



“Mphasis Limited Q3 FY20 Earnings Conference Call”

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Moderator: Good morning, ladies and gentlemen. And thank you for joining the Mphasis Q3 FY2020 Earnings Conference Call. I am Janis, your moderator for the day.

We have with us today Mr. Nitin Rakesh, CEO of Mphasis; and Mr. Suryanarayanan V, CFO. As a reminder, there is a webcast link in the call invite mail that the Mphasis management team would be referring to today. The same presentation is also available on the Mphasis website, www.mphasis.com in the investor section under filing as well as both on the NSE and BSE websites. I request you to please have the presentation handy.

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. I would now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir.

Shiv Muttoo: Thank you. Good morning, everyone. And thank you for joining us on Mphasis Q3 FY20 Results Conference Call. We have with us today Mr. Nitin Rakesh – CEO; and Mr. Suryanarayanan – CFO of the company.

Before we begin, I would like to state that some of the statements in today's discussion may be forward-looking in nature and may involve certain risks and uncertainties. A detailed statement in this regard is available on the Q3 FY20 results release that has been sent to all of you earlier. I now invite Nitin to begin the proceedings of this call. Over to you.

Nitin Rakesh: Thank you, Shiv. Good morning, everybody. Thanks for joining our call this morning. We appreciate your sustained interest in Mphasis, and I trust you have had an opportunity to go through our Q3 FY20 results, as well as the other operational performance information in our MD&A. I would like to start our discussion by showcasing what we are witnessing in the market and then proceed to demonstrate our numbers from various vantage points, namely segment, channel as well as overall. This would hopefully help you understand the performance better.

There are many factors changing customer priorities. In this era of exponentially disruptive technological change, often referred to as the fourth industrial revolution, products and services that are cutting edge one day are outdated the next. In this context, the experience the company offers is increasingly differentiated to the consumers. But the scope of customer expectation and experience is changing too. To win, companies must not only deliver remarkable marketing, sales, e-commerce and service interactions but also prove that they have the end consumers priorities in mind and provide experiences that truly differentiate. But while expectations for personalized connected experiences are soaring, trust in companies to responsibly handle data they require is bottoming out. With more choice, more access to information and less incentive to be loyal, today's end consumers are firmly in control of the relationships with enterprises.

Consumers and business buyers alike seek differentiated experiences based on trust and understanding and will shop around to find them. Consumers are demanding an Amazon and Netflix like experience from everyone, including financial services, or insurance, or any other enterprise today, which means that they must start looking at products and technologies that will give the same experience to the end consumer. For example, one of the wealth management companies we work for has a model for cloud sourcing what their peers are investing in. So, this whole concept of how you integrate the external data of what is happening in social media with the internal data in a regulatory compliant way is something that banks and other financial services companies are starting to do. And you can see that dramatically changes the user experience.

While all of this is happening, enterprises are also missing the mark. In a recent report on customer expectations done by Salesforce, they call out the customer expectations as a set of behaviors and actions that individuals anticipate when interacting with the company. Historically, customers have expected basics like quality of service, fair pricing- but modern consumers have much higher expectations such as proactive service, personalized interactions and connected experience across channels.

Customers expect a lot from the companies but don't have faith in them to deliver. About half of the end consumers say that most enterprises fall short of their expectations for their experiences. The reality today is that today's customers are expecting enterprises to understand and care about them as unique individuals and treat them accordingly. Technology thus is a rapidly changing field with new innovations, speculations and trends inundating the business world every quarter. But there is so much going on, it's easy to be misled by hype. To miss the genuine world-changing innovation or to embrace a technological cul-de-sac at the expense of long-term growth. External forces have an impact on customer needs, economics and decision-making. The new priorities that we have seen very clearly are:

- Customers expect connected journeys
- Customers expect personalization
- Customers expect innovation
- Customers expect data protection

Mphasis has also been on its own value-migration journey alongside what our enterprise clients are expecting from us. While our enterprise customers continue to expand their digital capabilities, the ability to deliver new software-based services efficiently is becoming extremely critical, and legacy enterprises have been busy modernizing those back-end processes and systems to support today's digital age.

Based on an age-old HBR published concept of value migration, value migrates from outdated business designs to new ones that are better able to satisfy customers' most important priorities. It's the entire system for delivering utility to customers and earning a profit from the activity.

Mphasis, as an organization, has too built its entire business around the central reality of our enterprise customers' priorities. We call it the front-to-back transformation that is pivoted around end customers as we have showcased in the past many interactions with all of you.

One of the challenges I have mentioned earlier is that the consumer behavior is changing dramatically, which means financial services organizations need to bring in focus to the consumer in a very quick way. On the other hand, they have legacy systems that are slow to move. This is the Holy Grail guiding our core investment thesis as well. For example, our acquisition of Stelligent Systems was to accelerate this concept of front-to-back transformation through a DevOps based model. Digital change is accomplished with DevOps and creates a positive impact on KPIs in a shorter cycle. When you are building an application, you are not just looking at building a piece of technology, but you are starting with the end customer in mind and saying that if this is what the customers wants to do, how would we speed up the process and what experience would we provide to the customer. For example, recently, we have been selected as a strategic partner for an enterprise-wide digital transformation journey by a large Fortune 100 U.S. multinational enterprise. We are helping this client embark on a large-scale transformation journey to proactively and preemptively transform their business and operations to be a next-gen tech-driven enterprise through their 150-year-old asset-heavy industry. The partnership is aimed to help them in their acceleration from being a siloed functional organization to a connected enterprise where their customers, suppliers, partners and staff can interact with business value, speed and agility using a 'platformization' approach with their core offerings now pivoting from being functional to providing the digital platform as a service. We see this trend play out across sectors, across geographies and is one of the core thesis of how large transformation programs are going to evolve over the next few years.

Our numbers also tell the story of consistency and transformation, because outcome matters. We have been consistently growing and transforming our business. In Q3 FY20, consolidated gross revenue grew 5.7% quarter-on-quarter and 13.3% year-over-year on a reported basis. In constant currency terms, growth was 4% Q-o-Q and 12.6% Y-o-Y. YTD, our overall gross revenue has grown 12.2% on a reported basis Y-o-Y, and 11.9% in constant currency terms.

