



Tata Consultancy Services Limited

**Q2 FY13 Earnings Conference Call.
October 19th, 2012, 20:00 hrs IST (10:30 hrs US ET)**

Moderator

Ladies and gentlemen, good day and welcome to the TCS Earnings Conference Call. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Kedar Shirali of TCS. Thank you. And over to you, sir.

Kedar Shirali

Thank you, Marina. Good evening and welcome, everyone. Thank you for joining us today to discuss TCS' financial results for the Second Quarter of Fiscal Year 2013 that ended September 30, 2012. This call is being webcast through our website and an archive including the transcript will be available on the site for the duration of this quarter. The financial statements, results presentation and press releases are also available on our website.

Our leadership team is present on this call to discuss our results. We have with us today Mr. N. Chandrasekaran – Chief Executive Officer and Managing Director; Mr. S. Mahalingam – Chief Financial Officer and Executive Director; Mr. Phiroz A. Vandrevalla – Director; Mr. Ajay Mukherjee – Head of Global Human Resources.

Chandra and Maha will give us a brief overview of the company's performance followed by the Q&A session.

As you are aware, we do not provide specific revenue or earnings guidance. Anything said on this call which reflects our outlook for the future or which could be construed as a forward-looking statement must be reviewed in conjunction with the risks that the company faces.

We have outlined these risks in the second slide of the analyst presentation available on our website.

With that, I would like to turn the call over to Chandra.

N. Chandrasekaran Thank you, Kedar and good morning, good afternoon, good evening everyone. I am very happy to report that we have had an excellent performance in Q2.

As you may have seen, we have delivered a topline growth of 5.1% in Rupee terms and 4.8% in CC terms and 4.6% in Dollar terms. Volumes grew 4.95% and it has been pretty well rounded growth.

We have grown in all our markets. US has delivered 3.6% growth; Latin America about 8.3% growth; UK about 5.7% growth; Asia-Pacific about 7.3% growth, Continental Europe again 4.7% growth. So, it is a pretty well-rounded growth across markets.

In terms of industries – we are very happy with the growth again. BFSI has delivered a 4.3% growth; Telecom has done well at 5.5% growth and Manufacturing grew almost +9.5% and Retail has grown 7%. All the industries have done well. Life Sciences has been a bit soft at around 1.3-1.4%.

So the growth is pretty broad-based and we have seen it coming from all quarters. There are no one-offs. There is no specific kicker from one corner that has driven the volume. So, it has been a good volume story. Pricing has been pretty much stable. We will talk about the margin analytics and the revenue analytics a little later on. But, pricing has been pretty stable and the environment from growth point of view is good and I will come to that in a minute.

Looking at margins, we have delivered 26.8% at the operating level and over 22% at the net level. The operating margin dropped a little over 70 basis points due to a couple of reasons. One, we had to move some work onsite. We have taken some transformation engagements in Europe in the last few quarters, where the staffing of onsite ramp-up

in terms of both local resources as well as expats is high and we are having some additional costs in executing these engagements. It is a start-up phase and this will even out and will normalize to the usual onsite/offshore ratio. That is one reason. Second reason is that all our emerging markets – Latin America, India, Middle East, Africa, Asia Pacific – all have done well. In India, we have taken some system integration contracts. You will see the cost of third-party equipments and products has gone up this quarter. So these are a couple of reasons why you see a small drop in margins this quarter but otherwise company is operating at very healthy margins in all engagements. We are executing well, we are closing deals with the right price levels and are focused on productivity. So there are no concerns on that front.

From a deal perspective, it has been a very good quarter. We have had excellent deal signings and I would like to list at least 11 of them in the large deal category. The deals have come across the board, in all verticals. Four of them are in BFSI. I am particularly happy that three of them have come from BFS and one is in Insurance, a pretty large transformational deal. We had two deals in Telecom, which again I am happy about, a couple of deals in Retail and one deal each in Manufacturing, Government and the Energy sectors.

The outlook in terms of the deal pipeline as well as client decision-making is pretty satisfactory. Clients are making decisions, deals are getting closed and ramp-ups are happening.

Employee addition has been pretty strong; 18,654 employees were added at a gross level, taking the tally to 254,076 associates. And it has also been a quarter where our attrition has been managed incredibly well. Our HR folks have done a stupendous job and our attrition in the quarter is an all-time low in the last ten quarters. IT Services attrition was at a 10.2%. Including BPO and everything else, it is a little over 11%. Utilization has gone up, including trainees to 81.6% and excluding trainees to 72.8%, both up from the previous quarter.

