"Mphasis Limited Q3 FY19 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day, and Welcome to the Mphasis Limited Q3 FY19 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 telephone. Please note that this is being recorded. I now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir.

Shiv Muttoo: Thanks. Good morning, everyone. Thank you for joining us at Mphasis' Q3 FY19 Earnings Conference Call. We have with us today Mr. Nitin Rakesh – CEO and Mr. V. Suryanarayanan – CFO.

Before we begin, I would like to state that some of the statements in today's discussion maybe forward-looking in nature and may involve certain risks and uncertainties. A detailed statement in this regard is available in the Q3 FY19 results announcement release that have been sent to you earlier.

I now invite Mr. Nitin Rakesh to begin the proceedings of the call. Over to you.

Nitin Rakesh: Thank you, Shiv. Good morning, everybody. Hope you all had a good start to 2019. Thanks for joining our call this morning. I trust you all had the opportunity to go through our Q3 2019 results and other operational performance information in the MD&A.

Over the past six quarters, we have witnessed the company's strong performance and a return to consistent revenue growth in both Direct Core and DXC/HP business. We are happy to see this trend continue in Q3 FY 2019 along the four key vectors of growth, we call 4Gs of Growth: Consistent, Competitive, Profitable and Responsible growth.

Consolidated gross revenue grew 2.8% QoQ and 23.5% YoY on a reported basis. The growth was 3.1% QoQ and 14% YoY in constant-currency terms. The growth was driven by Direct Core and DXC/HP businesses. Given that the acquisition of Stelligent Systems closed mid-quarter, the impact of that in Q3 is limited to less than 0.5% of revenue.

In our stated revenue growth objective at the beginning of FY 2018, we had called for accelerating growth in our Direct Core segment, along with bringing growth back to our DXC/HP channel. Let me address these two segments in detail today.

Starting with Direct Core, I am pleased to say that the quarterly revenue growth in this segment is the highest ever at 6% QoQ and 16.9% YoY in constant-currency basis. We had called out three primary vectors to accelerate Direct Core growth.

Firstly, strategic accounts: Being the primary engine of growth, I am pleased to see continued healthy double-digit growth in our top client relationships, aided by the differentiated service offerings, superior client management and wallet share gains in the most competitive segment of our business. This gives us continued confidence in our ability to drive differentiation and growth through the remainder of our businesses.

Secondly, we also talked about adding a new engine of growth with portfolio synergy from the Blackstone channel. I am pleased that we have continued to add clients and revenue growth through this channel into FY 2019. We now have 10 portfolio companies that are Mphasis clients, with five new additions in FY 2019 YTD, of which three were added in Q3 FY 2019. We have seen healthy scale up of these relationships, and this segment will approximately represent close to 5% of overall company revenues by the end of FY 2019. We believe there are continued opportunities in this channel as we expand these relationships. And we also continue to focus on new client acquisition in the channel as we expanded our efforts to provide additional coverage across geographies as well.

Thirdly, our investments in sales and marketing are beginning to pay off in our new client acquisition.

- We have registered a very healthy growth in both the number of new clients added as well as revenue generated from this segment in Q3 FY 2019 within our Direct Core business. In Q3, this segment has grown over 100% YoY and is now a credible engine of growth for Direct Core, which augurs really well for overall company growth in quarters to come.
- We have continued to invest heavily for the future and as you can see from the MD&A disclosures, we have made healthy investments in our sales, and net cost is up over 20% YoY, while we managed to contain the overall SG&A expenses for repurposing some of the G&A costs as well as by creating shared services driven scale efficiencies. The various margin levers we spoke about in the past quarters generated productivity improvements and operational efficiencies to the tune of over approximately 3%. And that has really helped us fuel this investment further.
- The rebranding initiative, combined with our focus on industry analyst coverage, TPA program and client engagement-driven brand building continues to support the pipeline growth as well as positively impact the quality and size of deals. We are encouraged by the fact that 80% of our new wins are in the right next gen areas, and that continues to propel our overall growth.

We continue to build a strong revenue pipeline pivoted around new gen services. Our Direct International business won new deals worth $122 million of TCV this quarter, with 81% of these wins in the new gen Services. This takes our YTD TCV wins to $484 million, which represents a growth of 11% over corresponding period in FY 2018, which, as you all know, was already our best year for deal wins.

Our strategy of growing in technologies such as cloud and cognitive is resonating well with our clients, and we are winning significant deals in this space. To give you some concrete examples, let me talk about three deals that we won this quarter.

- A deal with a leading global logistics provider to automate large parts of their custom clearance process using our DeepInsights platform, leveraging on the AI and machine learning algorithms that have been customized to the domain and the process. This is a great example of applied tech mindset that we are proactively taking to our clients to create wins.
- Second noteworthy deal was from Blackstone channel with a company that provides advanced technology data and expertise to financial services. This engagement will deliver services in the areas of digital technology using F2B as well as cognitive and AI assets and our joint go-to-market in the areas of risk, wealth management and content services.
- Thirdly, we also entered into a strategic alliance and a client engagement with an insurance platform provider for development and maintenance of insurance products through a global services center in India. Mphasis will help drive the insurance service provider's vision of moving its products and services onto the cloud with an objective to deliver innovative, agile and world-class solutions to the global clients. The multi-year deal will be delivered out of our new development center at Noida. The Mphasis team will bring in advisory specialists from digital, agile, DevOps, QA and Cloud CoEs. Another great example of how we are bringing all our next gen capabilities together to create winning strategies.

