

Tata Consultancy Services Limited**Q2 FY23 Earnings Conference Call.
October 10, 2022 , 19:00 hrs IST (09:30 hrs ET)**

Moderator: Ladies and gentlemen, good day and welcome to the TCS Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '**' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kedar Shirali – Global Head, Investor Relations at TCS. Thank you, and over to you, sir.

Kedar Shirali: Thank you, operator. Good evening and welcome, everyone. Thank you for joining us today to discuss TCS' financial results for the second quarter of fiscal year 2023 that ended September 30, 2022. 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; Mr. N G Subramaniam -- Chief Operating Officer; Mr. Samir Seksaria -- Chief Financial Officer; and Mr. Milind Lakkad, Chief HR Officer.

Our management team 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 lists.

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

Rajesh Gopinathan: Thank you, Kedar. Good morning, good afternoon and good evening to all of you. We are very pleased with our performance in Q2. Our revenue grew **18%** in rupee terms and **15.4%** in constant currency terms and **8.6%** in dollar terms, reflecting the continued strength of demand for our services.

Our operating margin for the quarter was **24%**, an expansion of **0.9%** sequentially and a contraction of **1.6%** on a year-on-year basis. Our net profit crossed the **₹10,000** crore mark this quarter and our net margin was at **18.9%**.

I will now invite Samir, Milind and NGS to go over different aspects of our performance during the quarter. I will step in again later to provide some more color on the demand trends we are seeing. Over to you, Samir.

Samir Seksaria:

Thank you, Rajesh. Let me first walk you through the headline numbers. In the second quarter of FY 23, our revenues grew **15.4%** YoY on a constant currency basis. Reported revenue in INR was **₹553.09** billion, a year-on-year growth of **18%**.

In USD terms, the sharp fall of all currencies in our basket versus the dollar in Q2, resulted in a deflated reported revenue of **\$6.88** billion, a YoY growth of **8.6%**. While the rupee depreciated by **3.4%** against the dollar sequentially, it appreciated **4.4%** against GBP and **3%** against euro, eroding the benefit at the operating margin level.

This currency benefit along with a flatter workforce pyramid and improved productivity of fresh hires helped mitigate the impact of normalizing travel and facility expenses and continued headwind from backfilling and retention expenses.

Overall, our operating margin expanded by **0.9%** sequentially and was at **24%**. Looking ahead, we believe the supply side issues have peaked and should start easing in the second half of the year.

Net margins were at **18.9%**. Effective tax rate for the quarter was **25.7%**. Our accounts receivable was at **62** days' sales outstanding in dollar term, down 1 day compared to Q1.

Net cash from operations was at **₹106.75** billion which is **102.3%** of net income. Free cash flow was **₹100.62** billion.

Invested funds as on 30th September stood at **₹592.9** billion.

The Board has recommended an interim dividend of **₹8** per share.

Over to you, Milind.

Milind Lakkad:

Thank you, Samir. On the people front, our investments in capacity building and organic talent development allowed us to achieve our strong business growth with relatively modest net headcount addition.

In Q2, we added **9,840** employees on a net basis, bringing our workforce strength to **616,171** as on September 30th. It continues to be a very diverse workforce with **157** nationalities represented and with women making **35.7%** of its base.

On the learning front, TCS clocked **11.7** million learning hours in Q2, resulting in the acquisition of **1.5** million competencies.

Our FY 23 fresher onboarding is proceeding as per plan. In keeping with our culture of being committed to our employees, we have honored all offers we had made and have onboarded **35,000** freshers in H1 and with **20,000** brought onboard in Q2 alone.

The TCS employer brand continues to shine strongly helping us attract the best talent across the world. We launched the TCS National Qualifier Test for FY 24 on August 15th and received an overwhelming response with half a million registrants, an all-time high.

Industry-wide churn continue to be high in Q2. Our LTM attrition in IT services inched up further to **21.5%**. That said, the technology job market which had overheated in the last few quarters has begun to cool off, and compensation expectations of new hires are also becoming more realistic. With supply catching up across the industry, the pressure to poach experienced talent is easing. So, we should start seeing the churn settle in the coming months. Based on the monthly trends, we believe our quarterly annualized attrition figure has peaked in Q2 and should start moderating in the second half.

Lastly, we continue to be benchmarked with the best employers globally for our workplace practices, and policies. In Q2, we won more than 50 awards globally across various aspects of HR value chain, including our work towards gender equity.

Over to you, NGS for some color on our segments and products and platforms.

N G Subramaniam:

Thank you, Milind. Let me walk you through our segments and performance details for the quarter. All growth numbers are on year-on-year basis and constant currency terms.