We are seeing very good traction with customers. Demand looks good. Technology is in the forefront of everything that the customers want to do and the nature of deals are wide ranging. We are engaged in a number of efficiency-related deals where we are either optimizing the infrastructure, optimizing the application portfolio, optimizing the core ERP in terms of an SAP instance or a supply chain system or finance and accounting system or a CRM system. We are also seeing enormous opportunities in the digital and cloud and mobile and predictive analytics area. Customers clearly are investing in digital space. And there is an opportunity to partner to rethink their businesses, processes and productivity, whether it is a retail company or banking or a financial services institution or a manufacturing company. We are seeing traction across the board and we wanted to give you some samples on the kind of engagements in analytics and mobility that we get, which we have added as part of the pack this quarter.

So, we are quite positive where we are with respect to the outlook going forward. Barring the usual things that you will see in Q3 which is in the holidays in US, furloughs that you see every year, I do not see anything negative about the environment and we are quite positive and remain bullish on the future. Thank you. And over to you, Maha.

S. Mahalingam

Thanks Chandra. Our first quarter revenue of Rs. 156.208 billion represents a growth of 5.1% QoQ and 34.3% YoY. Revenue in dollar terms, just to repeat that, is \$2.853 billion, which is a sequential growth of 4.6% and YoY growth of 13%. In constant currency the revenue is \$2.86 billion, a sequential growth of 4.8%.

The breakup of our sequential INR growth of 5.1% is as follows:

Volume growth: +4.95%, constant currency realization: -49 basis points, currency impact: +22 basis points, and onsite shift: +38 basis points.

Operating Margin – Strong growth in emerging markets with the onsite ramp up on large deals led to a 75 basis points QoQ decline in our EBIT margin to 26.75%. The breakup of that is as follows:

Currency impact: -12 basis points, productivity shift: -22 basis points, SG&A efficiency: +9 basis points, onsite shift: -50 basis points, all totaling -75 basis points.

I said currency had an impact of -12 basis points. You would have noticed that currency had a negative margin impact despite the positive revenue impact. This is because of a timing mismatch between when the revenues in a particular currency are booked and when the costs in that currency are incurred.

Other income as a percentage of revenue was 1.99% compared to 1.17% in the previous quarter, driven by forex gains in our currency hedges, moderated of course by the revaluation losses on account of the quarter end appreciation of the rupee. Effective tax rate was 21% compared to 22.2% in the previous quarter.

These two factors i.e. the higher other income and lower provision for taxes relative to the previous quarter mitigated the impact of the QoQ operating margin decline at the net income level. Our net income margin for Q2 was 22.5%, up 42 basis points QoQ.

Our accounts receivable stood at 81 DSO in dollar terms, up one day from the previous quarter. Invested funds as of 30th September was Rs. 107.9 billion.

In summary, strong and disciplined execution allowed us to mitigate the impact of a sharp change in business mix this quarter and still deliver an operating margin not very far from our aspirational level of 27%. Other financial metrics, EPS, operating cash flow, DSO have all been more satisfactory as well.

With that we can now open the line for questions.

Moderator Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from Joe Foresi from Janney Montgomery Scott. Please go ahead.

Joe Foresi I was wondering first off, why the change in tone on the client side? In other words, why are they making decisions now and were a little bit slower in the first half of the year? And do you expect that to continue to 2013?

N. Chandrasekaran I do not think that we ever said there has been slow decision-making. We have always maintained that the decision-making has been good but we have said that the discretionary projects are going through a lot more scrutiny and sometimes there could be delays in starting ramp-ups. Those are the kind of comments that we have made.

What we are seeing now especially are projects around digital, projects around transformation and we have not seen any stoppage and these projects are happening as plan.

Anything more than this is very difficult for me to say because our revenues are not only coming from traditional infrastructure deals, revenues are coming from projects of different sizes which I would call as coming from the discretionary budgets. It is happening. I have visited customers and met with customers. My team and I have met with lots of customers and most of our key customers and we remain confident that customers are staying the course. Having said that we will wait for the budgets for the next year to be done, towards December and give you any update in January.