Direct International grew 6.9% Q-o-Q and 17.8% Y-o-Y on a reported basis, and 5.1% Q-o-Q and 16.9% Y-o-Y in constant currency terms. Direct core, which constitutes 82% of Direct international business, grew 6.3% sequentially and 15.6% Y-o-Y on a reported basis. In constant currency terms, Direct Core revenues grew 4.5% sequentially and 14.7% year-over-year, aided by consistent and strong deal wins. This takes our YTD Y-o-Y growth rate to 16.2% on a constant currency basis in the Direct Core business. Growth in Direct Core has been broad-based across strategic accounts, Blackstone portfolio and new client segments. Blackstone portfolio and new client segment continued the strong growth momentum Y-o-Y, constant currency growth rate of over 50% and 80%, respectively.

Digital Risk continues to witness strong growth momentum and reported a sequential growth of over 13% in constant currency terms this quarter. We are pleased let you know that we have crossed upper band of USD 30 million this quarter, aided by strong deal wins from the past few quarters.

We have also seen continued growth in our focus areas. Despite a challenging market environment and seasonal softness, we continue to see strong growth momentum and positive outlook in our key focused verticals of banking and capital markets. BCM segment has reported a strong US\$ revenue growth of 16% year-over-year. The growth was broad-based across banking and capital markets as well as in Direct Core and Digital Risk. Insurance segment also reported strong sequential growth, aided by some strong deal wins that we called out in the last few quarters. While the industry narrative may be bearish for the BFSI segment, it is becoming apparent that there is accelerated demand for agility by our customers, transferring into initiatives across customer experience, data as well as core application transformation, including cyber security. All of these are areas that we have invested in over the last few years. This is enabling us to expand our wallet share in new spend areas, while also staying clear of pricing pressures that exist in areas of legacy ADM and IMS. The numbers you see here are also a testimony that we are winning in multiple industry segments, including BCM. What is interesting to note is that a number of micro verticals within BCM, such as consumer banking, wealth management, brokerage, are all growing well. Majority of our BCM segments are less prone to cyclical trends as they are B2C focused and digital-disruption prone. For example, payments, retail wealth are all riding a secular investment cycle in transformation and digital tech.

We are also pleased with the robust growth in emerging industry segment of over 7% sequentially. Emerging industries are growing at 18% CAGR over the past eight quarters. Logistics and transportation, the sub-segment which comprises over 50% of this emerging portfolio, has grown at about 33% year-over-year.

Europe region continues to remain a focus area for us and has reported strong sequential revenue growth this quarter. This is the highest reported growth for the region in the last five years. We are very happy with the sales efforts and the investments we have put in in this region that are now starting to yield good results. We see good traction here and continue to expect to see growth in the coming quarters as well.

Now if you look at the Direct Core business, it has consistently been delivering strong growth, reflected in our deal win momentum as we won TCV of \$189 million net new deals in Direct International in Q3 FY20. This takes our YTD deal wins to \$514 million. More than 80% of the YTD deal wins are in new-gen focus areas. The deal wins have again been broad-based across strategic accounts, new clients and Blackstone portfolio.

Turning to the DXC relationship. A strategic client engagement partnership focusing on service transformation and solution led approach to GTM, coupled with geographical diversification and

industry vertical market focus is helping us to maintain our consistency here as well. With the recent change of broader DXC, the new leadership strategy is moving towards an enterprise technology stack. Through this, DXC is harnessing significant opportunity, not only in their core foundational business of IPO, but identifying significant opportunities with customers in applying transformations across the stack.

I was very pleased to see that DXC has now continued to focus on investments in customers, people and capabilities, and we believe that our portfolio is highly complementary to DXC's enterprise technology stack, especially in the application layer. We are bullish about unlocking further value, both with the strong go-to-market foundation we have established over the last few years as well as moving up the stack with next level of services, especially application led and modernization, cloud adoption and service transformation.

Moving on to earnings growth and cash generation. Our operating margin improved 10 basis points sequentially and 30 basis points on a Y-o-Y basis to 16.2% despite a typically seasonally challenging quarter for the sector. During the period, we were able to pull some operating levers, including fixed price projects as well as automation initiatives, and using our IP platforms. This, along with strong revenue growth, helped us improve our operating margins sequentially, and we are confident of operating in the guided range of 15.5% to 17% for FY20.

Our cash generation continues to be strong, and total cash and cash equivalents in the balance sheet stood at Rs. 21,520 million, roughly US\$ 300 million as of December 31, 2019. Adjusted for the net loan drawdown, net operating cash generated during the quarter was around Rs. 2,600 million, roughly US\$ 36.5 million. This takes our YTD free cash flow generation to \$110 million.

Our focus on strong operating profit growth is also driving EPS growth. We are pleased with the strong growth of over 20% CAGR in both our operating profit as well as in our EPS in the last three years. Most of this has been driven by broad-based growth across portfolios and the margin levers that we pulled through this period, including pyramid optimization, changes in commercial model, strategic shoring, automation, and most importantly, our pricing strategy.

Our core investment thesis for FY20 continues to be strong, and we continue to execute against our plan for FY20 and beyond. If you look at the acceleration in Direct Core, we have consistently grown 2x the market and witnessed strong overall growth at almost 16% year-over-year for five quarters in a row. Our new client acquisition business has grown over 80% and Blackstone channel continues to grow at 50% on a Y-o-Y basis. Our strategic partnership with DXC and HP channel continues to be a strong, consistent performer, and we believe we have a strong set of complementary services, especially through service transformation and application modernization. In Q3 FY20, 58% of our revenues came from service transformation in this channel. We talked about continued momentum in deal wins, and our YTD TCV wins of \$514 million positions us well for the foreseeable future. Our guidance margin of 15.5% to 17% continues to be a steady robust range that we are operating in. We have also made continued

progress in implementation of IP-based platforms, delivery transformation, NEXT Lab and Talent Next programs. And of course, a strong cash flow generation, an optimal cash strategy continues to provide maximization of shareholder value.

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

Moderator: Sure. Thank you very much. Ladies and gentlemen, we will now begin the questions-and-answer session. We take the first question from the line of Nitin Padmanabhan from Investec Capital. Please go ahead.

