Tata Consultancy Services Limited

Q3 FY 2015 Business Update Webcast
December 12, 2014,16:00 hrs IST

Kedar Shirali: Thanks everyone for joining us this afternoon for our business update for Q3 FY 2015. We have here with us our CFO – Mr. Rajesh Gopinathan who will brief us on the quarter and take questions after that.

As you know, we do not give any guidance, revenue or earnings related, so anything we say during this update which could be construed as forward-looking, we advise you to see such statements in the light of all the risks that the business faces. We have outlined those risks on the second slide of the deck which has been uploaded on our website and which is also being webcast as we speak.

With that I start off today's update, requesting Rajesh to brief us on the quarter.

Rajesh Gopinathan: Thanks, Kedar, and Season's Greetings to all of you. Q3 is the quarter of seasonality, and our revenue is going to unfortunately reflect the negativity of this seasonality. So we are broadly likely to see an impact which is similar to what we have seen in the previous year. It is going to be a weak quarter seasonally.

Drilling down a bit more into the revenue side of it, from a vertical industry perspective, we expect to see the usual furlough impacts on Retail, Manufacturing and Hi-Tech. Specific impact and exactly how it will turn out – we will get more clarity over the next couple of weeks. But one way or the other, all three of them are likely to see furlough impact in this quarter.

On the BFSI front, we are expecting a weak quarter dragged down by seasonal weakness as well as the continuing weakness in Insurance and weakness in our Banking products portfolio.

As for the other verticals, Telecom is likely to be slightly better and other smaller verticals are also likely to be slightly better than company average. But overall, the Q3 weakness will be reflected across all verticals.

From a geographical market perspective, the overall demand environment in US is in line, and once again -- I am going to be repeating this word a lot -- it will be in-line and seasonally weak, similar to what we have seen in previous years also. Europe, relatively speaking, compared to all other geographies, will do better than the company average. UK will be weak impacted both by the seasonality as well as the weakness in Insurance. APAC and India are likely to be in-line. In India, we are coming off a very strong last quarter and that momentum is pulling through, but the overall demand environment remains fragile and we still have it on a watch mode.

From a service line perspective, once again, Infrastructure Services will do better than company average; all other service lines are likely to be pretty much bunched together around the median, so not much of a differential commentary there.

From a currency perspective, this is a quarter where we have seen a lot of volatility, especially on the cross currency front. Today itself it has been volatile so as it stands, currently we expect (-220 basis points) impact from CC to reported USD revenue. In terms of reported INR, we expect (-10 to -20) basis points, and all of this is obviously subject to how December pans out and where we end December when we get in for billing.

The net impact of this, which is essentially rupee weakness against the dollar of about One Rupee, offset by about Rs 2.5 to 3 strength against the other currencies. So net-net, the impact at the margin line is almost balancing each other. As of now, if things stay as they are right now, we probably are likely to see 10-20 basis points positive, but all of these are with the caveat that everything depends on how finally December closes at.

From a pricing and realization perspective, pricing trends are fairly stable. If at all, expect a slight uptick on realization, given the furloughs and holidays and all, some amount of volatility in utilization and realization is to be expected, but broadly we expect a slight positive uptick.

Then margins, we expect to stay within our target margin band of 26% to 28%.

From the Other Income perspective, other income will be slightly higher; two things at play here; as we stand today, the forex position should give us a slightly better number than what we had last quarter, and our interest income will be slightly lower because of the average cash position that we had. Last quarter, the big distribution happened in early August, so we had 1-month of cash last quarter. This quarter, we obviously have a lower average cash position so that will get impacted on it.

So that is the overall summary here. I will open it up for questions.

Participant: So three questions. One, is there any noticeable difference in trends compared to 3Q of last year? Second, you mentioned there is a slight uptick in realization. What is driving that? And third, are you seeing any specific weakness in the Energy segment?

Rajesh Gopinathan: Broadly it is in line with last year, but may be with a bit more of weakness in sentiment. So how that turn we will have to wait and see, so broadly in line with last year with a bit of weaker or negative sentiment.