Joe Foresi And then just on the competitive environment, have you seen any changes there? I know you talked about pricing being stable, but any market shifts that you could point out because there has been, obviously, some inconsistency on execution across different vendors?

N. Chandrasekaran There are always situations where somebody is willing to go down on pricing or somebody is more competitive. Those things always happen in an environment like this on a specific deal and then you as a

company and as a management have to take a call whether or how you respond. But I cannot say that I am seeing a pattern.

Joe Foresi

And then a last quick question from me. As you look forward, how do you frame the balance between growth and profitability? Are there any targets on the profitability side? Do you worry about the long-term, given some of the commoditization has taken place?

N. Chandrasekaran

No, we have said this multiple times: we believe that growth and profitability are not in contradiction. We believe that this industry can operate at a healthy margin. It is important to shape the business model as we go along, in order to be able to sustain that margin primarily because of the rate at which new technologies are emerging and the speed at which companies have to adapt. We have to be prepared because the investments that will be required, whether it is in skill building, competency centers or in building intellectual property in terms of products and platforms, will only continue to increase. So that really requires us to operate at a good margin.

We have said in several forums and our CFO has also mentioned it for the last couple of years at least, that we are looking to operate around the margin at which we are operating, around 27%. Sometimes we get a currency benefit, sometimes we get a currency headwind, but there are enough levers. As long as we do not see huge volatility within a short period of time, we have levers and we will exercise those levers in order to operate at a healthy margin.

Moderator

Thank you. The next question is from Ankur Rudra from Ambit Capital. Please go ahead.

Ankur Rudra

On the nature of demand and the nature of deals you signed, it just seems like the proportion of discretionary deals is increasing at least in the largest deal you spoke about. Is that true for the broader portfolio as well?

N. Chandrasekaran

No, I think there is a good mixed bag. If I have to categorize the deals if you typically signed six large deals, probably all the large deals

came from large-scale efficiency drive before and then you worked on smaller scale projects on the discretionary side.

Now, what we are seeing, at least in this quarter, is discretionary spend throwing up a number of small deals. There is a great adoption of digital technology and that is flowing in nicely. But we have also closed a couple of large-scale deals, which I feel has come out of discretionary spend; good-sized deals which are transformational in nature – core system replacement at an insurance company for example. Those kinds of deals, at least a couple of them are very, very noteworthy ones. So, I think the discretionary spend is happening.

But whether it happens in BFSI, Manufacturing, everything else, will it happen immediately? I do not know. But we have not seen stoppages and we are not seeing decisions not happening. We are just going through the process. We bid and then the schedule is followed.

Ankur Rudra

On the nature of contracting, we have been hearing from some of your peers that given greater comparative intensity and the weak macro economy, contract terms in SLAs for traditional deals are getting a bit more adverse for service providers. I was wondering if you are seeing that and how do you push back on that?

N. Chandrasekaran

Yes, I mean, there are demands in the traditional deals and we have to take it deal by deal. Some we will be able to respond to because we have an advantage, some we will not be able to respond. Then we have to take a call. We are just being disciplined in what we do, that is the only way to respond. But, I would not broad brush anything. I would not say this is what is happening across the board, I mean, that is not what I would say.

Moderator

Thank you. The next question is from Edward Caso from Wells Fargo. Please go ahead.

Edward Caso

I want to ask about the infrastructure deals. You have been growing very strongly here for quite a few quarters. Is this new work? Is this

takeaways from the global providers as those have come up for renewal? And if that is the case what are you doing to win those takeaways?

N. Chandrasekaran I think a significant number of them are some sort of takeaways in direct form or in some other transformative form. There are also some deals where a new solution in terms of cloud and etc. is being adopted, but the significant portion of them, I would say, are takeaway deals or renewal deals of that nature.

Obviously, I am not going to be able to sit down and explain to you the sales process here. But TCS has built huge tools in the way we approach these things and we concentrate and focus on how we differentiate ourselves and how we also execute better. Sometimes we just need to be so sure that we can execute better, so that the competitiveness can be maintained.

So in these deals you have to be competitive. You need to be sure about execution and you need to develop differentiators. We are focusing on all the three things and we have had a fair share of wins. I would say that we again qualify and there are deals where we clearly opt out. And in the deals which we do, we put a lot of focus and we are able to win those deals and execute and grow.