All our industry verticals grew strongly in Q2. Growth was led by Retail and CPG which grew **22.9%** after a similar strong double digit growth last quarter. Growth is being driven by ongoing spending by retailers towards making their supply chains more agile and resilient, and improving the shopping experience for their customers. We've also seen an uptick in the travel, transportation and hospitality sector, driven by increased investment in resilient operations.

Communications and Media grew **18.7%** driven by investments around 5G and delivering personalized offerings to consumers.

Technology and Services vertical grew **15.9%** while Manufacturing as well as Life Sciences and Healthcare both grew **14.5%**.

BFSI, our largest vertical grew **13.1%**, powered by strong spending on cloud, data analytics and customer experience.

Let me now walk you through the growth figures by geography.

Among major markets, North America led with **17.6%** growth, UK grew **14.8%** while Continental Europe grew 14.1%.

In emerging markets, India grew **16.7%**, Middle East & Africa grew **8.2%** and Asia Pacific grew **7%**.

It is befitting that Latin America led with **19%** growth in Q2. During the quarter, we celebrated the completion of 20 years of TCS' presence in the region. In these two decades, our business across the region has grown significantly, catering to the local market, as well as serving as a near shore center for North American clients.

Moving on to our Products and Platforms, they did really well in Q2.

Ignio™, our cognitive automation software suite signed up four new customers and three clients went live during the quarter. TCS filed two patents around ignio during the quarter and was granted one. The market demand for ignio-trained professionals continue to grow. The number of ignio trained professionals now stands at **16,398**. The number of ignio certified professionals is at **6,984** to-date.

A large American technology company specializing in consumer electronics, software, online services, and mobile phone manufacturing extended ignio AIOps' event management capabilities to their supply chain. This eliminated duplicate alerts and processed genuine alerts, giving SMEs more time to focus on real issues, thereby reducing overall resolution time. The tool has handled over 25,000 alerts since implementation. 33% of these were suppressed and 66% were triaged to operations as legitimate alerts.

TCS BaNCS™, our flagship product suite in the financial services domain had four new wins during the quarter. One of the world's largest investment management companies based in the US, offering a broad selection of investment advice, retirement services and insights to individual investors, institutions and financial professionals, has selected TCS BaNCS Wealth Management for their retail business.

One of the UK's leading insurance organizations went live with the TCS Insurance platform, migrating 2.3 million policies onto TCS BaNCS this quarter. This is the largest ever policy migration in the UK life and pensions industry, and a major milestone in the customer's simplification journey towards eliminating aging legacy systems.

Our Quartz™ blockchain platform had two new wins and one go live in Q2. Quartz has been selected by a large electricity provider in North America to establish a private permission blockchain to track and manage energy consumption and renewable energy certificates allocation among multiple smaller entities. The initial pilot will demonstrate the ability of blockchain to bring different entities together on a shared ledger and track the actual energy consumption vis-à-vis the contracted quantity, automate the issuance of renewable energy certificates using smart contracts and enable real-time tracking of the certificates issued.

In life sciences, our award winning Advanced Drug Development suite had one new win. We onboarded a top five pharma major on our Supply Management Platform, part of the CCT suite, to deliver real-time insights into patient medication adherence.

TCS TwinX™, our AI-based digital twin solution, continue to gain ground in various industries, helping clients carry out complex what-if analysis and take informed business decisions. In Q2, we had two wins and three go lives for the TwinX platform.

TCS Optumera™, our AI-powered retail merchandising suite went live with two of our clients.

TCS iON™ had eight wins in this quarter and is seeing increasing demand and familiarity among educators for the ability to author question papers and auto or manually mark responses. In Q2, we served 150 assessment customers and administered 300 exams to around 6.6 million candidates.

Over 1,170 corporates now leverage the TCS National Qualifier Test as their entry level recruitment platform and over 3,150 candidates have gotten placed till date.

TCS' MasterCraft had 23 new wins this quarter, including 10 new clients and 13 renewals.

In terms of client metrics, these metrics are an important validation of our customer-centric business model. The customary practice has been to report these figures based on US dollar translated revenues.

With sharp currency volatility of the kind we saw in Q2, the print numbers of clients in non-US dollar markets may get underreported due to currency deflation. Despite that headwind, we have good additions in every revenue bucket in Q2 compared to the year ago.

We added five more clients in the \$100 million plus band, bringing the total to 59. We added 10 more clients in the \$50 million band, bringing the total to 124. We added 36 more clients in the \$20 million plus band, bringing the total to 283. We added 38 more clients in the \$10 million plus band, bringing the total to 455. 41 more clients were added in the \$5 million band, bringing the total to 650 and 72 more clients in the \$1 million plus band, bringing the total to 1,210.

