hiring is pretty tight and salaries have really shot up over the last year or so. So, do you see any constraints in hiring, limiting your revenue growth or do you see that impacting your cost in any way?

Ajoy Mukherjee: No, we do not see any constraint as far as hiring is concerned in the US.

Rajesh Gopinathan: Having said that, the US unemployment rate is at a historical low and obviously, as we have always maintained, it is a supply constrained market and a fairly efficiently priced market. So, net - net it will play out in its own ways.

Ashish Chopra: And secondly, in your conference I think you had mentioned that Diligenta is a more volatile business and that is included within your regional markets and others, is that correct? And if so, it was a surprise because I was under the impression that Diligenta is a platform based BPO business with long-term contract.

Rajesh Gopinathan: In fact, the line item there has not just volatile businesses. A better characterization would be: non-standard revenue profile businesses. Diligenta, as you rightly said, is a platform-based business. But if you look at its revenue profile over a contract term, it is a very skewed revenue profile with a fairly high front-end loading and a declining loading into its tail and a long tail. So, [it is a] very, very different revenue profile and revenue characteristic compared to our typical services business. What we are clubbing there is businesses with non-services kind of revenue profiles, and using [the term] volatile as a more generic term to describe it.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to the management for closing remarks. Over to you.

Rajesh Gopinathan: Thank you, operator. To sum up the call, we had a promising start to the fiscal year with a strong volume growth of 3.5%. Other than BFSI and Retail there was robust growth across most of our industry verticals with every one of them growing upwards of 3.5% in the quarter.

BFSI and Retail & CPG which have been weak for the last few quarters almost showed some improvement in Q1.

We see our service practice reorganization as a significant change in our operating model and expect to see good scale build up in the newer service practices under the leadership of some of our most successful business leaders.

Our Digital business continues to grow very strongly with significant market traction and deal wins in every element of the Digital service stack.

Our products and platforms are also doing exceedingly well with good wins in Q1 and a strong pipeline. And as I said, the climate continues to be strong and pricing remains stable from a longer-term perspective.

We have strong deal wins in Q1 and expect to close to larger deals in the current quarter, which gives us confidence for the rest of the year.

On that note, I would like to conclude today's call. Thank you all for joining in.

Moderator: Thank you very much, members of the management. Ladies and Gentlemen, on behalf of TCS, that concludes today's conference call. Thank you all 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 the proceedings.