Edward Caso My other question is around utilization for five quarters now. Is the year-over-year declines in your utilization both with and without trainees has been, and fairly sharp and you continue to sort of bring in, obviously, it was a big quarter for freshers. I guess the question is, is that a view that you expect the demand to come up? Is this a surprise on the attrition numbers? And then maybe any sense on what your plans are for this year's round of freshers? One of your competitors said they're backing off on how many intakes, how many offers they are going to make. I'm curious what you can say on that front?

Ajoy Mukherjee As far as utilization is concerned, I think we have been operating at a fairly good utilization, this quarter is 81.6%, and excluding trainees is

what I am talking about. Previous quarter was 81.3%. So it is a 0.3% increase. In Q4 of last year it was 80.6. It has been going up in the last three quarters.

N. Chandrasekaran There is no sharp decline at all. On the other hand I think we have been operating and in fact, all the analysts have been appreciative, writing positive commentary on the way we are running utilization. I have also said that we are comfortable even to go to 83%, 84%. And on the trainee front, do you want to add something, Ajoy?

Ajoy Mukherjee Trainees, as you know, they start joining from June onwards and we had given offers, they are joining now. As far as next year is concerned, from a campus point of view, we are going to hire 25,000. That is the number that we are planning and process is already on. We have already given offers to about 12,000 trainees during the campus interviews.

N. Chandrasekaran The only thing that I would say is that on this point, you have to be careful in how you read the hires that we do. We are seeing a good growth and we are operating at a healthy utilization at 81.6%, but we can go up further. On the other end, we are operating at 72.8%. We have room to improve utilization there. We have gone up to 76-77% comfortably in the past. So there are 4-5 percentage points there at least that we will be comfortable in doing.

Also, we are able to attract very good talent from the market. Some we will hire here, some we will hire in the US and Europe and other parts of the world for execution. In Latin America, all the execution happens with local hires, so we will do that. So overall in India, the fresh trainees in campuses we are going with 25,000 people, but we will be hiring from all other ends and we will calibrate it as we go.

Moderator Thank you. The next question is from Moshe Katri from Cowen & Co. Please go ahead.

Moshe Katri This is a question for Maha. Can you get us some details on how some of those transformational deals ramp? Maybe talk about the

initial margin impact and then how do you get scale? What sort of a timeframe should we look for margins to come back to where they were before some of these deals started pressuring margins?

S. Mahalingam

The first thing I want to say is that the decline in margins is not substantial as far as this quarter is concerned. It is 75 basis points. That is the first point.

The second point is this that the employee cost, if you take it along with the business associates and so on, it has not gone up significantly in relation to the revenue. If I remember correctly, I think it was something closer to about 22 or 23 basis points, which was really the difference that really took place this quarter when compared to the previous quarter – I will have to re-verify that figure.

And therefore, when you look at it from overall perspective, employee cost to some extent has contributed to the decline in margins. There are a lots of things that we have got to be looking at, at the same time. The first one is really in terms of the business associates' cost that is incurred. The second one is the project cost, especially when we get complex contracts and we might have to go ahead and get especially some of these contracts that we do in India, and so there are certain project costs that we are incurring. Project expenses which we need to maintain control over. The third one is really in terms of the other operating expenses that we are incurring.

The main thing is that there are a few factors that we have as far as this is concerned. We are investing in newer types of projects, I mean, we have talked about the platform-based deals, you know about that. We have talked about some of the large projects we take on, where there is insourcing of people that come in. When depreciation of the rupee takes place, these are the areas that you can afford to get into a little more aggressively and yet ensure that we stick to our aspirational margins. We invest the excess into the business.

To your statement as to whether margins will come back, first I am saying that as far as we are concerned, we have a control over the

expenses in the overall categories that I described. Second thing is that we are also getting into complex and assignments and so on since the benefit of rupee depreciation gives us scope to do so. I do not see any fundamentally different reset in the cost structure which would put the margin picture in doubt.

Moshe Katri And then, last question for Chandra. Are we expecting the budget cycle for next year to be on track? Based on what you are seeing out there, do you think we are going to get delays of the kind we had earlier this year? Maybe some color here would be helpful.

N. Chandrasekaran Let me make sure that I understand that question right. You are asking me whether the budgets are going to be on track?

Moshe Katri On track meaning, budgets will be on time or do you think we are going to have some delays in terms of clients formulating budgets for next year?