Overall, it has been a very satisfying quarter from an operations perspective.

Let me now request Rajesh to speak on the demand drivers during the quarter.

Rajesh Gopinathan: Thank you, NGS. Before I get into the demand drivers, let me spend a minute talking about the demand environment and mood among clients.

Despite growing news flow around a possible economic slowdown across the world and client concerns over how that might affect their businesses, we haven't seen any change in their spending on us so far. As you could see from the growth figures, demand for our services continues to be strong in Q2 across all verticals and all markets even in Continental Europe and UK, where the pessimism levels are at the highest.

Project ramp-ups proceeded as scheduled, and we're not seeing any delays or cancellations. Deal closures also remained strong in Q2.

That is not to say that the deteriorating macro had no impact at all. Clients have become more cautious when committing to longer-term investments. Some of the larger transformation programs are seeing prioritization of projects that offer quicker wins versus those with longer term paybacks. Many of our clients are also working on plans for various economic scenarios for next year. We have also seen some sporadic instances of delayed decision-making on new deals. Those apart, clients have been telling us that even if their business outlook changes over the next few months for the worst, technology will be one of the last areas to be impacted.

The big driver of demand in this quarter was the continued investment by our clients on cloud transformation. The scale, breadth and depth of our cloud expertise, deep domain knowledge, strong partnership credentials with the hyperscalers and our portfolio of

intellectual property on the cloud, make us one of the largest beneficiaries of this opportunity.

We are now seeing client focus shift to execution of the transformation agendas announced earlier, and this plays to our strengths. We have seen instances where clients are unable to leverage the flex capacity of the cloud until they shift a larger portion of the workload and they are seeking our help in accelerating that move.

Further, many organizations which rushed to move their workloads to the cloud without sufficient planning and controls in place, are now discovering that they are not only losing out on the economic benefits of the hyperscaler clouds, but are actually incurring higher costs than they did with their own data centers.

Such clients are very open to our proactive proposals with our FinOps advisory offerings to help optimize their spends on the cloud, and our cloud orchestration services powered by TCS Cloud Exponence™, our multi-tenant cloud delivery platform to help them seamlessly and optimally manage multiple environments spanning public, private and hybrid clouds.

We won several cloud transformation deals in Q2. For example, we were selected by a leading American biopharmaceutical company as a transformation partner to modernize their technology estate. We will build for them a next-gen operating model leveraging cloud, agile, DevSecOps, and cloud-native technologies that will help them enhance enterprise resilience, accelerate the pace of innovation and improve the customer experience.

In addition to the migration of workloads to the cloud, several clients engaged us in Q2 to architect advanced analytics, leveraging cloud native capabilities to help them launch new products, understand the customers better, and deliver a richer customer experience.

For example, for a large UK bank, we proposed a transformation solution entailing the design of an enterprise data fabric architecture that enables advanced analytics at scale, leveraging our deep contextual knowledge, portfolio of tools and accelerators and hyperscaler cloud expertise. This will help the bank drive more personalized products and services, understanding the customers financial needs at various life stages and deepening relationships with customers thereby propelling growth for the bank.

Similarly, a leading American hotel and motel operator, engaged us to develop an advanced cloud analytics solution to help transform customer and agent experience by consolidating and harmonizing data from across their enterprise.

The economic uncertainty is also resulting in greater interest from clients in our Machine First™ approach to transform their IT and business operating models.

You might recall from my earlier commentary on this topic, that this approach basically entails embedding AI and machine learning deep within an enterprise to create leaner, more agile and resilient operations, which can flex up or down depending on the business environment, and whose efficiency gains can fund some of their front office transformation initiatives.

We had several such wins this quarter of which I will mention only two.

We were engaged by Xerox for their enterprise-wide business transformation journey to enhance their competitiveness and power their growth. TCS' Cognitive Business Operations, and Xerox' Centers of Excellence embarked on multiple transformation initiatives across the various business functions, including finance and accounting.

The digital transformation program powered by TCS Cognix has automated the processing, improving speed, accuracy and throughput. Its AI-powered dashboards and various analytical models equip the finance function with intelligent and real-time insights for decision-making. This has resulted in a positive impact on the cash flow, and significantly improved operational efficiency.

A European industrial tools manufacturer chose us to transform their service desk operations. We will leverage cognitive technologies and implement a leading employee experience platform for auto-healing of user issues and improve user experience.

Coming to the third driver of demand, it is what we broadly classify as growth and transformation. What stands out in these engagements is the value of our deep contextual knowledge of our clients' business and technology landscapes and our highly collaborative inside-out approach to transformation. This results in impactful transformation solutions that don't face traditional organizational resistance to change and get us much appreciation from the management teams.