Nitin Padmanabhan: A decent quarter. Nitin, just wanted your thoughts on DXC. So at least on the face of it, the observations are that over the last three quarters, revenues have sort of plateaued. And second, the call last night with DXC sort of suggested they did an assessment of 20 or 30 accounts in the challenged territory and some of them had terminations and two accounts terminated and there were some partial terminations.

So, two questions based on this. One is, after a quarter under the new leadership, anything out there that gives you some incremental color on how this will proceed? And second, do you think the pause that we have seen on the revenue growth is just a transitory thing? And third, is there any overlap on the problem accounts that they talked about on the call with us that could impact us in the future? Thank you.

Nitin Rakesh: Thanks, Nitin. Again, I think, interesting that you spent no time on the growth segment but pointed to what you could perceive to be the problem area. I actually don't perceive that to be a problem area, because whatever we are executing on is actually well within line with what we guided at the beginning of the year. Whether you look at the YTD growth number or the forecast for the full-year growth we talked about at-market, and I think we are probably going to end up a little bit on the upper end of the at-market growth.

Of course, there has been a renewed strategic alignment at DXC, given the change in management over the last five months. They have been fairly vocal about their problem areas, their priorities. And they are moving away from taking an approach to the business which was driven by efficiency and cost to now entering a phase where they are focused on investments, client and capability buildup. And that, in a number of ways, provides a new platform for us to find complementarity and alignment. So that's the number one thing, because in a number of ways, again, going back to the call that you referenced overnight, they were very clearly talking about entering this phase that will last through FY21 as well.

So, we are very excited about the new tech stack that they have identified. They have talked about the enterprise technology stack with five layers, with ITO at the base, followed by cloud and security services, applications and Industry IT, analytics and engineering and, of course, advisory. And right in the middle of the stack sits applications and industry. And that's an area

where we have very strong complementarity, because even if you look at their entire strategy that seems to be driven and focused with ITO at the base, which is where their last quarter acquisition of Virtual Clarity also sits.

So, at this point in time, I think the overlap is minimal. Our understanding of their enterprise clients is extremely helpful in identifying alignment areas, and that's the focus of our teams as we go forward. Whether this turns into a deeper partnership or it remains on status quo, we will update you as we go through. Just keep in mind, still all in a way, evolving, developing, and they are going through a number of initiatives to unlock value as well as have a number of market development initiatives in play as well.

I would refrain from commenting on "troubled clients", because I think that's their prerogative to talk about, we don't really want to talk about whether they are included. As I said, I am very enthused by the technology stack discussion because now we are talking about how go-to-market alignment can actually become more powerful. If you remember, a couple of quarters ago we talked about DMX, which is DXC- Mphasis Next, which was really all about going to market for new application transformation deals, and now that gets supplemented by this stack.

Nitin Padmanabhan: Sure. So, from what you are saying, it doesn't really dent your confidence in terms of industry level growth even for the foreseeable future, so that's a fair takeaway to have?

Nitin Rakesh: Yes. At this point in time, that's the best outlook I can give you. Because as I said, things are evolving and developing. We will have to wait and watch and see how they are progressing in their investment cycles as well as in their market development efforts and continue to find ways to realign.

Moderator: Thank you. Next question is from the line of Parag Gupta from Morgan Stanley. Please go ahead.

Parag Gupta: My first question is on Direct Core. I just wanted to get a better understanding from you on what you hear from your customers. Do you see some amount of acceleration in the end market or do you think customers are still a little uncertain given what's happening in the macro and also given the U.S. election? So just want to get some sense on that.

And second is, how should we think about Digital Risk going forward? Are you seeing further improvement in that business and what's the likely trajectory over the next 12 months? Thank you.

Nitin Rakesh: Sure. So both good questions. Let's start with the Direct Core business, especially the macro environment. There are parts of the business that are sensitive to the uncertainty, especially interest rates, elections, global macro, of course, the new uncertainty that got introduced with global growth concerns around the outbreak in China. So a lot of these things are moving parts. The thing that gives me confidence about our ability to continue to run through with growth is

threefold. Firstly, as I mentioned in my remarks, there are certain trends that are secular in nature. The fact that consumer expectation will continue to put pressure on enterprises to apply agility, transformation and levers that enhance the experience are irreversible trends. The move towards embracing everything as a service, the change in consumption of tech is an irreversible trend. Hence, you have seen 50% to 75% growth in just the adoption of public cloud provider services.

If we are well aligned to those trends, there is a little bit of immunity to global macro. But of course, at the same time, we have to constantly focus on making sure that we don't take our eye off the ball on discretionary spend and the trends there. So far, it looks like it's fairly stable. I don't think there is any further acceleration in the spend number. But there is definitely a further acceleration in the shift of the spend from legacy or run to these transformation initiatives. So, I don't think the pressure on core is going to go away, whether it is renewal cycle driven, whether it is large platform-shift driven. And in number of cases, it may even be driven en-masse adoption of different approaches towards enterprise underlying platform. That's kind of what we are seeing. There are certain segments that are interested domains. But again, even in those spaces they have to find investment dollars to make investments. So, aligning ourselves to some of those trends early on has really helped us find the investment dollars that we can create and generate for the clients to invest in. So that's on the Direct Core side.

Europe is a little bit better now, especially given the UK uncertainty behind us and people have started to focus on the future. That's partly the reason we saw some closures of deals starting to happen three, four months ago, and that's starting to show up in our revenue numbers this quarter. And that will continue for the next couple of quarters as well. So in a nutshell, the environment will continue to be uncertain, given the multiple moving parts. But the prospects for growth are a direct correlation to how best you are positioned to having a service portfolio that has a little bit more secular nature versus legacy nature.

Coming to the next question on Digital Risk. Three things have happened here. Firstly, of course, there is a cyclical tailwind with the interest rate cuts that started in the early part of last calendar year. We called for that, again, in our FY19 year ending call when we talked about a slow move up to the \$28 million to \$30 million quarterly revenue range. We went past that range again this quarter. And we are very pleased with that. Because what that means is that not only do we have the ability to scale with client requirements, we have actually also consolidated our position in making sure that we have a higher spend on the wallet as the spend recovered in the last three quarters.