N. Chandrasekaran Honestly, I think I should wait another couple of months. But based on all the dealings have had, I get a sense that budgets are going to be on time and there is not going to be delays and I feel that it is going to be a good fiscal next year.

Moderator Thank you. The next question is from Mitali Ghosh from Bank of America. Please go ahead.

Mitali Ghosh On the banking vertical, I was wondering if you could comment in terms of how you are seeing the trajectory. I mean, if you look at the top ten clients, especially the six to ten have grown kind of slower on a LTM year-on-year basis. So I am just wondering if this could be to do with the banking vertical. And maybe they are just seeing the tail of the previous quarter. It would be helpful if you could help us understand what it is looking like now?

N. Chandrasekaran As I said, Mitali, we have delivered in rupee terms, a 4.7% growth in BFSI, which is pretty much in line with the company, I mean, it has been a very good quarter for our BFSI vertical. And even in dollar

terms it is about 4.2%. Now, the growth has come from both Services and also our Product portfolio.

If you really look at the type of engagements basically three categories; engagements which drive efficiency or optimization; second is, regulatory changes and compliance related; third one is digital analytics, etc. We have given examples, especially picked in the banking vertical, because I thought you all would like to see that. So if you see the mobility engagements I have put in, quite a number of engagements from Banking sector so that it will give you color. So these are the three types of engagements broadly.

And as I said, out of the 11 large wins I announced, four of them are in BFSI: one in Insurance, three in BFS. So it has been pretty healthy. The pipeline in Banking looks good and I feel that every bank has got an agenda on all the three dimensions. On the efficiency dimension, they have got a clear target where they want to be, how they want their IT investments to change in terms of optimizing the investments they have done. They have got a plan on digital or discussing a plan on digital; and the third one is definitely risk and compliance regulatory, etc.

Apart from this, there are new initiatives been discussed which are platform-driven. Those things I am not counting, because there is a lot of discussion happening on that front, which will all translate into real projects but I think – and this is my personal sense and not something somebody has told me – my own assessment is that it is at least four quarters away. It is not going to happen overnight. These things take time. So this is what is happening in the BFSI vertical.

Mitali Ghosh

Secondly, on the margin front, we have touched upon the aspirational 27% kind of target. Just wanted to understand that a little better. Because on the one hand, we have been seeing good growth from a lot of the emerging markets, I mean US has been slightly slower. And also from things like Infrastructure Management services. Rupee is probably going to appreciate from where it has been. So taking all

these into account how should we think about margins going forward and the aspiration number?

N. Chandrasekaran I would not like to broad brush emerging markets as lower margin and so on and so forth. Each market has got a different price point and a different cost point. It is a question of building critical mass, which we have been driving with our client-centric strategy of full services. As long as we are successful and do that, we make the right margins.

Otherwise, for the portion of revenues that you have seen in the emerging markets this quarter, if the margins are going to be significantly down, you should have seen a big drop, but that is not the case. So, when we say that, we have got to view around a particular number – not as a guidance, but that is the kind of margins that we think we can operate at and we should operate at in order to be able to give ourselves room for the kind of investments that we need to make.

We remain confident and there are a number of levers. As I have said in the past, when the rupee depreciates strongly we try and leverage that in terms of more investments. And when the rupee appreciates, then we have to exercise the levers to be able to handle that. So, as long as we do not have a huge volatility, certainly a swing of huge percentage, in general that is our aspiration.

Mitali Ghosh And just one quick last question on campus hiring. The target this time is lower than the target same time last year. Is this a reflection of the fact that you mentioned you want to take up utilization or is it the reflection of the fact that maybe the environment is somewhat uncertain?

N. Chandrasekaran I would not like to read anything negative in this statement. I think we are just taking a calibrated view. We are able to attract talent and definitely 25,000 trainees is a good number. Our attrition has also come down. If you translate the last year's number and this year's number there is a significant benefit also we get. And also we will do off-campus hiring and we are also hiring in other markets. So we will

take a calibrated view and initially we have gone ahead with the 25,000 number and Ajoy's team has already made half of the offers.

Moderator Thank you. The next question is from Keith Bachman from Bank of Montreal. Please go ahead.