Let me illustrate this with three examples:

We have been working closely for over a decade with a leading bank in North America that services the startup and innovation industry. Our deep contextual knowledge of the business gained over these years has made TCS a trusted advisor to their growth journey towards becoming a large financial institution.

To support the business expansion and to effectively prepare them for a transition from a category-IV to a category-II bank, which was as required by regulators given their significantly fast growth, TCS helped them conduct a detail risk and regulatory assessment and prepare a roadmap to meet the regulatory requirements related to liquidity, market and credit risk. This entailed reimagination of the overall business framework for the treasury and capital markets swap dealer business for the bank.

TCS led the discussions with the bank to define the target state business architecture, solution architecture and implementation roadmap. We brought in actionable points of view, best practices recommendation, and presented a tactical as well as a strategic approach to the solution implementation.

As a business outcome, the real-time liquidity monitoring and management is expected to reduce the nostro buffer for the bank by more than 40% and ensure compliance to enhanced regulatory requirements. The target reference architecture is expected to bring down the time-to-market by 10% to 15%.

Similarly, we're working with a large pharma and medtech company to reimagine discovery and development of therapies by blending science, data science, and emerging technologies. We have developed an advanced AI and model-based adaptive risk monitoring solution with a predictive engine to predict risk mitigation insights for clinical risk management. The solution was co-created with the client and is now part of the TCS ADD platform.

We are also a strategic partner supporting the digital surgical platform for their medtech segment. The platform is in an early stage of evolution and has foundational capabilities of edge connectivity, analytics and AI suite with an objective to provide capabilities to launch specific use cases for connected digital surgeries.

A third instance is where TCS led the transformation of the space, range and display capabilities for Marks & Spencer, enabling it to improve customer choice while optimizing the range of products based on local consumer demand. This is achieved through automated data-driven range decisions, and by producing over 12,000 live store-specific planograms.

By enhancing the accuracy of floor plans and equipment into the planogram fixtures, our solution ensured that the optimized display plan could be faithfully implemented in the stores. This transformation helped M&S meet local demand, improve availability, reduce waste and improve profitability and align future business goals and the food retail strategies.

Our deep domain knowledge is placing us at the heart of industry-level transformations across multiple industry verticals. One such industry that is going through a tremendous amount of technology-led transformation is the utility sector, at an industry level, as well as at the level of individual enterprises. Almost every quarter, I've shared examples of transformation work we're doing in this sector.

In Q2 last year, I'd spoken about five-minute settlement solution that we built for the Australian Energy Market Operator, that is helping spur innovation in that market and lower costs for consumers. This time I want to highlight a transformation in the UK gas market.

The UK energy regulator introduced a program for faster and more reliable supplier switching option for energy consumers with a new centralized switching service, to facilitate competition and deliver better outcome for consumers.

TCS worked with Xoserve, the central data service provider for the UK gas market to design and deliver a complex solution that transforms core business processes like switching and contract creation, settlement, device update and maintenance, meter reading, billing, delivery and others, leveraging a leading hyperscaler ERP solution.

TCS' deep domain expertise and technology expertise were critical in delivering the solution capable of processing 150,000 switches in under 30 minutes. The solution allowed the transition and migration of 24 million UK gas meters' data to enable CSS switching activity. The solution went live in Q2. With the new solution, the 14-days that it took to switch a supplier has now been reduced to just one day.

Similarly, last quarter I'd spoken about a Fortune 500 electric and gas utility that partnered with us to launch a new business model to generate new revenue streams based on home energy services. Let me share one more example along similar lines.

Engie France, the leading utility retailer is transforming its business model by expanding from a commodity-based business of gas and electricity to a new service-oriented model of smart home solutions, offering to drive energy efficiency for consumers and ensuring sustainability.

TCS partnered with Engie right from the conceptualization, design and proofs of concept.

Leveraging our deep domain knowledge and expertise in core ERP, we developed a solution for subscription in CRM with incentive and promotion management, and integrated billing for service and energy-commodity charges in a consolidated invoice.

This offering has been launched in the market and has received a very positive response, improving customer satisfaction and growing market share for Engie.

I'd mentioned in earlier calls that many of our G&T engagements are business model innovations. Let me share three such examples of business transformation solutions that went live in Q2.

An American multinational conglomerate engaged us to build a comprehensive asset performance management solution that they will market to their industrial and warehouse customers.

The cloud-based IoT platform we built for them ingests real-time data from various assets and enables new value-added services around improved asset visibility, monitoring capabilities, and predictive insights, leading to improved asset performance, optimized operations, increased plant availability and higher throughput for their end-customers, and new revenue streams for our client.