Further, during the quarter, to strengthen our capabilities around cloud and cognitive services, we invested $25 million towards the acquisition of Stelligent services, which specializes in DevOps automation on Amazon Web Services. Stelligent has been providing continuous integration and delivery solutions on AWS to leading enterprises in the US. It has a long-standing commitment to AWS and is an AWS partner network (APN) premier consulting partner, recognizing the top APN consulting partners globally that have distinguished themselves by investing significantly in the AWS practice. It has also attained AWS Financial Services Competency and was one of the first service providers to attain AWS DevOps Competency status back in 2015. They are also one of the few companies globally to achieve 100% AWS certification company status company-wide. We are seeing positive impact on our core client engagement with Stelligent services, and we continue to build our synergy acquisition thesis.

Now, let me turn the focus to the DXC/HP channel. We continue to be very encouraged by the healthy, sequential and year-over-year growth in this segment, both across DXC as well as other HP entities. DXC/HP business grew 5.6% sequentially and 37.9% YoY on a reported basis, and 6.4% QoQ and 28.3% YoY in constant-currency terms.

Let me elaborate a little bit more on the various modes of engagement between DXC and Mphasis. DXC partners with Mphasis to help their clients transform and modernize their business applications for the cloud at speed, scale and reduced costs. There are multiple ways we engage.

- Firstly, value capture: Helping DXC manage their costs more efficiently as well as by applying consumption-based models, automation capabilities and next-generation IT skills, DXC and Mphasis help clients reduce the costs of the legacy IT and reinvest the savings in modernizing mission critical and highly valued business applications to cloud at speed and scale.
- This also led to the solution partner relationship in 2017, which was set up to transform and modernize enterprise applications for public, private and hybrid cloud. The collaboration builds on deep, complementary vertical expertise, strong portfolios and next gen IT services that we bring to the table, including cloud and digital innovations and accelerated automation capabilities to deliver strong business value to organizations across industries globally. The two companies will continue to work together to help clients accelerate the modernization of their applications as they continue to move to the cloud. As a recognition of this effort, we were awarded the Client Satisfaction Award in Q3 by DXC for having the greatest positive impact on DXC's client satisfaction and DXC's Net Promoter Score with their clients. We are very proud of this achievement.

We will continue to invest in client engagement and partnership building as we expand growth with them. There were some concerns expressed by some of you on certain DXC initiatives regarding the external labor cost rationalization announced late last year. Let me elaborate a few data points on that.

DXC spends approximately $3.5 billion in this area, as per their public disclosures. And their focus is along a few core vectors to reduce costs: applying automation, consolidating suppliers, and increasing low-cost delivery mix in their delivery. Mphasis is closely engaged in enabling DXC to execute along all these vectors. Our wallet share continues to grow at the cost of tail vendors as well as by applying multiple service transformation and automation levers, as well as in actively engaging with them to help adopt right shoring strategies. At less than 10% wallet share of spend, we believe there is continued opportunity across the value chain at DXC.

Further to DXC Technology's announcement to acquire Luxoft Holding, Luxoft brings complementary capabilities to DXC as well as to the Mphasis-DXC partnership across all the vectors of service portfolio, geography, vertical mix or delivery mix. Mphasis continues to be a credible long-term partner for DXC for application transformation opportunities as well as for our client service transformation for core IT operations. As you may have read from the public announcements, Luxoft will continue to operate as a standalone entity with limited integration with DXC. Mphasis' account management and delivery teams are already well integrated within the DXC ecosystem, and we believe we can play a credible role post closure of the deal in June.

We expect no impact on our DXC relationship in the short to medium-term and expect the positive impact in the medium to long-term as we believe that the combined entity will provide an expanded base for joint opportunities by cross-selling core services as well as combined geographic synergies.

Let me now turn my attention to the Digital Risk business, which witnessed some volatility in this quarter due to delay in closure of certain new contracts as well as continued pressure on volumes due to prevailing high interest rate environment. While we managed to keep the business steady in the $28 million to $30 million quarterly revenue range for the past few quarters, Q3 was a difficult quarter due to the market volatility impacting the project business as deals got pushed into Q4. We are pleased that we are continuing to win new clients with our superior domain and technology-led capability in that business. And we have also been able to consolidate our position as the sole outsource provider in the largest digital risk client relationship. This has provided renewed visibility to a healthy QoQ recovery in Q4 and potentially back towards the previous stated revenue range in FY 2020.

Moving on to other financial results of Q3 FY 2019.

Operating margins improved 30 basis points year-over-year to 15.8%, primarily led by revenue growth and operational efficiencies achieved through the year. Operating margin declined 60 bps QoQ due to the salary increments administered during the quarter and seasonal client shutdowns. We are confident of operating within the guided band of 15% to 17% EBIT for FY 2019.

Our operating cash generation remains strong. And total cash on balance sheet as of 31st December stood at Rs. 18,270 million, approximately $262 million. During the quarter, we completed share buyback with a total outlay of approximately $140 million and acquisition of Stelligent for about $25 million. Adjusted for the non-operating cash flows, cash and cash equivalents increased by Rs. 2,335 million, i.e. $33 million during the quarter.

Overall, we are pleased with the execution so far on our strategic priorities of growth this year with strong TCV wins and growth across major business segments. We are pleased with the health of our pipeline, the capabilities both organic and inorganic that we have built across the service offerings and continued strong execution in next gen services. Our strong relationship, engagement and partnership framework is creating significant strategic opportunities in this business, enabling us to continue to build a strong pipeline for sustained revenue growth. We will continue to execute against our plan.

As I complete my second year as CEO at Mphasis, I am grateful to our clients for their business and trust, to the Board for their support and to each employee for their hard work as well as to all of you for your interest and investments.

On that note, I thank you once again and request the operator to open the line for questions.

Moderator: Thank you very much, sir. Ladies & gentlemen, we will now begin the question-and-answer session. The first question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Nitin, to start with, on the Luxoft acquisition by DXC:, while we understand that there is a limited overlap until now, and that is an area where you guys can do more, but it really impacts the aspiration which you have in the cloud and cognitive space. How do you look at this from a medium-term perspective? Where are the opportunities? And does it mean that your capabilities on the new side will be more prominent on the Direct Core side rather than on the DXC side?