Keith Bachman I have two if I could. You mentioned some more onsite work, particularly for transformational projects in Europe, but just more broadly on onsite – is that driven by political issues or your own staffing issues? And is that something you think is a permanent part or will you kind of transition back to a normal portfolio? I just want to clarify that, please.

N. Chandrasekaran It has nothing to do with the political issue or it is nothing to do with our own inability to staff – it is primarily the situation of the particular project. We have taken a huge chunk of work in these three or four engagements where we have had to also hire local people and also take over some resources from the clients. The offshore work has not kicked in because the full transition is going on. So all the ramp-up, even with expats from India, has happened onsite because we are doing a lot of transition. So the need of the project at this point in time requires us to operate in this mode.

Probably if it had just been one transformational project, we would not have noticed it. We would not have talked about it. However, two or three of them are going on at the same time. Honestly, just the fact that we are operating at good margins gives us the flexibility to go ahead and commit to take on two or three such engagements.

Otherwise, a few years ago, probably if our margins were low, you will have to always ask whether we can take this on. But currently, we are willing to make that investment, not get worried whether we will get hit by 30 or 40 basis points and we will have a difficulty in explaining to analysts. We are not going through that.

Keith Bachman Then my second question is you mentioned that there was a strong deal pipeline across the verticals. I wanted to just get a sense of

distribution. And what I mean by that is, is that skewed by a few larger deals across all the verticals or is it a breadth of deals that you are seeing, both large and small? And the reason I ask is your results are good and your commentary seems bullish. I just want to understand is this more TCS winning some of the larger deals or is it broader based across the market? Thank you.

N. Chandrasekaran This quarter I am particularly happy because there is no one-off kicker. The volume growth of 5% has come pretty broad-based. Last quarter, we had a significant volume – nearly 1% – come from the Friends Life kicker. So there is no kicker at this point in time. It is pretty broad-based.

The deals that we have won, the total order book that we have won is pretty good and it does not have a kicker like Friends Life which is a billion plus, there is no such kicker. It is pretty broad-based, 50 million, 100 million, 150 million types of deals, there are also some 20 million, 10 million deals and they have come from BFS, Manufacturing and Retail and so on and have come from different markets.

It is the same thing when you look at the pipeline too. It is pretty broad-based. It is not to say that if we get an opportunity for a large deal – of \$1 Bn, \$1.5Bn – we will not go after that. We will go after that. But my commentary is not coming based on – I know for sure I am going to win this deal which is \$1 Bn. There is no such thing. It is just distributed and it is healthy. All my business unit heads and their teams are confident. They are doing the right things and they are seeing traction with their customers. So overall, it is looking good.

Moderator Thank you. The next question is from Viju George from JP Morgan. Please go ahead.

Viju George Chandra, I just had one question on margins. I mean, I know it has been asked before but if I look at your YoY average realized rate, you have depreciated 18% vis-à-vis the dollar in INR/USD terms. Logically this should have given you 600 basis points of margin upside, all else being the same. Now I understand that a good part of this might have

been put back as investments in the business and some part probably as costs which can be pulled back. But if the rupee were to appreciate from here, I just want to understand your ability to pull back. Do you think that of the 600 basis points that ideally should have been the gap, you could recover a fair portion of that if need be, if the rupee reverses and starts to strengthen?

N. Chandrasekaran I think this question has been asked before. As I said that I think we should avoid taking a particular margin when the rupee was 46 or 48 and translating it to say that this is the translation of upside, this is the way the dollar has moved against the rupee, then let us translate it immediately into the corresponding increase in the margins. I think I would like to really not suggest that we do that.

I will talk about two things. One is even on the currency side, it is a basket of currencies always. It is not only the dollar, sometimes incremental revenues can come from different parts of the world, different currencies. But leave that aside.

From the business point of view, we always have to make calls and we also do not want to be getting into unrealistic margin targets which we cannot sustain. So we see it as an opportunity to be able to take on either a transformational deal or invest more in a single market. We have invested in several emerging markets. There are times we decide okay, now this is the time to go whole hog. So if you are currently operating at this level, should we be increasing our investment in this market, so that we can get to a critical mass and leverage the one year window probably we have, in order to do that. We make those kind of calls.