Second thing that we did very consciously is integrated some of these client relationships further deeper into our direct business. And a number of the wins that we are seeing are reflecting that integration at an end client level. And that is actually the most positive outcome of the last, I would say, nine months or so with a very strong execution by our leadership team on driving these synergies stronger.

And third thing that we continue to focus on is, as far as possible, to make this a lot more sustainable growth driver. And the focus there has been to use this positioning to gain a higher share of the wallet in the market itself, win new clients and integrate them as quickly as possible for both tech and ops. So, using this as a Trojan Horse with the tailwind of the cyclical has given us access to clients and segments that we are now starting to make a lot more structural Mphasis relationships.

So, that's why I am a little bit more positive about the sustainability and the strategic split of the business in this avatar. And that's the reason why we also have fairly strong confidence, at least for the next three to four quarters in the sustainability of the revenue momentum we have seen. Now of course, not every quarter is going to be double-digit sequential growth quarter. But we don't think this was a one or two quarter blip that will disappear fairly shortly.

Parag Gupta:

Got it. Nitin, that's very helpful. Just one follow up on Digital Risk. You mentioned the macro environment is, obviously, uncertain, and it can have its own impact on the business, and that's something to watch out for. But do you think the macro also plays on Digital Risk? Or do you think it's a lot more sustainable from that perspective?

Nitin Rakesh:

The DR cyclical is a little bit more sensitive to the U.S. interest rate cycle. And given that the global macro concerns are causing, if anything further the reduction cycle is probably not done yet. That actually plays as a tailwind into DR. So, in a number of ways, this is a nice structural fit with a cyclical hedge that gives us the ability to play out that cycle in a way that the portfolio growth actually continues to stay robust.

Moderator:

Thank you. We take the next question from the line of Dipesh Mehta from SBI Securities. Please go ahead.

Dipesh Mehta:

A couple of questions, first on the sales and marketing investment. If you look for last four quarters, that investment is largely stabilized. If you can provide some perspective, considering our focus on Direct Core, how one should look our investment into sales and marketing going forward?

Second question is about the Blackstone portfolio. If you can provide some perspective how that portfolio is doing and now it is what percentage of Direct Core? If you can provide some data around it.

The third question is about the deal win TCV. If we look nine months, it grew around mid-single digit kind of thing, if we look Y-o-Y perspective. So how one should look this translating into revenue trajectory for calendar 2020? Thank you.

Nitin Rakesh:

Our sales and marketing investments, while they will look flattish on a dollar basis or even on a percentage basis, there is a lot of churn that has happened in the last 18 to 24 months because the

way we sell, what we sell, has dramatically shifted. Again, all of it is by design. We are at a point where we will see some acceleration in sales and marketing spend. But as a percentage of revenue, we will probably be able to absorb some of that investment, because keep in mind that our revenues are also growing healthy double-digit in Direct Core. So that gives us the ability to invest, even if some of it has to be now accelerated. And that's the plan for the next, I would say, two quarters.

The pipeline also gives us the confidence that we should be fairly quickly able to absorb any additional investment that we make. And we are not done with the year yet. I know, yes, you talked about the YTD number. There was a big quarter in FY19, at the beginning of the year that kind of skews that YTD number. We have had probably the highest TCW wins in five quarters in Q3, and our pipeline has never been better. So, we are fairly comfortable with the momentum of both growth and deal wins.

And again, in alignment with the type of deals we talked about, both the nature, the tenure and the revenue profile of these deals is obviously changing, and it's changing for the better, because we are able to pull-through some longer-term revenue along with the transformation deals. And that gives us the ability to see some longer-term visibility as well. So, our visibility in the revenue mix is also improving, and that's evident by the fact that our fixed price percentage continues to go up, I would say, pretty consistently over the last few quarters.

On Blackstone, It's right now about 7% of Direct Core revenue, that's up from low to mid-single digits last year. It's still growing at 50% year-over-year, and if DC is growing at 16% and this grows at 50%, it won't be too long before you see it go to 10%. Which is, again, what we guided that we think it can double from the 4%, 5%, it was last year to double-digits in a short span of time.

We are very happy and comfortable with that performance. Pipeline is very strong there as well. We have over a dozen Blackstone relationships, as we speak, within the portfolio companies. Some of them were Blackstone companies, are no longer Blackstone companies, but are still our clients. So, we are very happy with that as well, because that shows the longevity of the relationships that we build. And it's fair to also say that, at least, two of those clients have now broken into our top-20 client list. It's not just small accounts, these are now starting to scale into meaningful relationships.

Moderator: Thank you. Next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Nitin, congratulations on a good quarter. First, I wanted to follow up on the DXC question, which was asked earlier. Now if you look at the Y-o-Y growth, I think over last two years, it has kind of come down from about 30% to now barely close to 3% Y-o-Y in this quarter. Can you please

give some more perspective on this, why has this decline happened? Do you think this should kind of recover going forward as DXC kind of cleans its own books? Or is it entirely base effect?

Nitin Rakesh:

Mukul, again, this is a pretty consistent question and my answer is also going to be fairly consistent for a number of reasons. Firstly, the 20% growth rate that we saw in the first year or two of our reincarnation was not sustainable, and we called out that almost both those years, and more importantly at the beginning of this financial year. Our guidance in both those years was at or above. Guidance for this current year was at, for the full year will probably be at that guidance. And it's a fairly considered, thought through strategic decision that we made to continue to move our investments in areas where we have a higher strategic impact.

With the renewed focus that they have on transformation and growth, that does provide us a new platform. But what we will continue to focus on is the quality of revenue, the longevity of our own wins and the ability to drive deeper transformation. And some of those considerations will continue to go into deciding how we play that channel. Keeping in mind that we are seeing, I would say, best-in-class growth in the Direct Core business, and in the Direct International business, given the transformation I talked about in the DR channel. That does give us the cushion to make some of these strategic choices towards a portfolio mix that is a longer term, sustainable, stronger portfolio mix. And that's, as I said, a strategic, conscious decision we have been working through with over the last few quarters. Beyond that as I said, as we get into FY21, as we talk about how our portfolio will look like, we will provide more color. But at this point in time, I am very comfortable with the way we are executing on the overall book of business, the way we managed to maintain best-in-class growth in a number of ways. And we have set up a foundation for sustained growth momentum in our overall company.