Nitin Rakesh: So Mukul, I think you actually quite nicely summarized this in your note after the announcement came out, and you said bad for sentiment but not for anything else. And that is the way I think of it as well. Firstly, this is something that we have discussed extensively with our partnership folks and the executive management team at DXC. The bulk of Luxoft services actually isn't even IT directly in many cases. And going back to the data points that I gave in my opening remarks that the total spend DXC has is about $3.5 billion, and this is just with third-party service providers. Our wallet share is less than 10%. We have tremendous opportunities to continue to expand through that deal rationalization. And even in cloud and cognitive areas, I do not think the opportunity only exists in applying consumer-facing technology or the user experience there, which is primarily where Luxoft has played. The opportunity is also there in applying service transformation capabilities to core IT, application modernization, cloud migration, none of these are areas where Luxoft has a strong offering. So it is synergistic. It is clearly a portfolio that makes a lot of sense to continue to work on expanding our wallet share with them. And given that we understand their client segments really well, we have been delivering for those clients for over 10 years, and we have a very strong way of aligning with the DXC client engagement and delivery teams, in the short to medium term, I do not see any impact; medium to long term, as I said, there is an expanded opportunity for us.

Mukul Garg: Understood. So, should we assume that you would probably, hypothetically, also reach out to Luxoft in the future and then see like later on whether that can also become a meaningful relationship?

Nitin Rakesh: Answer is yes, but it is too soon for that because the transaction was just announced, probably take two quarters to close. They are doing limited integration because they wanted to retain certain segments of Luxoft business as independent units. But absolutely, the opportunity exists, and we will continue to focus on where we can play a role from synergy perspective.

Mukul Garg: Understood. And the second question was on the Blackstone channel. I think that is something which is growing quite well, you added 3 clients this quarter. Can you help us understand the experience so far? Any color you can provide on any regional or sectoral color there, or is it pretty broad-based? And what has been the size of these deals in terms of how fast are they scaling up? Are they $1 million deals right from the start? Or do you think it will be a slow ramp-up?

Nitin Rakesh: Sure. Firstly, we are very pleased that we now hit double-digit number of clients, so we have 10 portfolio clients from this channel, which is meaningful. We talked about the fact that by the end of FY 2019, we will see close to 5% revenue from that channel, so that is definitely meaningful revenue. And that revenue expansion would not have happened if we were not signing deals that were moving the needle. So, the way we look at it is we do not think $1 million is a large deal from that record either. We have seen deals that have gone into $50 million or above also. And we have seen deals that have been in the $5 million to $10 million range also. So, it is a question of what type of deal you are signing, what the tenure of the deal is, what role you are going to play, and we have seen that also pretty varied. We have done multi-year, long-term, service transformation-led run the business deals that have a significant core IT transformation element. We have also done shorter-burst digital dev or experience transformation type deals. So it is pretty wide, pretty varied. From a geographical perspective, it is primarily we focus on U.S and Europe. We do have a client from Asia as well. But given the Blackstone's primary sphere of influence is with the US and Europe, that's been a bigger part of our business as well in flowing through those deals.

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

Sandeep Shah: First question on the TCV. If we just look at Q-o-Q, it has declined, but I do agree last quarter was abnormally high. But even on a YoY, it looks declined. So, any specific reason what has led to this?

Nitin Rakesh: The good thing about TCV wins is that they will never be in straight line. So, the focus for us is can we, on a sustained basis, continue to see a pipeline expansion and conversion. You answered your question when you said the last quarter was the highest ever we have had. So clearly, there was some impact of that, you have to keep filling the pipeline and convert it. And there is a lead time to that as well. So, I wouldn't read too much into one quarter TCV wins versus last year or last quarter. For the year, as I said, FY 2018 was a record win year. FY 2019 is already ahead of that, that is what we are pleased about. And we think by the time we get done with FY 2019, we will continue to see that effect.

Sandeep Shah: Okay. And just further to that, if I am not wrong, I think in the Direct International ex of Digital Risk, we are stronger in BFSI. And the way we are looking, I think most of the large caps are also talking really positive about the same. With rupee close to Rs. 70- 71, I guess you are witnessing that the competitive pressure in the segment is higher, or you believe the demand is so good that everybody will get their fair share of the pie?

Nitin Rakesh: The right answer is some of the above but let me elaborate on that. There is extreme competitive pressure in what we call traditional services. BFSI is probably the most competitive segment of the business because the buyers are most mature, and they also have a strong and expanded captive strategy. So, the best way to find growth in BFSI, and we have been pretty consistent on that, is to have a strong set of service offerings that are not just limited to legacy IT. There is tremendous appetite, and you have seen that from the growth in insurance for us this quarter. There is tremendous appetite for us to continue to provide services that help banks and insurance companies to apply technology in front of the consumer, drive things like personalization and data strategies, to drive automation-led analytical insights when it comes through efficient operations. But of course, if you look at application maintenance, legacy maintenance work, infra services, QS testing services in the traditional way, there is tremendous amount of pressure both from a pricing point of view and automation led challenges. So, it is a question of what your service portfolio mix is. And if you have a good blend of service transformation and digital capabilities, there is enough opportunity for all.

Sandeep Shah: Okay, fair enough. Just on DXC in terms of your reference to the subcontracting cost optimization as an initiative they discussed end of last calendar year, they also said two more reason in terms of rationalizing: one being in-sourcing; and second being a rate renegotiation. So, do you believe this can have an impact? And how do you see about the growth momentum, which has been really handsome in FY 2018 and 2019 and 25%, 30% in the DXC channel? Do you believe that can be sustained beyond FY 2019, entering into FY 2020?