Ingram Micro, one of the largest technology distributors in the US, engaged us as a partner to power their pivot into e-commerce and achieve their mission to transform from a traditional distributor to a platform company that does distribution.

We built them a new digital experience ecosystem platform connecting their customers, vendors and associates. It reimagines the customer journey, making it frictionless and highly personalized, with conversational experiences, and an AI-powered recommendation engine that enables intelligent bundled offers.

Similarly, Tapestry Inc. – a leading New York-based house of iconic accessories and lifestyle brands, consisting of Coach, Kate Spade, & Stuart Weitzman – partnered with TCS to drive their omnichannel modernization, implementing order management for its brands to help increase net incremental growth and improve customer satisfaction. This partnership created a flawless omnichannel order fulfillment and improved customer journey experience.

So, overall, these examples give you a flavor for the kind of services and the kind of opportunities that we're able to address across our customer and market landscape.

Coming to our order book, we again had a strong set of deal wins in Q2, amounting to a TCV of \$8.1 billion. By vertical, BFSI had a TCV of \$2.3 billion, while retail order book stood at \$1.6 billion. The TCV of deals signed in North America stood at \$4.3 billion. Interestingly, while the pessimism around the macro is possibly highest in UK and Europe, our order book there is stronger in Q2 than in Q1.

While the strength of our order book as well as the pipeline for Q3 is somewhat comforting, given the volatility, we remain very vigilant and are staying very close to our clients.

With that, we can open the line for questions.

Moderator: We will now begin with the question-and-answer session. First question is from the line of Kumar Rakesh from BNP Paribas. Please go ahead.

Kumar Rakesh: My first question was specifically around European geography and UK. In this quarter on a CC YoY basis also, we saw a pretty robust growth of 14% to 15%, which is a higher growth compared to how we reported last quarter. One of our larger peers who recently reported also saw pretty strong growth in Europe and talked about double-digit growth in their November quarter as well. Given the fear around macro economy being pretty severe in that geography, what is driving this much stronger growth in Europe despite those fears? Is there some structural growth drivers which we are now seeing in the European geography or the impact could potentially come with a lag?

Rajesh Gopinathan: Rakesh, we have always maintained, and it has been borne out through the pandemic, that technology is at the core of solutions both on the growth side as well as on the consolidation and optimization side. So, technologies remains very core to business agendas for our clients across the full spectrum, across all markets. And we are benefiting from participating in that cycle.

It's very difficult for us to zoom out and comment on the macro situation. We can only tell you what is going on with the specific clients that we have. We are in no better position than you... you are, in fact, in a much better position than us to be able to take a call on the macro. This is what we see and we are running with it.

In individual customer conversations, opportunities exist, but caution also exists. I called that out last time also that in executive conversations, people are talking about caution. We need to remain vigilant to see whether that will translate into the budgeting and planning cycle for next year, and what that implies for overall demand. We'll have to play it by the ear as it comes.

Kumar Rakesh: My second question was around heading into December quarter, which is usually seasonally weak, are we getting any sense how the seasonality this time around? Could there be higher than usual seasonality or could it be the usual seasonality? In interacting with clients, how are they looking at their next year budget? Any sense on that could be very helpful.

Rajesh Gopinathan: Leaving aside the fact that Europe is in a fairly volatile situation, and this winter is going to be critical in Europe, our conversations with clients indicate regular seasonality. We have had extensive client interactions – we hosted our North American clients at our annual TCS Summit, and also had a series of client events across Europe. So, overall, I don't think there is any change to the seasonality patterns that we are picking up. However, this does not address the possibility of some severe shifts in Europe during the winter.

Kumar Rakesh: And client interactions on next year's budget planning?

Rajesh Gopinathan: Too early to take a call. We don't know. I mean, we get to hear of it only in the second or third month of the year, as it starts actually translating into projects. At this stage, we don't have visibility. As I said in the last call also, there is a cautionary stance that customers are talking about. They're talking about scenario planning. And the scenarios are more weighted on the downside than on the upside.

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

Sandip Agarwal: Although, you know it is very hard to comment on how things will pan out, but, Rajesh, is there any kind of caution which you're seeing in your discussions with the client, particularly from the US geography, because individuals in UK and Europe, traditionally we have seen the economic pressure generally results into some help for outsourcing because it is more cost effective in the past, but that correlation doesn't show up immediately in the US. So, what are you seeing, is there any kind of caution which clients are highlighting on the fears of recession or you're seeing any action into the direction when they are ordering? Have you seen any kinds of delays or anything which makes us more vigilant?