Mukul Garg:

Got it. And given that DXC, over the last few months have been talking a lot about making new investments. And as you said earlier, that move from cost cutting to investment phase, do you think that would also kind of flow through to Mphasis in terms of increased investment requirements to stay in line with DXC in terms of capabilities to partner and get new deals?

Nitin Rakesh:

So Mukul, I will just say this, that our investments have already been elevated and we have already built a portfolio of services that are very easily applicable to that channel. And if anything, we will see a lot more operating leverage come through by leveraging the same capability set. Because at Mphasis, we don't build capability by channel, we build capability across the company. That's the reason we have centralized those eight capability tribes that we have talked about for the last three quarters. So I am actually fairly comfortable that we have adequate investments that have already been made that continue to provide the operating leverage as needed to them as well. And that's been our value proposition to them over the last few months.

Moderator:

Thank you. We take the next question from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad:

Congratulations on the quarter. I have got three questions, actually. First, on the top account, which seems to have declined in the quarter, I mean, should that be more of a quarterly aberration because that has essentially been a strong growth driver for us?

Second one being on the EMEA out performance. Anything that you can highlight within regions or verticals that seem to be driving this? And thirdly, on the BFSI segmental margins, that seems to be slipping. If you can comment on that too, please?

Nitin Rakesh:

So, the first question was around top client. And again, the issue is a little bit more seasonality, client shutdown impact. But to be very honest, I am actually very happy that we are improving our client metrics. Because if you see the strong growth that is coming outside of our clients, that's actually very, very good for the long-term sustainability of the growth. Yes, yes like our top 10 clients to grow. And, yes, we have actually seen double-digit growth in that strategic client segment. But to be very honest, I think I am actually very comfortable with the fact that we are growing everything else around that much faster, because that's the best way to get sustained long-term growth.

So, think of the portfolio growth, think of the investments we made in go-to market, think of the hunting engine we set up over the last 18 to 24 months, and the results that are starting to show up. Because you can continue to find growth from existing clients, and that was the story of Direct Core for, I would say, three or four years until FY17-FY18. For the last six quarters, where we have seen sustained between 50% to 80% growth in new channels is actually the best thing that could have happened to Direct Core long-term sustainability of growth. We have acquired so many new logos, as you can see from our new client acquisition spree, that now the focus is on actually finding ways to create long-term sustainable wallet share based relationships with those. And of course, they had to continue to show value for us to do that. So, I wouldn't read too much into one client movement on a quarter-over-quarter basis. And it probably will continue to show you that, I would say, in the short and medium term you will continue to see higher growth coming from non-top clients because that's just the base effect and the size of buyers that comes in.

Second question was around Europe growth. What we call EMEA is primarily Europe for us. Within Europe, we obviously have a large footprint compared to the rest of Europe in UK. And that is where we have seen the maximum acceleration. We have seen some wins outside UK, as well on the continent, but that's, I would say, very small base. But we do have some very strong client relationships built out on the continent as well in the last six to nine months. All of those, again, bode well for the long-term sustainable growth of that market for us. Again, we are under-penetrated with 12% of our revenue. It's grown the fastest in the last five years that it has in Q3. It is now well poised for a significant tailwind that we would like to sustain in that region as well.

And your final question around BFSI margin, It's kind of related to the whole client shutdown as well. I wouldn't read too much into that either. But at the same time, I am actually pleased that we were able to maintain and actually expand on EBIT in a challenging quarter.

Moderator: Thank you. Next question is from the line of Abhishek from Elara Capital. Please go ahead.

Abhishek S: Just a quick question on gross margins. Were you surprised or were the gross margin improvement in line with what you were anticipating for Q3? Or given the growth, it could have been a little better?

Nitin Rakesh: I mean, keep in mind, Q3 is in a way a number of ways a slightly challenging quarter, because predictability only comes in much later in the quarter and what the impact will be. The impact that we see on the overall company gross margin, in a way, I wouldn't say too different from where we expected it to be. If anything, I think there is a little bit of leverage that we have that we can expand into. I don't think it will be any surprise that we see slight improvement in that metric as well. But again, keep in mind, we actually manage at an operating margin level and there is definitely be an in-quarter impact sometimes of large deal conversions, because you ramp up or our utilization will have an impact on gross margin as well. But that's an operating lever that we will continue to manage through to make sure that we come out around the right side of the operating margin profile.

Abhishek S: Okay. That's helpful. And just second bookkeeping question for Surya. Sir, the interest expense on a Y-o-Y basis is up substantially, though not a meaningful number. But any particular reason, anything to call out in terms of interest expense?

V. Suryanarayanan: No, nothing specific. Sometimes just to manage the variability of working capital, the loan gets a little more drawdown resulting in higher interest expense. There is nothing specific to call out on that.

Moderator: Thank you. Next question is from the line of Mahesh Babu from Centrum Broking. Please go ahead.

Madhu Babu: Sir, just on the capital allocation front. Last time, a similar time, we completed the buyback in Dec 2018. This year, how should we see? We should see a lump sum dividend or the final dividend? Or how are we looking at the capital allocation?

Nitin Rakesh: Mahesh, again, expected question. If you look at the last three years, our capital allocation policy has been fairly consistent. If we find accretive use of cash within the business, we will apply that to the business. Otherwise, we will return it to shareholders. From that perspective, besides the annual dividend practice that we have been following for a number of years, we have done some special interventions to return excess cash to shareholders. We will follow the same guideline. And if we don't have an accretive use of the cash, at that point in time we will take the proposal

to the Board to decide how best to use that cash or return it back to shareholders. I think no surprise that our cash yield, our return of cash to shareholders, that yield has been in excess of 7% over the last few years, on an average basis. So clearly, we continue to follow a similar, prudent, consistent approach. And I don't think tax changes on a year-to-year basis are going to have a massive impact on how we change our capital allocation policy.