Energy – there is a negative sentiment in the overall ERU space, but our reported numbers will benefit from the momentum that we had last quarter; last quarter we had a 16% Q-on-Q growth and so that momentum will continue through. But adjusted for that, there is a definite weakening on the Energy side -- the difference in terms of where the sentiment is and where the momentum is vis-à-vis where the reported numbers will be...

In terms of realization, pricing is stable. Realization typically has an impact in terms of what the numbers of hours are, whether it is a holiday. If there are lesser working days, if it is a holiday season, our fixed price projects will have some impact. So nothing very dramatic in terms of an external environment -- it is more the mathematics of the reporting style.

Participant: Just a follow up on that, so what is driving the weakness in sentiment, so you mentioned it is similar to last year but probably slightly weaker sentiment?

Rajesh Gopinathan: I think we saw some amount of momentum slackening last quarter. So let us say that we were a lot more optimistic at the beginning of the year than we are currently. So it is more of a sentiment thing. If you ask a specific question as compared to where we were at the same time last year, definitely the mood is different right now.

Participant: Sir, if you are sensing that sentiment is a bit weaker as you are saying right now, does this flow through to CY-'15 as well?

Rajesh Gopinathan: Right now it is difficult to take a call especially given our experience during this year. So we would rather wait for middle of next quarter when we will have more specific inputs. Wait and watch, Jan-Feb will be a better time to comment about it.

Participant: In the weakness you mentioned the furloughs in Retail, Manufacturing, and Hi-Tech, how much of this is more than you thought this quarter compared to before? And can you may be add some more color in terms of, are there any deferrals, etc., among your projection?

Rajesh Gopinathan: No, as of now it is a normal furlough, but as I said, there still are a couple of weeks left to go. So the specifics of where it will end up we will have to wait and see, but nothing dramatically different to call out per se.

Participant: And increasing projects cancellation, deferrals, etc.?

Rajesh Gopinathan: No, this is not about cancellation and deferrals, it is a more systematic shutdown that they take and forced holidays that typically we go through.

Participant: Could you give us some idea about the budgets for the next year from whatever initial remarks you are hearing from your clients?

Rajesh Gopinathan: That is why I said, we would rather defer that discussion for a couple of months, given our experience, to give you a better sense of it once things are a bit firmer. So Jan-Feb of next year we will give you a better idea.

Participant: And any update on some of the deals which got deferred or ramp ups which got deferred last quarter in the Retail segment?

Rajesh Gopinathan: No. In Retail, Q3 is always a slow period. Typically there will be rarely any development activity that happens during the holiday season because that is a lockdown period for Retail. They will not do any new production go-lives during this period. It is a very stable environment kind of a period. So if something gets put on the block by September it is very unlikely that it gets revived in December, but that is normal Retail behavior. So we will have to wait for the next quarter for it to come up.

Participant: You mentioned some weakness in BFS portfolio as well. Is there any client-specific issue or can you attribute it to some geography or something or why is BFS ….?

Rajesh Gopinathan: It is not BFS, it is BFSI, as I said the weakness is specific to Insurance and in Insurance it is not client-specific, it is fairly broad-based across most of the large customers and then we have ongoing weakness in our Diligenta portfolio also.

Participant: I thought beyond Insurance you also mentioned some weakness in BFS, that is not ….?

Rajesh Gopinathan: No, in BFS, it is normal seasonality.

Participant: Just the weakness in sentiment which you said on a y-o-y basis versus start of the year, so is it more to do with any vertical specific or is it more to do with any service where you anticipated spend to get released and it is not getting released on time?

Rajesh Gopinathan: Nothing specific in this quarter, I was commenting only in terms of a comparative terms and especially one of the reasons why we are not taking a call on the next year.

We are saying that given where we are we would rather wait for better clarity before we comment about FY-'16.