Rajesh Gopinathan: In US we've not picked up any threats in terms of caution, I mean extra caution than what is normally expected. So, US is not showing anything particularly concerning. People are overall continuing to invest and normal seasonality should apply. Otherwise, we are seeing a fairly strong environment in US.

Moderator: The next question is from the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: Rajesh, last time in this 1Q conference call, you said that the trend of multi-tower outsourcing deals or multi-service transformational deals are going up, and you started signing more number of such deals. Is that trend continuing in this quarter as well? And also, with macro being concerning, do you witness this trend being higher in Europe as a geography, versus that of US?

Rajesh Gopinathan: I'm sorry, I don't specifically remember exactly what I had said, but let me abstract and answer this. Operating model transformation as a demand driver has very strong trend and we are seeing multiple opportunities across all markets on operating model transformation.

Operating model transformation is being characterized by a few very distinct points. One is the shift to what we call a vertical operating model, or a product-centric operating model, where tech and ops is being aligned very closely to business units and to business outcomes.

The other big one is, of course, the adoption of agile and lean into everything in operations, even more importantly, significant leverage of our Cognix platform, which is powered by MFD™. The embedding of automation at a granular level across enterprise's operation suite, both on the tech side as well as on the operations side, is also core to the operating model transformation that we see.

So, this kind of enterprise-wide operating model transformations continue to be a big driver of demand. The couple of examples that I had shared, Xerox and one of the others are examples of that. And that demand trend I think is quite strong and will continue to remain strong into the foreseeable future.

Sandeep Shah: Is it fair to say in terms of what you said in an earlier question, in the second half seasonality could be normal especially in the US, but there could be some issues in the Europe and there could be significant shifts if the macro issues goes more concerning versus what you anticipate now?

Rajesh Gopinathan: It's a prudent assumption. But from our side, we will remain focused on the opportunity on the ground, and we will deal with it one opportunity at a time. But at an overall level, it would be prudent to assume so.

Sandeep Shah: And a last question to CFO as well. In this quarter, is there 100% variable pay being paid or there is some adjustment looking at the macro issues and could be an impending showdown, especially in the Europe?

Milind Lakkad: We are going to pay 100% of variable pay for 70% of our employees. The remaining 30% will get paid based on the business rate performance.

Sandeep Shah: This is for 2Q or this is for the rest of the FY'23?

Milind Lakkad: No, no, this is for Q2.

- Moderator:** The next question is from the line of Ravi Menon from Macquarie. Please go ahead.
- Ravi Menon:** Wanted to check about the strong additions in the 1 million and 5 million. I know we did make organizational change, but I guess it's too soon to see the impact of that. So, should we think of this as change in your go-to-market and trying to close a lot more of the smaller deals and is there more demand for digital transformation from the smaller firms because there might be laggards in this transformation?
- Rajesh Gopinathan:** No, Ravi, this is just a bit of the impact of the currency volatility that you are seeing. Our client metric in non-US markets, APAC, LATAM, parts of Europe, etc., are more weighed towards smaller sized customers. And when we report those revenues in US dollar terms, they are getting significantly impacted by the strength of the US currency vis-à-vis the local currencies in these markets.
- So, although our business response is not going down, in the translation of revenues into US dollar terms, it is showing up that way. At the bottom of the pyramid, the impact is a lot more, because the non-US market is more concentrated at the bottom of the pyramid. So, it's a bit of a mathematics.
- We're also internally debating what is the best way to communicate this metric. But we also don't want to react immediately to this extreme cross currency volatility that we saw in Q2. But we'll put our heads together as to how to communicate this better in the future if required.
- Ravi Menon:** And how should we think about the lateral hiring, being a little lower than the revenue growth, is just a reflection of expectation that the worst of the supply side challenges are behind us, and we can now improve utilization or should we think of this as linked to slightly softer demand visibility, or maybe a combination of both?
- Rajesh Gopinathan:** Ravi, your question was about the headcount growth, right?
- Ravi Menon:** Yes, that's a little lower than the revenue growth, I mean, we have seen that –
- Rajesh Gopinathan:** Ravi, we have been significantly investing into headcount addition through last year. As you know, our headcount growth was close to 20% against revenue growth of about 15%, and that we have built up a fair amount of headroom. So, you should expect that we will be using that lever a bit more as we go into this year, and try to balance our overall headcount to our overall revenue from a longer-term perspective. So, it's in line with our plan, and into that environment, we've significantly invested, and we are now reaping the benefits of that investment, as many of those early hires become productive into this cycle.

