



## **Tata Consultancy Services Limited**

### **Q4 FY 2015 Business Update Webcast March 5, 2015, 16:00 hrs IST**

**Kedar Shirali:** Thanks everyone for joining us today for the Business Update of Q4FY15. We will follow the usual format; Rajesh will give an overview of how business has been this quarter and then we will open the floor for questions. This event is a live webcast and an audio archive as well as transcript will be made available on our website after the event.

Anything that we say today which could be construed as forward-looking needs to be seen in conjunction with the risks that the business faces. We have outlined all of these risks in the second slide of the presentation which is also uploaded on our website and which those logged into the live webcast can see on the screen at the moment. With that I will request Rajesh to start the proceedings. Thanks.

**Rajesh Gopinathan:** Thanks, Kedar, and Welcome to all of you. I will quickly summarize Q4 and then take Q&A. So Q4 revenue we expect it to be in line with the Q4 trends of last year.

Going over the industry verticals, we expect BFS to be in-line. Retail, Manufacturing and Hi-Tech will see some amount of better growth as they are recovering from a muted Q3. We expect to see continued weakness in Diligenta and Insurance and also in the Energy vertical, which we have been speaking about for some time now, Telecom continues to be volatile unfortunately. As we have said Telecom is a regional, so this time around some amount of weakness coming in from the emerging markets side of it. Europe is better but emerging markets in terms of Telecom is likely to come in weaker than company average in this quarter. But that has to be kept in mind as we said it is bit of a volatile one. Telecom is going to come in weaker than company average. That is the summary on the verticals' side.

From a geography perspective, not much different per se. Europe continues to do better than the others and there's not much to call out on the other

geographies. Similarly, in terms of services, ITIS will continue to do better, everything else is pretty much in line with the overall growth.

On the currency side, we are likely to see a lot of volatility subject to the natural caveat that this is based on the numbers as we see today, based on Jan and Feb averages. We are likely to see a currency impact of almost 275 bps between CC to reported INR and almost (-200) between CC to reported USD.

At current levels, assuming close out in this form, we expect EBIT level hit due to currency of 40 basis points. So again, these are fairly large numbers, so the caveat is that it is based on what we saw in Jan and Feb and where we are today, and is subject to a lot of change as to what happens in March.

Similarly, with the same caveat, the forex impact based on our current position is a positive impact of about Rs.150-200 crores which we will report after the EBIT line. Our target EBIT margin band remains unchanged subject to any volatility that March could introduce to it, but no significant structural change to it. With that I will open up the floor for questions.

**Participant:** A couple of questions; just to clarify, how come 275 bps impact, margins only by 40 bps?

**Rajesh Gopinathan:** What is happening is that the big impact is coming from Euro and partially from the GBP. On the other side, we have some positive side of it.

**Participant:** Any further insights into budgets for this year; do you expect spending patterns to be different this year versus last year?

**Rajesh Gopinathan:** Jan and Feb have started off on a slightly slow basis, but I think it is better that we wait to see how March pans out and then we will give you a commentary about the year, post the March results in April.

**Participant:** One is when you say Retail would be returning to growth, are you looking at mid-to-high digits or mid-single-digits kind of growth?

**Rajesh Gopinathan:** I do not want to get at specifics, but we have seen some amount of weakness in Retail last quarter as you see. So we expect better than the company average in this quarter.

**Participant:** And in the BFS side, do you think that clients have enough visibility and confidence in their budgets to make large cap decisions, multi-year ones like core banking replacement and stuff like that?

**Rajesh Gopinathan:** Let us keep this commentary today to Q4. Like Anantha was also asking about the full year side of it, we will leave it for April. I think March is a better one to judge it and talk about it.

**Participant:** This year's hiring seems to have been skewed a little towards laterals even if you exclude the overseas hiring. So is that a part of the reason why employee cost has nudged up slightly or do you think that will be the case again this quarter as well?