Nitin Rakesh: So, Sandeep, I think the reason I referenced to that in the presentation from DXC which talked about these levers, because there was some concern raised by some of the investors and analysts on the Street. So, you are already seeing that. That initiative was announced in September-October time frame. We have lived through that. We are already at the end of January. So, if there was an impact, you would have already seen that impact here in the numbers. So from our perspective, each and every lever they announce is actually opportunity for us because, clearly, there is a long tail of providers. Clearly, they have chosen to work with a chosen set of providers from a strategic perspective. And we have enough of a competence in taking traditional deals and applying transformation to make sure that they stay profitable for us as well. So, all things being equal, this will continue to be a strong growth channel for us, and we continue to believe that there is further opportunity.

Sandeep Shah: So just a comment on the growth consistency. Is it possible like one can expect the momentum to continue beyond FY 2019?

Nitin Rakesh: I mean, if you are focused on what you should model for FY 2020, I think that is a difficult question for me to answer. I think it is not feasible to expect a 20-plus percent YoY growth given that we have already seen two years of sustained growth. But we can look at as an above-market growth.

Sandeep Shah: Okay. Just last two questions on book-keeping. Surya, just wanted to understand, last quarter, the employee number has been restated. What is the reason for the same? And what should we build as a tax rate because, this quarter, the tax rate has gone down materially?

V. Suryanarayanan: On the headcount, basically, we had some contractors who came in at the end of the quarter basis which we updated the numbers. And we want to highlight that these are end of the quarter numbers. The second point on tax rate: some of the assessments got completed, we got some tax credits, which helped us. But on an overall basis, as we have mentioned earlier, ETR will be in the range of 25% to 27%.

Sandeep Shah: Thank you. The next question is from the line of Rishi Jhunjhunwala from IIFL. Please go ahead.

Rishi Jhunjhunwala: A couple of questions. One, on Digital Risk, so can you elaborate a bit more in terms of what has been the issue? And you have mentioned that the annual run rate will revert back in FY 2020. So, is it something which is dependent on macro improving in that segment versus execution from your side? And lastly, what is the endgame in terms of where do you think Digital Risk should stabilize on revenue and margins?

Nitin Rakesh: So Rishi, as I explained in my opening remarks, Digital Risk has two components. One is the steady stream, the origination, purchase, refinance, home equity, processing business. There, we were able to consolidate our position with our largest client. But reality is that the origination volumes are down pretty significantly year-over-year. And that definitely means that we have to sell more to fill that bucket. We started calling that out two quarters ago as well. We have filled some of that revenue with projects that give us in-quarter revenue or over sharp bursts. That business got really impacted with the market volatility because that basically is secondary market trades or portfolio being traded between banks, where we have gotten to do diligence as a specialist provider. Some of those deals obviously did convert. But by the time we realized, revenues moved from Q3 to Q4. Hence, we are talking about sequential growth in DR revenue Q4 over Q3. And as the visibility improves, we will give more color for whether we'd get back to a stated revenue range. But think of it as it used to be 15% of our revenue. We kept the revenue stable, we improved our EBIT profile over the last 6 quarters. Given that everything else has grown pretty rapidly around it, it is now less than 10% of our revenue. So, the impact that this business has on growth, and obviously, it is muted, while this quarter did have an impact on overall growth, the total impact will continue to be muted. We can't predict when the cycle will turn. All we are really doing is to continue to consolidate our position with existing clients and win new business through cross-selling with new clients, all of which has happened in the last quarter as well. So the best way to think about this business is, and our focus at this point in time is to continue to stabilize the revenue and maintain our profitability, which we think is going to be the focus for Q4. And as we get a little more visibility and depending on whether the Fed decides to continue to hike or halt, there may be a sequential impact to the business because the cycle will turn at some point. And again, as that happens, we will update you.

Rishi Jhunjhunwala: Okay. And secondly on margins, so your range has been around 15% to 17%. If we really look at excluding the hedges or hedging losses that you have incurred in nine months of FY 2019, you are kind of averaging more than 17% already. And I guess now, basically, it looks like the hedging losses probably, if rupee remains at around 70, will actually turn into gains and will add to your overall margin profile. So how do we think about that over the next 12 months?

Nitin Rakesh: So Rishi, you are right, I think the operational efficiency that I mentioned, almost 300 bps has been brought into the EBIT over the last six quarters. We had a cost take-out program. We did rationalization of G&A expenses. We did rationalization of our supply chain. Pyramid optimization, readjustment of utilization, campus-hiring programs. So, all of these have been levers. There is also an additional lever on the fixed price percentage, managed services, projects driving higher automation led savings. So, all of these programs continue to be well at play, and that is something that has really helped us counter the currency "losses" that we talked about. As we enter into FY 2020, there is definitely an upward bias to EBIT margins. And I think as we get closer to exiting FY 2019, depending on where the rupee stabilizes, keep in mind there is an event trigger at the end of this year, an election when that might create some volatility. But we are still consistent with our hedging policy. You can see the average has raised our in-stock for FY 2020. And that is available in the MDA. We'll continue to update you, but definitely, there is an upward bias to the margins given that we will see some of the hedge gains from our policy play-out in 2020. But it all depends on where the rupee trends. So, we will give you our latest updates getting into 2020.

Rishi Jhunjhunwala: And one last question on how much will the impact of wage hikes in this quarter and what had offset this.

Nitin Rakesh: I mean, there was more than just wage hikes. This was seasonally a difficult quarter. There were client shutdowns. There was wage hike. There was one-time impact around our Stelligent acquisition because, as per the new accounting rules, we have to book that impact in quarter versus spreading it over the deal. And finally, there was also some impact from that DR revenue decline. So, despite these four headwinds, we were able to manage the margin pretty healthily. And all the levers I talked about from an operational execution perspective has played into that.