But no specific industry weakness - the only industry weakness continues to be what we saw last quarter also, which is in Insurance. There is some amount of cooling off in Energy at an overall industry level, but we are likely to see Energy grow better than average this quarter because of the flow-through momentum of last quarter.

Participant: Second question in terms of Digital spending. How is the momentum Q-on-Q basis? Is there any kind of a slowdown you are expecting?

Rajesh Gopinathan: No slow down on that. It is still project-specific spending and that continues with seasonal weakness. So one of the big sectors where Digital was seeing a high offtake was Retail. And in Retail, as I said it is normal industry behavior for them not to do new things during the holiday season. So whatever has to happen, happens well before Thanksgiving and then for two months you pretty much have a system lock down, and they keep a stable environment during the holiday season. So that is where we are, we do not see any unseasonal slowdown; we expect it to resume back in the next quarter.

Participant: It appears to be that your visibility has somewhat clouded in the last let us say 60 to 90 days compared to where you tend to be at this time in the cycle in every year. Would that be a fair assessment of where you see yourself at?

Rajesh Gopinathan: I would rather put it this way that given our experience last year, we are being a bit more circumspect about taking a call or communicating and articulating a call after we have a bit more of clarity. So it is rather that than any specific uncertainty.

Participant: Ask you in a different way, are your sales cycle in some of your projects lengthening?

Rajesh Gopinathan: Not necessarily, no.

Participant: We have maintained that FY-'15 would be better than FY-'14 with second half being slightly lower. Do you continue to stand by that statement or is there something to be re-looked at that more from an overall year's perspective from an organic growth?

Rajesh Gopinathan: Nothing different from what we said last quarter. Given where we ended up last quarter we had said both that it is lower than where we would have ideally liked it to be and it is unlikely that we would be able to make it up in Q3 given Q3 is a weak quarter and that has borne out. So we are unlikely to be able to get to where we were expecting initially. Q3 is weaker. So, we are not going to be making up the deficit.

Participant: Just wanted to get some clarity on the Europe side, you were saying that that seems to be a bright spot still, so that seems unexpected given all the turmoil over there. So what kinds of projects are you seeing over there both from which geographies and which horizontals and the nature of the deals as well?

Rajesh Gopinathan: Europe, in the overall context is similar to where it was earlier. So we are talking relatively now, and relatively it is better than the other geographies. Demand is coming from the same things that we have been doing for the last 4-5 quarters, essentially increasing penetration, it is fairly broad-based; lot of activity in the Nordics and the northern part of Europe, weaker on the southern part, but we have steady increasing penetration across almost all markets of Europe, and I think that market is overall absorbing the global delivery model a lot more

than what it was doing earlier. So project specific broad-based demand. Rather, it is market acceptance across the wide region.

Participant: So could I read that as more IT outsourcing rather than small discretionary spend, say, Digital?

Rajesh Gopinathan: Absolutely, our growth in Europe is entirely driven by outsourcing growth rather than discretionary spend.

Participant: And is there any BPO also there, or is it just Infrastructure and Application Outsourcing?

Rajesh Gopinathan: Mostly it is ADM and ITIS.

Participant: We had earlier indicated that 3Q and 4Q of this year will be better than 3Q and 4Q of last year given your commentary it appears that 3Q is more in line. What is our view on 4Q – will there be moderation there as well or?

Rajesh Gopinathan: Yeah, 4Q is more complicated because last year, if you remember, what happened in 4Q was that we had a fair amount of hit in the India business. As India had a good quarter last quarter, we are likely to have an in-line quarter this quarter, but it is a weak demand environment, and this quarter we are enjoying the momentum that we had from last quarter. But it is difficult to say where it will be in 4Q, and that will have a material impact on what 4Q is. So we will give you a better idea of that, may be when we come out with the results in January, but 4Q is complicated because of that element.

Participant: And secondly in terms of Digital, are you seeing similar momentum as expected earlier on the ground or there is any moderation in momentum there as well?