Moderator: Next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: Two questions. Firstly, is it fair to assume that the book-to-bill in Europe would have improved on a quarter-on-quarter basis, basis the commentary that you made and how the pipeline replenishment has happened in Europe after the deal wins concluded?

Rajesh Gopinathan: We typically desist from giving you incremental metrics, because that sets a precedent. But when you take Europe and UK together, yes, the book-to-bill has improved. But the actual growth of the pipeline is more than the growth of our qualified pipeline. So, you are seeing some amount of elongation of the deal pipeline between total pipeline and the qualified pipeline. Now, these numbers are volatile because it can change depending on how the environment changes, but that's where we are.

Gaurav Rateria: Secondly, in last quarter, you talked about revenue productivity getting impacted as you created capacity. So, has that got sort of sorted out and you saw some improvement in revenue productivity, which also had margins and should this be seen as one of the levers for second half in terms of margin performance on revenue productivity side?

Rajesh Gopinathan: The way to think about is it is not in terms of a short-term margin lever, but as a strategic call we have taken to significantly expand our employee onboarding, especially on the entry-level employees. We had hired close to 120,000 freshers last year and invested into that pool given the longer-term visibility that we have on demand. We will tweak our employee model on an ongoing basis looking at the demand. So, that is a reasonable expectation, but our overall hiring model is predicated on much longer cycles rather than on short term, quarter-on-quarter adjustments.

Moderator: The next question is from the line of Manik Taneja from JM Financial. Please go ahead.

Manik Taneja: Just wanted to pick your brains about the aspect that historically what we've seen is that we've improved our margins through periods of slow growth. Do you envisage something similar playing out going forward as well? And if you could also help us with the margin levers that you think will play out in the near-term given the fact that you've suggested that pricing increases is not universal and is still happening only in certain parts of the book.

Rajesh Gopinathan: If we have strong visibility of low revenue growth, and we become much more careful and optimize it, but I think at this stage, I don't think we are at that point for us to be able to make a comment on that. So, margin optimization comes in more when there is good visibility on stable demand environments, and we use those periods to clean up on the margin side. Right now, whether we are at an inflection point or not, we'll know only in a

few quarters' time. Otherwise, we'll continue to stay in the growth and investment mode. But short-term margin levers, I will hand it to Samir to talk about.

Samir Seksaria: In the short-term between the quarters, we would expect to focus on our operating metrics. Utilization will continue to provide opportunity for optimization. Realization has improved this quarter and we'll expect to leverage further on that. We will also enhance our rigor on execution. And as the headwinds start trending down, we should expect that to also support margins.

Moderator: The next question is from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: Rajesh, while H1 bookings has held up above the 7 billion to 9 billion midpoint, how should we be thinking bookings trajectory for H2, more around the replenishment of the funnel of the qualified deal pipeline, any progression around that?

Rajesh Gopinathan: Apurva, difficult to say. We are running at 1.2 times book-to-bill which is a fairly healthy rate to run at. And we can take a bit of volatility on that on a quarter-on-quarter basis. So, to take a near-term call on what will happen next quarter or the quarter after that, difficult for us to do. And more importantly, it does not have a significant impact on our business model, neither in our planning cycles or in our execution cycle. So, our focus, of course, will be to maximize and capture as much as we can. But it's not really a big factor that changes any of our planning scenarios.

Apurva Prasad: Just to follow up on that, Rajesh, so this 1.2 book-to-bill from a medium-term perspective, is that the number to build?

Rajesh Gopinathan: Apurva, I don't want to get drawn out on that.

Apurva Prasad: On the supply side, Rajesh, any comments on the learning hours which had a decline YoY for Q2? And if you could also help us with the hyperscaler certification numbers, the number that was 71,000 last quarter?

Rajesh Gopinathan: Learning hours to some extent is impacted by the volume of freshers coming in. As you know, we had a very large volume of freshers coming in over the last couple of quarters which has moderated over the last two quarters. So, that will have a flow through impact on the learning hours. As we went in through the reorganization, that also had some impact. But at an aggregate level, our focus on reskilling and training and investing into people continues at scale and there is absolutely no change in it.

Apurva Prasad: And hyperscaler certification number?

Rajesh Gopinathan: I don't know whether we give that out. It is available in whatever forum it is given, and you'll find it there.

Moderator: The next question is from the line of Bharat Sheth from Quest Investment Advisors. Please go ahead.

Bharat Sheth: Rajesh, can you give a little bit more color on products and platforms, which I understand is contributing around mid-teen kind of total revenue and since we are moving towards more on migrating to SaaS business, is the revenue recognition a bit slow and when do we expect that to catch up, and what could be the margin lever in this business?