**Rajesh Gopinathan:** No, in fact, as you are aware, we gave industry-leading salary hikes last year and partially that has contributed to the higher employee cost, but the overall cost equation was also kept in mind in terms of our ability to manage margins within the target band. The decision between laterals and freshers is a fairly dynamic decision. I do not think that has contributed significantly to this; it is more in terms of our decision on the salary hike.

**Participant:** You were on a watch-mode on India in the last mid-quarter update; how is it right now?

**Rajesh Gopinathan:** Overall sentiment I would say is positive, but remember that we are a downstream player in it. So, first the investments have to come on the ground and then we will see participation. So, the sentiment is definitely positive, but how India will pan out in this quarter we will have to wait and see. As of now, we think it is flattish or maybe slightly positive. We are not seeing any runaway growth in India. So, we will wait. But then in India in Q4, March is a big month. A lot of happens in March, so we will have to see how that works out.

To summarize, sentiment is definitely positive and the momentum is definitely positive. On ground, actual investments and spends, we will have to wait for some time, is what we are saying.

**Participant:** How does the order pipeline look like now versus 12-months back?

**Rajesh Gopinathan:** Again, I would like to keep this commentary specific to this quarter and that is the way we will play it out, this is a mid-quarter update on this, we will talk about the overall pipeline and the overall sentiment in our April update.

**Participant:** You just said that the Jan-Feb has started slightly slower. So this is what we anticipated in terms of YoY change versus what it has to be in 2014 versus 2015, is there any drastic change what you witnessed in Jan-Feb?

**Rajesh Gopinathan:** No change from last year. But then as we have said, the expectation is of an acceleration vis-à-vis what we are seeing is some softness. So if you were to compare last year to this year probably it is similar, but then last year did not also accelerate out the way we expected it to.

**Participant:** What we anticipated in the January conference call versus that a slight deceleration?

**Rajesh Gopinathan:** Not a deceleration, but a lack of acceleration.

**Participant:** You said that Q4 largely to be in line with Q4 of earlier years. Should we take it FY15 or last year?

**Rajesh Gopinathan:** Last year.

**Participant:** This 150 translation related loss also.

**Rajesh Gopinathan:** I do not know exactly what you mean by translation loss for us. We have reported into the operating line. So till the operating line it is the actual raw number. All impact of hedging is taken after the operating line. And the accumulated impact of hedging, both receivables and revenue is ...

**Participant:** The question is, is this FOREX impact or hedging impact?

**Rajesh Gopinathan:** It is FOREX impact, including receivables and revenue hedge.

**Participant:** Client-specific issues in BFS. I do not know whether you already commented on it but are you seeing anything of that nature in any of your clients?

**Rajesh Gopinathan:** No client-specific issues not in BFS. We see overall weakness in Insurance, but again I would not call it client-specific. It is fairly across the board in Insurance. BFS is on average.

**Participant:** Outside of currency impact, underlying demand trend in Europe does it continue to be healthy?

**Rajesh Gopinathan:** It continues to be healthy, relatively better than the company average. It will also have its own seasonality, but it continues to be much better than company average.

**Participant:** Is it too early to see any discretionary projects? Or is it unlikely that you see much in this quarter?

**Rajesh Gopinathan:** Yes, typically, it is not a quarter where we see too much of discretionary. So we do not expect service lines like EntSol and all... it is not a quarter where they will do significantly better. They typically do better in June and September quarters. So, this time too, the trend is not likely to change.

**Participant:** I know you are making comments about FY16, but there were some sales cycle winning in the last quarter, has that eased up, stayed the same versus last quarter?

**Rajesh Gopinathan:** We have not really spoken about sales cycle. I said in a few industries, especially Retail, etc., it was a bit slower than what we expected and that is what I commented saying that compared to that, Retail is coming off that and likely to report better growth.

**Participant:** You have not commented on Japan specifically, but any update there?

**Rajesh Gopinathan:** Japan is growing; technically it will probably register a growth that is slightly better than the overall average, but we are talking of much smaller numbers. So to that extent it is growing. And there is a bit of currency

volatility there. On a currency adjusted basis it is growing. Actually on a reported currency basis it will probably do slightly better also.