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

Ravi Menon: Good to see the strong growth in offshore revenue. Just wanted to see if you could give some color on that. And what has led to the sharp increase in application maintenance services and application development?

Nitin Rakesh: So glad that you picked up on that, Ravi. 66% of our revenue is now ADM, and that has grown at the cost of certain commoditized services in infra and BPS. And this was a strategic and conscious approach. The reason why you are seeing an expanded application maintenance portfolio is it is actually linked to the long-term service transformation-led multi-year deals that I have talked about across the portfolio mix, mostly managed services. So, that provides a nice, healthy backlog of business to execute on and gives some comfort that we'll have continued growth through conversion of those deals. And on the application development side, that is a very nice complement to all the digital dev work that we do across the value chain, both front to back transformation as well as helping clients about data analytics and personalizing services. So, it is a very nice complement. There is virtual cycle right now that is playing out in us, taking core IT, transforming it, bundling it into multiyear deals as well as getting expanded wallet share with service transformation. It is service transformation as well as digital transformation deals.

Ravi Menon: And even though, your infrastructure services declined somewhat, the headcount is still up. So, is it that you are looking at ramping up more deals there? Or should we read this as some contracts have been lost, but you have still not cut down on the people?

Nitin Rakesh: There is always a positive spin, and there are always ways to look for bad news. I do not think there is any bad news in that number. The way to think about it is that we signed some projects. Those projects will turn into revenue. And also, that we may actually take on a project that may have a certain headcount and that headcount will actually get restructured as we apply some of the levers.

V. Suryanarayanan: And Ravi, in addition, as I mentioned earlier, these are headcount at the end of the quarter, and they are not really FTE. So you will have impact on the revenue in the coming quarters as well.

Ravi Menon: Got it, sir. And then lastly, just for the Stelligent acquisition as well looks like infrastructure side is down about 11% QoQ. So, is this due to lower working days or anything else in there?

Nitin Rakesh: I do not think those two are linked, Ravi. The Stelligent has no impact on our infra services. So, I am just trying to see what data points you are referring to.

Ravi Menon: Wouldn't you classify Stelligent acquisition within the infrastructure management services?

Nitin Rakesh: No, we do not.

V. Suryanarayanan: No.

Nitin Rakesh: It is primarily DevOps. DevOps is all in applications.

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

Viju George: I was just struck by the substantial increase in the unbilled revenues. It seems you have gone up 35% QoQ and in terms of days of sales by 10 days. What is leading to this?

Nitin Rakesh: Go ahead, Surya.

V. Suryanarayanan: As you know, Q3 is generally a seasonal quarter with lot of client shutdowns. There were delays in getting the client approval on time sheets, etc, which delayed the invoicing, but that is all well in place in January. There is no cause for concern.

Viju George: Okay. So, you think this is a seasonal spike and that should even out as we go through the year?

V. Suryanarayanan: Yes.

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

Madhu Babu: The top five clients, there has been a very solid growth. What has driven this? And which are the services?

Nitin Rakesh: I think it is quite broad-based. As I called out in our strategic account portfolio, I think we are seeing healthy wallet share gains, primarily led by confluence of both service transformation and front-to-back deals. So this is a continued theme that has played across the service portfolio, primarily, as I said, led by the combination of applying new tech as well as applying tech to all IT.

Madhu Babu: And second, sir, on the emerging industries, which has shown good growth and even in India. India has shown a good growth this quarter. So, what has driven verticals within emerging segments?

Nitin Rakesh: Emerging is primarily made up of travel logistics, health care and some part of manufacturing. And I think we have seen good growth across all the three, primarily across travel logistics and health care. On the other question, the growth is coming from rest of the world, not just India. India has actually been fairly stable. In fact, it has come down a little bit. And rest of the world basically constitute that anything that is non-US, non-Europe. And this has primarily come from our Australia business.

Madhu Babu: Okay. And just one last thing. DXC was talking of, directionally, 250 to 300 basis points of margin expansion and the traditional business to show a growth of 4% to 7% by FY 2022. So, on the traditional business de-growth, I mean, how do we see that impacting our work there?

Nitin Rakesh: I spent some time in detail in my remarks about the two vectors that we are driving at DXC. One is helping them expand their service portfolio through things like cloud migration, application transformation, modernization. And that is where you actually link the traditional business to next gen services. If they continue to do that in their top accounts, we will continue to create opportunity for them as well as for ourselves. And I think that vector, and that is why I request everybody on this call, we have to find ways to get away from the legacy relationship that we had when it was under HP, which was extension of delivery only, primarily, offshore. Those dynamics have changed dramatically. We are helping them across the portfolio of services, especially on the application side, whether it is cost take-out, value capture and more importantly, transformation deals. So that is kind of the only way we can continue to focus on growth. And that is the reason you are seeing that the infra percentage of revenue itself is coming down for us, overall company. And some of that is linked to the fact that we are diverting our attention away in the DXC channel as well away from just infra to primarily, applications.

Madhu Babu: So just last one. The on-site hiring has been good in the application side. So how do we supply market there and in terms of the wage pressures?

Nitin Rakesh: Now, our industry is in business because our job is to find "niche skills" that are not available in the market. We would not be in business if we couldn't do that. We are glad the way we executed on that. And we talked about multiple levers over the previous few quarters, from local relationships, to local hiring, to securing new talent pools in the right locations and more importantly, in the right technologies. And that is played out well this quarter. So if we were only reliant on one or two vectors, our supply chain would have seen the same pressure that we talk about. And there is pressure, and we are pleased with the way we are executing.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBICAP Securities Limited. Please go ahead.