Sometimes, we look at a platform, sometimes we look at a market. Take LatAm for example. Every time we had an opportunity, we invested in LatAm. That is what we did over the last few years. And now I think very happy with where we are in LatAm. We have distinct advantage. We have great clients. We have a margin profile that is continuing to deliver better results every quarter and we are expecting it to grow and we will use the cycles to do things diligently. I mean I do

not want to get into very specifics. So whether we will pull back and then hit the number exactly on the quarter in which one would like, may be 30 basis points here and 40 basis points there. But I think we should have the flexibility. I hope you all will understand and give us that flexibility.

Overall, we think that this business has to be built with respectable margins, which is where we are, because it is going to require investments. We are prepared to make those investments because the technology cycles are getting really rapid. Unless or otherwise we invest in those cycles and also invest in future offerings, whether it is platform-based play or product-based play or something else, we will find ourselves in a difficult situation later.

So short answer to your question is that we leverage when we get the upside and we remain confident that when the currency goes the other way, as long as it is sensible shifts, we will manage that.

Viju George Just one more question, would you say that the environment for discretionary spending has probably picked up in the last three or four months, even if marginally? The mood is better with clients?

N. Chandrasekaran Yes, it is better in the last three or four months.

Moderator The next question is from Divya Nagarajan from UBS, please go ahead.

Divya Nagarajan I have been discussing this issue with you and Kedar in the past as well. But just looking at your top 10 clients, I understand some of them are significantly large, where growth has slowed down versus the company average and that has been the trend for the last year or so. If I were to look ahead into fiscal '14 and beyond, these are still 25% of your revenue. So what do you think will compensate for that sluggishness in growth if you assume that this trend will continue? Or if you think there will be a pickup in the top 10 in terms of growth rates and what will drive that?

N. Chandrasekaran The best way to look at it is, first thing is that we are growing, in absolute number we are growing. And second thing is that I do not have any client-specific problems with any client. We do not have any problem with any of these clients where we are compensating for a huge drop in revenue from somebody else. There is no such thing.

Then the next thing to look at is, we have a significant number of BFS clients. You have seen that in the last several quarters, BFS growth has been muted and has been consistently lower than the company average. So when you have a large number of clients in the BFS segment and you should expect and also Telco clients have been growing slow when you look at the last four to six quarters, and growth has been coming in those clients, growth has been happening in those verticals, but they have been below the company average. So when you look at the LTM perspective that will happen. I don't think that that is a cause of worry.

And also as we grow large, we should be prepared that all clients in the 10 bracket will not grow on the company average; some will grow slower, some will grow faster, but we really look at agility that is why we have the full services play and we continue to engage, we continue to try and increase our share and increase our proximity and relationship with all these clients.

So, first of all, I am not concerned about the growth in the top 10 clients. I would also say that I can't uniformly say that all of them will grow or will not grow at the company average. In a given quarter, at least half of them will grow above the company average and half of them will be either at or below the company average, which is okay for us.

But there will also be clients in the next 10 or in the next 20 or in the next 30, which will grow very significantly, double the company average sometimes. We need to be able to be very sharp in what we do with these clients and be relevant all the time and there is no easy solution. The only thing I can say is that with every client, we have got to be relevant. How can we be more relevant? How can we

understand what their pain points are? How can we understand how they are investing in innovation? What is it that they are doing to reinvent themselves? These are the questions we ask.

The only positive thing is we are much, much better prepared, positioned, and have acceptance as a brand, and relevance in the market today than ever before.

Divya Nagarajan On the question of margins, I know we have spoken enough about it, but not enough. I am trying to understand, we seem to be currently in a very benign margin environment currencies, still a bit of a tailwind. We are looking at attrition coming off quite considerably with market hiring slowing down, utilization continues to remain robust. I am trying to understand for us to maintain the 27% level, other than pricing, what would be the key margin levers from here on?

N. Chandrasekaran I will make a couple of comments, then I will leave it to Maha to answer. Many of our investments and businesses which we create – they are all continuing to improve margins, whether it is Diligenta, whether it is Latin America, whether it is some parts of Asia Pacific and some of the large scale contracts, etc. That will always be the case, so don't underestimate that. Some of these investments are made very consciously.

Also I would like to recall that we did improve the margin from 22% to 28% without any currency advantage. So there are a lot of things that we do, it is not as simplistic. We have to take it as it comes, but we have levers and we will have to exercise the right ones.

S. Mahalingam Diviya, you need to look at it from a management standpoint. If you take the bulk of assignments at TCS, they deliver a certain gross margin and we monitor that and we make sure that they continue to do that.