**Participant:** Any change in payouts or Dividend policy?

**Rajesh Gopinathan:** We have flushed out nine-months back, but technically no change at a strategy level, subject of course to the board and the overall decision but as of now no anticipated change in the overall strategy.

**Participant:** Jan-Feb thing which you just mentioned could it be just a temporary phenomenon because in the US most retail auto companies because of the cold weather they have missed numbers, so..?

**Rajesh Gopinathan:** That is why I did not expand much on it. Actually if you look at it, Retail and Manufacturing are doing better for us, whereas you would expect that something like that will happen. So it is difficult to pin point and say that this is due to this or that. It is slightly weaker. We are doing better but then these were the ones that did not do that well because there were furloughs, etc., and all in last quarter. With such small numbers, by the time we strip everything and sterilize everything, you do not know really what trend to talk about. These were the sectors that were most impacted last quarter because of the normal seasonal furlough effect. So somehow that positivity is also there. But yes, definitely, there should be some amount of impact due to the other aspects you mention, but it is very difficult for us, on a very small number, to get into hair splitting on it.

**Participant:** Energy segment as a sentiment worsened from last quarter or is it the same kind of...?

**Rajesh Gopinathan:** I do not know whether we should say sentiment has worsened, but definitely the on-ground activity has actually significantly come down. So we are looking at significant degrowth. This was not entirely unanticipated from last quarter, but it has kept on picking up momentum in the negative direction. Probably it will be some time before it finds a base somewhere.

**Participant:** Rajesh, just a question not necessarily on this quarter per se, but you have mentioned the target EBIT margin band is unchanged. If I look at the last 3-

4 years since you have had this 26-28% band, currency has obviously been significantly in favor in last 3-4 years, your utilization has moved up quite significantly over the same period. So when we look at say the next year or a couple of years whatever timeframe you are comfortable talking about, what are the positive drivers for margins from here despite the wage hikes and all on a constant currency basis?

**Rajesh Gopinathan:** Again, this is not the forum to get into it, but over that period, you always saw it going above 30%, and as we had said that we will essentially calibrate our incremental investments into some of these markets or deals which have a challenging margin profile initially and we will calibrate those investments based on the headroom that we have, and that we will work within the target and if the target is reached in either direction structurally we will come back to you and we have meant that.

So we have essentially taken that initially you saw it the entire currency impact flow to, we have reported in certain quarters 300 plus basis points improvement and we have taken that and we have set it to growth initiatives and various both geographic lines as well as service lines.

From a strategy perspective, the intention is to continue to support those initiatives which are already on the ground and they are long cycle initiatives. We are closely monitoring the currency situation; the continuous weakness in the euro zone definitely will have impact on the margins line and we will have to essentially wait and see whether we change any of our strategic calibration based on that. So that is why I said currently it is unchanged. Either if we continue to remain aggressive and if that is going to put significant impact on the margin side of it we will come back and talk about it.

As of now, we think that it is in a level, because actually it is the cross-currency volatility going back to what Anantha has asked in the beginning, the entire revenue side is not playing down into the margin side, because it depends on how much you are offshored. If I am not as heavily offshored in the place where actually I have the maximum depreciation, then the relative impact is lesser than the positive I get in a place where I am significantly more offshored. So better currency there actually gives me much better

offset. So there are multiple things at play. But we will essentially use this as one of the big decision drivers that if it gets this thing, either we will communicate or we can put it, one way or the other we will talk about it.

**Participant:** Is it fair to assume that at this point of time none of your investments have been cut back or scaled because of the cross-currency impact at a margin level?

**Rajesh Gopinathan:** That is right. So we continue to fully support all the big initiatives. Whether it be France and Japan on the geographical side, or the Digital and continuing investments into treasury side of it, all of that we are continuing to fully fund and fully support, and no change in strategy based on this as of now.