Dipesh Mehta: A couple of questions. Can you help us understand or provide some detail about the Stelligent acquisition, which we closed? Past performance also, if you can help us understand how last two, three years they have grown and what kind of margin they are currently running at. And how you expect it to play out in next couple of years? Second is about if I look number of clients which we added this quarter and compare with TCV, it seems that the client addition is very early, but it is not getting reflected into TCV. So, any kind of change in nature of business or tenure or anything which you would like to highlight where these are not correlated this quarter? Third question is about wage hike, whether it is fully reflected in Q3 or it is partially reflected.

Nitin Rakesh: So, let me address the first two and I will ask Surya to talk a little bit about the third question. I talked about the fact that Stelligent is a premier AWS partner network company providing DevOps, automation and deployment, accelerating the whole cloud development cycle. They have been in existence for a few years. Their growth track record in the recent past has been pretty healthy. They are still a very small company from a revenue perspective. For us, this is not so much a revenue play, it is more a capability and tuck-in acquisition. Their margin profile actually makes no impact given just the size of the business, less than 1% of our revenue. From our perspective. I think the primary objective was can we take that small niche asset and infuse that into our top relationships and create further differentiators, especially as it relates to DevOps, DevSecOps and acceleration of the dev cycles by providing higher agility and shorter-term bursts to the deployment cycle. And secondly, they are also a big player in what we are calling the containerization technology, which is an important capability for application modernization using public cloud network. So for us, it is a capability acquisition. It gives us access to some top talent. They are 100% AWS certified shop, which is few companies in the world have that status. And we are using that really to restructure the way we work with AWS, the way we tap into their leads and their pipeline and eventually, finding accelerated growth into our overall business. The second question was around TCV. To some extent, it is unlikely the place that we will go into a new client and sign a very large deal. TCV picks up once you open client relationships. Once in a while, you will get $30 million, $40 million new logo. But the way it typically works is that you have to find a way to expand those relationships once you establish your track record. So there is no direct correlation in quarter TCV with in quarter a number of clients. But this augurs well for our overall new-client acquisition business. And as I called out, even in Q3, we have seen more than 100% YoY growth in the revenue that comes from this segment for us, which actually is really good for the long-term health of the business.

V. Suryanarayanan: On the wage hike: In Q3, we had multiple factors which affected the margins by 60 bps. One was, of course, the wage hike. Then the transaction cost for the acquisition of Stelligent. And to some extent, margin declined because of the Digital Risk. But we had other levers which improved overall margins. And with these coming back in Q4, we are confident that it will be a much better margin than Q3.

Dipesh Mehta: No. Surya, my question was whether wage hike is now fully reflected in Q3.

V. Suryanarayanan: Yes.

Dipesh Mehta: Or it is partially given your employees…?

V. Suryanarayanan: It is fully reflected.

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

Ashish Chopra: Nitin, I had a couple of questions. So firstly, on the DXC channel again. So, you have given us comfort as far as your wallet share or the volume share growth and the addressable opportunity within the same. I just wanted to know in terms of the pricing aspect of it, now while DXC has not acted upon it. But if you could just share some color on how do they go about on pricing. And is there any way that you could lend any comfort on the fact that, that remains protected for the kind of work that you do, considering that they have a fairly steep margin expansion target that they had outlined?

Nitin Rakesh: So, Ashish, every figure or event can be seen as a threat or an opportunity. And I think the way we have approached it is we have actually turned everything into an opportunity. If you look at the fact that they are spending $3.2 billion with contractors other than us, and that is an opportunity for us to apply some of the levers we have and actually give them the savings without necessarily compromising on our own business. Of course, that requires investment. That requires the ability to take on those projects and apply the levers that we can find them savings for, because if you just do what was being done before by other providers, you will not find those savings. So, the way I look at it is:, I never said we did not have pressure or we would not have pressure. All I said is the way we are executing in that business by applying service transformation levers primarily is what is giving us the comfort for finding both growth and sustainability of margins.

Ashish Chopra: Fair enough. And when you mentioned the $3.5 billion of subcontracting spend, so would all of that typically be addressable with the kind of work that you do? Or would the nature of work also be fairly different?

Nitin Rakesh: I think the nature of work is not just a primary vector. That, I think, we can address predominantly with either application-centric or segments of infra. I think the only vector that we have to measure, at least for a company of our size, is the geographical spread of their spend, because we may not be in every country, every market that they are in. I mean, they have a pretty significant business across all of Europe. Our presence in Europe is not as extensive. They have a pretty significant business across all of Asia. Our presence in Asia; outside of India is also limited. So the only vector for us is geographic location. And that probably is the second or third vector. The primary vector is whether we can apply tech to eliminate. So, we have done deals that have spanned across markets that we were not there, because it did not require us to be in those markets long term, given that we were actually going to transform their business by applying right-shoring.

Ashish Chopra: Got it. And just lastly on Digital Risk. If you could share how does it strategically fit into the overall scheme of offerings for Mphasis? And I mean, considering that if at all it has been more of sort of a stand-alone silo. Despite the opportunity within that market, is there a scope for reconsidering whether it fits into your overall targets and portfolio of businesses?

Nitin Rakesh: So firstly, that is a debate that has no right or wrong answer. It is a debate that we have more often with analysts than internally. And the reason is you could also look at the timing and the opportunity cost of any action that you may want to execute. The portfolio of clients is of high interest to us. The primary vector that we have executed on in the last nine months, and we talked about it in our May Analyst Day, was what we call the One Mphasis approach, where we are taking all of Mphasis services to all of our clients. That has started to show some results because we managed actually, as I mentioned, get cross-sell opportunities, both taking their services to our clients, which is obviously the most synergistic way to do it, as well as taking our services to their clients, because the overall client portfolio overlap was fairly limited between DR customers and Mphasis customers. Of course, that has a certain motion of its own, and we will continue to find ways to execute on that lever. Beyond that, any strategic action, I do not think this is the right time to consider.