When we talk about investments in some of the newer things or developing a new service line to deliver much higher, we need to go in with a slightly lower margin and then start improving them over a

period whether different service line or it could be platform-based solutions that we have, whatever they are. The scale with which we do that is going to be determined by the ability of depreciated rupee and so on.

As far as the SG&A is concerned, we have controlled it very, very effectively because we have a good spread. We have made sure that each of those offices continued to deliver increased revenue and so on. So there is certain amount of cost control that is taking place as far as SG&A is concerned and we are making sure that they deliver much higher revenue.

So you will have to look at it from an overall management pattern. As Chandra said, we have a focus on it. There could be differences from a one quarter, two quarter kind of perspective. But over a longer period of time, we think that, if the rupee appreciates significantly, we can certainly push margin improvement in some of these areas that we have invested quite a bit and also look at the choice of assignment, the kind of mix that we ought to have and so on. So that is the kind of play that we think we are in.

We are not essentially fighting a price war at this time and therefore I do not think that comes into the equation. So the margins are really all about costs and cost control.

Moderator Thank you. The next question is from Pinku Pappan from Nomura, please go ahead.

Pinku Pappan Chandra, could you talk a little bit about the Telecom vertical? I think last month when we met Maha, he was talking about not so positive outlook there. So has anything changed, because this quarter we have seen a good growth there?

N. Chandrasekaran I think Telecom in general, as we have always said, has been a tough industry vertical. But we have won a few engagements in the last three or four quarters and those wins have been giving us growth last

quarter and this quarter as well. And again, we have signed up a couple of deals this quarter.

But we are still not comfortable enough to say that Telecom is operating as any other vertical, because a lot of the existing clients, large clients are not really growing the way we would like. So we are getting growth, we are winning deals and getting growth, but we are compensating some of that on a large base. Not that we are dropping in many clients. It is just that the growth is pretty low or flattish in some clients.

So that is why Maha mentioned to you in the last meeting that Telco is a soft vertical. I would like to maintain that. But having said that, we have won deals and we are winning deals and we are ramping up, so we will see some growth.

Pinku Pappan The second question is to confirm winning the UK Criminal Records deal, could you give us some details about the deal and maybe talk about it?

N. Chandrasekaran We do not talk about specific deal details. All I would say is that it is a pretty good deal. It is pretty large and we have started the engagement and we are right on.

Pinku Pappan Has the revenue flowed in from this quarter or is it going to be from next quarter?

N. Chandrasekaran It is a full services deal, we have both IT and BPO, so it is a very nice deal, and we like it.

Pinku Pappan Chandra, my question is about the revenue. It started in 2Q itself or it is going to start from next quarter?

N. Chandrasekaran It will start next quarter.

Pinku Pappan And the last question is, given how discretionary spending is coming back and we are seeing growth there, do you think H2 revenue growth

will turn out to be better than what you had initially assumed at the start of the year?

N. Chandrasekaran I think the issue in Q3 is that December is pretty soft and we will definitely have furloughs that we have seen repeatedly at all the industrial clients – Manufacturing, Hi-Tech, even sometimes Retail-CPG. So we definitely see furloughs where we lose a week, two weeks, sometimes three weeks, and that has to be taken into account. So Q3 will be soft and it has been soft every year, and I don't have any data point to feel that it will be different this year. So we have always mentioned that H1 will be stronger, but we will have growth and we will do well.

Moderator Ladies and gentlemen, due to time constraints that was the last question. I now hand the conference over to the management for closing comments.

N. Chandrasekaran Thank you all for joining us on a Friday evening. Really appreciate your time and very quality interactions. We have had another strong quarter. As I mentioned, we are quite happy with the volume, with the well-roundedness of growth across industries and markets. Deal closures have been good, deal pipeline and closure cycles are healthy. Our utilization is where it needs to be, our employee addition is excellent and our retention is very good and attrition is being managed very well by our HR team.

Our investments are in the right areas and those are yielding results and lot of traction. Customers are showing willingness to partner with us in many co-creation opportunities. So we remain confident as we look into the future for this year and the next fiscal year. Thank you very much and have a nice day and a great weekend.

Moderator Thank you gentlemen of the management team. On behalf of TCS, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.

[Note: The transcript has been edited for improved readability]