ANALYST MEET

April 23, 2018

CORPORATE PARTICIPANTS

M. D. Ranganath
Executive Vice President and Chief Financial Officer

M.D. Ranganath

Thanks, Mohit. After the wonderful presentation of all our leaders and colleagues, I am sure you all want to see how it all weaves into the revenue guidance and the margin guidance.

Let me step back and look at the Fiscal'18 performance. Fiscal'18 was unique in many ways, most importantly, this is the year when the company demonstrated its resilience on multiple fronts. If I were to focus on a couple of key parameters, which I am going to delve in more detail later on, this was the year where company delivered very robust free cash flow, healthy EPS growth, and also return on equity. This was possible primarily on account of a very strategic P&L and balance sheet management and very resilient margins. Also, we had efficient capital management during the year.

This resilient margin was on the back of a very focused effort in building a very competitive cost structure as well as the productivity improvements. One of the key statistic, if we look at this year, while the revenues grew 7.2%, the net headcount growth was just 1.9%. This has lot of elements to it. I am going to get into more details subsequently. This is something which we want to highlight that the margin resilience was not just on the back of cost optimization. It is on a broader set of parameters which helped us in driving resilient margins. The employee cost which is typically largest part of our operating expenses has been steady, which I am going to talk about later.

This was also the year where we implemented a comprehensive and predictable capital allocation policy, which also helped us in driving ROE to some extent. Let me get into some of these elements in more detail to highlight the specific aspects.

First, the revenue, we had 7.2% growth on the back of 25.5% of digital revenue. The key point, we would like to highlight here is the trajectory of revenue growth in fiscal'17 vs fiscal'18. If you look at fiscal'17 we started on YoY growth of 10.9%, but tapered down to 5% by the time we reached Q4. If you look at FY'18, Q2 was the bottom with 5.4% on YoY growth and we have seen improving trajectory on the YoY basis in each of the last two quarters. This is something which is kind of contrast between the two years.

If we look at some of the key elements of the revenue growth apart from the digital momentum that we got in the last year, some of the key metrics which we closely watch is how our top clients are growing, are the number of $100 mn clients improving. If we look at the last two years, there has been improvement on both counts. As Mohit talked about, there will be enormous focus in the coming years towards further accelerating some of the top client growth as well as penetrating some of the key clients much more effectively and most importantly the large deal wins.

The free cash flow was up 15.3% in this year, which is double the rate of the revenue growth. It is a combination of many things, of course, better working capital management and at the same time, the margins also held, and also the efficient use of capital on multiple fronts.

Operating margin, we started the year at 24.1% and ended the year at 24.7% on a quarter basis. This was on multiple dimensions, for example, 25% of our business is Digital and 75% is Core, what we call as Core IT Services. During the year, some of the margin improvements happened on both components, it was not just the optimization part. For example, in a very focused way we looked at how do we get better billing rates for the digital services. Typically, what happens is many of them get embedded under a large umbrella MSA. We wanted to make sure that we differentiate the billing rates for the digital piece in a better way and do not get merged with MSA rates. We think on this one we need to accelerate further in the coming year.

Coming to the Core IT part, there are three dimensions that we worked on – One dimension which is all the headline numbers of utilization, onsite mix, etc., but that is only part of the story.

The Second part of the story was how we make sure that the automation in some of the three key services which is testing, infrastructure management and maintenance, which Narry talked about, translates to rate of revenue growth which is much faster than the headcount growth. At the company level, the differential is 7.2% to 1.9%, but if you look at these individual services, the difference is much, much sharper. That helped us.

Third is FP Projects. 51% of our revenue come from FP projects and these fixed price projects have a large onsite component as well and we looked at how to improve the productivity pieces in those, that helped us to some extent this year and we want to accelerate that in the coming year.

Also in Ravi's presentation, there are insights on how are we building an onsite pyramid. So far in the 37-years history of the company, the focus of the pyramid was always at offshore. We looked at the onsite pyramid, and hired about 650 fresh engineers, that is also helping us. I think the propensity of the clients to accept, pyramid onsite is also much more encouraging than in the early years. The key message is that the resilient margin is on the back of both elements, getting a better rate on the digital, and second, the productivity improvements that I talked about. All this led to revenue per employee crossing $54,600 for the first time and we sequentially grew 6.2%. The denominator is all employees, it is not just billable employees. It is the total headcount of the company, total revenue divided by total headcount. This metric is very important for us because finally whether it is automation, utilization, billing rate, onsite mix, everything is distilled into one single number, and this is a number which we watch very closely. Whether all the automation, whether all the things that we have done, is it really resulting in faster revenue growth than the headcount growth. I think this year that has been the primary factor that you see as a result of both the elements on Digital and the Core IT services.

One point to note is, despite digital typically being onsite-heavy, and it is now 25.5% of our revenue, our onsite mix has come down. There are multiple dimensions that we need to look at. Employee cost as a percentage of revenue has been pretty much steady, in fact, and this number has been steady over the last three years. Even this year, we will be focusing on some of these elements as well.

EPS growth was 17.8%, this had the impact of US APA which we concluded, but even after normalizing for that, it has been ahead of the revenue growth. ROE, there is an element of the buyback that we did towards the end of third quarter. I think on both elements; these numbers have been healthy for fiscal'18.

As you know, in April 2017, the board approved Capital Allocation Policy which addressed two aspects – one was the flow aspect. That means of every $100 of free cash flow, how much would be returned back to shareholders, we said up to 70%. The second part of the policy was also about how much of the cash on the balance sheet is going to be returned. At that point in time we had $6 bn on the balance sheet and we said $2 bn would be returned. I am happy to say, that despite a very complex regulatory pieces that we had to encounter, we successfully closed and implemented the capital allocation policy.

The point that I would like to highlight is the dividend part as well. Last year we paid little over a billion dollars, which translated to about 63% of free cash flow of the last year. We implemented the policy this year and the dividend announced including the final dividend, itself is up 24%. It is on account of two factors. One, the free cash flow has increased; second, higher percentage of free cash flow. The Board approved another $400 mn to be paid as a special dividend and including that, the dividend is up 61%, of course, both are subject to approval of the shareholders.

If you include all the capital that is expected to be returned for fiscal’18, it adds up to close to $3.8 bn.

Again this April, the board reviewed the capital allocation policy, looked at the medium-term and short-term cash requirements, which is M&A, capital expenditure and the operational cash buffers and so on. It looked at it, and again as I said, two key aspects. One on the flow part, the board reiterated its commitment to pay up to 70% of the free cash flow every year. Second aspect, in addition to the above, the board also identified $2 bn to be paid out for fiscal’19 in two components. One, the special dividend of $400 mn, which after the shareholders’ approval in June will be paid out in June. Second, up to $1.6 bn to be returned to shareholders in a manner that will be decided by the board. Of course, these are the specific capital allocation policy that the board announced. This does not mean that we do not have sufficient plan for M&A and other cash requirements. We have very closely analyzed what are those requirements and the short-term and the medium-term cash requirements, both strategic and operational needs of the company. I think this has been put in a way that it is both predictable and comprehensive.

These were some of the quick thoughts we wanted to share today on the ‘Financial Performance.’

Referring to the last slide, these are some of the key parameters and fairly well published numbers which all of you are very familiar with. Essentially it shows, between fiscal’16 and fiscal’18, how do the key parameters compare, whether in terms of free cash flow yield, dividend yield, market cap to free cash flow, market cap to revenue.