Rajesh Gopinathan: No moderation on the Digital side. It continues to be fine. But Digital is still small projects, and we expected that also to be of the same line. So I would say that on Digital, there is no change in our expectations, and it continues to be playing out along the lines that we had thought.

Participant: There have been a fair amount of noise on this employee optimization issue. Any comments on that?

Rajesh Gopinathan: No comments, I think we have commented already that it is part of a normal cycle, nothing out of the ordinary.

Participant: I have a follow up to that, also read about how you might actually be looking at optimizing the onsite positions too seeing of some of these are need not be onsite and can be done from offshore. Is that also an ongoing thing every year or this is something extra?

Rajesh Gopinathan: Absolutely, you will typically find onsite expanding during the growth period and contracting during the leaner quarters but that is normal again as initial parts of outsourcing contracts you will see higher onsite and steady state delivery will see a higher offshore component. So that cyclicality will continue and typically Q3 and Q4 will see that pull back and Q1 and Q2 will see the expansion.

Participant: There was a media article which spoke about 35,000 freshers for next year, is that kind of…?

Rajesh Gopinathan: No change to that.

Participant: So likely to be down from what we did for this year, right, this year was about 40-45,000 of….?

Rajesh Gopinathan: No, it was 25,000 for this year. It is higher than this year.

Participant: In the last conference call you said that $25-30 million worth of revenue which was supposed to come has not been coming. So those are still in the pipeline or it is getting deferred and is it getting materialized in this quarter, and, if yes, then why not a slightly better outlook versus Q3 of last year?

Rajesh Gopinathan: That is what we had said, we had said last time that we were overall about $25 million lower than what we would have wanted to be or what we had expected to be, and that we had said we are unlikely to be able to make it up in the next quarter because it is a seasonally weak

quarter. So that we are not going to be making up that lost ground and therefore that trajectory is going to get impacted through. So that is in line with what I am telling now also.

Participant: But can it come in the Q4 or is it still in the pipeline or?

Rajesh Gopinathan: It is not a specific project, I spoke in aggregate. We did not have a bad quarter per se, we have said it was slightly lower than what we had generally expected. Some of the specific weaknesses in Insurance continue. LATAM was negative -- compared to that base, LATAM is expected to be positive this quarter. But then that is a fairly volatile geography in any case. So nothing specific as a chunk that is getting deferred or is likely to come or not come and all, so no lost ground.

Participant: In terms of on a regular interval there are more clients looking in terms of insourcing. So have we seen any instances which is happening within our top set of clients?

Rajesh Gopinathan: No, some amount of that commentary was last year and we have not seen a trend towards insourcing at all.

Participant: On the Japanese JV what is the incremental revenue expectation?

Rajesh Gopinathan: When we had done it, we had expected a run rate of about JPY15 billion and we are currently between JPY 14 to 15 Bn. As we had told you last quarter, that is a slightly lower than what we expected, so by the time we end Q4, we could potentially be back at that. So nothing materially different in terms of the overall expectation of about JPY15 billion a quarter kind of a run rate. On the currency front, it has gone bonkers, so we were at 102-103 when we spoke about it, today we are at 120, but then that is part of the thing and we are in for it.

Participant: Considering the volatility in different currencies, especially the cross currencies, any change in our hedging strategy or we are trying to see how do we protect this kind of volatility on EURO GBP and JPY?

Rajesh Gopinathan: So we have a strategy of covering one to two quarters forward on a rolling basis which has still not changed, but obviously anything like

this is constantly under review. So if a change happens we will communicate that, but as of now no change in strategy especially given the nature of volatility, so we will continue to remain short to medium.

Participant: But is it not that most of that hedging is USD-INR and not the cross-currency side of it?

Rajesh Gopinathan: No, we hedge primarily 4-5 currencies, so bulk of the hedging is across USD, GBP, Euro and AUD, and all of them we hedge as a net against INR.

Kedar Shirali: If there are no more questions, we will wrap up today's Business Update. Thank you all for joining us here. That concludes the update.

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