Madhu Babu: Sir. And another thing, apart from BFSI, could you give us some view on the deals we are winning in other verticals, like logistics and transport, which is growing at a rapid pace? Is it full stack offerings we are winning there? And just on other verticals, non-BFSI verticals, where are we winning? Thanks.

Nitin Rakesh: Sure. we talked about the capability build-out that happens across eight competency tribes. That base or the foundation of our inverted "T" strategy is the same. Whether it is DevOps, very much applicable to other verticals. Next gen application development or cloud native app dev, modernization, data, cyber, all of them have significant applicability across verticals. But our approach is to lead with the point of view or an enterprise proposition on how you apply these technologies and then bring in the domain flavor or the industry flavor. The good news is the message is resonating across industries.

The example I quoted in my opening remarks about the platformization of old legacy enterprise which was very siloed and treated applications as independent, and now starting to connect all the applications and create platforms that customers can subscribe to is a phenomenon that is playing across every industry, more so in logistics and travel because they are starting to open up their systems to their third-party vendors. And instead of offering the end-to-end service, they have the ability to now offer unbundled services as well. That is creating a lot of tailwinds in other verticals besides banking as well.

Moderator: Thank you. Next question is from the line of Manik Taneja from Emkay Global. Please go ahead.

Manik Taneja: Nitin, I had a question with regards to the European footprint. If you could break out the mix of business between UK. and the continent? And also talk about how you think we are placed versus some of the Tier 1 competition in terms of addressing the European market?

Nitin Rakesh: Are you talking about the Europe market itself in the second question?

Manik Taneja: Yes. That's correct.

Nitin Rakesh: Okay. So, I wouldn't break out the business between UK and non-UK because that's not a level of disclosure we are giving at this point in time. Simply because, as I said, it's still under penetrated for us, and we want to establish ourselves a little bit more before we start disclosing more information. And as you can see, transparency is one of the cornerstones of the quarterly disclosures that we do. So, we will disclose at the time when we have much more visibility and

sustainability in that number. What is working for us in the region is not very different from what is working for us in the U.S. because the trends that we have talked about, where consumption of tech has moved from on-prem, CAPEX driven, large buying cycles to consumption on demand driven by consumer agility and cost takeout, it's the same trend across verticals and across continents. So, it's very similar.

What's helping is the reference-ability that we have built with some of these large client relationships in global banks. Because the global banks are truly global and have a pretty strong recall in all major markets, especially in the UK, Europe, even in Asia-Pacific. We are using the reference-ability to create opportunities. And there isn't a Tier 1 "company" that we haven't won against in every market that we are operating in. And the reason is very simple, if we have the right set of services aligned at the right time with the right transformation mindset, and it makes sense for the customers to accelerate their transformation journey, and they already have the comfort that we have done it before, then that message is a very strong message that resonates.

Keep in mind that the way we sell has changed, again, we made disclosure on that as well proactively. 80% plus of our wins are proactive in nature. And that motion is not very different in the UK and Europe market either. And if we can just continue to execute and scale that motion, first, in both existing accounts in the UK and new logos, then I think that we have created a very long-term, secular growth market for ourselves.

Manik Taneja:

Sure. Thank you. So, if I could ask one more question, just wanted to get some sense in terms of the fresher level hiring that we might have done in the current quarter as well as the year-till-date for FY20?

Nitin Rakesh:

Yes. Again, fresher level hiring in quarter actually has less meaningful impact to us. What we have to look for is, what is the overall revenue growth versus headcount growth trend? And at the same time, how the operating margin levers are being used, both from a utilization perspective and from a pyramid optimization perspective. So we are fairly comfortable in the supply chain approach that we are now working with, both offshore and onshore. And given that we saw almost over 4% sequential growth in revenue and less than 2% headcount growth in quarter, and improved our offshore leverage, should actually give you a pretty good sense of how the operating levers are working.

Moderator:

Thank you. Next question is the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain:

Congratulations on strong numbers. Two observations from your opening commentary. You spoke about the enterprise investment to serve the clients on proactive, personalized, connected journey. And second, you also said that tech is changing very fast, with trend turning outdated very fast. So how do we ensure sustained growth performance, balancing these challenges and opportunities on a consistent basis?

Nitin Rakesh: Sorry, your voice was a little bit muffled. Can you go a little slower, especially on your second question?

Rahul Jain: So basically, what I am asking is that, from a proactive, personalized, connected journey aspect, where do you want to serve your customers? And at the same time, you also talked about the technology trends changing very fast, so how we balance these challenges and opportunity on a consistent basis?

Nitin Rakesh: Yes. That's the crux of what we call, staying ahead. I think we spent a lot of time and effort with our tech counsels, our architectural community, and of course, the interaction we have with client and the partner ecosystem to make certain investments and bets on trends that we think are less topical but more sustainable. For example, the bets that we made on DevOps, the bets that we made on hybrid multi-cloud and, of course, embedding automation in daily use of software drill run and maintain are actually much more secular in nature. And then, of course, you go out and look for the opportunity to build partner or buy these capabilities. We have expanded a lot of our investments in all three areas. We continue to build through our NEXT Labs and our next set of offering, which is basically the whole IP platform. That actually will get a lot bigger boost as we enter into FY21 purely based on the sharpening of the pencil we will pause some but double down in some areas, and we have a pretty good, clear plan of doing that.

Second, Our investment with partners has substantially gone up. And these aren't just partners that are in a large tech platform. Of course, we have strong relationships with the likes of AWS and Microsoft Azure, and of course the GCP platform. But we also have a strong relationship with the likes of Pivotal, and we continue to find interesting startups who we have recently started to work with. So it's a very sustained, open innovation mindset that we adopt.

Finally, everything goes down to where we think our clients need the most help. And we have a very active engagement with our client leadership to make sure that we are investing in areas where we see the biggest pain point. And the trick really is, the closer we can get to anticipating our client problem, not just needs, the sooner we can help engage with them in defining those right problems to solve, the sooner we will be able to get into some of these deals very proactively. And that's kind of the whole strategic motion that we apply.

Rahul Jain: Okay. And secondly, in light of some growth normalization in HP to industry level mark, do you see that we will be able to deliver profitability closer to the lower end of the band? Or we can be anywhere in that entire range on a sustainable basis?