**Participant:** Just on the large outsourcing deals. Now, if we look at there are more players who are now getting into that kind of a deal wins versus earlier being concentrated in a few ones including TCS. So do you see that there is a pricing discipline which is getting disturbed or how is it?

**Rajesh Gopinathan:** No, in fact, if you look at it structurally, the industry is consolidating more and more towards a fewer of the larger players. So actually at an overall aggregated basis, the current rate is towards further consolidation rather than towards further fragmentation. Practically, in a given geography or in a given service line, there might be increase or decrease in competitive play. But actually what you are seeing on the ground the numbers will also show that; it is getting more and more concentrated and we think structurally that will continue. The industry will consolidate more and more towards a larger play.

**Participant:** In terms of pipeline of large outsourcing deals, like today versus last year how is it in terms of first time plus renewal?

**Rajesh Gopinathan:** There has been a big step up due to business coming out of Europe, because there are a lot of new deals there over the course of the last year or so, Europe continues to see momentum. Other markets: no major change, one way or the other.



**Participant:** Do you see any need for large capex in data centers all over the world somebody like HP recently they won a deal with Deutsche Bank, they attributed this to their capability to have data centers across, and so do you think that is necessary for you in Infrastructure Services or large deal going forward?

**Rajesh Gopinathan:** Our Infrastructure strategy is primarily asset-light with essentially a services layer on top. We see ourselves providing a services layer on top of a utility data center, compute facility provider, and as of now no change to that strategy. But it is a fairly rapidly evolving space and we do have tactical investments in that all over the world. At a strategy level as of now, we do not anticipate ourselves moving into that space in a big way, but obviously this is a fairly rapidly evolving space and we will keep options open. As of now the intention is to have a pure services overlay on top of somebody else who provide the compute layer and we believe the compute layer will be utility over time.

**Participant:** Just a follow up to the question, so has the competitive landscape in the IMS Services component further intensified or how is competition in that space?

**Rajesh Gopinathan:** That space was concentrated in the hands of a few players internationally and some of them are structurally very weak and it is getting fragmented and more players are coming in. So, yes, there is greater participation by other pure service players in that space, but I think that is more than offset by the increasing business that is coming.

I think it is getting referred to as a renewal cycle or whichever, but essentially think of it as a lot of incremental contracts as each of these contracts come in for renewal, it is up in place with a lot many more players than what it used to be earlier. So overall the flow of new deals far exceeds the increased intensity.

**Participant:** Trying to fish for a guidance into FY16, but looks like as you are entering the year, you seem to be ending the year with more challenges in more verticals this year than last year?

**Rajesh Gopinathan:** This year versus last year we will talk about it after the year unfolds. We spoke about it based on anticipation last year and obviously it turned out that things did not quite ... so let us get a bit more of clarity then we will talk about it. That is safer for us and safer for you.

**Participant:** You called out weakness in Diligenta and Insurance. I thought the weakness in Insurance was on account of Diligenta. I did not know there was a...

**Rajesh Gopinathan:** Diligenta we had called out specifically as a more concentrated one. But at the overall level, industry-wide, there is a weakness in Insurance. Diligenta we are talking about actually degrowth, because of the cycle of the deal going through. So that is a more specific one, but at the industry level we see softness.

**Participant:** I understand Diligenta a deal-specific thing, I understand Energy as well. Why do you think it is happening in Insurance?

**Rajesh Gopinathan:** A good question. Actually, it is a question that many people are struggling with in the industry itself. Difficult to say. Partially it has impacted due to the whole annuity space going through a big churn. It is more difficult for them to actually deliver on it, so it is seeing a net degrowth. So the whole annuity space is structurally real challenged and constrained. There is some amount of lag effect probably coming in due to the lack of investment cycle which is driving into the actual P&C side of it. But, actually at an industry level there is no clear indication, but definitely there is a weakness. Actually out of the financial cycle, it was one of the industries that did better. But then especially over the last couple of years, there seems to be a structural slowdown.

**Kedar Shirali:** If there are no more questions, we conclude today's Business Update.

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