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

Ashwin Mehta: Nitin, I had one question in terms of, which is a follow-up to the pricing question. So in terms of DXC relationship, when does the rate card come up for renegotiation? Is it on the completion of your MSA, say, in April 2021 or after the limit of 990 million gets exhausted?

Nitin Rakesh: I think there is a five-year contract that guarantees the MRC that comes up for renewal actually in September 2021, at the end of August 2021. So there is still a good two years and nine months for that to happen. But keep in mind that is a construct it actually has a rate card. Not every deal we do is rate card-based, because there is a significant service transformation-based deals we have started to deploy. If there were pricing concerns, you would have seen that play out in the average rates, because average rates are up across the company. So we are not really thinking of it, but of course, we have to be prepared for it as and when it approaches. But for now, we are just focusing on finding opportunity and executing on it,and making sure that we are able to continue to build our wallet share.

Ashwin Mehta: And in terms of your fixed price versus time and material proportions on the HP/DXC side, would you say that it is higher than what your company average is?

Nitin Rakesh: We have not consciously disclosed that because those things tend to fluctuate quarter-over-quarter depending on the type of deals you sign. So, the best thing will be to continue to monitor it across company.

Ashwin Mehta: And a third one, in terms of Europe. So, Europe has grown pretty smartly for you. So, is it kind of driven by you also geographically expanding as you target some of the DXC clientele? Or it is a direct business that is driving your geographical expansion into Europe? And how do you see the outlook in terms of this market?

Nitin Rakesh: It is pretty broad-based. It is not one client or one segment. It is a conscious effort to expand into markets and create new engines of growth. So, what you are seeing is actually fairly broad-based. And the way to think about it is that we think there is continued opportunity because of wallet share, and our overall company proportion is only 11% of revenue. We are trying to get it closer to 20%- 25% over the next two to three years and that is the way we are driving this business.

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

Sumeet Jain: Firstly, I wanted to know around your margin levers. So Nitin, over the last six, seven quarters, we have seen a consistent increase in your utilizations, pyramid optimization and the rate cards. I mean ex of FX, if you think for FY 2020, how much more room do you have to increase these operating parameters, particularly around the utilization? If I look at across buckets, it is at very high levels right now?

Nitin Rakesh: Great question, Sumeet. I think the way to think about utilization is not in isolation, but the way to think about it is in association or conjunction with the pyramid. When we started this exercise six quarters ago, we talked about the fact that our pyramid was actually not optimal because we had growth challenges in the years preceding FY 2018. And that basically meant that we could not execute on a consistent supply chain model with some predictive pyramid optimization. So, our entire supply chain was dependent really on just in time hiring. As we have seen the growth come back, that has played back into our ability to optimize the pyramid. And part of that is reflecting in the utilization. But on a stand-alone basis, even today, without looking at the pyramid, the utilization numbers will actually not have enough meaning. So, our focus is to continuously optimize the pyramid as we continue to find growth. And as we do that, you will see utilization levels continue to stay elevated, because most of the additions we will be doing is lean pyramid optimization. So, this is a continuous effort. We are happy we generated 300 bps of operational efficiency. That has funded in our investment and still given us additional upside on the margins. We have seen 200 bps of net addition into the EBIT line. As I mentioned earlier, as we look at FY 2020, there is an upward bias, but we will give you a little better color as we get into FY 2020. Because in the end we have to look at what the FX will do or the hedging will mean. We got some tailwinds in 2018. We used them well to invest in the business. We got some headwinds in 2019, so we used our initiatives to counter them. As we get into 2020, I think if there is opportunity to expand EBIT, we will definitely do it. But the primary vector will be continuous execution on consistent growth.

Sumeet Jain: All right. Makes sense. And also, if I look at your on-site rate, particularly for the application side, I think after a gap of several quarters, we have seen a bit of a softness there. So anything around the pricing pressure in your market you are seeing currently?

Nitin Rakesh: No, nothing to call out for. This is, you see it as an average across the portfolio. And nothing specifically, to be honest, that has kind of stood out in there. So, quarter-over-quarter, $1 up or down is not something we worry on, especially onshore rates where the trend is pretty steady, especially in new gen services. Again, on the offshore side, I think we are pleased that we got a little bit of bump, because that actually plays better into profitability as well. And this is, again, linked to the managed services link, right-shoring and elimination of roles from geographies that we think we do not need.

Sumeet Jain: Got it. And lastly, on your client-budget commentary for 2019. Are you seeing any future indication from them as to how they are planning?

Nitin Rakesh: I think it is too early on in the cycle. I know there were some concerns expressed by some segments about certain clients, specific clients that have called out for the slowness or softness, but that is nature of the business. Borrowing segments like the mortgage business, nothing specifically to call out. I think the environment looks to be pretty stable. Of course, 2019 and 2018 are different years from a geopolitical and other aspects. So, there are certain clouds on the horizon, whether it is Brexit or it is the current ongoing deadlock in the US. So far, we have not seen much impact on it. If things turn, either way, we will give you more update. But the other thing to call out in that regard from a client budget or a macro perspective, there is a megatrend that we talked about over the last few quarters have not really changed much. There will be continued pressure on legacy IT services, because every client wants to shift the mix of budget and spend from legacy to new or digital. So that pressure on core IT will continue to be there, and that is something I spend a fair bit of time on in really calling out. And that is where there is pricing pressure because the demand is muted. That is also where most of the renewal deals get very competitive, unless we really apply some levers. So, service transformation plays really well into that game. The other trend that we haven't really seen any softness is in the fact that there is continued focus from every enterprise client on expanding their consumer-facing tech capability, especially as it relates to driving the customer experience and personalization. Finally, I am pleased we have a portfolio that actually can address certain macro headwinds, because if cost take-out becomes the primary vector, again, we see that more as an opportunity, less as a threat. And we adjust fairly quickly, and I have enough faith in the fact that our engagement teams and our delivery teams are very nimble to switch the narrative from just helping the digital transformation to actually helping with cost take-out as a result of the initiative.