Nitin Rakesh: So ,I know what you are asking. All I will tell you is that there are certain assumptions that are made about profitability across segments, and not all of them may be correct.

Moderator: Thank you. Next question is from the line of Rishi Jhunjhunwala from IIFL. Please go ahead.

Rishi Jhunjhunwala: A couple of questions here. Nitin, can you talk a little bit about the emerging industries? We haven't broken it down from a composition of revenue perspective, it has continued to increase and has been growing well. What parts of the verticals are doing well there? And how much of that is coming from our Direct Core business?

Nitin Rakesh: So good question, Rishi. Over the last two quarters, at least, we are starting to break down emerging. So if you go to the slide #7 of the earnings commentary deck that we used, at the bottom of that chart you will see 50% of emerging verticals is logistics and transportation, about 15% is healthcare, about 18% is manufacturing and others about 17% as of Q3 end. We gave the same chart for Q2 as well. You can see where the growth is coming from. Bulk of the growth came from logistics travel. And of course, healthcare and pharma has grown as well in the last, I would say, six quarters. The reason is twofold. Firstly, we already had existing large client relationships that we saw big opportunities in, and we actually jumped on them, and they worked out really well for us in the last two to three years. Due to that fixed strong reference-ability, we also started to see opportunities both inbound and, of course, through our sales process to expand just the overall footprint. Because once you start building expertise, that expertise is transferable to other clients as well.

So, we realized that the segment is now a significant chunk of our revenue, and hence we started to break it down. What is selling there is, again, not very different; 'platformization', app modernization, breaking down siloed applications into connected platforms, breaking it down into providing micro services driven consumption ability. I mean think of a railroad company that transported goods from place A to place B, now they are giving the ability for shippers to effectively not just transport and ship goods but effectively get the entire journey of the good from an R&D perspective, sensor, health of the shipment, and of course customize how they want to be able to pay for those services. So that's just a very small example of the 'platformization' of the unbundling of individual siloed applications into a different consumption pattern. Hopefully, that gives you a little bit of a better idea of how we are operating in that segment.

Rishi Jhunjhunwala: Yes. Thank you. And the other thing is just on Digital Risk, so clearly past two quarters the growth has been pretty strong. Just wanted to understand on an annualized basis where the revenue and margins would be? And is it a correct understanding that, that business actually has significant operating leverage and could have contributed to our margin performance for the past quarter?

Nitin Rakesh: I will answer your question in two different ways. This was the first quarter, at least in the last six, that it saw a Y-o-Y growth in revenue. Because the trajectory kind of bottomed out in Q1, Q2 this year, and it's come back, as I said, to pass the upper band of the \$28 million to \$30 million range. For the foreseeable future, next, I would say, two quarters at least, we think we will operate above that range. And given the work that we have done to systematically integrate and transform this channel, our endeavor is to make this a growth channel, long-term sustainability wise. There is still a little bit of an operating leverage work that needs to be done, because when you ramp up

so aggressively, you have to make investments. But as we continue to find synergy benefits, it will actually continue to become accretive to margins as well. At this point, it is not accretive to margins. So, it is still operating at a margin band that is lower than the company margin.

Rishi Jhunjhunwala: Understood. And just one bookkeeping, how much was the wage hike impact in this quarter? And is it staggered over two, three quarters?

Nitin Rakesh: Yes. We haven't broken it down because we talked about over the last two quarters, we talked about the fact that we have started to take a slightly different approach where instead of lumping everything in one quarter we spread out our entire people investment through the spectrum of Talent Next and we have linked it very closely to re-skilling and up-skilling. So, in quarter impact is hard to give, because it's a constant exercise that happens every quarter. And it's not linked to a calendar cycle. It's linked, I would say, a lot more to an individual career progression of an employee.

Moderator: Thank you. Next question is from the line of Ruchi Burde from BOB Capital. Please go ahead.

Ruchi Burde: I have a question related to the wage revision. During the year, you had called out there would be change in the system, and it would be more distributed wage hike aligned to the skills. And we saw the wage hike impacts in the quarter would possibly be quite lower because of that. So now moving into next financial year, do you think that the revised system that has shaped up is what you would continue with or you think that a few more calibration initiatives are required?

Nitin Rakesh: Again, Ruchi, in continuation to what I just said, we will probably continue to align it even closer to the employee life cycle and up-skilling versus lumping it into one quarter or two quarters. And that, if anything, it will get a little bit more even than it is today, and that's by design. And again, going back to the previous couple of questions ago, we talked about the management of the business. We are managing it, obviously, to an operating level, and we have to continue to find ways to find some leverage as well. This quarter is a good example of that, because for a 4% growth, our headcount growth was half of that. That means that there is opportunity to apply other levers besides just labor. So all of these will go into the mix of our wage decisions or labor cost discussions.

Ruchi Burde: Okay. The second question I had was regarding your HP - DXC business. With the breakup that you had given, it looks like you are DXC part of business still had better growth. And for the last two quarters, the growth was actually accelerating as the non-DXC part of HP - DXC business, which is showing some troubles. So would you like to share some comments over there?

Nitin Rakesh: Yes, In-quarter impact of client shutdown is what's causing the distortion to you. I think that the non-DXC part of the business will grow faster over the next few quarters versus the DXC part, just by the base effect. And we made investments in that business as well. So that's kind of the way we are looking at it.