N G Subramaniam: Overall, the products and platforms business is quite stable. The number of opportunities that come our way across verticals and across the solutions that we have is looking good. The business model has certainly transformed itself into a pure play SaaS-based operating environment. Without any exceptions, every opportunity that we bid for, is for a SaaS-based offering. So, if you really look at it, we have also transitioned, I should say beautifully, from a license-based, on-prem, AMC kind of a model to a pay-per-use SaaS model in the last two years.

All our products and platforms are now available on a cloud platform. It's either installed in our own cloud environment, or with some of the platforms, we've also chosen to operate in a hyperscaler cloud. In either of these cases, the key thing is that the SaaS model is prevailing.

The way that we monitor it now is with the ARR or the annual recurring revenue that is contracted. That is the metric we are monitoring and with which we are measuring our own performance, as opposed to the earlier way of what is the license fee, what is the AMC, what is the services element to it and so on and so on. So, it is maturing.

And our products and platforms business itself has matured with the whole environment of onboarding the clients on a single instance SaaS. Some of the things that we are seeing developed is the data privacy element, the data localization element. For example, in Europe, the data residency increasingly is becoming a necessity to be located in Europe. These are the things that are getting sharpened as I speak. But overall, it's a good growing business and the ARR metric is going to become increasingly relevant. At some stage, we hope we'll be able to start reporting separately on ARR basis as we mature our model.

Bharat Sheth: And what are the margin levers you have in this business?

N G Subramaniam: Margins essentially depend on the business volume of transactions that they are going to put in. It varies. Efficiency is going to come from the fact that we're not going to be doing too much customization. People are going to be using the products and platforms more as a COTS model. So, you don't have to maintain too many customer-specific customizations at any point in time. That is going to be run efficiently.

Secondly, our own support model is going to be heavily optimized, and it's going to be a lot more standardized.

Thirdly, the product release cycles are going to be a lot more standard, and we will be able to define it rather than defined by customers at every instance. These are the things that I see at an operating level.

And as we add more optionality to the offerings, in the sense that, look, I can give you the standard platform, but there are certain additional services that I can bring in, for example, client reporting. Either customer can take data and then do it themselves, or for example, as a value added service we can provide client reporting separately. Or a certain amount of analytics they can do themselves or they can come and leverage our value-added services for that. So, it's a standard service, value added service, efficiencies that come through a standard way of product management, product releases and upgrades, all this will contribute to the margins.

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

Rahul Jain: Just on the subcon side and on the global hiring side, subcon cost has been going up, of course, for the supply side factors. But given the expectation of a relatively better supply environment in the global market, is that going to change the subcon cost as well as direct hiring outside India?

Samir Seksaria: I'll answer first on the subcontractor cost. So, as you would have seen, subcontractor cost has started trending downwards. Most of the subcontractor cost increase was on account of two factors. With borders opening up and visa availability in most countries improving, we would expect subcontractor costs to start trending down. Also, as the headwinds from attrition eases, we would expect the use of subcontractors also to trend downwards.

Rahul Jain: Will we be incrementally using it as a metric given the macro remains uncertain?

Moderator: Mr. Jain, please use the handset mode the audio is not coming clear from your line.

Rahul Jain: So, is it safe to assume that subcon cost may not go down substantially in near future even if supply side eases out, because it may be a good margin lever to have in case the macro weakens? This could be a good alternative to manage the demand and supply situation better, or it should ease out irrespective of it?

Samir Seksaria: We will try to balance it and it would be a dynamic thing. If demand continues to be strong, we would try to capture the demand first, rather than optimizing the subcontractor cost. That's the lever which we know how to use and will optimize as and when need arises.

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

Rajesh Gopinathan: Thank you, operator. We had a very good second quarter growing **18%** in INR terms and **15.4%** in constant currency. Our growth was strong across all our industry verticals and all our markets.

Importantly, we had a good order book once again. While clients continue to worry about the uncertain economic environment and are planning for different scenarios, we are not seeing any material change in client spending behavior.

There are some sporadic instances of delayed decision making. But those happen at normal times too, so it's hard to pin this down specifically to the economic environment.

Our operating margin expanded sequentially to **24%** and our net margin expanded to **18.9%**. On the people front, the capacity we built up over the last few quarters and our investment in organic talent development is helping us meet this demand.

Our attrition inched up to **21.5%** in IT services on LTM basis. However, we believe the situation is easing, and that our quarterly annualized attrition has peaked this quarter, and will start tapering off going forward.

With that, we wrap up our call. Thank you all for joining us on this call today. Enjoy the rest of your evening or day and stay safe.

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

Note:

This transcript has been edited for readability and does not purport to be a verbatim record of the proceedings.