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

Rahul Jain: Basically, on an overall basis based on the TCV wins, the business opportunity across key clients, new client wins, the DXC partnership and the Blackstone client interactions where do you see 2019 ending: on a similar or a better note? And how does that change your growth aspirations for next one to three years?

Nitin Rakesh: I think the one to three years, of course, is unchanged. We called for above-market growth, with a continuous improvement in operating margin profile. And that is the trajectory that we will continue to execute on. To me, what is more important is consistency of growth versus a lower quarter here or there. That is the way we are constructing the business, and we will continue to execute on that vector.

Rahul Jain: So, I mean, some of the peers, they have this kind of a goal post of improving the growth rate than what has been secured. Is that how we look at it? Or it is more about the industry growth rate benchmark which is in mind, which we try to beat.

Nitin Rakesh: Yes. We do not look at a benchmark. So again, if you look at the last seven quarters since FY 2018 started and we actually went on this journey, our CQGR is about 3.6% on a gross revenue basis. And the variability has really been between 3% and 4%, the lower end has been 3% and the upper end has been 4%. And if we just do that consistently, then we do not need to worry about improving the growth.

Rahul Jain: So based on where you are today, do you think this is what you would intend to and should ideally achieve?

Nitin Rakesh: I cannot answer that question for you from a modeling perspective. That is where you have to kind of figure out where there are puts and takes. The consistent answer from me will be that our focus will be to consistently find sequential and annual growth.

Rahul Jain: Right. And on the DXC part–, you have been winning more wallet share than we have seen in the past that what kind of revenues Mphasis used to do with the HP channel. So how does that change? And what is a milestone in whatever time frame that one can aspire for in this customer?

Nitin Rakesh: It is not uncommon in some of our really large relationships for us to have a healthy double-digit wallet share. I do not think we are there yet with DXC. So, we continue to aspire towards increasing our wallet share, not by reducing others, but by actually winning net new dollar revenue. We will get to where we need get to. I do not think we have "a number" or "a target" that we put out there.

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

Apurva Prasad: So, I had another question on the HP/DXC side. Nitin, if you can just help us bifurcate, if it all that is possible, any quantitative inputs in terms of how much of this would be cost take-out versus service transformation. And how different would growth be in both these two segments?

Nitin Rakesh: It is not easy to give you the bifurcation, because there are multiple underlying clients and multiple different motions. So that is not the way we are actually tracking the business, because how do you differentiate cost take-out numbers in this transformation. Because the service of moving an application to the cloud has both elements of taking cost out, because you are retiring your existing infrastructure and eliminating CAPEX or OPEX. And that also has an element of transforming the application for you to make it digital-ready. Applying container tech is a very good example of that. So, that is the right way to actually think about the bifurcation.

Apurva Prasad: So the way we define the new gen Services within the Direct International piece; If we had to look at a similar metric, how would that be?

Nitin Rakesh: That is not a number we are actually giving out. Are we tracking it? Yes. Are we giving it out? No.

Apurva Prasad: Okay. And Surya, if you can just help with the Digital Risk revenue for the quarter?

V. Suryanarayanan: It is around 22 million.

Apurva Prasad: Right. And if I got the commentary right, you are saying it will get back to the 28 million to 30 million in FY 2020?

V. Suryanarayanan: Yes.

Nitin Rakesh: What we have basically said is you will see sequential growth in Q4 over Q3. And as we get into FY 2020, we progressively think we will get back to the previous-stated range. Again, dependent on a lot of moving parts, especially on the macro front in that particular business. So we will give you more color at the beginning of the next quarter.

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

Sandeep Shah: Yes, just a follow-up. Surya, just wanted to look at when we look at the hedge disclosures, the average rate comes out to be close to around 71. So, is it fair to say most of your unfavorable hedges, if we assume the current spot rate of 71 continues, has been expired, and going forward, this hedge loss line may be actually flat or marginally improving? And this 71-average hedge may also have a chance to improve as we enter into FY 2020.

V. Suryanarayanan: Yes, you are right.

Sandeep Shah: Okay. So even one can assume Q4 onwards, it is unlikely to be a loss.

V. Suryanarayanan: Yes. Of course, it all depends on the spot. So, keeping the current levels of spot, we will have gains compared to Q3.

Nitin Rakesh: In Q4 probably not so much, because Q4 is already committed to in FY 2018. So as we progressively get into FY 2020, what you are saying is right.

Moderator: Thank you. The next question is from the line of Mihir Manohar from Capco Capital. Please go ahead.

Mihir Manohar: Sir, just wanted to ask two specific questions. Are there any further buybacks under discussion? And secondly, what we intend to have as a payout ratio?

Nitin Rakesh: Sorry, I could not understand those questions. Can you repeat that and be a little slow?

Mihir Manohar: Yes, sure. So, are there any further buybacks under discussion?

Nitin Rakesh: See, we just completed the buyback. There is nothing else to call out for right now, because there is a certain cooling-off period given the regulation for you to consider another one. So right now, there is nothing to call out.

Mihir Manohar: Okay, got it. And what do we intend to have as a payout ratio, dividend payout ratio post this buyback?

Nitin Rakesh: I think we have been consistent. We have always called out for 1/2 of our retained earnings to be paid out as dividend. And it is not a policy, but the practice is likely to continue.

Moderator: Ladies and gentlemen, this was the last question for today. I now hand the conference over to the management for their closing comments. Over to you, sir.

Nitin Rakesh: Again, we had a pretty interactive discussion. I am glad we were able to address a number of those questions. So, thank you all for your attention, and I look forward to seeing you for our FY 2019 May earnings call. Thank you so much.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Mphasis Limited, that concludes this conference call. Thank you for joining us, and you may now disconnect your lines.