- Ruchi Burde:** Okay. Going forward, I mean, both would kind of chip in further growth, is what you are trying to indicate?
- Nitin Rakesh:** That is the plan.
- Moderator:** Thank you. Next question is from the line of Sandeep Shah from CGS-CIMB. Please go ahead.
- Sandeep Shah:** Congrats on good set of results. Just on DXC, Nitin, I wanted to understand that the business divestiture which the DXC is planning had any impact in this quarter or maybe there in Q4 or Q1 before we start getting the opportunity from new investments, which they are focusing in enterprise IT stack?
- Nitin Rakesh:** So, I mean, Sandeep, in the last update that they gave overnight in their earnings call, they actually haven't even started the sale process yet. They probably expect to start the process this quarter. We already called out for the fact that our presence in those segments is fairly low. But given that they haven't started the process, I don't think you will see the impact play out at least for the next two to four quarters, depending on the cycle of the divestiture. So there is some runway available for us to continue to find transformation. And by the way, I don't see that as a threat. We are, again, very closely monitoring the process. We are very closely engaged with a number of leaders that run those businesses. I actually think there may be opportunities for us as they go to divestment.
- Sandeep Shah:** Okay. If I can just ask for a follow-up. We can fairly say that there is a visibility for a positive sequential growth in the coming quarters.
- Nitin Rakesh:** Sorry, can you be a little bit louder? Are you talking about sequential positive growth in the DXC - HP channel?
- Sandeep Shah:** Yes, in the coming quarters.
- Nitin Rakesh:** Instead of giving you a quarterly guidance, I will stay with our full year focus. For the year, we will be, as I said, closer to the at-market growth number. Whether we end up middle or the higher band remains to be seen through Q4. And as we get into FY21, we will give you some guidance there as well. But at this point in time, we are fairly comfortable with what we have previously stated.
- Sandeep Shah:** Okay. Second question, looking at the budget changes in terms of abolishment of DDT, any view which the Board is taking in terms of what could be a beneficial way of distributing cash, is it dividend or a buyback?
- Nitin Rakesh:** As I said, tax changes have little impact on our use-of-cash strategy. I will repeat what I said a few minutes ago, we will continue to look for equity uses of cash. And if you don't find those opportunities to invest in the business, we will return the cash to the shareholders. When we

decided to run the cash to the shareholders and what the quantum is, at that point the Board will decide what should be the mechanics of returning that cash.

Sandeep Shah: Okay. And just last question, with change in wage inflation method, is there any change in the attrition rate? If you can share some detail or any number on the attrition on a Q-on-Q or Y-o-Y.

Nitin Rakesh: Yes, I don't think we made that metric public for a number of reasons, mostly competitive. But we have seen improvement in that metric consistently through FY20.

Moderator: Thank you. We take the next question from the line of Mohit Jain from Anand Rathi. Please go ahead. Ladies and gentlemen, we have lost the line for the current participant. We take the next question from Sumeet Jain from Goldman Sachs.

Sumeet Jain: Congrats for the performance on the direct channel. I think on the DXC side, I just wanted to have three questions. Firstly, I think you mentioned that the non-DXC part is going to grow faster going forward. And even hived out business at DXC, you have a very low exposure towards that part. So, What gives you a lack of clarity at this stage that next year, you will not be able to have a similar growth in the DXC channel, what you had this year?

Nitin Rakesh: Sumeet, I am not clear about the question. Are you saying, what gives me the confidence that next year will be similar growth or...?

Sumeet Jain: Yes. What does stops you for giving a similar outlook next year for the DXC channel?

Nitin Rakesh: Because I am not on next year outlook, yet.

Sumeet Jain: I mean, given that the budgeting exercise for DXC, I think, just concluded yesterday. So just wanted to have a sense whether you are getting any visibility from them?

Nitin Rakesh: Because I am not sure what budgeting excess you are referring to. Because as I said, when we get into our full year financial year ending call, we will provide some more guidance to FY21. That's the practice we follow. Now they had their earnings announcement yesterday, and they talked about FY21 plan, but that has a little bearing on how we play out there. We will obviously, as I said, give you more update on the next call.

Sumeet Jain: Got it. And secondly, just in case the outlook deteriorates next financial year, how quickly can you reallocate your resources from the DXC channel to the direct channel, so that the overall growth of the company doesn't get hampered?

V. Suryanarayanan: Sumeet, Surya here. It's too early now to talk about the outlook for the next year. And as Nitin mentioned, post the Q4 results, we will give an outlook for FY21.

Nitin Rakesh: He was asking about allocation of resources from one channel to the other. Is that the right question? Is that what you are asking, Sumeet?

Sumeet Jain: Yes.

Nitin Rakesh: Yes. Again, the way we run it is, as I said, our lot of capability build up is centralized, it's run into our capability tribes. So, capability is already centralized, and I don't have to allocate resources. The only allocation of resources happens from a sales and marketing perspective. And that's a call we take not just in our HP - DXC channel, we take it across the company pretty much on a very, very regular basis. That's the sales review process that we continue to follow through. So at this point in time, we are fairly comfortable with the allocation of resources. I talked about slight expansion in our sales expenses, especially in the direct channel. At this point in time, we are not thinking of making any changes to the sales investment that we have in other channels, and we will stay with that consistency until we think there is a reason for us to do that. Because our mindset is still of every channel is a growth channel, and I haven't seen any reason that tells me otherwise.

Sumeet Jain: Got it. Thanks, Nitin, for that clarity. And just lastly, among your top customers' budgeting exercise, any commentary you can share how the budget looks like in CY20 over CY19, given that we have the U.S. election this year?

Nitin Rakesh: I answered that question in the very early part of the call. What I said was, the budget seems stable, but the distribution of budgets is very rapidly moving towards transformation and investment in further translating tech and moving rapidly away from core IT, Opex, ADM, IMS type budgets. So every client we have is talking about run to change, everyone is looking at freeing up technical debt, everyone is looking at modernizing the old platforms that accumulate the tech debt, and effectively moving the consumption model from large CAPEX driven approach to pay-as-you-go approach. And that's why the whole hybrid multi-model is here to stay at least for now.

If you aligned to that, the growth outside of the core continues to be healthy double-digit, even in established clients. There are clients that are spending between 20% and 30% more money this year in transformation programs than they did last year, and we are very well aligned towards helping them find that money and tagging along, as I said, a lot of the long-term revenue along with the transformation deals.

Moderator: Thank you. Well, ladies and gentlemen, that was the last question for today. I would now like to hand the call back to the Mphasis management for their closing comments.

Nitin Rakesh: Thank you all for your time and your questions. We are pleased with the results, as I said, and continue to be enthusiastic about the health of our pipeline. And we are focused on consistent



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performance, while continuing to keep our client transformation needs at the center of our strategy and execution. And we look forward to seeing you on the next quarterly call.

Moderator:

Thank you. On behalf of Mphasis Limited, we conclude today's conference. Thank you for joining. You may now disconnect your lines.